30 September 2020

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THE MERCHANTS TRUST PLC
Half-Yearly Financial Report
For the six months ended 31 July 2020

Financial Headlines

- Dividends declared for the first six months of 2020/21 are 13.6p per share, up 0.7% on last year.
- NAV total return* -31.4% and share price total return -34.3%.
- Underlying portfolio total return of -25.5% compared with -17.8% for the FTSE All-Share Index.
- Ordinary shares yield 7.8% at 343.0p, compared with a yield of 4.2% for the FTSE All-Share Index at the close of business on 28 September 2020.

* Debt at market value

Interim management report

We are disappointed to report that during the first six months of the current year, a period of unprecedented uncertainty for the global economy and UK equities, the net asset value ('NAV') total return* of shares in The Merchants Trust has fallen by 31.4%. This decline represents an underperformance against the FTSE All-Share Index, which was down 17.8%. This underperformance comprises two factors: the underlying portfolio total return of -25.5% against the FTSE All-Share Index return of -17.8% and second, the effect of financial gearing of the portfolio in a falling market which has amplified the negative return.

While the board shares shareholders' disappointment in this recent performance, it does follow a period of very strong outperformance in our previous financial year. Over the longer term, the trust has outperformed the FTSE All-Share Index, before fees, in six of the last ten discrete years and has grown its dividend in each of the last 38 years.

In my statement in April I noted that the COVID-19 pandemic was a very present shadow and during the first half year it has produced a background of extreme market volatility. We are still far from clear of the short-term and long-term economic effects of the crisis, but your board continues to focus on the trust's long-term objectives of producing good total returns and paying a high and growing income. The board is also focused on ensuring that the manager's ability to manage the portfolio is not compromised, and that operational risks do not increase, as a result of disruption caused by the pandemic.

Regarding the underlying portfolio total return, our portfolio manager, Simon Gergel, explains in his review that in this environment, many investors have continued to favour "growth" and what are termed "quality" stocks, which generally have higher and more reliable profits. Many of these stocks have been trading at ever higher earnings multiples whereas many unloved "value" stocks have seen their share prices compressed to low levels that our manager believes to be undervalued. In the period under review, this has caused a drag on the performance of the trust, given our manager's "value" based investment strategy.

During this period of extreme polarisation between highly rated "growth" stocks and underrated "value" stocks, our manager has taken the opportunity to carefully review the composition of the portfolio. Merchants' long-standing philosophy of finding sound companies, with the potential to pay a high income, trading at low valuations, has served shareholders well over the long term, and we continue to believe it is appropriate. I would point out, however, that our manager's investment process is not driven simply by valuation. The strength of the businesses we invest in remains paramount, and this is an important distinction to make in an environment where there have been several high-profile cases of managers and funds with more aggressive "value" styles falling from grace.

Lastly, the gearing of the portfolio, which in the long term has been to the benefit of shareholders, has during this six-month period amplified the negative returns. The board actually reduced the gearing before the start of the pandemic, as it believed a more conservative approach was appropriate after many years of rising markets. However, we are clear that over the long term, carefully managed gearing of the portfolio can enhance returns and improve the dividend yield.

Half year results

Net asset value
As at 31 July 2020, the NAV per ordinary share (with debt at market value) was 352.3p. On a capital basis, the NAV per ordinary share (with debt at market value) decreased by 33.9%, underperforming the benchmark capital return of -19.1%.

The total return reflects both the change in NAV per ordinary share and the ordinary dividends paid. For the six months to 31 July 2020, the total return NAV per ordinary share decreased by 31.4%, whilst the FTSE All-Share Index decreased by 17.8%.

Net earnings and dividends
Earnings in the six months to 31 July 2020 were 8.9p per ordinary share (2019:16.1p), a decrease of 44.7% over the equivalent period in the previous year.

The board has declared a second quarterly dividend of 6.8p per ordinary share, payable on 12 November 2020 to shareholders on the register at close of business on 9 October 2020. A Dividend Reinvestment Plan (DRIP) is available for this dividend for which the relevant Election Date is 23 October 2020 and the ex-dividend date is 8 October 2020.

The Merchants Trust continues to be an AIC ‘Dividend Hero’, an elite group of investment trust companies that have increased their dividends each year for 20 years or more. The company’s dividend has increased for 38 consecutive years and a high and growing yield remains a key objective of the company. The total distribution declared for the first half of 2020/21 is 13.6p, an increase of 0.7% on the same period last year (13.5p). The company’s revenue reserves remain strong, and as at 31 July 2020 revenue reserves were 22.6p per share (2019 – 28.8p).

