The Merchants Trust

Investment trusts review

Edison investment research

Income trust with a 6.2% yield

Investment trusts

During the last 12 months, the Merchants Trust (MRCH) has outperformed its benchmark index, the FTSE 100, by 3.0% in terms of NAV total return. Despite this, the discount has gone from a premium of 5.9% to a discount of 2.0% with debt at fair value. For the half-year ended 31 July 2012, in total return terms the underlying portfolio beat the FTSE 100 by 4.2% (the FTSE 100 rose by 1.4%). Gearing added 0.8% to performance, despite an expensive tranche of debt that expires in 2018. The trust pays quarterly dividends and its recent interims suggest that the trust is well positioned to provide investors with 31 years of uninterrupted dividend growth. MRCH is managed using a value-driven investment style and remains defensively positioned.

12 months ending	Total share price return* (%)	Total NAV return* (%)	Total return FTSE 100* (%)	Total return FTSE 350 High Yield* (%)	Total return FTSE All-Share * (%)
24/10/2009	37.7	49.6	41.2	30.3	44.0
24/10/2010	25.0	17.1	13.3	8.3	14.0
24/10/2011	3.6	2.3	(0.1)	5.7	(0.4)
24/10/2012	3.1	11.8	8.8	8.8	10.1

Note: *Twelve-month rolling discrete performance.

Investment strategy: Higher-yielding FTSE 100 companies

MRCH aims to provide an above-average level of income; it currently yields 6.2% compared with the FTSE 100 index yield of 3.6% and FTSE 350 High Yield index yield of 4.8%. It invests in higher-yielding equities, uses gearing (net gearing of 22.3% as at 30 September 2012) and selectively writes covered out-of-the-money call options to generate additional revenue income. Revenue reserves have been used to support dividend payments over the last three years, but the gap has closed substantially as dividends on the underlying portfolio have increased. Management looks to invest in companies that offer at least a market yield on an 18-month view.

Sector outlook: Opportunities in cyclical stocks

The manager believes it is correct for the portfolio to be defensively positioned, given current market uncertainties. However, with increases in the valuation of defensive stocks during the last six months, it believes many are now fully valued and that there are opportunities to acquire quality cyclical stocks at compelling valuations. Reflecting this, the portfolio has become less defensive during the last six months.

Valuation: Discount above long-term averages

With the discount widening and premium contracting over the last 12 months, MRCH's current discount of 10.6% (debt valued at par) and discount of 1.7% (debt valued at market) are above its five-year discount averages of 6.2% and -0.5% respectively. The performance of the underlying portfolio has seen an uptick in the last six months, which the price performance has not kept pace with. At 6.2% the yield remains strong, so we consider that MRCH should continue to be attractive to investors favouring a defensive portfolio with regular income at a decent yield, or those looking for geared exposure to the FTSE 100.

29 October 2012

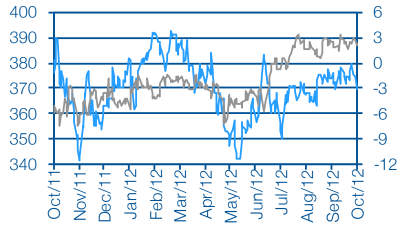
Price	372.5p
Market cap	£385m
AUM	£551m
NAV*	416.65p
Discount to NAV	10.6%
NAV**	378.99p
Discount to NAV	1.7%
Yield	6.2%

** Adjusted for debt at par value and excluding income, as at 25 October 2012.*

*** Adjusted for debt at market value, excluding income, as at 25 October 2012.*

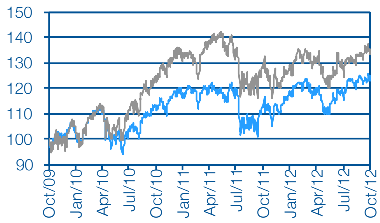
Ordinary shares in issue	103.2m
Code	MRCH
Primary exchange	LSE
AIC Sector	UK Growth & Income

Share price/discount performance



** Positive values indicate a discount; negative values indicate a premium*

Three-year cumulative performance



52-week high/low	392.70p	341.50p
NAV* high/low	389.43p	354.73p

** Adjusted for debt at market value, excluding income.*

Gearing

Gross	25.3%
Net	22.3%

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Exhibit 1: Trust at a glance

Investment objective and fund background

MRCH's investment objective is to provide an above-average level of income and income growth together with long-term growth of capital through investing mainly in higher yielding UK FTSE 100 companies.

Developments last quarter

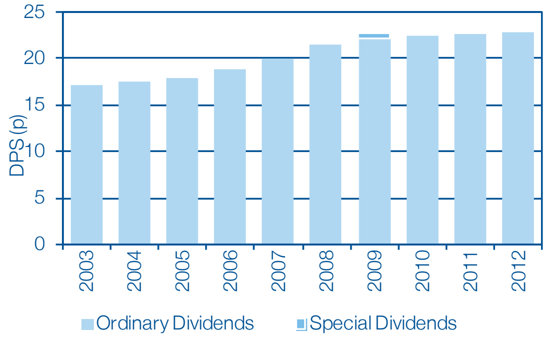
13 September 2012: Interim report released.

