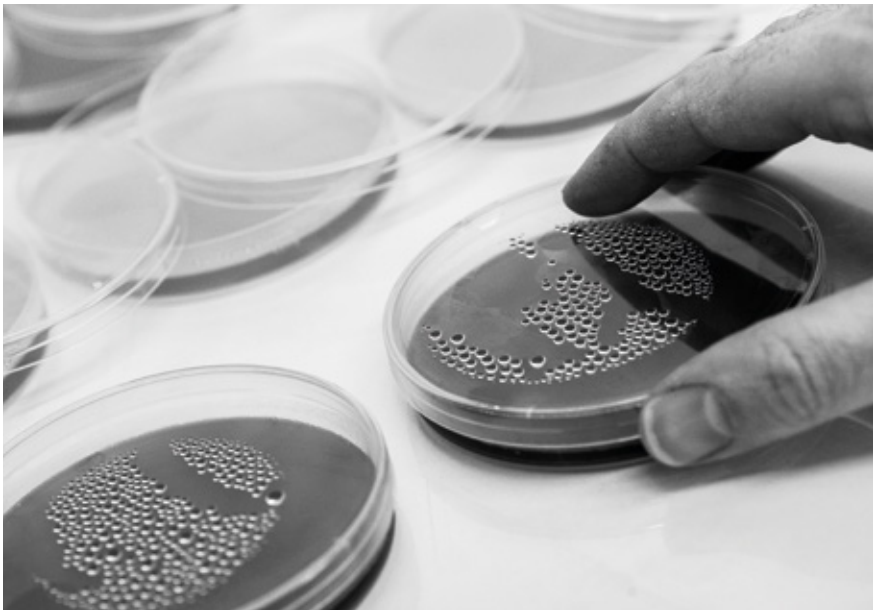
Northern 2 VCT PLC

Annual report and financial statements

31 March 2020



mercia
asset management

Northern 2 VCT PLC is a Venture Capital Trust (VCT) managed by Mercia Fund Management.

It invests mainly in unquoted venture capital holdings and aims to provide high long-term tax-free returns to shareholders through a combination of dividend yield and capital growth.

Contents

At a glance

Venture capital portfolio at 31 March 2020 consists of 45 small and medium businesses across diverse sectors which employ 3,734 staff.

Invested scale-up capital of over £10 million to 23 businesses over the last year to drive growth.

Hands on support typically provided in the form of a director on the board of each unquoted investee.

Part of an industry dedicated to developing and promoting small and medium businesses:

*Since November 2017, VCTs representing 90% of the market, have invested nearly £1 billion in over 180 smaller and growing businesses.**

*Around two thirds of the businesses recorded revenue of less than £5m in the last year and often struggle to access funding available to more mature, larger SMEs.**

*Supporting innovation: around 100 VCT backed businesses have spent over £130 million on activities eligible for R&D tax credits in the most recent financial year.**

**Source:* The Association of Investment Companies.

Financial summary

Year ended 31 March:	2020	2019
Net assets	**£74.4m**	£84.1m
Net asset value per share	**53.5p**	64.7p
Return per share		
Revenue	**0.2p**	1.2p
Capital	**(7.2)p**	2.0p
Total	**(7.0)p**	3.2p
Dividend per share for the year		
Interim dividend	**2.0p**	2.0p
Proposed final dividend	**1.5p**	2.0p
Total	**3.5p**	4.0p
Cumulative return to shareholders since launch		
Net asset value per share	**53.5p**	64.7p
Dividends paid per share*	**121.4p**	117.4p
Net asset value plus dividends paid per share	**174.9p**	182.1p
Mid-market share price at end of year	**47.50p**	59.00p
Share price discount to net asset value	**11.2%**	8.8%
Tax-free dividend yield (based on net asset value per share at the start of the year)	**5.4%**	6.0%

*Excluding proposed final dividend payable on 4 September 2020.

Definitions of the terms and alternative performance measures used in this report can be found in the Glossary of terms on page 45.

Key dates

Results announced
8 July 2020

Shares quoted ex dividend
13 August 2020

Record date for final dividend
14 August 2020

Annual general meeting
26 August 2020, 11.00am, NVM Private Equity, Time Central, 32 Gallowgate, Newcastle upon Tyne, NE1 4SN

Final dividend paid
4 September 2020

Chairman's statement

Your company is well positioned to continue to support and promote its growing portfolio of entrepreneurial businesses.

It has been another extremely busy year for the company, the latter part of which has been dominated by the urgent responses necessary as a consequence of the coronavirus (COVID-19) pandemic. This has caused significant disruption to businesses and the working life of people in the UK. I wish to emphasise to shareholders that since the emergence of COVID-19 our investment manager has been working very closely with portfolio companies to support them through the unprecedented challenges which many have been facing whilst observing government guidelines. However, as a result of its healthy cash reserves and a successful share offer which concluded shortly after the year end, your company is well positioned to continue to support and promote its growing portfolio of entrepreneurial businesses.

Results and dividend

In the year ended 31 March 2020 the company recorded a return on ordinary activities of minus 7.0 pence per share (2019: positive return of 3.2 pence), equivalent to 10.8% of the opening net asset value (NAV) per share. Your company's NAV per share as at 31 March 2020, after deducting dividends paid during the year of 4.0 pence, was 53.5 pence compared with 64.7 pence as at 31 March 2019. This negative total return was primarily driven by a decrease in the directors' valuations of unquoted investments following a realistic assessment of the valuations of some investee companies resulting from their varying exposure to the effects of COVID-19. Whilst the cumulative return to shareholders decreased to 174.9 pence per share (2019: 182.1 pence), the 17.7% increase in the company's NAV total return over the past five years is ahead of the 2.9% increase in the broad UK equity market index that we use as a comparator.

We announced in September 2018 that our aim in the medium term is to generate a return on ordinary activities sufficient to support an annual dividend yield of 5% of opening NAV. Whilst the unrealised reduction in the value of the investments held has contributed to a negative return for the current year, the board continues to carefully assess the potential of the investment portfolio to increase shareholder value in the future. Your directors are aware of the importance to shareholders of receiving regular dividend payments and after very careful deliberations are proposing a final dividend of 1.5 pence per share in respect of the year ended 31 March 2020. If approved at the annual general meeting, the final dividend will be paid on 4 September 2020 to shareholders on the register on 14 August 2020. Taken with the interim dividend of 2.0 pence per share paid in January 2020, this makes a total annual dividend of 3.5 pence per share, equivalent to a tax-free yield of 5.4% per share by reference to the opening NAV.

The target dividend yield will remain subject to regular review and the level of future dividend distributions will have regard to the level of returns generated by the company in the medium term, the timing of investment realisations, the availability of distributable reserves and continuing compliance with the VCT scheme rules.

Investment manager update

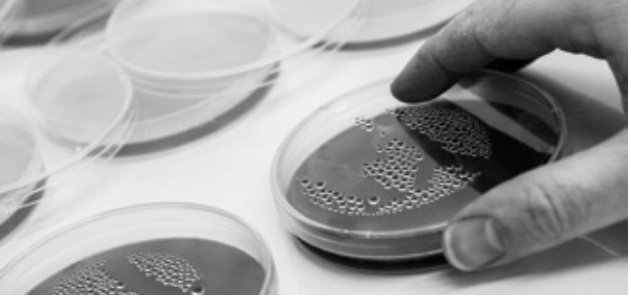
In December 2019, your directors consented to the novation of the company's investment management agreement with NVM Private Equity LLP (NVM) to Mercia Fund Management Limited (Mercia) which became effective on 23 December 2019. After lengthy consideration and commissioning professional due diligence, your directors concluded that the change in manager is a positive development for your company and that it comes at the right time in the continuing evolution of the VCT sector. In reaching this conclusion your directors identified a number of potential benefits to the company including increased deal flow from Mercia's extensive network of early stage funds, an enhanced regional presence and access to further value-adding resources provided by the wider Mercia group. In order to ensure continuity of service, the NVM VCT team, led by partners Tim Levett and Charlie Winward, transferred to Mercia and now constitutes the new autonomous VCT division within the Mercia group. We believe that the combination of the former NVM investment team with Mercia's venture credentials will create one of the UK's leading regionally based venture fund management groups. No material changes were made to the terms of the investment management agreement.

Investment portfolio

Following the first reports of COVID-19 at the end of 2019, the virus spread rapidly during the first quarter of 2020 and was characterised as a global pandemic by the World Health Organization on 11 March 2020. The evolving situation has presented our portfolio companies with significant challenges that are likely to persist for some time. Our venture capital portfolio is diversified, with no particular concentration on any one end-market sector and as such the impact on individual investments varies considerably.

Measures intended to reduce the spread of the virus in the UK including the temporary closure of certain businesses and restrictions on the movement of people were announced at the end of March 2020. Whilst a number of portfolio businesses faced the prospect of an immediate and significant drop in revenues as a result of the 'lockdown', a number of our companies observed an increase in activity, particularly those such as Oddbox, CurrentBody and Entertainment Magpie which deploy an ecommerce business model. A full review of the portfolio was undertaken to identify key risks and to prioritise various mitigating actions. Our manager typically provides support in the form of an investment executive to the board of each unquoted portfolio company. In all cases the executives have been working closely with investee management teams to make plans either to preserve cash until the immediate disruption subsides or to find ways of increasing working capital to support current levels of trading.

We continue to follow the International Private Equity and Venture Capital Valuation (IPEV) guidelines, being the industry accepted best practice, when determining the fair value of our investments. Although the vast majority of our portfolio is represented by unquoted investments, the IPEV guidelines require that all investment valuations reflect the market conditions prevailing as at the valuation date. Taking relevant quoted markets as a benchmark, the valuation data for many of the sectors in which we invest indicated a reduction during the first quarter of 2020. Having most recently undertaken a full valuation of the portfolio as at 24 March 2020 to support the NAV which the company announced as at that date, we have considered all relevant information that





David Gravells *Chairman*

could have been known as at 31 March 2020 in order to assess the valuations as at the financial year end. We have also taken account of supplementary IPEV guidance relating to the COVID-19 pandemic, issued on 31 March 2020. The passage of time since the last NAV announcement has enabled the directors to receive more up to date trading information for investee companies as at 31 March 2020 and to refine our estimates. The net result of this detailed process is an unrealised reduction in the value of the unquoted portfolio contributing to a reduced NAV per share of 53.5 pence. The reduction, whilst substantial, is slightly less severe than the movement deduced for the purpose of calculating the NAV as at 24 March 2020 of 50.0 pence.

Venture capital investment activity

During the year, further progress has been made in the development of the venture capital portfolio. We are still actively seeking to make new investments particularly as periods of recovery from recession have in the past often proven to be a good time to invest. Following our rigorous investment process, seven new VCT-qualifying investments were completed in the year prior to the 'lockdown' at a total cost of £4.3 million. A number of our investee businesses are pursuing strategies that may be accelerated in the current environment, such as innovative delivery and distribution, the digitisation of traditional off-line business processes and the development of advanced medical technologies. Many are examples of businesses which are not only meeting the changing demands of consumers and clients but are also responding to evolving social and environmental challenges. As previously highlighted, the businesses in the earlier stage portfolio are likely to require multiple rounds of funding as they scale up. Follow-on investments totalling £5.8 million were made in 16 existing portfolio companies during the year to support their continued development. The total investment rate of £10.1 million is encouraging and maintains the momentum established over the past two years (2019: £10.3 million and 2018: £10.1 million). Inevitably in a portfolio of this type there will be some early losses of which we incurred one in the year with the sale of Primal Food for a nominal sum.

Share offer and liquidity

Having reviewed the medium-term investment pipeline with NVM in September 2019, your board proposed a prospectus share offer which was launched in January 2020. We were very pleased that strong demand was experienced for this offer, with gross proceeds of £12.5 million being raised and new shares allotted shortly after the year end. Your directors would like to express their appreciation of the support from the existing shareholders who participated in the offer and the nearly 600 new shareholders whom we welcome to the share register.

Gross proceeds of £1.0 million were received during the year through the issue of new shares under our dividend investment scheme. This scheme enables shareholders to re-invest some or all of their dividends in new shares attracting income tax relief and remains open to new participants.

We have maintained our policy of being willing to buy back the company's shares in the market, when necessary in order to maintain liquidity, at a 5% discount to NAV. During the year, a total of 3,048,000 shares were repurchased for cancellation, equivalent to approximately 2.3% of the opening share capital.

Annual general meeting

The company's annual general meeting (AGM) will take place in August 2020. The AGM usually provides an excellent opportunity for shareholders, directors and the manager to meet in person and exchange views and comment. However, the health and wellbeing of both shareholders and colleagues is of upmost importance to the board and therefore in the light of the changeable situation regarding guidance on non-essential travel and social distancing, we have concluded that the AGM should not be open to physical attendance by shareholders. Detailed arrangements are however being made to enable virtual attendance and shareholders will be invited to submit proxy votes and questions in advance of the meeting. Full details and formal notice of the AGM will be provided shortly.

Board of directors

All the directors will be seeking re-election at the AGM, in accordance with the AIC Code of Corporate Governance.

VCT legislation and regulation

Following the significant amendments to the relevant legislation announced in both 2015 and 2017, the past two years have seen a welcome period of regulatory stability. The final change which has been phased into practice is the increase in the minimum proportion of investments required to be held by a VCT in VCT-qualifying holdings, from 70% to 80%. This first applied to the company with effect from 1 April 2020 and I am pleased to report that the target was met in advance of the deadline.

VCT qualifying status

The company has continued to meet the stringent and evolving qualifying conditions laid down by HM Revenue & Customs for maintaining its approval as a VCT. Mercia monitors the position closely and reports regularly to the board. Philip Hare & Associates LLP has continued to act as independent adviser to the company on VCT taxation matters.

Outlook

Whilst the COVID-19 pandemic, and the measures necessary to respond to it, present unprecedented economic challenges for businesses operating in the UK and globally, the board has been reassured by the manager's swift and proactive response and the level of support which has been provided to investee companies. Making definitive statements about the future trajectory of the economy is not possible in times of such heightened uncertainty. Nonetheless we remain committed to supporting the development and prosperity of entrepreneurial early stage businesses. Access to capital is one of the most important factors contributing to the success of such businesses and your board believes that the company is well placed to provide that vital support with a view to enhancing shareholder value in the long term.

David Gravells
Chairman

8 July 2020

Directors and advisers

David Gravells MSc JP (Chairman)

aged 70, is an experienced entrepreneur with a wide experience of private equity-financed businesses. He is a non-executive director of a number of companies including the Student Loans Company. He was appointed to the board in 2007 and became chairman in 2008.

Alastair Conn FCA

aged 65, co-founded NVM Private Equity in 1988 and was managing director and then financial director before retiring from the firm in 2018, continuing as a consultant until March 2020. He is a member of the advisory board of North East Finance and a non-executive director of North East Access To Finance and North East Social Investment Company. He was appointed to the board in 1999.

Simon Devonshire OBE

aged 52, has extensive business experience in corporate leadership, financial governance, strategy, communications and sales and marketing. He has a portfolio of business interests including currently serving as chairman of Ploughshare Innovations and was previously an entrepreneur in residence at the Department for Business, Energy and Industrial Strategy. He was appointed to the board in 2017.

Cecilia McAnulty CA

aged 57, was formerly a partner and portfolio manager with Centaurus Capital, a London based hedge fund, head of structured finance at Royal Bank of Scotland and a director of Barclays Capital. She is a non-executive director of Alcentra and a member of the Industrial Development Advisory Board of the Department of Business, Energy and Industrial Strategy. She was appointed to the board in 2014.

Frank Neale MBA

aged 69, is a partner in IRRfc, a private equity advisory business. He is a past vice-chairman of the British Private Equity and Venture Capital Association. He was appointed to the board in 1999.

Secretary and registered office

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Registered number

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Solicitors

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Registrars

Equiniti Limited
Aspect House
Spencer Road
Lancing BN99 6DA
Shareholder helpline: 0800 028 2349

Shareholder information

The company

Northern 2 VCT PLC is a Venture Capital Trust (VCT) which has been listed on the London Stock Exchange since January 1999. The company invests mainly in unquoted venture capital holdings, with its remaining assets invested in a portfolio of equity investments, quoted investment funds and bank deposits.

Since inception, Northern 2 VCT PLC was managed by NVM Private Equity LLP. Following the consent of the Directors, the investment management agreement was novated on 23 December 2019 to Mercia Fund Management Limited (Mercia), a wholly owned subsidiary of Mercia Asset Management PLC (MAM). MAM is a specialist firm of asset managers headquartered in Henley-in-Arden, with total assets under management of c.£800 million. MAM invests capital across its four asset classes of balance sheet, venture, private equity and debt capital, providing flexible funding solutions to early stage regional businesses as they scale up.

MAM has a strong footprint across the UK regions through its eight offices and an increasingly wide network, which provides potential deal flow to each of its managed funds. With established executive and non-executive director talent pools, 19 university partnerships, extensive personal networks through one of the largest investment teams in the UK and a portfolio of over 400 businesses, MAM has developed an extensive deal flow pipeline. Mercia also acts as manager or adviser of Northern Venture Trust PLC and Northern 3 VCT PLC, in addition to various other investment funds. The company, Northern Venture Trust PLC and Northern 3 VCT PLC are generally known in the market as the Northern VCTs and are the only VCTs which Mercia manages or advises.

Mercia Asset Management PLC is quoted on AIM with the epic "MERC".

Northern 2 VCT is a member of the Association of Investment Companies (AIC).

Venture Capital Trusts

Venture Capital Trusts (VCTs) were introduced by the Chancellor of the Exchequer in the November 1994 Budget, the relevant legislation now being contained in the Income Tax Act 2007. VCTs are intended to provide a means whereby private individuals can invest in small unquoted trading companies in the UK, with an incentive in the form of a range of tax benefits. With effect from 6 April 2006, the benefits to eligible investors include:

- income tax relief at up to 30% on new subscriptions of up to £200,000 per tax year, provided the shares are held for at least five years;
- exemption from income tax on dividends paid by VCTs (such dividends may include the VCT's capital gains as well as its income); and
- exemption from capital gains tax on disposals of shares in VCTs.

Subscribers for shares in VCTs between 6 April 2004 and 5 April 2006 were entitled to income tax relief at 40% rather than 30% and the shares had to be held for at least three years rather than five years.

