HERALD INVESTMENT TRUST PLC

Annual General Meeting – Q&A

As a result of the Coronavirus, the UK government has established measures prohibiting large gatherings. In light of these restrictions, the Annual General Meeting was held on 20th April 2021 as a closed meeting.

In the Annual Report shareholders were encouraged to submit their forms of proxy in advance of the meeting and submit any questions in advance of the AGM to the following email address: info@heralduk.com.

The board received the following questions and in conjunction with the Investment Manager has provided the below responses to be made available via the Investment Manager's website after the AGM.

1) Many congratulations on the breathtakingly marvellous performance in 2020. I have read the report, and see that much of this has come from holding the right shares as stocks have rerated to sharply higher P/Es I did not detect significant exiting of these now-expensive shares, how do you decide when is the right time to sell?

    Yes the majority of the return has come from higher P/Es. The top 25 top performers delivered £247m profit or 61% of the year's return in 2020. These 25 had an aggregate market value of £449m, a book cost of £73m, so the average return is 6x. Furthermore, we added to some positions for an aggregate value of £6.8m during the year and reduced 15 of the top 25 positions in aggregate realising £70.9m in cash, which realised £61.5m in profit. Only one was a complete sale. In other words, there has been material profit taking. From the proceeds of investments realised, 69 new investments were made in 2020 for an aggregate consideration of £91.6m.

2) Many other Investment Trusts have followed the procedure you have adopted for their AGMs – held a closed meeting, accepting written Q&A, but most have posted a video presentation by the investment manager on their websites. I wonder if you could consider doing that as a spoken review tends to add much colour and emphasis to a review of the year?

    A presentation has been prepared and a statement made, both of which are being posted to the website.

3) I had not realised before (mea culpa) but you do not seem to use gearing, and indeed have a reasonable amount of cash on the balance sheet. This is unusual for a trust focussed on growth (although Nick Train may beg to differ). I wondered why this is, could you help me understand why you don't use this tool.

    From time-to-time gearing has been used. In particular we had leverage from 2002 to 2007 and resumed when the market fell in the financial crisis. In hindsight we were too cautious last year, and should have been geared, but it was not obvious to us that disruption to manufacturing supply chains, particularly from Asia that occurred at the start of the coronavirus pandemic, would be resolved so effectively, nor that the IT based service companies that dominate this portfolio, would continue to trade so effectively with work from home. Cash and Government bonds, which are held as a proxy for cash, are now at a lower level, but we are not inclined to gear while P/Es are at relatively high levels. A normalisation of bond yields could see an opportunity to buy at better valuations. The closed end nature of an investment trust has the benefit of allowing us to be nearly fully invested, while retaining the ability to add if an event causes a useful correction through gearing.

4) I am astonished by the number of investments you hold, how is this manageable with the team you have, or does this represent a philosophical outlook based on a buy and hold / longer term perspective?

   This investment trust targets small market capitalisation quoted companies, as it has always done. We wish to retain this focus. The challenge of smaller company investing is liquidity. For this reason and for the higher stock specific risk associated with investing in early-stage companies, it is difficult for private investors and professional generalist investors alike to access this part of the market, and we aim to provide a useful vehicle for this. As Managers we have maintained the discipline of keeping the holding size of each investment below 10% of the outstanding capital except in exceptional circumstances. We have purposefully not raised new capital since 1996, but as the fund grows, we either have higher % stakes and thus making liquidity more challenging, when both buying and selling, or having more holdings or buying back shares. In practice we have undertaken a combination of all three. There is however, a positive offsetting the increased liquidity challenges. A larger fund gives us more scope to take meaningful positions in early-stage high risk companies without undue risk, and to broaden our range of counterparties. This is particularly important in the MiFID II regulatory environment where we must pay for research and have arrangements with over 70 brokers worldwide. In addition, we have over time significantly increased the size of the team to broaden our global coverage.

   We are further motivated to provide capital to early-stage companies. Although we have only raised £95m of outside capital we have invested over £500m in primary capital. Often than can seem meaninglessly small initially, but providing capital enables the companies to exist, and with performance and follow-on fund raisings many have become today's largest positions. We are evangelists for the small company sector, because small companies of today can become medium and large companies in due course and the market is less efficient in pricing small companies. It is fulfilling to have provided needed capital, and sometimes we have been the only source of capital, whilst simultaneously delivering strong returns to investors.

5) Well done for buying back shares given the persistent discount, although I note this has been a modest activity. Are there guidelines which set limits on the amount of buybacks you are willing to do?

   Buybacks are opportunistic. It is not the policy of the Company to control the discount. It would be irresponsible given the illiquidity in the underlying portfolio at times of market stress. The AGM limit is 15% of the outstanding capital.