Herald Inv Trust PLC

Annual Financial Report

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Herald Investment Trust PLC
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ANNUAL FINANCIAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2020 (AUDITED)

This is the Annual Financial Report of Herald Investment Trust plc as required to be published under DTR 4 of the UKLA Listing Rules.

Results and dividend

The net asset value (NAV) of the Company as at 31 December 2020 was 2,285.3p per ordinary share (2019 - 1,668.1p). This represented an increase of 37.0% during the year, compared to an increase in the comparative total return indices of 4.9% (Numis Smaller Companies plus AIM (ex. investment companies) Index) and an increase of 38.8% (Russell 2000 (small cap) Technology Index (in sterling terms)). The discount at year end was 1.8% (2019 - 11.3%) and the share price increased by 51.7% to 2,245.0p.

The Company made a revenue loss of £3,997,000 (2019: profit of £31,000) giving loss per share of 6.00 pence per share (2019: profit per share of 0.05p). The directors do not recommend a dividend for the year ended 31 December 2020 (2019 - nil).

The financial information set out in this Annual Financial Report does not constitute the Company's statutory accounts for 2019 or 2020. Statutory accounts for the years ended 31 December 2019 and 31 December 2020 have been reported on by the Independent Auditor. The Independent Auditors' Reports on the annual report and financial statements for 2019 and 2020 were unqualified, did not draw attention to any matters by way of emphasis, and did not contain a statement under 498(2) or 498(3) of the Companies Act 2006. The Company's statutory accounts for the year ended 31 December 2019 have been filed with the Registrar of Companies. The Company's statutory accounts for the year ended 31 December 2020 will be delivered to the Registrar in due course.

The financial information in this Annual Financial Report has been prepared using 'FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS102), which forms part of Generally Accepted Accounting Practice ('UK GAAP') issued by the Financial Reporting Council. The financial statements have also been prepared in accordance with The Companies Act 2006 and with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies and Venture Capital Trusts' issued by the Association of Investment Companies ('AIC') in October 2019.

STATISTICS AND PERFORMANCE - YEAR'S SUMMARY

	31 December 2020	31 December 2019	% change
Total net assets	**£1,503.4m**	£1,122.8m	
Shareholders' funds	**£1,503.4m**	£1,122.8m	
Net asset value per ordinary share[A]	**2,285.3p**	1,668.1p	+37.0
Share price[A]	**2,245.0p**	1,480.0p	+51.7
Numis Smaller Companies plus AIM (ex. investment companies) Index (capital only)	**6,040.0**	5,842.6	+3.4
Russell 2000 (small cap) Technology Index (in sterling terms) (capital only)[B]	**4,637.0**	3,359.5	+38.0
Dividend per ordinary share	**-**	-	
(Loss)/profit per ordinary share (revenue)	**(6.00p)**	0.05p	
Ongoing charges[A]	**1.08%**	1.09%	
Discount to NAV[A]	**1.8%**	11.3%	

Year to 31 December	**2020**	**2020**	2019	2019
Year's high and low	**High**	**Low**	High	Low
Share price	**2,265.0p**	**897.0p**	1,514.0p	1,060.0p
Net asset value[A] per ordinary share	**2,288.6p**	**1,238.3p**	1,679.6p	1,301.4p
Discount[A]	**28.8%**	**1.0%**	18.5%	6.8%

At 31 December	**2020**	2019
(Loss)/profit per ordinary share		
Revenue	**(6.00p)**	0.05p
Capital	**614.30p**	355.30p
Total	**608.30p**	355.35p

[A] Alternative Performance Measure.

[B] Investments and indices valued at USD/GBP exchange rate of 1.368 at 31 December 2020 (1.325 31 December 2019).

LONG TERM PERFORMANCE SUMMARY

The following table indicates how an investment in the Company has performed relative to its comparative index (applied retrospectively) and its underlying fully diluted net asset value over the period since inception of the Company.

	31 December 2020	Inception 16 February 1994	% change
	2,285.33p	98.70p	2,215.43

Net asset value per ordinary share (including current year income)[A]			
Net asset value per ordinary share (excluding current year income)[A]	**2,291.41p**	98.70p	2,221.59
Share price	**2,245.00p**	90.90p	2,369.75
Numis Smaller Companies plus AIM (ex. investment companies) Index	**6,039.99**	1,750.00	245.14
Russell 2000 (small cap) Technology Index (in sterling terms)†	**4,637.03**	688.70*	573.30

[A] Alternative Performance Measure.
* At 9 April 1996 being the date funds were first available for international investment.
† The Russell 2000 (small cap) Technology Index was rebased during 2009 following some minor adjustments to its constituents. The rebased index is used from 31 December 2008 onwards.

CHAIRMAN'S STATEMENT AND REVIEW OF 2020

After this challenging year I am delighted to report that the Company's net asset value per share appreciated by 37.0% in 2020. It is evident that technology has played a huge role in the changes that have occurred in a Covid-inflicted world, such as the mass migration to working at home, internet shopping, and home entertainment. It has also enabled the economy to function surprisingly well despite social-distancing. A few of our investee companies have seen increased demand associated with these changes, a few have suffered, and the majority have managed to adapt in a stable way. This stability has led investors to rerate our target sectors, focused on smaller quoted companies in the technology, media and telecommunications sectors globally. The portfolio holdings in aggregate have had limited exposure to the more troubled parts of the economy.

The UK portfolio which accounts for nearly 50.0% of the assets of the Company delivered a total return of 32.4%. This compares favourably with the Numis Smaller Companies plus AIM (ex investment companies) Index, which delivered a total return of 4.9%. This return has taken the cumulative profits from our UK investments to over £1.0bn since inception in 1994: an exciting achievement. To put this in context: £65m was raised in 1994 and £30m two years later, and no further capital has been raised since. This capital has been recycled, when profits have been realised in mature investments and over £560m has been invested as primary capital directly into emerging companies, including £436m in the UK, to support their growth in addition to investments bought in the secondary market. Overseas holdings have delivered further profits of over £500m. The star performer for the year has been the UK company ITM Power, which appreciated by £34.5m in the year.

Although over the long-term returns have been greatest in the UK, all the overseas regions delivered higher percentage returns than the UK in 2020. North America remains the second biggest region with c25% of the assets of the Company. Its sterling total return for the year has been 57.9% compared to the total return of 38.7% in the Russell 2000 (small cap) Technology Index, which is a particularly pleasing degree of outperformance. The strongest contributor has been Five9, an investment originally made at an average price of $4.65 in 2015, which closed the year at a price of $174.0. It provides internet-based telephony for call centres and enables "contact centre" employees to work from home. The exposure to EMEA (Europe, Middle East and Africa) increased from 6.0% to 8.6%. The return was 53.8% with Nordic Semiconductor, a designer of low power Bluetooth semiconductors, and Esker, which provides software for electronic invoicing and procurement, contributing 41.5% of the return, representing two fifths of the EMEA return.

The Asian exposure was increased from 6.8% to 10.1%, and the return from these holdings was also strong at 60.7%.The best performer was Kingdee International Software, a Hong Kong listed Chinese Enterprise Resource Planning provider. The Japanese and

Korean elements of the portfolio also delivered strongly. Although Coronavirus appears to have started in China, and supply chains were hit early in the year, Asian countries have generally contained the virus more effectively than the West. This has crucially enabled the continued supply of technology hardware worldwide.

Overall, on Bloomberg forecasts, a measure of the price to earnings (p/e) of the profitable companies in the portfolio has risen from 23.2x at the start of 2020 to 30.8x implying a rerating of a third: this rerating accounted for the majority of the year's appreciation in net asset value of 37.0%. Nevertheless, in aggregate the profits in investee companies have also appreciated this year. This is a testament to the success most companies have made in adapting to working from home and working shifts to enable appropriate social distancing. We further observe that the rerating of UK stocks has on average been 21.2% which is similar to the Asian rerating, but much lower than the rerating in EMEA (+39.6%) and North America (+61.3%). It is apparent that investors were apprehensive about the UK market perhaps reflecting Brexit uncertainties, and also reflecting the illiquidity in the UK smaller companies' market, and the regulatory pressures which have made so many investors withdraw from this asset class.

The income account has been adversely affected by a 17.7% decline in dividend income. UK dividends have fallen 25.3%. A number of companies announced final figures in March when there was peak Covid uncertainty, which led to many dividends being cancelled. Later in the year when trading had proved stable, payments were resumed; and a further recovery is expected in 2021. The Company buys back shares opportunistically from time to time. This year 2.3% of the outstanding share capital was repurchased and cancelled for £24.8m: at an average price of £16.26 per share. During the year we also conducted a competitive process to ensure the best secretarial arrangements for the Company. Following this, Praxis were appointed. In light of the strong growth in assets the fee structure is changing from a flat rate of 1.0% to 1.0% on net assets up to £1.25bn and 0.8% thereafter.

The Company has been largely unaffected by Brexit. The EU has not recognised Investment Trust vehicles so has classified them as AIFs (Alternative Investment Funds). There has never been a level playing field in services, so there are no EU-based investors on the Company's share register. In contrast over 12.0% of the Company's shares are owned in North America, and a small proportion in Switzerland and the Channel Islands. Post Brexit the Company would benefit if the UK rolled back and excluded Investment Trusts from the AIFMD legislation, which includes the requirement to have a depositary (at a cost of circa. £200,000 per annum). We believe that we could ensure equal security for shareholders at substantially lower cost and with less distraction for the Manager. As to the effect of Brexit on the portfolio, we have seen negligible impact to date.

Environmental, Social and Governance ('ESG') has become a very topical issue. The Company has benefited directly from the appreciation of some long-held shares, and our target sectors typically score well on ESG. Firstly, technology companies generally enable more efficient working, help lower carbon emissions, and have low emissions themselves; secondly, the sectors are skill intensive. From a shareholder perspective, relevant skillsets are valuable and support firm product pricing, but companies have to be competitive in salaries and working conditions to retain talent. This leads to good social scores but increases costs to shareholders in terms of share dilution. The Manager became a signatory of the PRI (Principles for Responsible Investing) in January 2020 and is applying to be on the list of the initial signatories of the revised 2020 UK Stewardship Code.