15 August 2012: First interim dividend, for the year ending 31 January 2012, of 5.8p paid.

Forthcoming		Capital structure		Fund details	
AGM	May 2013	Total expense ratio	0.47%	Group	Allianz Global Investors/RCM (UK)
Preliminary results	April 2013	Net gearing	22.3%	Manager	Simon Gergel
Year end	31 January	Annual mgmt fee	0.35% of assets	Address	155 Bishopsgate, London EC2M 3AD, UK
Dividend paid	Quarterly	Performance fee	None		
Launch date	February 1889	Trust life	Indefinite	Phone	+44 (0)800 317 573
Wind-up date	N/A	Loan facilities	See page 7	Website	www.merchantstrust.co.uk

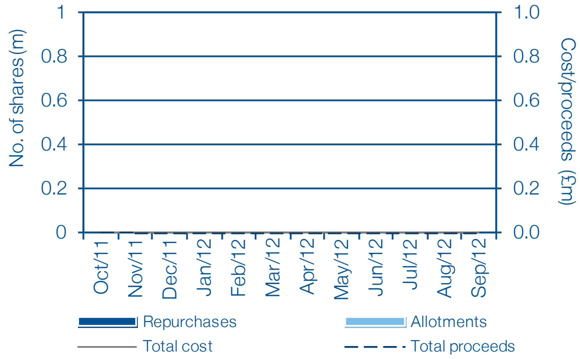
Dividend policy and history

Quarterly dividends paid in February, May, August and November. MRCH aims to maintain a high and growing dividend.

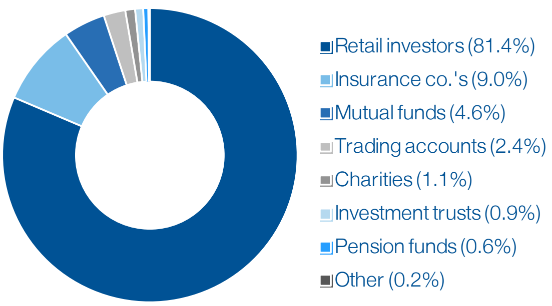


Share buy-back policy and history

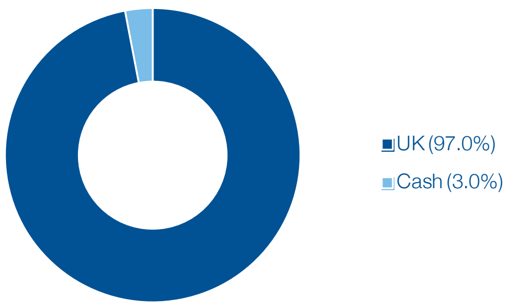
Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 10% of issued share capital.



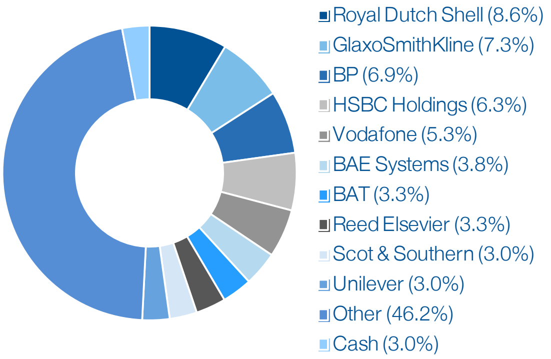
Shareholder base (as at 7 October 2012)



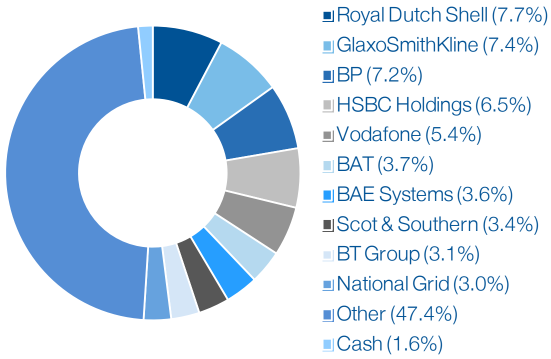
Geographic distribution of portfolio (as at 31 August 2012)



Portfolio composition (as at 31 August 2012)



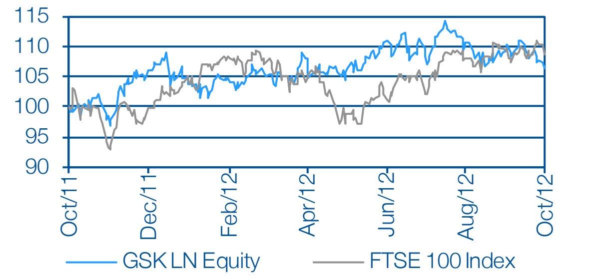
Portfolio composition (as at 29 February 2012)



