

The Merchants Trust PLC

Interim Report for the six months ended 31 July 2006



Investment Objective

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

Benchmark

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

Trust Performance

Revenue	For the six months ended 31 July		
	2006	2005	% change
Revenue	£14.59m	£13.68m	+6.7
Available for Ordinary Dividend	£12.13m	£11.33m	+7.1
Earnings per Ordinary Share	11.85p	11.10p	+6.7
Dividend declared per Ordinary Share	9.80p	9.30p	+5.4
Assets	At	At	% change
	31 July 2006	31 January 2006	
Total Net Assets	£548m	£515m	+6.4
Ordinary Share price	476.0p	451.0p	+5.5
Net Asset Value per Ordinary Share	528.1p	504.1p	+4.8
Discount of Ordinary Share price to Net Asset Value	9.9%	10.5%	
Net Asset Value per Ordinary Share (with debt at market value)	498.1p	467.1p	+6.6
Discount of Ordinary Share price to Net Asset Value (with debt at market value)	4.4%	3.4%	

The discount represents the difference between the share price and the Net Asset Value per share, expressed as a percentage of the Net Asset Value per share.

Interim Report

for the six months ended 31 July 2006

Highlights

- Dividends of 9.8p per share declared for the first six months, up 5.4%.
- Net Asset Value of 528.1p per share, up 4.8% compared with 2.9% rise in the FTSE 100 Index.
- Historic dividend yield of 4.0% net at 484p per share on 18 September 2006.

Interim Results

Earnings per share

In the first six months of the current year, earnings have risen by 6.7% to 11.85p per share. As in previous years, we expect dividend receipts to have been weighted towards the first half of the current financial year.

Interim Dividends

The Board has declared a second quarterly dividend of 4.90p per share, payable on 14 November 2006 to shareholders on the register at close of business on 13 October 2006. The total distribution declared for the first half of 2006/7 is 9.80p net, an increase of 5.4% when compared with the same period last year.

Net Asset Value

The net asset value per ordinary share was 528.1p at 31 July 2006. This represents an increase of 4.8% when compared with the equivalent figure at 31 January 2006 – the end of the last financial year. Before taking account of the impact of the Trust's borrowings, the underlying rise in the Trust's total assets, excluding expenses allocated to capital, was 4.5%. Over the same period the FTSE 100 Index rose by 2.9%, whilst the FTSE 350 Higher Yield Index rose by 1.7%.

New Shares

On 29 June 2006 1,655,941 new ordinary shares were issued to 320 former members of Allianz Dresdner Income Growth Investment Trust plc, a split capital investment trust which reached the end of its planned life.

New Director

The Directors are pleased to welcome James Sassoon who was appointed to the Board on 11 July. James is currently The Chancellor's Representative for Promotion for the City at HM Treasury. From 2002 to 2006 he was Managing

Director of HM Treasury's Finance and Industry Directorate and a Member of the Treasury Board. Before that, he had worked at UBS Warburg since 1987 where he held a number of positions, including Vice Chairman, Investment Banking. He is a chartered accountant and he will succeed Joe Scott Plummer as Chairman of the Audit Committee.

Prospects

The direction of future interest rate changes remains uncertain and is likely to have a significant effect on short term stock market sentiment. The uncertainty is driven by the opposing forces of higher inflationary pressures and concern over the sustainability of economic growth. Inflationary pressures seem to be driven largely by rising energy and commodity costs which might be expected to moderate over time although the risk is that these flow through to the wider economy through retail prices or higher wage increases. Set against this is the risk of slower economic growth which would normally counter inflationary pressures. The growth threat seems the greater risk at present as consumers face rising utility bills and taxes and there has been a modest rise in unemployment. However the UK is also benefiting from higher total employment and a robust corporate sector. The progress of the housing market, currently showing some strength, remains key to consumer confidence.

Despite the economic uncertainty, the corporate sector looks robust with companies generally having strong balance sheets and reporting good profit and cashflow growth. This is leading to broadly based dividend growth. There are also a number of companies making special dividend payments, especially in the natural resources sector, reflecting buoyant trading conditions in their industries. Although some of these payments may not be sustainable in the longer term, the overall outlook for dividend growth looks healthy.

