

17 April 2009

The Merchants Trust

12 Months Ending	Total Share Return* (%)	Total NAV Return* (%)	Total Return Benchmark * (%)
08/04/09	-38.2	-43.8	-31.6
08/04/08	-15.2	-12.4	-2.9
08/04/07	+14.5	+12.1	+9.7
08/04/06	+37.6	+33.3	+25.0

Note: * 12-month rolling discrete performance.

Investment summary: A reliable source of regular income at a compelling yield

With its recent results announcement The Merchants Trust Plc (MRCH) has once again increased its dividend, providing investors with 27 years of uninterrupted dividend growth. The trust is managed using a value-driven investment style and remains defensively positioned, reflecting the current economic climate. The discount has tightened recently, but the trust still offers an 8.7% yield (excluding the special dividend in relation to the refund of VAT on past management fees). Management believes that current stock market valuations incorporate an overly pessimistic outlook and that many equities are now very cheap by historical standards.

Investment strategy: Higher yielding FTSE 100 companies

The trust has a significant income requirement and, to help meet its dividend objectives, the manager looks to invest mainly in higher yielding FTSE 100 companies while employing a significant level of gearing, currently 44%, to enhance returns over the longer term. In addition, management will only look to invest in companies that offer at least a market yield, on an 18-month view, unless there is a compelling investment case to the contrary. Management also employs strategies to preserve income within the portfolio.

Sector outlook

Across the market conditions have been challenging during the last 12 months, with dividend cuts and rights issues being commonplace. Larger non-financial companies tend to offer more robust cash flows and many have been quick to make the necessary adjustments, so dividend receipts have held up comparatively well and in some cases have been boosted by the relative weakness of sterling.

Valuation

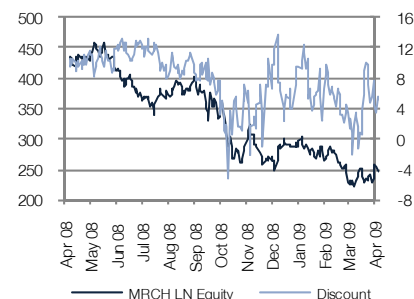
The current discount of 0.7% (debt valued at par) and premium of 4.6% (debt valued at market) are below MRCH's longer-term discount averages of 9.0% and 2.4%, respectively. However, given recent performance there is evidence to suggest that investors will be able to enter and exit the trust at valuations around these levels. The yield also remains strong and, as such, we believe MRCH may be attractive to investors looking for regular income, at an attractive yield, or those looking for a defensive exposure to the FTSE 100.

Price	258.25p
Market Cap	£266m
AUM	£383m
NAV	260.10p*
Discount to NAV	0.7%*
NAV	246.95p**
Premium to NAV	4.6%**
Yield	8.7%

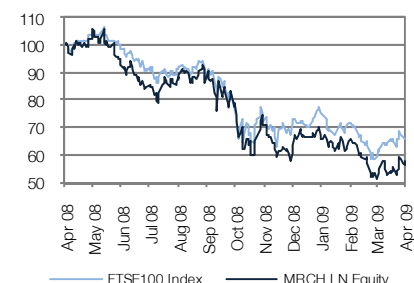
* Adjusted for debt at par value and excluding income, as at 15 April 2009.

