Northern 2 VCT PLC

Half-yearly Financial Report
30 September 2021

mercia
asset management

Welcome

Northern 2 VCT 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

For additional information visit our investor area online **www.mercia.co.uk/vcts/**

Financial summary

	Six months ended 30 September 2021	Six months ended 30 September 2020	Year ended 31 March 2021
Net assets	**£112.7m**	**£104.8m**	**£115.5m**
Net asset value per share	**69.2p**	**64.3p**	**71.3p**
Return per share			
Revenue	0.2p	0.3p	0.3p
Capital	3.2p	12.5p	21.5p
Total	**3.4p**	**12.8p**	**21.8p**
Dividend per share declared in respect of the period	**2.0p**	**2.0p**	**7.5p**
Cumulative return to shareholders since launch			
Net asset value per share	69.2p	64.3p	71.3p
Dividends paid per share*	130.4p	122.9p	124.9p
Net asset value plus dividends paid per share	199.6p	187.2p	196.2p
Mid-market share price at end of period	**64.0p**	**51.1p**	**61.0p**
Share price discount to net asset value	**7.5%**	**20.6%**	**14.5%**
Annualised tax-free dividend yield (based on the net asset value per share)**			
Excluding special dividend	5.4%	5.6%	6.5%
Including special dividend	11.7%	N/A	14.0%

* Excluding interim dividend not yet paid.

** The annualised dividend yield is calculated by dividing the dividends in respect of the 12-month period ended on each reference date by the net asset value per share at the start of the period.

Key dates

24 November 2021

Half-yearly results announced

6 January 2022

Shares quoted ex dividend

28 January 2022

Interim dividend paid (to shareholders on register on 7 January 2022)

Half-yearly management report to shareholders

for the six months ended 30 September 2021

I am pleased to report on an encouraging six month period to 30 September 2021, building on the strong performance of the previous financial year. The period saw several pleasing exits from investments, while portfolio businesses continued to make good use of our invested capital to pursue their growth plans. Inevitably the impact of COVID-19 has continued to influence the UK economy, but the widespread rollout of vaccines in the UK has permitted at least a partial return to normal business activity. Our investment manager, Mercia, has continued to provide strategic support to the existing portfolio, while investment activity has also accelerated driven in part by our ability to invest alongside other Mercia funds.

Results and dividend

The unaudited net asset value (NAV) per share at 30 September 2021 was 69.2 pence (71.3 pence (audited) at 31 March 2021), and is stated after deducting both the final dividend of 1.5 pence per share and the second interim (special) dividend of 4.0 pence per share in respect of the 2020/21 financial year, which were paid in September 2021.

The return per share as shown in the income statement for the six months ended 30 September 2021 was 3.4 pence, compared with 12.8 pence in the corresponding period last year when our results reflected the initial strong phase of recovery from the depressed investment valuations of March 2020. Although the total return for the period was driven primarily by an increase in the directors' valuations of unquoted investments, it should be noted that the successful AIM flotation of musicMagpie in April 2021 enabled us to sell half our shareholding for cash and so crystallise £7.6 million of the unrealised revaluation reserve shown in the 31 March 2021 balance sheet.

Investment income fell to £835,000 from £949,000 during the same period last year, reflecting the disposal of some income-yielding investments as the portfolio mix continued to pivot towards earlier stage venture capital arrangements, following the 2015 change to the definition of VCT-qualifying assets.

After careful consideration, the board has declared an unchanged interim dividend for the year ending 31 March 2022 of 2.0 pence per share, which will be paid on 28 January 2022 to shareholders who are on the register on 7 January 2022. It remains our objective to pay a dividend at least equivalent to 5% of the opening NAV in each year.

Investment portfolio

While COVID-19 continues to provide challenges for some of our portfolio companies, the changes it has brought about in consumer habits and working practices have provided opportunities for others. The technology and software sub-sectors have remained broadly resilient throughout the pandemic and investments in these areas now represent around 30% by value of the portfolio.

