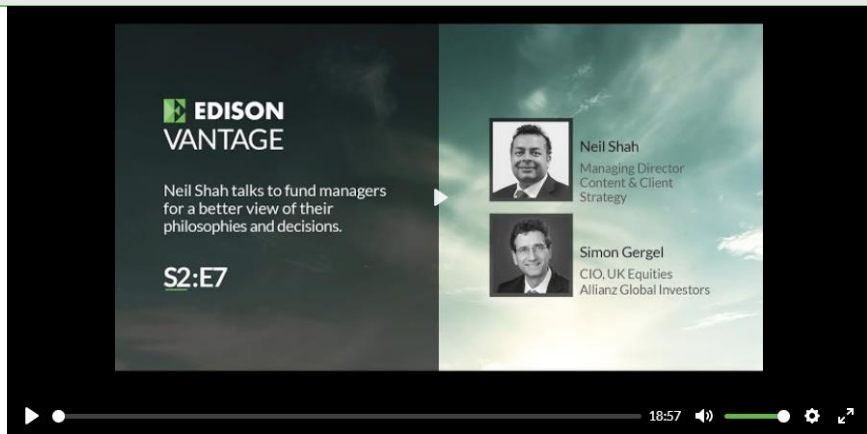


# The Merchants Trust

Higher dividends for the last 41 years

Simon Gergel at Allianz Global Investors has managed The Merchants Trust (MRCH) for the last 17 years. His disciplined fundamental investment process has proved to be a successful strategy as MRCH is ahead of its benchmark over the last one, three, five and 10 years. The trust's NAV total returns also rank top out of 20 funds in the AIC UK Equity Income sector over the last three years. MRCH has a commendable dividend track record, having increased its annual payments for the last 41 consecutive years, and its yield is consistently above the level of the UK market. Gergel's, and the board's, confidence in the positive prospects for the UK market is illustrated by a higher level of gearing; the remainder of the trust's debt facility was drawn down in November 2022.

## March 2023 Vantage interview with Simon Gergel



Source: MRCH, Edison Investment Research

## The analyst's view:

- MRCH's positive long-term performance track record is notable given investors' preference for higher-valued growth stocks for most of the last decade.
- The UK market is looking very attractively valued on both an absolute and relative basis. Gergel is encouraged by the investment opportunities in the UK given the wide range of valuation multiples available.
- A significant improvement in MRCH's revenue income since the pandemic-induced dividend cuts means the trust's FY23 dividend is fully covered.
- MRCH is successfully delivering on its dual mandate of income and capital growth from a relatively concentrated portfolio of 53 names. Around 95% of the fund is invested in UK companies with the balance in European businesses.

## Regular share issuance indicates robust demand

There is strong demand for MRCH's shares. In FY23 (ending 31 January), its share base was increased by around 10%, raising c £69.3m. So far in FY24, a further c 3% of the share base has been issued, raising c £25.3m. The trust regularly trades above NAV: the latest 1.2% premium compares with an average 0.7% premium over the last 12 months, an average 0.5% premium over the last three years and an average 0.1% discount over the last five years.

## Investment trusts UK equity income

25 April 2023

**Price** 579.0p  
**Market cap** £837m  
**Total assets** £796m

NAV\* 572.0p

Premium to NAV 1.2%

\*Including income. At 21 April 2023.

Dividend yield 4.8%

Shares in issue 144.5m

Code MRCH

Primary exchange LSE

AIC sector UK Equity Income

Financial year end 31 January

52-week high/low 604.0p 483.0p

NAV\* high/low 597.6p 485.7p

\*Including income.

## Gearing

Net gearing\* 13.0%

\*At 28 February 2023.

## Fund objective

The Merchants Trust'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 large-cap UK companies (up to 10% of the fund may be invested in overseas equities). The benchmark is a broad UK stock market index.

## Bull points

- Long-term record of outperformance versus the UK stock market.
- Attractive above-market dividend yield and commendable 41-year record of higher annual payments.
- Competitive fee structure.

## Bear points

- Rising inflation and interest rates, and a slowing UK economy, increase the risk of profit warnings.
- UK has been out of favour with global investors since the 2016 Brexit vote.
- Relative performance is likely to struggle in a growth/momentum-led market.

## Analyst

Mel Jenner +44 (0)20 3077 5700

[investmenttrusts@edisongroup.com](mailto:investmenttrusts@edisongroup.com)

[Edison profile page](#)

**The Merchants Trust is a  
research client of Edison  
Investment Research Limited**

## The manager's view: Opportunities in overlooked UK

---

Gergel explains that UK equities were resilient in 2022 and generated a positive return, unlike most other markets. However, this has gone by relatively unnoticed as UK equities have generally been out of favour with global investors since the 2016 Brexit vote. As a result, in aggregate, UK company valuations are very attractive both on an absolute basis and versus global equities.