The Annual General Meeting will be held on 20 April 2021 at the Company's registered office. However, due to the ongoing restrictions on large gatherings, it will not be possible for shareholders to attend in person. I would therefore strongly encourage shareholders to vote instead by proxy. Full details of the Annual General Meeting, the resolutions proposed and how to vote by proxy are described in the Notice of Meeting and supporting explanatory notes on pages 74 to 75 of the annual report and financial statements. Shareholders who have questions that they would have raised at the Annual General Meeting, should submit them by 16 April 2021 to the Company's email address, **info@heralduk.com** . Answers will be published on the Company's website in advance of the meeting. If circumstances were to change, the board will notify the market of any alteration to the Annual General Meeting arrangements.

The $64m question is what the second-order effects of the virus crisis will be. Fiscal deficits are huge globally and quantitative easing has driven markets in 2020. We expect political pressures will ensure that there will be no rapid policy tightening. Abnormally low absolute and real interest rates seem set to prevail, which should support equity markets for the time being. As vaccines are rolled out, economies will normalise and there may well be a recovery in those stocks more adversely affected by the various lockdowns.

After such a strong year of absolute and relative performance, further performance will be challenging. We should feel more confident if valuations were lower, but we remain convinced that our target sectors have both defensive and high-growth characteristics which in the long run place them well compared to other sectors in the equity market and other asset classes such as bonds.

INTERNAL RATE OF RETURN (IRR) STERLING PERCENTAGE RETURNS BY REGION*

	1 year	5 year	10 year
Herald - UK Numis Smaller Companies plus AIM (ex. Investment company) Index total return	 32.0 4.9	 146.4 47.3	 306.2 144.1
Herald - North America Russell 2000 (smallcap) Technology Index total return	55.6 38.8	296.6 206.3	567.1 397.6
Herald - Asia	63.4	181.5	228.0
Herald - Europe Middle East and Africa	59.7	302.7	715.7
Herald - Total Return NAV per Share[A]	37.0	159.2	284.8

* IRR (costs including those of borrowing and interest rate swaps are accounted for at Company level).

[A] Alternative Performance Measure.

Ian Russell
Chairman
22 February 2021

INVESTMENT MANAGER'S REPORT

Had I been told that much of the world would be in varying degrees of lockdown for much of the year, I would have anticipated an evaporation of profits in portfolio companies and weaker share prices.

In the early part of the year manufacturing stopped in China and supply chains for certain components led to widespread product shortages. We did not envisage that China would control the virus so quickly and that much of the developed world would have failed to do so nearly a year later. Asia dominates as the location for manufacturing technology products, while North America and the UK are more focussed on software, IP services and media. The latter have generally been remarkably effective in continuing operations with workers at home. It is extraordinary how seamlessly and quickly the adjustment took place. The smaller quoted company investment world in which we operate moved from face-to-face meetings and conferences to video conferencing, which has enabled some continuity.

These calls are better than reading reports and analysing balance sheets alone, and better than telephone calls, but an inferior means of communicating than in person. We have found them effective for catching up with companies we know well, but less effective for group meetings, and companies new to us. We are reluctant to make new investment in companies until we have got to know management, but this year for the first time we have had to. We look forward to a return to normal operations as and when vaccinations permit this, and to a time when communication within our team will be easier again.

The endless Zoom calls have made me appreciate that the seamless transition has not occurred without huge efforts, because I have seen many tired looking chief executives on the screen. I am enormously grateful, and shareholders should be too, for the evident grit and effort that has clearly been made for the benefit of shareholders, employees and the wider economy.

I am aware that in the early part of my career there was greater respect for entrepreneurs and a respect for the associated wealth creation, which was so needed after the dire economy of the 1970s. They are needed as much again now. I would go further and say it is a cri de coeur that we must respect more those who take responsibility, pay taxes and create wealth. Happily, the UK has many with a creative and entrepreneurial spirit.

My concern is that the stock market has become less supportive, with fewer professional smaller company investors, and a more arduous legal and regulatory environment. I observe also how many fewer companies there are in our remit in the United States than there were. The expense of Sarbanes Oxley made it less economic to float small companies in the US, while private equity has been able to use more favourable tax structures and cheap bank debt to take many businesses private. Forty-five companies in the Company's portfolio have been taken over in the last few years by private equity, mainly in the UK and US. In the UK there has been a greater replenishment cycle with companies coming to AIM for development capital, whereas IPOs in the US tend to be exits at a later stage for smart venture investors. In contrast the number of companies has grown in Europe and Asia.

To quantify this, I show below an analysis of the number of companies within the Bloomberg's technology and communications sectors with a market capitalisation >$100m and <$3bn now and a decade ago:

	2010	**2020**	**% change**
UK	82	103	+26
EMEA	239	310	+30
Asia (developed)	836	1,369	+64
United States	574	394	-31

There may be an argument to say that the US has been so successful with venture capital that public companies are not needed. I am sceptical. In an ideal world, companies would have permanent capital and investors would have liquidity at any time. The stock market has offered this for many years to companies and to small investors alike and to a lesser extent to institutional investors. In contrast, venture capital and private equity offer neither permanent capital nor liquidity and impose overleverage. At the same time, the concentration of quoted funds in a few hands means genuine efficient asset allocation becomes difficult and small companies become irrelevant for the large funds. It is a pity. I hope that in time the powers that be in the US and elsewhere will appreciate the benefits of public markets.

REGIONAL ALLOCATION CHANGES (STERLING THOUSANDS)

	Valuation at		Amortisation	Appreciation/ (depreciation)	**Valuation at 31**

	31 December 2019	Net acquisitions/ (disposals)			**December 2020**
Equities*					
UK	586,110	(24,851)	-	179,378	**740,637**
EMEA	67,378	19,110	-	42,384	**128,872**
North America	257,769	(29,543)	-	138,477	**366,703**
Asia Pacific	76,861	22,994	-	52,090	**151,945**
Total equities	988,118	(12,290)	-	412,329	**1,388,157**
Government bonds	45,108	(3,607)	(35)	960	**42,426**
Total investments	1,033,226	(15,897)	(35)	413,289	**1,430,583**
Net liquid assets	89,623	(13,666)	-	(3,173)	**72,784**
Total assets+	1,122,849	(29,563)	(35)	410,116	**1,503,367**

* Equities includes convertibles and warrants.
+ The total assets figure comprises assets less current liabilities.

PORTFOLIO P/E BY REGION (AS AT 31DECEMBER)

	2013	2014	2015	2016	2017	2018	2019	**2020**
UK	16.9	15.8	16.4	15.9	19.6	15.9	21.7	**26.2**
EMEA	14.9	13.4	16.3	17.5	21.4	17.7	25.0	**34.9**
Asia	9.6	12.3	13.2	13.1	14.8	16.3	20.7	**25.0**
NorthAmerica	20.9	19.2	20.1	20.7	27.8	24.0	27.9	**45.0**
Totalfund	16.8	16.1	16.9	16.7	20.7	17.7	23.2	**30.7**

RERATING BY REGION

		1yrrerating		2yrrerating		3yrrerating		7yrrerating
UK		20.7%		64.8%		33.7%		55.0%
EMEA		39.6%		97.2%		63.1%		134.2%
Asia		20.8%		53.4%		68.9%		160.4%
NorthAmerica		61.3%		87.5%		61.9%		115.3%
Totalfund		32.3%		73.4%		48.3%		82.7%

Source: Bloomberg. Analyst earnings estimates, where available, are aggregated using the Bloomberg weighted harmonic average calculation. This excludes loss-making companies from the p/e calculation. A weighted harmonic average will normally be lower than a geometric or arithmetic average. By way of comparison the 2020 Total Fund weighted average arithmetic p/e (120.5x) or median p/e (34.75x). The 2020 index method p/e (including loss making companies) is 73x.

In the UK, as opportunities open up post Brexit to forge our own destiny, we would like to see change in two particular areas. Firstly, we would like quoted companies to have equality of treatment in terms of tax and regulation with similar sized unquoted companies to remove the inbuilt bias towards highly leveraged private structures. Secondly, we would like to see a greater diversity of long-term capital directed towards helping smaller quoted companies scale up their operations and to provide them with the permanent capital they need to support long-term growth plans. The UK Chancellor has expressed a desire to make the UK stock market an attractive place to list. In our experience there is a greater need to attract investors than companies. Companies will not be attracted to list while markets in other jurisdictions and private equity pay higher prices than the UK market. It will be fascinating to see how things evolve over the next few years, and we shall endeavour to adapt as necessary.

We intend to continue investing where we see value. We currently see that there is a trade-off between risks in less regulated markets and expensive valuations with declining liquidity in more regulated markets. A crude measure of valuation is derived from the Bloomberg-derived estimates of forward p/e by region of the Company's portfolio over time. It does highlight the sharp upward rerating over the last two years.

UK

The return on the UK portfolio was -2% at the interim stage, but there has been a strong second half leading to a return for the year of 32.4%. This is pleasing relative to the total return of theNumis Smaller Companies plus AIM (ex. investment companies) Index of 4.9%. It also compares favourably with various UK technology indices, albeit the outperformance is not as great versus AIM technology companies, as it is versus larger companies. The five best UK holdings delivered a total return of £85.6m, which is material in relation to the total UK return of £185.2m. These five were ITM Power (ITM), BATM Advanced Communications (BATM), Ilika, S4 Capital and YouGov. In turn they were five of the top ten in all regions. Candidly had I been asked to say which companies would be best performers in 2020 none of these would have been on my shortlist, which is one reason we have a broad spread of investments. Equally I respect management in each of these, and all but S4 Capital which we first bought in 2018, have been long-held positions, but you never quite know when others will also be attracted.

ITM has been one of three hydrogen players in the portfolio, the other two being Ballard Power Systems and Hydrogenics in Canada. Sadly, the latter was acquired in 2019 by Cummins before the fashionable run in the subsector seen this year. ITM converts electricity into hydrogen, to provide storage of renewable energy. I do gulp at the valuation of ITM with a market capitalisation of £2.8bn, and minimal revenues, we have realised gains of £11m during the year. We did participate in funding rounds in 2012, 2014, 2016, 2017 and 2019 as well as one in 2020. In the 5 rounds prior to this year I invested in aggregate £4.0m at an average price of 30.1p, and a further £1.5m at 235p in September. The funding rounds in 2016 and 2017 were at 15p and 17p respectively when the company was friendless, and which were at a lower price than the 50p level in 2012. This is the nature of long-term early stage investing, but had we not invested the company would not have existed for the more recent gains. This provides an emphatic example of the long-term support and funding that we provide for early-stage companies. The concept which excites us is that the cost of wind and solar power is low, but insufficiently reliable in its generating output. If surplus renewable energy can be cost effectively stored it would be a huge breakthrough. Initially ITM's aim was to generate hydrogen to fuel cars and buses, but a bigger market is to replace heating gas. The investment by Linde in the last round and joint venture for project management adds credibility to the management team with its ambitious target.