After the challenges faced due to COVID-19 in the year to March 2021, investment activity in the six months to September 2021 moved ahead of pre-pandemic levels, with £2.8 million of funding provided to three new venture capital investments and £3.7 million of follow-on capital invested into the existing portfolio. To put this in context, in the six months to September 2019 (ie pre-pandemic) we invested a total of £4.6 million in new and follow-on opportunities. It is pleasing to see the increased deployment rate, enabling us to support more growing businesses, which has been achieved while continuing to apply our usual demanding criteria in the appraisal of potential new investments.

We have continued to see a healthy level of exits from portfolio companies, maintaining the pattern established in the preceding year. As well as the AIM flotation of musicMagpie, which at flotation generated cash and quoted stock with a combined value of £17.1 million from an original investment of £1.5 million, there were partial exits from Oddbox in the period and Currentbody.com just after period end at valuations which respectively produced returns of over ten times and three times our investment cost. We have retained reduced holdings in all three companies, reflecting our manager's confidence in their medium-term prospects.

During the period we also made further progress in realising the company's maturing portfolio of later-stage investments acquired under the pre-2015 VCT rules. The remaining such investments now represent less than 40% by value of the total venture capital portfolio.

Shareholder issues

The company's cash position has remained strong, with the £12.2 million proceeds of our 2019/20 public share offer supplemented by successful investment realisations. Your directors did not seek to raise further capital in the 2020/21 tax year, a decision which we believe has been validated by events over the past 18 months. However as the economy continues to emerge from the pandemic we are beginning to see evidence of an upturn in demand for long-term growth capital for smaller companies in the UK. In order to have confidence in our capacity to address this demand for funding over the next two to three years, in July 2021 we announced our intention to launch a new share offer in the 2021/22 tax year in conjunction with the other Northern VCTs. It is expected that a prospectus containing further information will be published in January 2022.

A total of £1.4 million was received during the period through the issue of new shares under our dividend investment scheme. The company has maintained its policy of buying back its own shares in the market from time to time, at a discount of 5% to NAV. During the period, 1,177,026 shares were purchased for cancellation, for a total consideration of £795,000.

Investment manager

Following Mercia's acquisition of NVM Private Equity's VCT management business two years ago, the VCT investment team has been fully integrated into Mercia and our deal flow is benefiting from the strength of the wider Mercia network. The phased transition of administrative and company secretarial functions to Mercia is now in its final stages and is due to be completed by March 2022.

VCT-qualifying status and legislation

The company has continued to meet the stringent qualifying conditions laid down by HM Revenue & Customs for maintaining its approval as a VCT. Our investment manager 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.

The VCT scheme rules have been subject to significant legislative changes over the last five years and whilst there have been no further developments in 2021, it is possible that further changes will be made in the future. We will continue to work closely with our investment manager to maintain compliance with the scheme rules at all times.

Outlook

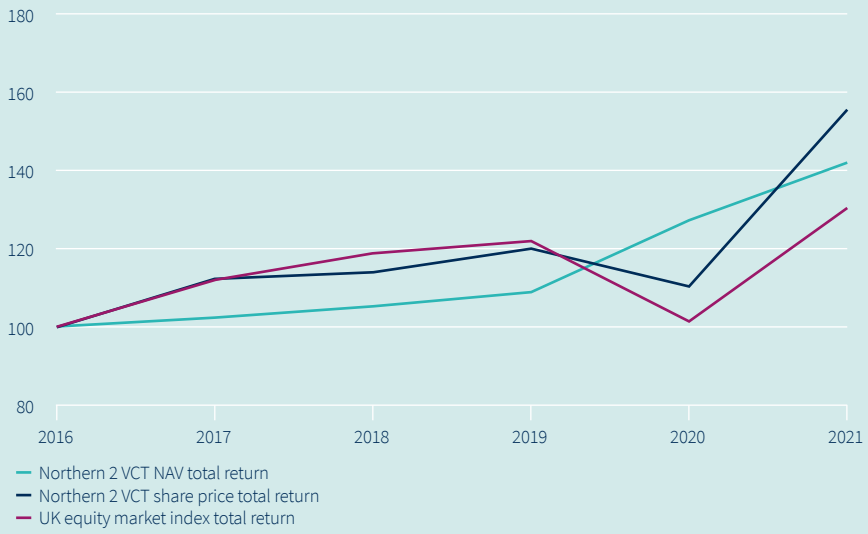
As the UK economy recovers from the pandemic, volatility remains and factors such as inflation and supply shortages will continue to test the resilience of the portfolio. We have been encouraged by the strength exhibited by the portfolio overall thus far and have confidence in its diversity moving forward. We expect that longer-lasting structural changes to behaviours such as working from home will continue to provide challenges and opportunities to our portfolio companies for the foreseeable future. The investment team at Mercia will continue to work with portfolio companies and to identify new opportunities to support the growth of early-stage companies.

