Herald Investment Management Limited

2022 Stewardship Code Report

Spring 2023

Stewardship is at the heart of the Herald approach

Over **1,500**
one-on-one meetings per year

Invested in over
350
quoted and unquoted companies

Research from over
70
providers

Signatory to
UN PRI

The core of Herald's ethos rests on the aim of being long term supportive shareholders. The stewardship process entails actively engaging and interacting with investee companies and where required helping to effect change in issues that are important to the governance or future sustainability of those companies. We actively encourage management to think about employees, customers and broader stakeholders ahead of short-term shareholder returns, and firmly believe that this leads to the best long-term outcomes for outside shareholders.

- Aim to be long term and supportive shareholder.
- Fundamental analysis is central to investment decisions.
- ESG factors considered as part of the investment case.
- Engage with management teams of all investee companies on a broad range of issues, including ESG.
- Two client funds with different remits, with over 90% of assets invested in smaller quoted companies.
- Consistent provider of primary capital to early-stage companies.
- Actively investing in companies which enable lower power consumption and the production of renewable energy.
- TMT sector naturally low carbon and below the market average for carbon consumption.
- Our governance structures are reviewed by our board and by the boards of our clients on a recurring basis.
- Stewardship policies are regularly updated.

Stewardship is at the heart of the Herald approach. 2022 key findings

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The material findings of our ESG analysis are as follows:

- Herald generally engages with management issues discreetly prior to shareholder votes. Sometimes we have influenced board recommendations. In a few cases we have voted against management.
- Certain regulation is disproportionate when applied to smaller companies. Herald contributes to the development of an appropriate governance framework for early-stage UK companies through the QCA.
- Within the Herald portfolios historically, small companies with low ISS corporate governance scores have frequently delivered the best percentage returns for shareholders. We believe founder management with material stakes can be better stewards of the company than external investors, and should, at the fund manager's discretion, be given leeway on a judgmental basis e.g. Executive Chair, special shares.
- Herald has contributed primary capital to companies in alternative energy such as hydrogen from 2012 and are optimistic that capital investment and technology will address the challenges. Necessity is the mother of invention and energy storage is key.
- The challenge of meeting the carbon targets is not yet reflected in government investment plans but will be a driver for technical solutions. Energy prices and security of supply are a risk to the economy.
- The cost incurred by investee companies on ESG, particularly smaller emerging companies, is a material headwind to earnings growth. As standards globalise these costs do not become a disadvantage, but balance is required on the pace of cost rises.

Contents

This is a report of Herald Investment Management Limited's stewardship activities with reference to the FRC's 2020 UK Stewardship Code. In order to evidence effective stewardship, signatories to the code are required to report annually on the activities they undertake to fulfil their stewardship responsibilities and the outcomes of this activity.

UK Stewardship Code Principles

Principle 1

Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

REPORTING EXPECTATIONS

Context

Signatories should explain:

The purpose of the organisation and an outline of its culture, values, business model and strategy.

Purpose
Herald Investment Management Limited (Herald) was established in 1993, initially to invest in smaller quoted companies in the technology, media and telecommunications (TMT) sectors.

Business model
We believed that early-stage companies in the TMT sectors that required development capital could be profitable investments because technology opens up new markets which smaller, entrepreneurial companies can exploit. We felt that investors recognised this opportunity but were deterred from investing directly in these companies by the high stock-specific risk and the illiquidity of such investments.

Initial strategy
Herald Investment Trust PLC (HIT) was established as a closed-end investment vehicle to invest in smaller companies with high stock-specific risk and poor liquidity. The closed-end vehicle diversifies the risk and provides more liquidity for investors than direct investment in the investee companies.

Subsequent strategic developments
Knowledge of the sector gained from hundreds of investments in smaller quoted companies has since been applied in a UCITS fund, Herald Worldwide Technology Fund (HWTF), for larger quoted companies, and two venture partnerships. The strategy of Herald and the strategy of Herald's clients' funds are regularly reviewed by the relevant boards and remains valid and current.

