26 May 2023

HARGREAVE HALE AIM VCT PLC

(the “**Company**”)

Interim Management Statement

Q2 2023

Introduction

This interim management statement covers the second quarter of the 2022/23 financial year, 1 January 2023 to 31 March 2023. Investment performance measures contained in this report are calculated on a pence per share basis and include realised and unrealised gains and losses.

Overview

Sentiment improved at the start of the second quarter of the 2023 financial year as investors became more confident that inflation was close to peaking and, with it, the interest rate tightening cycle that had done so much damage to risk assets in 2022. Sentiment was further buoyed by the reopening of the Chinese economy, the last of the major economies to relax COVID restrictions. Towards the end of the quarter, concerns started to surface that some mid and large sized US regional banks (subject to a lighter touch regulatory regime than the larger globally systemically important banks) might struggle to operate profitably in a high interest rate environment, leading to depositor flight. Silicon Valley Bank (SVB) was the first of several significant bank failures. There were problems in Europe, too, with a hastily arranged distressed sale of Credit Suisse to UBS. For now, the fallout appears well contained with deposits and taxpayers protected by the actions of the regulators and other market participants.

Terminal interest expectations and the bond market have been unusually volatile as investors responded to fresh economic data, adjusted for the tighter credit conditions and assessed the implications for monetary policy. By some estimates, the failure of SVB might tighten financial conditions by the equivalent of a 1.5% increase in US base rates.

The UK economy continues to outperform against low expectations. The Office of Budget Responsibility (OBR) and the Bank of England (BoE) raised their real GDP forecasts for 2023 in the quarter and again post period end. In its May 2023 Monetary Policy Report, the BoE significantly upgraded its guidance with the UK economy now expected to grow by 0.9% over the 12 month to June 2024.

UK inflation (CPI) remained stubbornly high, defying predictions that it would fall below 10% in March. In response, the BoE has continued to raise base rates with market participants predicting a terminal rate of 5.3% in Q4’23 with inflation expected to fall back to around 5% by the end of 2023. Monetary policy remains data dependent, placing enormous weight on each inflation print, setting the scene for further periods of heightened volatility.

UK consumer confidence remains very low but on an improving trend. UK labour demand and employment remain robust and UK government support on energy prices has cushioned household disposable incomes from some of the worst potential impacts. Whilst still lagging inflation, average wage growth (excluding bonuses) remained strong at 6.6% in the 3m to February 2023. Looking ahead, recipients of the state pension and unemployment benefits will see payments increase by more than 10% later this year, helping retirees and giving some of the most economically deprived a welcome boost to their finances.

After a strong start, UK stock markets were mixed across the quarter with sentiment fading as investors took increasing note of signs of distress within the US banking industry. AIM (-2.65%) continued to underperform the FTSE 100 (+2.42%) and FTSE 250 (+0.40%) indices as investors continued to favour larger more established companies over smaller, higher risk and less liquid companies.

Performance

In the 3 months to 31 March 2023, the unaudited NAV per share decreased from 60.31 pence to 52.84 pence, resulting in a NAV total return to investors of -3.47 pence per share (-5.75%) after adding back the 4.0p of dividends paid in the quarter. The NAV total return (dividends reinvested) for the period of -6.16% compared with -2.65% in the FTSE AIM All-share Index total return and +2.03% in the FTSE All-Share Index total return (also calculated on a dividends reinvested basis). The qualifying investments made a net loss of -2.92 pence per share whilst the non-qualifying investments loss was -0.23 pence per share. The adjusting balance was the net of the Marlborough Special Situations Fund, running costs and investment income.

Qualifying Investments

Equipmake (+16.0%, +0.29 pence per share) raised £6.2m at 5p per share in January. Whilst news has been limited, interim results confirmed trading remained in line with expectations. The company has a strong pipeline which it expects to convert to contracts over the remainder of 2023.

Zoo Digital (+11.4%, +0.29 pence per share) announced a second strategically significant platform contract with a major Hollywood studio to support the localisation and preparation of content for distribution through its streaming platform. Post period end, the company raised funds and acquired a minority stake in a Japanese localisation company. At the same time, Zoo reported that a temporary disruption at its largest client would leave revenues for the 12 months to March 2023 behind previously upgraded forecasts. Profit guidance was unchanged.

