Investment Manager's Report

This report covers the three months from 1 April 2015 to 30 June 2015.

Investment Report

After reaching new highs in April, major European and North American equity indexes began to sell off in June with the FTSE 100 index falling 8.6% as investors became increasingly focussed on events in China and Greece. In the context of the UK, the market continues to look attractive with further evidence of strong and sustainable growth in the economy, strong employment data, accommodative monetary policy and low food and energy prices. The interest rate cycle looks set to turn within the next 6 months, both here and in the US. Policy makers are making frequent and detailed commentary on the subject and, with the pace of tightening likely to be slow, we don't expect the change of stance to present a major risk to UK equity markets. If there are to be challenges, we see greater risk in China, Greece and US equity market valuations (relative to the modest level of earnings growth forecast).

It has always been our view that companies like to invest against a backdrop of regulatory and fiscal stability. To that end, the conservative majority in the general election and their pro-business policies should encourage small businesses to develop, invest and ultimately grow. While there remain significant challenges in Europe, it is our view that the long term outlook for UK small companies is arguably better now than at any time since the financial crisis.

Performance

In the three months to 30 June 2015, the NAV increased from 75.05p to 77.59p. No dividends were paid, giving investors a total return of 2.54 pence per share, which translates to a gain of 3.38%. During the same period the FTSE AIM All-Share gained 5.51%.

The qualifying investments made a net contribution of 2.32 pence per share with 34 out of the 68 qualifying investments increasing in value, 11 unchanged and 23 decreasing in value. The balance was a mixture of non-qualifying portfolio gains (+0.54 pence per share), costs, income and small gains made through share buy backs.

TrakM8 was the top performing qualifying investment (+53.1%, +0.76 pence per share). Following an excellent trading update that revealed strong organic growth in revenue and earnings within their 2015 financial year, management guided that 2016 was likely to be higher than previously forecast. Other stocks that made a significant contribution included Imaginatik (+150.0%, +0.66 pence per share), Cohort (+11.5%, +0.35 pence per share) and Craneware (+22.6%, +0.30 pence per share).

The biggest losses within the period came from Flowgroup (-41.2%, -0.65 pence per share), Audioboom (-29.4%, -0.31 pence per share) and Premaitha (-15.6%, -0.20 pence per share).

We made five qualifying investments over the quarter, which included two additional investments into existing qualifying companies and three secondary placings into listed companies. We invested a total of £0.94m into qualifying investments over the period.

Within the portfolio of qualifying investments we reduced the size of our investment in TrakM8, Imaginatik, Nektan and Tangent Communications. These partial exits were to maintain sensible individual weightings within the portfolio.

Portfolio Structure

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

The VCT is comfortably through the HMRC defined investment test and ended the period at 93.8% invested as measured by the HMRC investment test. By market value, the VCT had a 65.5% weighting to qualifying investments.

The allocation to non-qualifying equity investments increased marginally from 8.1% to 8.8%, representing the company's on-going small participation in non-qualifying equity issues and IPOs at attractive valuations. In line with the investment policy, we maintained our investment in the Marlborough Special Situations Fund as a temporary home for proceeds from fundraising, with a small quarter end weighting of 0.9%. Fixed income as a percentage of the fund stayed flat at 0.8% and cash ended the quarter at 24.6%, marginally lower than 26.1% last quarter.

Post Period Update

Deal flow has been strong since the quarter end and three additional qualifying investments have been made in Reneuron, Belvoir and Portr. We believe there is a strong pipeline of qualifying investment opportunities.

Joint Offer for Subscription of Ordinary Shares

On 2 October 2014 the Directors of Hargreave Hale AIM VCT 1 plc and Hargreave Hale AIM VCT 2 plc announced the launch of a new joint offer for subscription of new shares in both VCT's to raise up to £10 million into each company.

The Offer for Hargreave Hale AIM VCT 1 plc is not yet fully allocated and will be open until 30 September 2015 (unless fully subscribed by an earlier date). On the basis of Subscription Forms received as at the close of business on 27 July 2015 Hargreave Hale AIM VCT 1 plc has raised £9.99 million.

Buybacks

In total, 369,825 ordinary shares were purchased between 1 April 2015 and the date of this report, at a total value of £268,092.

Dividends

No dividends were paid out during the quarter. The 1.75p interim dividend was paid on 17 July 2015.

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Date: 28 July 2015