

The Merchants Trust PLC

Report and Accounts for the year ended 31 January 2007



Contents

Key Facts	3	Directors' Report.....	15
Investment Objective.....	3	Statement of Directors' Responsibilities	21
Benchmark.....	3	Corporate Governance.....	22
Financial Highlights.....	3	Directors' Remuneration Report	26
Performance Attribution Analysis.....	3	Independent Auditors' Report	27
Chairman's Statement	4	Income Statement.....	28
Historical Record	5	Reconciliation of Movements in Shareholders' Funds	29
Investment Managers' Review.....	6	Balance Sheet	30
Listed Holdings.....	8	Cash Flow Statement	31
Distribution of Total Assets	10	Statement of Accounting Policies.....	32
Performance Graphs	12	Notes to the Accounts.....	34
Financial Risk Management.....	13	Notice of Meeting.....	45
Directors.....	14	Investor Information & Contact Details	47

Key Facts

Investment Objective

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

Benchmark

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

Financial Highlights for the years ended 31 January

Revenue	2007	2006	% change
Revenue	£27,750,450	£24,714,263	+12.3
Available for Ordinary Dividend	£22,854,005	£19,853,959	+15.1
Earnings per Ordinary Share	22.17p	19.44p	+14.0
Dividends per Ordinary Share	20.00p	18.90p	+5.8

Assets	2007	2006	% change
Total Net Assets	£588,834,675	£514,713,196	+14.4
Net Asset Value per Ordinary Share	567.5p	504.1p	+12.6
Ordinary Share Price	513.0p	451.0p	+13.7
Discount of Net Asset Value to Ordinary Share Price	9.6%	10.5%	n/a
Discount (Debt at market value)	5.9%	4.0%	n/a

Performance Attribution Analysis

for the year ended 31 January 2007

	%
Capital return of FTSE 100 Index	7.7
Relative return from Portfolio	2.9
Capital return of Portfolio	10.6
Impact of gearing on Portfolio	2.9
Retained Revenue	0.6
Expenses charged to Capital	(1.5)
Change in Net Asset Value per Ordinary Share	12.6

Chairman's Statement

Results

I am pleased to report that during the financial year the net asset value per share rose by 12.6% to 567.5p and the total return per share, including dividends paid, was 16.4%. This compares with the total returns of 11.3% and 11.2% recorded by the FTSE 100 Index and the FTSE 350 Higher Yield Index, respectively.

Gearing had a positive effect on the asset value, adding approximately 2.9% to the returns to shareholders. The full performance breakdown is shown on page 3.

In the twelve months to 31 January 2007, the Trust's share price rose by 13.7% from 451.0p to 513.0p. At 3 April 2007, the Trust's ordinary shares yielded 3.7% compared with the yield on the FTSE100 Index of 3.0%.

Market Background

The UK equity market made steady gains for most of the year, although it fell back significantly during May and June. This was part of a wider setback that affected many financial assets. However from mid June onwards the market resumed its upward path, encouraged by a resumption of takeover activity. Relatively low borrowing costs also helped support the economy and the stock market. Dividend growth within the market has been healthy as companies' cash flows have generally been strong.

Earnings per share

In 2006/7 earnings per share rose by 14.0% to 22.17p. The increase in revenue of just over £3m reflected good growth in dividend payments received by the Trust. This year's earnings do, however, include a number of special dividends received by the Trust totalling £1.3m (2006 – nil).

Dividends

The Board is recommending a final dividend of 5.1p per share giving a total of 20.0p for the year. Starting from a level of 4.15p in 1981/2, the dividend has been increased in each of the last 25 years. This is a notable performance which has been achieved during a wide variety of economic and market conditions.

Repurchase of Shares

As the Trust has traded close to its underlying asset value during this period, no shares have been repurchased. As in previous years, the Board is proposing to renew the authority to repurchase shares at the forthcoming AGM on 14 May 2007. Since December 2003 it has been possible for companies, including investment trusts, to hold shares repurchased in the market in Treasury, rather than cancel them. At this stage, your Board has decided not to seek approval

from shareholders to hold shares in Treasury but we will continue to monitor how the use of this facility by the investment trust sector develops.

On 29 June 2006 1,655,941 shares were issued at a small premium to net asset value to former members of Allianz Dresdner Income Growth Investment Trust plc, a split capital investment trust which reached the end of its planned life.

Prospects

Notwithstanding recent market volatility, the corporate sector is continuing to perform well and the outlook for profits and dividends growth, at least in the short term, is promising. However, the UK economy is likely to be sensitive to any further interest rate rises. Market valuations in aggregate are reasonable although dividend yields are less supportive than a year ago, especially for medium sized companies. As long as bond yields and credit spreads remain relatively low, corporate activity and share buy backs should provide further support to the equity market.

Sir John Banham

After over 14 years as a Director of the Trust, Sir John Banham will be retiring from the Board after the AGM in May this year. During his career Sir John has been the Chairman of a number of FTSE 100 companies, Controller of the Audit Commission and Director General of the Confederation of British Industry. He has been able to bring a unique insight to our deliberations over the years and we will miss his contribution and experience enormously.

Annual General Meeting

The Annual General Meeting of the Company will be held on Monday 14 May 2007 at 12.00 noon and we look forward to seeing as many shareholders then as are able to attend.

Hugh Stevenson
Chairman
4 April 2007

Historical Record

Years ended 31 January Revenue and Capital

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Revenue (£'000s)	20,399 [‡]	20,119 [‡]	22,590	21,546	21,596	22,101	22,247	22,675	24,714	27,750
Earnings per Ordinary Share	14.88p	15.21p	17.93p	16.35p	16.70p	17.26p	17.34p	17.58p	19.44p	22.17p
Dividends per Share	14.25p	15.59p [†]	16.00p	16.40p	16.80p	17.20p	17.60p	18.00p	18.90p	20.00p
Tax Credit per Share	3.56p	3.90p [§]	1.78p	1.82p	1.87p	1.91p	1.96p	2.00p	2.10p	2.22p
Gross Ordinary Dividend	17.81p	19.49p	17.78p	18.22p	18.67p	19.11p	19.56p	20.00p	21.00p	22.22p
Total Net Assets attributable to										
Ordinary Capital (£'000s)	420,326	424,859	390,317	473,729	420,983	273,407	357,442	424,511 [•]	514,713	588,835
Net Asset Value per										
Ordinary Share	410.8p	415.2p	381.4p	463.5p	412.3p	267.8p	350.1p	415.8p [•]	504.1p	567.5p
NAV Total Return (%) [*]	+30.2	+4.9	-4.3	+25.8	-7.4	-30.9	+37.3	+20.8 [•]	+25.6	+16.4
Retail Price Index Increases (%) ^{**}	+2.5	+2.6	+2.1	+1.8	+2.6	+2.7	+2.4	+2.1	+2.3	+4.2

Notes

[‡] Restated in accordance with Financial Reporting Standard 16 'Current Taxation'.

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

[§] Inclusive of 0.74p tax credit on the FID which is notional and not repayable.

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

^{**} RPIX – excludes the effect of mortgage rates.

[•] Restated in accordance with Financial Reporting Standards 25 'Financial Instruments: Disclosure and Presentation' and 26 'Financial Instruments: Measurement'. Years prior to 2005 have not been restated.

Investment Managers' Review

Economic Background

The UK economic background was relatively benign during 2006. GDP Growth was solid, with latest estimates around 2.7%, despite concerns over the impact on consumer spending of rising utility bills, council taxes and mortgage costs.

From a low base, the inflation rate rose steadily, prompting the Bank of England's Monetary Policy Committee to raise interest rates twice in August and November from 4.5% to 5% and then again in January 2007 to 5.25%. Although the Consumer Price Index (CPI) reached an estimated 3.0% in 2006, the adjusted "core" CPI remained just below the Bank's 2% target rate. With gas prices falling sharply towards the end of the period and oil prices below their high point, inflationary pressures seemed to be subsiding.

House price appreciation recovered during the year from mid to high single digits, providing some support to consumer confidence which had been impacted by rising bills and high levels of indebtedness. Overall consumer spending remained resilient, despite an increasing minority of people getting into financial difficulties, as witnessed by rising bankruptcies and Individual Voluntary Arrangements. Jobs data was mixed with modestly rising unemployment counteracted by rising total employment, boosted by immigration.

Overall therefore the UK economic background was supportive without being exceptionally strong. Overseas, continental European economies saw some pick up in growth from modest levels whilst the US was robust apart from well publicised problems in the housing and auto industries. Asian economies continued to grow strongly adding to the global demand picture.

Company profits growth was generally healthy, supported by the economic conditions. There were good dividend increases across the market with several special payments as companies passed on high levels of cashflow to their shareholders. These payments also reflected a move to make companies balance sheets "more efficient" by taking on more debt.

Market Trends

The stock market produced a double digit total return over the twelve months to 31 January 2007, with the FTSE 100 Index up 11.3% and the FTSE Higher Yield Index up 11.2%. Strong gains early in the year were completely lost in May and June as the market responded to a worldwide "flight to quality". Higher risk assets such as commodities, emerging market debt and equities in general fell furthest. However by late June the market had regained its poise and thereafter made steady gains until the period end.

The market benefited from a large number of takeovers, fuelled by increased corporate confidence, strong company balance sheets, the high availability of cheap debt and private equity funds keen to invest money after record fund raisings.

This trend particularly helped medium sized companies and the FTSE 100 Index returns lagged the return on the mid cap FTSE 250 Index by over 10%. The mid cap index has now outperformed the FTSE 100 Index in 7 of the last 8 financial years, delivering an average outperformance of around 10% per annum over that period.

At the sector level, performances were widely dispersed, led by industrial metals, which saw a bid for the steel company Corus, telecoms, real estate, food retail and utilities. Common threads running through several of these sectors were asset backing and stable cashflows. Shares benefited from new legislation allowing tax efficient property vehicles (REITs) and speculation of takeover activity.

The worst performing sectors included oil and gas producers, with widely publicised issues at BP and Royal Dutch Shell, technology, pharmaceuticals and certain industrial sectors. The other two large sectors, banks and mining, performed close to the index overall.

Investment Performance

Investment Performance was well ahead of the FTSE 100 Index. The portfolio benefited from a number of takeover approaches, including AWG, AB Ports and Scottish Power along with speculation driving other shares. Other big contributors included BT which rose over 50% as investors reacted enthusiastically to an improving operating performance in a tough industry. Slough Estates performed well in a buoyant property sector. Smiths Group, a diversified engineering and medical company, benefited from the announcement of two deals with General Electric to sell its aerospace business and to put its rapidly growing detection division into a joint venture.

Several of the medium sized company holdings also performed well, notably Premier Foods and RHM which agreed a merger near the year end, Provident Financial, National Express and Britvic.

Portfolio Changes

Several themes have driven many of the investment decisions during the year. As noted in the interim report, many of the largest companies traded at depressed levels during the year, offering high and growing dividend yields combined with strong finances, healthy cashflows and low valuations. We took advantage of depressed share prices to make significant additions to Royal Dutch Shell, BP, GlaxoSmithKline and Vodafone amongst others.

We also took advantage of the modest valuations being ascribed to many higher growth industries, with purchases including Reed Elsevier, Emap and Reuters in the media sector, Xansa, a small company in the IT services sector, and Smiths Group.

We made a number of opportunistic medium sized company investments, purchasing high yielding shares such as transport company National Express, Britvic, the soft drinks manufacturer, and Marshalls, a UK building products company.

Investment Managers' Review

Portfolio positioning in commodity related sectors and companies was an important consideration as commodity prices were volatile and in many cases traded well above historic levels. We took some profits in mining companies as share price appreciation pushed dividend yields down to unattractive levels for a high income portfolio. We also purchased Centrica, the owner of British Gas, where profitability had been squeezed by the inability to pass on high gas prices to consumers. We anticipated a benefit as gas prices reverted to more normal levels. In a similar vein we purchased Rexam, a beverage can manufacturer, which was suffering from high aluminium prices which should ultimately either subside or be passed through to customers. We took some profits on Scottish Power, a beneficiary of high electricity prices, when it was bid for by the Spanish utility Iberdrola.

The revaluation of asset backed and infrastructure companies provided opportunities for profit taking among real estate companies and utilities. Sales included Land Securities, United Utilities and BAA.

In the Summer we disposed of several investments that had exposure to the US housing market on concerns over a potential downturn. Housebuilders Wimpey and Taylor Woodrow were sold along with engineering company Tomkins. Takeovers also took certain stocks out of the portfolio as mentioned above.