Prior to 6 April 2004, subscribers for shares in VCTs were entitled to income tax relief at 20% and could also obtain capital gains deferral relief. Capital gains deferred by pre-6 April 2004 subscriptions are not affected by the subsequent changes in VCT tax reliefs.

In order to maintain approved status, a VCT must comply on a continuing basis with the provisions of Section 274 of the Income Tax Act 2007; in particular, a VCT is required at all times to hold at least 70% by value of its investments (as defined in the legislation and increased to 80% for accounting periods beginning on or after 6 April 2019) in qualifying holdings, of which at least 70% (for investments made by funds raised after 5 April 2011 and for all investments made after 5 April 2018) must comprise eligible shares. For this purpose a "qualifying holding" is an investment in new shares or securities of an unquoted company (which may however be quoted on AIM) which has a permanent establishment in the UK, is carrying on a qualifying trade, and whose gross assets and number of employees at the time of investment do not exceed prescribed limits.

The definition of "qualifying trade" excludes certain activities such as property investment and development, financial services and asset leasing. The Finance (No 2) Act 2015 contained a number of significant changes to the VCT rules for investments completed after its introduction, designed to secure approval of the VCT scheme by the European Commission. A company whose trade is more than seven years old (ten years for 'knowledge intensive' companies) will generally only qualify for VCT investment if it has previously received State-aided risk finance before the end of the initial investing period or the new investment exceeds 10% of the total turnover for the past five years and the funds are used for new products and/or geographical markets; there is a lifetime limit of £12 million (£20 million for 'knowledge intensive' companies) on the amount of State-aid funding receivable by a company; and VCT funds may not be used by a company to acquire shares in another company or to acquire a business. A breach of the requirements may lead to a loss of VCT status.

The Finance Act 2018 contained further changes to the conditions for a VCT to maintain its approved status. The changes were designed to increase the level of qualifying investments made by VCTs. A non-exhaustive list of the main points is as follows:

- investments made from 15 March 2018 are only qualifying if they meet the risk-to-capital condition. This principles based condition broadly requires the investee to be an early stage, higher risk, entrepreneurial company which has the potential to grow in the long-term;
- debt finance provided by VCTs must be made on an unsecured basis;
- a VCT must invest at least 30% of any funds raised in an accounting period commencing on or after 6 April 2018 in qualifying holdings within 12 months of the period end;
- investments made from 6 April 2018 in qualifying holdings must comprise at least 70% of eligible shares, regardless of when the money used to fund the investment was raised; and
- the proportion of the total value of investments required to comprise qualifying holdings will be increased from 70% to 80% for accounting periods beginning on or after 6 April 2019.

Financial calendar

Subject to regular review by the directors, the company's financial calendar for the year ending 31 March 2021 is as follows:

November 2020

Half-yearly financial report for the six months ending 30 September 2020 published

January 2021

Interim dividend paid

May 2021

Final dividend and results for year ending 31 March 2021 announced

June 2021

Annual report and financial statements published

July 2021

Annual general meeting; final dividend paid

Share price

The company's share price is carried daily in the Financial Times, the Daily Telegraph and the Newcastle Journal. The company's FTSE Actuaries classification is "Investment Companies – VCTs".

A range of shareholder information is provided on the internet at www.shareview.co.uk by the company's registrars, Equiniti Limited, including details of shareholdings, indicative share prices and information on recent dividends (see page 4 for contact details for Equiniti Limited).

Share price information can also be obtained via the company's website.

Dividend investment scheme

The company operates a dividend investment scheme, giving shareholders the option of investing their dividends in new ordinary shares in the company with the benefit of the tax reliefs currently available to VCT subscribers. Information about the dividend investment scheme can also be obtained from the Company Secretary (see page 4 for contact details).

Electronic communications

The company continues to provide the option to shareholders to receive communications from the company electronically rather than by paper copy. Shareholders who wish to join the scheme, which is operated by the company's registrars, Equiniti Limited, should visit www.shareview.co.uk, register for a Shareview portfolio and select 'Email' as their preferred method of delivery of company communications.

Strategic report

This report has been prepared by the directors in accordance with the requirements of Section 414 of the Companies Act 2006. The company's independent auditor is required by law to report on whether the information given in the strategic report and directors' report is consistent with the financial statements. The auditor's report is set out on pages 26 to 28.

Corporate objective

The company's objective is to provide high long-term tax-free returns to investors through a combination of dividend yield and capital growth, by investing primarily in unquoted UK manufacturing, service and technology businesses which meet the manager's key criteria of good growth potential, strong management and ability to generate cash in the medium to long term.

Investment policy

The company's investment policy has been designed to enable the company to achieve its objective whilst complying with the qualifying conditions set out in the VCT rules, as amended by HM Government from time to time.

The directors intend that the long-term disposition of the company's assets will be approximately 80% in a portfolio of VCT-qualifying unquoted and AIM-quoted investments and 20% in other investments selected with a view to producing an enhanced return while avoiding undue capital volatility, to provide a reserve of liquidity which will maximise the company's flexibility as to the timing of investment acquisitions and disposals, dividend payments and share buy-backs.

Within the VCT-qualifying portfolio, investments will be structured using various investment instruments, including ordinary and preference shares, loan stocks and convertible securities, to achieve an appropriate balance of income and capital growth. The selection of new investments will necessarily have regard to the VCT rules, which are designed to focus investment on earlier stage development capital opportunities.

The portfolio will be diversified by investing in a broad range of VCT-qualifying industry sectors and by holding investments in companies at different stages of maturity in the corporate development cycle. The normal investment holding period is expected to be in the range from three to ten years.

No single investment will normally represent in excess of 3% of the company's total assets at the time of initial investment. As investments are held with a view to long-term capital growth as well as income, it is possible that individual holdings may grow in value to the point where they represent a significantly higher proportion of total assets prior to a realisation opportunity being available.

Investments will normally be made using the company's equity shareholders' funds and it is not intended that the company will take on any long-term borrowings.

Investment management

During the year, the company consented to the novation of its existing investment management agreement with NVM Private Equity LLP (NVM) to Mercia Fund Management Limited (Mercia) which became effective on 23 December 2019. As of that date, the NVM VCT team, led by partners Tim Levett and Charlie Winward, transferred to Mercia to form a new VCT division within the Mercia group. No material changes were made to the terms of the investment management agreement.

The board's management engagement committee reviews the terms of Mercia's appointment as investment manager on a regular basis. Further information about the terms of the management agreement with Mercia and the remuneration payable to Mercia is set out in the directors' report on pages 16 and 17 and in Note 3 to the financial statements.

Co-investment arrangements

The company operates within a co-investment and allocation policy that applies to all funds managed by Mercia. Under the terms of this policy, where an investment opportunity is VCT qualifying and the funding requirement is in excess of £2 million, the company and the other VCTs managed by Mercia are the preferred and sole lead investors. For these opportunities the company is entitled to participate pro rata to net assets alongside the other VCT funds managed by Mercia; save where the investment opportunity is located in Yorkshire, Humberside, Teeside or the North East, where minimum syndication requirements mean that certain other funds managed by Mercia can participate in the funding round alongside the Northern VCTs; with an allocation of up to (but not exceeding) 20% (10% in the North East). Where the funding round for a new opportunity is under £2 million the VCTs will not be the lead investors; but if any such deal is in excess of £1.5 million, the Northern VCT funds have the right to participate at a de minimis level of £0.5 million.

In relation to follow-on rounds of investment where the company and other Northern VCTs are existing investors, the company, alongside the other Northern VCT funds, shall have priority to determine how much they wish to invest, with no requirement to offer such investment opportunity to other Mercia or external parties (although they are free to do so if so determined by the manager).

Under a co-investment scheme, Mercia executives are required to invest personally alongside the funds in each VCT-qualifying investment on a predetermined basis.

Overview of the year

During the year under review Northern 2 VCT recorded a return, before dividends, of minus 7.0 pence per share, equivalent to 10.8% of the opening net asset value per share of 64.7 pence. The negative return was driven primarily by an unrealised reduction in the valuation of the investment portfolio related to COVID-19. The movement in total net assets and net asset value per share is summarised in Table 2.

Total income from investments during the year decreased to £1.1 million (2019: £2.6 million) however it should be noted that the prior year figure included the receipt of significant interest arrears upon the realisation of two investments. As the proportion of earlier stage investments in the unquoted portfolio increases as intended, it is expected that investment income will continue to decrease as the potential returns targeted become more focused on capital growth rather than income generation.

The basic investment management fee payable to the manager was £1.7 million (2019: £1.6 million) and there was no performance-related management fee payable in respect of the current year (preceding year nil).

The net cash outflow from the venture capital portfolio during the year was £3.9 million, comprising disposal proceeds of £6.2 million less investments of £10.1 million. Portfolio cash flow over the past five years is summarised in Table 1.

After taking account of other cash flows, including dividend payments of £5.6 million, the company's total cash balances decreased over the year by £11.2 million to £15.2 million. In addition the company holds quoted equity investments and interest-bearing investments valued at £7.0 million, compared with £7.8 million at 31 March 2019.

Dividends

The directors have declared or proposed dividends totalling 3.5 pence per share in respect of the year, comprising a 0.2 pence revenue dividend and a 3.3 pence capital distribution.

Venture capital investment portfolio

The latter part of the year was dominated by news of the evolving Coronavirus (COVID-19) outbreak which has presented unprecedented challenges to many of our portfolio management teams. Following the first reports of COVID-19 in Asia in December 2019, the initial effects in the UK were principally felt by businesses with complex international supply chains or overseas customers in certain territories. As the virus spread to further countries, it was characterised as a pandemic by the World Health Organization on 11 March. Measures to control the spread of COVID-19 in the UK announced in March 2020 included restrictions on the movement of people and the requirement to observe social distancing wherever possible.

The short-term impact on individual portfolio companies varies significantly depending on the sector in which they operate and the ability of their employees to work effectively from home. For instance businesses operating in the entertainment and leisure sector such as No.1 Lounges (an airport lounge operator) and Grip UK (an indoor climbing wall operator) were faced with almost immediate site closures when restrictions were announced on 20 March 2020 and an indeterminate period without any income.

Table 1: Venture capital portfolio cash flow

Year ended 31 March	New investment £000	Disposal proceeds £000	Net cash inflow/(outflow) £000
2016	12,276	7,362	(4,914)
2017	5,934	13,284	7,350
2018	10,060	6,975	(3,085)
2019	10,299	11,541	1,242
2020	10,125	6,180	(3,945)
Total	**48,694**	**45,342**	**(3,352)**

Table 2: Movements in net assets and net asset value per share

	£000	Pence per ordinary share
Net asset value at 31 March 2019	84,109	64.7
Net revenue (investment income less revenue expenses and tax)	252	0.2
Capital surplus arising on investments:		
Realised net gains on disposals	(728)	(0.5)
Movements in fair value of investments	(8,050)	(5.8)
Expenses allocated to capital account (net of tax relief)	(1,293)	(0.9)
Total return for the year as shown in the income statement	(9,819)	(7.0)
Proceeds of issues of new shares (net of expenses)	7,441	(0.2)
Shares re-purchased for cancellation	(1,791)	–
Net movement for the year before dividends	(4,169)	(7.2)
Net asset value at 31 March 2020 before dividends recognised	79,940	57.5
Dividends recognised in the financial statements for the year	(5,584)	(4.0)
Net asset value at 31 March 2020	**74,356**	**53.5**

By contrast businesses which trade via an e-commerce model such as Entertainment Magpie (online market place for second hand goods) and Oddbox (home delivery of fruit and vegetables) started to make preparations in March for a potential upturn in business during the 'lockdown'. The portfolio also includes a number of software businesses whose work forces are largely able to operate effectively from home, the impact on which will be driven more by the effect of the pandemic on customer demand.

In all cases Mercia has been working very closely with investee management teams either to preserve cash until the immediate disruption subsides or to find ways of creating additional cash headroom in order to enable the necessary investment in working capital to support any potential increase in trading.

Although the vast majority of the portfolio is represented by unquoted investments, investors often look to the quoted markets as a benchmark and valuations for many of the sectors in which the company is invested reduced during the first quarter of 2020.

A summary of the venture capital holdings at 31 March 2020 is given on page 11, with information on the fifteen largest investments on pages 12 to 15.

Venture capital investment activity

During the year ended 31 March 2020, seven new venture capital investments were completed at a cost of £4.3 million, and additional funding totalling £5.8 million was invested in 16 existing portfolio companies, by way of follow-on funding rounds. The proportion of follow-on investments is increasing in line with the shift in focus to earlier stage companies, which often require multiple rounds of growth finance to realise their potential.

New investments

The new investments completed during the year were:

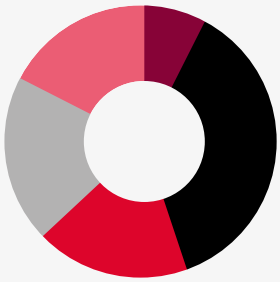
- **Tutora (trading as Tutorful) (£1,035,000)** – online arrangement and delivery of private tutoring services, Sheffield
- **Voxpopme (£891,000)** – video based consumer insight software, Birmingham
- **Quotevine (£706,000)** – SaaS solution for asset and automotive finance providers, Bedford
- **Oddbox Delivery (£648,000)**– supply and home delivery of fruit & vegetables, London
- **Duke & Dexter (£388,000)** – supply and retail of premium men's footwear, London
- **Atlas Cloud (£324,000)** – IT managed services provider, Newcastle upon Tyne
- **Nutshell (£324,000)** – enterprise application development, Newcastle upon Tyne

Investment realisations

Details of investment disposals during the year are given in Note 9 on page 38. The most significant disposals (original cost or proceeds in excess of £0.5 million) are summarised in Table 3 (See over the page).

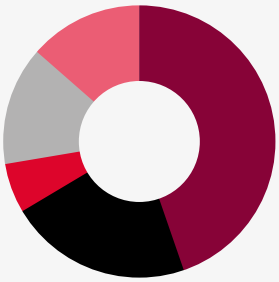
MSQ Partners Group was the subject of a secondary management buy-out financed by LDC, delivering a return of over 2.5 times the original cost over the life of the investment. The remaining funds invested in a holding company, **Graza**, were returned to the company upon its liquidation.

In addition unquoted investment sales, **Agilitas IT Holdings** and **Volumatic Holdings** redeemed loan stock totalling £0.9 million during the year.



Age of investment

Up to 1 year	7.7%
1-3 years	38.0%
3-5 years	16.9%
5-7 years	19.2%
Over 7 years	18.2%



Industry sector

Technology/electronics	44.5%
Consumer	22.6%
Industrial/manufacturing	4.4%
Services	15.7%
Healthcare/biotechnology	12.8%

Table 3: Significant investment realisations

Company	Date of original investment	Original cost £000	Sales proceeds £000	Realised surplus/ (deficit) £000
MSQ Partners Group – secondary buyout	2014	1,672	3,555	1,883
Nasstar – agreed takeover	2005	390	1,003	613
Graza – return of investment upon liquidation	2015	502	494	(8)
Primal Food – divestment to a trade acquirer	2018	967	–	(967)

Table 4: Venture capital investment valuation by category

Category	Number of investments	Valuation £000	% of portfolio by value
Unquoted investments at directors' valuation			
Earnings/revenue multiple	17	23,044	44.1
Price of a recent investment subsequently calibrated as appropriate	14	17,078	32.7
Cost subsequently calibrated as appropriate	14	10,530	20.2
Quoted investments at bid price			
Listed on London Stock Exchange	1	449	0.9
Quoted on AIM	6	1,123	2.1
Total	**52**	**52,224**	**100.0**

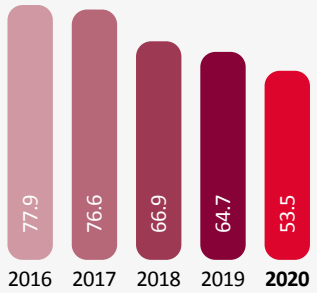
We remain committed to building a portfolio of investments in smaller innovative UK companies across a diverse range of sectors with significant growth potential. Inevitably in a portfolio of this type there will be some early losses of which we incurred one in the year with the sale of **Primal Food** for a nominal sum.

In the AIM-quoted portfolio, the investment in **Nasstar** was realised in full as the result of an agreed takeover for proceeds of £1.0 million, delivering a return of over 2.5 times cost. In addition the company's holding in **Brady** was realised, along with a partial disposal of **Ideagen**.

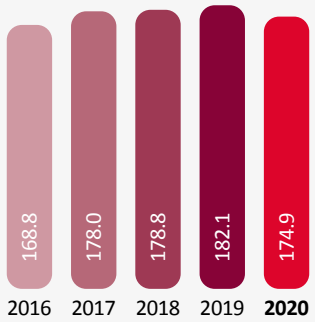
The pie charts above show the composition of the venture capital portfolio at 31 March 2020 by value according to age, industry sector, financing stage and whether quoted or unquoted. The management buyout investments were completed before updates to the VCT rules prohibiting this type of investment activity were enacted, in November 2015.

Valuation policy

Unquoted investments are valued in accordance with the accounting policy set out on page 34, which follows the International Private Equity and Venture Capital Valuation (IPEV) guidelines, being the industry accepted best practice. The emergence of COVID-19 and the national response to supress it has heightened the level estimation uncertainty when assessing the future prospects of individual portfolio

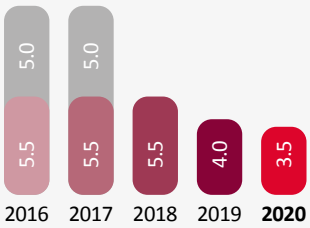


Net asset value (p)



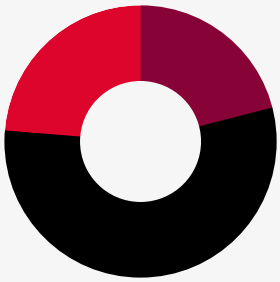
Net asset value plus cumulative dividends paid per share* (p)

*excludes dividends proposed, but not yet paid



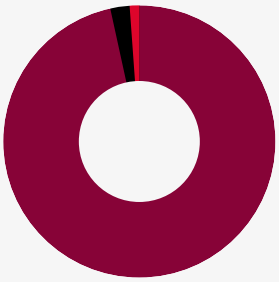
Dividend per share (p)

Special dividends



Financing stage

- Development capital – pre November 2015 21.0%
- Development capital – post November 2015 56.3%
- MBO 22.7%



Quotation

- Unquoted 96.9%
- AIM 2.2%
- London Stock Exchange 0.9%

companies as at the balance sheet date. IPEV released a supplement to its latest guidance on 31 March 2020 to specifically address the challenges of valuing investments during the COVID-19 pandemic, which the directors have taken account of when undertaking their usual detailed valuation process.