** Adjusted for debt at market value, excluding income, as at 15 April 2009.

Share price/discount graph



One-year cumulative performance graph



Share details

Code	MRCH
Listing	FULL
AIC Sector	UK Growth & Income
Shares in issue	102.8m

Price

52 week	High	Low
Price	457.5p	222.0p
NAV	506.5p	226.0p

Analyst

Matthew Read 020 3077 5700
mread@edisoninvestmentresearch.co.uk

Exhibit 1: Trust at a glance

Investment objective and fund background				Developments last quarter	
The investment objective of the company 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.				31 January 2009: Financial year end. 20 February 2009: Dividend of 5.6p paid. 7 April 2009: Annual report published.	
Forthcoming		Capital structure		Fund details	
AGM	12 May 2009	Total expense ratio	0.51%	Group	Allianz Global Investors/RCM (UK)
Preliminary	April 2009	Gearing	44.0%	Manager	Simon Gergel
Year end	31 January	Annual mgmt fee	See pg 7	Address	155 Bishopsgate, London EC2M 3AD
Dividend paid	Quarterly	Performance fee	None		
Launch date	February 1889	Trust life	Indefinite	Phone	0800 317 573
Wind-up date	N/A	Loan facilities	See pg 7	Website	www.merchantstrust.co.uk
Dividend policy and history			Share buyback policy and history		
Quarterly dividends paid in February, May, August and November. MRCH aims to maintain a high and growing dividend.			Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 10% of issued share capital.		
<p>DPS (p)</p>			<p>Number of shares ('000s) / Total cost (£m)</p>		
Shareholder base (as at 31 December 2008)			Geographic distribution of portfolio (as at 28 February 2009)		
<ul style="list-style-type: none"> Retail Investors (79%) Insurance Companies (8%) Mutual Funds (6%) Gartmore Investment Management Clients (3%) Charities (2%) Other (2%) 			<ul style="list-style-type: none"> UK (97.8%) Money Market (2.2%) 		
Portfolio composition (as at 28 February 2009)			Portfolio composition (as at 31 August 2008)		
<ul style="list-style-type: none"> Royal Dutch Shell (9.8%) Vodafone (9.5%) Glaxosmithkline (8.9%) BP (8.2%) BAE Systems (4.5%) Scot & Southern (4.2%) BAT (3.7%) Centrica (3.6%) BHP Billiton (3.5%) HSBC Holdings (3.4%) Other Quoted (38.5%) Cash (2.2%) 			<ul style="list-style-type: none"> Royal Dutch Shell (9.3%) BP (8.0%) Glaxosmithkline (7.6%) Vodafone (7.5%) HSBC Holdings (6.4%) Anglo American (3.5%) BAE Systems (3.2%) Rio Tinto (3.2%) Scot & Southern (3.0%) BT Group (2.9%) Other Quoted (44.5%) Cash (0.8%) 		

Source: The Merchants Trust/Edison Investment Research

Exhibit 2: Holdings in portfolio themes at a glance

GlaxoSmithKline		Code: GSK LN	Market Cap: £52,610.1m
		Div Yield (trailing 12 m'ths)	6.25%
		Industry/Sector	Pharmaceuticals & Tech./Pharma
		Listing	FULL
		Website	www.gsk.com
<p>At 9.4% of the portfolio, GlaxoSmithKline is one of MRCH's core holdings. This reflects management's views that 1) the valuation of GSK is attractive; and 2) as a bedrock, MRCH currently has a number of large core holdings in strong businesses that are well financed and offer good yields.</p>			
Inchcape		Code: INCH LN	Market Cap: £61.0m
		Div Yield (trailing 12 m'ths)	22.56%
		Industry/Sector	General Retailers/Speciality Retailer
		Listing	FULL
		Website	www.inchcape.com
<p>At 0.4% of the portfolio, MRCH's holding in Inchcape reflects two current portfolio themes: 1) management likes companies exposed to consumer spending as it believes that this will return, ahead of corporate, as the effects of lower bills filter through; and 2) because of the car replacement cycle, ie vehicles naturally wear out and need replacement, in a downturn the automotive sector starts to return after about 12 months.</p>			
IG Group		Code: IGG LN	Market Cap: £747.9m
		Div Yield (trailing 12 m'ths)	6.94%
		Industry/Sector	General Financial/Speciality Finance
		Listing	FULL
		Website	www.iggroup.com
<p>MRCH's IG Group holding, at 0.5% of the portfolio, reflects management's view that IG is cash generative and has good long term growth prospects. IG is well established in the UK and is now a market commentator in Spain and France. Management believes that, despite problems with the German rollout, the last fall was overdone and growth from IG's overseas platforms is under appreciated.</p>			
Dairy Crest		Code: DCG LN	Market Cap: £404.5m
		Div Yield (trailing 12 m'ths)	8.93%
		Industry/Sector	Food Producers/Food Products
		Listing	FULL
		Website	www.dairycrest.co.uk
<p>MRCH's Dairy Crest holding, at 0.9% of the portfolio, reflects management's view that concerns regarding debt levels and possible breach of banking covenants have been overdone. Dairy Crest has some very solid brands and the company has experienced good growth. The proceeds from the recent sale of its stake in Yoplait, £63.5m, have been used to pay down debt, providing significantly more headroom on the balance sheet.</p>			
Aviva		Code: AV. LN	Market Cap: £6,219.7m
		Div Yield (trailing 12 m'ths)	15.67%
		Industry/Sector	Life Insurance/Life Insurance
		Listing	FULL
		Website	www.aviva.com
<p>The Aviva holding, at 1.7% of the portfolio, provides MRCH with exposure to high yielding asset classes that management finds increasingly interesting. Management believes poor performance and solvency concerns have depressed recent valuations but that insurers have had superior regulation (solvency rates were increased in 2002) and that, unlike banks, insurers will have room to address issues.</p>			