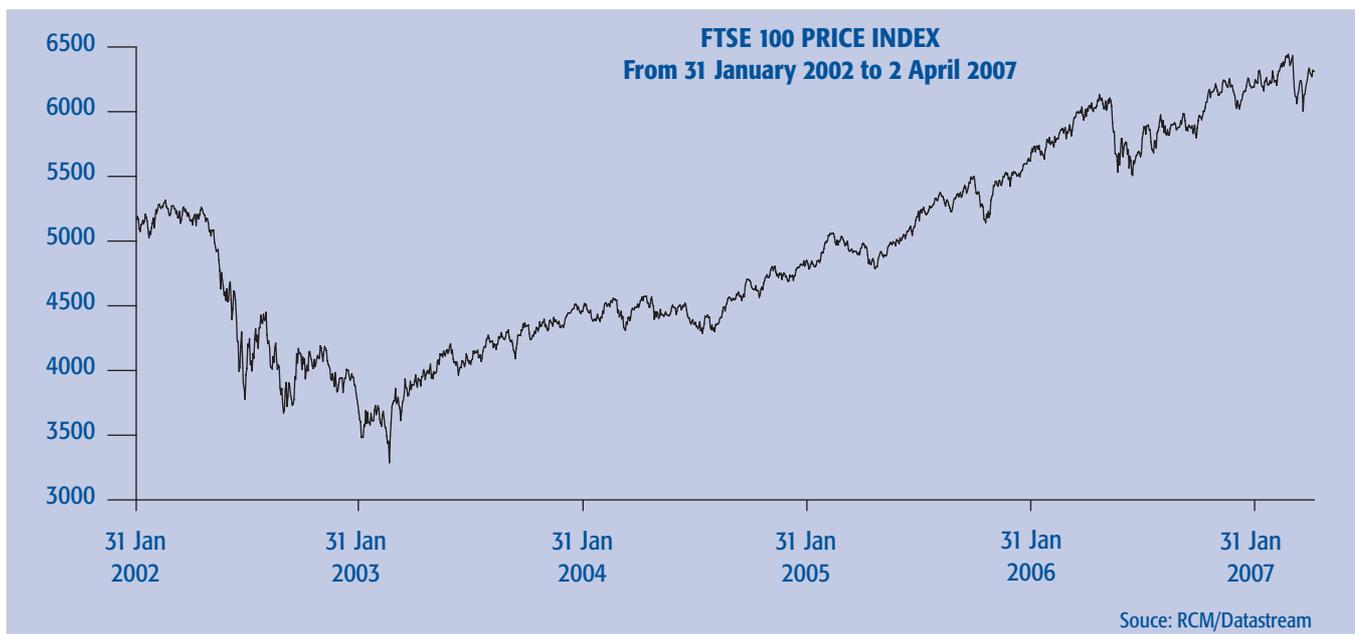
Future Policy

Recent interest rate increases will feed through to mortgage costs putting pressure on consumer expenditure. How far the Bank of England raises interest rates depends upon the path of inflation in the months ahead. If rates only rise modestly from here, we expect consumers and the overall economy to continue to be resilient. However further significant rate rises could lead to more of a slowdown.

The corporate sector is well positioned for further growth in profits and dividends although the economic environment and foreign exchange rates, notably the US dollar, will have a strong influence. We are particularly focused on the US economy which has a major bearing on global trade and financial markets.

Whilst market valuations are still reasonable in aggregate, there is a large gap between the valuations of the largest companies which look attractive and mid and small sized companies which are more fully valued. Average dividend yields are no longer as supportive as they were with a historic yield of 3.0% on the FTSE at the year end compared with ten year government bond yields and base rates at 5.0% and 5.25% respectively.

We continue to favour the larger companies offering better yields, robust balance sheets and strong cashflows. Elsewhere we see selected opportunities, notably in certain higher growth sectors that are modestly valued.



Listed Holdings

at 31 January 2007

	Value (£)	Principal Activities
Royal Dutch Shell 'B' Shares	54,133,750	Oil & Gas Producers
GlaxoSmithKline	49,822,500	Pharmaceuticals & Biotechnology
BP	49,174,000	Oil & Gas Producers
HSBC	44,745,800	Banking
Vodafone	40,331,850	Mobile Telecommunications
Royal Bank of Scotland	31,273,200	Banking
Barclays	27,010,000	Banking
Lloyds TSB	23,521,675	Banking
HBOS	21,978,000	Banking
Anglo American	17,493,600	Mining
Scottish & Southern Energy	16,082,000	Electricity
Reed Elsevier	14,205,450	Media
Centrica	12,428,500	Gas, Water & Multiutilities
Aviva	11,986,600	Life Insurance
Lonmin	11,975,850	Mining
BT	11,735,100	Fixed Line Telecommunications
Smiths	11,560,675	Aerospace & Defence
Bradford & Bingley	10,642,275	Banking
Tesco	10,638,100	Food & Drug Retailers
Rexam	10,637,820	General Industrials
Gallaher	10,346,700	Tobacco
Scottish Power	10,118,884	Electricity
Legal & General	9,842,100	Life Insurance
Rio Tinto	9,634,700	Mining
British American Tobacco	9,489,450	Tobacco
Kingfisher	9,258,975	General Retailers
Reuters	9,077,812	Media
Britvic	8,880,000	Beverages
FKI	8,749,574	Industrial Engineering
Resolution	8,577,418	Life Insurance
National Grid	8,179,200	Gas, Water & Multiutilities
Friends Provident	8,050,700	Life Insurance
British Insurance	8,020,395	Non-life Insurance
National Express	7,739,550	Travel & Leisure
GKN	7,699,950	Automobiles and Parts
Marshalls	7,554,750	Construction and Materials
Slough Estates	7,494,816	Real Estate

Listed Holdings

at 31 January 2007

	Value (£)	Principal Activities
Emap	7,097,750	Media
Diageo	7,025,450	Beverages
Persimmon	6,786,500	Construction & Materials
Premier Foods	6,635,950	Food Producers
Drax Group	6,242,428	Electricity
Alliance & Leicester	6,062,450	Banking
Provident Financial	5,471,250	General Financial
Pearson	5,052,600	Media
Xansa	4,600,275	Software & Computer Services
RHM	4,435,250	Food Producers
Rentokil Initial	3,316,600	Support Services
Severn Trent	2,924,324	Gas, Water & Multiutilities
	695,742,546	

Distribution of Total Assets

at 31 January 2007

Total Assets (less creditors falling due within one year) £702,382,755 (2006 – £628,066,597)

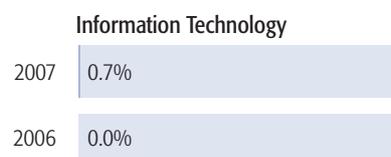
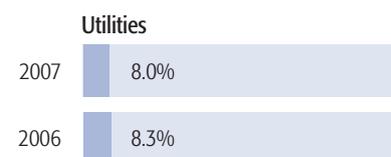
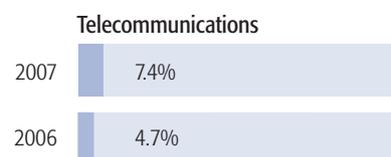
	Percentage of Total Assets		
	2007	2006	
Equities			
Oil & Gas			
Oil & Gas Producers	14.7	16.3	2007
	14.7	16.3	2006
Basic Materials			
Chemicals	–	1.0	2007
Mining	5.6	6.7	2006
	5.6	7.7	
Industrials			
Aerospace & Defence	1.6	–	2007
Construction & Materials	2.1	3.7	2006
General Industrials	1.5	0.5	
Industrial Engineering	1.2	0.5	
Industrial Transportation	–	2.4	
Support Services	0.5	–	
	6.9	7.1	
Consumer Goods			
Automobiles & Parts	1.1	0.6	2007
Beverages	2.3	2.4	2006
Food Producers	1.6	2.9	
Tobacco	2.8	2.5	
	7.8	8.4	
Healthcare			
Pharmaceuticals & Biotechnology	7.1	5.4	2007
	7.1	5.4	2006
Consumer Services			
Food & Drug Retailers	1.5	–	2007
General Retailers	1.3	3.6	2006
Media	5.0	1.6	
Travel & Leisure	1.1	1.1	
	8.9	6.3	

Distribution of Total Assets

at 31 January 2007

Percentage of Total Assets

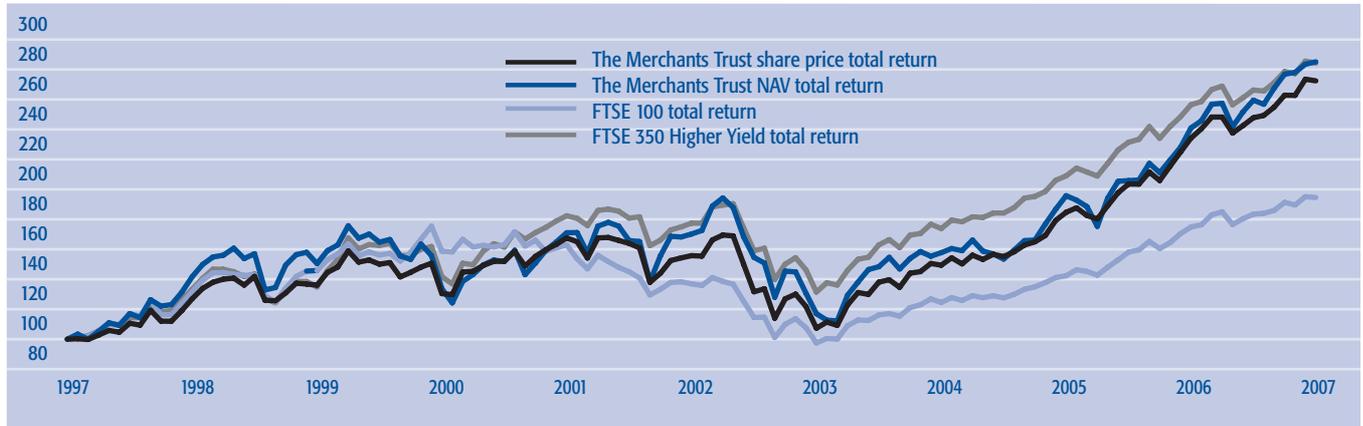
	2007	2006
Telecommunications		
Fixed Line Telecommunications	1.7	2.7
Mobile Telecommunications	5.7	2.0
	<u>7.4</u>	<u>4.7</u>
Utilities		
Electricity	4.6	4.0
Gas, Water & Multiutilities	3.4	4.3
	<u>8.0</u>	<u>8.3</u>
Financials		
Banks	23.5	24.0
General Financial	0.8	1.1
Life Insurance	5.5	4.4
Non-Life Insurance	1.1	0.8
Real Estate	1.1	4.5
	<u>32.0</u>	<u>34.8</u>
Information Technology		
Software & Computer Services	0.7	–
	<u>0.7</u>	<u>–</u>
Total Equities	99.1	99.0
Net Current Assets	<u>0.9</u>	<u>1.0</u>
Total Assets	<u>100.0</u>	<u>100.0</u>



Performance Graphs

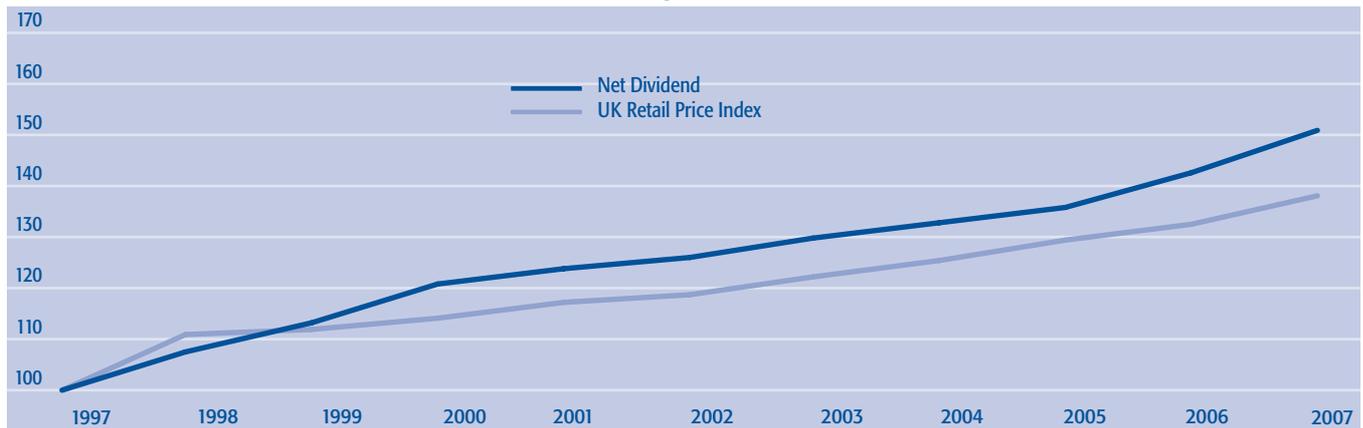
10 year record as at 31 January

The Merchants Trust Total Return compared to key UK equity indices



Source: Russell/Mellon

The Merchants Trust Net Dividend Growth compared to inflation



Source: Russell/Mellon

The Merchants Trust PLC



Source: Russell/Mellon

Financial Risk Management

The Company is exposed to financial risk through its financial assets and financial liabilities. The most important components of its financial risk are market price risk, interest rate risk, foreign currency risk, credit risk and liquidity risk. The risk profile and the policies adopted to manage risk did not change materially during either the current or previous year.