Where valuations are based on company earnings, audited historic results will be taken into account along with more recent unaudited information and projections where these are considered sufficiently reliable. For investments in earlier stage businesses, where a material arm's length transaction has recently been concluded, this is usually taken as the starting point for fair value, and subsequently tested and recalibrated to reflect changes in market conditions or company specific performance. Provision against cost is made where an investment is under-performing significantly.

As at 31 March 2020 the number of venture capital investments falling into each valuation category was as shown in Table 4.

Key performance indicators

The directors regard the following as the key indicators pertaining to the company's performance:

Net asset value and total return to shareholders: the charts at the bottom of the page opposite show the movement in net asset value and total return (net asset value plus cumulative dividends) per share over the past five financial years.

Dividend distributions: the charts at the bottom of this and the opposite page show the dividends (including proposed final dividend) declared in respect of each of the past five financial years and on a cumulative basis since inception.

Ongoing charges: the charts at the bottom of this page show total annual running expenses as a percentage of the average net assets attributable to shareholders for each of the past five financial years.

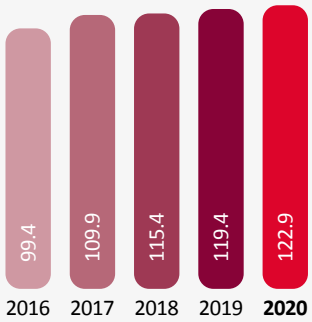
Maintenance of VCT qualifying status: the directors believe that the company has at all times since inception complied with the VCT qualifying conditions laid down by HM Revenue & Customs.

Risk management

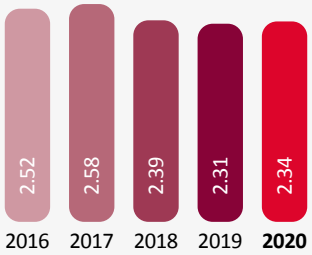
The board carries out a regular and robust assessment of the risk environment in which the company operates and seeks to identify new risks as they emerge. The principal and emerging risks and uncertainties identified by the board which might affect the company's business model and future performance, and the steps taken with a view to their mitigation, are as follows:

Investment and liquidity risk: investment in smaller and unquoted companies, such as those in which the company invests, involves a higher degree of risk than investment in larger listed companies because they generally have limited product lines, markets and financial resources and may be more dependent on key individuals. The securities of smaller companies in which the company invests are typically unlisted, making them illiquid, and this may cause difficulties in valuing and disposing of the securities. The company may invest in businesses whose shares are quoted on AIM – the fact that a share is quoted on AIM does not mean that it can be readily traded and the spread between the buying and selling prices of such shares may be wide. ***Mitigation:*** the directors aim to limit the risk attaching to the portfolio as a whole by careful selection, close monitoring and timely realisation of investments, by carrying out rigorous due diligence procedures and maintaining a wide spread of holdings in terms of financing stage and industry sector, within the rules of the VCT scheme. The board reviews the investment portfolio with the manager on a regular basis.

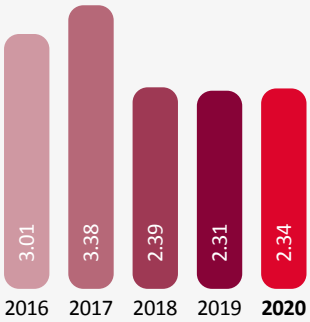
Financial risk: most of the company's investments involve a medium to long-term commitment and many are relatively illiquid. ***Mitigation:*** the directors consider that it is inappropriate to finance the company's activities through borrowing except on an occasional short-term basis. Accordingly they seek to maintain a proportion of the company's assets in cash or cash equivalents in order to be in a position to pursue new unquoted investment opportunities and to make follow-on investments in existing portfolio companies. The company has very little direct exposure to foreign currency risk and does not enter into derivative transactions.



Cumulative dividends per share (p)



Ongoing charges excluding performance fees (% of average net assets)



Ongoing charges including performance fees (% of average net assets)

Economic risk: events such as economic recession or general fluctuation in stock markets, exchange rates and interest rates may affect the valuation of investee companies and their ability to access adequate financial resources, as well as affecting the company's own share price and discount to net asset value. The level of economic risk has been elevated by the COVID-19 pandemic which is widely predicted to cause a global recession after the balance sheet date. ***Mitigation:*** the company invests in a diversified portfolio of investments spanning various industry sectors, and maintains sufficient cash reserves to be able to provide additional funding to investee companies where it is appropriate and in the interests of the company to do so. The manager typically provides an investment executive to actively support the board of each unquoted investee company. At all times, and particularly during periods of heightened economic uncertainty, the investment executives share best practice from across the portfolio with investee management teams in order to mitigate economic risk.

Brexit risk: the implementation of the decision for the UK to withdraw from the European Union (EU) is a process which involves significant uncertainty. The impact on the future business environment in the UK is therefore difficult to predict. ***Mitigation:*** whilst we do not expect that Brexit will have a significant impact on the operations of Northern 2 VCT itself, the board and the manager follow Brexit developments closely with a view to identifying changes which might affect the company's investment portfolio. The manager works closely with investee companies in order to plan for a range of possible outcomes.

Stock market risk: some of the company's investments are quoted on the London Stock Exchange or AIM and will be subject to market fluctuations upwards and downwards. External factors such as terrorist activity or global health crises, such as the COVID-19 pandemic, can negatively impact stock markets worldwide. In times of adverse sentiment there may be very little, if any, market demand for shares in smaller companies quoted on AIM. ***Mitigation:*** the company's quoted investments are actively managed by specialist managers, including Mercia in the case of the AIM-quoted investments, and the board keeps the portfolio and the actions taken under ongoing review.

Credit risk: the company holds a number of financial instruments and cash deposits and is dependent on the counterparties discharging their commitment. ***Mitigation:*** the directors review the creditworthiness of the counterparties to these instruments and cash deposits and seek to ensure there is no undue concentration of credit risk with any one party.

Legislative and regulatory risk: in order to maintain its approval as a VCT, the company is required to comply with current VCT legislation in the UK, which reflects the European Commission's State-aid rules. Changes to the UK legislation or the State-aid rules in the future could have an adverse effect on the company's ability to achieve satisfactory investment returns whilst retaining its VCT approval. ***Mitigation:*** the board and the manager monitor political developments and where appropriate seek to make representations either directly or through relevant trade bodies.

Internal control risk: the company's assets could be at risk in the absence of an appropriate internal control regime which is able to operate effectively even during times of disruption, such as that caused by COVID-19. ***Mitigation:*** the board regularly reviews the system of internal controls, both financial and non-financial, operated by the company and the manager. These include controls designed to ensure that the company's assets are safeguarded and that proper accounting records are maintained.

VCT qualifying status risk: while it is the intention of the directors that the company will be managed so as to continue to qualify as a VCT, there can be no guarantee that this status will be maintained. A failure to continue meeting the qualifying requirements could result in the loss of VCT tax relief, the company losing its exemption from corporation tax on capital gains, to shareholders being liable to pay income tax on dividends received from the company and, in certain circumstances, to shareholders being required to repay the initial income tax relief on their investment. ***Mitigation:*** the investment manager keeps the company's VCT qualifying status under continual review and its reports are reviewed by the board on a quarterly basis. The board has also retained Philip Hare & Associates LLP to undertake an independent VCT status monitoring role.

Additional disclosures required by the Companies Act

Section 172 Statement

Section 172 of the Companies Act 2006 requires a director to promote the success of the company. In doing this they must act in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to the likely consequences of any decision in the long term, the need to act fairly as between members of the company and the need to foster the company's business relationships with suppliers, customers and others.

The company takes a number of steps to understand the views of shareholders and other key stakeholders and considers these in board discussions and decision making.

Key stakeholders

Shareholders

The directors recognise the value of maintaining regular communications with shareholders. Formal reports are sent to shareholders at the half-year and year-end stages, and an opportunity is given to shareholders at the annual general meeting to question the board and the investment manager on matters relating to the company's operation and performance. The manager holds an annual VCT investor seminar to which shareholders are invited and the directors attend.

The directors' decisions are intended to achieve the company's corporate objective. Maintaining the company's status as a VCT is a critical element of this.

Investment manager

The company's most critical business relationship is with the investment manager, Mercia. There is regular contact with Mercia and members of Mercia's executive committee attend all of the company's board meetings.

Portfolio Companies

The company holds minority investments in its portfolio companies and it has appointed Mercia to manage the portfolio. Whilst day to day interaction with portfolio companies is delegated via the investment management agreement to Mercia, updates on the entire portfolio are received by the board at least quarterly. The directors take an active interest in the challenges faced by portfolio companies.

The company had no employees during the year and there are five directors, four of whom are male.

As an externally managed investment company, the company is not directly responsible for any greenhouse gas emissions.

Future prospects

Whilst uncertainty remains as to the outcome of the negotiations between the UK and the rest of the EU concerning a future trading relationship, we do not expect that this will have a significant impact on the operations of Northern 2 VCT itself.

COVID-19 presents unprecedented challenges for UK businesses and the longer term impact on the economy and individual sectors is currently unknown. The potential effects of this period of heightened uncertainty on portfolio companies differs between cases, however Mercia typically has a representative on the board of each unquoted investment and continues to support investee management teams to plan for a range of possible outcomes. The operations of Northern 2 VCT have necessarily evolved during the lockdown, however the board has continued to hold effective board meetings remotely, making use of video conferencing services. The directors regularly monitor the service received from the company's manager, registrars and custodians who have all enacted contingency plans to deal with COVID-19 and who all continue to operate effectively.

Following a successful share offer during the year, the company remains well capitalised to support its portfolio of entrepreneurial SMEs and to add to it selectively as market conditions permit.

By order of the Board

J K Bryce
Secretary

8 July 2020

Investment portfolio

as at 31 March 2020

	Cost £000	Valuation £000	% of net assets by value
Fifteen largest venture capital investments (see pages 12 to 15)			
Agilitas IT Holdings	930	5,215	7.0
Lineup Systems	975	4,137	5.6
Currentbody.com	1,771	3,073	4.1
Sorted Holdings	2,715	2,958	4.0
Entertainment Magpie Group	1,503	2,853	3.8
SHE Software Group	2,195	2,720	3.7
Volumatic Holdings	906	1,898	2.6
It's All Good	1,145	1,698	2.3
Biological Preparations Group	2,166	1,605	2.2
Knowledgemotion	1,778	1,559	2.1
GRIP-UK t.a. The Climbing Hangar	1,928	1,522	2.0
Medovate	1,450	1,450	2.0
Soda Software Labs t.a. Hello Soda	1,499	1,391	1.9
Clarilis	1,012	1,206	1.6
Intelling Group	1,142	1,056	1.4
	23,115	**34,341**	**46.3**
Other venture capital investments			
Tutora t.a. Tutorful	1,035	1,035	1.4
Gentronix	942	903	1.2
Administrate	1,235	900	1.2
Ridge Pharma	898	898	1.2
Voxpopme	891	891	1.2
Rockar	989	871	1.2
ThanksBox t.a. Mo	866	866	1.2
Intuitive Holding	1,508	829	1.1
Newcells Biotech	484	787	1.1
Buoyant Holdings	1,057	732	1.0
Upp Technologies (previously Volo Commerce)	2,114	700	0.9
Contego Solutions t.a. NorthRow	789	652	0.9
Oddbox	648	648	0.9
Pure Pet Food	642	642	0.9
Channel Mum	1,194	509	0.7
Life's Great Group t.a. Mojo Mortgages	959	505	0.7
Axial Systems Holdings	1,004	473	0.6
Arnlea Holdings	1,287	451	0.6
Vectura Group**	272	449	0.6
Seahawk Bidco	479	412	0.6
Quotevine	706	411	0.6
AVID Technology Group	1,744	401	0.5
Duke & Dexter	388	388	0.5
Ablatus Therapeutics	355	352	0.5
Nutshell	324	324	0.4
Atlas Cloud	324	324	0.4
Adept Telecom*	235	297	0.4
Ideagen*	62	297	0.4
Cello Health Group*	251	281	0.4
Haystack Dryers	1,497	250	0.3
Angle*	134	188	0.2
Customs Connect Group	1,470	160	0.1
Collagen Solutions*	299	43	–
Velocity Composites*	97	14	–
No 1 Lounges	1,977	–	–
Fresh Approach (UK) Holdings	1,454	–	–
Lending Works	830	–	–
Total venture capital investments	**54,555**	**52,224**	**70.2**
Total listed equity investments	6,381	5,691	7.7
Total listed interest-bearing investments	1,248	1,276	1.7
Total fixed asset investments	**62,184**	**59,191**	**79.6**
Net current assets		15,165	20.4
Net assets		**74,356**	**100.0**

*Quoted on AIM

**Listed on London Stock Exchange

Fifteen largest venture capital investments

Agilitas IT Holdings

Cost	£930,000
Valuation	£5,215,000
Basis of valuation	Earnings multiple
Equity held	14.1% (Mercia/NVM funds total 55.3%)
Business/location	Provider of outsourced IT inventory management services, Nottingham
History	Management buy-out financing, June 2014, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT, NV2 LP
Income in year	Dividends nil, loan stock interest £54,000

Audited financial information:

Year ended 31 March	2019 £m	2018 £m
Sales	12.0	9.5
EBITDA	2.4	2.0
Profit before tax	1.0	0.6
Profit after tax	0.8	0.5
Net assets	1.7	0.9

Lineup Systems

Cost	£975,000
Valuation	£4,137,000
Basis of valuation	Revenue multiple
Equity held	17.4% (Mercia/NVM funds total 52.2%)
Business/location	Multi-channel advertising and media software, London
History	Development capital financing, December 2011, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest £18,000

Audited financial information:

Year ended 30 June	2019 £m	2018 £m
Sales	11.1	9.3
EBITDA	0.4	0.6
(Loss)/profit before tax	(0.1)	0.1
(Loss)/profit after tax	–	0.1
Net liabilities	(0.1)	(0.1)

Currentbody.com

Cost	£1,771,000
Valuation	£3,073,000
Basis of valuation	Revenue multiple
Equity held	8.5% (Mercia/NVM funds total 25.7%)
Business/location	Online market place for home use beauty devices, Cheadle
History	Development capital financing, March 2018, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 30 January	2019 £m	2018 £m
Sales	9.4	6.8
EBITDA	(0.6)	(0.1)
Loss before tax	(1.2)	(0.2)
Loss after tax	(1.2)	(0.2)
Net liabilities	(1.0)	(0.3)

Sorted Holdings

Cost	£2,715,000
Valuation	£2,958,000
Basis of valuation	Price of a recent investment subsequently calibrated as appropriate
Equity held	5.9% (Mercia/NVM funds total 18.0%)
Business/location	Delivery management software platform serving the e-commerce market, Manchester
History	Development capital financing, May 2016, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Unaudited financial information:

Year ended 31 May	2019 £m	2018 £m
Sales	2.7	2.2
EBITDA	(5.6)	(4.5)
Loss before tax	(7.8)	(6.2)
Loss after tax	(6.7)	(5.3)
Net assets/(liabilities)	2.9	(1.0)

Note: "EBITDA" is defined as earnings before interest, tax, depreciation and amortisation.

Entertainment Magpie Group

Cost	£1,503,000
Valuation	£2,853,000
Basis of valuation	Earnings multiple
Equity held	9.1% (Mercia/NVM funds total 36.7%)
Business/location	Re-commerce website for pre-owned entertainment media and electronic items, Manchester
History	Management buy-out, September 2015, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT, NV2 LP
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 May	2018* £m	2017 £m
Sales	109.5	101.1
EBITDA	1.7	2.3
Loss before tax	(2.3)	(1.0)
Loss after tax	(2.3)	(1.0)
Net (liabilities)/assets	(5.2)	0.5

*excludes discontinued operations

SHE Software Group

Cost	£2,195,000
Valuation	£2,720,000
Basis of valuation	Price of a recent investment subsequently calibrated as appropriate
Equity held	10.9% (Mercia/NVM funds total 33.6%)
Business/location	Health and safety platform provider, East Kilbride
History	Development capital financing, February 2018, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 March	2019 £m	2018 £m
Sales	4.5	3.5
EBITDA	(2.2)	(0.5)
Loss before tax	(2.8)	(0.9)
Loss after tax	(2.5)	(0.9)
Net assets	3.1	2.6

Volumatic Holdings

Cost	£906,000
Valuation	£1,898,000
Basis of valuation	Earnings multiple
Equity held	16.9% (Mercia/NVM funds total 50.6%)
Business/location	Manufacturer of intelligent cash handling equipment, Coventry
History	Management buy-out, March 2012, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends £26,000, loan stock interest £42,000

Audited financial information:

Year ended 31 March	2019 £m	2018 £m
Sales	9.6	5.6
EBITDA	1.8	0.6
Profit/(loss) before tax	0.9	(0.3)
Profit/(loss) after tax	0.6	(0.3)
Net assets	2.0	1.4

It's All Good

Cost	£1,145,000
Valuation	£1,698,000
Basis of valuation	Earnings multiple
Equity held	9.9% (Mercia/NVM funds total 30.2%)
Business/location	Manufacturer of premium savoury snack products, Gateshead
History	Development capital financing, February 2014, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 December	2018 £m	2017 £m
Sales	27.4	23.5
EBITDA	1.8	1.2
Profit before tax	0.5	–
Profit after tax	0.7	–
Net assets	2.1	1.4

Fifteen largest venture capital investments
continued

Biological Preparations Group

Cost	£2,166,000
Valuation	£1,605,000
Basis of valuation	Earnings multiple
Equity held	16.0% (Mercia/NVM funds total 47.5%)
Business/location	Developer and supplier of products based on microbial, antimicrobial, plant extract and enzyme technology, Cardiff
History	Management buy-out financing, March 2015, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends £15,000, loan stock interest £132,000

Audited financial information:

Year ended 31 December	2018 £m	2017* £m
Sales	7.2	6.3
EBITDA	0.9	0.7
Loss before tax	(0.6)	(0.8)
Loss after tax	(0.7)	(0.9)
Net liabilities	(2.1)	(1.4)

*excludes exceptional costs

Knowledgemotion

Cost	£1,778,000
Valuation	£1,559,000
Basis of valuation	Price of a recent investment subsequently calibrated as appropriate
Equity held	8.5% (Mercia/NVM funds total 25.8%)
Business/location	Online educational content platform, London
History	Development capital financing, July 2017, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 December	2018 £m	2017 £m
Sales	1.4	0.6
EBITDA	(1.4)	(1.1)
Loss before tax	(1.4)	(1.1)
Loss after tax	(1.4)	(0.9)
Net assets	0.4	1.8

GRIP-UK (t.a. The Climbing Hangar)

Cost	£1,928,000
Valuation	£1,522,000
Basis of valuation	Price of a recent investment subsequently calibrated as appropriate
Equity held	14.7% (Mercia/NVM funds total 45.5%)
Business/location	Operator of indoor climbing walls, Liverpool
History	Development capital financing, August 2018, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 30 September	2019 £m	2018 £m
Sales	2.4	0.9
EBITDA	(0.5)	(0.4)
Loss before tax	(0.6)	(0.5)
Loss after tax	(0.6)	(0.4)
Net assets	2.1	2.7

Medovate

Cost	£1,450,000
Valuation	£1,450,000
Basis of valuation	Cost subsequently calibrated as appropriate
Equity held	8.9% (Mercia/NVM funds total 27.5%)
Business/location	Commercialisation of medical technologies from the NHS, Cambridge
History	Development capital financing, November 2017, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 December	2018 £m
Sales	–
EBITDA	(0.9)
Loss before tax	(1.0)
Loss after tax	(1.0)
Net assets	4.7

Note: "EBITDA" is defined as earnings before interest, tax, depreciation and amortisation.