Creating long-term value
In HIT a material proportion of the portfolio, consistently c17% at any one time, has been in early-stage loss-making companies which can often be held for an extended period through to profitability and further growth. The companies in this incubator element of the portfolio will evolve over time. Some which were early-stage loss-making microcaps at the time of initial investment are now significant companies and it is often the case that they have returned multiples of book cost in value to our investors. There tends to be a natural life cycle for each investment.

Their investment beliefs, i.e. what factors they consider important for desired investment outcomes and why.

Key factors we look for in companies we invest in
Competent management, with integrity and a desire to build a business. Pricing power which can often be achieved through intellectual property, patents, know-how, branding, or the network effect (e.g. certain internet companies). Recurring revenue streams are also attractive and are found in subscription, rental models and maintenance contracts. Organic growth is preferred to companies built through acquisitions. Straightforward balance sheets, cash generation, and transparent and appropriate remuneration policies.

Activity

Signatories should explain what actions they have taken to ensure their investment beliefs, strategy and culture enable effective stewardship.

Being long-term investors of primary capital, we are proud to have invested, without tax incentives, over £645m in primary capital, of which £516m is in UK companies, for developing businesses. On average, the top 20 holdings in our flagship fund have been held for 16 years and have a combined value of 4.8x book cost and we have already realised £134m of gains from 18 of the top 20 holdings. On a number of occasions, we have rejected takeover approaches where we believed more value could be achieved over time.

Active investment management is key
We are active managers, investing in a range of over 350 quoted and unquoted companies using fundamental analysis. We rarely invest without meeting management and sometimes visit the

operations of the companies. We usually meet management twice a year during the ownership period and meet hundreds of other potential investments each year. Unfortunately, face-to-face meetings were not possible from March 2020 in the Covid environment, but numerous video meetings were held instead. Whilst video meetings allow us to fulfil the stewardship requirements of our process, they are inferior to meeting management in person, particularly initial interactions with unknown management teams. We are delighted that in-person meetings have resumed progressively through 2022, including overseas travel and conferences. We are, therefore, now able to undertake our normal level of investment due diligence most of the time. The new investments made without a face-to-face meeting during the Covid restrictions are marginal as a percentage of total assets. China, Hong Kong and some less developed countries in Asia have been slow to remove Covid travel restrictions which has ruled visiting some markets out. The pace of investment has been modest in 2022, due to the obvious economic and geopolitical risks. In particular the war in Ukraine has driven up energy and food prices causing rampant global inflation and very significant interest rate rises and creating increasing fears of recession and a consumer spending slowdown. Furthermore, companies in the target TMT remit had been trading on high valuations reflecting low interest rates, and the resilience of the sector in general in the Covid environment. It has, therefore, been considered appropriate to husband cash resources to ensure that we can fund any investee companies requiring cash in a more challenging trading and funding environment, and in the belief that more attractive valuations would emerge.

Outcome

Signatories should disclose:

How their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making; and

We defined the mandate at the launch of our funds, because it was a strategy that we believed would generate value for shareholders.