The manager says that the UK stock market is home to many large international companies operating in interesting industries. However, the UK stock market has a different mix compared with other equity markets, with less high-growth and technology exposure, and higher weightings in more traditional areas such as mining, banking and consumer goods, which were more resilient in last year's particular market environment. Gergel suggests that investors had become a bit more interested in the UK but then the global pandemic occurred and the war in Ukraine added to inflation pressures, which led to further outflows from the UK and very modest UK equity valuations.

Given this valuation backdrop, the board increased MRCH's gearing from c 12% to c 15% in November 2022; gearing had declined due to strong markets and the trust's robust share issuance. The manager explains that MRCH's portfolio yield is around 4.5% and the cost of debt is just over 4.0%, so even if there is no capital growth, a higher level of gearing should be beneficial to the trust's total returns.

Gergel comments that when assessing companies as potential investments, there are three areas he considers: fundamentals, valuation and themes. Fundamental analysis includes a firm's business model, its competitive position, its financial profile and ESG credentials. In terms of valuation, does a company offer good value versus history and other opportunities in its sector? Themes refers to a consideration of structural trends and risks, industry cycles and avoiding value traps; these are companies that appear to be inexpensive, but have problems that are not reflected in their current share prices.

The manager comments that there are times when he has to take a step back during periods of high stock market volatility, such as around the Brexit vote, during the global pandemic and following the war in Ukraine. He stresses the importance of taking a longer-term (ie three- to five-year) view about whether businesses will recover, as you cannot predict what will happen in the six to 12 months after a major market-moving event. Gergel says he has to determine whether an investment case has changed, if not, share price weakness could be a good opportunity to top up a portfolio holding. However, if a business has been compromised, it may be better to sell the position. He opines that humility is an important attribute for a successful fund manager.

MRCH has exposure to the housebuilding sector. The manager explains that it is a consolidated industry because it is difficult to set up a new company due to planning rules, tough regulation and acquiring land. He says the housebuilders in the trust's portfolio have strong land banks, good records of high returns and robust balance sheets with net cash; prior to the global financial crisis, housebuilders had net debt positions, but have since learned their lesson. Gergel notes sector valuations are modest, with housebuilders trading at a discount to the value of their land banks, while they offer attractive dividend yields. In terms of long-term themes, the manager says the UK has a housing shortage and there is long-term demand for homes. He comments that there is no doubt that housebuilding is a cyclical business and if volumes and prices decline there will be a short-term hit to profits. However, he suggests that businesses can be reset, as costs will also decline and profits can recover quite quickly.

## New portfolio positions

In January 2023 Gergel initiated a position in **Pets at Home Group**, which is a UK market-leading retailer, selling both in-store and online. It has scale advantages, such as the ability to develop its own brand range of pet food and nutritional products. The pet industry is relatively resilient, with consumers prioritising spending on their pets during periods of economic weakness. Pets at Home also has a vet services business. Vets4Pets is one of the UK's largest chains with more than 400 practices, often co-located within its stores. Most of these are joint ventures, with Pets at Home providing capital and support services, while allowing vets considerable autonomy to manage their businesses like entrepreneurs. This business model provides considerable two-way cross-selling opportunities. Although the vet services business only represents a small percentage of Pets at Home's sales, it generates nearly one-third of the company's profits. The manager believes that the high quality and growth potential of the vet business is not reflected in the firm's valuation. The holding was added to the portfolio following share price weakness in the retail sector in 2022.

Gergel added **Admiral Group** to MRCH's portfolio in December 2022. It is the UK's market leader in car insurance, benefiting from a cost advantage versus many of its peers, allowing it to generate superior returns over a business cycle and increase its market share. Admiral is slowly diversifying into UK home insurance and international car insurance. Over the last year, the whole insurance industry has suffered from significant inflationary cost pressures, which have negatively affected its profitability. However, this has resulted in sharp policy price rises, which should benefit future profits. Admiral's share price fell sharply in 2022, which provided a good opportunity for the manager to invest in a high-quality company with an attractive dividend yield.