Shareholders will be aware that there have been a large number of dividend cuts by listed companies, including those held within the investment portfolio, due to the pandemic. Taking these cuts into account, the income received by the company will be significantly lower both this year and probably next year compared to the last financial year. We would like to reassure shareholders that the company had more than one year's total dividend payment in revenue reserves at the year end, which the board is prepared to use to cover any shortfalls. The great advantage of investment trusts is that they can put away money in good times for use in bad times and the board considers that these are the kind of conditions in which reserves may be called upon.

Our manager has a balanced view on the outlook for dividends over the next 24 months and we have recently been encouraged by a number of companies reinstating deferred dividends or resuming dividend payments, although not all dividends will recover to their previous levels in the short term. We would encourage you to read his associated comments in the Investment Manager’s Review beginning on page 5.

Gearing
The company has used gearing in its capital structure for many decades and the board continues to believe that this has the potential to improve the long-term income and capital returns for shareholders. The amount of debt was reduced by £16 million at the end of January 2020. The decision was taken not with any foresight of the events which have occurred, but rather recognising the UK market had had a strong run and therefore it was prudent to ease back the debt level. This has lowered the company’s finance costs and will help the company withstand current pressures on investment performance.

Due to market falls since March 2020, the level of gearing as a percentage of net assets is now at similar levels to the end of December 2019 but remains within the range set out in our strategy. At 31 July 2020 debt amounted to £93 million (31 January 2020: £93 million, 31 July 2019: £111 million), or 20.9% of net assets (31 January 2020: 15.0%, 31 July 2019: 19.5%) Gearing primarily comprises long term loan notes maturing in 2052, secured bonds maturing in 2029 and a revolving credit facility maturing in 2022.

Material events and transactions

We held the 2020 Annual General Meeting later than usual, and without any shareholders present, on 23 June. All resolutions put to shareholders were passed on a poll. We hope that shareholders took the opportunity to watch the investment update video recorded by Simon Gergel and posted on our website.

A general meeting was also held in April at which approval for further share issuances was given.

The third quarterly dividend of 6.8p per share was paid on 11 March 2020 to shareholders on the register on 31 January 2020. A fourth interim dividend of 6.8p per share was paid on 29 May 2020 to shareholders on the register on 24 April 2020. The total dividend paid and declared for the year ended 31 January 2020 was 27.1p.

There were no related party transactions in the period.

Since the period end, the first quarterly dividend for the year ending 31 January 2021 of 6.8p per share was paid on 19 August 2020 to shareholders on the register on 10 July 2020.

Share issuances and buy backs
The board has a policy in place to (i) issue new shares when the company's ordinary shares are trading at a premium to NAV with debt at market value and (ii) buy back shares for holding in treasury to help dampen share price volatility when it is at a sustained discount to NAV. The renewal of this programme was approved by shareholders at the AGM in June this year. During the period under review the company has issued 6,016,423 new shares.

Performance attribution analysis against the FTSE All-Share Index	**Capital return %**	**Income return %**	**Total return %**
Return of Index	-19.1	1.3	-17.8
Relative return of portfolio	-7.7	0.0	-7.7
Return of portfolio	-26.8	1.3	-25.5
Impact of gearing on portfolio	-5.5	0.3	-5.2
Movement in market value of debt	-0.8	0.0	-0.8
Finance costs	-0.2	-0.1	-0.3
Management fee	-0.1	-0.1	-0.2
Administration expenses	0.0	-0.1	-0.1
Change in revenue reserve	-0.8	0.8	0.0
Other (including share issuances)	0.3	0.4	0.7
Change in net asset value per ordinary share (debt at market value)	-33.9	2.5	-31.4

Outlook

Notwithstanding current uncertainties, we remain long-term investors, confident of the future returns available from a diversified portfolio of UK shares which continues to offer good value compared to its global peers. Our manager continues to seek out strong, structurally well positioned companies, with the ability beyond the current situation to pay above-average dividend yields, and trading on attractive valuations. The investment team continues to actively review individual company exposures and risks, and will make associated portfolio adjustments where necessary, to manage income generated and to take advantage of exacerbated pricing anomalies. Looking further ahead, we are confident in the ability of Merchants' diversified portfolio, featuring a mixture of defensive and more cyclical companies, many of which are trading on low valuations, to meet our objectives over the long term.

Colin Clark
Chairman
199 Bishopsgate
London EC2M 3TY

30 September 2020

Principal Risks and Uncertainties

Since the publication of the Annual Report the board has kept in close contact with the manager and other third party service providers to understand their responses to the COVID-19 pandemic and in particular actions taken to mitigate the effects of the pandemic on the company and its business.