Herald has always believed that good ESG practices are consistent with delivering better financial performance. The UK Stewardship Code and the UN-supported Principles for Responsible Investment (PRI) recognise that institutional investors have a duty to act in the best long-term interests of their beneficiaries. Herald shares the belief underlying the PRI, namely that ESG issues affect the performance of investment portfolios to varying degrees across companies, sectors, regions, asset classes and through time. At Herald, we believe that successful investing is about identifying, and owning for the long term, companies that can sustainably generate excess returns on capital for years to come. Our objectives are to achieve attractive returns over the medium-to-long term whilst minimising the risk of permanent capital loss for our clients. To achieve this, we seek to identify and invest in high quality companies that have the potential to appreciate in value over 5 to 10 years. When a company is struggling to raise primary capital, we are still prepared to invest if we believe the long-term potential is attractive, in the knowledge that returns will be poor in the short term, but that without funding the company will not exist or develop to its potential. It is within our assessment of a company's quality that ESG factors play an important role. As long-term investors, an assessment of ESG risks and opportunities is an inherent part of our investment process, as gaining a robust understanding of these issues is a key part of assessing the outlook for future cash flow generation and the risks associated with the investment. As long-term owners we aim to act as responsible stewards of our clients' investment by exercising our proxy voting rights and having open dialogue with portfolio companies on a broad range of issues, including ESG ones. Over the years, we have taken steps that highlight our commitment to responsible investing, and we will continue to review and evolve our approach. We have adhered to the UK Stewardship Code since 2010, and in January 2020, we became signatories of the UN-supported Principles for Responsible Investment (PRI), the globally recognised accord for responsible investment. In 2020 we revised our Stewardship Approach and Policy in line with the revised 2020 Stewardship Code, submitted our report for 2020 to the FRC in early 2021, and became a signatory to the revised code. We remain a signatory. We are active investors who interact closely with the management of the companies in which we invest as well as their suppliers and customers where possible. We recognise that ESG considerations, such as a company's board structure, environmental practices, or labour policies, can affect a company's valuation and financial performance. Therefore, our investment team incorporate ESG issues into their research and decision-making process. Investment research includes an assessment of a company's inherent quality based on the following quality criteria:

• Economic Moat – Assessment of the sustainability of a company's competitive advantage(s)

• Agency Risk – Assessment of the extent that management will act in the best interest of shareholders

• Business Risk – Assessment of the predictability and reliability of future cash flows and earnings

• Re-Investment Potential – Assessment of a company's ability to reinvest profits back into its business at high incremental rates of return.

Analysis of ESG factors forms part of the suite of issues that affect the Agency and Business Risk of companies. Gaining a robust understanding of these issues is a key element in the assessment of the outlook for, and risks to, the sustainability of future cash flow generation. Importantly, Herald is focused on materiality. Herald's investment team will make a determination about the ESG risks that are material for each company. Assessing a company's corporate governance practices is, and has always been, an important aspect of Herald's investment process. We recognise that there is no one single indicator with global application that identifies when companies are failing to adopt best corporate governance practices, and that different markets may adopt different practices and structures of corporate governance. Therefore, our approach to corporate governance may change according to a company's local laws, regulations, and established guidelines. Specifically, as it relates to environmental issues, we recognise the growing importance that these factors play in the global economy. While the importance of these factors will differ by company, sector, or region, as our investments are focused in the technology, media, and telecommunications sectors, these companies tend to be enablers of environmental efficiency rather than contributors to environmental risks. Although, no industrial sectors are currently explicitly excluded from the remit, the nature of the Technology, Media and Telecommunications (TMT) sectors that Herald focuses on implicitly limits investment in a number of the most environmentally damaging sectors, such as coal mining or generating energy by burning fossil fuels. The fund's focus on TMT sectors to some extent inherently limits exposure to some key environmental risks.