Market valuations also look supportive for long term investment, especially given the low level of bond yields by historic standards. Takeover activity has continued at a high level, aided by low interest rates, and provides some further underpinning to the market.

Hugh Stevenson
Chairman

155 Bishopsgate
London EC2M 2AD

18 September 2006

Fund Managers' Report

Economic and Market Background

The UK economy was relatively steady in the period with various factors offsetting each other. A small tick up in unemployment was counteracted by gains in the level of total employment. Similarly, slowing government expenditure was offset by a recovery in the housing market. Whilst central banks around the world increased interest rates in response to rising inflation and recovering economic growth, the Monetary Policy Committee of the Bank of England held off from raising rates until early August, just after the end of the half year.

The stock market followed global trends closely. After making steady gains for the first three months, there was a sharp sell off in May followed by a gentle recovery which started in mid June. The May decline coincided with falls in many asset classes, notably higher risk investments such as emerging market equities and commodities, in response to interest rate and inflation concerns. By the end of the period, the market was back in positive territory with a capital return on the FTSE 100 index of 2.9% and a return of 1.7% on the FTSE 350 Higher Yield Index.

The relatively low level of bond yields and high availability of credit continued to fuel private equity takeover activity. Strong balance sheets and renewed confidence also encouraged a number of corporates to launch takeover approaches, often in competition with private equity vehicles. This corporate activity lent support to the overall market and helped the portfolio in the half year. Further support for the market came from strong dividend growth.

Another feature of the market was the re-emergence of several fund raisings or rights issues after a prolonged period when companies have been more generally returning cash to shareholders via buy-backs or increased dividends. Companies like Resolution, buying Abbey National's closed life business, or Premier Foods, buying Campbells', announced significant share issues to a receptive market.

Many of the best performing areas were relatively defensive sectors like food retail, real estate, tobacco and utilities. The best performing sector was the small industrial metals sector, driven by global steel industry consolidation, followed by industrial transport which saw bids for airport operator BAA and Associated British Ports. The worst performing areas included several cyclical sectors such as automobiles and parts, leisure goods, technology hardware and software. A poor performance by Smith & Nephew held back the health care equipment sector.

Portfolio Changes

Many of the largest companies continue to trade at attractive valuations, with high yields and growing dividends. The Trust added to these holdings, with purchases of Royal Dutch Shell, Vodafone, Barclays and GlaxoSmithKline. Elsewhere, several higher growth sectors now look good value compared to the past with share prices, in a number of cases, no longer adequately reflecting the long term growth opportunities of their businesses. The Trust sought to take advantage of this where there were stocks with reasonable dividend yields and the opportunity for above average profit and dividend growth in the long term. Companies in this category included the media businesses Reed Elsevier and Reuters.

Sales reflected a variety of different factors. Holdings in the smaller banks, Bradford & Bingley and Alliance & Leicester, were trimmed after rallying on takeover speculation. The real estate sector saw investor demand driving property yields down significantly. The position in Land Securities was reduced partly on concern over the outlook for retail rental growth as retailers coped with rising costs, relatively muted consumer spending and a gradual shift to the internet. Some profits were taken on Rio Tinto in the mining sector where dividend yields have become less attractive.

Elsewhere, money was divested from companies, including Taylor Woodrow and Tomkins, exposed to a possible US consumer slowdown. This seems more likely after successive rises by the Federal Reserve pushed interest rates to over 5%.

Corporate activity was also a feature in the portfolio. BAA was taken over, EMI attempted to merge with Warner Music and Boots merged with Alliance Unichem. All three positions were sold in the period. The takeover of Associated British Ports completed after the period end.