The principal risks and uncertainties facing the company, together with the board's controls and mitigation, are those described in the Annual Report for the year ended 31 January 2020 published in April 2020, under the headings below, as having the highest impact:

- Market decline and investment performance
- Emerging risks which continue to have elements of uncertainty, including those caused by the COVID-19 pandemic and Brexit preparations

The board's approach to mitigating these risks and uncertainties is set out in the explanation with the Risk Map in the Annual Report. In the board's view these will remain the principal risks and uncertainties for the six months to 31 January 2021.

Going Concern

The directors have considered the company's investment objective and capital structure and having noted that the portfolio is liquid as it consists mainly of securities which are readily realisable, and through continuous assessment of the company's financial covenants, have concluded that the company has adequate resources to continue in operational existence for the foreseeable future. The directors have also considered the risks and consequences of the COVID-19 pandemic and have concluded that the company has the ability to continue in operation and meet its objectives in the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

Responsibility Statements

The directors confirm to the best of their knowledge that:

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

Colin Clark
Chairman

30 September 2020

Enquiries:

For further information, please contact:

Allianz Global Investors GmbH, UK Branch
Stephanie Carbonneil
Head of Investment Trusts
Tel: 020 3246 7256

Investment Manager's Review

Economic and Market Background

The COVID-19 pandemic has been primarily a human tragedy, with millions of people directly affected globally, and hundreds of thousands of deaths. Our sympathies go out to everyone impacted.

Against that background, the last six months has seen some of the most volatile and challenging investment conditions of my career. Technology has enabled us to operate effectively, mostly from home, whilst continuing to have good access to company management teams and boards. But there have been rapid changes in the economic environment and extreme market reactions.

The year started with signs of rising economic activity, in the wake of the Conservative party winning a large majority at the general election in late 2019. We then saw the sharpest ever recorded contraction in the UK economy with a 20% drop in second quarter output, as large swathes of the economy were shut down by the Government. We also saw unprecedented government support packages including a furlough scheme covering over 9 million people, VAT deferral, business rate relief and new lending schemes. Central banks supported the economy, with the Bank of England cutting interest rates to a record low of 0.1%. Many businesses were under severe pressure, and we saw numerous dividend cuts and cancellations, as companies pre-emptively sought to shore up their finances, when faced with a potential demand or supply shock and liquidity stress. This trend was exacerbated by the Bank of England temporarily banning dividend payments for large banks and the insurance regulator also putting pressure on companies to be prudent.

Financial markets saw huge volatility in the wake of the pandemic and its economic impact, and in response to the dramatic government actions. The FTSE All-Share Index fell by a third, to a low point of 2728 on 23 March, before recovering to give a total return of -18% for the half year. The UK was one of the weaker global equity markets, with European shares falling significantly less and US stock markets up over the period. The US technology index gained almost 20%, as many of the tech giants, like Amazon and Netflix, were seen as beneficiaries of people being stuck at home.

Bond markets were no less dramatic, with bond prices appreciating and yields dropping in response to the economic shock and central bank stimulus. 10 year gilt yields ended the period at 0.1%, with the UK Government paying negative interest rates, meaning effectively that investors have to pay the government interest, on bonds of up to 7 year maturity. Events in the oil market were even more extreme, with the calamitous drop in demand leading, at one point, to negative oil prices, before the oil price staged a dramatic recovery amid OPEC production cuts. The gold price rose sharply, reflecting its position as a safe haven in times of stress and a potential inflation
hedge.

FTSE ALL-Share Index

There was a wide dispersion of returns at the sector and company level within the stock market, as might be expected in such an extreme environment. There were two broad themes driving sector returns. The first was the exposure of the sector to the effects of the pandemic. Those sectors and stocks least impacted, or even benefiting from behavioural changes, performed best, whilst those most impacted fell heavily. Among the larger sectors, mining, pharmaceuticals and food retail all produced positive returns, with mining benefiting from strong commodity prices, especially gold. The weakest sectors included travel & leisure and aerospace & defence, both directly impacted by disruption to travel and aviation. Banks also fell heavily, due to their economic sensitivity and the dividend ban. All three sectors fell by over 40%.

The second broad theme was a sharp polarisation in the market, exacerbated by uncertainty and low interest rates, between companies that are perceived to offer higher and more dependable growth compared to those that are more cyclical or face other challenges. There is always, rightly, a premium in the market for “quality” or “growth” companies over “value” companies, but this gap has widened appreciably, and risen above the extreme levels we saw during the tech bubble in 1999, according to Morgan Stanley research. This trend was visible in the underperformance of certain sectors that are less cyclical than the broad economy and would normally be expected to outperform in a recession, such as telecommunications and tobacco. But there was also a particularly wide range of individual stock performances.

Investment Performance

Merchants’ NAV fell significantly in the first half of the year, due to the sharp drop in the stock market, underperformance from the investment portfolio and the impact of financial gearing, which amplifies returns in either direction. A full attribution of NAV returns is shown on page 3. In this section of the report, we explain the performance of the investment portfolio, compared to the FTSE All-Share index benchmark.