Source: The Merchants Trust, Edison Investment Research

Exhibit 2: Holdings in portfolio themes at a glance

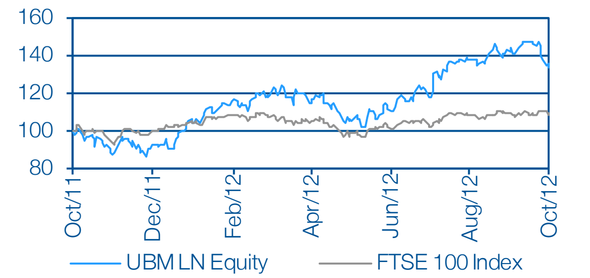
GlaxoSmithKline	Code: GSK LN	Market cap: £69,478m



Div yield (trail. 12 months)	5.11%
Industry/Sector	Pharmaceuticals & Tech./Pharma
Listing	LSE - Premium Listing
Website	www.gsk.com

At 7.5% of the portfolio, GlaxoSmithKline (GSK) is one of MRCH's core holdings. This reflects management's views that GSK's valuation is attractive and, as a bedrock, MRCH retains a number of large core holdings in strong multinational businesses that are well financed and offer good yields. GSK, currently MRCH's second-largest holding, made the single biggest contribution to performance during the year ended 31 January 2012.

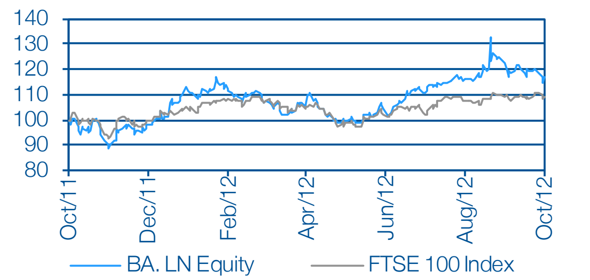
United Business Media	Code: UBM LN	Market cap: £1,623m



Div yield (trail. 12 months)	4.04%
Industry/Sector	Media/Publishing
Listing	LSE - Premium Listing
Website	www.unitedbusinessmedia.com

At 2.3% of the portfolio, United Business Media (UBM) is one of a number of holdings that provides MRCH with exposure to corporate expenditure through media and advertising. Having restructured, the manager considers that UBM has a strong core business that has moved well beyond print media. Around 60% relates to exhibitions. UBM also has a substantial exposure to emerging markets and the PR business is performing well.

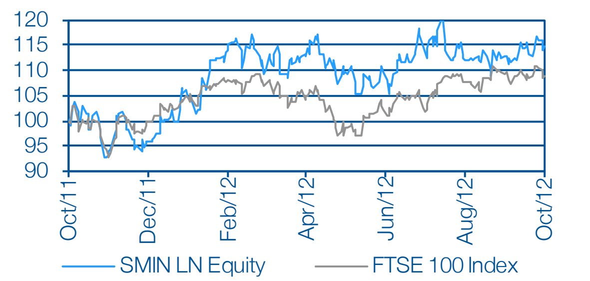
BAE Systems	Code: BA. LN	Market cap: £10,146m



Div yield (trail. 12 months)	6.12%
Industry/Sector	Aerospace & Defence/Defence
Listing	LSE - Premium Listing
Website	www.baesystems.com

At 3.7% of the portfolio, BAE Systems is both a core holding (ie, a well-financed multinational business that offers a good yield) and a stock that has been oversold on defence cuts. The manager considers the valuation remains attractive and that BAE is performing well. The manager believes half the business is maintaining existing fleets, that many of its contracts are long term and there are export opportunities.

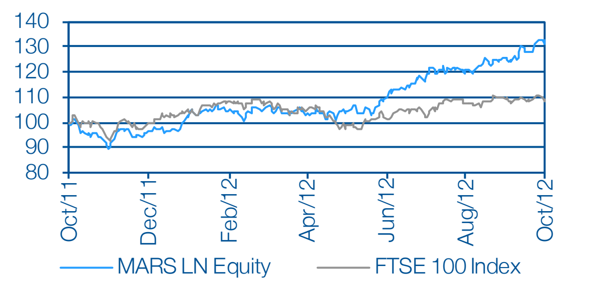
Smiths Group	Code: SMIN LN	Market cap: £4,087m



Div yield (trail. 12 months)	3.65%
Industry/Sector	General Industrials/Diversified Ind.
Listing	LSE - Premium Listing
Website	www.smiths-group.com

Smiths Group (SMIN) delivers products and services for the threat and contraband detection, medical devices, energy, communications and engineered components markets worldwide. It is an example of a high-quality growth stock with a reasonable yield available on a modest valuation. The manager considers that SMIN has strong competitive positions and decent barriers to entry. SMIN is generating strong cash flows and there is room for margin improvement.