Source: Datastream/Edison Investment Research

Fund profile

Launched in February 1889, MRCH is the oldest trust in the RCM stable. It is an income trust that pays quarterly dividends and has provided 27 years of uninterrupted dividend growth. Simon Gergel, head of RCM's Value Investment Style team, has led the management of MRCH since April 2006.

The fund manager: Simon Gergel

Manager's view

The portfolio remains defensively positioned as it is still too early to price in a recovery. Quantitative easing, as well as fiscal and monetary stimulus, should prevent the current slowdown from becoming a depression, but any recovery will be muted as the increased debt burden will ultimately have to be financed. Capacity constraints will not be seen until 2013, so the risk of inflation is low, and the manager believes growth will be below trend for several years. Unemployment will continue to rise, but the outlook for consumer spending should improve as the effects of lower mortgage and utility bills filter through. The outlook for corporate spending, by comparison, is expected to remain poor as companies continue to preserve cash although the extensive destocking, recently witnessed, should come to an end. Dividend cuts and rights issues are expected to remain a feature for some time, as companies look to recapitalise, although sterling's relative weakness has helped boost the performance of many large UK corporates with significant overseas exposures. The manager believes many current valuations reflect a particularly pessimistic outlook and, as a result, these equities are now very cheap on a long-term view. The following are key themes currently employed in the management of the portfolio:

- Retain large core holdings in well financed businesses with good yields – GlaxoSmithKline, Royal Dutch Shell, Vodafone, Scottish & Southern Energy and BAE Systems.
- Consumer recovery will help car companies and retailers that survive – Home Retail Group, Inchcape, GKN and Halfords.
- Buy cyclical survivors (market leaders, in cyclical industries, with strong balance sheets that should survive a protracted downturn and emerge with improved competitive positions) – Balfour Beatty, Man Group and IG Index.
- Value opportunities where the market perceives too much debt – Dairy Crest, Meggitt and Informa.
- Certain management turnaround and recovery situations may be attractive – Unilever, Compass and Melrose.
- High yielding depressed asset classes are now becoming interesting – Aviva, Legal & General, Hammerson and BT.
- Limit exposure to mining (because of the effects of a muted recovery) and banks (because of concerns relating to future dividends and government interference).
- Underweight food retail, tobacco and household goods, as these defensive sectors are currently overpriced.

Asset allocation

Overview

MRCH has 45 equity investments. The top 10 holdings account for 59.3% of the portfolio, cash accounts for 2.2% of the portfolio, with the remaining 35 equity investments accounting for 38.5% of the portfolio. As displayed in Exhibit 3, MRCH's asset allocation can differ widely to that of the benchmark index, reflecting the actively managed nature of the trust. As shown in Exhibit 1, apart

from the 2.2% of the portfolio held as cash, the remaining 97.8% of the portfolio is fully invested in the UK.

Underweights

MRCH is underweight consumer services, financials, basic materials, consumer goods and oil & gas, all of which should aid performance in the current climate. The relatively smaller underweights in consumer goods and services reflect the manager's views on the return of consumer spending.