Simon Gergel
RCM (UK) Limited

Income Statement

	For the six months ended 31 July 2006		
	Revenue £'000s	Capital £'000s	Total Return £'000s
			(Note 2)
Net gains on investments held at fair value	—	27,002	27,002
Income from investments	14,446	—	14,446
Other income	142	—	142
Investment management fee	(468)	(869)	(1,337)
Expenses of administration	(291)	(3)	(294)
Net return before finance costs and taxation	13,829	26,130	39,959
Finance costs: interest payable and similar charges	(1,699)	(3,116)	(4,815)
Return on ordinary activities before taxation	12,130	23,014	35,144
Taxation	—	—	—
Return attributable to Ordinary Shareholders	12,130	23,014	35,144
Return per Ordinary Share (Note 1) (basic and diluted)	11.85p	22.47p	34.32p

Balance Sheet

	As at 31 July 2006 £'000s
Investments held at fair value through profit or loss	662,034
Net current (liabilities) assets	(697)
Total Assets Less Current Liabilities	661,337
Creditors – amounts falling due after more than one year	(113,375)
Total Net Assets	547,962
Called up Share Capital	25,940
Share Premium Account	7,527
Capital Redemption Reserve	56
Capital Reserves: Realised	376,269
Unrealised	115,958
Revenue Reserve	22,212
Equity Shareholders' Funds	547,962
Net Asset Value per Ordinary Share	528.1p

The Net Asset Value is based on
103,759,877 Ordinary Shares in issue

For the six months ended 31 July 2005			For the year ended 31 January 2006		
Revenue £'000s	Capital £'000s	Total Return £'000s	Revenue £'000s	Capital £'000s	Total Return £'000s
		(Note 2)			(Note 2)
–	36,873	36,873	–	96,792	96,792
13,586	–	13,586	24,358	–	24,358
90	–	90	356	–	356
(391)	(726)	(1,117)	(824)	(1,530)	(2,354)
(272)	–	(272)	(622)	(6)	(628)
13,013	36,147	49,160	23,268	95,256	118,524
(1,682)	(3,124)	(4,806)	(3,414)	(6,219)	(9,633)
11,331	33,023	44,354	19,854	89,037	108,891
–	–	–	–	–	–
11,331	33,023	44,354	19,854	89,037	108,891
11.10p	32.34p	43.44p	19.44p	87.20p	106.64p

As at 31 July 2005 £'000s	As at 31 January 2006 £'000s
564,290	621,948
8,722	6,118
573,012	628,066
(113,336)	(113,353)
459,676	514,713
25,526	25,526
40	40
56	56
335,254	351,107
77,972	118,105
20,828	19,879
459,676	514,713
450.2p	504.1p

The Net Asset Value is based on
102,103,936 Ordinary Shares in issue

The Net Asset Value is based on
102,103,936 Ordinary Shares in issue

Reconciliation of Movements in Shareholders' Funds

	Called up Share Capital £'000s	Share Premium Account £'000s
Six months ended 31 July 2006		
Net Assets at 31 January 2006	25,526	40
Revenue Return	—	—
Dividends on Ordinary Shares	—	—
Capital Return	—	—
Shares issued during the year	414	7,487
Net Assets at 31 July 2006	25,940	7,527
 Six months ended 31 July 2005		
Net Assets at 31 January 2005	25,526	40
Revenue Return	—	—
Dividends on Ordinary Shares	—	—
Capital Return	—	—
Net Assets at 31 July 2005	25,526	40
 Year ended 31 January 2006		
Net Assets at 31 January 2005	25,526	40
Adjustment to record investments at bid value	—	—
Revenue Return	—	—
Dividends on Ordinary Shares	—	—
Capital Return	—	—
Net Assets at 31 January 2006	25,526	40

Capital Redemption Reserve £'000s	Capital Reserves Realised £'000s	Capital Reserves Unrealised £'000s	Revenue Reserve £'000s	Total £'000s
56	351,107	118,105	19,879	514,713
–	–	–	12,130	12,130
–	–	–	(9,797)	(9,797)
–	25,161	(2,147)	–	23,014
–	1	–	–	7,902
56	376,269	115,958	22,212	547,962
56	322,240	57,963	18,686	424,511
–	–	–	11,331	11,331
–	–	–	(9,189)	(9,189)
–	13,014	20,009	–	33,023
56	335,254	77,972	20,828	459,676
56	322,240	57,963	18,686	424,511
–	–	(28)	–	(28)
–	–	–	19,854	19,854
–	–	–	(18,661)	(18,661)
–	28,867	60,170	–	89,037
56	351,107	118,105	19,879	514,713