Marston's	Code: MARS LN	Market cap: £697m



Div yield (trail. 12 months)	4.83%
Industry/Sector	Travel & Leisure/Restaurants & Bars
Listing	LSE - Premium Listing
Website	www.marstons.co.uk

Marston's (MARS) is an independent brewing and pub retailing business. It is a new name in the portfolio with an allocation of 0.8%. MARS operates c 1,650 tenanted/leased pubs and 500 managed pubs in England and Wales. It also has five regional breweries in the UK. The manager considers that MARS is trading well, has a strong competitive position, and is generating very strong cash flows and that its real estate property portfolio provides good inflation protection.

Source: The Merchants Trust, Thomson Datastream, Edison Investment Research

Fund profile

Managed by RCM, a company of Allianz Global Investors, and its predecessors since its launch in February 1889, MRCH is the oldest trust in the RCM stable. It is an income trust that pays quarterly dividends and has provided 30 years of uninterrupted dividend growth. Simon Gergel, CIO of UK Equities and head of RCM's value and income investment style team, has led the management of MRCH's portfolio since April 2006.

The case for higher-yielding FTSE 100 equities

Our strategist, Alastair George, points out that equities appear good long-term value as risk-free rates of return have declined to historic lows across the yield curve. Unusually, there is now a significant yield advantage in favour of quality blue-chip non-financial equities compared to 10-year government bonds. If current dividend levels are maintained, it is difficult to see how such stocks will underperform bonds over the next 10 years, but the risk clearly lies in the dividend level, which in turn relies on corporate profitability. Where QE and government budget deficits support aggregate demand, corporate profitability is likely to remain robust and dividends secure. However, a lurch towards austerity (especially in the US) and protectionism would lead to a significant fall in profitability, which we believe is the key risk for developed and emerging market equities alike.

Comparing FTSE 100 equities to smaller-cap stocks FTSE 100 stocks will generally have greater liquidity, lower volatility and greater international exposure. Smaller companies typically have more room to provide meaningful growth and are more likely to be under researched, under owned and undervalued, providing investors with a greater opportunity to exploit informational advantages. The FTSE 100 is around 90% of UK market cap and, with six companies alone providing nearly 50% of the entire FTSE 100 dividend income, this is a natural hunting ground for income funds. The lower volatility of the large caps also allows investors to run a more concentrated portfolio than is required to achieve a given level of diversification in the smaller caps. However, concentration is not without its risks. Concentration caused problems when, for example, the major banks cut dividends in 2009 and when BP cut dividends following the Gulf of Mexico oil spill in 2010.

The fund manager: Simon Gergel

The manager's view

The manager considers that share price movements are polarised, with divergent performance between defensive and cyclical equities, as markets move between risk-on and risk-off phases. This makes portfolio construction challenging but the manager believes it is still correct for MRCH to have a defensively positioned portfolio, focusing on higher-yielding stocks given current market uncertainties, but has continued, during the last six months, to become less defensive. This reflects not only a devaluation of cyclical and financial shares but also a view that with increases in the valuations of defensive stocks, during the same period, many defensive stocks are now fully valued and there are opportunities to acquire quality cyclical stocks at compelling valuations. The manager reports finding many opportunities between the two polar extremes; companies that are not immune from economic issues but are not deeply cyclical either. Target companies have strong, well-established competitive positions, good corporate strategies, robust balance sheets, attractive valuations and good dividend yield. Inflation remains a medium-term risk so the manager is favouring companies with strong asset backing that gives them both a competitive advantage and a hedge against potentially resurgent inflation. The following themes are currently employed in managing the portfolio:

- Retain large core holdings in large well-financed multinational businesses with good yields, such as GlaxoSmithKline, Royal Dutch Shell, Vodafone, Scottish & Southern Energy and National Grid.
- Continue to limit exposure to mining (because of the effects of a slowdown/muted recovery) and banks (because of ongoing low dividends).
- Purchase high-quality growth stocks on modest valuations with reasonable dividend yields – Reckitt Benckiser, Smiths group, United Business Media, IG Group and Inmarsat.
- Seek companies with exposure to emerging market consumers – GlaxoSmithKline, British American Tobacco, United Business Media, Unilever and Mothercare.
- Corporate profits look healthy and the outlook for day-to-day for expenditure, in particular advertising and media, remains positive, for example United Business Media, Daily Mail and General Trust (DMGT) and Reed Elsevier.
- Many companies exposed to defence spending were oversold, in the manager's opinion, on the back of concerns about defence cuts. In addition, the civil aviation outlook is improving - BAE Systems, BBA Aviation, Cobham and Meggitt.
- Selectively overweight certain consumer-related stocks, which have been oversold (in spite of the obvious pressures on disposable income) such as Sainsbury's, Carnival, Greene King and Britvic. The manager believes the oil price is vulnerable to a growth slowdown, which could revive consumer spending and the sector.