After a period of very strong stock selection last year, the portfolio significantly underperformed the market in the first half of this year. The investment portfolio produced a total return of -25.5%, compared to a return of-17.8% on the FTSE All-Share index. There were two main reasons for the underperformance. First, as we explained in the annual report, at the start of the year the portfolio was positioned with a modest pro-cyclical bias. We were anticipating an improving economic environment, as political and Brexit uncertainty had largely been resolved after the general election of a Conservative government with a large majority. However, the COVID-19 pandemic and the lockdown dramatically changed the economic outlook and hit certain industries, such as travel, leisure and aerospace particularly hard. Second, the polarisation of the market led many of our modestly priced shares to underperform the market.

There was only a minor impact from industry selection, with underweight positions in the weak banks and oil producer sectors helping relative performance but offset by a large position in aerospace & defence, and an underweight in the strong pharmaceutical sector. Most of the underperformance came from stock selection, and the table shows the ten companies that had the biggest impact on relative performance, both positive and negative.

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

	Positive Stocks	Performance Impact %	Negative Stocks	Performance Impact %
Overweight (holding larger than index weight)	IG Group	0.6	Vistry	-0.9
	Stock Spirits	0.5	Meggitt	-0.9
	Antofagasta	0.5	National Express	-0.9
	Pennon	0.4	Hammerson	-0.7
	PZ Cussons	0.4	Senior	-0.7
	BHP	0.3	ITV	-0.6
			Landsec	-0.6
Underweight (zero holding or weight lower than index weight)	HSBC	0.9	AstraZeneca	-1.5
	Lloyds Bank	0.6	Reckitt Benckiser	-0.7
	Royal Dutch Shell	0.5	Rio Tinto	-0.7
	Compass	0.3		

Despite the overall result, there were some significant positive stock highlights. Spread betting firm IG Group reported record results as people at home actively traded in volatile financial markets, and IG’s shares produced a double-digit positive return. Two consumer goods companies, Stock Spirits and PZ Cussons, also performed well on the back of resilient demand for their products: vodka in Eastern Europe and handwash & soaps, respectively. Copper miner Antofagasta rose by a quarter and BHP outperformed, on the back of strong commodity prices, whilst the water utility Pennon also outperformed the weak market. The portfolio benefited from not owning certain companies where share prices fell heavily and pulled the stock market lower, notably the banks HSBC and Lloyds, and contract caterer Compass. An underweight stance in Shell was also helpful as the shares underperformed.

The biggest individual negative stock contributor was AstraZeneca, which is now the largest company in the UK stock market. Astrazeneca is not owned in the portfolio, partly due to its high valuation, but strong performance on the back of a promising drug pipeline and a further re-rating impacted the relative return. Most of the other top ten negative stock impacts came from individual companies that were exposed to the impacts of the pandemic. Housebuilder Vistry was hit by the temporary closure of building sites and concern over a weaker consumer outlook. Civil aerospace companies Meggitt and Senior were impacted by the sharp drop in flying hours and the resulting cuts to aircraft manufacturing schedules. National Express saw a sharp fall in demand from passengers and schools for its bus and coach services in the UK and internationally. Real estate companies Hammerson and Landsec were impacted by the forced shutdown of shops and shopping centres, which has accelerated the trend to online shopping and also led to many retail and restaurant failures. TV company ITV was impacted by a sharp drop in advertising sales as well as a forced shut down of its growing studio production business. Finally, not owning Reckitt Benckiser and Rio Tinto also held back relative performance as these shares outperformed.

Portfolio Changes

During this extraordinary period, our investment philosophy and process remain unchanged, although activity has been higher than usual. We continue to seek out fundamentally strong businesses, trading on attractive valuations which are expected to pay a dividend yield above or in line with the market average in the medium term. There were two major themes among purchases.

The first theme was to reduce the economic sensitivity of the portfolio and boost the income generation potential, by building up existing holdings in sound companies that were modestly priced but less cyclical than most, such as food ingredients producer Tate & Lyle, the tobacco companies Imperial Brands and BAT and the utilities National Grid and SSE.

We also introduced two telecommunications companies into the portfolio, Vodafone and BT. Telecommunications is an economically resilient activity, which can carry on throughout lockdown. We have had limited exposure to large UK telecommunications companies in the last few years, as there have been many pressures on the industry. However, we are starting to see fundamentals improve. Governments and regulators are keen to encourage investment in fibre networks and they are adjusting regulatory frameworks; companies are sharing infrastructure, such as mobile phone masts; and we are seeing greater consolidation. Share prices fell sharply in the first quarter of 2020, taking valuations to unusually attractive levels.