BATM showed great agility by adapting to produce Covid tests. Ilika develops solid state batteries. We invested in three funding rounds in 2014, 2015 and 2018 an aggregate sum of £2.1m, at prices of 60p, 73p and 20p in that order, and a further £1.1m at 40p in March 2020. I am astonished it has closed the year at 200p, but equally impressed that some of the world's leading semiconductor companies have sufficient demand for the product that Ilika are building manufacturing capacity. S4 Capital is Martin Sorrell's new vehicle focused on the digital world, and YouGov one of the few household names in the portfolio has made traction with its subscription products.

The UK also had the worst performers including Time Out, Aptitude Software, Kromek, Wilmington and M&C Saatchi which collectively lost £14.9m. In the first half the return of the media stocks was -20%, but this recovered to +19.5% by year end. There remained some notable laggards.

Although the UK return has underperformed all the overseas regions over the last 5 years it is entirely due to the UK's rerating being more modest. The Manager has had numerous conversations with all the UK companies we hold, and none appear apprehensive about the Brexit outcome. The UK portfolio p/e of 26.4x is higher than it has been, but materially more reasonable than valuation in EMEA and North America from which we take comfort. Overall, we see pluses and minuses with regard to the UK portfolio, seeing better value but worse liquidity than in other markets.

The most exciting statistic is that the cumulative return of the UK portfolio since inception is now £1.06bn, and the Time Weighted Return is 13.5% per annum. This compares with an annualised return of 5.2% for the FTSE-100 and 6.1% for the FTSE All-Share Index over the same time frame, and NASDAQ's annualised return has been 12.2% in sterling, even including the mega successes of Apple, Microsoft etc. It is fulfilling that primary capital has been invested through public offerings and placings to the tune of over £436m, which has helped create businesses and added-value jobs, as well as providing good returns to shareholders.

North America
The North American portfolio has returned 57.9% which compares well with the sterling total return of 38.8% from the Russell 2000 (small cap) Technology Index. North America continues to account for c.25% of net assets. We do however observe that the p/e of the portfolio has appreciated 61.3% over the last year. It has to be said that this is a crude measure and a number of factors contribute: (i) some lower p/e stocks have been taken over by private equity; (ii) the US fashion is to reward companies in share price terms for revenue growth and not profits, so earnings are not such a driver; and (iii) forward estimates do not normally include share-based compensation which materially flatters US valuations. In short, I find valuations of North American stocks uncomfortably high, but made that mistake a year ago. With the US Government in particular continuing such a loose fiscal and monetary policy mix, maybe the ratings can stretch further.

Whereas in the UK the pace of takeovers was lower than it has been for years, the pace continued in the US: Mellanox, Adesto Technologies, Inphi and Meet Group were all acquired during the year, realising an aggregate cash value of £29.3m with Fitbit and Pluralsight outstanding. This takes the cumulative value of North American takeovers to £156.6m over the last six years, which is remarkably similar to the value of the entire portfolio in that region at the start of the period.

Within the North American portfolio, the top three gainers in value were Five9, Pegasystems and Digital Turbine, which collectively returned £39.5m. However, 12 stocks appreciated more than 100%. In order, they were: Veritone, Digital Turbine, Ballard Power Systems, Materialise, Five9, Bandwidth, SailPoint Technologies, AXT, Brightcove, Ribbon Communications, Varonis Systems and Inphi.

We do not make investments when the market capitalisation exceeds $3bn, but a record proportion of the portfolio companies now exceed this $3bn level as a result of capital appreciation, particularly in North America. In this region, the aggregate value of these stocks is £212.6m with an aggregate book cost of £53.0m, so the average appreciation is 301.9%. These larger holdings have been used effectively as an ATM to invest in smaller companies over the years, but again this year, the scale of takeovers, and the scale of share price appreciation have been faster than the rate of reinvestment. We have considered raising the size threshold, but these larger holdings are more expensive, and we wish to retain our focus on earlier stage investments for new positions. There have been some smaller IPOs, and there is a growing fashion for SPACs (special purpose acquisition companies), which is a lower cost route to an IPO. Thus far we have avoided them because information disclosure is poorer, which attracts racier management, but we will follow progress in the coming quarters.

The most evident bubble has been in compensation at all levels in California, particularly in San Francisco and the Bay Area. It has been a challenge for small companies to compete for talent with the mega-successes like Alphabet, Apple and Facebook, which is why stock-based compensation has grown, and is now arguably out of control. Certainly, in some cases valuations do not seem to adequately reflect the dilutive effect which can often lead to share count increases of over 5% per annum. These companies, large and small, are currently all working from home. It will be fascinating to see what the second-order effects of Covid are.

Talented, ambitious and mercenary people have flocked to Northern California, so that housing costs and office costs are high as well as salaries, but there is also the creative stimulus of such an active hub, and the associated transfer of skills. Companies can now evidently hire cheaper remote workers but will this enable the same level of innovation? Certainly, one positive of the epidemic is that companies have become more cost-conscious, which may lead to a greater focus on profitability, which we regard as more sustainable than the infatuation with revenue growth. Nevertheless, this part of the world has driven the trend to hosted applications, and efficient datacentres. How effective they have proved in the stay at home environment.

Two areas are notable in terms of performance: firstly, unified communications, which has been central to enabling remote working and decentralised call centres. Five9, LivePerson, Bandwidth and TTEC have collectively appreciated £31.3m; secondly the security space, which lagged for much of the year but had a late spurt when there was a spate of hacking, thought to be the Russian Government through a SolarWinds update. In this field Varonis Systems, SailPoint Technologies, FireEye, Qualys, Rapid7, Mimecast and ManTech have returned over £20.1m.

EMEA

Over the long-term the European annualised returns have been the highest but the weighting has been low. We have purposefully increased resources in this region and the weighting has increased from 6.0% at the end of 2019 to 8.6% at the end of 2020. The total return for the year in sterling was 53.8%. Long-held investments in Nordic Semiconductor (+£10.2m +146.4%), Esker (+£7.7m +102.5%) and BE Semiconductor (+£5.6m +56.4%) contributed the most by value but newer holdings contributed well in percentage terms: Exasol (+193.1%), Upsales Technology (+121.6%), Efecte (+111.3%) and Napatech (+105.7%).

Alongside our long-held positions, some of which we added to earlier this year at useful prices, we have initiated several new positions in the portfolio and look forward to seeing how they develop and mature over the next few years. Private equity buyers are increasingly targeting Continental European companies - of the four takeovers in the portfolio since 2018, two have been to trade buyers and two to private equity. Had the option been available, or if we had had the support of larger French shareholders, we would have considered participating in the taking-private of Devoteam together with founder management and KKR last year.

Liquidity in the Company's investments is an increasing challenge, and poorest in the UK and Europe. It has always been challenging in Europe, and the UK has deteriorated so it has been worse than Europe recently. The growth of the fund is an additional challenge. The average percentage of companies we own in the UK is c3.8%, but only 1.8% in Europe, so there is more scope to increase the European weighting.

Asia

By a short head the Asian portfolio has delivered the best regional returns this year increasing 60.7%. Amongst the smaller company and technology indices within Asia, the Kosdaq IT Index in Korea rose 39.2%, the larger company TWSE Electronics Index in Taiwan increased 40.5% and the Mothers General Small Companies Index in Japan was up 35.6%.

The weighting in Asia has increased from 6.8% to 10.1% during the year with increased investments made in Japan and Australia in particular. This is in part a reflection of the dynamic nature of the smaller companies markets in Australia and Japan which have been active in raising capital from IPOs and secondary offerings. There are very significant capital flows into small listed Asian technology companies, both from local retail investors and from international institutional funds. IPOs have been priced highly with the offerings often covered many times by the demand. This has meant the Company's allocations in the most attractive IPOs have been significantly scaled back and that significantly less capital was deployed than intended.

The star performer has been Kingdee International Software which contributed 28.8% of the Asian gains. Elsewhere the returns were more broadly based. Historically the Asian portfolio has been focused on Taiwan and South Korea, but now Australia and Japan are significant too. The return in Japan was 63.3%, South Korea 58.2%, Taiwan 49.5% and Australia 45.4%. Following such strong performance valuations are stretched, particularly for high-growth internet and software companies. The Company has benefitted from holdings in such business models and though in many cases strong revenue growth has been delivered, relatively few companies have successfully broken out of their domestic markets and scaled successfully on an international stage.

Fraser Elms is the lead manager for this element of the Company. I am particularly grateful to Fraser and his team for endless night shifts as Asian conferences have gone virtual and the time difference is more challenging than elsewhere.

ESG

It has been a frustration to have spent so much time on demonstrating compliance with a wave of new ESG (Environmental, Societal, Governance) regulations, for me personally and for the wider team. We have invested for years directly in energy-efficient solutions such as hydrogen electrolysers and fuel cells, components for wind turbines, LED, batteries and so on. I recognise the aims of the Extinction Rebellion demonstrators sleeping in the street in which I live but I arrogantly believe that we at Herald have done and will do far more to help alleviate global warming through appropriate investment of primary capital in emerging technologies.

We have always engaged with management of investee companies; always encouraged management to worry about their share price on a five to ten-year view and not a one-year view; always been intolerant of creative accounting and dishonesty; and always been vigilant in discussing share-based compensation. In short, the ESG effort for us is to articulate the case-by-case way in which we have always operated rather than change our practice to one of box ticking.