Asset allocation

Investment process: Bottom-up stock selection

MRCH is managed using a predominantly bottom-up investment approach, supported by macro analysis, using the extensive fundamental research capability of RCM's UK equity team. The manager is also able to draw on the expertise of RCM's global team of 78 analysts. Analyst recommendations are monitored for their efficacy and analysts are incentivised accordingly. In conducting their analysis, the manager can draw on RCM's Grassroots research function. This is a proprietary network of c 70 freelance investigative journalists who research and gather information on a variety of business-related topics, supported by a team of c 300 field investigators who specialise in conducting quantitative market research. RCM believes that Grassroots provides access to public data on company-specific issues in a timely and value-creating manner.

When constructing the portfolio, the manager takes at least an 18-month view and does not chase sector allocations. Instead the manager looks thematically for ideas, such as themes based on the macroeconomic outlook, stage of the business cycle as well as industry and secular themes. In terms of stock selection, the manager looks for companies with favourable industry dynamics and strong competitive positions as well as strong free cash flow and thus a good capacity to pay sustainable dividends. The manager also considers valuation in absolute terms, relative to history, relative to market and the dividend yield. The manager has a contrarian style and targets stocks with at least a market yield on an 18-month view, backing them with conviction. Yield in isolation is not a consideration for buying a stock and stocks are not automatically disposed of if the yield drops below the market average. Instead purchase and sale decision are driven by total return considerations. The manager has access to a range of metrics to manage portfolio risk.

Overview

As at 20 September 2012, MRCH had 44 equity investments. The top 10 holdings account for 51.1% of the portfolio, cash 1.7%, with the remaining 34 equity investments accounting for 47.2%. As displayed in Exhibit 3, MRCH's asset allocation can differ substantially to that of the FTSE 100, reflecting the actively managed nature of the trust. As shown in Exhibit 1, apart from the 1.7% of the portfolio held as cash, the remaining 98.3% of the portfolio is fully invested in the UK.

Derivatives strategy

The manager is permitted to write selective covered call options to generate additional income for the trust. There is a maximum exposure of 15% of gross assets at the time of writing. The options usually have less than a four-month duration and, depending on the manager's views, the number of covered calls written on the portfolio can vary substantially. However, they typically vary between five and 20. For the year ended 31 January 2012 (the second full year the strategy has been in use) call overwriting generated over £1.9m (2011: £2.0m) of additional revenue income and a net profit of c £950k (2011: £480k) once the opportunity cost of any exercised options was taken into account. For the six months to 31 July the strategy has generated additional revenue income of £890k and a profit of £200k once opportunity costs are taken into account.

Exhibit 3: Sector allocations as at 20 September 2012

	Trust weight (%)	Benchmark weight (%)	Trust active weight (%)	Trust weight/ benchmark weight
Consumer services	15.5	8.3	7.2	1.87
Industrials	11.2	6.7	4.5	1.67
Utilities	8.2	4.5	3.7	1.82
Telecommunications	8.3	7.0	1.3	1.19
Technology	0.0	0.8	-0.8	0.00
Financials	17.5	18.3	-0.8	0.96
Healthcare	7.5	8.5	-1.0	0.88
Consumer goods	12.3	14.9	-2.6	0.83
Oil & gas	15.3	19.5	-4.2	0.78
Basic materials	2.5	11.5	-9.0	0.22
Cash	1.7	0.0	1.7	N/A
Total	100.0	100.0	0.0	

Source: The Merchants Trust, Edison Investment Research

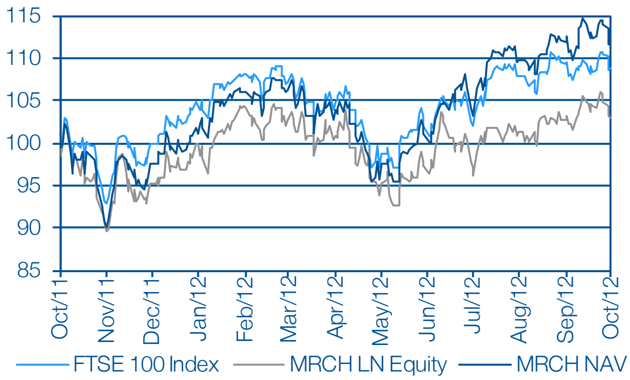
Current portfolio positioning

MRCH remains underweight basic materials, oil & gas, consumer goods, healthcare and technology. Within the financials allocation, the portfolio retains a significant underweight in banks, which is still largely offset by overweights in financial services, non-life insurance and life assurance. The manager remains underweight banks as he considers they remain difficult to value and yields remain low. MRCH remains overweight consumer services, industrials, utilities and telecommunications. Consumer services, largely driven by media, remains MRCH's largest active overweight. The industrials overweight (1.6x the benchmark allocation) is largely driven by holdings in aerospace and defence. As Exhibit 3 illustrates, the investment manager has given MRCH a more defensive allocation than the benchmark by overweighting defensive and underweighting cyclical sectors.