On behalf of the board:

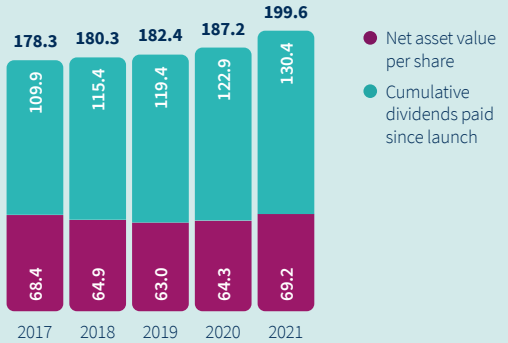
—
David Gravells
Chairman

Five-year performance

Comparative return to shareholders (assuming dividends reinvested)
Five years to 30 September 2021 (30 September 2016 = 100)



Net asset value and cumulative dividends per share
As at 30 September (pence per share)



Investment portfolio

(unaudited) as at 30 September 2021

Fifteen largest venture capital investments	Cost £000	Valuation £000	% of net assets by value
musicMagpie*	222	7,093	6.3%
Lineup Systems	975	5,970	5.3%
Currentbody.com	1,867	5,325	4.7%
Oddbox	355	3,879	3.4%
SHE Software Group	2,195	3,670	3.3%
Intelling Group	1,142	3,272	2.9%
GRIP-UK (t.a. The Climbing Hangar)	3,213	3,213	2.9%
Volumatic Holdings	216	2,796	2.5%
Buoyant Upholstery	1,057	2,500	2.2%
Clarilis	1,828	2,366	2.1%
Life's Great Group (t.a. Mojo Mortgages)	1,441	2,231	2.0%
Biological Preparations Group	2,166	2,008	1.8%
Newcells Biotech	1,612	1,925	1.7%
Rockar	1,693	1,848	1.6%
Tutora (t.a. Tutorful)	1,843	1,833	1.5%
Fifteen largest venture capital investments	**21,825**	**49,929**	**44.2%**
Other venture capital investments	**37,013**	**26,470**	**23.5%**
Total venture capital investments	**58,838**	**76,399**	**67.7%**
Listed equity investments	6,474	8,406	7.5%
Listed interest-bearing investments	1,427	1,359	1.2%
Total fixed asset investments	**66,739**	**86,164**	**76.4%**
Net current assets		26,552	23.6%
Net assets		**112,716**	**100.0%**

* Quoted on AIM.

Income statement

(unaudited) for the six months ended 30 September 2021

	Six months ended 30 September 2021		
	Revenue £000	Capital £000	Total £000
Gain on disposal of investments	**–**	**1,194**	**1,194**
Movements in fair value of investments	**–**	**4,731**	**4,731**
	–	**5,925**	**5,925**
Income	**835**	**–**	**835**
Investment management fee	**(274)**	**(822)**	**(1,096)**
Other expenses	**(222)**	**–**	**(222)**
Return before tax	**339**	**5,103**	**5,442**
Tax on return	**(33)**	**33**	**–**
Return after tax	**306**	**5,136**	**5,442**
Return per share	**0.2p**	**3.2p**	**3.4p**

- The total column of the income 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 supplemental 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 April 2021 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.