Soda Software Labs (t.a. Hello Soda)

Cost	£1,499,000
Valuation	£1,391,000
Basis of valuation	Cost subsequently calibrated as appropriate
Equity held	11.6% (Mercia/NVM funds total 34.4%)
Business/location	Data analytics services provider, Manchester
History	Development capital financing, October 2017, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 March	2019 £m	2018 £m
Sales	1.9	1.8
EBITDA	(1.8)	(0.9)
Loss before tax	(2.2)	(1.2)
Loss after tax	(2.0)	(1.0)
Net liabilities	(2.4)	(0.4)

Clarilis

Cost	£1,012,000
Valuation	£1,206,000
Basis of valuation	Cost subsequently calibrated as appropriate
Equity held	9.8% (Mercia/NVM funds total 29.7%)
Business/location	Provides automated legal document preparation software, Leamington Spa
History	Development capital financing, June 2018, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 December	2018 £m	2017 £m
Sales	0.9	0.4
EBITDA	(1.1)	(0.3)
Loss before tax	(1.1)	(0.3)
Loss after tax	(1.1)	(0.3)
Net assets/(liabilities)	1.6	(0.4)

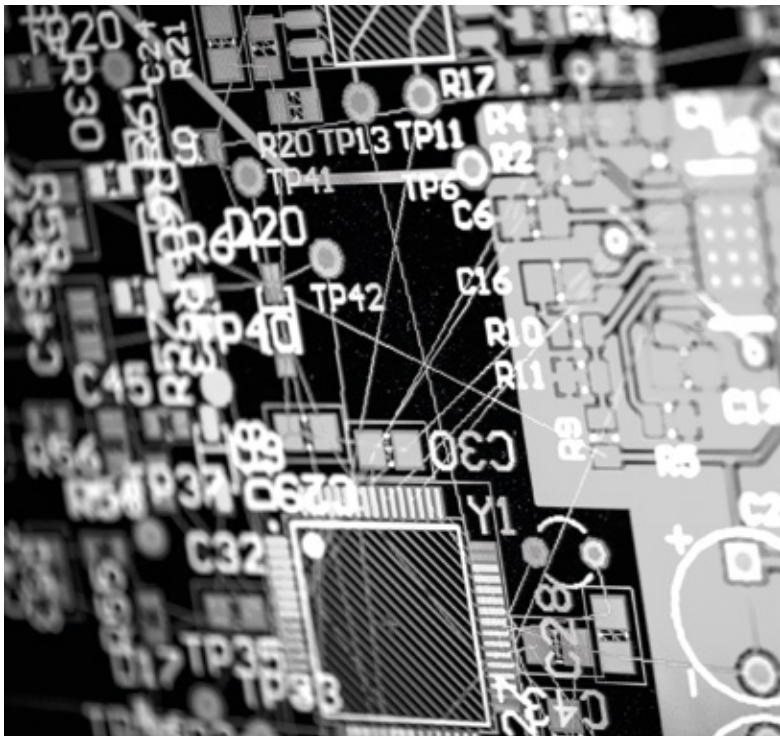
Intelling Group

Cost	£1,142,000
Valuation	£1,056,000
Basis of valuation	Earnings multiple
Equity held	12.4% (Mercia/NVM funds total 37.7%)
Business/location	Customer handling and support specialist, Manchester
History	Development capital financing, March 2017, led by NVM Private Equity
Other Mercia/NVM funds investing	Northern Venture Trust, Northern 3 VCT
Income in year	Dividends nil, loan stock interest nil

Audited financial information:

Year ended 31 July	2018 £m	2017* £m
Sales	13.0	3.2
EBITDA	0.1	(1.2)
Loss before tax	(1.7)	(1.7)
Loss after tax	(1.6)	(1.8)
Net liabilities	(2.7)	(1.1)

*8 month period



Directors' report

The directors present their report and the audited financial statements for the year ended 31 March 2020.

Activities and status

The principal activity of the company during the year was the making of long-term equity and loan investments, mainly in unquoted companies.

The directors have managed the affairs of the company with the intention of maintaining its status as an approved venture capital trust for the purposes of Section 274 of the Income Tax Act 2007. The directors consider that the company was not at any time up to the date of this report a close company within the meaning of Chapter 2 of Part 10 of the Corporation Tax Act 2010. The company's registered number is 03695071.

The directors are required by the articles of association to propose an ordinary resolution at the company's annual general meeting in 2025 that the company should continue as a venture capital trust for a further five year period, and at each fifth subsequent annual general meeting thereafter. If any such resolution is not passed, the directors shall within four months convene an extraordinary general meeting to consider proposals for the reorganisation or winding-up of the company.

Corporate governance

The statement on corporate governance set out on pages 20 to 24 is included in the directors' report by reference.

Results and dividend

The return on ordinary activities after tax for the year of minus £9,819,000 as shown in the income statement has been transferred to reserves.

The final dividend for the year ended 31 March 2019 of 2.0 pence and an interim dividend of 2.0 pence per share in respect of the year ended 31 March 2020 were paid during the year at a cost of £5,584,000 and have been charged to reserves.

The directors have proposed a final dividend of 1.5 pence per share for the year ended 31 March 2020. Subject to approval of the final dividend at the annual general meeting, the dividend will be paid on 4 September 2020 to shareholders on the register on 14 August 2020.

Provision of information to the auditor

Each of the directors who held office at the date of approval of this directors' report confirms that, so far as he/she is aware, there is no relevant audit information of which the company's auditor is unaware and that he/she has taken all the steps that he/she could reasonably be expected to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Statement on long-term viability

In accordance with the requirements of the AIC Code of Corporate Governance, the directors have assessed the prospects of the company over the three year period to March 2023. The directors consider that for the purpose of this exercise it is not practical or meaningful to look forward over a period of more than three years and that the period is appropriate for a business of the company's nature and size.

In making their assessment the directors have carried out a robust review of the risk environment in which the company operates, including those risks which might threaten its business model or future performance and the steps taken with a view to their mitigation (see pages 9 and 10 for further details on risk management). The directors have considered the ability of the company to comply on an ongoing basis with the conditions for maintaining VCT approved status. The directors have also considered the nature of the company's business, including its substantial reserve of cash and near-cash investments, the potential of its venture capital portfolio to generate future income and capital proceeds and the ability of the directors to control the level of future cash outflows arising from share-buy backs, dividends and investments. When assessing the potential future cashflows of the company, the directors have considered various scenarios including a 'downside case' where potential cash inflows are severely impacted by economic disruption caused by COVID-19. As detailed on page 22, the management engagement committee has also considered the company's relationship with the investment manager, Mercia, by reference to the performance of the venture capital portfolio and the expertise demonstrated by Mercia in venture capital investment.

Taking into account the company's current position and principal risks, the directors have concluded that there is a reasonable expectation that the company will be able to continue in operation over the three year period and meet its liabilities as they fall due over that period.

Going concern

The financial statements have been prepared on a going concern basis.

The directors performed an assessment of the company's ability to meet its liabilities as they fall due. In performing this assessment, the directors took into consideration the uncertain economic outlook in light of the COVID-19 pandemic including:

- the investments and liquid resources held by the company;
- the fact that the company has no debt or capital commitments;
- the ability of the company to meet all of its liabilities and ongoing expenses from its assets, including its year-end cash balance;
- revenue and operating cost forecasts for the forthcoming year;
- the ability of third-party service providers to continue to provide services; and
- potential downside scenarios including a fall in the valuation of the investment portfolio or levels of investment income.

Based on this assessment, the directors are confident that the company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements, and therefore determine the going concern basis to be appropriate.

Directors

None of the directors has a contract of service with the company and, except as mentioned below under the heading "Management", no contract or arrangement subsisted during or at the end of the year in which any director was materially interested and which was significant in relation to the company's business.

Directors' and officers' liability insurance

The company has, as permitted by the Companies Act 2006, maintained insurance cover on behalf of the directors and secretary indemnifying them against certain liabilities which may be incurred by any of them in relation to the company.

Management

Mercia took over management of the company's investment affairs after the novation of the pre-existing management agreement between the company and NVM Private Equity LLP (NVM), who had acted as manager since the company's inception. The principal terms of the company's management agreement with Mercia are set out in Note 3 to the financial statements.

The management engagement committee carries out a regular review of the terms of Mercia's appointment with a view to ensuring that Mercia's remuneration is set at an appropriate level, having regard to the nature of the work carried out and general market practice.

As required by the Listing Rules, the directors confirm that in their opinion the continuing appointment of Mercia as investment manager on the terms agreed is in the interests of the company's shareholders as a whole. In reaching this conclusion the directors have taken into account the performance of the investment portfolio and the efficient and effective service provided by Mercia to the company.

Remuneration receivable by the manager

The remuneration receivable by the manager by virtue of the management agreement with Northern 2 VCT comprises the following (note: the fees in respect of the period up until the novation of the management contract on 23 December 2019 were received by NVM, and the fees in respect of the remainder of the year were due to Mercia):

Remuneration payable by Northern 2 VCT

Basic management fee: the manager is entitled to receive a basic annual management fee equivalent to 2.06% of net assets, calculated half-yearly as at 31 March and 30 September. In consenting to the novation of the management agreement to Mercia in December 2019, it has been agreed that the fee due on the value of liquid assets above the threshold of £20 million will continue to attract a reduced rate of 1% per annum on a permanent basis. In the year ended 31 March 2020 the basic annual management fee was £1,724,000 (preceding year: £1,597,000).

Performance-related management fee: the manager is entitled to receive an annual performance related management fee equivalent to 12% of the total return in excess of a formula-driven hurdle rate, details of whose composition are set out in Note 3 to the financial statements. The hurdle rate for the year ended 31 March 2020 was 6.0% (preceding year: 6.0%). There was no performance-related management fee due for the year ended 31 March 2020 (preceding year: nil).

Accounting and secretarial fee: the manager provides accounting, administrative and secretarial services to the company for an annual fee of £60,000 per annum, linked to the movement in the RPI. The fee payable in respect of the preceding year was £58,000.

The total remuneration payable in aggregate to the manager by Northern 2 VCT in respect of the year, comprising the basic management fee and the accounting and secretarial fee, was £1,784,000 (preceding year £1,655,000).

Under current tax legislation the fees paid by the company to the manager are not subject to VAT. The total annual running costs of the company, including the basic management fee and the accounting and secretarial fee but excluding the performance-related management fee, are capped at 2.9% of average net assets and any excess will be refunded to the company by way of a reduction in the manager's basic management fee. The annual running costs of the company for the year ended 31 March 2020 were equivalent to 2.34% of average net assets (preceding year: 2.31%).

Remuneration payable by investee companies

Under the management agreement, the manager is entitled to receive fees from investee companies in respect of the arrangement of investments and the provision of non-executive directors and other advisory services. The manager is responsible for paying the due diligence and other costs incurred in connection with proposed investments which for whatever reason do not proceed to completion. In the year ended 31 March 2020 the arrangement fees receivable by the manager from investee companies which were attributable to investments made by Northern 2 VCT amounted to £243,000 (preceding year: £295,000), and directors' and monitoring fees amounted to £376,000 (preceding year: £346,000).

Executive co-investment scheme

Since 2006 the company has, together with the other VCT funds previously managed by NVM, participated in a co-investment scheme with the objective of enabling the manager to recruit, retain and incentivise its key investment executives. Under the scheme, which has been continued by Mercia, executives are required to invest personally (and on the same terms as the company and other VCT funds managed by Mercia) in the ordinary share capital of every unquoted investee company in which the company invests. The shares held by executives can only be sold at such time as the VCT funds managed by Mercia sell their shares and any prior ranking loan notes or preference shares held by the funds having been repaid. The executives participating in the scheme jointly subscribe for 5.0% of the non-yielding ordinary shares available to the Northern VCT funds, except in the case of investments where there is no class of yielding securities, in which case the executives jointly subscribe for 1.0% of the non-yielding ordinary shares available to the Northern VCT funds. At 31 March 2020 the co-investment scheme held investments in 51 investee companies acquired at a total cost of £1,231,000, of which £376,000 was attributable to investments made by Northern 2 VCT.

Share capital – purchase of shares

During the year the company purchased for cancellation 3,047,709 of its own shares, representing 2.3% of the called-up share capital of the company at the beginning of the year, for a consideration of £1,791,000.

Purchases were made in line with the company's policy of purchasing available shares at a discount to net asset value. At the 2019 annual general meeting, held in July 2019, shareholders authorised the company to purchase in the market up to 14,019,039 ordinary shares (equivalent to approximately 10% of the then issued ordinary share capital) at a minimum price of 5.0 pence per share and a maximum price per share of not more than 105% of the average market value for the ordinary shares in the company for the five business days prior to the date on which the ordinary shares were purchased. As at 31 March 2020 this authority remained effective in respect of 11,084,080 shares; the authority will lapse at the conclusion of the 2020 annual general meeting of the company on 26 August 2020.

Share capital – issue of shares

During the year the company issued 11,890,246 new ordinary shares for a cash consideration of £7,568,000.

Fixed assets

Movements in fixed asset investments during the year are set out in Note 8 to the financial statements.

Financial Instruments

The company's financial instruments comprise its investment portfolio, cash balances, debtors and creditors that arise directly from its operations such as sales and purchases awaiting settlement and accrued income. The financial risk management objectives and policies arising from its financial instruments and the exposure of the company to risk are disclosed in Note 17 to the financial statements.

Annual general meeting

Notice of the 2020 annual general meeting to be held on 26 August 2020 is set out in a separate circular to shareholders along with explanatory comments on the resolutions.

Substantial shareholdings

No disclosures of major shareholdings had been made to the company under Disclosure and Transparency Rule 5 (Vote Holder and Issuer Notification Rules) as at the date of this report.

Independent auditor

KPMG LLP have indicated their willingness to continue as auditor of the company and resolutions to re-appoint them and to authorise the audit committee to fix their remuneration will be proposed at the annual general meeting.

By order of the Board

J K Bryce
Secretary

8 July 2020

Directors' remuneration report

The board currently comprises five directors, all of whom are non-executive.

This report has been prepared by the directors in accordance with the requirements of Section 410 of the Companies Act 2006. A resolution to approve the directors' remuneration report and statement of the directors' remuneration policy will be proposed at the annual general meeting on 26 August 2020.

The company's independent auditor, KPMG LLP, is required to give its opinion on certain information included in this report, as indicated below. The auditor's report on these and other matters is set out on pages 26 to 28.

Directors' remuneration policy

The board currently comprises five directors, all of whom are non-executive. The board does not have a separate remuneration committee, as the company has no employees or executive directors. The board has established a nomination committee, chaired by Mr D P A Gravells and comprising all of the directors (other than Mr A M Conn), which meets annually (or more frequently if required) to consider the selection and appointment of directors and to make recommendations to the board as to the level of directors' fees. The board has not retained external advisers in relation to remuneration matters but has access to information about directors' fees paid by other companies of a similar size and type. No views which are relevant to the formulation of the directors' remuneration policy have been expressed to the company by shareholders, whether at a general meeting or otherwise.

The board considers that directors' fees should reflect the time commitment required and the high level of responsibility borne by directors, and should be broadly comparable to those paid by similar companies. It is not considered appropriate that directors' remuneration should be performance-related, and none of the directors are eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits in respect of their services as non-executive directors of the company.

The articles of association place an overall limit (currently £150,000 per annum) on directors' remuneration. The articles of association provide that directors shall retire and be subject to re-election at the first annual general meeting after their appointment and that any director who was not appointed or re-appointed at one of the preceding two annual general meetings shall retire and be subject to re-election at each annual general meeting. As a matter of good practice, the board has adopted the 2019 AIC code recommendation that all directors should seek annual re-election. None of the directors has a service contract with the company. On being appointed or re-elected, directors receive a letter from the company setting out the terms of their appointment and their specific duties and responsibilities. A director's appointment may be terminated on three months' notice being given by the company and in certain other circumstances. A director who ceases to hold office is not entitled to receive any payment other than accrued fees (if any) for past services.

Directors' remuneration for the year ended 31 March 2020 (audited information)

The fees paid to individual directors in respect of the years ended 31 March 2020 and 31 March 2019, which represent the entire remuneration payable to directors, are shown in Table 1.