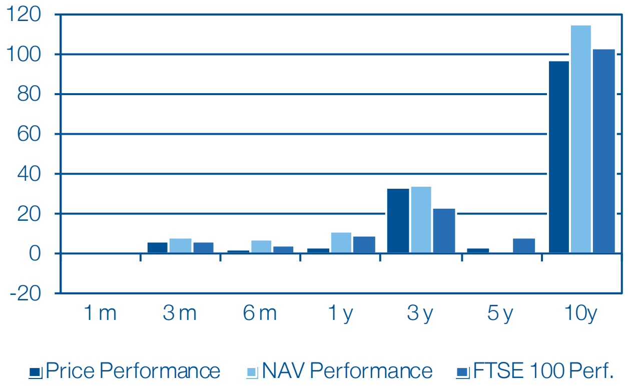
Recent performance

Exhibit 4: Investment trust performance

Price, NAV and benchmark total return perf, one year rebased



Price, NAV and benchmark total return performance (%)



Source: The Merchants Trust, Thomson Datastream, Edison Investment Research

Exhibit 5: Share price and NAV (with debt valued at par) total return performance (sterling adjusted), relative to benchmarks

	1 month	3 months	6 months	1 year	3 years	5 years	10 years
Price relative to FTSE 100	0.8	(0.6)	(1.8)	(5.8)	10.2	(5.5)	(5.9)
NAV relative to FTSE 100	0.2	1.5	3.8	3.0	10.7	(6.8)	12.4
Price relative to FTSE 350 High Yield	1.4	1.6	(3.4)	(5.7)	8.9	0.7	0.0
NAV relative to FTSE 350 High Yield	0.7	3.7	2.3	3.0	9.4	(0.6)	18.3
Price relative to FTSE All-Share	0.7	(1.1)	(2.3)	(7.0)	8.4	(6.5)	(21.4)
NAV relative to FTSE All-Share	0.1	1.0	3.3	1.7	8.9	(7.8)	(3.2)

Source: The Merchants Trust, Thomson Datastream, Edison Investment Research

As Exhibit 4 illustrates, MRCH's NAV has broadly tended to outperform that of its benchmark, the FTSE 100 Index, with the exception of 2008 and 2010 when MRCH suffered heavily from its exposures to the banking sector. The underperformance, apparent in the five-year period, reflects MRCH's investment policy to remain substantially fully invested and geared, which has affected performance during falling markets. Conversely, this policy has assisted performance during rising markets. In terms of performance for the year ended 31 January 2012, attribution analysis shows that total return on the index was 0.4%, while the relative return of the portfolio added 1.5%. Gearing and expenses charged to capital subtracted 0.9% and 1.7%, while other items added 0.2%. It is noteworthy that, during this period, the portfolio return was accretive but the impact of the structural gearing was negative. More recently, for the six months ended 31 July 2012, attribution analysis shows that the total return on the index was 1.4%, while the relative return on the portfolio added 4.2%. The impact of gearing added 0.8% while expenses charged to capital subtracted 0.8%. As such the impact of the structural gearing has, for this period, been accretive. Quantitative easing has lowered borrowing costs and driven up the market value of corporate debt, MRCH's included. However, the most expensive debt, the £52.2m of severally guaranteed debenture stock at 11.125%, expires in 2018. This will not only reduce the interest drag on the portfolio but, being currently valued above par, its value will reduce as it moves closer to maturity with a positive effect on the fair value NAV. This is illustrated in Exhibit 6.

Exhibit 6: Merchants Trust – debt repayment schedule

	Repayment due	Repayment amount (£m)	Market value – 31 August 2012 (£m)	Market value less Par repayment amount (£m)	Time to expiry (years)	Straight line yearly decrease (£m)
Stepped interest rate loan	2018	34.03	48.96	14.93	6	2.48
Fixed int. rate loan Fintrust (1993)	2023	30.00	47.00	17.00	11	1.55
Fixed int. rate loan Fintrust (1998)	2023	12.00	18.80	6.80	11	0.62
Secured Bonds	2029	30.00	36.80	6.80	17	0.40
Total		106.03	151.56	45.52		5.05

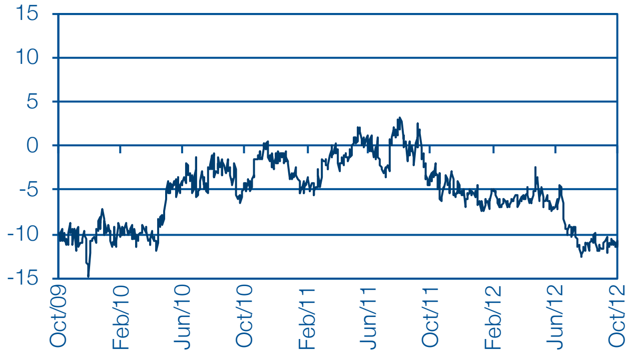
Source: The Merchants Trust, Thomson Datastream, Edison Investment Research