Six months ended 30 September 2020			Year ended 31 March 2021		
Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
–	332	332	–	8,998	8,998
–	20,546	20,546	–	28,956	28,956
–	20,878	20,878	–	37,954	37,954
949	–	949	1,421	–	1,421
(204)	(611)	(815)	(460)	(3,052)	(3,512)
(191)	–	(191)	(445)	–	(445)
554	20,267	20,821	516	34,902	35,418
–	–	–	(83)	83	–
554	20,267	20,821	433	34,985	35,418
0.3p	12.5p	12.8p	0.3p	21.5p	21.8p

Balance sheet

(unaudited) as at 30 September 2021

	30 September 2021 £000	30 September 2020 £000	31 March 2021 £000
Fixed assets			
Investments	**86,164**	81,920	87,078
Current assets			
Debtors	**297**	620	1,662
Cash and deposits	**26,349**	22,369	28,567
	26,646	22,989	30,229
Creditors (amounts falling due within one year)	**(94)**	(77)	(1,807)
Net current assets	**26,552**	22,912	28,422
Net assets	**112,716**	104,832	115,500
Capital and reserves			
Called-up equity share capital	**8,150**	8,154	8,102
Share premium	**21,490**	19,753	20,175
Capital redemption reserve	**570**	418	511
Capital reserve	**61,946**	57,787	63,547
Revaluation reserve	**19,434**	17,780	22,343
Revenue reserve	**1,126**	940	822
Total equity shareholders' funds	**112,716**	104,832	115,500
Net asset value per share	**69.2p**	64.3p	71.3p

Statement of changes in equity

(unaudited) for the six months ended 30 September 2021

	Non-distributable reserves				Distributable reserves		
	Called-up share capital	Share premium	Capital redemption reserve	Revaluation reserve*	Capital reserve	Revenue reserve	Total
At 1 April 2021	**8,102**	**20,175**	**511**	**22,343**	**63,547**	**822**	**115,500**
Return after tax	**–**	**–**	**–**	**(2,909)**	**8,047**	**304**	**5,442**
Dividends paid	**–**	**–**	**–**	**–**	**(8,855)**	**–**	**(8,855)**
Net proceeds of share issues	**107**	**1,315**	**–**	**–**	**–**	**–**	**1,422**
Shares purchased for cancellation	**(59)**	**–**	**59**	**–**	**(793)**	**–**	**(793)**
At 30 September 2021	**8,150**	**21,490**	**570**	**19,434**	**61,946**	**1,126**	**112,716**
Six months ended 30 September 2020							
At 1 April 2020	6,945	8,401	367	(2,993)	61,247	389	74,356
Return after tax	–	–	–	20,773	(503)	551	20,821
Dividends paid	–	–	–	–	(2,446)	–	(2,446)
Net proceeds of share issues	1,260	11,352	–	–	–	–	12,612
Shares purchased for cancellation	(51)	–	51	–	(511)	–	(511)
At 30 September 2020	8,154	19,753	418	17,780	57,787	940	104,832
Year ended 31 March 2021							
At 1 April 2020	6,945	8,401	367	(2,993)	61,247	389	74,356
Return after tax	–	–	–	25,336	9,649	433	35,418
Dividends paid	–	–	–	–	(5,690)	–	(5,690)
Net proceeds of share issues	1,301	11,774	–	–	–	–	13,075
Shares purchased for cancellation	(144)	–	144	–	(1,659)	–	(1,659)
At 31 March 2021	8,102	20,175	511	22,343	63,547	822	115,500