Overweights

MRCH's largest overweight is utilities, at over twice the benchmark allocation, which is a defensive position, as is the overweight in health care. Both should aid performance in the current climate.

MRCH also has significant overweights in industrials, technology and telecommunications, all of which would benefit from an uplift in domestic economic activity.

Exhibit 3: Sector allocations, as at 9 March 2009

	Trust Weight (%)	Benchmark Weight (%)	Trust Active Weight (%)	Trust Weight/Benchmark Weight
Utilities	11.3	5.5	5.8	2.05
Telecommunications	12.5	8.5	4	1.47
Industrials	8.4	4.6	3.8	1.83
Health Care	12.0	10.8	1.2	1.11
Technology	1.3	0.7	0.6	1.86
Consumer Services	7.8	9.9	-2.1	0.79
Financials	9.6	12.9	-3.3	0.74
Basic Materials	4.0	8.5	-4.5	0.47
Consumer Goods	9.4	14.3	-4.9	0.66
Oil & Gas	18.8	24.4	-5.6	0.77
Other assets/liabilities inc cash	4.9	0.0	4.9	N/A
Total	100.0	100.0	0	N/A

Source: The Merchants Trust/Edison Investment Research

Current portfolio positioning

As Exhibit 3 illustrates, the investment manager has given MRCH a more defensive allocation than the benchmark by overweighting defensive and underweighting cyclical sectors. This reflects the manager's view that it is still too early to price in a recovery, although ultimately MRCH's portfolio would benefit from an increase in domestic economic activity.

Top holdings

Turmoil in global markets has seen the benchmark index fall 31.6% in the last 12 months. As Exhibit 4 shows, nine out of MRCH's top 10 holdings have outperformed the benchmark during this period.

Exhibit 4: Ten largest equity holdings as at 28 February 2009

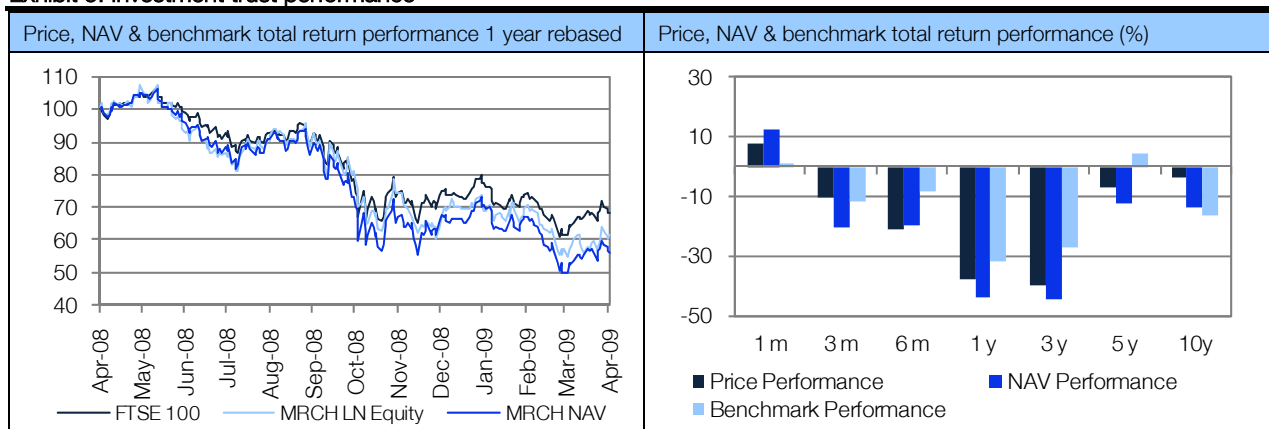
Holding	%	1 year total return price performance (%)	Performance relative to FTSE 100 Index (%)
Royal Dutch Shell	9.8	-17.1	+14.5
Vodafone Group	9.5	-16.5	+15.1
GlaxoSmithKline	8.9	-3.1	+28.4
BP	8.2	-12.1	+19.5
BAE Systems	4.5	-28.5	+3.1
Scottish & Southern Energy	4.2	-20.1	+11.5
British American Tobacco	3.7	-11.4	+20.2
Centrica	3.6	-14.9	+16.7
BHP Billiton	3.5	-19.8	+11.8
HSBC	3.4	-38.1	-6.5
Total	59.3		