The narrative below explains the different types of risks the Company may face. Numerical disclosures are listed in Note 18 to the Accounts.

This information is given so that investors in the Company can decide for themselves whether their investment is high or low risk. It allows them to assess what kind of impact the use of financial instruments (investments, cash/overdraft and borrowings) will have on the performance of the entity. Short term debtors and creditors are not considered to be financial instruments. They have been included at the bottom of the numerical disclosure in Note 18(a) merely to enable users of the Accounts to reconcile the summary provided to total net assets per the balance sheet.

As an investment trust, the Company invests in securities for the long term. Accordingly it is, and has been throughout the year under review, the Company's policy that no short term trading in investments or other financial instruments shall be undertaken.

Market price risk

Market price risk arises mainly from the uncertainty about future prices of financial instruments held. It represents the potential loss the Company might suffer through holding market positions in the face of price movements. The Board meets regularly to consider the asset allocation of the portfolio in order to evaluate the risk associated with particular industry sectors. A dedicated fund manager has the responsibility for monitoring the existing portfolio selection in accordance with the Company's investment objectives and seeks to ensure that individual stocks meet an acceptable risk reward profile.

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.

The Company invests predominantly in equities, the values of which are not directly affected by changes in prevailing market interest rates. Therefore there is minimal exposure to interest rate risk.

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

Foreign currency risk

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

The Company invests predominantly in UK listed securities. The value of these securities may be affected by the impact of movements in exchange rates on the underlying businesses either on a transactional or translational basis.

Credit risk

Credit risk is the risk of default by a counterparty.

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

Liquidity risk

Liquidity risk relates to the capacity to meet liabilities.

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.

Directors

Mr H. A. Stevenson (Chairman)

(Born September 1942) joined the Board in September 1999. Formerly Chairman of Mercury Asset Management Group plc, he is Chairman of Equitas Limited, Chairman of Standard Life Investments, a Director of Standard Life plc, a Non-Executive Director of the Financial Services Authority and a member of the Investment Committee of the Wellcome Trust.

Sir John Banham

(Born August 1940) joined the Board in August 1992. Formerly Controller of the Audit Commission and Director General of the Confederation of British Industry, Chairman of Tarmac plc, Kingfisher plc and until August 2005 he was Chairman of Whitbread PLC. He is Chairman of Johnson Matthey PLC and Spacelabs Healthcare Inc. He is also the Senior Non-Executive Director of Amvescap Plc and of Cyclacel Pharmaceuticals Inc. Sir John will be retiring from the Board at the conclusion of the forthcoming Annual General Meeting.

Mr R. A. Barfield

(Born April 1947) joined the Board in May 1999. Formerly Chief Investment Manager of Standard Life Assurance Company, he is a Director of The Baillie Gifford Japan Trust PLC, JPMorgan Fleming Overseas Investment Trust PLC, The Edinburgh Investment Trust PLC, Standard Life Investments Property Income Trust Limited, Umbro PLC and other companies. He is a member of The Public Oversight Board.

Sir Bob Reid

(Born May 1934) joined the Board in January 1995. He was formerly Deputy Governor of the Bank of Scotland, Chairman of Shell (UK), British Rail, London Electricity plc and Sears PLC. He is Senior Non-Executive Director of HBOS plc.

Mr J. M. Sassoon (Chairman of the Audit Committee from September 2006)

(Born September 1955) joined the Board in July 2006. He is The Chancellor's Representative for Promotion of the City at HM Treasury. From 2002 to 2006 he was Managing Director of HM Treasury's Finance and Industry Directorate and a Member of the Treasury Board. Prior to that he had worked at UBS Warburg since 1987 where he held a number of positions, latterly Vice Chairman, Investment Banking. He is a Chartered Accountant.

Mr P. J. Scott Plummer (Senior Independent Director and Chairman of the Audit Committee until September 2006)

(Born August 1943) is a Chartered Accountant and joined the Board in May 1997. He is a Director of Buccleuch Estates Limited. He was until November 2005 Chairman of Martin Currie Limited. He was formally a Director of Martin Currie Portfolio Investment Trust PLC and Candover Investments PLC.

All the above Directors are non-executive and independent of the Manager.

Directors' Report

The Business Review is addressed only to shareholders as a body, and no liability can be admitted by the Directors to any other parties in connection therewith. The purpose of the Business Review is limited to its statutory purpose, namely to assist shareholders in assessing the Company's strategies and the potential for these strategies to succeed. Any forward-looking statements contained in the Business Review reflect the knowledge and information available to the Directors at the date the Business Review was prepared. The Business Review will not be updated during the next financial year, but any forward-looking statements contained in the Business Review will be considered in the preparation of the next year's Annual Report.

Business Review

Business and Status of the Company

The Company is an investment company as defined in Section 266 of the Companies Act 1985.

The Company carries on business as an investment trust and was approved by HM Revenue & Customs as an investment trust in accordance with Section 842 of the Income and Corporation Taxes Act 1988 for the year ended 31 January 2006. In the opinion of the Directors, the Company has subsequently conducted its affairs so that it should continue to qualify. The Company will continue to seek approval under Section 842 of the Income and Corporation Taxes Act 1988 each year. The Company is not a close company for taxation purposes.

Regulatory Environment

The Company is listed on the London Stock Exchange and is subject to UK company law, financial reporting standards, listing rules, tax law and its own Articles of Association. In addition to annual and interim accounts published under these rules, the Company announces net asset values per share on a daily basis for the information of investors. It provides more detailed information on a monthly basis to the Association of Investment Companies, of which the Company is a member, in order for brokers and investors to compare its performance with its peer group. The Board of Directors is charged with ensuring that the Company complies with its own objectives as well as these rules. The Board has appointed RCM (UK) Limited to carry out investment management, accounting, secretarial and administration services on behalf of the Company. The Company has no employees or premises of its own.

Investment Objective and Policies

The Company's objective is to provide an above average level of income and income growth together with long term growth of

capital through a policy of investing mainly in higher yielding UK FTSE 100 companies. The Company's investment performance is assessed by comparison with other investment trusts within the UK Growth and Income sector. In addition, it is benchmarked against the FTSE 100 Index, reflecting the emphasis within the portfolio, as well as the FTSE 350 Higher Yield Index, reflecting the Company's higher yield objective.

The Company pays quarterly dividends and the Board has a policy of making these progressive from year to year, in keeping with the Company's stated objective to provide an above average level of income and income growth. The dividend has increased every year for the past twenty five years and details of historic dividend payments are set out on page 5.

Performance

In the year to 31 January 2007 the Company produced an NAV capital return to shareholders of 12.6%. This compares with the return on the Company's benchmark index of 7.7%. In the previous year the returns were 21.2% and 18.7% respectively. At 31 January 2007 the value of the Company's investment portfolio was £695.8m. The Investment Manager's review on pages 6 to 7 includes a review of developments during the year as well as information on investment activity within the Company's portfolio.

Key Performance Indicators ("KPIs")

The Board uses certain financial KPIs to monitor and assess the performance of the Company. The principal KPIs are:

Performance against the benchmark index

The Company's performance is benchmarked against the FTSE 100 Index. This is the most important KPI by which performance is judged.

Performance against the Company's peers

The Board also monitors the Company's performance with reference to its investment trust peer group.

Performance Attribution

The performance attribution is considered at each Board Meeting and enables the Directors to judge how the Company achieved its performance relative to the benchmark index and to see the impact on the Company's relative performance of factors including stock and sector allocation. A Performance Attribution Analysis for the year ended 31 January 2007 is given on page 3.

Directors' Report

Discount to net asset value ("NAV")

The Board has a share buy back programme which has a role to play in minimising the volatility of movements in the discount and in enhancing the NAV for existing shareholders as shares are bought back at a discount. In the year to 31 January 2007 the shares traded between a premium of 0.5% and a discount of 2.47% with debt at fair value.

Total expense ratio ("TER")

The most significant expense for the Company is the cost of the management fee and the costs of interest on the Company's borrowings. Other expenses include the costs of investment transactions, directors' fees and insurance, professional advice and regulatory fees and the costs of production of the reports to shareholders. The TER is calculated by dividing operating expenses by total assets less current liabilities, that is, the Company's management fee and all other operating expenses (including tax relief, where allowable, but excluding interest payments) as a percentage of average assets over the year. The TER for the year ended 31 January 2007 was 0.46% (2006 0.47%).

Revenue

The return attributable to Ordinary Shareholders for the year amounted to £22,854,005 (2006 – £19,853,959).

Earnings per ordinary dividend amounted to 22.17p. The first and second interim dividends of 4.9p and 4.9p respectively have been paid during the year. Since the year end the third interim dividend of 5.1p has been paid. The final proposed dividend of 5.1p is payable on 16 May 2007. In accordance with FRS 21 'Events after the Balance Sheet Date', the third and final dividends are not recognised as liabilities within the accounts.

Historical Record

The distribution of total assets is shown on page 10, and the historical record of the Company's revenue, capital and invested funds over the past ten years is shown on page 5. Graphs appear on page 12 showing the performance on a total return basis over the past ten years of the Net Asset Value of the Company's Ordinary Shares against the Company's benchmark indices, the growth in net ordinary distributions made by the Company against the Retail Price Index, and the Company's discount to Net Asset Value over the same period.

Invested Funds

Sales of investments during the year resulted in net gains based on historical costs of £53,443,663 (2006 – £36,622,105). Provisions contained in the Finance Act 1980 exempt approved Investment

Trusts from corporation tax on their chargeable gains. Invested funds at 31 January 2007 had a value of £695,769,971 (2006 – £621,948,270) before deducting net liabilities of £106,935,296 (2006 – £107,235,074).

Principal Risks and Uncertainties

With the assistance of the Managers the Board has drawn up a risk matrix which identifies the key risks to the Company. These key risks fall broadly under the following categories:

Investment Activity and Strategy

An inappropriate investment strategy, e.g., asset allocation or the level of gearing, may lead to under-performance against the Company's benchmark index and peer group companies, and also in the Company's shares trading on a wider discount. The Board manages these risks by diversification of investments through its investment restrictions and guidelines which are monitored and on which the Board receives reports. RCM (UK) Limited ("RCM (UK)") provides the Directors with management information including performance data and reports and shareholder analyses. The Board monitors the implementation and results of the investment process with the investment managers, who attend all board meetings, and reviews data which show risk factors and how they affect the portfolio. The Board reviews investment strategy at each board meeting.

Portfolio and Market

Market risk arises from uncertainty about the future prices of the Company's investments. This is commented on in 'Financial Risk Management' on page 13. The Board monitors the implementation and results of the investment process with the investment managers.

Accounting, Legal and Regulatory

In order to qualify as an investment trust the Company must comply with Section 842 of the Income and Corporation Taxes Act 1988 ("Section 842"), and details are given above under the heading 'Business of the Company'. A breach of Section 842 could result in the Company losing investment trust status and, as a consequence, gains in the Company's portfolio would be subject to Capital Gains Tax. The Section 842 criteria are monitored by RCM (UK) and results are reported to the Board at each Board Meeting. The Company must comply with the provisions of the Companies Act 1985, and the Companies Act 2006 as it becomes enacted ("Companies Acts"), and, as the Company's shares are listed on the London Stock Exchange, the Company must comply with the UK Listing Authority's Listing Rules and Disclosure Rules ("UKLA Rules"). A breach of the Companies Acts could result in the Company and/ or the Directors being fined or the subject of

Directors' Report

criminal proceedings. Breach of the UKLA Rules could result in the suspension of the Company's shares which would in turn lead to a breach of Section 842. The Board relies on its company secretary and its professional advisers to ensure compliance with the Companies Acts and UKLA Rules.

Corporate Governance and Shareholder Relations

Details of the Company's compliance with Corporate Governance best practice, including information on relations with shareholders, are set out in the Corporate Governance Report on page 22 to 25.