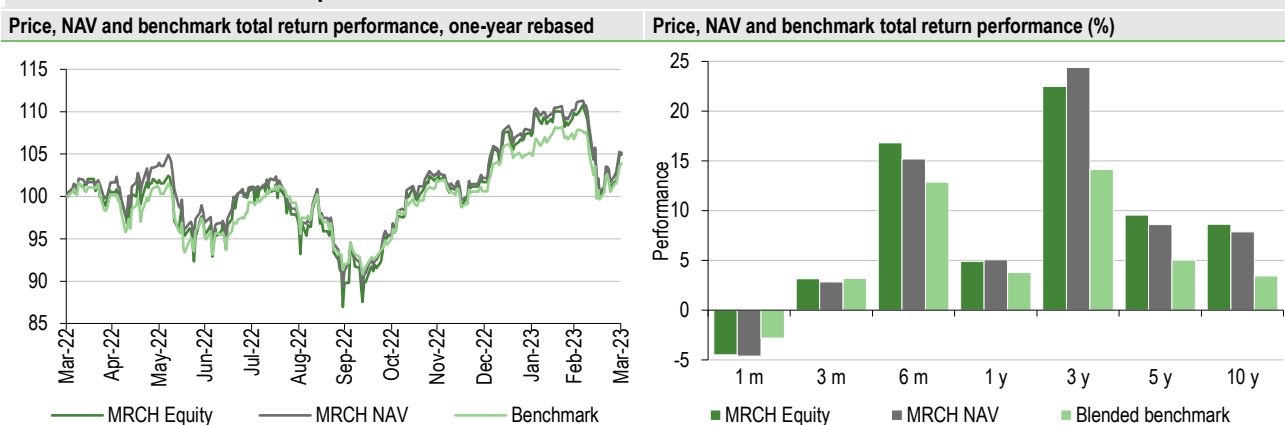
## Performance: Building on positive long-term record

**Exhibit 1: Five-year discrete performance data**

12 months ending	Share price (%)	NAV* (%)	Blended benchmark (%)	CBOE UK All companies (%)	CBOE UK 100 Companies (%)
31/03/19	7.9	3.3	6.2	6.2	0.8
31/03/20	(20.4)	(24.0)	(19.1)	(19.1)	0.8
31/03/21	44.1	52.8	26.6	26.6	11.8
31/03/22	21.6	19.9	13.2	13.2	15.9
31/03/23	4.9	5.1	3.8	3.8	5.7

Source: Refinitiv. Note: All % on a total return basis in pounds sterling. \*NAV with debt at market value.

**Exhibit 2: Investment trust performance to 31 March 2023**



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

MRCH's relative performance is shown in Exhibit 3. Gergel has continued to build on the trust's positive track record over the last six months and is ahead of the benchmark over one, three, five and 10 years, in both NAV and share price terms. The outperformance over the last decade is particularly noteworthy given that during most of this period, investors favoured higher-priced growth stocks rather than undervalued names.

**Exhibit 3: Share price and NAV total return performance, relative to indices (%)**

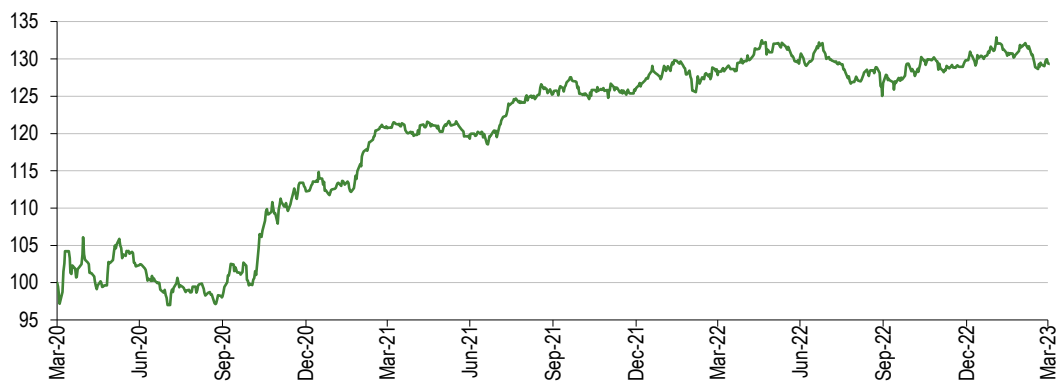
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to blended benchmark*	(1.8)	0.0	3.5	1.1	23.5	23.4	63.0
NAV relative to blended benchmark*	(1.9)	(0.3)	2.1	1.2	29.4	18.1	52.1
Price relative to CBOE UK All Companies	(1.8)	0.0	3.5	1.1	23.5	23.4	29.0
NAV relative to CBOE UK All Companies	(1.9)	(0.3)	2.1	1.2	29.4	18.1	20.4
Price relative to CBOE UK 100	(2.0)	(0.2)	3.7	(0.8)	34.0	13.1	57.0
NAV relative to CBOE UK 100	(2.2)	(0.5)	2.2	(0.6)	40.4	8.3	46.4

Source: Refinitiv, Edison Investment Research. Note: Data to end-March 2023. Geometric calculation. \*Blended benchmark is UK 100 Index until 31 January 2017 and UK All-Share Index thereafter.

Over the last year, the best contributors to MRCH's relative performance include: HomeServe (a home emergency repairs and improvements company, which was acquired by Canadian firm Brookfield Asset Management); BAE Systems (a multinational arms, security and aerospace company); and Imperial Brands (one of the world's leading tobacco companies).