Discount

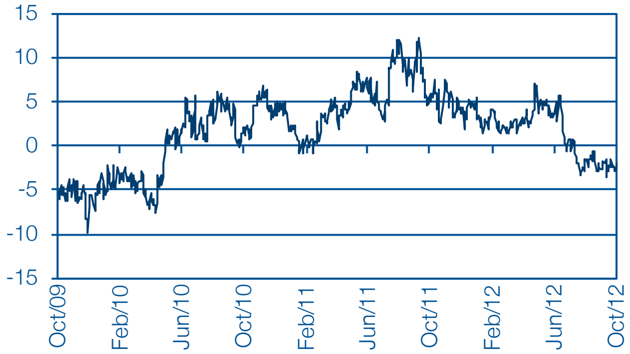
MRCH has the authority, renewed annually, to allot up to 10% or make market purchases of up to 14.99% of issued share capital, which gives the manager a mechanism to influence the discount, although there is no explicit maximum or target level. Exhibit 7 illustrates the discount – the first graph is produced using NAVs calculated valuing debt at par and the second values debt at market. Under both measures it can be seen that, after two years where MRCH's discount broadly contracted, the last 12 months have seen a trend towards a widening of the discount so that MRCH is now trading at discount comparable to the last quarter of 2009. From May 2010 until July 2012, MRCH predominantly traded at a premium with debt valued at market and as such, there was no need for the trust to use its repurchase authority, as illustrated in Exhibit 1. If the current discount widening continues, the board may consider it appropriate to recommence share repurchases. This would have the potential to be NAV accretive as well as having a concentrating effect on revenue reserves per share.

Exhibit 7: Discount/premium through three years

Discount/premium calculated using NAVs valuing debt at par*



Discount/premium calculated using NAVs valuing debt at market*



Source: Thomson Datastream, Edison Investment Research. Note: *Positive values indicate a premium; negative values indicate a discount.

Capital structure

MRCH is a conventional trust, having only one class of share in issue – 25p ords. It uses a range of other debt instruments to gear up: 3.65% cumulative preference stock, 4% perpetual debenture stock, 5.88% secured bonds expiring 2029, two fixed-interest-rate loan expiring 2023 and a stepped-interest-rate loan expiring January 2018. The stepped interest rate loan has an effective interest rate of 11.28%. The first portion of the two fixed interest rate loans is for a principal amount of £30m with an effective interest rate of 9.51%. The second portion is for a principal amount of £12m with an effective interest rate of 6.00%. These structural debt elements are now relatively expensive when compared to current rates of interest. All have fair values above their par values as illustrated in Exhibit 6. Although profitable over the longer term, the interest cost is potentially a drag on performance as discussed in the recent performance section. MRCH's borrowings are not allowed to exceed its called-up share capital and reserves, which allows it considerable flexibility in choosing its gearing policy and it currently has net gearing of 22.3%.

The management fee is 0.35% per year 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 0.47% for the year ended 31 January 2012 (2011 0.46%), which reflects the economies of scale offered by a trust of this size. As illustrated in Exhibit 9, MRCH's ongoing charges are competitive ranking fourth out of 21 when compared to its peers. MRCH has an indefinite life and there is no specific mechanism to wind up the company.

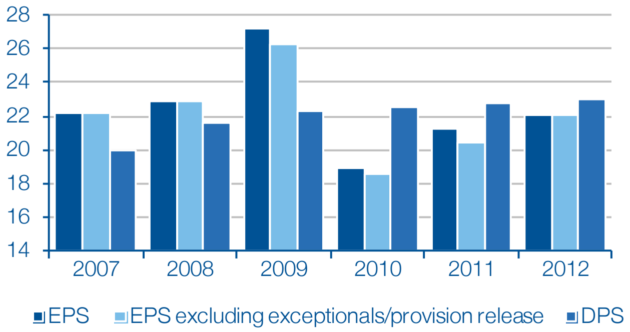
Dividend policy and record

Dividends are paid quarterly and a key objective is to maintain a high and growing total dividend. For the year ending 31 January 2012, MRCH paid a total dividend of 23.0p, providing 30 years of uninterrupted dividend growth since 1982. During this time MRCH increased its dividend by a total of 1,011%, an average yearly increase of 8.6%, or 8.4% annualised. Because of its significant dividend obligations, the board carefully models dividend flows and reviews the income outlook six times annually. As Exhibit 8 illustrates MRCH has, for the last three years, dipped into revenue reserves to support the dividend payment. These shortfalls, which reflect both the dividend cuts by the banks post 2009 as well as the BP dividend cut following the Gulf of Mexico oil spill, have become progressively smaller as dividend income has recovered. With companies earning very good margins, the market has saw strong dividend growth during 2011, which has continued into 2012. The manager and board are confident that MRCH is now moving back towards a position where the dividend will once again become covered. The recent results indicate that, as at 31 July 2012, MRCH had revenue reserves of 23.88p per share; or 12.28p after deducting the 1st and second dividends of 5.8p each (up from 5.7p for 2011). MRCH generated a revenue return of 12.50p during the six months to 31 July 2012 adding 0.90p (2011:0.19p) to revenue reserves after payment of the first two dividends.