FTSE 100 Index one-year performance = -31.6%

Source: The Merchants Trust/Edison Investment Research

Recent performance

Exhibit 5: Investment trust performance

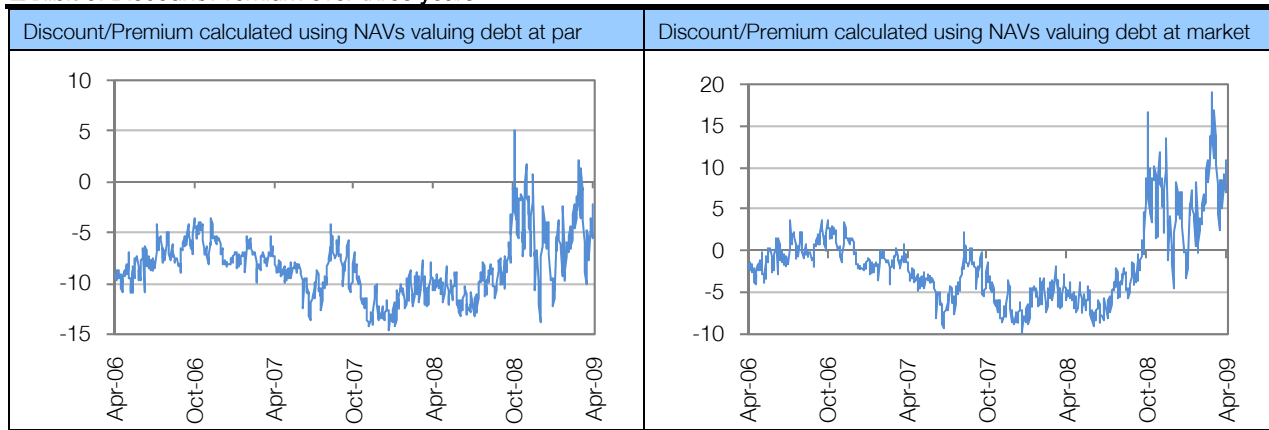


Source: Datastream/Edison Investment Research

As Exhibit 5 illustrates, MRCH’s performance has tended to follow that of the benchmark index, although over the three-month to five-year time horizons it has underperformed in terms of both price and NAV total return. This reflects MRCH’s investment policy, to remain substantially fully invested and geared, which has impacted performance during falling markets. In the year to 31 January 2009, management estimates that the cost of gearing to portfolio return was 7.6%. However, MRCH is predominantly held by private investors, many of whom are believed to hold it for its regular dividend and robust yield. When compared to its peers in terms of dividend yield, MRCH ranks third out of 18, as shown in Exhibit 7.

Discount/Premium

Exhibit 6: Discount/Premium over three years



Source: Datastream/Edison Investment Research

Note: Positive values indicate a premium; Negative Values indicate a discount.

MRCH has the authority, renewed annually, to allot up to 10% or make market purchases of up to 14.99% of issued share capital, which provides the manager with a mechanism to influence the discount, although an explicit commitment to maintain the discount at a particular level has not been provided. As Exhibit 6 illustrates, the discount has narrowed during the last six months and its volatility has increased. The increased volatility reflects the current financial climate but the extent of the fall in the discount suggests a potential re-rating, by investors, of merchants shares. During this period, investors have sought more defensive allocations with greater emphasis on dividends and yield, all of which MRCH offers. The first graph is produced using NAVs calculated valuing debt at par and the second values debt at market. It can be seen that under both measures MRCH has at times traded at a premium during the last six months, particularly if market values for debt are used. Under these conditions there has been no need for the trust to use its repurchase authority and

there have been no repurchases during the last 12 months. With the trust trading at a premium, judicious use of the allotment authority would be appropriate.