Operational

Disruption to, or failure of, RCM (UK)'s accounting, dealing or payment systems or the custodian's records may prevent accurate reporting and monitoring of the Company's financial position. RCM (UK) Limited has transferred operational functions, principally relating to trade processing and investment administration, to The Bank of New York – London Branch. Details of how the Board monitors the services provided by RCM (UK) and other suppliers and the key elements designed to provide effective internal control are included within the Internal Control section of the Corporate Governance report on page 23.

Financial

The financial risks to the Company are disclosed in Note 18. on page 43 to 44.

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 investment manager discusses his view of the outlook for the Company's portfolio in his report beginning on page 6.

Net Asset Value

The Net Asset Value of the Ordinary Shares of 25p at the year end was 567.5p as compared with a value of 504.1p at 31 January 2006.

The Company has been given authority by its shareholders to buy back shares for cancellation which, in the right circumstances, could be used by the Board to enhance shareholder value and help to reduce the discount to net asset value at which the Company's shares currently trade. No shares have been bought back since 2001, however, to enable the Company to respond to changes of circumstances, a resolution to renew the authority to purchase shares for cancellation is to be put to shareholders at the forthcoming Annual General Meeting and the full text is set out in the Notice of Meeting on page 45 .

Share Capital

Details of the Company's share capital are set out in Note 11 on page 40.

Payment Policy

It is the Company's payment policy for the forthcoming financial year to obtain the best terms for all business and therefore there is no consistent policy as to the terms used. In general, the Company agrees with its suppliers the terms on which business will take place and it is our policy to abide by these terms. The Company had no trade creditors at the year end (2006 – £nil).

Donations and Subscriptions

There were no charitable donations and subscriptions in respect of the year (2006 – £nil). No political donations were made during the year.

Corporate Governance

The Corporate Governance statement is set out on pages 22 to 25.

Directors' Fees

A report on the Directors' remuneration is set out on page 26.

Final Dividend

Subject to the final dividend being approved by shareholders at the Annual General Meeting, payment will be made on 16 May 2007 to shareholders on the Register of Members at the close of business on 13 April 2007 at the rate of 5.1p per Ordinary Share. Further details are provided in Note 6 on page 36.

Directors' Report

Substantial Shareholdings

In accordance with Section 198 of the Companies Act 1985 and the Disclosure of Interests in Shares (Amendment) (No. 2)

Regulations 1993, as at the date of this report, the Company has been advised of the following substantial share interests in its preference stock and ordinary share capital:

3.65% Cumulative Preference Stock:

P. S. & J. M. Allen – 185,582 (15.75%)

Prudential plc – 176,000 (14.9%);

Ecclesiastical Insurance Office plc – 134,690 (11.4%);

F&C Asset Management plc – 60,000 (5.1%)

D. J. Edwards – 50,000 (4.2%)

J. Y. Miller – 36,000 (3.0%)

Ordinary Shares:

Rensburg Sheppards Investment Management Group Limited – 4,524,860 (4.36%)

Legal & General Group PLC – 3,427,541 (3.3%)

Directors and Management

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

The Directors retiring by rotation at the Annual General Meeting are Sir John Banham, Sir Bob Reid and Joe Scott Plummer. Sir John Banham will be retiring after the AGM in May. Sir Bob Reid and Joe Scott Plummer each offers himself for re-election and both have the full support of the Board in doing so.

The Board considers Sir Bob Reid and Joe Scott Plummer to be independent, notwithstanding their length of service, and continues to be of the view that their extensive experience and active knowledge of industry and financial services are of great benefit to the Board.

The Board confirms that, since the year end, the performances of Sir Bob Reid and Joe Scott Plummer have been subject to a formal evaluation, and that each continues to be effective in, and to demonstrate commitment to, his role.

James Sassoon, having been appointed to the Board during the year, retires in accordance with the Articles of Association and offers himself for election.

Biographical details of the Directors are on page 14.

The current Directors and their beneficial interests in the share capital of the Company as at 31 January 2007 and 2006 or at the date of appointment to the Board are listed below:

	Ordinary Shares of 25p	
	2007	2006
Sir John Banham	2,000	2,000
R. A. Barfield	2,343	2,259
Sir Bob Reid	5,000	5,000
J. M. Sassoon	35,600	35,600
P. J. Scott Plummer	1,000	1,000
H. A. Stevenson	25,000	25,000

Since the year end, Mr R. A. Barfield has acquired a further 19 Ordinary Shares due to reinvestment of income in a share plan.

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 Articles of Association.

Management Contract and Management Fee

The management contract with RCM (UK) Limited ('RCM') provides for a fee of 0.35% per annum (2006 – 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 RCM. The management contract is terminable at one year's notice (2006 – one year).

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 Trust'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, which it found to be appropriate. The committee was satisfied with its review and believes that the continuing appointment of the Managers is in the best interests of shareholders as a whole.

Directors' Report

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

The Company has entered into an annual agreement with Allianz Global Investors to operate the Investment Trust Share Plan. The cost to the Company for the year ending 31 January 2007 is £65,453 excluding VAT (2006 – £197,462 excluding VAT). The fee relates to generic costs and is partially calculated on a usage and market capitalisation basis.

Individual Savings Accounts/PEPs

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

Directors' and Officers' Liability Insurance

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

Annual General Meeting

Purchase of Own Shares

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

Where purchases are made at prices below the prevailing net asset value of the Ordinary Shares, this will enhance net asset value for the remaining shareholders. It is therefore intended that purchases would only be made at prices below net asset value, with the purchases to be funded from the realised capital profits of the Company (which are currently in excess of £400 million). The rules of the UK Listing Authority ('Listing Rules') limit the price which may be paid by the Company to 105% of the average middle-market quotation for an Ordinary Share on the five business days immediately preceding the date of the relevant purchase. The minimum price to be paid will be 25p per Ordinary Share (being the nominal value). Overall, this proposed share buy-back authority, if used, should help to reduce the discount to net asset value at which the Company's shares currently trade.

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

Analysis of Share Register

	Shareholder Accounts			%	Ordinary Shares held			%
	Number	2006	2007		000's	2006	2007	
Private holders*	7,980	8,439	65.0	65.6	20,756	22,018	20.0	21.6
Nominees	3,820	3,909	31.1	30.4	77,613	74,417	74.8	72.9
Limited Companies	173	191	1.4	1.5	2,537	2,261	2.5	2.2
Investment Trusts and Funds	104	132	1.0	1.0	752	870	0.7	0.9
Bank and Bank Nominees	11	13	0.1	0.1	1,274	1,772	1.2	1.7
Insurance Companies	12	12	0.1	0.1	67	73	0.1	0.1
Pension Funds	5	5	0.0	0.0	23	22	0.0	0.0
Other holders	163	167	1.3	1.3	737	670	0.7	0.6
	<u>12,268</u>	<u>12,868</u>	<u>100.0</u>	<u>100.0</u>	<u>103,759</u>	<u>102,103</u>	<u>100.0</u>	<u>100.0</u>

*Including PEP, ISA and Share Plan Nominees.

Based on an analysis of the Ordinary Share register at 2 April 2007 (2006 – 1 April).

Directors' Report

The Company's Articles of Association permit the Company to redeem or purchase its own shares out of capital profits. Under the Listing Rules, the maximum number of shares which a listed company may purchase through the market pursuant to a general authority such as this is equivalent to 14.99% of its issued share capital. For this reason, the Company is limiting its renewed authority to make such purchases to 15,553,605 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 14 May 2007.

The authority will last until the Annual General Meeting of the Company to be held in 2008 or the expiry of 18 months from the date of the passing of this resolution, whichever is the earlier. The authority will be subject to renewal by shareholders at subsequent annual general meetings.

Allotment of New Shares and Disapplication of Pre-emption Rights

Approval is sought for the renewal of the Directors' authority to allot relevant securities, in accordance with Section 80 of the Companies Act 1985, up to a maximum aggregate nominal amount of £8,646,656, representing approximately 33% of the existing Ordinary Share capital. This authority would expire five years from the date of renewal, if not previously revoked or varied.

A resolution was passed at the Annual General Meeting held on 9 May 2006 to authorise the Directors to allot the unissued Ordinary Share capital for cash. The authority is renewable annually and expires at the conclusion of the Annual General Meeting in 2007. A Special Resolution is therefore proposed under special business at the forthcoming Annual General Meeting to renew this authority for a further year.

The power to allot new Ordinary Shares for cash, other than pro rata to existing shareholders, is limited to the aggregate nominal amount of £1,296,998 Ordinary Share capital, being approximately five per cent 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 14 May 2007.

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

Auditors

The Directors will place a resolution before the Annual General Meeting to re-appoint PricewaterhouseCoopers LLP as Auditors for the ensuing year. A resolution to authorise the Directors to determine the Auditors' remuneration will also be proposed at the Annual General Meeting.

By Order of the Board
K. J. Salt
Secretary

4 April 2007

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Annual Report and the accounts in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice. Company law requires the Directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the Company for that period. In preparing these accounts, the Directors are required to:

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

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

The accounts are published on www.allianzglobalinvestors.co.uk, which is a website maintained by the Company's Investment Managers, RCM (UK) Limited. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of the accounts may differ from legislation in other jurisdictions.

Corporate Governance

The Board has put in place a framework for corporate governance which it believes is appropriate for an investment trust company and which enables the Company to comply with the applicable provisions of the Combined Code on Corporate Governance ('the Combined Code'). The Board has also taken account of the AIC Code of Corporate Governance which was issued by the Association of Investment Trust Companies in July 2003 and endorsed by the Financial Reporting Council in 2006. The Board has reviewed and applied the requirements of both codes except where stated otherwise. The Board considers that the Company has complied with the applicable provisions of the Combined Code throughout the accounting period to 31 January 2007. Much of this statement describes how the relevant principles of governance are applied to the Company.

The Board

The Board currently consists of six Directors, all of whom are non-executive and independent of the Company's investment manager. Their biographies, on page 14, demonstrate a breadth of investment, industrial, commercial and professional experience.

The Chairman of the Company is a non-executive Director and Joe Scott Plummer was appointed as the Senior Independent Director in March 2005.

The Board follows the AIC Code and considers Sir John Banham and Sir Bob Reid and Joe Scott Plummer, to be independent, notwithstanding that each has served on the Board for more than nine years. The Board does not consider that length of service has diminished the independence of these directors and continues to be of the view that their extensive experience and active knowledge of industry is of great benefit to the Board.

The Board's tenure policy is that new Directors stand for election at the first Annual General Meeting following their appointment and then at least one third of Directors retire by rotation at each Annual General Meeting. Every Director is required to seek re-election at least every three years and annually after nine years' service. The names of the Directors retiring by rotation at this year's Annual General Meeting are given on page 18.

The composition of the Board is reviewed regularly. In the Directors' view the stability of the Board has been a source of strength but they are nevertheless aware of the need to refresh the composition from time to time and the Board intends to recruit further non-executive directors.

The Board meets at least six times a year and convenes ad hoc meetings as and when required. Between meetings, regular contact with the investment managers is maintained. The Board has

formally adopted a schedule of matters reserved for its approval to ensure that it maintains full and effective control over appropriate issues. These matters include approval of the Company's investment policy, capital structure, share price and discount, committee membership and terms of reference, financial reporting, risk management, board appointments and removals, corporate governance, internal controls and contracts. A procedure has been adopted for Directors, in the furtherance of their duties, to take independent professional advice at the expense of the Company. The Directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed and that the Company complies with applicable rules and regulations. When a new Director is appointed there is an induction process carried out by the investment manager. Directors are provided, on a regular basis, with key information on the Company's regulatory and statutory requirements and internal financial controls. Changes affecting Directors' responsibilities are advised to the Board as they arise.

During the current year, the effectiveness of the Board was assessed through interviews conducted by the Chairman with each Director. In addition, the performance of the Directors was evaluated by each Director, followed by a discussion with the Chairman. The Chairman's own performance was evaluated by the other Directors, who met under the chairmanship of Joe Scott Plummer. The results of the effectiveness assessment and performance evaluation have been presented to the Nomination Committee.

The effectiveness assessment determined that the balance of the Board was satisfactory.

The Board has contractually delegated to the investment manager the management of the investment portfolio, and the day to day accounting and company secretarial requirements. This contract was entered into after full and proper consideration by the Board of the quality and cost of services offered, including the financial control systems in operation, in so far as they relate to the affairs of the Company. The Board receives and considers reports regularly from the investment manager and ad hoc reports and information are supplied to the Board as required. The Board's statement on its review of the management contract appears on page 18.