Directors' share interests (audited information)

The interests of the directors of the company (including the interests of their connected persons) in the issued ordinary shares of the company, at the beginning of the year, at the end of the year and at the date of this report, are shown in Table 2.

All of the directors' share interests were held beneficially.

The company has not set out any formal requirements or guidelines to directors concerning their ownership of shares in the company.

Relative importance of spend on pay

As the company has no employees, the directors do not consider it appropriate to present a table comparing remuneration paid to employees with distributions to shareholders.

Company performance

The graph opposite compares the total return (assuming re-investment of all dividends) to shareholders in the company over the five years ended 31 March 2020 with the total return from a broad UK equity market index over the same period.

Statement of voting at annual general meeting

At the annual general meeting on 11 July 2019 the resolution to approve the directors' remuneration report for the year ended 31 March 2019 was approved by a show of hands. 96.1% of the proxy votes received in relation to the resolution were either for or discretionary.

Statement by the chairman of the nomination committee

In accordance with the directors' remuneration policy, directors' fees were reviewed by the nomination committee during its meeting on 13 February 2020, when it was decided that fees should increase to £27,500 for the chairman, £24,000 for the chair of the audit committee and the senior independent director and £22,000 for the remaining directors for the year to 31 March 2021. The directors' fees were last amended in April 2018. There have been considerable changes to the VCT legislation in recent years leading to an increase in the volume of investment activity of the company. This has required a greater time commitment from the directors in order to discharge their duties effectively and accordingly, it was recommended that the directors' remuneration should be increased as detailed above. By setting the fees at a level which reflects the current requirements of the roles, we aim to ensure that we are able to attract high quality people as we refresh the board over time.

By order of the Board

D P A Gravells
Chairman of the
Nomination Committee

8 July 2020

Table 1: Directors' fees

	Year ended 31 March 2020	Year ended 31 March 2019
D P A Gravells (Chairman)	26,000	26,000
A M Conn*	–	–
S P Devonshire	20,000	20,000
C A McAnulty (Chair of audit committee)	22,000	22,000
F L G Neale	20,000	20,000
Total	**88,000**	**88,000**

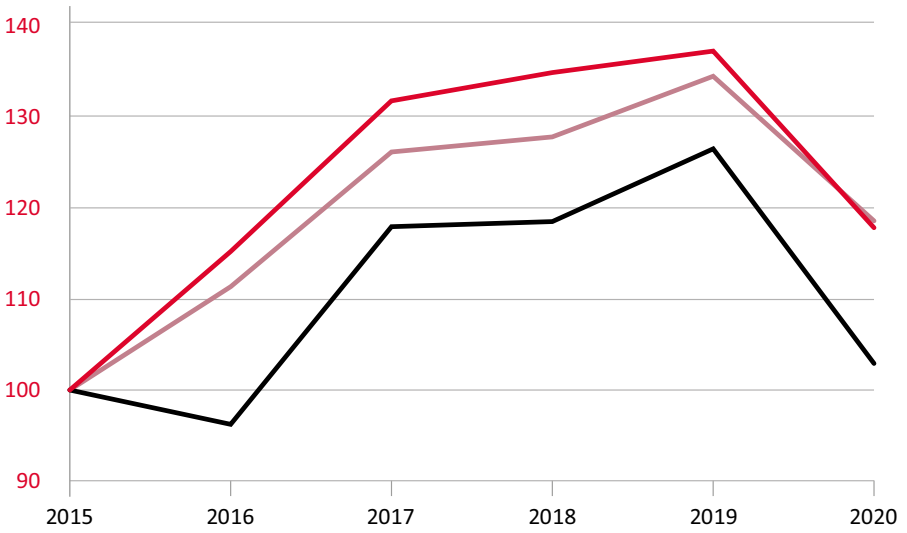
*Mr A M Conn waived his entitlement to directors' fees in respect of both years.

Table 2: Directors' interests in ordinary shares

	8 July 2020	31 March 2020	31 March 2019
D P A Gravells (Chairman)	44,668	44,668	35,288
A M Conn	527,356	507,706	460,719
S P Devonshire	–	–	–
C A McAnulty	85,884	66,284	66,284
F L G Neale	176,082	156,482	140,848

Return to shareholders in Northern 2 VCT PLC

Five years to 31 March 2020 (March 2015 = 100)



Northern 2 VCT NAV total return
Northern 2 VCT share price total return
UK equity market index total return

Corporate governance

The company is committed to maintaining high standards in corporate governance.

The board of Northern 2 VCT PLC has considered the principles and recommendations of the Association of Investment Companies Code of Corporate Governance (AIC Code). The AIC Code addresses all the principles set out in the 2018 UK Corporate Governance Code, as well as setting out additional principles and recommendations on issues that are of specific relevance to the company. The AIC Code can be viewed at www.theaic.co.uk/aic-code-of-corporate-governance-0.

The board considers that reporting in accordance with the principles and recommendations of the AIC Code will provide better information to shareholders.

The company is committed to maintaining high standards in corporate governance and during the year ended 31 March 2020 complied with the recommendations of the AIC Code and the relevant provisions of the UK Corporate Governance Code, except as set out below.

The UK Corporate Governance Code includes provisions relating to the role of the chief executive, executive directors' remuneration and the need for an internal audit function. For the reasons set out in the AIC Code, and in the preamble to the UK Corporate Governance Code, the board considers these provisions are not relevant to the position of Northern 2 VCT PLC, which is an externally managed venture capital trust. The company has therefore not reported further in respect of these provisions.

Board of directors

The company has a board of five non-executive directors, who are considered to be independent of the company's investment manager, Mercia Fund Management (Mercia) and the majority of whom are considered to be independent of the company's previous investment manager, NVM Private Equity. The board meets regularly in person or by conference call five times each year, and on other occasions as required.

The board is responsible to shareholders for the effective stewardship of the company's affairs and has a formal schedule of matters specifically reserved for its decision which include:

- consideration of long-term strategic issues;
- valuation of the unquoted investment portfolio; and
- ensuring the company's compliance with good practice in corporate governance matters.

A brief biographical summary of each director is given on page 4.

The chairman, Mr D P A Gravells, leads the board in the determination of its strategy and in the achievement of its objectives. The chairman is responsible for organising the business of the board, ensuring its effectiveness and setting its agenda, and has no involvement in the day to day business of the company. He facilitates the effective contribution of the directors and ensures that they receive accurate, timely and clear information and that they communicate effectively with shareholders.

The board has established a formal process, led by the chairman, for the annual evaluation of the performance of the board, its principal committees and individual directors. The directors are made aware on appointment that their performance will be subject to regular evaluation. The performance of the chairman is evaluated by a meeting of the other board members under the leadership of Mr F L G Neale, the senior independent director of the company.

The company secretary, Mr J K Bryce, is responsible for advising the board through the chairman on all governance matters. All of the directors have access to the advice and services of the company secretary, who has administrative responsibility for the meetings of the board and its committees. Directors may also take independent professional advice at the company's expense where necessary in the performance of their duties.

The company's articles of association and the schedule of matters reserved to the board for decision provide that the appointment and removal of the company secretary is a matter for the board.

The articles of association provide that directors shall retire and be subject to re-election at the first annual general meeting after their appointment and that any director who was not appointed or re-appointed at one of the preceding two annual general meetings shall retire and be subject to re-election at each annual general meeting. However the board has as a matter of good practice adopted the AIC Code recommendation that all directors should seek annual re-election.

Independence of directors

The board regularly reviews the independence of its members and is satisfied that the company's directors are independent in character and judgement and there are no relationships or circumstances which could affect their objectivity (with the exception of Mr A M Conn who was an employee of NVM, the company's investment manager until 23 December 2019, during the year).

The AIC Code recommends that where a director has served for more than nine years, the board should state its reasons for believing that the individual remains independent. The board is of the view that a term of service in excess of nine years is not in itself prejudicial to a director's ability to carry out his/her duties effectively and from an independent perspective; the nature of the company's business is such that individual directors' experience and continuity of board membership can significantly enhance the effectiveness of the board as a whole. The company does not have a set limit on the tenure of the members of the board and the chairman, however the board has as a matter of good practice adopted the AIC Code recommendation that all directors should seek annual re-election, and acknowledges that regular refreshment of its membership is desirable.

Board committees

The board has appointed three standing committees to make recommendations to the board in specific areas. The board does not have a separate remuneration committee, as the company has no employees or executive directors. Detailed information relating to the remuneration of directors is given in the directors' remuneration report on pages 18 and 19.

Audit Committee

During the year the audit committee comprised:

Miss C A McAnulty (Chair)
Mr S P Devonshire
Mr D P A Gravells
Mr F L G Neale

The audit committee's terms of reference include the following roles and responsibilities:

- monitoring and making recommendations to the board in relation to the company's published financial statements and other formal announcements relating to the company's financial performance;
- monitoring and making recommendations to the board in relation to the valuation of the company's unquoted investments;
- monitoring and making recommendations to the board in relation to the company's internal control (including internal financial control) and risk management systems;
- periodically considering the need for an internal audit function;
- making recommendations to the board in relation to the appointment, re-appointment and removal of the external auditor and approving the remuneration and terms of engagement of the external auditor;
- reviewing and monitoring the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
- monitoring the extent to which the external auditor is engaged to supply non-audit services; and
- ensuring that the investment manager has arrangements in place for the investigation and follow-up of any concerns raised confidentially by staff in relation to the propriety of financial reporting or other matters.

The committee reviews its terms of reference and its effectiveness annually and recommends to the board any changes required as a result of the review. The terms of reference are available on request from the company secretary and on the company's website. The audit committee ordinarily meets three times per year and has direct access to KPMG LLP, the company's external auditor. The board considers that the members of the committee are independent and have collectively the skills and experience required to discharge their duties effectively, and that the chairman of the committee meets the requirements of the UK Corporate Governance Code as to recent and relevant financial experience. We note that the chairman, Mr D P A Gravells, is a member of the audit committee. Whilst this is not compliant with the provisions of the 2018 UK Corporate Governance Code, it is compliant with the provisions of the AIC Code. As all members of the audit committee are independent non-executive directors, we believe that this is appropriate.

During the year ended 31 March 2020 the company did not have an independent internal audit function as it is not deemed necessary given the size of the company and the nature of the company's business. However, the committee considers annually whether there is a need for such a function and if so would recommend this to the board.

During the year ended 31 March 2020 the audit committee discharged its responsibilities by:

- reviewing and approving the external auditor's terms of engagement, remuneration and independence;
- reviewing the external auditor's plan for the audit of the company's financial statements, including identification of key risks and confirmation of auditor independence;
- reviewing the manager's statement of internal controls operated in relation to the company's business and assessing the effectiveness of those controls in minimising the impact of key risks;
- reviewing periodic reports on the effectiveness of the manager's compliance procedures;
- reviewing the appropriateness of the company's accounting policies;
- reviewing the company's draft annual financial statements and half-yearly results statement prior to board approval, including the proposed fair value of investments;
- reviewing the external auditor's detailed reports to the committee on the annual financial statements;
- reviewing the taxation advisers' VCT status monitoring and compliance reports;
- considering the effectiveness of the external audit process; and
- recommending to the board and shareholders the reappointment of KPMG LLP as the independent auditor of the company.

The key area of risk that has been identified and considered by the audit committee in relation to the business activities and financial statements of the company is the valuation and existence of unquoted investments, particularly in light of the significant economic uncertainty caused by COVID-19. Another important area of risk that is considered by the audit committee is compliance with HM Revenue & Customs conditions for maintenance of approved venture capital trust status.

These issues were discussed with the investment manager and the auditor at the pre-year end audit planning meeting and at the conclusion of the audit of the financial statements.

Valuation of unquoted investments: the investment manager confirmed to the audit committee that the investment valuations had been carried out consistently with prior periods and in accordance with published industry guidelines (including the supplementary guidance issued by IPEV on 31 March 2020), taking account of the latest available information about investee companies and current market data. The investment manager highlighted that the assessment of the future prospects of portfolio companies was subject to heightened estimation uncertainty due to the COVID-19 pandemic. The audit committee reviewed the estimates and judgements used in the investment valuations and was satisfied that the final valuations are appropriate.

Venture capital trust status: the investment manager confirmed to the audit committee that the conditions for maintaining the company's status as an approved venture capital trust had been complied with throughout the year. The position was also confirmed and reported on by Philip Hare & Associates LLP in its capacity as adviser to the company on taxation matters and the relevant report was reviewed by the audit committee.

The investment manager and auditor confirmed to the audit committee that they were not aware of any material misstatements. Having reviewed the reports received from the manager and auditor, the audit committee is satisfied that the key areas of risk and judgement have been appropriately addressed in the financial statements and that the significant assumptions used in determining the value of assets and liabilities have been properly appraised and are sufficiently robust. The committee considers that KPMG LLP has carried out its duties as auditor in a diligent and professional manner.

Following a detailed review of the draft annual report, the audit committee concluded that, taken as a whole, it was considered it to be fair, balanced and understandable. The audit committee recommended to the board that the directors' responsibilities statement in respect of the annual report and the financial statements, should be signed accordingly.

The committee regularly reviews and monitors the auditor's effectiveness and independence. KPMG LLP has confirmed that it is independent of the company and has complied with the applicable auditing standards. KPMG LLP together with its predecessor KPMG Audit Plc has held office as auditor for seventeen years; in accordance with professional guidelines the engagement leader is rotated after at most five years, this is the first year that the current partner has served.

As part of its review, the committee considers the nature and extent of non-audit services supplied by the auditor, all of which must be approved by the committee. There were no non-audit services contracted for during the year. The audit committee is currently reviewing when it will conduct an audit tender process in light of the requirements and deadlines for mandatory audit tendering and rotation. Under current regulations the last period for which KPMG LLP will be permitted to act as auditor of the company will be the year ending 31 March 2023.

Nomination Committee

During the year the nomination committee comprised:

Mr D P A Gravells (Chairman)
Mr S P Devonshire
Miss C A McAnulty
Mr F L G Neale

The nomination committee considers the selection and appointment of directors and makes annual recommendations to the board as to the level of directors' fees. The committee monitors the balance of skills, knowledge, diversity and experience offered by board members, and satisfies itself that they are able to devote sufficient time to carry out their role efficiently and effectively. When recommending new appointments to the board the committee draws on its members' extensive business experience and range of contacts to identify suitable candidates, and would consider the use of formal advertisements and external consultants where appropriate. The committee recognises the benefits of diversity in the constitution of the board and it is the committee's intention that the diversity of representation on the board will continue to increase over time. New directors are provided with briefing material relating to the company, its investment manager and the venture capital industry as well as to their own legal responsibilities as directors. The committee has written terms of reference which are reviewed annually and are available on request from the company secretary and on the company's website.

Management Engagement Committee

During the year the management engagement committee comprised:

Mr D P A Gravells (Chairman)
Mr S P Devonshire
Miss C A McAnulty
Mr F L G Neale

The management engagement committee undertakes a periodic review of the performance of the investment manager, Mercia, and of the terms of the management agreement including the level of fees payable and the length of the notice period. The principal terms of the agreement are set out in Note 3 to the financial statements on page 35.

Following the latest review by the committee, the board concluded that the continuing appointment of Mercia was in the interests of the company and its shareholders as a whole. Mercia has demonstrated its commitment to and expertise in venture capital investment since their appointment. Mercia has also performed its company secretarial and accounting duties efficiently and effectively.

Attendance at board and committee meetings

Table 1 sets out the number of substantive board and committee meetings held during the year ended 31 March 2020 and the number attended by each director compared with the maximum possible attendance.

Corporate responsibility

The board aims to ensure that the company takes a positive approach to corporate responsibility, in relation both to itself and to the companies it invests in. This entails maintaining a responsible attitude to ethical, environmental, governance and social issues, and the encouragement of good practice in investee companies. The board seeks to avoid investing in companies which do not operate within relevant ethical, environmental and social legislation or otherwise fail to comply with appropriate industry standards.

Investor relations

In fulfilment of the Chairman's obligations under the UK Corporate Governance Code, the Chairman gives feedback to the board on any issues raised with him by shareholders with a view to ensuring that members of the board develop an understanding of the views of shareholders about their company. The board recognises the value of maintaining regular communications with shareholders. Formal reports are sent to shareholders at the half-year and year-end stages, and an opportunity is given to shareholders at the annual general meeting to question the board and the investment manager on matters relating to the company's operation and performance. The manager holds an annual VCT investor seminar to which shareholders are invited. Proxy voting figures for each resolution are announced at general meetings and are made available publicly following the relevant meeting.

Further information can also be obtained via the company's website.

Table 1: Directors' attendance at meetings

	Board	Audit committee	Nomination committee	Management engagement committee
Number of meetings held	7*	2	1	1
Attendance (actual/possible):				
D P A Gravells (Chairman)	7/7	2/2	1/1	1/1
A M Conn	7/7	N/A	N/A	N/A
S P Devonshire	6/7	2/2	1/1	1/1
C A McAnulty	6/7	2/2	1/1	1/1
F L G Neale	7/7	2/2	1/1	1/1

*In addition to the seven meetings of the board held in person during the year, there were a further six meetings held by conference call.

Internal control

The directors have overall responsibility for ensuring that there are in place robust systems of internal control, both financial and non-financial, and for reviewing their effectiveness. The purpose of the internal financial controls is to ensure that proper accounting records are maintained, the company's assets are safeguarded and the financial information used within the business and for publication is accurate and reliable; such a system can provide only reasonable and not absolute assurance against material misstatement or loss. The board regularly reviews financial performance and results with the investment manager. Responsibility for accounting and secretarial services has been contractually delegated to Mercia under the management agreement. Mercia has established its own system of internal controls in relation to these matters, details of which have been reviewed by the audit committee.

Non-financial internal controls include the systems of operational and compliance controls maintained by the investment manager in relation to the company's business as well as the management of key risks as referred to in the section headed "Risk management" below.

The directors confirm that by means of the procedures set out above, and in accordance with "*Internal Controls: Guidance for Directors on the Combined Code*", published by the Institute of Chartered Accountants in England and Wales, they have established a continuing process for identifying, evaluating and managing the significant potential risks faced by the company and have reviewed the effectiveness of the internal control systems. This process has been in place throughout and subsequent to the accounting period under review.

Risk management

Risk management is discussed in the strategic report on pages 9 and 10.