There is one issue where I am firmly at odds with the regulatory pressures and that is the requirements for board diversity. In short there are simply not enough experienced women in the sector and of suitable calibre to fill a third of board posts in the TMT smaller companies space in which we invest and we have seen instances of unsuitable candidates being appointed and doing real damage. We intend to be pragmatic when voting on mandatory quotas for boards and overly burdensome regulations for the smaller companies in our portfolio. Many social problems could be resolved with greater economic growth and value-added jobs. The beauty of small company investing is that it is about baking cakes not cutting them up. When our investors have gained so have entrepreneurs, employees and the wider economy. I hope that a combination of Covid and Brexit will make people realise that we have to think from first principles and make cakes rather than just worrying about how to cut a shrinking one.

Outlook

The Covid shock has put us all into particularly uncharted waters. At least governments the world over are expanding the money supply so the possibility of disruptive relative currency devaluations is reduced. Social unrest would be the worst outcome, and governments want re-election, so interest rates are likely to remain low for a while globally, and equity prices are likely to remain expensive. The UK is less expensively rated, but liquidity is challenging so it is likely to fall as a percentage of assets longer term. We have always focused on providing development capital to emerging companies but 25% of the Company's net assets now exceed $3bn market capitalisation through so much capital appreciation.

In addition, the scale of the Company makes it more challenging for new investments to make a meaningful impact on performance. On the other hand, we require our scale to engage with brokers and investment banks on a global basis, and the absolute scale of investment required to finance the development of new advanced technology is increasing. We shall endeavour to continue to adapt and remain evangelists for our chosen sector.

Katie Potts
Fund Manager
22 February 2021

	Marketvalue equityportfolio 31 Dec 2020	% ofequity portfolio 31 Dec 2020	Totalreturn equityportfolio 31 Dec 2020	Totalreturn equityportfolio 31 Dec 2019
Software	**390.6**	**28.1**	**145.9**	57.6
ComputerServices	**151.2**	**10.9**	**24.5**	43.3
Semiconductors	**114.6**	**8.3**	**45.0**	30.8
Telecommunications Equipment	**88.6**	**6.4**	**22.6**	6.5
MediaAgencies	**79.3**	**5.7**	**7.1**	2.2
Internet	**72.9**	**5.3**	**22.0**	7.8
ElectricalComponents&Equipment	**68.0**	**4.9**	**19.7**	11.9
Publishing	**64.2**	**4.6**	**-2.4**	30.1
ComputerHardware	**36.7**	**2.6**	**6.6**	6.7
BusinessSupportServices	**26.8**	**1.9**	**6.5**	1.9
Fixed LineTelecommunications	**15.6**	**1.1**	**0.2**	4.4
Other	**279.7**	**20.2**	**123.0**	51.5
Total	**1,388.2**	**100.0**	**420.7**	254.7

* FTSE Russell Industry Classification Benchmark - Subsector

CLASSIFICATION OF INVESTMENTS

Classification*	UK %	EMEA %	North America %	Japan & Asia Pacific %	**2020 Total %**	2019 Total %
OIL & GAS	**3.3**	**-**	**0.7**	**-**	**4.0**	**1.2**
Alternative Energy	3.3	-	0.7	-	**4.0**	1.2
BASIC MATERIALS	**0.1**	**-**	**-**	**0.3**	**0.4**	**0.3**
Chemicals	0.1	-	-	0.3	**0.4**	0.3
INDUSTRIALS	**7.2**	**0.6**	**2.4**	**1.5**	**11.7**	**10.9**
Construction & Materials	0.1	-	-	-	**0.1**	0.1
Aerospace & Defence	0.6	-	0.4	-	**1.0**	0.9
Electronic & Electrical Equipment	3.6	0.6	1.4	0.4	**6.0**	4.3
Industrial Engineering	-	-	-	0.3	**0.3**	0.1
Support Services	2.9	-	0.6	0.8	**4.3**	5.5
CONSUMER GOODS	**1.1**	**-**	**0.5**	**-**	**1.6**	**1.3**
Leisure Goods	1.1	-	0.5	-	**1.6**	1.3
HEALTH CARE	**1.2**	**0.4**	**-**	**-**	**1.6**	**1.5**
Health Care Equipment & Services	1.1	0.4	-	-	**1.5**	1.4
Pharmaceuticals & Biotechnology	0.1	-	-	-	**0.1**	0.1
CONSUMER SERVICES	**10.4**	**0.4**	**1.0**	**0.7**	**12.5**	**14.2**
General Retailers	-	-	-	0.5	**0.5**	0.4
Media	10.3	0.4	1.0	0.2	**11.9**	13.3

Travel & Leisure	0.1	-	-	-	**0.1**	0.5
TELECOMMUNICATIONS	**1.2**	**0.3**	**-**	**0.1**	**1.6**	**1.6**
Fixed Line Telecommunications	0.9	0.1	-	0.1	**1.1**	1.3
Mobile Telecommunications	0.3	0.2	-	-	**0.5**	0.3
UTILITIES	**0.2**	**-**	**-**	**-**	**0.2**	**0.1**
Electricity	0.2	-	-	-	**0.2**	0.1
FINANCIALS	**1.5**	**-**	**-**	**0.5**	**2.0**	**2.0**
Financial Services	0.3	-	-	0.5	**0.8**	0.8
Equity Investment Instruments	1.2	-	-	-	**1.2**	1.2
TECHNOLOGY	**23.1**	**6.9**	**19.8**	**7.0**	**56.8**	**54.9**
Software & Computer Services	18.1	3.9	14.0	4.8	**40.8**	38.3
Technology Hardware & Equipment	5.0	3.0	5.8	2.2	**16.0**	16.6
TOTAL EQUITIES (including convertibles and warrants)	**49.3**	**8.6**	**24.4**	**10.1**	**92.4**	**-**
Total equities - 2019 (including convertibles and warrants)	52.2	6.0	23.0	6.8	**-**	88.0
BONDS	**1.3**	**-**	**1.5**	**-**	**2.8**	**4.0**
NET LIQUID ASSETS**	**1.3**	**0.6**	**2.8**	**0.1**	**4.8**	**8.0**
TOTAL ASSETS	**51.9**	**9.2**	**28.7**	**10.2**	**100.0**	**-**
Total assets - 2019	57.1	6.7	28.8	7.4	**-**	100.0
SHAREHOLDERS' FUNDS	**51.9**	**9.2**	**28.7**	**10.2**	**100.0**	**-**
Shareholders' Funds - 2019	57.1	6.7	28.8	7.4	**-**	100.0
Number of equity investments (including convertibles and warrants)	145	34	75	70	**324**	288

* FTSE Russell Industry Classification Benchmark.
** Cash, current assets and liabilities.

TOP 20 EQUITY HOLDINGS
AS AT 31 DECEMBER 2020

A brief description of the twenty largest equity holdings in companies is as follows:

GB Group		
GB Group (GBG) is a global leader in Identity Data Intelligence. GBG solutions help organisations quickly validate and verify the identities and locations of their customers, GBG's products combine an unparalleled breadth of data from over 150 global partners, that in aggregate, enable GBG to verify billions of people in over 70 countries, accounting for approximately 60% of the world population. GBG's market-leading technology, is used by over 20,000 customers including some of the best-known organisations around the world - including US e-commerce giants, Asia's biggest banks and European household brands. With a rich heritage of more than 30 years, offices in 19 locations and more than 1,000 employees globally, GBG helps companies and governments to fight fraud and cybercrime, lower cost of compliance and improve the customer digital onboarding experience in today's digital economy.		£47.5M VALUATION 3.2% OF TOTAL ASSETS 2.6% OF ISSUED SHARE CAPITAL HELD £3.0M BOOK COST

ITM Power		
ITM Power designs and manufactures products which generate hydrogen gas, based on Proton Exchange Membrane (PEM) technology. This technology uses electricity and water to generate hydrogen gas on-site and has a product offering capable of being scaled to 100MW+ in size. ITM Power Plc is a globally recognised expert in hydrogen technologies which take excess energy from the power network, convert it into hydrogen and use it in one of three broad market areas - Mobility, Power-to-X and Industry. The shift away from carbon towards hydrogen is led by the drive for improved air quality worldwide, the growth of renewable power generators in the energy mix and a need to decarbonise industrial processes.		£31.4M VALUATION 2.1% OF TOTAL ASSETS 1.1% OF ISSUED SHARE CAPITAL HELD £3.1M BOOK COST

Pegasystems		
Pegasystems (Pega) is the leader in software for customer engagement and operational excellence. Pega's adaptive, cloud-architected software - built on its unified Pega Platform - empowers people to rapidly deploy and easily extend and change applications to meet strategic business needs. Over its 35-year history, Pega has delivered award-winning capabilities in Customer Relationship Management (CRM) and digital process automation (DPA) powered by advanced artificial intelligence and robotic automation, to help the world's leading brands achieve breakthrough business results.		£29.3M VALUATION 1.9% OF TOTAL ASSETS 0.4% OF ISSUED SHARE CAPITAL HELD £1.5M BOOK COST

YouGov		
YouGov is an international research data and analytics group. Their data-led offering supports and improves a wide spectrum of marketing activities for a customer base that includes media owners, brands and media agencies. YouGov works with some of the world's most recognised brands. Key syndicated data solutions include the daily brand perception tracker, YouGov BrandIndex, and the media planning and segmentation tool, YouGov Profiles. The YouGov Realtime service provides a fast and cost-effective solution for reaching nationally representative and specialist samples. YouGov's Custom Research division offers a wide range of quantitative and qualitative research, tailored by sector-specialist teams to meet clients' specific requirements. YouGov's proprietary global panel of over 11 million registered members across more than 40 markets provides thousands of data points on consumer attitudes, opinions and behaviour on a daily basis.		£27.3M VALUATION 1.8% OF TOTAL ASSETS 2.4% OF ISSUED SHARE CAPITAL HELD £2.7M BOOK COST

Future		
Future is a global multi-platform media company, organised into two divisions, Media and Magazines. The Media division focuses on being at the forefront of digital innovation, revenue streams include eCommerce, digital advertising, events, lead generation, newsletters and CRM, and digital licensing. Media revenues are now generated from 111 websites and typically over 50 events a year are held in the UK, US and Australia. The Magazine division is the home of an extensive range of specialist magazines and bookazines both in print and digital format. Future's magazines are exported to many countries in addition to being sold in the UK on the newsstand and through subscription. Future has a portfolio of 115 magazines, which was increased following the acquisition of TI Media in April 2020. Future's total global circulation of magazines and bookazines is 3.8m. Future's strength in the tech specialist and gaming and entertainment verticals remains and is supplemented by other audiences in diverse interest groups that span three core areas: Passions, Living and B2B. In total the group now has an audience reach of close to 400m.		£24.2M VALUATION 1.6% OF TOTAL ASSETS 1.4% OF ISSUED SHARE CAPITAL HELD £4.6M BOOK COST