Herald considers the environmental impact of its own operations

Herald owns the building in London from which it primarily operates and over the years has invested to improve the environmental performance of the building including upgrading, the heating, lighting and air conditioning. A number of Herald staff have taken up the offer of electric company cars and there have been EV charging points installed in the car park. The installation of solar panels on the roof has been considered but ruled out due to shading from a taller building next door. The heating within the floors is electric and only the common areas are heated by a gas boiler. To reduce the CO2 emissions of the building further we had entered a long-term contract to purchase renewable / green energy. As energy prices spiked during 2022, the electricity supplier reneged on the contract and is now no longer supplying Herald with green electricity. There is clearly far greater demand within the UK for electricity generated from renewable resources than there is supply – in part due to decades of underinvestment in nuclear power and a moratorium on onshore wind, failures by successive UK governments. It will be many years before there is sufficient green electricity in the UK to shift the UK's overall energy consumption meaningfully to renewable sources. Herald will seek to move back to renewable electricity when prices have stabilised and its current fixed term contract expires. In 2022 Herald engaged an ESG consultant, Inspired ESG, to improve Herald's environmental reporting and start reporting Herald's own scope 1 and 2 emissions in line with TCFD recommendations. This process is ongoing and Herald will consider additional measures to reduce and mitigate its environmental impact as they are identified. In going through this process, the ancillary benefit will be to educate Herald investment staff, who might then be able to offer more informed guidance to some of the small companies within the portfolio that have yet to embark on developing such reporting.

Proxy Voting

Herald considers that proxy voting rights are an important power, which if exercised diligently can enhance client returns, and they should be managed with the same care as any other asset managed on behalf of its clients.

We strongly believe it is inappropriate to delegate voting to outside agencies or internal compliance. Voting cannot responsibly be formulaic without jeopardising our shareholders' interests.

Specifically, in the past, we have found that often there is no, or even a negative correlation between investment returns and poor governance. Frequently, however, there is a strong correlation with high returns and "poor" governance, because entrepreneurial technology companies are generally led by strong founders, who may breach conventions such as issuing special shares or split capital, having an executive Chair, or non-independent directors. We have not necessarily voted against these companies because we believe strong management with good long-term records, and often high personal shareholdings, are better custodians of our investors' assets than most institutional shareholders, and that we should continue to be supportive and grateful for their efforts on our investors' behalf. In contrast we attempt to avoid investing in companies which appear to be run for the benefit of directors and management rather than outside shareholders and, if we do, are prepared to vote against where relevant.

The level of engagement on ESG issues is also considered in the context of the percentage ownership of the investee companies' share capital. When we are a significant shareholder, we think it is particularly important to exercise our responsibilities, which have a greater chance of effecting change. Engagement in relation to ESG issues can take a number of forms, and does not necessarily involve Herald seeking to effect change. For example, many companies conduct annual shareholder outreach programs as a forum to discuss general corporate governance, sustainability, executive compensation, acquisition strategies, any changes or initiatives a company has made throughout the year. These provide the opportunity for a company to solicit shareholder feedback and discuss views provided by other shareholders. Herald may also seek engagement to achieve a better understanding of the management of material ESG issues or to seek clarity in relation to a specific proxy proposal. In many cases, engagement is a result of proxy voting. For example, depending on the materiality of the issue and the size of Herald's holding, where Herald has determined to vote against management's recommendation, Herald may engage with a company, outlining its rationale for the vote and providing advice on what the company should do to remedy the issue. When seeking change, Herald will typically begin engagement with company management, the company's broker or nominated adviser (in the UK). Herald may seek to escalate engagement from management to committee Chairs, Senior Independent Directors and/or the Chair of the board. Herald is cautious of collaborating with other shareholders due to concerns about breaking concert party rules or insider trading regulations but on occasion may do so when it is believed to be in the clients' interests. Herald also recognises the limitations of our influence as a minority shareholder and in cases of strong disagreement our ultimate action may well be to sell the investments.

an assessment of how effective they have been in serving the best interests of clients and beneficiaries.

We defined the mandate at the launch of our funds, because it was a strategy that we believed would generate value for shareholders and 25 years later the mandate is essentially unchanged, and the returns speak for themselves.