The largest performance detractor was AstraZeneca, which is not represented in the trust's portfolio. Gergel explains that he only initiates a position in companies where he has a positive view. He considered that AstraZeneca's valuation was not compelling, plus he had concerns about some of the company's accounting policies and level of cash flow generation. MRCH's major pharma exposure is via positions in GSK and Sanofi.

**Exhibit 4: NAV total return performance relative to the benchmark over three years**



Source: Refinitiv, Edison Investment Research

## Peer group comparison

MRCH is the sixth largest member of the 20-strong AIC UK Equity Income sector. The trust's total return ranks first over three years; it is 38.4pp higher than the sector average and 8.5pp higher than that of the second-ranked fund. MRCH's returns are also above average over the other periods shown, ranking ninth over the last 12 months, fifth over the last five years and seventh over the last decade. The trust is one of four funds in the sector that are currently trading at a premium. It has a competitive ongoing charge and an average level of gearing. The trust's dividend yield is 40bp higher than the sector mean.

**Exhibit 5: AIC UK Equity Income sector at 24 April 2023\***

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Merchants Trust	836.9	3.6	91.3	38.7	100.6	1.1	0.6	No	110	4.8
abrdn Equity Income Trust	159.6	(6.4)	44.0	(6.3)	51.7	(0.7)	0.9	No	114	6.8
BlackRock Income and Growth	40.4	6.1	49.9	25.2	97.0	(10.0)	1.2	No	106	3.8
Chelverton UK Dividend Trust	37.2	(14.5)	79.0	(7.9)	108.2	3.5	2.0	No	149	6.7
City of London	2,112.7	5.2	51.3	26.5	87.8	2.2	0.4	No	107	4.9
CT UK Capital and Income	324.3	1.9	52.2	19.0	89.8	(4.1)	0.6	No	108	3.8
CT UK High Income Units	104.5	3.4	39.6	13.4	58.4	(11.6)	1.0	No	108	5.0
Diverse Income Trust	316.0	(14.3)	28.2	9.7	109.7	(4.1)	1.1	No	100	4.4
Dunedin Income Growth	446.3	9.4	40.0	39.4	83.6	(5.5)	0.6	No	107	4.4
Edinburgh Investment	1,123.1	5.6	64.2	19.6	81.3	(8.0)	0.5	No	108	3.8
Finsbury Growth & Income	1,908.1	10.9	33.9	42.3	164.5	(4.8)	0.6	No	101	2.0
Invesco Select UK Equity	104.9	(0.5)	62.8	25.7	115.6	(20.7)	0.7	No	105	4.7
JPMorgan Claverhouse	405.8	0.4	52.2	15.9	89.9	(6.2)	0.7	No	108	4.9
Law Debenture Corporation	1,066.4	0.5	70.4	39.7	137.4	2.2	0.5	No	113	3.5
Lowland	331.0	0.7	54.7	3.8	70.8	(10.1)	0.6	No	115	5.0
Murray Income Trust	995.4	5.3	41.9	40.1	90.7	(7.8)	0.5	No	108	4.2
Schroder Income Growth	213.3	4.6	59.7	26.3	103.4	(2.6)	0.7	No	110	4.3
Shires Income	78.8	(0.5)	42.2	25.3	87.5	(3.4)	1.0	No	121	5.4
Temple Bar	727.4	5.5	82.8	10.7	57.9	(6.1)	0.5	No	109	3.9
Troy Income & Growth	186.5	(1.2)	18.4	17.8	73.3	(3.0)	0.9	No	102	2.8
<b>Sector average (20 funds)</b>	<b>575.9</b>	<b>1.3</b>	<b>52.9</b>	<b>21.2</b>	<b>93.0</b>	<b>(5.0)</b>	<b>0.8</b>		<b>110</b>	<b>4.4</b>
<b>MRCH rank</b>	<b>6</b>	<b>9</b>	<b>1</b>	<b>5</b>	<b>7</b>	<b>4</b>	<b>6</b>		<b>7</b>	<b>8</b>

Source: Morningstar, Edison Investment Research. Note: \*Performance to 21 April 2023. NAV with debt at par. TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

---

## General disclaimer and copyright

This report has been commissioned by The Merchants Trust and prepared and issued by Edison, in consideration of a fee payable by The Merchants Trust. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

**Accuracy of content:** All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

**Exclusion of Liability:** To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out of or in connection with the access to, use of or reliance on any information contained on this note.

**No personalised advice:** The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

**Investment in securities mentioned:** Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Copyright: Copyright 2023 Edison Investment Research Limited (Edison).

---

## Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

---

## New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

---

## United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

---

## United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.

---