Diploma		
Diploma is a group of specialised distribution businesses serving industries with long-term growth potential and with the opportunity for sustainable superior margins through delivering quality customer service, deep technical support and value-adding activities. The three sectors the company focuses on are life sciences, seals and controls.		£22.5M VALUATION 1.5% OF TOTAL ASSETS 0.8% OF ISSUED SHARE CAPITAL HELD £0.7M BOOK COST

Next Fifteen Communications		
Next Fifteen Communications (Next 15) is a family of marketing businesses spanning digital content, PR, consumer, technology, marketing software, market research, public affairs and policy communications. Founded in 1981, Next 15 are centered on the technology of marketing: data, insight, analytics, apps, content platforms and content itself.		£20.2M VALUATION 1.3% OF TOTAL ASSETS 4.2% OF ISSUED SHARE CAPITAL HELD £2.4M BOOK COST

S4Capital		
S4Capital is a digital advertising and marketing services company established by Sir Martin Sorrell in May 2018. The company's strategy is to build a purely digital advertising and marketing services business, initially by integrating leading businesses in three practice areas: first-party data, digital content, digital media planning and buying. The Group employs approximately 3,750 people in 31 countries, across The Americas, Europe, the Middle East & Africa and Asia Pacific.		£20.0M VALUATION 1.3% OF TOTAL ASSETS 0.7% OF ISSUED SHARE CAPITAL HELD £4.9M BOOK COST

LivePerson		
LivePerson enables improved customer interactions through the use of Conversational AI. LivePerson technology empowers brands to give customers better experiences through AI-powered messaging instead of forcing them to waste time on hold or crawling through websites. For consumers, AI-powered conversations make it natural and easy to buy products and resolve questions in the messaging channels they use every day, including Apple Business Chat, WhatsApp, Facebook Messenger and SMS. For brands, this means happier customers, higher efficiency, and lower costs. Over 18,000 customers - including leading brands like HSBC, Orange, GM Financial, and The Home Depot - have deployed LivePerson's conversational platform to orchestrate how AI and human agents serve customers at scale. This solution helps millions of people shop and get customer service through the world's most popular messaging channels, brand websites and apps, and even voice assistants.		£19.4M VALUATION 1.3% OF TOTAL ASSETS 0.6% OF ISSUED SHARE CAPITAL HELD £2.9M BOOK COST

Five9		
Five9 is a leading provider of cloud software for contact centres and facilitates more than 5 billion call minutes annually. Since the Company's inception, it has exclusively focused on delivering its platform in the cloud and disrupting a significantly large market by replacing legacy on-premise contact centre systems. The Company's purpose-built, highly scalable and secure Virtual Contact Centre, or VCC, cloud platform delivers a comprehensive suite of easy-to-use applications that allows simultaneous management and optimisation of customer interactions across voice, chat, email, web, social media and mobile channels, either directly or through application programming interface. Delivered on-demand, the solution enables clients to quickly deploy agent seats in any geographic location with only a computer, headset and broadband Internet connection. Five9's mission is to empower organisations to transform their contact centres into customer engagement centres of excellence, while improving business agility and significantly lowering the cost and complexity of their contact centre operations.		£18.5M VALUATION 1.2% OF TOTAL ASSETS 0.2% OF ISSUED SHARE CAPITAL HELD £0.4M BOOK COST

Volex		
Volex is a leading integrated manufacturing specialist. Providing power and connectivity for both everyday items and complex machinery, from radiation oncology treatments, industrial lasers, right through to electric vehicles for the 21st century, Volex is integral to a vast universe of modern manufacturers. The Group designs and manufactures products that ensure a critical connection never fails and are used in everything from defibrillators and ventilators through to data networking equipment and vehicle telematics. Headquartered in the United Kingdom, Volex serves the needs of its blue-chip customer base from its manufacturing sites located across nine countries and three continents, employing over 6,000 people. Volex's products are sold through its own global sales force and through distributors to Original Equipment Manufacturers ('OEMs') and Electronic Manufacturing Services companies.		£17.7M VALUATION 1.2% OF TOTAL ASSETS 3.8% OF ISSUED SHARE CAPITAL HELD £6.2M BOOK COST

BATM Advanced Communications		
BATM Advanced Communications is a leading provider of real-time technologies for networking and cybersecurity solutions and for bio-medical and bio-waste treatment solutions via its two operating divisions. Its disruptive technology is backed by strong intellectual property and patents, which is the foundation for the development of BATM's market-leading, innovative and cost-effective solutions. The Bio-Medical division is focused on the development and provision of diagnostic laboratory equipment and services as well as innovative products to treat biological pathogenic waste in the medical, agricultural and pharmaceutical industries. The Networking and Cyber division offers innovative telecom network solutions, with a focus on advanced software and cyber security, mainly targeting Tier 1 businesses and governments worldwide. Established in 1992, BATM is headquartered in Israel with offices in North America, Europe and the Far East.		£17.5M VALUATION 1.1% OF TOTAL ASSETS 4.3% OF ISSUED SHARE CAPITAL HELD £4.7M BOOK COST

Varonis Systems		
Varonis Systems is a pioneer in data security and analytics, fighting a different battle than conventional cybersecurity companies. Varonis focuses on protecting enterprise data: sensitive files and emails; confidential customer, patient and		£16.6M VALUATION 1.1% OF TOTAL ASSETS

employee data; financial records; strategic and product plans; and other intellectual property. The Varonis Data Security Platform detects insider threats and cyberattacks by analysing data, account activity and user behaviour; prevents and limits disaster by locking down sensitive and stale data; and efficiently sustains a secure state with automation. With a focus on data security, Varonis serves a variety of use cases, including governance, compliance, classification and threat analytics. Varonis started operations in 2005 and has customers spanning firms in the financial services, public, healthcare, industrial, insurance, energy and utilities, consumer and retail, technology, media and entertainment and education sectors.		0.4% OF ISSUED SHARE CAPITAL HELD £4.2M BOOK COST

Nordic Semiconductor		
Nordic Semiconductor is a fabless semiconductor company specializing in wireless technology for the IoT. Nordic's reputation is built on leading-edge technology and development tools that shield designers from RF complexity. The company pioneered ultra-low power wireless and helped develop Bluetooth LE. Its Bluetooth LE solutions made it the market leader, and are complemented by ANT+, Thread and Zigbee products. Nordic's low power, compact LTE-M/NB-IoT cellular IoT solutions leverage cellular infrastructure to extend the IoT network. Complementing its short-range and cellular IoT wireless technologies, Nordic's technology portfolio includes the Wi-Fi development team and IP assets acquired from Imagination Technologies in 2020.		£16.4M VALUATION 1.1% OF TOTAL ASSETS 0.7% OF ISSUED SHARE CAPITAL HELD £3.4M BOOK COST

IQE		
IQE is the leading global supplier of compound semiconductor wafers that enable a diverse range of applications across: mobile handsets, global telecoms infrastructure, connected devices and infra-red and sensing applications. IQE has been particularly successful in the production of VCSELs, which enable 3D sensing. With a 30-year, proven track record in epitaxy, IQE has invested in significant capacity in recent years to fuel anticipated growth in demand for compound semiconductors, driven by the macro trends of 5G and connected devices. The superior performance qualities of compound semiconductors make them essential to these macro trends, facilitating higher power ranges, higher frequency ranges and the ability to emit and detect light. As a global epitaxy wafer manufacturer, IQE is uniquely positioned in this growth market with an intellectual property portfolio - know-how and patents that produce superior quality, yields and unit economics. IQE is headquartered in Cardiff UK, with c. 650 employees across nine manufacturing locations in the UK, US, Taiwan and Singapore.		£16.0M VALUATION 1.1% OF TOTAL ASSETS 2.8% OF ISSUED SHARE CAPITAL HELD £8.9M BOOK COST

Idox		
Idox develops specialist software and information management solutions for government, health, engineering, transport and property sectors across the UK and internationally. Idox focuses on public and asset intensive industries, both areas are characterised by the dual challenge of improving productivity and service standards whilst addressing continued pressure on expenditure. The requirement to generate greater efficiency through digital transformation is therefore driving continuing investment in software in these complex regulated markets.		£16.0M VALUATION 1.1% OF TOTAL ASSETS 7.2% OF ISSUED SHARE CAPITAL HELD £5.3M BOOK COST

Ilika		
Ilika is a UK pioneer in solid-state battery technology with their innovative Stereax micro batteries designed for Industrial IoT and MedTech markets, and their Goliath large format batteries for the electric vehicle and consumer electronics markets. Ilika has been working with solid-state battery technology since 2008 and has developed a type of lithium-ion battery, which, instead of using liquid or polymer electrolyte, uses a ceramic ion conductor. Stereax battery technology offers compelling advantages over conventional lithium-ion batteries, including smaller footprint, high energy density, non-toxic materials, faster charging, increased cycle life, low leakage and reduced flammability. Stereax solid-state batteries are also customisable in shape and form, stackable and operational at high temperatures.		£15.9M VALUATION 1.0% OF TOTAL ASSETS 5.8% OF ISSUED SHARE CAPITAL HELD £3.2M BOOK COST

BE Semiconductor Industries		
BE Semiconductor Industries (Besi) is a leading supplier of semiconductor assembly equipment for the global semiconductor and electronics industries offering high levels of accuracy, productivity and reliability at a low cost of ownership. Besi develops leading-edge assembly processes and equipment for leadframe, substrate and wafer level packaging applications in a wide range of end-user markets including electronics, mobile internet, computer, automotive, industrial, LED and solar energy. Customers are primarily leading semiconductor manufacturers, assembly subcontractors and electronics and industrial companies.		£15.5M VALUATION 1.0% OF TOTAL ASSETS 0.4% OF ISSUED SHARE CAPITAL HELD £0.9M BOOK COST