Both main funds that Herald manages have delivered strong returns for investors over many years. This has been achieved with low portfolio turnover and whilst being a fundamental, long-term supportive shareholder. Herald Investment Trust plc (HIT) has provided over £645m of primary capital to innovative technology, media and telecommunications companies. In context only £95m of capital has been raised, so there has been a steady recycling process. Many companies have been holdings within the portfolio for in excess of ten years and support of five or more funding rounds at an individual company in such a timescale would not be atypical. The capital Herald has provided has facilitated these companies to create exciting new technologies, which have enhanced communications, increased productivity, saved energy, created high technology value-added jobs and grown the wider economy to the benefit of all stakeholders. Given the technology-focused nature of the portfolio, the management teams are generally of a very high calibre and behave responsibly, being highly cognisant of their responsibilities to all stakeholders. In general, due to the nature of the companies within the portfolio, the environmental impact as measured by CO^2 emissions is estimated to be a fraction of those of a generalist large cap index, and many technology companies are leaders in targeting carbon neutrality and ensuring the welfare of workers throughout their supply chains. In general, the governance of portfolio companies is good when considered proportionately to their size and stage of development. In the case of small companies, often trading on small exchanges, the rules that they are obliged to follow are not as prescriptive as for large companies. Governments around the world perceive that excessive regulation and disclosure requirements can be onerous and stifle entrepreneurial endeavour. Those risk-taking individuals motivated to invent new technologies and found new businesses - often changing the world for the better - are not necessarily focused on ESG processes when they have to worry about making sales of a new product to a first customer or managing to fund the payroll at the end of the month. This is not to suggest that they do not care; in many cases management teams are founder led and immensely proud of their companies and their employees. Whilst they may have good employee welfare and sound environmental practices, they tend not to have the resources to produce the extensive reporting that larger companies are now doing. There is a challenge for an investor in such companies in proving their portfolios ESG credentials, as light touch regulation means that ESG quantitative data is limited in availability, because governments deliberately set lower standards of disclosure for smaller quoted companies to prevent onerous rules forcing companies to stay private. Furthermore, Herald will generally only invest in management teams and companies that they respect and in which they believe. This means that in general the portfolio holdings are well managed and behave responsibly, which somewhat limits the need for active intervention. Herald explains the areas they generally feel the need to actively engage in its stewardship policy. In some ways it is easier to demonstrate active engagement for portfolios of companies that are large, mature and damaging the environment, or poorly managed, as there is data available and a more interventionist stewardship approach is clearly required.

Herald is sought out as an investor by many companies and is widely respected as a leading small company technology investor by the global broking community. Investors in Herald's client funds also tend to have a very long-term perspective, with many holders having been investors for many years; based on shareholder meetings held throughout the year, we believe they are content with the investment approach we have taken. For example, the turnover of shares in Herald Investment Trust is very low - typically less than 10% of the share register changing hands in a year. Communications with the boards of Herald's client funds are frequent, transparent and open. In turn the funds are well regulated and provide detailed and comprehensive reporting to their beneficial owners. The strong long term track record is evidence that Herald has delivered good long-term performance from a portfolio of companies that the beneficial owners are comfortable to be invested in.

Principle 2

Signatories' governance, resources and incentives support stewardship.

REPORTING EXPECTATIONS

Activity

Signatories should explain how:

Their governance structures and processes have enabled oversight and accountability for effective stewardship within their organisation and the rationale for their chosen approach.

Herald's board approves the Stewardship Approach and Policy and reporting thereon. The firm's investment managers and compliance staff have collaborated in defining our stewardship approach and policy to ensure it is both appropriate and can be successfully executed. Herald Investment Management Limited's Stewardship Policy and Approach is available on Herald's website.

https://heralduk.com/wp-content/uploads/2022/06/Herald-Investment-Management-Stewardship-Approach-and-Policy-Spring-2022.pdf

This document is regularly reviewed by and discussed with Herald's investment clients who have the opportunity to comment and make suggestions.

For Herald's actively managed portfolios and investments, Herald's investment team undertakes in-depth company research, seeking to identify sustainable competitive advantages that enable businesses to generate excess returns on capital and predictable cash flow. As bottom-up fundamental investors, we consider ESG risk alongside other risks faced by companies we own. ESG risk analysis is integrated in our investment process and is not a separate function. We are active investors who interact closely with the management of the companies in which we invest, as well as their suppliers and customers where possible. We recognise that ESG considerations, such as a company's board structure, environmental practices, or labour policies, can affect a company's valuation and financial performance. Therefore, our investment team incorporate ESG issues into their research and decision-making process.