Share capital, rights attaching to the shares and restrictions on voting and transfer

As at 31 March 2020 there were 138,886,797 ordinary shares in issue (as at that date none of the issued shares were held by the company as treasury shares). Subject to any suspension or abrogation of rights pursuant to relevant law or the company's articles of association, the shares confer on their holders (other than the company in respect of any treasury shares) the following principal rights:

(a) the right to receive out of profits available for distribution such dividends as may be agreed to be paid (in the case of a final dividend in an amount not exceeding the amount recommended by the board as approved by shareholders in general meeting or in the case of an interim dividend in an amount determined by the board). All dividends unclaimed for a period of 12 years after having become due for payment are forfeited automatically and cease to remain owing by the company;

(b) the right, on a return of assets on a liquidation, reduction of capital or otherwise, to share in the surplus assets of the company remaining after payment of its liabilities pari passu with the other holders of ordinary shares; and

(c) the right to receive notice of and to attend and speak and vote in person or by proxy at any general meeting of the company. On a show of hands every member present or represented and voting has one vote and on a poll every member present or represented and voting has one vote for every share of which that member is the holder; the appointment of a proxy must be received not less than 48 hours before the time of the holding of the relevant meeting or adjourned meeting or, in the case of a poll taken otherwise than at or on the same day as the relevant meeting or adjourned meeting, be received after the poll has been demanded and not less than 24 hours before the time appointed for the taking of the poll.

These rights can be suspended. If a member, or any other person appearing to be interested in shares held by that member, has failed to comply within the time limits specified in the company's articles of association with a notice pursuant to Section 793 of the Companies Act 2006 (notice by company requiring information about interests in its shares), the company can until the default ceases suspend the right to attend and speak and vote at a general meeting and if the shares represent at least 0.25% of their class the company can also withhold any dividend or other money payable in respect of the shares (without any obligation to pay interest) and refuse to accept certain transfers of the relevant shares.

Shareholders, either alone or with other shareholders, have other rights as set out in the company's articles of association and in the Companies Act 2006.

A member may choose whether his shares are evidenced by share certificates (certificated shares) or held in electronic (uncertificated) form in CREST (the UK electronic settlement system). Any member may transfer all or any of his shares, subject in the case of certificated shares to the rules set out in the company's articles of association or in the case of uncertificated shares to the regulations governing the operation of CREST (which allow the directors to refuse to register a transfer as therein set out); the transferor remains the holder of the shares until the name of the transferee is entered in the register of members. The directors may refuse to register a transfer of certificated shares in favour of more than four persons jointly or where there is no adequate evidence of ownership or the transfer is not duly stamped (if so required). The directors may also refuse to register a share transfer if it is in respect of a certificated share which is not fully paid up or on which the company has a lien provided that, where the share transfer is in respect of any share admitted to the Official List maintained by the UK Listing Authority, any such discretion may not be exercised so as to prevent dealings taking place on an open and proper basis, or if in the opinion of the directors (and with the concurrence of the UK Listing Authority) exceptional circumstances so warrant, provided that the exercise of such power will not disturb the market in those shares. Whilst there are no squeeze-out and sell-out rules relating to the shares in the company's articles of association, shareholders are subject to the compulsory acquisition provisions in Sections 974 to 991 of the Companies Act 2006.

Amendment of articles of association

The company's articles of association may be amended by the members of the company by special resolution (requiring a majority of at least 75% of the persons voting on the relevant resolution).

Appointment and replacement of directors

A person may be appointed as a director of the company by the shareholders in a general meeting by ordinary resolution (requiring a simple majority of the persons voting on the relevant resolution) or by the directors; no person, other than a director retiring by rotation or otherwise, shall be appointed or reappointed as director at any general meeting unless he or she is recommended by the directors or, not less than seven or more than 42 clear days before the date appointed for the meeting, notice is given to the company of the intention to propose that person for appointment or re-appointment in the form and manner set out in the company's articles of association.

Each director who is appointed by the directors (and who has not been elected as a director of the company by the members at a general meeting held in the interval since his appointment as a director of the company) is to be subject to election as a director of the company by the members at the first annual general meeting of the company following his appointment. At each annual general meeting of the company, any director who was not appointed or re-appointed at one of the preceding two annual general meetings shall retire and be subject to re-election.

The Companies Act 2006 allows shareholders in general meeting by ordinary resolution (requiring a simple majority of the persons voting on the relevant resolution) to remove any director before the expiration of his or her period of office, but without prejudice to any claim for damages which the director may have for breach of any contract of service between him or her and the company.

A person also ceases to be a director if he or she resigns in writing, ceases to be a director by virtue of any provision of the Companies Act, becomes prohibited by law from being a director, becomes bankrupt or is the subject of a relevant insolvency procedure, or becomes of unsound mind, or if the board so decides following at least six months' absence without leave or if he or she becomes subject to relevant procedures under the mental health laws, as set out in the company's articles of association.

Powers of the directors

The company's articles of association specify that, subject to the provisions of the Companies Act 2006 and articles of association of the company and any directions given by shareholders by special resolution, the business of the company is to be managed by the directors, who may exercise all the powers of the company, whether relating to the management of the business or not, except where the Companies Act 2006 or the articles of association of the company otherwise require. In particular the directors may exercise on behalf of the company its powers to purchase its own shares to the extent permitted by shareholders. Authority was given at the company's 2019 annual general meeting to make market purchases of up to 14,019,039 ordinary shares at any time up to the 2020 annual general meeting and otherwise on the terms set out in the relevant resolution, and authority is being sought at the annual general meeting to be held on 26 August 2020 as set out in a separate circular.

By order of the Board

J K Bryce
Secretary

C A McAnulty
Chair of the
Audit Committee

8 July 2020

Directors' responsibilities statement

The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they are required to prepare the financial statements in accordance with UK accounting standards, including FRS 102 "*The Financial Reporting Standard applicable in the UK and Republic of Ireland*".

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of its profit or loss for the year.

In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a strategic report, directors' report, directors' remuneration report and corporate governance statement that complies with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the directors in respect of the annual report and financial statements for the year ended 31 March 2020

We confirm that to the best of our knowledge:

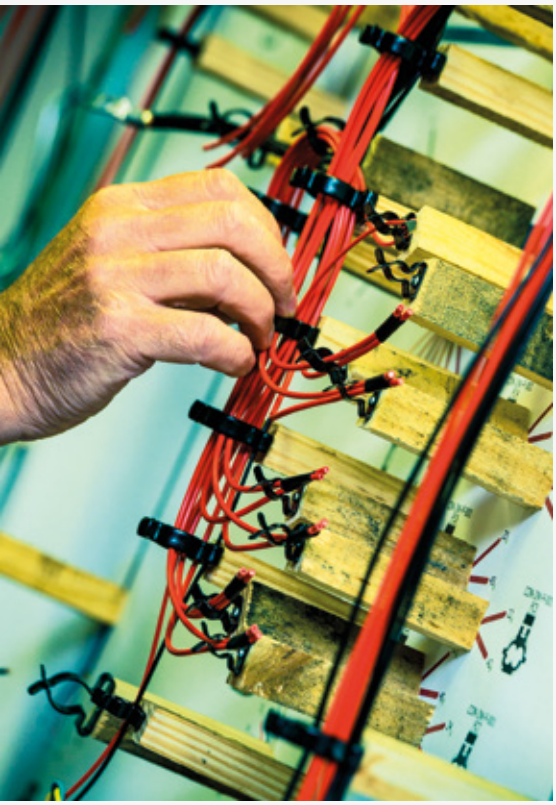
- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company; and
- the strategic report and directors' report includes a fair review of the development and performance of the business and the position of the issuer, together with a description of the principal risks and uncertainties that they face.

We consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.

By order of the Board

J K Bryce
Secretary

8 July 2020



Independent auditor's report

To the members of Northern 2 VCT PLC only

Opinions and conclusions arising from our audit

1. Our opinion is unmodified

We have audited the financial statements of Northern 2 VCT PLC ("the company") for the year ended 31 March 2020 which comprise the income statement, balance sheet, statement of changes in equity, statement of cash flows, and the related notes, including the accounting policies in Note 1.

In our opinion the financial statements:

- give a true and fair view of the state of company's affairs as at 31 March 2020 and of its return for the year then ended;
- have been properly prepared in accordance with UK accounting standards, including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Overview

Materiality: (financial statements as a whole):

- £740,000 (2019: £907,700), which represents 1% of total assets (2019: 1%).

Key audit matter

Recurring risks:

- Valuation of unquoted investments (which in our opinion are of higher risk than in the prior year due to the impact of COVID-19).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors on 14 February 2003. The period of total uninterrupted engagement is for the 17 financial years ended 31 March 2020. We have fulfilled our ethical responsibilities under, and we remain independent of the company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matter in arriving at our audit opinion above, together with our key audit procedures to address this matter and, as required for public interest entities, our results from those procedures. This matter was addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on this matter.

Valuation of unquoted investments (£50.7m million; 2019: £53.2 million)

Refer to page 21 (audit committee report), pages 34 – 35 (accounting policy) and pages 30 – 44 (financial disclosures).

The risk

Subjective valuation

68.1% (2019: 58.6%) of the company's total assets (by value) is held in investments where no quoted market price is available. Unquoted investments are measured at fair value, which is established in accordance with the International Private Equity and Venture Capital Valuation Guidelines by using measurements of value such as prices of recent orderly transactions, earnings multiples and net assets. There is a significant risk over valuation of these investments.

The effect of these matters is that, as part of our risk assessment, we determined that the valuation of unquoted investments has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (Note 17) disclose the sensitivity estimated by the company.

Our response

Our procedures included:

- **Historical comparisons:** Assessment of investment realisations in the period, comparing actual sales proceeds to prior year end valuations to understand the reasons for significant variances and determine whether they are indicative of bias or error in the company's approach to valuations;
- **Methodology choice:** In the context of observed industry best practice and the provisions of the International Private Equity and Venture Capital Valuation Guidelines, we challenged the appropriateness of the valuation basis selected;
- **Our valuations experience:** Challenging the investment manager on key judgements affecting investee company valuations, such as discount factors and the choice of benchmark for earnings multiples. We compared key underlying financial data inputs to external sources, investee company audited accounts and management information as applicable. We challenged the assumptions around sustainability of earnings based on the plans of the investee companies and whether these are achievable and we obtained an understanding of existing and prospective investee company cashflows to understand whether borrowings can be serviced or whether refinancing may be required. We performed retrospective reviews against audited financial statements (where available) in order to assess the accuracy of unaudited information provided by investee companies. Our work included consideration of events which occurred subsequent to the year end up until the date of this audit report;
- **Comparing valuations:** Where a recent transaction has been used to value a holding, we obtained an understanding of the circumstances surrounding the transaction and whether it was considered to be on an arms-length basis and suitable as an input into a valuation; and
- **Assessing transparency:** Consideration of the appropriateness, in accordance with relevant accounting standards, of the disclosures in respect of unquoted investments and the effect of changing one or more inputs to reasonably possible alternative valuation assumptions.

Our results: We found the company's valuation of unquoted investments to be acceptable (2019: acceptable).

We continue to perform procedures over the impact of the UK exiting the European Union. However, following the fact that the UK has now left the European Union, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

3. Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £740,000 (2019: £907,700), determined with reference to a benchmark of total assets, of which it represents 1% (2019: 1%).

We agreed to report to the audit committee any corrected or uncorrected identified misstatements exceeding £37,000 (2019: £45,000), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the company was undertaken to the materiality level specified above and was performed by a single audit team.

4. We have nothing to report on going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the company or to cease its operations, and as they have concluded that the company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

In our evaluation of the directors' conclusions, we considered the inherent risks to the company's business model and analysed how those risks might affect the company's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if:

- we have anything material to add or draw attention to in relation to the directors' statement in Note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the company's use of that basis for a period of at least twelve months from the date of approval of the financial statements; or
- the related statement under the Listing Rules set out on page 17 is materially inconsistent with our audit knowledge.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5. We have nothing to report on the other information in the annual report

The directors are responsible for the other information presented in the annual report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Directors' remuneration report

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Disclosures of principal risks and longer-term viability

Based on the knowledge we acquired during our financial statements audit, we have nothing material to add or draw attention to in relation to:

- the directors' confirmation within the statement of long-term viability on page 16 that they have carried out a robust assessment of the emerging and principal risks facing the company, including those that would threaten its business model, future performance, solvency and liquidity;
- the principal risks and uncertainties disclosures describing these risks and explaining how they are being managed and mitigated; and
- the directors' explanation in the statement of long-term viability of how they have assessed the prospects of the company, over what period they have done so and why they considered that period to be appropriate, and their statement as to whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Under the Listing Rules we are required to review the statement of long-term viability. We have nothing to report in this respect.

Our work is limited to assessing these matters in the context of only the knowledge acquired during our financial statements audit. As we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made, the absence of anything to report on these statements is not a guarantee as to the company's longer-term viability.

Corporate governance disclosures
We are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our financial statements audit and the directors' statement that 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 and performance, business model and strategy; or
- the section of the annual report describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We are required to report to you if the corporate governance statement does not properly disclose a departure from the provisions of the UK Corporate Governance Code specified by the Listing Rules for our review.

We have nothing to report in these respects.

6. We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements and the part of the directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7. Respective responsibilities

Directors' responsibilities
As explained more fully in their statement set out on page 25, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or other irregularities (see below), or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect
We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience and through discussion with the directors, the manager and the administrator (as required by auditing standards). We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), and its qualification as a venture capital trust under UK tax legislation, any breach of which could lead to the company losing various deductions and exemptions from UK corporation tax, and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation. We identified the following areas as those most likely to have such an effect: the Listing Rules and certain aspects of company legislation recognising the financial and regulated nature of the company's activities and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the company's members, as a body, in accordance with chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

John Waterson
(Senior Statutory Auditor)
for and on behalf of KPMG LLP,
Statutory Auditor
Chartered Accountants
KPMG LLP
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG

8 July 2020

Financial statements

Income statement

for the year ended 31 March 2020

	Notes	Year ended 31 March 2020 Revenue £000	Capital £000	Total £000	Year ended 31 March 2019 Revenue £000	Capital £000	Total £000
(Loss)/gain on disposal of investments	8	–	(728)	(728)	–	2,827	2,827
Movements in fair value of investments	8	–	(8,050)	(8,050)	–	762	762
		–	(8,778)	(8,778)	–	3,589	3,589
Income	2	1,052	–	1,052	2,638	–	2,638
Investment management fee	3	(431)	(1,293)	(1,724)	(399)	(1,198)	(1,597)
Other expenses	4	(369)	–	(369)	(393)	–	(393)
Return on ordinary activities before tax		252	(10,071)	(9,819)	1,846	2,391	4,237
Tax on return on ordinary activities	5	–	–	–	(275)	275	–
Return on ordinary activities after tax		252	(10,071)	(9,819)	1,571	2,666	4,237
Return per share	7	0.2p	(7.2)p	(7.0)p	1.2p	2.0p	3.2p

- The total column of this statement is the statement of total comprehensive income of the company prepared in accordance with FRS 102 "*The Financial Reporting Standard applicable in the UK and Republic of Ireland*". The supplementary revenue return and capital return columns have been prepared in accordance with the Statement of Recommended Practice "*Financial Statements of Investment Trust Companies and Venture Capital Trusts*" issued in October 2019 by the Association of Investment Companies ("AIC SORP").
- There are no recognised gains or losses other than those disclosed in the income statement.
- All items in the above statement derive from continuing operations.
- The accompanying notes are an integral part of this statement.

Balance sheet

as at 31 March 2020

	Notes	31 March 2020 £000	31 March 2019 £000
Fixed assets			
Investments	8	59,191	64,125
Current assets			
Debtors	12	79	221
Cash and cash equivalents		15,203	26,431
		15,282	26,652
Creditors (amounts falling due within one year)	13	(117)	(6,668)
Net current assets		15,165	19,984
Net assets		74,356	84,109
Capital and reserves			
Called-up equity share capital	14	6,945	6,502
Share premium	15	8,401	1,555
Capital redemption reserve	15	367	215
Capital reserve	15	61,247	67,341
Revaluation reserve	15	(2,993)	6,679
Revenue reserve	15	389	1,817
Total equity shareholders' funds		74,356	84,109
Net asset value per share	16	53.5p	64.7p

● The accompanying notes are an integral part of this statement.

The financial statements on pages 30 to 44 were approved by the directors on 8 July 2020 and are signed on their behalf by:

D P A Gravells
Director

Statement of changes in equity

for the year ended 31 March 2020

	Notes	Non-distributable reserves				Distributable reserves		Total
		Called-up share capital £000	Share premium £000	Capital redemption reserve £000	Revaluation reserve* £000	Capital reserve £000	Revenue reserve £000	£000
At 1 April 2019		6,502	1,555	215	6,679	67,341	1,817	84,109
Return on ordinary activities after tax		–	–	–	(9,672)	(399)	252	(9,819)
Dividends paid	6	–	–	–	–	(3,904)	(1,680)	(5,584)
Net proceeds of share issues	15	595	6,846	–	–	–	–	7,441
Shares purchased for cancellation	15	(152)	–	152	–	(1,791)	–	(1,791)
At 31 March 2020		6,945	8,401	367	(2,993)	61,247	389	74,356

Year ended 31 March 2019	Notes	Non-distributable reserves				Distributable reserves		Total
		Called-up share capital £000	Share premium £000	Capital redemption reserve £000	Revaluation reserve* £000	Capital reserve £000	Revenue reserve £000	£000
At 1 April 2018		6,505	392	110	7,836	71,629	571	87,043
Return on ordinary activities after tax		–	–	–	(1,157)	3,823	1,571	4,237
Dividends paid	6	–	–	–	–	(6,831)	(325)	(7,156)
Net proceeds of share issues	15	102	1,163	–	–	–	–	1,265
Shares purchased for cancellation	15	(105)	–	105	–	(1,280)	–	(1,280)
At 31 March 2019		6,502	1,555	215	6,679	67,341	1,817	84,109

*The revaluation reserve is generally non-distributable other than that part of the reserve relating to gains/losses on readily realisable quoted investments, which is distributable.

● The accompanying notes are an integral part of this statement.