Cash Flow Statement

for the six months ended 31 July 2006 and comparative periods

	Six months to 31 July 2006 £'000s	Six months to 31 July 2005 £'000s	Year to 31 January 2006 £'000s
Net cash inflow from operating activities	11,789	11,966	22,806
Servicing of Finance			
Interest paid	(4,780)	(4,774)	(9,557)
Dividends paid on Preference Stock	(21)	(21)	(64)
Net cash outflow on servicing of finance	(4,801)	(4,795)	(9,621)
Financial investment			
Purchase of fixed asset investments	(128,364)	(79,751)	(139,141)
Sale of fixed asset investments	124,557	87,429	146,799
Net cash (outflow) inflow from investing activities	(3,807)	7,678	7,658
Equity dividends paid	(9,797)	(9,189)	(18,661)
Net cash (outflow) inflow before financing	(6,616)	5,660	2,182
Financing			
Cash transferred from Allianz Dresdner Income Growth Investment Trust plc	909	—	—
(Decrease) increase in cash	(5,707)	5,660	2,182

Twenty Largest Equity Holdings

as at 31 July 2006

	Valuation £'000s	% of Total Assets*	Principal Activities
Royal Dutch Shell	62,548	9.46	Oil and Gas Production
BP	51,600	7.80	Oil and Gas Production
HSBC Holdings	46,996	7.11	Banking
GlaxoSmithKline	39,395	5.96	Pharmaceuticals
Vodafone	27,110	4.10	Telecommunications
Royal Bank of Scotland	26,637	4.03	Banking
Barclays	22,922	3.47	Banking
HBOS	22,414	3.39	Banking
Lloyds TSB	21,782	3.29	Banking
BT	19,614	2.97	Telecommunications
Anglo American	16,539	2.50	Mining
Scottish Power	13,640	2.06	Electricity
Lonmin	13,437	2.03	Mining
Scottish & Southern Energy	12,997	1.97	Electricity
Legal & General	11,185	1.69	Life and General Insurance
Tesco	10,390	1.57	Food & Drug Retailer
Reed Elsevier	10,003	1.51	Media
Rio Tinto	9,818	1.48	Mining
Smiths Group	9,776	1.48	Aerospace & Defence
Drax	9,029	1.37	Electricity
	<u>457,832</u>	<u>69.24</u>	

*Total assets include current liabilities.

Portfolio Analysis

as at 31 July 2006

	UK %	Other %	Total %
Listed equities	100.1	—	100.1
Net current liabilities	(0.1)	—	(0.1)
Total Assets	<u>100.0</u>	<u>—</u>	<u>100.0</u>

Notes

Note 1

The return per Ordinary Share is based on a weighted average number of shares in issue during the period of 102,396,699 shares (31 July 2005 – 102,103,936; 31 January 2006 – 102,103,936).

Note 2

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

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

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

Included in the cost of investments are transaction costs on purchases which amounted to £866,297 (31 July 2005 – £492,649; 31 January 2006 – £888,492) and transaction costs on sales which amounted to £203,769 (31 July 2005 – £176,898; 31 January 2006 – £302,257).

On 30 June 2006 investments and cash amounting to £7.0m and £0.9m respectively were transferred into the Company following the reconstruction of Allianz Dresdner Income Growth Investment Trust plc, as consideration for 1,655,941 new Ordinary Shares issued at 477.1p.

Note 3

In accordance with FRS 21 'Events after the Balance Sheet Date', the final dividend payable on Ordinary Shares is recognised as a liability when approved by shareholders. Interim dividends are recognised only when paid.

Dividends paid on Ordinary Shares in respect of earnings for each period are as follows:

	Six months to 31 July 2006 £'000s	Six months to 31 July 2005 £'000s	Year to 31 January 2006 £'000s
Third Interim dividend 4.50p paid 17 February 2005	–	4,594	4,594
Final dividend 4.50p paid 11 May 2005	–	4,595	4,595
First Interim dividend 4.60p paid 18 August 2005	–	–	4,697
Second Interim dividend 4.70p paid 10 November 2005	–	–	4,799
Third Interim dividend 4.80p paid 17 February 2006	4,901	–	–
Final dividend 4.80p paid 10 May 2006	4,901	–	–
Uncollected dividends from prior years	(5)	–	(24)
	9,797	9,189	18,661

Note 3 (continued)

Dividends payable at the period end are not recognised as a liability under FRS 21 'Events After the Balance Sheet Date'. Details of these dividends are set out below.