Esker		
		£15.3M VALUATION

Esker helps organizations around the world streamline their business document processes. Esker was founded as a software company in 1985 with a direct and simple vision in mind - to help businesses deliver their paper documents electronically. Today, Esker is widely recognized as a leader in AI-driven process automation software. Companies use Esker's cloud-based solutions to drive greater efficiency, accuracy, visibility and cost savings throughout their procurement to payment and order to cash processes. Over 600,000 users and 6,000 SaaS customers operating in 50+ countries use Esker's automation solutions, these customers are supported by more than 750 Esker employees in 14 subsidiaries worldwide.		1.0% OF TOTAL ASSETS 1.7% OF ISSUED SHARE CAPITAL HELD £4.0M BOOK COST

Kingdee International Software		
Kingdee International Software was established in 1993 and is headquartered in Shenzhen, China. The company's original focus was to develop enterprise application software for fast-growing businesses. With the increasing adoption of cloud-based services in China, Kingdee has more recently developed a strong cloud product offering. This includes; Kingdee Cloud Cosmic (a cloud service platform for large enterprises), Kingdee Cloud Galaxy (a digital innovative cloud service platform for medium and large enterprises and fast-growing enterprises), Kingdee Jingdou Cloud (one-stop cloud services platform for micro and small-sized enterprises), Cloud-Hub (intelligent cloud office), Guanyi Cloud (cloud services for e-commerce operators). Kingdee provides services and products to more than 6.8 million enterprises, government agencies and other organisations.		£14.7M VALUATION 1.0% OF TOTAL ASSETS 0.1% OF ISSUED SHARE CAPITAL HELD £0.9M BOOK COST

INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER

	2020 Revenue £'000	**2020 Capital £'000**	**2020 Total £'000**	2019 Revenue £'000	2019 Capital £'000	2019 Total £'000
Gains on investments	**-**	**412,632**	**412,632**	-	245,174	245,174
Losses on foreign exchange	**-**	**(3,173)**	**(3,173)**	-	(3,119)	(3,119)
Income	**9,361**	**-**	**9,361**	11,735	-	11,735
Investment management fee	**(12,223)**	**-**	**(12,223)**	(10,537)	-	(10,537)
Other administrative expenses	**(837)**	**(100)**	**(937)**	(779)	(54)	(833)
(Loss)/profit before finance costs and taxation	**(3,699)**	**409,359**	**405,660**	419	242,001	242,420
Finance costs of borrowings	**-**	**-**	**-**	(156)	-	(156)
(Loss)/profit before taxation	**(3,699)**	**409,359**	**405,660**	263	242,001	242,264
Taxation	**(298)**	**-**	**(298)**	(232)	-	(232)
(Loss)/profit after taxation	**(3,997)**	**409,359**	**405,362**	31	242,001	242,032
(Loss)/profit per ordinary shares (basic and diluted)	**(6.00p)**	**614.30p**	**608.30p**	0.05p	355.30p	355.35p

There is no final dividend proposed (2019 - nil).

The total column of this statement is the profit and loss account of the Company, prepared in accordance with UK Accounting Standards.

The (loss)/profit after taxation is the total comprehensive income and therefore no additional statement of comprehensive income is presented. The supplementary revenue and capital columns are presented for information purposes in accordance with the Statement of Recommended Practice issued by the Association of Investment Companies. All items in the above statement derive from continuing operations of the Company. No operations were acquired or discontinued in the year.

BALANCE SHEET

AT 31 DECEMBER

	2020 £'000	2019 £'000
Fixed assets		
Investments held at fair value through profit or loss	**1,430,583**	1,033,226
Current assets		
Cash and cash equivalents	**72,929**	88,843
Other receivables	**1,460**	1,995
	74,389	90,838
Current liabilities		
Other payables	**(1,605)**	(1,215)
	(1,605)	(1,215)
Net current assets	**72,784**	89,623
TOTAL NET ASSETS	**1,503,367**	1,122,849
Capital and reserves		
Called up share capital	**16,446**	16,828
Share premium	**73,738**	73,738
Capital redemption reserve	**5,506**	5,124
Capital reserve	**1,410,424**	1,025,909
Revenue reserve	**(2,747)**	1,250
SHAREHOLDERS' FUNDS	**1,503,367**	1,122,849
NET ASSET VALUE PER ORDINARY SHARE (including current year revenue)	**2,285.33p**	1,668.13p
NET ASSET VALUE PER ORDINARY SHARE (excluding current year revenue)	**2,291.41p**	1,668.08p

STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2020

	Called up Share Capital £'000	**Share Premium £'000**	**Capital Redemption Reserve £'000**	**Capital Reserve £'000**	**Revenue Reserve £'000**	**Shareholders' funds £'000**
Shareholders' funds at 1 January 2020	**16,828**	**73,738**	**5,124**	**1,025,909**	**1,250**	**1,122,849**
Profit/(loss) after taxation	**-**	**-**	**-**	**409,359**	**(3,997)**	**405,362**
Shares purchased for cancellation	**(382)**	**-**	**382**	**(24,844)**	**-**	**(24,844)**
Shareholders' funds at 31 December 2020	**16,446**	**73,738**	**5,506**	**1,410,424**	**(2,747)**	**1,503,367**

FOR THE YEAR ENDED 31 DECEMBER 2019

	Called up Share Capital '000	Share Premium '000	Capital Redemption Reserve '000	Capital Reserve '000	Revenue Reserve '000	Shareholders' funds '000
Shareholders' funds at 1 January 2019	17,225	73,738	4,727	804,245	1,219	901,154
Profit after taxation	-	-	-	242,001	31	242,032
Shares purchased for cancellation	(397)	-	397	(20,337)	-	(20,337)
Shareholders' funds at 31 December 2019	16,828	73,738	5,124	1,025,909	1,250	1,122,849

CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER

	2020 £'000	**2020 £'000**	2019 £'000	2019 £'000
Cash flow from operating activities				
Profit before finance costs and taxation	**405,660**		242,420	
Adjustments for gains on investments	**(412,632)**		(245,174)	
Purchase of investments	**(186,269)**		(148,856)	
Sale of investments	**202,369**		193,007	
	(657)		(116)	

Adjustment for other movements in investment gains				
Decrease/(increase) in receivables	**548**		(516)	
Increase in payables	**226**		254	
Amortisation of fixed income book cost	**35**		(407)	
Effect of foreign exchange rate changes	**3,173**		3,119	
Overseas tax on overseas income	**(311)**		(136)	
Net cash inflow from operating activities		**12,142**		43,595
Cash flow from financing activities				
Undrawn facility fee paid	**(39)**		(156)	
Shares purchased for cancellation	**(24,844)**		(20,337)	
Net cash outflow from financing activities		**(24,883)**		(20,493)
Net (decrease)/increase in cash and cash equivalents		**(12,741)**		23,102
Cash and cash equivalents at start of the year		**88,843**		68,860
Effect of foreign exchange rate changes		**(3,173)**		(3,119)
Cash and cash equivalents at the end of the year		**72,929**		88,843
Comprised of:				
Cash and cash equivalents		**72,929**		88,843

Cash flow from operating activities includes interest received of £1,333,000 (2019 - £1,429,000) and dividends received of £7,391,000 (2019 - £9,636,000).

As the Company did not have any long-term debt at both the current and prior year ends, no reconciliation of the net debt position is presented.

INCOME

	2020 £'000	2019 £'000
Dividend income from investments		
UK dividends from listed investments	**2,468**	3,179
UK dividends from unlisted investments (inc AIM)	**2,475**	3,437
Overseas dividends from UK-listed and AIM companies	**328**	631
Overseas dividend income	**2,887**	2,659
	8,158	9,906
Interest income from equity investments		
Income from unlisted (inc AIM) UK convertible bonds	**595**	256
Income from unlisted US convertible bonds	**33**	-

	628	256
Fixed interest		
UK interest from government securities	**4**	-
Overseas interest from government securities	**581**	1,170
	585	1,170
Other income		
Deposit interest	**(10)**	395
Underwriting commission	**-**	8
	(10)	403
Total income	**9,361**	11,735

Included within dividend income are special dividends of £445,000 (2019: £37,000).

Status

The Company is an investment company within the meaning of s833 of the Companies Act 2006 and operates as an investment trust in accordance with s1158 of the Corporation Tax Act 2010 as amended (s1158). The Company is subject to the Listing Rules of the Financial Conduct Authority and governed by its articles of association, amendments to which must be approved by shareholders by way of special resolution. The Company obtained approval from HM Revenue and Customs of its status as an investment trust under s1158 and the directors are of the opinion that the Company has and continues to conduct its affairs in compliance with s1158 since this approval was granted.

Objective

Herald's objective is to achieve capital appreciation through investments in smaller quoted companies in the areas of technology, media and telecoms.

Investments will be made throughout the world. The business activities of investee companies will include information technology, broadcasting, printing and publishing and the supply of equipment and services to these companies.

Investment policy - strategy

While the policy is global investment in smaller quoted companies in TMT, the approach is to construct a diversified portfolio through the identification of individual companies which offer long-term growth potential, typically over a five year horizon or more. The portfolio is actively managed and does not seek to track any comparative index. With a remit to invest in smaller companies with market capitalisation generally below $3bn, there tends to be a correlation with the performance of smaller companies, as well as those of the technology sector. A degree of volatility relative to the overall market should be expected.

The risk associated with the illiquidity of smaller companies is reduced by generally restricting the stake in any one company to less than 10% of the shares in issue.A number of investments are in early stage companies, which have a higher stock specific risk but the potential for above average growth. Stock specific risk is reduced by having a diversified portfolio of over 250 holdings.

In addition, to contain the risk of any one holding, the manager generally takes profits when a holding reaches more than 5% of the portfolio. The manager actively manages the exposure within the constraint that illiquid positions cannot be traded for short-term movements.

The Company has a policy not to invest more than 15% of gross assets in other UK-listed investment companies.

From time to time, fixed interest holdings, non-equity or unlisted investments may be held on an opportunistic basis.

The Company recognises the long-term advantages of gearing and has a maximum gearing limit of 50% of net assets. Borrowings are invested primarily in equity markets but the manager is entitled to invest in other securities in the companies in the target areas when it is considered that the investment grounds merit the Company taking a geared position. The board's intention is to gear the portfolio when appropriate. Gearing levels are monitored closely by the manager and reviewed by directors at each board meeting.

The Company may use derivatives which will be principally, but not exclusively, for the purpose of efficient portfolio management (i.e. for the purpose of reducing, transferring or eliminating investment risk in its investments, including protection against currency risk).