Corporate Governance

Attendance by Directors at formal Board and committee meetings during the year was as follows:

Director	Board	Management		
		Audit Committee	Nomination Committee	Engagement Committee
No. of meetings	6	2	1	1
H. A. Stevenson	6	2*	1	1
Sir John Banham	5	1	–	–
R. A. Barfield	6	2	1	1
Sir Bob Reid	6	2	1	1
J. M. Sassoon**	3	1	–	–
P. J. Scott Plummer	6	2	1	1

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

** Joined the Board in July 2006.

Board Committees

Audit Committee

The Audit Committee consists of all of the independent non-executive Directors, with the exception of the Chairman of the Board, and has defined terms of reference and duties. The role of the Audit Committee is to assist the Board in relation to the reporting of financial information. The Audit Committee is chaired by James Sassoon. The committee considers that, collectively, its members have sufficient recent and relevant financial experience to discharge their responsibilities fully. The committee meets at least twice each year and reviews the annual accounts and interim report and considers the Auditors' report on the annual accounts, the planning and the process of the audit and the Auditors' independence and objectivity. It has also considered the non-audit services provided by the Auditors and determined that they have had no impact on the Auditors' independence and objectivity. The Audit Committee reviews the Company's accounting policies and considers their appropriateness. The Committee also reviews the terms of appointment of the Auditors together with their remuneration. It meets representatives of the Managers twice-yearly and receives reports on the internal controls maintained on behalf of the Company and reviews the effectiveness of these controls. 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.

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 Hugh Stevenson, the Chairman of the Board. All Directors serve on the committee and consider nominations made in accordance with an agreed procedure.

Management Engagement Committee

The Management Engagement Committee meets at least once each year to review the Management Agreement and the Managers' performance. It has defined terms of reference and consists of the non-executive Directors and excludes any Directors previously employed by the Managers. It is chaired by Hugh Stevenson, the Chairman of the Board.

The Board has not constituted a Remuneration Committee; all Directors are non-executive and remuneration matters are dealt with by the whole Board.

The Terms of Reference for each of the committees may be viewed by shareholders on request.

Financial Reporting

The Statement of Directors' Responsibilities in respect of the accounts is on page 21.

The Independent Auditors' Report can be found on page 27.

Auditors' Information

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

- in so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all the steps he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 234ZA of the Companies Act 1985.

Going Concern

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

Internal Control

The Directors have overall responsibility for the Company's system 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.

Corporate Governance

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process is subject to review by the Board and accords with the Internal Control Guidance for Directors in the Combined Code published in September 1999 and revised in October 2005 (“the Turnbull guidance”). The process has been fully in place throughout the year under review and up to the date of signing of these Report and Accounts.

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 in a risk matrix. 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.
- The appointment of RCM (UK) Limited (‘RCM’) as the Manager provides investment management, accounting and company secretarial services to the Company. The Manager therefore maintains the internal controls associated with the day to day operation of the Company. These responsibilities are included in the Management Agreement between the Company and the Manager. The Manager’s system of internal control includes organisation arrangements with clearly defined lines of responsibility and delegated authority as well as control procedures and systems which are regularly evaluated by management and monitored by its internal audit department. RCM is regulated by the Financial Services Authority (‘FSA’) and its compliance department regularly monitors compliance with FSA rules. The Company receives 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 Allianz Global Investors’ 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 Manager’s and Custodian’s systems of controls and approves the appointment of any sub-custodians. The Audit Committee also receives reports from the Manager’s and Custodian’s internal auditors, compliance department and independent Auditors.
- The Board reviews the Internal Control reports of the Managers and third party service providers, including those of the Company’s Registrars, Capita Registrars, and Custodian, HSBC Bank plc.

The Board has undertaken a full review of the aspects covered by the Turnbull guidance and believes that there is an effective framework substantially in place to meet the requirements of the Combined Code.

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

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 and the Chairman of the Audit Committee, 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 report to the Board on matters raised at these meetings.

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 at 155 Bishopsgate, London EC2M 3AD.

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

Socially Responsible Investment and Environmental Policy

The Investment Managers have been directed by the Board to take account of companies’ corporate social responsibility and environmental performance when taking investment decisions.

Corporate Governance

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 Managers.

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

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

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

Directors' Remuneration Report

This report is submitted in accordance with the Directors' Remuneration Report Regulations 2002 for the year ended 31 January 2007.

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.

Policy on Directors' Remuneration

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 of Association limit the aggregate fees payable to the Board of Directors to a total of £150,000 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' and officers' liability insurance cover is held by the Company. Following the approval of the proposal at last year's Annual General Meeting to change the Company's Articles of Association to enable the Company to grant indemnities to the Directors individually, deeds of indemnity have been entered into with the Directors.

Remuneration

The policy is to review Directors' fees from time to time, but reviews will not necessarily result in a change to the rates. As disclosed in last year's report, in the year under review until 31 May 2006 the Directors were paid at a rate of £12,000 per annum, with an additional £3,000 payable to the Audit Committee Chairman. The Chairman of the Board was paid at a rate of £20,000 per annum. These rates were increased with effect from 1 June 2006 to £15,000 per annum for the Directors, with the Audit Committee Chairman receiving an additional £2,000, and £25,000 per annum for the Chairman of the Board.

The Directors carried out a review in January 2007 and decided not to increase the fees in the current year.

Directors' Emoluments

The following disclosures on Directors' remuneration have been audited as required by Part 3 of Schedule 7A of the Companies Act 1985.

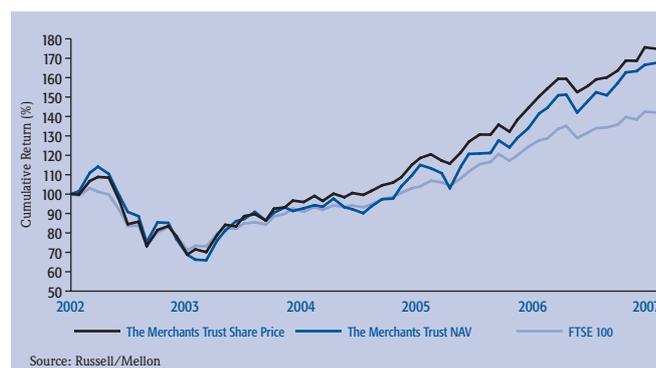
The Directors' Emoluments during the year and in the previous year are as follows:

	Directors' fees	
	2007	2006
	£	£
H. A. Stevenson	23,334	19,852
Sir John Banham	14,000	11,971
R. A. Barfield	14,000	11,971
Sir Bob Reid	14,000	11,971
J. M. Sassoon	9,062	–
P. J. Scott Plummer	15,554	13,623
Totals	89,950	69,388

Performance Graph

The graph below measures the Company's share price and net asset value performance against its benchmark index of the FTSE 100 Index.

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



By Order of the Board
K. J. Salt
Secretary
4 April 2007

Independent Auditors' Report

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

We have audited the accounts of The Merchants Trust PLC for the year ended 31 January 2007 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Reconciliation of Movements in Shareholders' Funds and the related notes. These accounts have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the accounts in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities. The Directors are also responsible for preparing the Directors' Remuneration Report.

Our responsibility is to audit the accounts and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the accounts.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the Combined Code 2003 specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited accounts. The other information comprises only the Key Facts, Performance Attribution Analysis, Chairman's Statement, Historical Record, Investment Managers' Review, United Kingdom Listed Holdings, Distribution of Total Assets, Performance Graphs, Financial Risk Management, the Directors' Report, the Corporate Governance Statement and the unaudited part of the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 January 2007 and of its net return and cash flows for the year then ended;
- the accounts and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the accounts.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

4 April 2007

Income Statement

for the year ended 31 January 2007

		2007 £ Revenue	2007 £ Capital	2007 £ Total Return	2006 £ Revenue	2006 £ Capital	2006 £ Total Return
	Note						
Net gains on investments at fair value	8	–	71,440,601	71,440,601	–	96,792,013	96,792,013
Income	1	27,750,450	–	27,750,450	24,714,263	–	24,714,263
Investment management fee	2	(961,650)	(1,785,921)	(2,747,571)	(823,956)	(1,530,205)	(2,354,161)
Administration Expenses	3	(488,138)	(3,021)	(491,159)	(621,878)	(5,424)	(627,302)
Net return before finance costs and taxation		26,300,662	69,651,659	95,952,321	23,268,429	95,256,384	118,524,813
Finance costs: interest payable and similar charges	4	(3,446,657)	(6,321,084)	(9,767,741)	(3,414,470)	(6,219,001)	(9,633,471)
Net return on ordinary activities before taxation		22,854,005	63,330,575	86,184,580	19,853,959	89,037,383	108,891,342
Taxation	5	–	–	–	–	–	–
Net return attributable to Ordinary Shareholders		22,854,005	63,330,575	86,184,580	19,853,959	89,037,383	108,891,342
Return per Ordinary Share (basic and diluted)	7	22.17p	61.44p	83.61p	19.44p	87.20p	106.64p

Dividends in respect of the financial year ended 31 January 2007 total 20.00p (2006 – 18.90p), costing £20,745,854 (2006 – £19,273,678). Details are set out in Note 6.

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

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

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

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 January 2007

	Note	Called up Share Capital £	Share Premium Account £	Capital Redemption Reserve £	Capital Reserve Realised £	Capital Reserve Unrealised £	Revenue Reserve £	Total £
Net Assets at 31 January 2006		25,525,984	39,809	56,250	351,107,802	118,104,550	19,878,801	514,713,196
Revenue Return		–	–	–	–	–	22,854,005	22,854,005
Dividends on Ordinary Shares	6	–	–	–	–	–	(19,964,324)	(19,964,324)
Capital Return		–	–	–	50,187,850	13,142,725	–	63,330,575
Shares issued during the year		413,985	7,487,238	–	–	–	–	7,901,223
Net Assets at 31 January 2007		<u>25,939,969</u>	<u>7,527,047</u>	<u>56,250</u>	<u>401,295,652</u>	<u>131,247,275</u>	<u>22,768,482</u>	<u>588,834,675</u>
Net Assets at 31 January 2005		25,525,984	39,809	56,250	322,240,327	57,962,642	18,685,896	424,510,908
Adjustment to record investments at bid value		–	–	–	–	(28,000)	–	(28,000)
Revenue Return		–	–	–	–	–	19,853,959	19,853,959
Dividends on Ordinary Shares	6	–	–	–	–	–	(18,661,054)	(18,661,054)
Capital Return		–	–	–	28,867,475	60,169,908	–	89,037,383
Net Assets at 31 January 2006		<u>25,525,984</u>	<u>39,809</u>	<u>56,250</u>	<u>351,107,802</u>	<u>118,104,550</u>	<u>19,878,801</u>	<u>514,713,196</u>

The Notes on pages 32 to 44 form an integral part of these Accounts.

Balance Sheet

as at 31 January 2007

	Note	2007 £	2007 £	2006 £
Fixed Assets				
Investments held at fair value through profit or loss	8		695,769,971	621,948,270
Current Assets				
Debtors	10	2,836,903		3,586,680
Cash at bank	10	7,003,101		5,374,796
		9,840,004		8,961,476
Creditors: Amounts falling due within one year	10	<u>(3,227,220)</u>		<u>(2,843,149)</u>
Net Current Assets			6,612,784	6,118,327
Total Assets Less Current Liabilities			702,382,755	628,066,597
Creditors: Amounts falling due after more than one year	10		<u>(113,548,080)</u>	<u>(113,353,401)</u>
Total Net Assets			<u>588,834,675</u>	<u>514,713,196</u>
Capital and Reserves				
Called up Share Capital	11		25,939,969	25,525,984
Share Premium Account			7,527,047	39,809
Capital Redemption Reserve			56,250	56,250
Capital Reserves: Realised	12	401,295,652		351,107,802
Unrealised	12	<u>131,247,275</u>		<u>118,104,550</u>
			532,542,927	469,212,352
Revenue Reserve	13		<u>22,768,482</u>	<u>19,878,801</u>
Equity Shareholders' Funds	14		<u>588,834,675</u>	<u>514,713,196</u>
Net Asset Value per Ordinary Share	14		567.5p	504.1p

The accounts on pages 28 to 44 were approved and authorised for issue by the Board of Directors on 4 April 2007 and signed on its behalf by

Hugh Stevenson

Cash Flow Statement

for the year ended 31 January 2007

	Note	2007 £	2007 £	2006 £
Net cash inflow from operating activities	16		28,262,666	22,805,795
Servicing of finance				
Interest paid		(9,530,065)		(9,556,529)
Dividends on Preference Stock		(42,997)		(64,496)
Net cash outflow from servicing of finance			(9,573,062)	(9,621,025)
Financial investment				
Purchases of fixed asset investments		(236,518,625)		(139,140,607)
Sales of fixed asset investments		238,513,660		146,798,780
Net cash inflow from investing activities			1,995,035	7,658,173
Equity dividends paid	6		(19,964,324)	(18,661,054)
Net cash inflow before financing			720,315	2,181,889
Financing				
Cash transferred from Allianz Dresdner Income Growth Investment Trust plc in connection with the issue of Ordinary Shares	11		907,990	–
Increase in cash	17		1,628,305	2,181,889

Further details of non-cash consideration are provided in Note 11 on page 40.