Statement of cash flows

for the year ended 31 March 2020

	Year ended 31 March 2020 £000	Year ended 31 March 2019 £000
Cash flows from operating activities		
Return on ordinary activities before tax	(9,819)	4,237
Adjustments for:		
Loss/(gain) on disposal of investments	728	(2,827)
Movements in fair value of investments	8,050	(762)
Decrease/(increase) in debtors	142	(16)
(Decrease)/increase in creditors	(83)	66
Net cash (outflow)/inflow from investing activities	(982)	698
Cash flows from investing activities		
Purchase of investments	(11,850)	(17,730)
Sale/repayment of investments	8,006	18,626
Net cash (outflow)/inflow from investing activities	(3,844)	896
Cash flows from financing activities		
Issue of ordinary shares	7,568	1,304
Share issue expenses	(127)	(39)
Share subscriptions held pending allotment	(6,468)	6,468
Purchase of ordinary shares for cancellation	(1,791)	(1,280)
Equity dividends paid	(5,584)	(7,156)
Net cash outflow from financing activities	(6,402)	(703)
(Decrease)/increase in cash and cash equivalents	(11,228)	891
Cash and cash equivalents at beginning of year	26,431	25,540
Cash and cash equivalents at end of year	15,203	26,431

Notes to the financial statements

for the year ended 31 March 2020

1. Accounting policies

A summary of the principal accounting policies, all of which have been consistently applied throughout the year and the preceding year, is set out below.

(a) Basis of accounting

The financial statements have been prepared under FRS 102 "*The Financial Reporting Standard applicable in the UK and Republic of Ireland*" and in accordance with the Statement of Recommended Practice "*Financial Statements of Investment Trust Companies and Venture Capital Trusts*" issued in October 2019 by the Association of Investment Companies ("AIC SORP").

The company has adopted "*Amendments to FRS 102 – Fair value hierarchy disclosures*" issued by the Financial Reporting Council in March 2016.

The financial statements are prepared in sterling which is the functional currency of the company and rounded to the nearest £000.

The financial statements have been prepared on a going concern basis.

The directors performed an assessment of the company's ability to meet its liabilities as they fall due. In performing this assessment, the directors took into consideration the uncertain economic outlook in light of the COVID-19 pandemic including:

- the investments and liquid resources held by the company;
- the fact that the company has no debt or capital commitments;
- the ability of the company to meet all of its liabilities and ongoing expenses from its assets, including its year-end cash balance;
- revenue and operating cost forecasts for the forthcoming year;
- the ability of third-party service providers to continue to provide services; and
- potential downside scenarios including a fall in the valuation of the investment portfolio or levels of investment income.

Based on this assessment, the directors are confident that the company will have sufficient funds to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements, and therefore determine the going concern basis to be appropriate.

(b) Significant estimates and judgements

Disclosure is required of judgements and estimates made by management in applying the accounting policies that have a significant effect on the financial statements. While estimates are based on best judgement using information and financial data available, the actual outcome may differ from these estimates. A price sensitivity analysis is provided in the other price risk sensitivity section of Note 17 on page 42.

The key estimate in the financial statements is the determination of the fair value of the unlisted investments by the directors as it significantly impacts the valuation of the unlisted investments at the balance sheet date. The fair valuation process involves estimates using inputs that are unobservable.

The key judgement in the valuation of the unquoted investments process is the directors' determination of the appropriate application of the International Private Equity and Venture Capital (IPEV) guidelines to each unlisted investment. The judgement applied in the selection of the methodology used for determining the fair value of each unlisted investment can have a significant impact upon the valuation.

(c) Valuation of investments

Purchases and sales of investments are recognised in the financial statements at the date of transaction (trade date).

The company's investments have been designated by the directors as fair value through profit and loss at the time of acquisition and are measured at subsequent reporting dates at fair value. In the case of investments quoted on a recognised stock exchange, fair value is established by reference to the closing bid price on the relevant date or the last traded price, depending on the convention of the exchange on which the investment is quoted. In the case of unquoted investments, fair value is established in accordance with IPEV guidelines by using measurements of value such as calibrating to the price of recent investment and earnings or revenue multiples; where no reliable fair value can be estimated using such techniques, unquoted investments are carried at cost subject to provision for impairment where necessary. The key assumption when using the price of a recent investment as an input to the valuation is that the price obtained remains a reasonable proxy for fair value for a period of time such that an enterprise value can be inferred and subsequently recalibrated where necessary to take account of changes to either the prevailing market conditions or performance of the investee.

The price of a recent investment is not a default position for establishing fair value as at the measurement date and when this technique is employed, the resultant valuations are cross-checked for reasonableness by employing an alternative valuation technique.

The key assumptions for the multiples approach are the selection of the most appropriate earnings or revenue measure (historic or forecast) and the selection of the multiple itself which may be influenced by the multiples achieved by a range of comparable companies in either private or public transactions.

Gains and losses arising from changes in fair value of investments are recognised as part of the capital return within the income statement and allocated to the revaluation reserve. Transaction costs attributable to the acquisition or disposal of investments are charged to capital return within the income statement.

Those venture capital investments that may be termed associated undertakings are carried at fair value as determined by the directors in accordance with the company's normal policy and are not equity accounted as required by the Companies Act 2006. The directors consider that, as these investments are held as part of the company's portfolio with a view to the ultimate realisation of capital gains, equity accounting would not give a true and fair view of the company's interests in these investments. Quantification of the effect of this departure is not practicable. Carrying investments at fair value is specifically permitted under FRS 102 (Section 14.4B), where venture capital entities hold investments as part of a portfolio.

(d) Income

Dividends receivable on quoted equity shares are brought into account on the ex-dividend date. Dividends receivable on unquoted equity shares are brought into account when the company's right to receive payment is established and there is no reasonable doubt that payment will be received. Fixed income returns on non-equity shares and debt securities are recognised on an effective interest rate basis, provided there is no reasonable doubt that payment will be received in due course.

(e) Expenses

All expenses are accounted for on an accruals basis. Expenses are charged to revenue return within the income statement except that:

- expenses which are incidental to the acquisition or disposal of an investment are allocated to capital return as incurred; and
- expenses are split and allocated partly to capital return where a connection with the maintenance or enhancement of the value of the investments held can be demonstrated, and accordingly the basic element of the investment management fee has been allocated 25% to revenue return and 75% to capital return, in order to reflect the directors' expected long-term view of the nature of the investment returns of the company. The performance-related element of the investment management fee is charged 100% to capital return.

(f) Revenue and capital

The revenue column of the income statement includes all income and revenue expenses of the company. The capital column includes realised and unrealised gains and losses on investments and that part of the investment management fee which is allocated to capital return.

(g) Taxation

UK corporation tax payable is provided on taxable profits at the current rate. The tax charge for the year is allocated between revenue return and capital return on the "marginal basis" as recommended in the SORP. Provision is made for deferred taxation on all timing differences calculated at the current rate of tax relevant to the benefit or liability.

(h) Dividends payable

Dividends payable are recognised as distributions in the financial statements when the company's liability to make payment has been established.

(i) Provisions

A provision is recognised in the balance sheet when the company has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. No provision is established where a reliable estimate of the obligation cannot be made. Provisions are allocated to revenue or capital depending on the nature of the circumstances.

(j) Capital reserve

The following are accounted for in the capital reserve: gains or losses on the realisation of investments; realised and unrealised exchange differences of a capital nature; the cost of repurchasing ordinary shares, including stamp duty and transaction costs; and other capital charges and credits charged to this account in accordance with the above policies.

(k) Revaluation reserve

Changes in the fair value of investments are dealt with in this reserve.

2. Income

	Year ended 31 March 2020 £000	Year ended 31 March 2019 £000
Investment income:		
Dividends from unquoted companies	41	203
Dividends from quoted companies	279	190
Property income distributions	2	9
Interest receivable:		
Bank deposits*	85	89
Loans to unquoted companies	617	2,052
Listed interest-bearing investments	28	95
	1,052	2,638

*Denotes income arising from investments not designated as fair value through profit or loss at the time of acquisition.

3. Investment management fee

	Year ended 31 March 2020			Year ended 31 March 2019		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
Basic investment management fee	431	1,293	1,724	399	1,198	1,597

Mercia Fund Management (Mercia) provides investment management, secretarial and administrative services to the company under an agreement dated 20 December 1999, which may be terminated at any time by not less than twelve months' notice being given by either party. The agreement was novated from the previous investment manager, NVM Private Equity LLP to Mercia on 23 December 2019.

The manager receives a basic management fee, payable quarterly in advance, at the rate of 2.06% per annum of net assets calculated half-yearly as at 31 March and 30 September. The fee due on the value of liquid assets above the threshold of £20 million attracts a reduced rate of 1% per annum. The manager bears the cost of the fees of Brewin Dolphin for managing the listed interest-bearing and equity portfolios. The manager also provides administrative and secretarial services to the company for a fee of £60,000 per annum (linked to the movement in the RPI). This fee is included in other expenses (see Note 4).

The manager is entitled to receive a performance-related management fee equivalent to 12% of the amount, if any, by which the total return in each financial year (expressed as a percentage of opening net asset value) exceeds a performance hurdle. The hurdle is a composite rate based on (a) 7% on average long-term investments, (b) the higher of (i) base rate plus 1% and (ii) 2.5% on average cash and interest bearing investments, (c) base rate plus 4% on average listed equity investments during the year. The hurdle rate for the year ended 31 March 2020 was 6.0% (year ended 31 March 2019: 6.0%).

Following a period in which net assets decline, a "high water mark" will apply to the calculation of the performance-related fee but will be then adjusted downwards to the extent that a positive return is achieved in the following financial year. The performance-related management fee is subject to an overall cap of 2.25% of net assets. Any performance-related element of the investment management fee is charged 100% to capital return. There was no performance fee due in respect of the year ended 31 March 2020 (2019: nil).

The total running costs of the company, excluding performance-related management fees, are capped at 2.9% of its net assets and Mercia has agreed that any excess will be refunded by way of a reduction in its fees.

4. Other expenses

	Year ended 31 March 2020 £000	Year ended 31 March 2019 £000
Administrative and secretarial services	60	58
Directors' remuneration	88	88
Auditor's remuneration – audit services	29	25
– non-audit services	–	–
Legal and professional expenses	27	25
Share issue promoter's commission	34	49
Irrecoverable VAT	29	29
Other expenses	102	119
	369	393

Information on directors' remuneration is given in the directors' remuneration report on pages 18 and 19.

5. Tax on return on ordinary activities

	Year ended 31 March 2020			Year ended 31 March 2019		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
(a) Analysis of charge/(credit) for the year						
UK corporation tax payable/(recoverable) on the return for the year	–	–	–	275	(275)	–
(b) Tax reconciliation						
Return on ordinary activities before tax	252	(10,071)	(9,819)	1,846	2,391	4,237
Return on ordinary activities multiplied by the standard rate of UK corporation tax of 19.0% (2019 19.0%)	48	(1,913)	(1,865)	350	455	805
Effect of:						
UK dividends not subject to tax	(61)	–	(61)	(75)	–	(75)
Capital returns not subject to tax	–	138	138	–	(537)	(537)
Movements in fair value of investments not subject to tax	–	1,530	1,530	–	(145)	(145)
Increase/(decrease) in surplus management expenses	13	245	258	–	(48)	(48)
Tax charge/(credit) for the year	–	–	–	275	(275)	–

(c) Factors which may affect future tax charges

The company has not recognised a deferred tax asset in respect of surplus management expenses carried forward of £1,599,000 (31 March 2019 £236,000), as the company may not generate sufficient taxable income in the foreseeable future to utilise these expenses. There is no other unprovided deferred taxation.

Approved venture capital trusts are exempt from tax on capital gains within the company. Since the directors intend that the company will continue to conduct its affairs so as to maintain its approval as a venture capital trust, no current or deferred tax has been provided in respect of any capital gains or losses arising on the revaluation or disposal of investments.

6. Dividends

	Year ended 31 March 2020			Year ended 31 March 2019		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
(a) Recognised as distributions in the financial statements for the year						
Previous year's final dividend	1,402	1,402	2,804	325	4,228	4,553
Current year's interim dividend	278	2,502	2,780	–	2,603	2,603
	1,680	3,904	5,584	325	6,831	7,156
(b) Paid and proposed in respect of the year						
Interim paid – 2.0p (2019 2.0p) per share	278	2,502	2,780	–	2,603	2,603
Final proposed – 1.5p (2019 2.0p) per share	–	2,454	2,454	1,403	1,403	2,806
	278	4,956	5,234	1,403	4,006	5,409

The revenue dividends paid and proposed in respect of the year form the basis for determining whether the company has complied with the requirements of Section 274 of the Income Tax Act 2007 as to the distribution of investment income.

7. Return per share

The calculation of the return per share is based on the loss on ordinary activities after tax for the year of £9,819,000 (2019: £4,237,000) and on 139,793,223 (2019: 130,606,159) shares, being the weighted average number of shares in issue during the year.

8. Investments

All investments are designated as fair value through profit or loss on initial recognition, therefore all gains and losses arise on investments designated at fair value through profit or loss.

FRS 102 (including subsequent amendments issued in March 2016) requires an entity to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following classifications:

- Level 1 – unadjusted quoted prices 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 (ie developed using market data) for the asset or liability, either directly or indirectly.
- Level 3 – inputs that are unobservable (ie for which market data is unavailable) for the asset or liability.

	31 March 2020 £000	31 March 2019 £000
Level 1		
Quoted venture capital investments	1,572	3,122
Listed equity investment funds	5,691	6,438
Level 2		
Listed interest-bearing investment funds	1,276	1,368
Level 3		
Unquoted venture capital investments	50,652	53,197
	59,191	64,125

8. Investments *continued*

Movements in investments during the year are summarised as follows:

	Venture capital – unquoted Level 3 £000	Venture capital – quoted Level 1 £000	Listed equity Level 1 £000	Listed interest -bearing Level 2 £000	Total £000
Book cost at 31 March 2019	47,106	2,311	6,687	1,342	57,446
Fair value adjustment at 31 March 2019	6,091	811	(249)	26	6,679
Fair value at 31 March 2019	53,197	3,122	6,438	1,368	64,125
Movements in the year:					
Purchases at cost	10,125	–	1,532	193	11,850
Disposals – proceeds	(4,983)	(1,197)	(1,537)	(289)	(8,006)
– net realised gains/(losses) on disposal	(613)	(58)	(57)	–	(728)
Movements in fair value	(7,074)	(295)	(685)	4	(8,050)
Fair value at 31 March 2020	50,652	1,572	5,691	1,276	59,191
Comprising:					
Book cost at 31 March 2020	53,204	1,351	6,381	1,248	62,184
Fair value adjustment at 31 March 2020	(2,552)	221	(690)	28	(2,993)
	50,652	1,572	5,691	1,276	59,191
Equity shares	31,111	1,572	5,691	–	38,374
Preference shares	5,143	–	–	–	5,143
Interest-bearing securities	14,398	–	–	1,276	15,674
	50,652	1,572	5,691	1,276	59,191

The gains and losses included in the above table have all been recognised in the income statement on page 30. The listed equity category in the table above comprises quoted investment funds which hold listed equity securities. The listed interest-bearing category in the table above comprises quoted investment funds which hold listed interest-bearing securities.

FRS 102 requires disclosure, by class of financial instrument, if the effect of changing one or more inputs to reasonably possible alternative assumptions would result in a significant change to the fair value measurement. The information used in determination of the fair value of Level 3 investments is chosen with reference to the specific underlying circumstances and position of each investee company. See Note 17 for details of the impact of sensitivity analysis on the financial statements.

At 31 March 2020 there were no commitments (31 March 2019: none) in respect of investments approved by the manager but not yet completed.

9. Investment disposals

Disposals of venture capital investments during the year were as follows:

	Original cost £000	Carrying value at 31 March 2019 £000	Disposal proceeds £000	Realised gain/(loss) against carrying value £000
Graza – return of investment on liquidation	502	502	494	(8)
Volumatic Holdings – repayment of loan stock	172	172	172	–
MSQ Partners Group – disposal of entire holding	1,672	3,487	3,555	68
Agilitas IT Holdings – repayment of loan stock	708	708	708	–
Ideagen PLC – disposal of entire holding	21	89	109	20
Brady PLC – disposal of entire holding	314	261	82	(179)
Summit Therapeutics PLC – disposal of entire holding	236	3	2	(1)
Nasstar PLC – disposal of entire holding	390	904	1,003	99
Primal Food – disposal of entire holding	967	725	–	(725)
Other disposals	–	–	53	53
	4,982	6,851	6,178	(673)

10. Unquoted investments

The cost and carrying value of material investments in unquoted companies held at 31 March 2020 are shown below. For this purpose any investment included in the table of the fifteen largest venture capital investments on page 11, or in the corresponding table in the previous year's annual report, is regarded as material.