Investment management agreement

The management of the Company and the implementation of its investment strategy is contracted to Herald Investment Management Limited ('HIML'). HIML is authorised and regulated by the Financial Conduct Authority both for investment management and as an Alternative Investment Fund Manager.

The management contract with HIML is subject to 12 months' notice by either party. The senior director of HIML with prime responsibility for the management of the Company's portfolio is Katie Potts, who is also a substantial shareholder of HIML Holdings Limited, the parent company of HIML. For the year under review, HIML was remunerated at an annual rate of 1.0% of the Company's net asset value (excluding current year net revenue) calculated using middle market prices. Compensation fees would only be payable in respect of this 12 month period if termination were to occur sooner. Careful consideration has been given by the board as to the basis on which the management fee is charged and, at the recommendation of the Investment Manager, the board agreed to a reduction in fees so that 1% is charged on the first £1.25 billion of the Company's net asset value (excluding current year revenue), and 0.8% thereafter with effect from 1 January 2021. The board considers that maintaining an appropriate level of ongoing charges for a specialist trust is in the best interest of all shareholders. The board is also of the view that calculating the fee with reference to performance would be unlikely to exert a positive influence over the long-term performance. At 31 December 2020, Katie Potts held 393,430 (2019: 448,095) of the Company's shares.

At 31 December 2020, the Company was the beneficial owner of 15.4% (2019: 15.4%) of the ordinary share capital of HIML Holdings Limited.

The board considers the investment management arrangements for the Company on a continuing basis and a formal review is conducted annually. The board considers, amongst others, the following topics in its review: investment performance in relation to the investment policy and strategy; the continuity of personnel managing the assets and reporting to the board; the level of service provided in terms of the accuracy and timeliness of reports to the board and the frequency and quality of both verbal and written communications with shareholders.

Following the most recent review the board is of the opinion that the continued appointment of HIML as investment manager, on the terms agreed, is in the interests of shareholders due to the experience of the manager, the track record of performance and the quality of information provided to the board.

Purchase of own shares

At the AGM of the Company to be held on 20 April 2021, the Company will as usual be seeking authority to make limited purchases of the Company's ordinary shares. Buy-backs are considered by the board to be a useful tool, where surplus cash is not being utilised for investment, to assist in the maintenance of liquidity in the Company's shares. Shares will only be bought back at a time when the Company's shares are trading at a discount to its prevailing net asset value.

Significant financial issues relating to the 2020 financial statements

The UK Corporate Governance Code requires us to describe any significant issues considered in relation to the financial statements and how those issues were addressed. While there were no significant issues, two matters of risk of particular focus at the balance sheet date are the risks that investments might not have been correctly valued or beneficially owned. No issues were discovered.

Principal risks and uncertainties

In accordance with the corporate objective of maximising capital appreciation the Company invests in securities on a worldwide basis. The Company can use gearing although no gearing was employed during the year. The Company's other financial instruments consist of cash and cash equivalents, short-term debtors and creditors.

The main risks arising from the Company's financial instruments are:

A. MARKET RISK

(i) Other price risk, being the risk that the value of investment holdings will fluctuate as a result of changes in market prices caused by factors other than interest rate or currency rate movement;

(ii) Interest rate risk, being the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates; and

(iii) Foreign currency risk, being the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

B. CREDIT RISK

Being the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Company is exposed to counterparty credit risk from the parties with which it trades and will bear the risk of settlement default. Counterparty credit risk to the Company arises from transactions to purchase or sell investments held within the portfolio.

There were no past due nor impaired assets as of 31 December 2020 (2019 - nil).

The counterparties engaged with the Company are regulated entities and of high credit quality.

C. LIQUIDITY RISK

Being the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

These risks and the policies for managing them have been applied throughout the year and are summarised below.

A. MARKET RISK

(i) Other Price Risk

The Company's investment portfolio is exposed to market price fluctuations which are monitored by the manager in pursuance of the corporate objective. Listed securities held by the Company are valued at bid prices, whereas material unlisted investments are valued by the directors on the basis of the latest information in line with the relevant principles of the International Private Equity and Venture Capital Valuation Guidelines (Accounting Policy 1(c)). These valuations represent the fair value of the investments.

Other Price Risk Sensitivity

15.5% of the Company's total equity investments at 31 December 2020 (2019 - 20.4%) were listed on the main list of the London Stock Exchange and a further 36.5% (2019 - 37.4%) on AIM. The NASDAQ Stock Exchange accounts for 23.5% (2019 - 21.8%), New York Stock Exchange for 3.0% (2019 - 4.2%) and other stock exchanges or unlisted 21.5% (2019 - 16.2%). A 10% increase in equity investment prices at 31 December 2020 would have increased total net assets and profit & loss after taxation by £138,816,000 (2019 - £98,812,000). A decrease of 10% would have the exact opposite effect. The portfolio does not target any exchange as a comparative index, and the performance of the portfolio has a low correlation to generally used indices.

The shares of Herald Investment Trust plc have an underlying NAV per share. The NAV per share of Herald Investment Trust plc fluctuates on a daily basis. In addition, there is volatility in the discount/premium the share price has to NAV.

(ii) Interest Rate Risk
The majority of the Company's assets are equity shares and other investments which neither pay interest nor have a maturity date. However, the Company does hold convertible bonds and government bonds, the interest rate and maturity dates of which are detailed below. Interest is accrued on cash balances at a rate linked to the UK base rate.

The interest rate risk profile of the financial assets and financial liabilities at 31 December was:

Financial Assets

	2020 Fair value £'000	**2020 Weighted average interest rate/ interest rate**	**2020 Weighted average period until maturity/ maturity date**	2019 Fair value £'000	2019 Weighted average interest rate/ interest rate	2019 Weighted average period until maturity/ maturity date
Fixed rate:						
US bonds	**22,422**	**1.3%**	**1.8 Years**	45,108	1.3%	1.6 Years
UK bonds	**20,004**	**1.5%**	**0.1 Years**	-	-	-
Overseas convertible bonds	**1,005**	**4.2%**	**3.2 Years**	-	-	-
UK convertible bonds	**3,693**	**6.8%**	**1.5 Years**	2,646	7.9%	1.7 Years
Floating rate cash:						
Non-sterling	**53,155**	**0.0%**		33,908	0.8%	
Sterling	**19,774**	**0.0%**		54,935	0.0%	
	72,929			88,843		

The benchmark rate which determines the interest payments received on cash balances is the Bank of England base rate.

Interest rate risk sensitivity
(a) Cash
An increase of 100 basis points in interest rates as at 31 December 2020 would have a direct effect on net assets. Based on the position at 31 December 2020, over a full year, an increase of 100 basis points would have increased the profit & loss after taxation by £729,000 (2019 - £888,000) and would have increased the net asset value per share by 1.11p (2019 - 1.32p). The calculations are based on the cash balances as at the respective balance sheet dates and are not representative of the year as a whole.

(b) Fixed rate bonds
An increase of 100 basis points in bond yields as at 31 December 2020 would have decreased total net assets and profit & loss after taxation by £412,000 (2019 - £679,000) and would have decreased the net asset value per share by 0.63p (2019 - 1.01p). A decrease in bond yields would have had an equal and opposite effect. The convertible loan stocks having an element of equity are not included in this analysis as given the nature of the businesses and the risk profile of their balance sheets; they are considered to have more equity like characteristics.

(iii) Foreign Currency Risk
The Company's reporting currency is sterling, but investments are made in overseas markets as well as the United Kingdom and the asset value can be affected by movements in foreign currency exchange rates.

Furthermore many companies trade internationally both through foreign subsidiaries, and through exports. The greatest foreign currency risk occurs when companies have a divergence in currencies for costs and revenues. A much less risky exposure to currency is straight translation of sales and profits. However the location of the stock market quote only has a limited correlation to the costs, revenues and even activities of those companies, and so this note should not be regarded as a reliable guide to the sensitivity of the portfolio to currency movements. For example, the holdings in the portfolio that have suffered most from US$ weakness are UK companies with dollar revenues and sterling costs.

The Company does not hedge the sterling value of investments that are priced in other currencies. Overseas income is subject to currency fluctuations. The Company does not hedge these currency fluctuations because it is impossible to quantify the effect for the reasons stated above. However, from time to time the manager takes a view by holding financial assets or liabilities in overseas currencies.

Exposure to currency risk through asset allocation by currency of listing is indicated below:

At 31 December 2020

	Investments £'000	**Cash and deposits £'000**	**Other receivables and payables £'000**	**Net exposure £'000**
US dollar	**391,663**	**43,078**	**92**	**434,833**
Euro	**96,657**	**8,742**	**74**	**105,473**
Australian dollar	**46,095**	**-**	**17**	**46,112**
Taiwan dollar	**33,387**	**1,335**	**-**	**34,722**
Japanese yen	**30,229**	**-**	**27**	**30,256**
Norwegian krone	**19,987**	**-**	**-**	**19,987**
Korean won	**16,058**	**-**	**62**	**16,120**
Other overseas currencies	**36,226**	**-**	**5**	**36,231**
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	**670,302**	**53,155**	**277**	**723,734**
Sterling	**760,281**	**19,774**	**(422)**	**779,633**
	1,430,583	**72,929**	**(145)**	**1,503,367**

At 31 December 2019

	Investments £'000	Cash and deposits £'000	Other receivables and payables £'000	Net exposure £'000
US dollar	307,531	20,389	4	327,924

Euro	50,049	3,803	67	53,919
Taiwan dollar	19,111	5,416	-	24,527
Australian dollar	23,474	-	530	24,004
Norwegian krone	14,202	4,300	-	18,502
Korean won	12,010	-	97	12,107
Japanese yen	7,082	-	7	7,089
Other overseas currencies	13,657	-	-	13,657
Exposure to currency risk on translation of valuations of securities listed in overseas currencies	447,116	33,908	705	481,729
Sterling	586,110	54,935	75	641,120
	1,033,226	88,843	780	1,122,849

Foreign currency risk sensitivity
At 31 December 2020, had sterling strengthened by 10% (2019 - 10%) in relation to all currencies, with all other variables held constant, total net assets and profit & loss after taxation would have decreased by the amounts shown below based on the balances denominated in foreign currency. A 10% (2019 - 10%) weakening of sterling against all currencies, with all other variables held constant, would have had the exact opposite effect on the financial statement amounts. However, companies whose cost base diverges in currency terms from its sales will in the longer term have a significantly greater effect on valuation than simple translation. In the short term investee companies generally cover their currency exposure to varying degrees. There is insufficient publicly disclosed information to quantify this, but in the long term this effect is expected to dwarf simple translation of foreign listings in terms of both risk and reward, because many investee companies trade globally. Furthermore, the country of listing is not necessarily an indication of the geography of some or even any operational activities for investee companies. The Manager does not use financial instruments to protect against currency movements. From time to time financial leverage has been made using debt in overseas currencies.