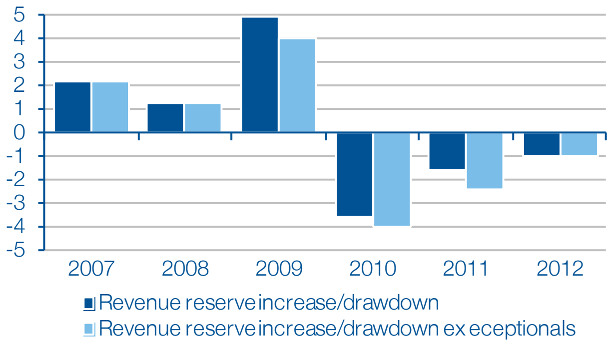
MRCH generated a revenue return of 22.0p per share for the year ended 31 January 2012 and paid out a total dividend of 23.0p for the year. With the quarterly dividend now set at 5.8p, this suggests a minimum total payment of 23.2p for the 2013 year. However, with 0.9p added to revenue reserves during the first half, despite the increase of the first two dividends by 0.1p, it is clear that if the pattern of dividend receipts in the second half of the year is comparable to last year that MRCH will be very close to covering its dividend. In fact, the manager believes the primary unknowns are the size and timing, ie within the current financial year, of a special dividend from Vodafone. Ultimately, we expect that MRCH will be able to maintain the current quarterly dividend at 5.8p for the remainder of the 2013 financial year and is likely to be able to continue its path of steady dividend growth. Exhibit 9 provides an illustration of the components that make up MRCH's Yield.

Exhibit 8: Analysis of revenue reserve

Comparison of EPS, DPS and EPS excluding exceptionals

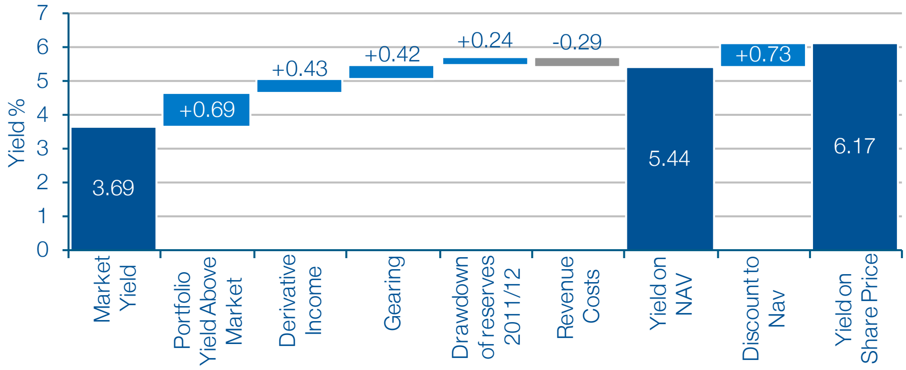


Revenue reserve increase/drawdown inc. and exc. Exceptionals



Source: The Merchants Trust

Exhibit 9: Dividend Yield Analysis as at 18 September 2012



Source: The Merchants Trust

Peer group comparison

As Exhibit 10 illustrates, the AIC UK Growth and Income sector is a comprehensive peer group with 20 constituents (a sample is given below). Within this group, MRCH ranks 21st over one year, 12th over three years and 15th over five years when considering share price total return.

Exhibit 10: Global growth sector, as at 24 October 2012

Company	Share price total return on £100			Ongoing charges (%)	(Disc)/ prem.	Net gearing (100=no gearing)	Five-year dividend growth (%)	Div. yield
	One year	Three years	Five years					
Sector average	**112.5**	**149.3**	**125.7**	**0.77**	**0.5**	**112**	**1.5**	**4.2**
Merchants	**103.1**	**133.5**	**102.9**	**0.64**	**(3.9)**	**124**	**1.6**	**6.2**
City of London	111.8	148.8	129.9	0.45	2.7	107	4.0	4.6
Diverse Income Trust	130.1	N/A	N/A	1.52	5.8	98	N/A	3.8
F&C Capital Income	111.9	128.2	115.8	0.81	0.7	103	1.9	3.9
Finsbury Growth & Income	118.0	169.2	142.6	0.98	1.1	105	0.6	2.6
Lowland	127.2	175.3	111.0	0.62	(0.3)	112	3.4	3.2
Perpetual Income & Growth	114.1	154.2	136.0	1	0.1	116	6.8	3.9
Temple Bar	113.8	149.4	151.8	0.5	2.1	105	3.0	3.7
Value & Income	104.3	132.7	102.6	1.35	(21.6)	129	1.7	4.4

Source: The Association of Investment Companies

The board

All directors are non-executive and independent of the manager. They are SJ Fraser (chairman), HE Staunton (senior independent director), MJE McKeon and P T Yates (directors). The average length of director service is 3.4 years.

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