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

Statement of cash flows

(unaudited) for the six months ended 30 September 2021

	Six months ended 30 September 2021 £000	Six months ended 30 September 2020 £000	Year ended 31 March 2021 £000
Cash flows from operating activities			
Return before tax	**5,442**	20,821	35,418
Adjustments for:			
Gain on disposal of investments	**(1,194)**	(332)	(8,998)
Movements in fair value of investments	**(4,731)**	(20,546)	(28,956)
Decrease/(increase) in debtors	**1,365**	1,042	(460)
(Decrease)/increase in creditors	**(1,713)**	(1,732)	1,690
Net cash outflow from operating activities	**(831)**	(747)	(1,306)
Cash flows from investing activities			
Purchase of investments	**(7,547)**	(3,432)	(9,973)
Sale/repayment of investments	**14,386**	1,583	18,917
Net cash inflow/(outflow) from investing activities	**6,839**	(1,849)	8,944
Cash flows from financing activities			
Issue of ordinary shares	**1,430**	12,914	13,427
Share issue expenses	**(8)**	(302)	(352)
Purchase of ordinary shares for cancellation	**(793)**	(511)	(1,659)
Equity dividends paid	**(8,855)**	(2,446)	(5,690)
Net cash (outflow)/inflow from financing activities	**(8,226)**	9,655	5,726
Net (decrease)/increase in cash and cash equivalents	**(2,218)**	7,059	13,364
Cash and cash equivalents at beginning of period	**28,567**	15,203	15,203
Cash and cash equivalents at end of period	**26,349**	22,369	28,567

Notes to the financial statements

(unaudited) for the six months ended 30 September 2021

1. 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 April 2021 by the Association of Investment Companies ("AIC SORP").

2. The calculation of return per share is based on the return after tax for the six months ended 30 September 2021 and on 161,752,727 (2020: 162,912,035) ordinary shares, being the weighted average number of shares in issue during the period.

3. The calculation of net asset value per share is based on the net assets at 30 September 2021 divided by the 162,993,971 (2020: 163,071,097) ordinary shares in issue at that date.

4. The interim dividend of 2.0 pence per share for the year ending 31 March 2022 will be paid on 28 January 2022 to shareholders on the register at the close of business on 7 January 2022.

5. The unaudited half-yearly financial statements for the six months ended 30 September 2021 do not constitute statutory financial statements within the meaning of Section 434 of the Companies Act 2006, have not been reviewed or audited by the company's independent auditor and have not been delivered to the Registrar of Companies. The comparative figures for the year ended 31 March 2021 have been extracted from the audited financial statements for that year, which have been delivered to the Registrar of Companies; the independent auditor's report on those financial statements (i) was unqualified, (ii) did not include any reference to matters to which the auditor drew attention by way of emphasis without qualifying the report and (iii) did not contain a statement under Section 498 (2) or (3) of the Companies Act 2006. The half-yearly financial statements have been prepared on the basis of the accounting policies set out in the annual financial statements for the year ended 31 March 2021.

6. Each of the directors confirms that to the best of their knowledge the half-yearly financial statements have been prepared in accordance with the Statement "Half-yearly financial reports" issued by the UK Accounting Standards Board and the half-yearly financial report includes a fair review of the information required by (a) DTR 4.2.7R of the Disclosure Rules and Transparency Rules, being an indication of important events that have occured during the first six months of the financial year and their impact on the condensed set of financial statements, and a description of the principal risks and uncertainties for the remaining six months of the year, and (b) DTR 4.2.8R of the Disclosure Rules and Transparency Rules, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the entity during that period, and any changes in the related party transactions described in the last annual report that could do so.

7. Copies of this half-yearly report have been mailed to shareholders and are available to the public at the company's registered office, and on the company's website.

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 investment manager on a regular basis.

Financial risk: most of the company's investments involve a medium to long-term commitment and many are 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.

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 caused a global recession during 2020. **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 investment 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 UK withdrew from the European Union (EU) on 31 January 2020. The impact on the future business environment in the UK remains difficult to predict. **Mitigation:** whilst we do not expect that Brexit will have a significant impact on the operations of Northern 2 VCT PLC itself, the board and the investment manager follow Brexit developments closely with a view to identifying changes which might affect the company's investment portfolio. The investment 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. Changes to the UK legislation 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 investment 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 investment 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.

Company information

Directors
David Gravells (Chairman)
Alastair Conn
Simon Devonshire
Cecilia McAnulty
Frank Neale

Secretary
James Bryce LLB

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