	Six months to 31 July 2006 £'000s	Six months to 31 July 2005 £'000s	Year to 31 January 2006 £'000s
Third Interim dividend 4.80p paid 17 February 2006	–	–	4,901
Final dividend 4.80p paid 10 May 2006	–	–	4,901
First Interim dividend 4.90p payable 16 August 2006 (2005 – 4.60p)	5,084	4,697	–
Second Interim dividend 4.90p payable 14 November 2006 (2005 – 4.70p)	5,084	4,799	–

The second interim dividend noted above is based on the number of shares at period end. However, the dividend subsequently paid will be based on the number of shares in issue on the record date and will reflect any purchase or cancellations of shares by the Company settled subsequent to the period end.

Note 4

The interim statement has neither been audited nor reviewed by the Company's auditors. The financial information for the year ended 31 January 2006 has been extracted from the statutory accounts for that year which have been delivered to the Registrar of Companies. The Auditor's report on those accounts was unqualified and did not contain a statement under either Section 237(2) or Section 237 (3) of the Companies Act 1985.

Investor Information

Directors

H A Stevenson (Chairman)
P J Scott Plummer (Chairman – Audit Committee)
Sir John Banham
R A Barfield
Sir Bob Reid
J M Sassoon

Managers

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155 Bishopsgate
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Telephone: 020 7859 9000
Represented by Simon Gergel
Allianz Global Investors is the marketing name of RCM (UK) Limited, which is authorised and regulated by the Financial Services Authority.

Secretary and Registered Office

Kirsten Salt BA (Hons) ACIS
155 Bishopsgate
London EC2M 3AD
Telephone: 020 7065 1513
Registered Number: 28276

Registrars

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00 44 20 8639 2157
Email: ssd@capitaregistrars.com

Results

Half-year announced in September.
Full year announced in March.
Reports and Accounts posted to shareholders in April.
Annual General Meeting held in May.

Ordinary Dividends 2006/2007

	Dividend	Payment Date
First interim	4.9p	17 August 2006
Second interim	4.9p	14 November 2006
Third interim		February 2007
Final		May 2007

Website

Further information about the Trust is available on the Managers' website:
www.allianzglobalinvestors.co.uk.

Net Asset Value

The Net Asset Value of the Ordinary Shares is calculated weekly and the top ten holdings are announced monthly. They are published on the London Stock Exchange Regulatory News Service. They are also available from Allianz Global Investors, via Investor Services on 0800 317 573 or on the Managers' website:
www.allianzglobalinvestors.co.uk.

Share Plan

Investors are able to buy shares in the Company at low cost through the Allianz Global Investors Share Plan. Investments can be in the form of a regular monthly contribution, an individual lump sum or a combination of the two. There is an arrangement for the reinvestment of dividends as well as facilities for selling and switching. Full details of the Share Plan are available from Allianz Global Investors either via Investor Services on 0800 317 573 or on the Managers' website:
www.allianzglobalinvestors.co.uk, or alternatively, please use the FREEPOST card enclosed to request any literature you may require.

Maxi ISA and PEP Transfer

Shareholders can invest in the shares of the Company through the Allianz Global Investors Investment Trust Maxi ISA and PEP Transfer. Full details are available from Allianz Global Investors, via Investor Services on 0800 317 573 or on the Managers' website:
www.allianzglobalinvestors.co.uk, or alternatively, please use the enclosed FREEPOST card to request any literature you may require.

Shareholders' Enquiries

Capita Registrars maintain the share register. In the event of queries regarding shareholdings, lost certificates, registered details, etc., shareholders should contact the registrars on 0870 162 3100 or, if telephoning from overseas 0044 20 8639 2157, or by e-mail: ssd@capitaregistrars.com. Changes of name or address must be notified to the registrars in writing.

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

AITC Membership

The Company is a member of the Association of Investment Trust Companies.

Category: UK Growth & Income.

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