We added another high yielding company to the portfolio, Diversified Gas and Oil (DGOC). DGOC owns a large portfolio of gas producing wells, pipelines and associated assets in North America. These are generally mature but undermanaged assets that were seen as non-core by larger companies. The gas wells generate significant cash flows, much of which is hedged against commodity price volatility for several years into the future. The clear focus that DGOC management brings to these assets improves efficiency and prolongs well lives. This investment was partly financed by a switch from Royal Dutch Shell when that company cut its dividend.

The second theme was to take advantage of high volatility, to add to shares that we believe can come through this period with robust fundamentals, but which offered particular value and the potential for high total returns. Much of this activity involved building up existing positions as shares fell heavily during the period of peak uncertainty and included companies like DFS, Redrow, WPP, Inchcape and Tyman. We also introduced two new companies. One of these is Next plc. Next has an outstanding record among listed UK retailers, having migrated the business successfully from predominantly shop and catalogue based retailing towards online, whilst broadening the product range and earning consistently high returns and strong cash flows. Whilst current trading is under huge pressure from the lockdown and social distancing, Next has reacted in its characteristically decisive way to protect its financial position and reposition for the future. The bulk of profits now comes from the online business and the associated credit book. Next has the opportunity to grow that business both in the UK and internationally, including by selling third party brands.

The other new holding was housebuilder Bellway. This was a straight switch out of sector peer Vistry. Vistry was formed when Bovis Homes bought the housing activities of Galliford Try. Whilst we like the business, it was carrying quite a high level of debt, which increases the risk profile, so we switched into Bellway which has a similar valuation and fundamentals, but a stronger balance sheet.

Sales within the portfolio reflected similar themes to the share purchases. First, we sought to sell or reduce exposure to companies that might be particularly affected by the pandemic, or that are economically sensitive. We sold three companies completely. Informa is the world's largest exhibitions and events company, and we fear that this industry could be fundamentally impacted by new ways of working forced by restrictions on travel and social distancing. Prudential and Sirius Real Estate both have economic or financial cyclicality and we were able to sell them on reasonably full valuations. As well as these complete sales, we reduced exposure to National Express, where the short to medium term outlook for passenger volumes is unclear. We also reduced Royal Bank of Scotland (NatWest) and Morgan Advanced Materials to fund other cyclical investments where we had higher conviction.

Second, we took advantage of volatility to reduce positions in strong performing shares which offered more limited upside, or where our investment views have moderated. In particular, we took profits on Balfour Beatty, CRH and Antofagasta in the building materials, construction and natural resources sectors, as well as Pennon among the utilities. PZ Cussons and Stock Spirits were also reduced into strength.

We have taken advantage of high volatility to write a greater number of covered call options than in recent years. This has added modestly to income generation, although the benefits have been offset by a few option exercises, which gave rise to opportunity costs. We explain our approach to option writing in the Annual Report.

Outlook

The coronavirus pandemic makes the outlook especially hard to predict. The economy is starting to recover along a "last-in-first-out" playbook, with industries that shut down later and that can adopt social distancing, such as housebuilding, manufacturing and parts of retail, recovering quite rapidly. Whereas, those industries most affected, such as aviation, tourism and exhibitions, are only recovering slowly. There are signs that a second wave may be developing, which could slow or potentially reverse recent progress. On the other hand, there is potential for vaccines, better treatments, and improved testing and tracing, to make COVID-19 less of a threat, and allow most normal activity to recover more quickly.

Even if the coronavirus pandemic is contained, there will be lasting damage to the economy from rising unemployment and business insolvencies. There are other uncertainties to consider, such as whether a final Brexit deal will be negotiated with the EU and what form it will take, how the US-China relationship evolves, and what may happen before and after the US presidential elections.

Rather than ascribing too much confidence to any one scenario about how the economy will perform, we aim to maintain a balance in the portfolio between cyclical or financial stocks and defensive businesses. We are also trying to evaluate changes in consumer and corporate behaviour and, in particular, how the long-term prospects for specific industries has changed due to the pandemic.

Investment markets are not only influenced by the economic outlook but also by the financial stimulus provided by low interest rates and other policies. These are heavily distorting asset prices and valuations, including causing a huge distortion within the equity market. Investors are prepared to pay a massive premium for the perceived safety of higher "quality" and "growth" companies. Low interest rates do justify paying a higher premium than usual for a high growth company (those future profits are worth more in today's money). But this argument has been used to explain away not just a higher premium for "growth" companies, but also a lower absolute valuation of other "value" companies, which is not logical. The result of this is that perfectly sound businesses have been neglected and are trading at very attractive levels on a sensible medium-term view. We have identified many examples of companies that meet our investment criteria that are not structurally challenged yet traded at unusually cheap levels at the end of July.

