Investment Manager's Report

This report covers the first quarter of the 2015/16 financial year, 1 October 2015 to 31 December 2015. The manager's report contains references to movements in the Net Asset Value per share (NAV) and Total Return per share (net asset value per share plus distributed dividends per share). Movements in the NAV per share do not necessarily mirror the earnings per share (EPS) reported in the accounts and elsewhere, which convey the profit after tax within the Company within the reported period as a function of the weighted average number of shares in issue for the period.

Market Commentary

Following the falls in equity markets in August, markets fell further in September as the US Federal Reserve's decision to defer a long anticipated interest rate rise unsettled markets with commentators interpreting the delay as a sign that the US economy might be entering a period of lower growth. Further loosening of monetary policy from the ECB and China, coupled with stronger than expected US corporate earnings, soothed equity markets in October and November as investors waited for the outcome of the Federal Reserve's historic meeting in early December.

Whilst large cap equity indexes registered gains over the period, it is important to note the backdrop of continued weakness in commodity prices and related stocks. Although a sluggish China has clear implications for certain industries (commodities, autos and capital goods), we still believe the outlook for most small UK companies looks healthy. In the UK, domestic focused consumer goods and services have continued to outperform with the impact of lower energy prices, strong real wage growth and low unemployment all feeding through to increased consumer confidence and consumer spending.

Although elements of the portfolio are exposed (in some cases materially) to the commodity markets and/or the slowdown in China, our predominant focus on UK centric small businesses with secular growth leads us to believe that we can still generate positive returns over the medium term and beyond. We continue to deploy capital into attractively valued UK centric companies that should benefit from a business friendly government and a healthy UK economy.

Performance

In the three months to 31 December 2015, the NAV increased from 74.64p to 78.47p. No dividends were paid, giving investors a total return of 3.83 pence per share, which translates to a gain of 5.1%. During the same period, the FTSE 100 Total Return Index gained 3.7%, whilst the FTSE AIM All-Share Total return gained 3.1%.

The qualifying investments made a net gain of 3.17 pence per share with 33 out of the 71 making gains, 10 unchanged and 28 falling in value. The balance was a mixture of non-qualifying portfolio gains (+0.96 pence per share), costs, income and small gains made through buy backs.

Trakm8 was the top performing qualifying investment (+73.4%, +1.63 pence per share). The company released a very strong trading update in September followed by interims in November that were comfortably ahead of market expectations. Trakm8 continues to report significant growth in its telematics solutions division, including growth in higher value recurring revenues. Intercede also performed well (+29.9%, +0.51 pence per share). After a period where the stock was arguably over-sold in the market, Intercede reported interim results in November, highlighting four contract wins and strong revenue growth during the first half of the year. Other stocks that made a significant contribution included Learning Technologies Group (+28.3%, +0.41 pence per share), K3 Business Technology Group (+21.8%, +0.41 pence per share) and Idox (+25.9%, +0.39 pence per share).

The biggest losses within the period came from Reneuron (-31.3%, -0.26 pence per share), EKF Diagnostics (-45.0%, -0.37 pence per share) and TLA Worldwide (-26.5%, -0.48 pence per share).

We made 5 qualifying investments over the three months, which included 4 additional investments into existing qualifying companies and one secondary placing into a listed company. We invested a total of £0.95m into qualifying investments over the period.

Over the period we reduced the size of our investments in Trakm8, Cohort and Imaginatik following particularly strong runs in the shares. We also exited Jelf following receipt of the cash from the successful bid by March & Mclennan in September 2015.

Portfolio Structure

The HMRC investment tests are set out in Chapter 3 of Part 6 Income Tax 2007, which should be read in conjunction with this section of the investment manager's report. 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 89.9% invested as measured by the HMRC investment test. By market value, the VCT had 70.3% weighting to qualifying investments.

The allocation to non-qualifying equity investments increased from 13.8% to 15.0% as we sought to deploy more of the proceeds of the 2014/15 offer into the market following the correction in late August. We reduced our investment in the Marlborough Special Situations Fund from 4.4% to 2.2% of net assets. Cash ended the period slightly higher with a 13.0% weighting, versus 10.5% as at 30 September2015. Fixed income was reduced from 0.8% to 0.0%.

Dividends
On 10 December 2015, a dividend of 2.25p was announced to shareholders in relation to the final report for the year ended 30 September 2015. The dividend was paid on 20 January 2016.

Post Period Update
January has been one of the most challenging periods since the financial crisis. Macro related issues, primarily non-domestic, have exacerbated a sell off that started in late December and has led to a sharp fall in the net asset value of the VCT. Frustrating as this is, we draw some consolation from the more positive news coming out of our investee companies which, as of the time or writing, does not suggest any marked deterioration in their outlook. No additional qualifying investments have been made following the period end.

The NAV fell to 71.31 pence per share as at 22 January 2016. The VCT returned -6.3% between period end and 22 January 2016, including the 2.25 pence per share dividend paid on 20 January 2016, against a return of -5.43% for the FTSE 100 Total Return index and -6.94% for the FTSE AIM All-Share Total Return Index.

Joint Offer for Subscription of Ordinary Shares
On 1 December 2015, the Directors of Hargreave Hale AIM VCT 1 plc and Hargreave Hale AIM VCT 2 plc announced the launch of a joint offer for subscription of new shares in both Hargreave Hale AIM VCTs to raise up to £15 million into Hargreave Hale AIM VCT 1 plc and £10 million into Hargreave Hale AIM VCT 2 plc.

At the date of this report, the new offer has resulted in funds being received of £3.28 million by Hargreave Hale AIM VCT 1, and the issue of 3.04 million shares.

Buybacks
In total, 244,732 ordinary shares were purchased between 1 October 2015 and the date of this report, at a total value of £180,132.

For further information please contact:
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