Capital structure

At first glance, MRCH appears to have a complicated capital structure that, in addition to its 25p ordinary shares, comprises 3.65% cumulative preference stock, 4% perpetual debenture stock, 5.88% secured bonds expiring 2029, a fixed interest rate loan and a stepped interest rate loan. However, MRCH is in fact a conventional investment trust. It only has one class of ordinary shares and the remaining instruments are all in effect means of borrowing to gear the trust, as part of the policy to enhance returns over the longer term. In March 2009 MRCH submitted a blocklisting application for 10.3m ordinary shares, ie 10% of the company's issued share capital, although no allotment can be made unless the lowest market offer price is at least at a premium to NAV, including accrued income, where debt is valued at market. As Exhibit 6 illustrates, when NAVs are calculated valuing debt at market, MRCH has traded at a premium over the last six months, and so we expect additional shares will be allotted when market conditions are appropriate. MRCH's borrowings are not allowed to exceed its called up share capital and reserves, allowing MRCH a great degree of flexibility in choosing its gearing policy. The trust's investment policy is to remain substantially fully invested and this, combined with the fall in equity markets, has impacted heavily on performance, which in turn has seen long-term debt as a proportion of net assets increase during the year to 31 January 2009 from 22.5% to 36.0%. As at 31 January 2009, total borrowings stood at £115.4m and the AIC currently calculates that MRCH has gearing of 44%. The management fee is 0.35% per annum of the value of the assets, calculated quarterly, after the deduction of any current liabilities, any loans under one year and any funds within the portfolio managed by RCM. There is no performance fee and the management contract can be terminated at one year's notice. The total expense ratio (TER) was 0.51% for the year ended 31 January 2009 (0.46% for the year ended 31 January 2008), which is comparatively low, reflecting the economies of scale offered by a trust of this size. As illustrated in Exhibit 7, MRCH's TER ranks fourth out of 18 when compared to its peers. MRCH does not have a fixed life and no specific mechanism exists to wind up the company.

Dividend policy and record

Dividends are paid quarterly and a key objective is to maintain a high and growing dividend, ie growth in total dividend, year-on-year. With the announcement of its final quarterly dividend, for the year ending 31 January 2009 of 5.6p and thus a total dividend for the year of 22.3p, MRCH has met this objective and provided 27 years of uninterrupted dividend growth since 1982. During this period MRCH has increased its dividend by a total of 878%, an average yearly increase of 9.4%, or 9.2% annualised, which is well above the rate of inflation. In addition to this, MRCH has declared a special dividend for the 2009 year of 0.5p, which relates to the recovery of VAT on past investment management fees. At present this gives a dividend yield of 8.7% and 8.9%, excluding and including the special dividend, respectively. Because of its significant dividend obligations, the board carefully models dividend flows and reviews the income outlook six times annually. MRCH increased its dividend between 2006 and 2008 significantly, with year-on-year growth rates of 5.0%, 5.8% & 8.0%. Between 2008 and 2009 the dividend has grown by 3.2% and, while still above the rate of inflation, is a reflection of the current financial climate. The recent full year results indicate that MRCH has revenue reserves equivalent to 79% of the previous year's dividend payment to support the dividend if required. MRCH invests in larger companies, which tend to offer more robust cash flows and, with its current reserves, MRCH has the capacity to smooth dividends. Over the longer term

MRCH's ability to maintain the dividend will depend on the performance of its underlying holdings. MRCH's policy of investing in companies that provide at least a market yield offers a degree of protection. However, management has highlighted the following four key risks to the dividend: (1) the current downturn becomes a depression, (2) equity and bond markets experience significant falls, exacerbating the issue of pension deficits, (3) the US dollar weakens, eroding the sterling cash flows of FTSE 100 companies with significant overseas exposures, and (4) the oil price falls below \$40 a barrel, for a significant period, which would put a significant amount of the portfolio's dividends at risk.

Peer group comparison

As Exhibit 7 illustrates, the AIC sector 'UK Growth and Income' is a relatively comprehensive peer group. There are 18 constituents and, within this peer group, MRCH ranks 15th over a one-year period, 13th over a three-year period and 13th over a five-year period when considering share price total return.