	31 March 2020		31 March 2019	
	Total cost £000	Carrying value £000	Total cost £000	Carrying value £000
Agilitas IT Holdings				
Ordinary shares	221	4,507	221	1,849
Loan stock	708	708	1,417	1,417
	929	5,215	1,638	3,266
Lineup Systems				
Ordinary shares	175	3,337	174	2,110
Loan stock	800	800	800	800
	975	4,137	974	2,910
Currentbody.com				
Ordinary shares	669	2,047	185	553
Loan stock	1,102	1,026	1,102	1,102
	1,771	3,073	1,287	1,655
Sorted Holdings				
Ordinary shares	2,552	2,794	2,552	3,461
Loan stock	164	164	164	164
	2,716	2,958	2,716	3,625
Entertainment Magpie Group				
Ordinary shares	168	1,518	168	580
Preference shares	277	277	277	277
Loan stock	1,058	1,058	1,058	1,058
	1,503	2,853	1,503	1,915
SHE Software Group				
Ordinary shares	1,873	2,397	1,873	2,109
Preference shares	322	322	–	–
	2,195	2,719	1,873	2,109
Volumatic Holdings				
Ordinary shares	216	1,208	216	1,248
Loan stock	690	690	862	862
	906	1,898	1,078	2,110
It's All Good				
Ordinary shares	117	670	117	590
Loan stock	1,028	1,028	1,028	1,028
	1,145	1,698	1,145	1,618
Biological Preparations Group				
Ordinary shares	221	–	221	–
Preference shares	340	–	340	156
Loan stock	1,605	1,605	1,605	1,605
	2,166	1,605	2,166	1,761
Knowledgemotion				
Ordinary shares	1,778	1,559	1,469	1,595
	1,778	1,559	1,469	1,595

10. Unquoted investments *continued*

	31 March 2020 Total cost £000	31 March 2020 Carrying value £000	31 March 2019 Total cost £000	31 March 2019 Carrying value £000
GRIP-UK (t.a. The Climbing Hangar)				
Ordinary shares	308	-	154	154
Preference shares	1,620	1,522	810	810
	1,928	1,522	964	964
Medovate				
Ordinary shares	802	802	802	802
Loan stock	648	648	648	648
	1,450	1,450	1,450	1,450
Soda Software Labs (t.a. Hello Soda)				
Ordinary shares	385	277	385	385
Loan stock	1,114	1,114	946	946
	1,499	1,391	1,331	1,331
Clarilis				
Ordinary shares	1,012	1,206	1,012	1,012
	1,012	1,206	1,012	1,012
Intelling Group				
Ordinary shares	109	23	109	506
Preference shares	230	230	230	230
Loan stock	804	804	804	804
	1,143	1,057	1,143	1,540
Intuitive				
Ordinary shares	156	–	156	117
Loan stock	1,352	829	1,352	1,352
	1,508	829	1,508	1,469
AVID Technology Group				
Ordinary shares	379	–	379	726
Preference shares	863	–	406	406
Loan stock	502	401	502	502
	1,744	401	1,287	1,634
No 1 Lounges				
Ordinary shares	178	–	178	1,153
Loan stock	1,799	–	1,799	1,799
	1,977	–	1,977	2,952
MSQ Partners Group				
Ordinary shares	–	–	206	2,020
Loan stock	–	–	1,466	1,466
	–	–	1,672	3,486

Additional information relating to material investments in unquoted companies is given on pages 12 to 15

11. Significant interests

Details of shareholdings in those companies where the company's holding at 31 March 2020 represents (1) more than 20% of the allotted equity share capital of any class, (2) more than 20% of the total allotted share capital or (3) more than 20% of the assets of the company itself, are given below. The address of the company named is Alderley Park, Alderley Edge, Cheshire. The company named is incorporated in England.

Company	Investment type	Class of shares (nominal value £0.05 unless stated)	Number held	Proportion of class held
Gentronix	Unquoted	B ordinary	16,568	32.0%
Gentronix	Unquoted	C ordinary	16,788	28.6%

The most recent published financial statements for Gentronix are for the year ended 31 August 2018, at this date the company's net assets totalled £460,000 (2017: £458,000).

12. Debtors

	31 March 2020 £000	31 March 2019 £000
Prepayments and accrued income	79	221

13. Creditors (amounts falling due within one year)

	31 March 2020 £000	31 March 2019 £000
Accruals and deferred income	117	109
Share subscriptions held pending allotment	–	6,559
	117	6,668

14. Called-up equity share capital

	31 March 2020 £000	31 March 2019 £000
Allotted and fully paid: 138,886,797 (2019: 130,044,260) ordinary shares of 5.0p	6,945	6,502

The capital of the company is managed in accordance with its investment policy with a view to the achievement of its investment objective, as set out on page 6. The company is not subject to externally imposed capital requirements.

During the year the company issued 11,890,246 ordinary shares of 5.0 pence for cash at an average premium of 58.6 pence per share. 3,047,709 ordinary shares were re-purchased for cancellation during the year at a cost of £1,791,000.

15. Reserves

	Share premium £000	Capital redemption reserve £000	Capital reserve £000	Revaluation reserve £000	Revenue reserve £000
At 1 April 2019	1,555	215	67,341	6,679	1,817
Premium on issue of ordinary shares	6,973	–	–	–	–
Share issue expenses	(127)	–	–	–	–
Shares purchased for cancellation	–	152	(1,791)	–	–
Realised on disposal of investments	–	–	(728)	–	–
Transfer on disposal of investments	–	–	1,622	(1,622)	–
Movements in fair value of investments	–	–	–	(8,050)	–
Management fee charged to capital net of associated tax	–	–	(1,293)	–	–
Revenue return on ordinary activities after tax	–	–	–	–	252
Dividends recognised in the year	–	–	(3,904)	–	(1,680)
At 31 March 2020	8,401	367	61,247	(2,993)	389

At 31 March 2020 distributable reserves amounted to £61,941,000 (2019: £68,935,000), comprising the capital reserve, the revenue reserve and that part of the revaluation reserve relating to holding gains/losses on readily realisable listed interest-bearing and listed equity investments.

16. Net asset value per share

The calculation of net asset value per share as at 31 March 2020 is based on net assets of £74,356,000 (2019: £84,109,000) divided by the 138,886,797 (2019: 130,044,260) ordinary shares in issue at that date.

17. Financial instruments

The company's financial instruments comprise equity and fixed-interest investments, cash balances and liquid resources including debtors and creditors. The company holds financial assets in accordance with its investment policy of investing mainly in a portfolio of VCT-qualifying unquoted and AIM-quoted securities whilst holding a proportion of its assets in cash or near-cash investments in order to provide a reserve of liquidity.

Fixed asset investments (see Note 8) are valued at fair value. For quoted investments this is either bid price or the latest traded price, depending on the convention of the exchange on which the investment is quoted. Unquoted investments are carried at fair value as determined by the directors in accordance with current venture capital industry guidelines. The fair value of all other financial assets and liabilities is represented by their carrying value in the balance sheet.

In carrying on its investment activities, the company is exposed to various types of risk associated with the financial instruments and markets in which it invests. The most significant types of financial risk facing the company are market risk, other price sensitivity risk, credit risk and liquidity risk. The company's approach to managing these risks is set out below together with a description of the nature and amount of the financial instruments held at the balance sheet date.

Market risk

The company's strategy for managing investment risk is determined with regard to the company's investment objective, as outlined in the strategic report on page 6. The management of market risk is part of the investment management process and is a central feature of venture capital investment. The company's portfolio is managed in accordance with the policies and procedures described in the corporate governance statement on pages 20 to 24, having regard to the possible effects of adverse price movements, with the objective of maximising overall returns to shareholders. Investments in unquoted companies, by their nature, usually involve a higher degree of risk than investments in companies quoted on a recognised stock exchange, though the risk can be mitigated to a certain extent by diversifying the portfolio across business sectors and asset classes. The overall disposition of the company's assets is monitored by the board on a quarterly basis.

Details of the company's investment portfolio at the balance sheet date are set out on page 11. An analysis of investments between debt and equity instruments is given in Note 8.

9.8% (2019: 11.4%) by value of the company's net assets comprises equity securities listed on the London Stock Exchange or quoted on AIM. A 5% increase in the bid price of these securities as at 31 March 2020 would have increased net assets and the total return for the year by £363,000 (31 March 2019: £478,000); a corresponding fall would have reduced net assets and the total return for the year by the same amount.

Other price sensitivity risk

68.1% (2019: 63.2%) by value of the company's net assets comprises investments in unquoted companies held at fair value. A sensitivity analysis is provided below which recognises that the valuation methodologies employed involve subjectivity in the selection of the key inputs, as described in the valuation policy on page 34. Although the directors believe that the estimates of fair value are appropriate, the use of different methodologies or assumptions regarding the inputs could lead to different measurements of fair value. The emergence of the COVID-19 pandemic has heightened the estimation uncertainty for each of the unquoted investments held as at 31 March 2020. Each portfolio company has been categorised as being subject to potentially higher or lower estimation uncertainty by considering a range of factors including the potential disruption to business activities caused by measures adopted to tackle the spread of COVID-19 and the availability and extent of cash resources. A greater sensitivity factor has been applied to those investments assessed as being susceptible to higher estimation uncertainty. Whilst the sensitivities applied illustrate the impact of varying the key inputs by the levels specified, it is possible that applying reasonable alternative assumptions to individual investments could lead to measurements of fair value which vary to a greater extent than that illustrated.

At 31 March 2020 Valuation basis	Fair value of unquoted investments £000	Variable input sensitivity %	Impact: increase £000*	Impact: increase % of net assets	Impact: decrease £000*	Impact: decrease % of net assets
Earnings/revenue multiple						
Higher sensitivity	13,342	+/- 20	2,832	3.8	2,440	3.3
Lower sensitivity	9,702	+/- 10	781	1.1	864	1.2
Price of a recent investment subsequently calibrated as appropriate						
Higher sensitivity	10,454	+/- 20	1,919	2.6	1,935	2.6
Lower sensitivity	10,672	+/- 10	679	0.9	655	0.9
Original cost subsequently calibrated as appropriate						
Higher sensitivity	2,761	+/- 20	429	0.6	521	0.7
Lower sensitivity	3,721	+/- 10	361	0.5	209	0.3
Total unquoted investments	50,652		7,001	9.5	6,624	8.9

*Impact on net assets and net return after taxation.

17. Financial instruments *continued*

Interest rate risk

Some of the company's financial assets are interest-bearing, of which some are at fixed rates and some variable. As a result, the company is exposed to fair value interest rate risk due to fluctuations in the prevailing levels of market interest rates.

(a) Fixed rate investments

The table below summarises weighted average effective interest rates for the company's fixed rate interest-bearing financial instruments:

	31 March 2020			31 March 2019		
	Total fixed rate portfolio £000	Weighted average interest rate %	Weighted average period for which rate is fixed Years	Total fixed rate portfolio £000	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Fixed-rate investments in unquoted companies	8,592	8.5	2.3	9,686	8.5	2.9

As the interest rates for these instruments is fixed, an increase or decrease of 25 basis points in market interest rates as at the reporting date would have no impact on the company's net assets or total return for the year.

(b) Floating rate investments

The company's floating rate investments comprise floating-rate loans to unquoted companies and cash held in interest-bearing deposit accounts. The benchmark rate which determines the rate of interest receivable is the UK bank base rate for interest bearing deposit accounts, which was 0.1% at 31 March 2020 (31 March 2019: 0.75%) and the LIBOR three month GBP rate for floating rate loans to unquoted companies, which was 0.57% at 31 March 2020 (31 March 2019: 0.84%). It is considered that an increase or decrease of 25 basis points in interest rates as at the reporting date would not have a significant effect on the company's net assets or total return for the year. The amounts held in floating rate investments at the balance sheet date were as follows:

	31 March 2020 £000	31 March 2019 £000
Floating rate loans to unquoted companies	5,806	11,541
Quoted interest-bearing investment funds	1,276	1,368
Interest-bearing deposit accounts	15,203	26,431
	22,285	39,340

17. Financial instruments *continued*

Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the company. The investment manager and the board carry out a regular review of counterparty risk. The carrying values of financial assets represent the maximum credit risk exposure at the balance sheet date.

At 31 March 2020 the company's financial assets exposed to credit risk comprised the following:

	31 March 2020 £000	31 March 2019 £000
Fixed-rate investments in unquoted companies	8,592	9,686
Floating rate loans to unquoted companies	5,806	11,541
Interest-bearing investment funds	1,276	1,368
Interest-bearing deposit accounts	15,203	26,431
Accrued dividends and interest receivable	–	106
	30,877	49,132

Credit risk relating to listed fixed-interest and floating rate investments is mitigated by investing in a portfolio of investment instruments of high credit quality, comprising securities issued by major UK and international companies and institutions. Credit risk relating to loans to and preference shares in unquoted companies is considered to be part of market risk.

Those assets of the company which are traded on recognised stock exchanges and quoted investment funds are held on the company's behalf by a third party custodian, a nominee company of Brewin Dolphin Limited. Bankruptcy or insolvency of a custodian could cause the company's rights with respect to securities held by the custodian to be delayed or limited.

Credit risk arising on transactions with brokers relates to transactions in quoted securities awaiting settlement. Risk relating to unsettled transactions is considered to be low due to the short settlement period involved and the high credit quality of the brokers used. The board further mitigates the risk by monitoring the quality of service provided by the brokers.

The company's interest-bearing deposit accounts, including short term cash deposits, are maintained with major UK clearing banks.

There were no significant concentrations of credit risk to counterparties at 31 March 2020 or 31 March 2019.

Liquidity risk

The company's financial assets include investments in unquoted equity securities which are not traded on a recognised stock exchange and which generally may be illiquid. As a result, the company may not be able to realise some of its investments in these instruments quickly at an amount close to their fair value in order to meet its liquidity requirements, or to respond to specific events such as a deterioration in the creditworthiness of any particular issuer.

The company's interest-bearing investment fund investments are considered to be readily realisable as they are of high credit quality as outlined above.

The company's liquidity risk is managed on a continuing basis by the investment manager in accordance with policies and procedures laid down by the board. The company's overall liquidity risks are monitored on a quarterly basis by the board.

The company maintains sufficient investments in cash and readily realisable securities to pay accounts payable and accrued expenses. At 31 March 2020 these investments were valued at £16,479,000 (31 March 2019: £34,237,000).

18. Contingencies

At 31 March 2020 contingent assets not recognised in the financial statements in respect of potential deferred proceeds from the sale of investee companies amounted to approximately £348,000 (31 March 2019: £288,000). The extent to which these amounts will become receivable in due course is dependent on future events.

The company had no contingent liabilities at 31 March 2020 or 31 March 2019.

19. Related party transactions

Fees payable during the year to the directors and their interest in shares of the company are disclosed within the directors' remuneration report on pages 18 and 19.

There were no amounts outstanding and due to the directors as at 31 March 2020 (31 March 2019: nil).
During the year loan note interest totalling £8,000 (2019: £10,000) was received from Gentronix, a related associate of the company.
The remaining investment in Graza, a previous related associate, was realised during the year for proceeds totalling £494,000.

20. Post balance sheet events

After the year end, on 2 April 2020, the company issued 24,444,699 ordinary shares for a consideration of £12,515,000 as a result of a share offer launched during the year ended 31 March 2020.

Glossary of terms

Alternative performance measure or APM

APMs are not prescribed by accounting standards but are industry specific performance measures which help users of the annual accounts and financial statements to better interpret and understand performance. Some of the terms in this glossary have been identified as APMs.

Cumulative return per share (APM)

The sum of the published NAV per share plus cumulative dividends paid per share since the company was launched. We use this measure as it enables comparisons to be made between different VCTs over the whole life of each fund. The cumulative return per share for Northern 2 VCT as at 31 March 2020 comprises the NAV per share of 53.5 pence (2019: 64.7 pence) plus the cumulative dividends paid of 121.4 pence (2019: 117.4 pence) giving a result of 174.9 pence per share (2019: 182.1 pence per share).

Cumulative dividends paid

The total amount of shareholder dividend distributions paid since the company was launched.

Distributable reserves

The sum of the capital reserve, revenue reserve and that part of the revaluation reserve which is related to readily realisable investments.

Dividend yield (APM)

The sum of dividends proposed or paid in respect of the last 12 months as at a given date expressed as a percentage of the net asset value per share at the start of the period. We use this measure as it shows the dividend income receivable by shareholders over a 12 month period expressed as a theoretical yield based on acquiring a single share at the NAV per share at the start of the period. The dividend yield as at 31 March 2020 is calculated by dividing the dividend per share paid or proposed over the preceeding 12 months of 3.5 pence (2019: 40 pence) by the NAV per share at the start of the period of 64.7 pence (2019: 66.9 pence) giving a result of 5.4% (2019: 6.0%).

Ex-dividend date

The date immediately preceding the record date for a given dividend. Shareholders who acquire their shares on or after the ex-dividend date will not be eligible to receive the relevant dividend.

Gain/loss on disposal of investments

The profit or loss on the sale of an investment during the year calculated by reference to the proceeds received on sale of the investment less the valuation of the investment at the last annual report date.

NAV total return (APM)

The theoretical return to a shareholder over a given period based on acquiring shares at the start of the period at the latest published NAV per share then utilising the proceeds of each dividend paid during the period to acquire further shares at the latest published NAV per share as at each ex-dividend date. We use this measure as it enables comparisons to be drawn against an investment index in order to benchmark performance. The result is plotted on page 19 and the calculation follows the method prescribed by the Association of Investment Companies.

	31 March 2020	31 March 2019	
Closing NAV per share (p)	53.5p	64.7p	a
Dividends paid out (p)	4.0p	5.5p	b
Effect of re-investing dividends (p)	(0.5)p	0.2p	c
Adjusted NAV per share (p)	**57.0p**	**70.4p**	**d=a+b+c**
Opening NAV per share (p)	64.7p	66.9p	e
NAV total return (%)	(11.9)%	5.3%	=(d/e)-1

Net asset value or NAV

The amount by which total assets of the company exceed its total liabilities. It is equal to the total equity shareholders' funds.

Net asset value per share or NAV per share

Net asset value divided by the number of ordinary shares.

Ongoing charges (APM)

The total of investment management fees and other expenses as shown in the income statement, as a percentage of the average net asset value. This measure is disclosed to provide information to shareholders, in line with industry best practice.

	31 March 2020 £000	31 March 2019 £000
Investment management fee	1,724	1,597
Other expenses	369	393
Total expenses (a)	**2,093**	**1,990**
Annualised average net assets (b)	89,293	86,020
Ongoing charges (a) / (b) (expressed as a percentage)	**2.34%**	**2.31%**

Record date

The cut-off date on which a shareholder needs to be beneficially entitled to a share on the share register of the company in order to qualify for a forthcoming dividend.

Share price total return (APM)

The theoretical return to a shareholder over a given period based on acquiring shares at the start of the period at the prevailing mid-market share price then utilising the proceeds of each dividend paid during the period to acquire further shares at the share price as at each ex-dividend date. We use this measure as it enables comparisons to be drawn against an investment index in order to benchmark performance. The result is plotted on page 19 and the calculation follows the method prescribed by the association of investment companies.

	31 March 2020	31 March 2019	
Closing price per share (p)	47.5p	59.0p	a
Dividends paid out (p)	4.0p	5.5p	b
Effect of re-investing dividends (p)	(0.7)p	0.0p	c
Adjusted price per share (p)	**50.8p**	**64.5p**	**d=a+b+c**
Opening price per share (p)	59.0p	63.5p	e
Share price total return (%)	(13.9)%	1.6%	=(d/e)-1

Total return for the year

The total income, gain or loss on disposal of investments and movements in the fair value of investments less ongoing charges for the period, as shown in the income statement.

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