Statement of Accounting Policies

for the year ended 31 January 2007

1. The accounts have been prepared under the historical cost convention, modified to include the revaluation of fixed asset investments, and in accordance with the United Kingdom law, United Kingdom Generally Accepted Accounting Practice (UK GAAP) and the revised Statement of Recommended Practice – 'Financial Statements of Investment Trust Companies' (SORP) issued in December 2005 by the Association of Investment Companies (formerly the Association of Investment Trust Companies).
2. Revenue – Dividends on equity shares are accounted for on an ex-dividend basis. UK dividends are shown net of tax credits. Income from convertible securities having an element of equity is recognised on an accruals basis. Interest receivable on non-equity shares is recognised on an accruals basis.

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.

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

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

3. Investment management fees and administrative expenses – The investment management fee is calculated on the basis set out in Note 2 to the accounts 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. Other administrative expenses are charged in full to revenue, except handling charges which are charged to capital.
4. Valuation – Investments are designated as held at fair value through profit or loss in accordance with FRS 26 'Financial Instruments: Measurement'. Listed investments are valued at bid market prices. 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 March 2005.

An unrealised Capital Reserve has been established to reflect differences between value and book cost. Net gains or losses arising on realisation of investments are taken directly to the realised Capital Reserve.

5. Finance costs – In accordance with the Financial Reporting Standard 25 'Financial Instruments: Disclosure and Presentation' and FRS 26 'Financial Instruments: Measurement', long term borrowings are stated at 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.

6. 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 accounts.

Statement of Accounting Policies

for the year ended 31 January 2007

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.

7. Foreign currency – In accordance with FRS 23 'The Effect of changes in Foreign Currency Exchange Rates', the Company is required to nominate a functional currency, being the currency in which the Company predominately operates. The functional and reporting currency is pound sterling, reflecting the primary economic environment in which the Company operates. Transactions in foreign currencies are translated into sterling at the rates of exchange ruling on the date of the transaction. Foreign currency assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. Profits and losses thereon are recognised in Capital Reserves..
8. Dividends – In accordance with FRS 21 'Events after the Balance Sheet Date', the final dividend payable on Ordinary Shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid.
9. Preference Stock – In accordance with FRS 25 'Financial Instruments: Disclosure and Presentation', the 3.65% Cumulative Preference Stock is classified as a liability as the rights of the stockholders to receive dividend payments are not calculated by reference to the Company's profits.

Notes to the Accounts

for the year ended 31 January 2007

1. Income

	2007 £	2007 £	2006 £
Total income comprises:			
Income from investments*:			
Equity income from UK investments†	27,334,101		24,206,347
Equity income from overseas investments		–	151,663
Income from fixed interest securities		7,325	–
		<u>27,341,426</u>	<u>24,358,010</u>
Other income:			
Deposit interest	274,898		339,652
Underwriting commission	124,962		10,363
Stocklending fees	9,164		6,238
		<u>409,024</u>	<u>356,253</u>
Total income		<u>27,750,450</u>	<u>24,714,263</u>

*All equity income is derived from listed investments.

†Includes special dividends of £1,302,224 (2006 – £nil).

2. Investment Management Fee

	2007 £ Revenue	2007 £ Capital	2007 £ Total	2006 £ Revenue	2006 £ Capital	2006 £ Total
Investment management fee	961,650	1,785,921	2,747,571	823,956	1,530,205	2,354,161

The management contract with RCM (UK) Limited ('RCM'), terminable at one year's notice, provides for a management fee based on 0.35% (2006 – 0.35%) per annum of the value of the Company's assets calculated monthly after deduction of current liabilities, short term loans under one year and any funds within the portfolio managed by RCM. The amounts stated include irrecoverable VAT of £409,213 (2006 – £350,620). Under the contract, RCM provides the Company with investment management, accounting, secretarial and administration services.

3. Administration Expenses

	2007 £	2006 £
Auditors' remuneration:		
for audit services	21,626	19,388
for non-audit services	3,525	7,050
	<u>25,151</u>	<u>26,438</u>
Directors' fees	89,950	69,388
Marketing costs of Share Plan	76,907	232,018
Other administrative expenses	296,130	294,034
	<u>488,138</u>	<u>621,878</u>

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

(ii) Until 31 May 2006 the Directors were paid at a rate of £12,000 per annum, with an additional payment to the Chairman of the Audit Committee of £3,000 per annum, and the Chairman was paid at a rate of £20,000 per annum. These rates were increased with effect from 1 June 2006 to £15,000 per annum for the Directors, with the Audit Committee Chairman receiving an additional £2,000, and £25,000 for the Chairman of the Board.

(iii) Audit fees for non-audit services in 2007 include fees of £3,000 for review of compliance with loan covenants.

(iv) Auditors' remuneration includes VAT of £3,763 (2006 – £3,938).

Notes to the Accounts

for the year ended 31 January 2007

4. Finance Costs: Interest Payable and Similar Charges

	2007 £ Revenue	2007 £ Capital	2007 £ Total	2006 £ Revenue	2006 £ Capital	2006 £ Total
On Stepped Rate Interest Loan repayable after more than five years	1,445,140	2,683,832	4,128,972	1,384,740	2,571,660	3,956,400
On Fixed Rate Interest Loan repayable after more than five years	1,315,731	2,443,501	3,759,232	1,321,650	2,454,493	3,776,143
On 4% Perpetual Debenture Stock repayable after more than five years	19,250	35,750	55,000	19,250	35,750	55,000
On 5.875% Secured Bonds repayable after more than five years	623,539	1,158,001	1,781,540	623,053	1,157,098	1,780,151
On 3.65% Cumulative Preference Stock repayable after more than five years	42,997	–	42,997	42,997	–	42,997
On Sterling overdraft	–	–	–	22,780	–	22,780
	<u>3,446,657</u>	<u>6,321,084</u>	<u>9,767,741</u>	<u>3,414,470</u>	<u>6,219,001</u>	<u>9,633,471</u>

5. Taxation

	2007 £ Revenue	2007 £ Capital	2007 £ Total	2006 £ Revenue	2006 £ Capital	2006 £ Total
a) Analysis of tax charge for the year						
Corporation tax	–	–	–	–	–	–
Tax charge on ordinary activities	–	–	–	–	–	–
b) Factors affecting the current tax charge for the year:						
Return on ordinary activities before taxation	<u>22,854,005</u>	<u>63,330,575</u>	<u>86,184,580</u>	<u>19,853,959</u>	<u>89,037,383</u>	<u>108,891,342</u>
Tax on the return on ordinary activities at the standard rate of Corporation tax in the UK of 30% (2006 – 30%)	6,856,201	18,999,173	25,855,374	5,956,188	26,711,215	32,667,403
Effects of:						
Non taxable income	(8,200,230)	–	(8,200,230)	(7,261,904)	–	(7,261,904)
Non taxable capital gains	–	(21,432,180)	(21,432,180)	–	(29,037,604)	(29,037,604)
Disallowable expenses	69,595	63,350	132,945	98,509	31,349	129,858
Excess of allowable expenses over taxable income	<u>1,274,434</u>	<u>2,369,657</u>	<u>3,644,091</u>	<u>1,207,207</u>	<u>2,295,040</u>	<u>3,502,247</u>
Current tax charge	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>

The Company's taxable income is exceeded by its tax allowable expenses, which include both the capital and revenue elements of the management fee and finance costs of borrowings. The Company has surplus expenses carried forward of £102.2m (2006 – £90.1m). Given the Company's current investment strategy, it is unlikely to generate sufficient UK taxable profits to relieve these expenses.

As at 31 January 2007 there is an unrecognised deferred tax asset, measured at the standard rate of 30%, of £30.7m (2006 – £27.0m). This deferred tax asset relates to the current and prior year unutilised expenses. It is considered unlikely that there will be a liability in the future against which the deferred tax asset can be offset. Therefore, the tax asset has not been recognised.

Due to the Company's status as an approved investment trust and the intention to continue meeting the conditions required to obtain approval in the foreseeable future, the Company has not provided deferred tax on any capital gains and losses arising on the disposal of investments.

Notes to the Accounts

for the year ended 31 January 2007

6. Dividends on Ordinary Shares

	2007 £	2006 £
Third interim dividend 4.8p paid 17 February 2006 (2005 – 4.5p)	4,900,989	4,594,677
Final dividend 4.8p paid 10 May 2006 (2005 – 4.5p)	4,900,989	4,594,677
First interim dividend 4.9p paid 17 August 2006 (2005 – 4.6p)	5,084,234	4,696,781
Second interim dividend 4.9p paid 14 November 2006 (2005 – 4.7p)	5,084,234	4,798,885
Uncollected dividends from prior years	<u>(6,122)</u>	<u>(23,966)</u>
	<u>19,964,324</u>	<u>18,661,054</u>

Dividends payable at the year end are not recognised as a liability under FRS 21 'Events after the Balance Sheet Date' (see page 33 – Statement of Accounting Policies). Details of these dividends are set out below.

	2007 £	2006 £
Third interim dividend 5.1p payable 16 February 2007 (2006 – 4.8p)	5,291,754	4,900,989
Final proposed dividend 5.1p payable 16 May 2007 (2006 – 4.8p)	<u>5,291,754</u>	<u>4,900,989</u>
	<u>10,583,508</u>	<u>9,801,978</u>

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

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

7. Return per Ordinary Share

	2007 £ Revenue	2007 £ Capital	2007 £ Total Return	2006 £ Revenue	2006 £ Capital	2006 £ Total Return
Return attributable to Ordinary Shareholders	<u>22,854,005</u>	<u>63,330,575</u>	<u>86,184,580</u>	<u>19,853,959</u>	<u>89,037,383</u>	<u>108,891,342</u>
Return per Ordinary Share	22.17p	61.44p	83.61p	19.44p	87.20p	106.64p

The weighted average number of shares in issue during the year was 103,083,890 (2006 – 102,103,936).

Notes to the Accounts

for the year ended 31 January 2007

8. Fixed Asset Investments

	2007 £	2006 £
Listed on The London Stock Exchange at market valuation	695,742,546	621,905,781
Unlisted at fair value	27,425	42,489
Total fixed asset investments	695,769,971	621,948,270
Market value of investments brought forward	621,948,270	535,094,994
Adjustment from mid market to bid prices	–	(28,000)
Unrealised gains brought forward	(118,104,550)	(57,934,642)
Cost of investments held brought forward	503,843,720	477,132,352
Additions at cost	244,541,594	139,140,607
Disposals at cost	(183,862,618)	(112,429,239)
Costs of investments held at 31 January	564,522,696	503,843,720
Unrealised gains at 31 January	131,247,275	118,104,550
Market value of investments held at 31 January	695,769,971	621,948,270
Net gains on investments		
Net realised gains on historical costs	53,443,663	36,622,105
Adjustment for net unrealised gains recognised in previous years	(37,189,607)	(24,567,546)
Net realised gains based on carrying value at previous balance sheet date	16,254,056	12,054,559
Net unrealised gains arising in the year	50,332,332	84,737,454
Gains on investments before special dividends	66,586,388	96,792,013
Special dividends credited to capital	4,854,213	–
Net gains on investments	71,440,601	96,792,013

Transaction costs on purchases amounted to £1,502,518 (2006 – £888,492) and transaction costs on sales amounted to £369,855 (2006 – £302,257).

Stocklending

Aggregate value of securities on loan at year-end	£0m	£28.0m
Maximum aggregate value of securities on loan during the year	£72.0m	£72.0m
Fee income from stocklending during the year	£9,164	£6,238

In respect of securities on loan at the year-end, the Company held £Nil (2006 – £29.4m) as collateral, the value of which exceeded the value of the loan securities by £Nil (2006 – £1.4m)

In respect of the maximum aggregate value of securities on loan during the year, the Company held £75.6m (2006 – £75.6m) as collateral, the value of which exceeded the value of securities on loan by £3.6m (2006 – £3.6m).