	2020 £'000	2019 £'000
US dollar	**43,483**	32,792
Euro	**10,547**	5,392
Australian dollar	**4,611**	2,400
Taiwan dollar	**3,472**	2,453
Japanese yen	**3,026**	709
Norwegian krone	**1,999**	1,850
Korean won	**1,612**	1,211
Other overseas currencies	**3,623**	1,366
	72,373	48,173

B. Credit Risk
Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment which it has entered into with the Company. The manager monitors counterparty risk on an ongoing basis.

The Company has investments in convertible loan stocks that have an element of equity. These securities are viewed as having a risk profile similar to the equity holdings. This is because the convertibles held are in nascent technology companies that may be loss-making and may have weak balance sheets. For this reason these stocks are categorised as equity holdings and for risk management purposes excluded from the credit risk analysis.

Credit Risk Exposure
The exposure to credit risk at 31 December was:

	2020 £'000	2019 £'000
Fixed interest investments	**42,426**	45,108
Cash and cash equivalents	**72,929**	88,843
Other receivables	**1,460**	1,995
	116,815	135,946

During the year the maximum exposure in fixed interest investments was £48,953,000 (2019 - £65,604,000) and the minimum £42,426,000 (2019 - £24,292,000). The maximum exposure in cash was £112,654,000 (2019 - £107,727,000) and the minimum £72,929,000 (2019 - £35,395,000).

C. Liquidity Risk
The Company's policy with regard to liquidity is to provide a degree of flexibility so that the portfolio can be repositioned when appropriate and that most of the assets can be realised without an excessive discount to the market price.

Equity Securities
The Company's unlisted investments are not readily realisable, but these only amount to 1.3% of the Company's total assets at 31 December 2020 (2019 - 1.3%).

In practice, liquidity in investee companies is imperfect, particularly those with a market value of less than £100 million. To reduce this liquidity risk it is the policy to diversify the holdings and generally to restrict the holding in any one company to less than 10% of the share capital of that company. Furthermore the guideline is for no single investment to account for more than 5% of the assets of the Company.

The market valuation of each underlying security gives an indication of value, but the price at which an investment can be made or realised can diverge materially from the bid or offer price depending on market conditions generally and particularly to each investment. 12.0% (£165 million) (2019 - 17.1% (£166 million)) of the listed equities in the portfolio are invested in stocks with a market capitalisation below £100 million, where liquidity is expected to be more limited. If these stocks had on average a realisable value 20% below the bid price the value of the total fund would be adversely affected by 2.2% (2019 - 3.0%).

Liquidity Risk Exposure
Contractual maturities of the financial liabilities at the year end, based on the earliest date on which payment can be required are as follows:

	2020 One year or less £'000	2019 One year or less £'000
Other payables	**1,605**	1,215
	1,605	1,215

Fair Value of Financial Instruments

The Company's investments, as disclosed in the Company's balance sheet, are valued at fair value.

Nearly all of the Company's portfolio of investments are disclosed in the Level 1 category as defined in FRS 102.

Categorisation is based on the lowest level input that is significant to the fair value measure in its entirety.

The three levels set out in FRS102 follow:

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.

The investment manager considers observable data to be that market data that is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

The analysis of the valuation basis for the financial instruments based on the hierarchy as at 31 December is as follows:

At 31 December 2020

	Level 1 £'000	**Level 2 £'000**	**Level 3 £'000**	**Total £'000**
Financial assets				
Equity investments	**1,368,578**	**-**	**12,494**	**1,381,072**
Government debt securities	**42,426**	**-**	**-**	**42,426**
Convertible loan stocks	**-**	**-**	**7,085**	**7,085**
Total investments	**1,411,004**	**-**	**19,579**	**1,430,583**

At 31 December 2019

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Financial assets				
Equity investments	973,063	-	10,517	983,580
Government debt securities	45,108	-	-	45,108
Convertible loan stocks	-	-	4,538	4,538
Total investments	1,018,171	-	15,055	1,033,226

A reconciliation of fair value measurements in Level 3 is set out below:

At 31 December 2020

	£'000
Opening balance at 1 January 2020	15,055

Purchases	2,223
Sales	(3,498)
Total (losses) or gains	
- on assets sold during the year	(75)
- on assets held at 31 December 2020	3,871
Assets transferred during the year	2,003
Closing balance at 31 December 2020	19,579

Other risks

Other risks to the Company's model, future performance, solvency or liquidity include the following:

Regulatory risk - failure to comply with applicable legal and regulatory requirements could lead to suspension of the Company's Stock Exchange listing, financial penalties by the UKLA or a qualified audit report. Breach of s1158 could lead to the Company being subject to tax on capital gains. The manager, depositary and administrator provide regular reports to the audit committee on their monitoring programmes. The manager monitors investment positions and the manager and administrator monitor the level of forecast income and expenditure.

Major regulatory change could impose disproportionate compliance burdens on the Company. In such circumstances representation would be made to seek to ensure that special circumstances of investment trusts are recognised.

Operational/financial/custody risk - disruption to or failure of the administrator's accounting systems or those of other third-party service providers could lead to an inability to provide accurate reporting and monitoring or a misappropriation of assets. The Company is exposed to the operational and cyber risks of its third-party service providers. The manager, administrator and company secretary each have comprehensive business continuity plans which facilitate continued operation of the business in the event of a service disruption or major disruption. The audit committee receives the administrator's report on internal controls and the reports by other key third-party providers are reviewed by the manager and company secretary on behalf of the audit committee.

The depositary reports six monthly on custody matters, including the continued safe custody of the Company's assets.

Cyber risk was also considered and is continually monitored as cyber threats are evolving and becoming increasingly sophisticated. The integrity of the Company's information technology is closely monitored by the board, each of the key service providers provides a report on its internal audit which covers information technology security and provides comfort to the board that appropriate safeguards are in place.

Emerging risk - failure to have in place procedures that assist in identifying new or familiar risks that become apparent in new or unfamiliar conditions. The audit committee reviews the risk map twice each year and the board regularly discusses industry trends and forthcoming legislation/regulatory change with its advisors, including the manager, the broker and company secretary. It also reviews regular updates from the AIC and the auditor on such matters. Climate change is considered as an emerging risk and the changes in climate change focused regulation, governing both the Company and investee companies, will create some uncertainty. A number of investments address the challenges arising from climate change and may benefit. However, if climate change has a significant adverse impact on the wider economy, the Company could be negatively affected. In comparison to the broader economy, the portfolio has a relatively low carbon footprint. The board encourages the manager to consider environmental, social and governance factors when selecting and retaining investments.

Discount volatility - the discount at which the Company's shares trade can widen. The board monitors the level of discount and the Company has authority to buy back its own shares.

Gearing risk - the Company may borrow money for investment purposes. If the investments fall in value, any borrowings will magnify the extent of this loss. If borrowing facilities are not renewed, the Company may have to sell investments to repay borrowings. All borrowings require the prior approval of the board and gearing levels are discussed by the board and manager at every meeting. The Company does not have any borrowing at year end. The majority of the Company's investments are in quoted securities.

Viability statement

The directors' view of the Company's viability has not changed since last year. The Company, as an investment trust, is a collective investment vehicle designed and managed for the long term. The directors consider that three years is an appropriate forward-looking time period. This recognises the Company's current position, the investment strategy, which includes investment in smaller companies, some of which are early stage, where a three-year horizon is a meaningful period over which to judge prospects, the board's assessment of the main risks that threaten the business model and the relatively fast moving nature of the sectors in which the Company invests. By definition, investment in smaller and early stage companies carries higher risks, both in terms of stock liquidity and longer term business viability and this risk is accepted by the board.

There are no current plans to amend the investment strategy, which has delivered good investment performance for shareholders over many years and, the directors believe, should continue to do so. The investment strategy and its associated risks are kept under constant review by the board. The board undertook a robust assessment of the risks pertaining to the Company, including risks to the Company's viability, and this is set out in the principal risks and uncertainties section. This included emerging risks such as the pandemic and climate change as set out therein. As part of this the board considered several severe but plausible scenarios, including the impact of significant market movements.

Other items relevant in the director's assessment of the Company's viability were: income and expenses projections and the fact that some of the Company's investments comprise readily realisable securities as proven by liquidity analysis of the portfolio; any borrowing facilities in place - noting there were none at the year end; and the fact that as a closed ended investment company the Company is not affected by the liquidity issues of open-ended companies caused by large or unexpected redemptions. The board also takes account of the triannual shareholder vote on whether the Company should continue as an investment trust. At the AGM in April 2019, 99.88% of votes cast were in favour of continuation. Given the performance of the Company and feedback from stakeholders, including the Company's broker and major shareholders, the board have no reason to believe that the continuation vote will not be approved at the AGM in 2022.

The directors confirm that, based on the above and on reviews conducted as part of the detailed internal controls and risk management processes, they have a reasonable expectation that the Company will continue to maintain its status as an investment trust, to implement its investment strategy and to operate and be able to meet its liabilities as they fall due for at least the next three financial years.

Directors' responsibility statement pursuant to DTR4

Each of the directors confirm that, to the best of their knowledge:

- the financial statements, which have been prepared in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), give a true and fair view of the assets, liabilities, financial position and loss of the Company;
- the annual report and financial statements includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that it faces and the directors' report contains those matters required to be disclosed by applicable law; and

- they consider that the annual report and financial statements, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position, performance, business model and strategy.

Copies of the Company's annual report and financial statements will be available from the Company's registered office or at www.heralduk.com once published on 12 March 2021.

On behalf of the board
PraxisIFM Fund Services (UK) Limited
Company Secretary
22 February 2021

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