Investment research includes an assessment of a company's inherent quality. Further information on the approach that investment staff take can be found on Herald's website in the document entitled "Herald's Approach to ESG Integration".

https://heralduk.com/wp-content/uploads/2021/02/Herald-Approach-to-ESG-Integration.pdf

As an FCA regulated firm we are subject to the governance requirements of the senior management arrangements and systems and controls section of the FCA Handbook (SYSC). These are set out in our compliance manual, which references the FRC stewardship code and requires staff to adhere to it.

Regular reporting on Herald's stewardship activities is provided to the independent boards of Herald's clients and they have endorsed Herald's approach to stewardship. They are generally consulted over significant and contentious stewardship issues.

They have appropriately resourced stewardship activities, including:

a) their chosen organisational and workforce structures.

Ultimately, stewardship responsibility lies with the Herald fund managers who engage with company management teams and non-executive directors and undertake the appropriate analysis. Where there are difficult or complex stewardship issues, these experienced professionals would typically consult with each other. Under the Senior Managers and Certification Regime (SMCR), all significant areas of responsibility are apportioned to the relevant senior managers, and we ensure that statements of responsibilities make appropriate reference to stewardship. Herald has chosen not to employ ESG specialists, as Herald's ESG process outlined above is an integral part of the investment decision making process and is carried out effectively by the relevant fund managers.

In light of the significant extra workload entailed in reporting stewardship activity and gathering the required information we have expanded the team and reorganised responsibilities. In particular, the lead fund manager delegated responsibility for the Asian portfolio many years ago, for the Continental European portfolio five years ago to another team member, and in mid-2021 further delegated the prime responsibility for stock selection in the North American region to one of the analysts. In 2022 two additional analysts have been recruited. The team now comprises six managers and a further three analysts. In addition, as commissions paid to brokers eroded, it was evident that smaller companies no longer visited London, so a presence in New York was established in 2015 with a further analyst based there. We now have a team of ten for two funds with c£1.35bn in aggregate under management.

We believe that we have the largest technology team in Europe, which is somewhat surprising because we are small in terms of funds under management. Investing in smaller companies is labour intensive with an average investment c£4m. However, we firmly believe that Stewardship is inextricably linked to fund management, and it is difficult to delegate to ESG specialists with limited third-party data on small companies. It does of course pose other challenges. We feel strongly that our ability to meet and compare companies targeting similar markets across the globe has improved our ability to choose the right companies to fund and therefore make successful investments. We are proud to have generated returns in our UK portfolio over 1,000% ahead of the Russell 2000 Technology Index in the US from since 1/7/1996, benefiting from the education from operating in the US and Asian circuits. This cross-referencing ability would diminish if each member of the team met fewer companies on a more regional basis. To offset this reduced mosaic of information, each member of the team also has global analytical responsibility for a subsector, such as media, semiconductors or technology services.

Herald is one of the smaller investment managers with approximately 20 staff, half of which are in the investment management team. With the exception of one investment team member based in New York all of the remaining members work in an open plan office in London and sit within 30 feet of each other. Information flows freely and consultation amongst team members is informal and frequent. Herald has deliberately avoided rigid and formulaic structures often adopted by larger organisations and prefers a more entrepreneurial and flexible structure – this often replicates the approach of the dynamic small technology companies in which Herald invests.

b) their seniority, experience, qualifications, training and diversity.