Notes to the Accounts

for the year ended 31 January 2007

9. Investments in Other Companies

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

Company	Total Net Assets* £	Class of Shares held	% of Class held	% Equity
First Debenture Finance PLC ('FDF')	(5,093,056)	'A' Shares	39.2	
		'B' Shares	59.2	49.2
		'C' Shares	45.6	
		'D' Shares	53.3	
Fintrust Debenture PLC ('Fintrust')	22,066	Ordinary	50.0	50.0

In the opinion of the Directors, the Company is not in a position to exert significant influence over the financial or operating policies of FDF or Fintrust, either through voting rights or through agreement with those companies' other shareholders, due to provisions in FDF and Fintrust's Articles of Association and in certain contracts between the Company and each of FDF and Fintrust. The aggregate share capital, reserves and results are immaterial to the Company's accounts. FDF and Fintrust are the lenders of the Company's Stepped Rate Loan and Fixed Rate Interest Loan, as detailed in Notes 10(i) and 10(ii), respectively. Apart from the finance costs, there were no other transactions between FDF, Fintrust and the Company during the year.

* As at the date of the latest published financial statements of FDF or Fintrust, as appropriate.

10. Current Assets and Creditors

	2007 £	2006 £
Debtors:		
Sales for future settlement	1,045,185	2,252,564
Accrued income	1,693,069	1,238,443
Other debtors	98,649	95,673
	<u>2,836,903</u>	<u>3,586,680</u>
Cash at bank:		
Current account	7,003,101	5,374,796

Notes to the Accounts

for the year ended 31 January 2007

10. Current Assets and Creditors (continued)

	Note	2007 £	2006 £
Creditors: Amounts falling due within one year –			
Purchases for future settlement		1,029,736	–
Other creditors		878,218	1,523,883
Interest on borrowings	10(vi)	<u>1,319,266</u>	<u>1,319,266</u>
		<u>3,227,220</u>	<u>2,843,149</u>
Creditors: Amounts falling due after more than one year –			
Stepped Rate Interest Loan	10(i)	35,829,571	35,512,189
Fixed Rate Interest Loan	10(ii)	46,111,863	46,253,156
5.875% Secured Bonds 2029	10(iii)	29,053,646	29,035,056
4% Perpetual Debenture Stock	10(iv)	1,375,000	1,375,000
3.65% Cumulative Preference Stock	10(v)	<u>1,178,000</u>	<u>1,178,000</u>
		<u>113,548,080</u>	<u>113,353,401</u>

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

The Stepped Rate Interest Loan includes adjustable Stepped Rate Interest Loan Notes of £5,133,520 and Stepped Rate Interest Bonds of £20,534,079 issued at 97.4%. These amounts are repayable on 2 January 2018 exclusive of any redemption expenses, together with a premium of £8,366,513.

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

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

The Company has guaranteed the repayment of £34,012,852, being its proportionate share (65.15%) of the required amount to enable FDF to meet all of its liabilities to repay principal and interest on its £52.2 million of 11.125% Severally Guaranteed Debenture Stock 2018. There is a floating charge on all the Company's present and future assets to secure this obligation. The Company has also agreed to meet its proportionate share of any expenses incurred by FDF, including any tax liability which may accrue to FDF generally or as a result of the redemption or earlier transfer of the Stepped Rate Loan Notes and Bonds held by FDF. The accounting treatment adopted in respect of the stepped rate interest and redemption premiums is set out in the Statement of Accounting Policies.

- (ii) The Fixed Rate Interest Loan of £42,000,000 is due to Fintrust Debenture PLC ('Fintrust'). This loan, issued in 1993, is repayable in 2023 and carries interest at the rate of 9.25125% per annum on the principal amount payable in arrears by equal half yearly instalments in May and November in each year. As security for this loan, the Company has granted a floating charge over all its undertakings, property and assets in favour of the lender. This charge ranks pari passu with the floating charge noted in 10(i) above.

The original loan from Fintrust is stated at net proceeds (being the principal amount of £30,000,000 less issue costs of £141,053) plus accrued finance costs.

Following the liquidation of Kleinwort Overseas Investment Trust plc ('KOIT') in March 1998, the Company assumed £12,000,000 of KOIT's obligations to Fintrust. Both the interest cost and repayment terms of this additional borrowing were identical to the Company's existing loan of £30,000,000. In order that the finance costs on this new borrowing be comparable to existing market rates at that time, the Company also received a premium payment from KOIT of £5,286,564. This premium is being amortised over the remaining life of the loan, as set out in the Statement of Accounting Policies. At 31 January 2007, the unamortised premium included within the Fixed Rate Interest Loan balance of greater than one year amounted to £4,229,629 (2006 – £4,373,764).

Notes to the Accounts

for the year ended 31 January 2007

10. Current Assets and Creditors (continued)

(iii) The £30,000,000 5.875% Secured Bonds, repayable on 20 December 2029, carry interest at the rate of 5.875% per annum on the principal amount payable in arrears by equal half yearly instalments in June and December each year. As security for this loan the Company has granted a floating charge ranking pari passu with the floating charges referred to in Note 10(i) and 10(ii) above over the whole of the present and future undertakings, property, assets and rights of the Company.

The accounting treatment adopted in respect of the Bonds is set out in the Statement of Accounting Policies.

(iv) The 4% Perpetual Debenture Stock is secured by a floating charge on the assets of the Company, which ranks prior to any other floating charge. Interest is repayable in arrears by equal half yearly instalments in May and November.

(v) The 3.65% Cumulative Preference Stock is recognised as a creditor due after more than one year under the provisions of FRS25 'Financial Instruments: Disclosure and Presentation'. The right of the Stock to receive payments is not calculated by reference to the Company's profits and, in the event of a return of capital are limited to a specific amount, being £1,178,000. Dividends on the Preference Stock are payable half yearly on 1 August and 1 February.

(vi) Interest on outstanding borrowings consists of:

	2007	2006
	£	£
Stepped Rate Interest Loan	313,728	313,728
Fixed Rate Interest Loan	783,545	783,545
5.875% Secured Bonds 2029	208,243	208,243
4% Perpetual Debenture Stock	13,750	13,750
	<u>1,319,266</u>	<u>1,319,266</u>

11. Called up Share Capital

	2007	2006
	£	£
Authorised		
150,403,747 Ordinary Shares of 25p (2006 – 107,431,245)	<u>37,600,936</u>	<u>26,857,812</u>
Allotted and fully paid		
103,759,877 Ordinary Shares of 25p (2006 – 102,103,936)	<u>25,939,969</u>	<u>25,525,984</u>

On 29 June 2006, investments and cash amounting to £7m and £0.9m respectively were transferred into the Company following the reconstruction of Allianz Dresdner Income Growth Investment Trust plc, as consideration for 1,655,941 new Ordinary Shares issued at 477.1p.

Notes to the Accounts

for the year ended 31 January 2007

12. Capital Reserves

	Realised £	Unrealised £	Total £
Balance at 1 February 2006	351,107,802	118,104,550	469,212,352
Net gains on realisation of investments	16,254,056	–	16,254,056
Special dividends	4,854,213	–	4,854,213
Transfer on disposal of investments	37,189,607	(37,189,607)	–
Net unrealised gains arising in year	–	50,332,332	50,332,332
Investment management fee	(1,785,921)	–	(1,785,921)
Finance costs: interest payable and similar charges	(6,321,084)	–	(6,321,084)
Other capital charges	(3,021)	–	(3,021)
Balance at 31 January 2007	<u>401,295,652</u>	<u>131,247,275</u>	<u>532,542,927</u>

13. Revenue Reserve

	£
Balance at 1 February 2006	19,878,801
Revenue for the year	22,854,005
Dividends on Ordinary Shares	(19,964,324)
Balance at 31 January 2007	<u>22,768,482</u>

14. Net Asset Value per Share

The Net Asset Value per share was as follows:

	Net Asset Value per Share attributable	
	2007	2006
Ordinary Shares of 25p	<u>567.5p</u>	<u>504.1p</u>
	Net Asset Value attributable	
	2007	2006
Ordinary Shares of 25p	<u>£588,834,675</u>	<u>£514,713,196</u>

The Net Asset Value per Ordinary Share is based on 103,759,877 Ordinary Shares in issue at the year end (2006 – 102,103,936)

15. Contingent Liabilities and Commitments

At 31 January 2007 there were no outstanding contingent liabilities (2006 – £nil) in respect of underwriting commitments and calls on partly paid investments.

Details of the guarantee provided by the Company as part of the terms of the Stepped Rate Loan are provided in Note 10(i) 'Current Assets and Creditors' on page 39.

Notes to the Accounts

for the year ended 31 January 2007

16. Reconciliation of Return on Ordinary Activities before Taxation to Net Cash Flow from Operating Activities

	2007 £	2006 £
Total return before taxation	86,184,580	108,891,342
Add: Finance costs: interest payable and similar charges	9,767,741	9,633,471
Add: Special dividends credited to capital	4,854,213	–
Less: Net gains on investments at fair value	<u>(71,440,601)</u>	<u>(96,792,013)</u>
	29,365,933	21,732,800
(Increase) decrease in debtors	(457,602)	379,653
(Decrease) increase in creditors	<u>(645,665)</u>	<u>693,342</u>
Net cash inflow from operating activities	<u>28,262,666</u>	<u>22,805,795</u>

17. Reconciliation of Net Cash Flow to Movement in Net Debt

(i) Analysis of net debt

	Cash £	Stepped and Fixed Rate loans £	5.875% Secured Bonds 2029 £	4% Perpetual Debenture Stock £	3.65% Cumulative Preference Stock £	Net Debt £
At 1 February 2006	5,374,796	(81,765,345)	(29,035,056)	(1,375,000)	(1,178,000)	(107,978,605)
Movement in year	<u>1,628,305</u>	<u>(176,089)</u>	<u>(18,590)</u>	<u>–</u>	<u>–</u>	<u>1,433,626</u>
At 31 January 2007	<u>7,003,101</u>	<u>(81,941,434)</u>	<u>(29,053,646)</u>	<u>(1,375,000)</u>	<u>(1,178,000)</u>	<u>(106,544,979)</u>

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

	2007 £	2006 £
Net cash inflow	1,628,305	2,181,889
Increase in long term loans	<u>(194,679)</u>	<u>(33,945)</u>
Movement in net funds	1,433,626	2,147,944
Net debt brought forward	<u>(107,978,605)</u>	<u>(110,126,549)</u>
Net debt carried forward	<u>(106,544,979)</u>	<u>(107,978,605)</u>

Notes to the Accounts

for the year ended 31 January 2007

18. Financial Risk Management

The note below should be read in conjunction with the Financial Risk Management statements of the Company on page 13.

(a) Interest Rate Risk Profile

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

Currency	2007 Fixed rate interest £000s	2007 Floating rate interest £000s	2007 Nil interest £000s	2007 Total £000s	2006 Fixed rate interest £000s	2006 Floating rate interest £000s	2006 Nil interest £000s	2006 Total £000s
Financial Assets								
Values not directly affected by changes in interest rates:								
Equities Sterling	-	-	695,770	695,770	-	-	621,933	621,933
Equities US Dollar	-	-	-	-	-	-	15	15
Cash Sterling	-	7,003	-	7,003	-	5,375	-	5,375
Total Financial Assets	-	7,003	695,770	702,773	-	5,375	621,948	627,323
Financial Liabilities								
Values directly affected by changes in interest rates:								
First Debenture								
Finance loan Sterling	(35,829)	-	-	(35,829)	(35,512)	-	-	(35,512)
Fintrust loan Sterling	(46,112)	-	-	(46,112)	(46,253)	-	-	(46,253)
5.875% Secured								
Bonds 2029 Sterling	(29,054)	-	-	(29,054)	(29,035)	-	-	(29,035)
4% Perpetual								
Debenture Stock Sterling	(1,375)	-	-	(1,375)	(1,375)	-	-	(1,375)
3.65% Cumulative								
Preference Stock Sterling	(1,178)	-	-	(1,178)	(1,178)	-	-	(1,178)
Total Financial Liabilities	(113,548)	-	-	(113,548)	(113,353)	-	-	(113,353)
Net Financial (Liabilities) Assets	(113,548)	7,003	695,770	589,225	(113,353)	5,375	621,948	513,970
Short term debtors and creditors								
				(390)				744
Net Assets per Balance Sheet				588,835				514,714

Notes to the Accounts

for the year ended 31 January 2007

18. Financial Risk Management (continued)

The fixed rate interest bearing liabilities bear the following coupon and effective rates as at 31 January 2006 and 31 January 2007:

	Maturity date	Amount borrowed £	Coupon rate	Effective rate since inception ¹
First Debenture Finance loan – bonds	2/1/2018	20,534,079	14.75%	11.28%
First Debenture Finance loan – notes	2/1/2018	5,133,520	14.75%	11.28%
Fintrust – original loan	20/11/2023	30,000,000	9.25125%	9.51%
Fintrust – new loan	20/11/2023	12,000,000	9.25125%	6.00%
5.875% Secured Bonds 2029	20/12/2029	30,000,000	5.875%	6.23%
4% Perpetual Debenture Stock	n/a	1,375,000	4.00%	n/a
3.65% Cumulative Preference Stock	n/a	1,178,000	3.65%	n/a

¹The effective rates are calculated in accordance with FRS 26 'Financial Instruments: Measurement' as detailed in the Accounting Policies.