There are a number of factors that could cause this polarisation of the market to reverse, potentially quite sharply. Any credible vaccine against the COVID-19 coronavirus, or signs that second wave pandemic fears are overdone, could raise optimism about a recovery in the economy, and could lead to a bounce in cyclical and "value" stocks. Even without that, there are plenty of signs suggesting worst case expectations in the UK stock market may be too pessimistic. Another possibility is that massive financial stimulus and de-globalisation trends could lead to inflationary pressures and lift bond yields, which have fuelled the crowding into "growth" stocks.

A long history of empirical evidence suggests paying high prices for equities tends to lead to earning low returns, and paying low prices delivers better returns. We saw a similar, though less extreme, situation in the first half of last year, which set up the conditions for strong outperformance from the portfolio in the second half.

One of the key objectives is to deliver a high income stream from the portfolio. That has been particularly challenging this year, as many companies had postponed, cancelled or cut dividends. Merchants' overall income was down 39% in the first half of the year. Fortunately, the year started from a strong position, with the dividend 110% covered by earnings last year and around a year's dividends in reserves. As explained above we have increased investment in many income paying companies and stepped up the level of call writing activity to enhance income generation. There are still many high yielding, sensibly priced companies in the market, including all of the top ten holdings, which made up 43% of the portfolio at the period end.

It remains hard to predict exactly how dividends will progress. In recent weeks we have been encouraged by a number of companies reinstating dividends that had been deferred from last year, including BAE Systems and Keller in this portfolio. Our central case is that dividends will increase significantly next year from this year's depressed level, but due to the timing of Merchants' year end, it will take a further year until dividends return close to "normal" for many of the portfolio holdings. The quantum of future dividend income is uncertain and the new "normal" level will be lower than the previous level for certain companies, which have reset their policy.

In conclusion, there has been an extreme polarisation within the equity market in recent months. By building a portfolio of lowly priced yet fundamentally strong businesses, with a balance of cyclical and defensive earning streams, we are confident that we can deliver both an attractive income for shareholders and good total returns, over the medium term. Any closing of the historically extreme gap between "growth" and "value" companies, should also lead to strong relative returns compared to broad market indices.

Simon Gergel
Allianz Global Investors

THE MERCHANTS TRUST PLC

Twenty Largest Equity Holdings as at 31 July 2020

Name	Value £'000s	% of Total Assets	Principal Activities
GlaxoSmithKline	34,056	6.66	Pharmaceuticals & Biotechnology
British American Tobacco	25,245	4.94	Tobacco
Imperial Brands	24,116	4.72	Tobacco
BAE Systems	20,800	4.07	Aerospace & Defence
SSE	20,491	4.01	Electricity
National Grid	19,575	3.83	Gas, Water & Multiutilities
IG Group Holdings	19,314	3.78	Financial Services
BHP	18,898	3.70	Mining
Tate & Lyle	17,908	3.50	Food Producers
St. James's Place	17,898	3.50	Life Insurance
Royal Dutch Shell B	17,058	3.34	Oil & Gas Producers
Legal & General	16,149	3.16	Life Insurance
Barclays	15,788	3.09	Banks
Land Securities Group	15,205	2.97	Real Estate Investment Trusts
Standard Life Aberdeen	13,900	2.72	Financial Services
WPP	13,490	2.64	Media
BP	13,255	2.59	Oil & Gas Producers
Stock Spirits Group	12,522	2.45	Beverages
Tyman	11,118	2.18	Construction & Materials
Vodafone Group	10,632	2.08	Mobile Telecommunications
	357,418	69.93	

Portfolio Analysis as at 31 July 2020

Sector	Value £'000s	%** of Total Assets
Financials	113,631	22.23
Consumer Goods	107,369	21.01
Industrials	91,802	17.96
Utilities	48,712	9.53
Consumer Services	42,384	8.29
Oil & Gas	34,652	6.78
Health Care	34,056	6.66
Basic Materials	26,450	5.18
Telecommunications	19,011	3.72
Net current assets	(6,970)	(1.36)
	511,097	100.00

** Total Assets include current liabilities

As at 31 July 2020 call options were written over 5.28% of the portfolio (valued at strike price). During the period, income generated from call options amounted to £418,339.