Exhibit 7: UK Growth and Income sector, as at 8 April 2009

Company	Share price total return on £100			Volatility (5 year)	Total Expense Ratio	Disc/ Prem	Gearing (100 = no gearing)	Dividend yield
	1 year	3 year	5 year					
Sector average	71.3	72.3	110.3	23.6	0.66	N/A	18	6.66
Merchants Trust	61.8	60.1	93.1	26.3	0.55	6.0	144	8.94
British & American	67.7	52.7	95.6	19.7	1.28	-26.6	151	11.23
City of London	74.6	80.0	120.8	26.6	0.37	5.0	112	6.46
Dunedin Income Growth	63.1	64.5	90.6	23.1	0.63	-2.5	114	7.50
Edinburgh Investment	76.0	80.4	122.1	23.8	0.40	5.7	132	6.55
F&C Capital & Income	72.4	73.1	101.7	19.3	0.68	4.3	108	5.06
Finsbury Growth & Income	75.5	67.5	118.6	18.5	0.96	-4.2	114	5.32
INVESCO Income Growth	65.9	71.0	103.6	18.9	0.97	-7.9	118	6.79
JPMorgan Elect Managed Income	64.6	59.8	91.1	15.7	0.76	1.0	100	6.28
Lowland	50.8	49.9	80.7	23.8	0.70	-5.9	115	6.58
Murray Income	70.8	71.1	116.4	24.8	0.77	1.8	113	6.72
Perpetual Income & Growth	81.6	82.0	120.8	24.9	1.07	-0.4	118	4.48
Schroder Income Growth	83.2	79.8	113.6	18.8	0.94	-2.4	100	5.94
Securities Trust of Scotland	62.8	63.6	94.4	21.3	0.58	-5.6	112	8.06
Shires Income	58.3	46.5	78.6	25.4	1.03	4.3	196	17.32
Standard Life Equity Income	78.0	79.9	112.4	16.9	0.93	2.5	100	5.14
Temple Bar	85.9	78.1	119.4	24.8	0.51	2.5	120	5.95
Value and Income	57.5	48.3	81.1	21.1	1.25	-24.9	148	7.69

Source: The Association of Investment Companies

The board

All directors are non-executive and independent of the investment manager. They are: HA Stevenson (chairman), PJ Scott Plummer (senior independent director), RA Barfield, Sir Bob Reid, Sir James Sassoon, MJE McKeon, HE Staunton (directors).

EDISON INVESTMENT RESEARCH LIMITED

Edison is Europe's leading independent investment research company. It has won industry recognition, with awards in both the UK and internationally. The team of 50 includes over 30 analysts supported by a department of supervisory analysts, editors and assistants. Edison writes on more than 250 companies across every sector and works directly with corporates, investment banks, brokers and fund managers. Edison's research is read by every major institutional investor in the UK, as well as by the private client broker and international investor communities. Edison was founded in 2003 and is authorised and regulated by the Financial Services Authority.

DISCLAIMER

Copyright 2009 Edison Investment Research Limited. All rights reserved. This report has been commissioned by The Merchants Trust and prepared and issued by Edison Investment Research Limited for publication in the United Kingdom. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison Investment Research Limited at the time of publication. The research in this document is intended for professional advisers in the United Kingdom for use in their roles as advisers. It is not intended for retail investors. This is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment. A marketing communication under FSA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison Investment Research Limited has a restrictive policy relating to personal dealing. Edison Investment Research Limited is authorised and regulated by the Financial Services Authority for the conduct of investment business. The company does not hold any positions in the securities mentioned in this report. However, its directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. Edison Investment Research Limited or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance.

Edison Investment Research

Lincoln House, 296-302 High Holborn, London, WC1V 7JH ■ tel: +44 (0)20 3077 5700 ■ fax: +44 (0)20 3077 5750 ■ www.edisoninvestmentresearch.co.uk
Registered in England, number 4794244. Edison Investment Research is authorised and regulated by the Financial Services Authority.