The weighted average effective rate of the Company's fixed interest bearing liabilities (excluding the 4% Perpetual Debenture Stock and the 3.65% Cumulative Preference Stock) is 8.54% (2006 – 8.54%) and the weighted average period to maturity of these liabilities is 17.2 years (2006 – 18.2) years.

(b) Currency Risk Profile

As at 31 January 2007 £nil (2006 – £14,944) of the assets of the Company were denominated in US Dollars with the effect that the total net assets and total return are not materially affected by currency movements.

(c) Fair Value Disclosures

The assets and liabilities of the Company are held at a fair value with the exception of the liabilities shown below:²

	2007 £ million Book value	2007 £ million Fair value	2006 £ million Book value	2006 £ million Fair value
First Debenture Finance Loan	35.8	48.4	35.5	52.3
Fintrust Loan	46.1	57.7	46.3	62.9
5.875% Secured Bonds 2029	29.1	31.1	29.0	34.1
4% Perpetual Debenture Stock	1.4	1.1	1.4	1.2
3.65% Cumulative Preference Stock	1.2	0.8	1.2	0.7

²The fair value is derived from the closing market value as at 31 January 2007 and 31 January 2006.

(d) Liquidity Profile

The maturity profile of the Company's financial liabilities at 31 January 2007, (being the borrowings from Fintrust, First Debenture Finance, the 5.875% Secured Bonds, the 4% Perpetual Debenture Stock and the 3.65% Preference Stock), is detailed in Note 10 'Current Assets and Creditors' on pages 39 to 40. The undrawn committed borrowings facilities available to the Company at 31 January 2007 were £10,000,000.

(e) Hedging Instruments

At the year end the Company had no hedging arrangements in place (2006 – nil).

Notice of Meeting

Notice is hereby given that the Annual General Meeting of **The Merchants Trust PLC** will be held at **One Moorgate Place, London EC2R 6EA**, on 14 May 2007 at 12.00 noon to transact the following business.

Routine Business

- 1 To receive and adopt the Report of the Directors and the Accounts for the year ended 31 January 2007 together with the Auditors' Report thereon.
- 2 To declare a final dividend of 5.1p per Ordinary Share.
- 3 To re-elect Sir Bob Reid as a Director.
- 4 To re-elect Mr P. J. Scott Plummer as a Director.
- 5 To elect Mr J. M. Sassoon as a Director.
- 6 To approve the Directors' Remuneration Report.
- 7 To re-appoint PricewaterhouseCoopers LLP as Auditors of the Company, to hold office until the conclusion of the next general meeting at which accounts are laid before the Company.
- 8 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 10 will be proposed as an Ordinary Resolution and Resolutions 9 and 11 as Special Resolutions:

- 9 That the Company be and is hereby generally and unconditionally authorised in accordance with Section 166 of the Companies Act 1985 (the 'Act') to make market purchases (within the meaning of Section 163 of the Act) of Ordinary Shares of 25p each in the capital of the Company ('Ordinary Shares'), provided that:
 - (i) the maximum number of Ordinary Shares hereby authorised to be purchased shall be 15,553,605;
 - (ii) the minimum price which may be paid for an Ordinary Share is 25p;
 - (iii) the maximum price which may be paid for an Ordinary Share is an amount equal to 105 per cent of the average of the middle-market quotations for an Ordinary Share

taken from the London Stock Exchange Official List for the 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 2008 or, if earlier, on the expiry of 18 months from the passing of this resolution, unless such authority is renewed prior to such time; and
 - (v) the Company may make a contract to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiration of such authority and may make a purchase of Ordinary Shares pursuant to any such contract.
- 10 That for the purposes of Section 80 of the Companies Act 1985 the Directors be generally and unconditionally authorised to exercise all the powers of the Company to allot relevant securities (within the meaning of the said Section) up to an aggregate nominal amount of £8,646,656 provided that:
 - (i) the authority granted shall expire five years from the date upon which this Resolution is passed but may be revoked or varied by the Company in general meeting and may be renewed by the Company in general meeting for a further period not exceeding five years; and
 - (ii) the 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.

Notice of Meeting

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

- (i) the power granted shall be limited to the allotment of equity securities wholly for cash up to an aggregate nominal amount of £1,296,998;
- (ii) the power granted shall (unless previously revoked or renewed) expire at the conclusion of the next Annual General Meeting of the Company after the passing of this resolution; and
- (iii) the said power shall allow and enable the Directors to make an offer or agreement before the expiry of that power which would or might require equity securities to be allotted after such expiry and the Directors may allot equity securities in pursuance of such offer or agreement as if that power had not expired.

155 Bishopgate,
London EC2M 3AD
4 April 2007

By Order of the Board
K. J. Salt
Secretary

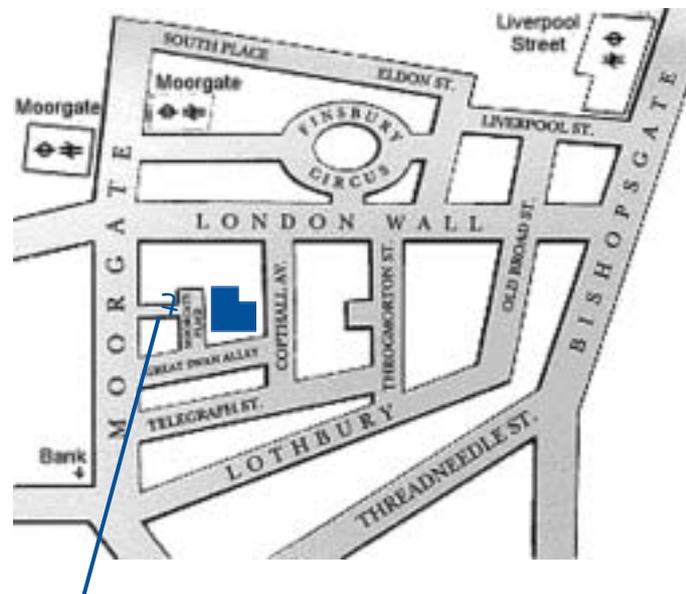
Notes: Members entitled to attend and vote at this Meeting may appoint one or more proxies to attend and, on a poll, vote in their stead. The proxy need not be a Member of the Company. Duly completed forms of proxy must reach the office of the Registrars at least 48 hours before the Meeting. A form of proxy is provided with the Annual Report. Completion of the enclosed form of proxy does not preclude a Member from attending the Meeting and voting in person.

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.

To be entitled to attend and vote at the Meeting (and for the purpose of the determination by the Company of the number of votes they may cast), Members must be entered on the Company's Register of Members at 6 p.m. on 12 May 2006 ('the specified time'). If the Meeting is adjourned to a time not more than 48 hours after the specified time applicable to the original Meeting, that time will also apply for the purpose of determining the entitlement of Members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period then, to be so entitled, Members must be entered on the Company's Register of Members at the time which is 48 hours before the time fixed for the adjourned Meeting or, if the Company gives notice of the adjourned Meeting, at the time specified in that notice.

Contracts of service are not entered into with the Directors, who hold office in accordance with the Articles of Association.

Annual General Meeting Venue



Chartered Accountants Hall, One Moorgate Place

Investor Information & Contact Details

The Managers

Allianz Global Investors is the marketing name of RCM (UK) Limited, Allianz Group's regulated UK fund management company, which is authorised and regulated by the Financial Services Authority.

Allianz Global Investors is one of the largest fund managers in Europe, and as at 31 December 2006, had combined assets of £876 billion under management. Through its predecessors, it has a heritage of investment trust management expertise in the UK stretching back to the nineteenth century and had £1.3 billion assets under management in a range of investment trusts as at 31 December 2006.

Results

Half-year announced in September

Full-year announced in March

Report and Accounts posted to shareholders in April

Annual General Meeting held in May

Ordinary Dividends

First quarterly paid in August

Second quarterly paid in November

Third quarterly paid in February

Final usually paid in May

Preference Dividends

Payable half-yearly on 1 August and 1 February

Payment of Dividends Direct to Bank Accounts

Cash dividends will be sent by cheque to first-named shareholders at their registered address together with a tax voucher. Dividends may be paid directly into shareholders' bank accounts. Details of how this may be arranged can be obtained from the Registrars, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU. Dividends mandated in this way are paid via BACS (Bankers' Automated Clearing Service). Tax vouchers will then be sent directly to shareholders at their registered address unless other instructions have been given.

Dividend Reinvestment Plan for Ordinary Shareholders

Dividend reinvestment has always been an option for Share Plan and/or Pep/ISA investors and the Company is pleased that a similar facility is now to be made available to Ordinary Shareholders as well. The Dividend Reinvestment Plan is to be operated by the Company's Registrars, Capita Registrars. Capita will enclose an introductory card with the final dividend payment in May, and further information on the Terms and Conditions, and details of how to apply, can be requested by completing and returning the card to the Registrars.

Market and Portfolio Information

The Company's Ordinary Shares are listed on the London Stock Exchange. The market price, price range, gross yield and net asset value are shown daily in The Financial Times and The Daily Telegraph. The net asset value of the Ordinary Shares is calculated weekly and published by the London Stock Exchange Regulatory News Service. The geographical spread of investments and ten largest holdings are also published monthly by the London Stock Exchange Regulatory News Service. They are also available to any enquirer of Allianz Global Investors, either via Investor Services on 0800 317 573 or on the Manager's website: www.allianzglobalinvestors.co.uk.

Share Prices

The share prices quoted in the London Stock Exchange Daily Official List for 31 January 2007 were 512.75p – 513.25p.

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

Share Plan

The Allianz Global Investors Investment Trust Share Plan provides a convenient and economical way for shareholders to increase their existing holdings. Investments can be in the form of a regular monthly contribution, or an individual lump sum or a combination of the two. There are arrangements for the reinvestment of dividends and for selling and switching. Full details of the plan are available from Allianz Global Investors, either via Investor Services on 0800 317 573 or the Manager's website: www.allianzglobalinvestors.co.uk.

Investor Information & Contact Details

Investment Trust Maxi ISA and PEP Transfer

Shareholders can invest in the shares of the Company through the Allianz Global Investors Investment Trust Maxi ISA and PEP Transfer. Full details are available from Allianz Global Investors, either via Investor Services on 0800 317 573 or the Manager's website: www.allianzglobalinvestors.co.uk.

Website

Further information about the The Merchants Trust PLC is available on the Manager's website:
www.allianzglobalinvestors.co.uk.

Association of Investment Companies (AIC)

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

AIC Category: UK Growth and Income

Shareholders' Enquiries

Capita Registrars are the Company's registrars and maintain the share register. In the event of queries regarding their holdings of shares, lost certificates, dividend cheques, registered details, etc., shareholders should contact them on 0870 162 3100 or, if telephoning from overseas, +44 20 8639 2157. Changes of name and address must be notified to the Registrars in writing.

Any general enquiries about the Company should be directed to the Company Secretary, The Merchants Trust PLC, 155 Bishopsgate, London EC2M 3AD.

Managers and Advisers

Fund Manager

RCM (UK) Limited
Represented by Simon Gergel

Secretary and Registered Office

Kirsten Salt BA (Hons) ACIS
155 Bishopsgate
London EC2M 3AD
Telephone: 020 7065 1513

Registered Number 28276

Registrars and Transfer Office

Capita Registrars
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU
Telephone (if calling from within the UK): 0870 162 3100
Telephone (if calling from overseas): +44 20 8639 2157
Email: ssd@capitaregistrars.com

Independent Auditors

PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London SE1 9SY

Bankers

HSBC Bank
Barclays Bank

Stockbroker

JPMorgan Cazenove

Legal Advisers

Herbert Smith LLP

Allianz Global Investors

Telephone: 0800 317 573 or www.allianzglobalinvestors.co.uk.

Allianz Global Investors
Phone 0800 317 573
Fax 020 7638 3508
www.allianzglobalinvestors.co.uk