<u>**THE MERCHANTS TRUST PLC**</u>

Summary of Unaudited Results

INCOME STATEMENT
For the six months ended 31 July 2020

	Revenue £'000s	**Capital £'000s**	**Total Return £'000s**
			(Note 1)
Losses on investments held at fair value through profit or loss	-	(194,751)	(194,751)
Losses on foreign currencies	-	(7)	(7)
Income from investments	11,624	-	11,624
Other income	424	-	424
Investment management fee	(345)	(641)	(986)
Administrative expenses*	(665)	(1)	(666)
Profit (loss) before finance costs and taxation	11,038	(195,400)	(184,362)
Finance costs: interest payable and similar charges	(629)	(1,105)	(1,734)
Profit (loss) on ordinary activities before taxation	10,409	(196,505)	(186,096)
Taxation	(19)	-	(19)
Profit (loss) after taxation attributable to ordinary shareholders	10,390	(196,505)	(186,115)
Earnings (loss) per ordinary share (Note 4) (basic and diluted)	8.92p	(168.76p)	(159.84p)

BALANCE SHEET
As at 31 July 2020

	£'000s
Fixed Assets	
Investments held at fair value through profit or loss	518,067
Net current liabilities	(6,970)
Total assets less current liabilities	511,097
Creditors: amounts falling due after more than one year	(66,678)
Total net assets	444,419
Called up share capital	29,724
Share premium account	75,984
Capital redemption reserve	293
Capital reserve	311,604
Revenue reserve	26,814
Equity shareholders' funds	444,419
Net asset value per ordinary share	373.8p

The net asset value is based on 118,894,887 ordinary shares in issue at 31 July 2020.

*Administrative expenses in 2020 include the London Stock Exchange block listing fee of £155,000.

INCOME STATEMENT
For the six months ended 31 July 2019

	Revenue £'000s	Capital £'000s	Total Return £'000s
			(Note 1)
Gains on investments at fair value through profit or loss	-	29,429	29,429
Income from investments	19,429	-	19,429
Other income	195	-	195
Investment management fee	(408)	(757)	(1,165)
Administrative expenses	(417)	(1)	(418)
Profit before finance costs and taxation	18,799	28,671	47,470
Finance costs: interest payable and similar charges	(1,164)	(2,122)	(3,286)
Profit on ordinary activities before taxation	17,635	26,549	44,184
Taxation	-	-	-
Profit after taxation attributable to ordinary shareholders	17,635	26,549	44,184
Earnings per ordinary share (Note 4) (basic and diluted)	16.13p	24.29p	40.42p

BALANCE SHEET
As at 31 July 2019

	£'000s
Fixed Assets	
Investments at fair value through profit or loss	656,137
Net current assets	24,084
Total assets less current liabilities	680,221
Creditors: amounts falling due after more than one year	(110,077)
Total net assets	570,144
Called up share capital	27,507
Share premium account	39,699
Capital redemption reserve	293
Capital reserve	470,945
Revenue reserve	31,700
Equity shareholders' funds	570,144
Net asset value per ordinary share	518.2p

The net asset value is based on 110,028,464 ordinary shares in issue at 31 July 2019.

BALANCE SHEET
As at 31 January 2020

	£'000s
Fixed Assets	
Investments at fair value through profit or loss	704,446
Net current liabilities	(15,260)
Total assets less current liabilities	689,186
Creditors: amounts falling due after more than one year	(66,652)
Total net assets	622,534
Called up share capital	28,220
Share premium account	54,092
Capital redemption reserve	293
Capital reserve	508,109
Revenue reserve	31,820
Equity shareholders' funds	622,534
Net asset value per ordinary share	551.5p

The net asset value is based on 112,878,464 ordinary shares in issue at 31 January 2020.

THE MERCHANTS TRUST PLC

STATEMENT OF CHANGES IN EQUITY

	Called Up Share Capital £'000s	Share Premium Account £'000s	Capital Redemption Reserve £'000s	Capital Reserve £'000s	Revenue Reserve £'000s	Total £'000s
Six months ended 31 July 2020						
Net assets at 1 February 2020	28,220	54,093	293	508,109	31,820	622,535
Revenue profit	-	-	-	-	10,390	10,390
Dividends on ordinary shares (Note 3)	-	-	-	-	(15,443)	(15,443)
Unclaimed Dividends	-	-	-	-	47	47
Capital loss	-	-	-	(196,505)	-	(196,505)
Shares issued during the period	1,504	21,891	-	-	-	23,395
Net assets at 31 July 2020	29,724	75,984	293	311,604	26,814	444,419
Six months ended 31 July 2019						
Net assets at 1 February 2019	27,182	33,718	293	444,396	28,338	533,927
Revenue profit	-	-	-	-	17,635	17,635
Dividends on ordinary shares (Note 3)	-	-	-	-	(14,273)	(14,273)
Capital profit	-	-	-	26,549	-	26,549
Shares issued during the period	325	5,981	-	-	-	6,306
Net assets at 31 July 2019	27,507	39,699	293	470,945	31,700	570,144