Tortilla Mexican Grill (+43.8%, +0.27 pence per share) reported revenue growth of 20% to £58.7m in FY22, driven by a record year of new site openings, the acquisition of Chilango and price rises. Inflationary pressures in food and energy, as well as the unwinding of COVID VAT relief (worth £3.9m in FY22) meant that adj. EBITDA declined to £4.0m. Whilst the company has increased prices further in 2023, it remains resolutely focussed on delivering value for money. The company has a healthy pipeline of new store openings, both operated and franchised, that should continue to drive growth in the medium term.

Polarean (-61.8%, -0.75 pence per share) has disappointed. Initially, the outlook looked promising with the company finally receiving FDA clearance for Xenoview, its drug-device combination product that allows MRI scanners to provide detailed evaluation of lung function. Later updates revealed that the company had failed to correctly plan or cost its commercialisation strategy, resulting in a substantial cut to guidance. The FY22 closing cash balance of $16m provides runway until May 2024.

Gousto (-71.7%, -0.45 pence per share) raised new equity in February 2023 to fund capital expenditure and working capital. Operational and financial performance has improved following a difficult period in mid-2022. Gross margins remain healthy despite the demanding supply environment. Adjustments made to overheads and operational footprint (current and future) are starting to feed through to improving operating profit margins and cash performance. The company continues to focus on quality and choice whilst elevating its value proposition, helping to drive higher levels of customer satisfaction. Although we increased the company's enterprise value, the addition of a new class of share resulted in a reduction to the value of the investment.

Bidstack's (-29.1%, -0.32 pence per share) contractual dispute with Azerion continues to hinder progress and put pressure on the company's balance sheet. The company is seeking to recover monies owed through the Danish courts. The FY22 trading update reported revenues (excl. Azerion) +103% to £5.3m and cash of £8.7m.

Non-Qualifying Investments

JD Sports continued its recent share price rally after releasing a strong Christmas trading statement. Bodycote weathered the inflationary storm and supply chain constraints in 2022 and announced final results that were in line with expectations. Hilton Foods share price recovered following a trading update in line with its reduced (November 2022) guidance, indicating stability in the Seafood business and a strong focus on rebuilding profit margins in its multi-customer business. NCC, the cyber security provider, surprised the market with two profit warnings in consecutive months. The company cited longer sales cycles within its US technology sector client base and fallout from the failure of Silicon Valley Bank. Diversified Energy completed the $250 million acquisition of assets in Texas. The share price has been sensitive to movements in the spot market for natural gas despite an extensive hedging programme that covers more than 85% of its 2023 gas production (at a 35% premium to spot), 80% of 2024 and 70% of 2025. NatWest reported results that were in line with consensus whilst guiding slightly lower on FY23 profits as higher interest rates weighed on its net interest margin.

Portfolio structure

The VCT is comfortably above the HMRC defined investment test and ended the period at 95.79% invested as measured by the HMRC investment test. By market value, the weighting to qualifying investments increased from 55.90% to 58.10%.

Qualifying investment activity significantly picked up in the quarter with £6.9m invested into three qualifying companies, including one follow-on AIM investment. There was one full disposal of a qualifying company during the period (In The Style).

A significant shift in the yield curve brought with it the opportunity to build a non-qualifying portfolio of six investment grade corporate bonds and one UK Gilts ETF. Following the rise in interest rates short duration investment grade bonds provide attractive returns with yields to maturity in excess of 4% available for durations of less than 5 years. The allocation at quarter end was 11.3%.

There were additions to the investment in the Marlborough Special Situations Fund, increasing the weighting from 7.2% to 8.2%. The allocation to non-qualifying equities increased from 9.5% to 11.5% with several investments made into high yielding equities. Cash decreased from 27.7% to 10.9% of net assets despite inflows from the offer.

The HMRC investment tests are set out in Chapter 3 of Part 6 Income Tax Act 2007, which should be read in conjunction with this interim management statement. Funds raised by VCTs are first included in the investment tests from the start of the accounting period containing the third anniversary of the date on which the funds were raised. Therefore, the allocation of qualifying investments as defined by the legislation can be different to the portfolio weighting as measured by market value relative to the net assets of the VCT.

Share Buy Backs & Discount Control

1,805,109 shares were acquired in the quarter at an average price of 52.97 pence per share. The share price decreased to 50.0p and traded at a discount of 5.37% following the publication of the 31 March 2023 NAV on 6 April 2023.

Post Period End Update

The unaudited NAV per share increased from 52.84 pence to 53.39 pence in the month to 30 April 2023, an increase of 1.0%. The FTSE AIM All-Share index and the FTSE All-Share index increased by +2.75% and +3.35% respectively. There was one new qualifying investment made in the month into Fadel, which raised £8.0m gross and completed an IPO onto AIM on 6 April 2023.

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