THE MERCHANTS TRUST PLC

CASH FLOW STATEMENT

	Six Months ended 31 July 2020 £'000s	Six Months ended 31 July 2019 £'000s
Operating activities		
(Loss) profit before finance costs and taxation	(184,362)	47,470
Less: Losses (gains) on investments at fair value	194,751	(29,429)
Less: Losses on foreign currency	7	-
Purchase of fixed asset investments held at fair value through profit or loss	(131,577)	(81,967)
Sales of fixed asset investments held at fair value through profit or loss	121,259	79,035
Increase in other receivables	(955)	(1,600)
Decrease in other payables	(285)	(26)
Less: Overseas tax suffered	(19)	-
Net cash (outflow) inflow from operating activities	**(1,181)**	**13,483**
Financing activities		
Interest paid	(1,712)	(3,394)
Dividends paid on cumulative preference stock	(21)	(21)
Dividends paid on ordinary shares	(15,443)	(14,273)
Unclaimed dividends	47	-
Share issue proceeds	25,566	6,306
Net cash inflow (outflow) from financing activities	**8,437**	**(11,382)**
Increase in cash and cash equivalents	**7,256**	**2,101**
Cash and cash equivalents at the start of the period	10,546	22,952
Effect of foreign exchange rates	(7)	-
Cash and cash equivalents at the end of the period	17,795	25,053
Composed of:		
Cash at bank	17,795	25,053

Notes to the Financial Statements

Note 1 – Financial Statements

The half-yearly financial report has been neither audited nor reviewed by the company's auditors. The financial information for the year ended 31 January 2020 has been extracted from the statutory financial statements for that year which have been delivered to the Registrar of Companies. The auditors' report on those financial statements was unqualified and did not contain a statement under section 498 of the Companies Act 2006.

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

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

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

Note 2 – Accounting Policies

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

The condensed set of financial statements has been prepared on a going concern basis in accordance with FRS 102 and FRS 104, 'Interim Financial Reporting' and the Statement of Recommended Practice – 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' ('SORP'). The impact of COVID-19 has been thoroughly considered and the directors have concluded that there are no material uncertainties related to going concern. They have also been prepared on the assumption that approval as an investment trust will continue to be granted.

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

Note 3 – Dividends on Ordinary Shares

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

	Six months ended 31 July 2020 £'000s	**Six months ended 31 July 2019 £'000s**
Third quarterly dividend 6.8p paid 11 March 2020 (2019: 6.5p)	7,649	7,067
Fourth quarterly dividend 6.8p paid 29 May 2020 (2019: Final 6.6p)	7,794	7,206
	15,443	14,273

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

	Six months ended 31 July 2020 £'000s	Six months ended 31 July 2019 £'000s
First quarterly dividend 6.8p paid 19 August 2020 (2019: 6.7p)	8,085	7,372
Second quarterly dividend 6.8p payable 12 November 2020 (2019: 6.8p)	8,085	7,482
	16,170	14,854

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

Note 4 – Earnings per Ordinary Share

The earnings per ordinary share is based on a weighted number of shares 116,440,988 (31 July 2019: 109,323,492) ordinary shares in issue.

Note 5 – Fair Value Hierarchy

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

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

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

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

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

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

As at 31 July 2020, the financial assets at fair value through profit and loss of £517,938,000 (31 July 2019: £656,050,000; 31 January 2020: £704,418,000) are categorised as follows:

	Level 1 £'000s	Level 2 £'000s	Level 3 £'000s	Total £'000s
Financial assets at fair value through profit or loss at 31 July 2020				
Equity investments	518,063	-	-	518,063
Financial instruments	-	-	4	4
Derivative financial instruments - written call options	-	(129)	-	(129)
	518,063	(129)	4	517,938
Financial assets at fair value through profit or loss at 31 July 2019				
Equity investments	656,133	-	-	656,133
Financial instruments	-	-	4	4
Derivative financial instruments - written call options	-	(87)	-	(87)
	656,133	(87)	4	656,050
Financial assets at fair value through profit or loss at 31 January 2020				
Equity investments	704,442	-	-	704,442
Financial instruments	-	-	4	4
Derivative financial instruments - written call options	-	(28)	-	(28)
	704,442	(28)	4	704,418

For exchange listed equity investments the quoted price is either the bid price or the last traded price depending on the convention of the relevant exchange. For written options the value of the option is marked to market based on traded prices. Financial instruments valued using valuation techniques level 3 have, in the absence of relevant trading prices or market data, been valued based on the directors' best estimate.

Note 6 – Status of the Company

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

Note 7 – Transactions with the Investment Manager and related parties

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

There are no other identifiable related parties as at 31 July 2020, 31 July 2019 and 31 January 2020.

The half-yearly financial report will be sent to shareholders at the end of September 2020 and will be available to members of the public from the company's registered office at 199 Bishopsgate, London EC2M 3TY or by calling the Investor Services Helpline on 0800 389 4696.