Herald senior investment team's members have decades of individual experience investing in TMT companies globally and come from unusually diverse backgrounds. Our investment team frequently contribute to government and industry consultations within the UK, and their views are widely sought and, we believe, generally respected. Many members of the team have second degrees and relevant professional qualifications, including as qualified accountants and investment analysts. A number of the team have prior experience from working at leading investment organisations. Details of the experience and qualifications of the senior members of the Herald investment team can be found on the Herald website.

https://heralduk.com/team/

Simply from the biographies, of the investment team members, it is evident that they have a high degree of diversity.

Senior members of the investment team feed into consultations on Corporate Governance, regulatory and market structures. Engagement with our investee companies at Board level occurs on a daily basis. The junior members of the team are included in these daily discussions and frequently they learn the most by listening to their peers' conversations, before, during and after meetings. We really see the benefit that now most of the team are in the office five days a week post the Covid interruption.

Helped by of the expanded team we have kept on top of regulation in the widest sense without compromising our investment management efforts.

c) their investment in systems, processes research and analysis.

The investment process is research-intensive with six investment managers, three analysts and a research associate in New York, conducting circa 1,500 one on one meetings a year with companies.

In addition, we have paid research agreements with over 70 providers with typical annual external research spend of around £1m. Key investment analysis and portfolio management systems are utilised from leading providers including Bloomberg, Refinitiv, Capital IQ, SS&C (Geneva), Institutional Shareholder Services (ISS), Bank of New York Mellon, and Northern Trust.

d) the extent to which service providers were used and the services they provided; and

Bank of New York Mellon provides fund accounting services for HIT. Bank of New York Mellon also provides custody and depositary services directly to the client. Link Asset Services are the registrars, and Apex Group the company secretary.

For the HWTF UCITS fund, fund accounting, custody, depositary and registrar services are provided by Northern Trust.

Institutional Shareholder Services (ISS) proxy voting reports are purchased for analysis and informational purposes. Proxy voting decisions are made by the investment team with the ISS reports being one of numerous inputs into this process.

e) how performance management or reward programmes have incentivised the workforce to integrate stewardship and investment decision-making.

The investment managers are investors in the funds and the management company. Their interests are aligned with those of shareholders to make returns in the long term. The depth and breadth of the stewardship activities of the Herald investment team and the effectiveness of those activities, are assessed as part of the annual appraisal process and reflected in the individual's annual bonus.

Outcome

Signatories should disclose:

How effective their chosen governance structures and processes have been in supporting stewardship; and

We have found that our reputation for being long-term, long-only, supportive shareholders leads investee companies to seek Herald as a shareholder. When we cornerstone a fundraising, it is often easier for companies to complete the required funding, given our track record of delivering strong long-term returns to shareholders.

We believe that we have appropriate governance structures in place, which are regularly reviewed by the independent boards of our client funds. Herald Investment Management Limited constantly reviews new regulations to ensure compliance with best practice.

How they may be improved.

Our current governance structures are reviewed by the board of Herald Investment Management Limited and by the boards of our clients on a recurring basis. Now that reports are publicly available, we can review the quality of governance and reporting from other UK investment managers and look for potential improvements.

Ever higher standards of reporting and governance are being demanded from UK-regulated investment managers by regulators and investors. A current challenge is meeting the desire for increased transparency with regards to the environmental impact that the portfolio has on climate change and producing analysis of the risks that climate change will have on the portfolio without imposing uneconomically high costs on investee companies. As technology investors a key skill has always been to look to the future, investing in companies that disrupt the status quo and are not themselves disrupted. Proving that we are actually doing this effectively is a challenge, as there is very limited information from the small companies in which we invest due to their more limited reporting requirements. In aggregate we believe that the portfolio has greenhouse gas emissions a fraction of the level of the leading general stock market indices in the UK and US. The vast majority of the data is estimated, or proxy based, because globally small companies generally do not have available, or report, greenhouse gas emissions data.

As we have expanded the team, we are all constantly moving up the learning curve. A further area for potential improvement is around collating and reporting on information we receive from shareholder engagement with investee companies. For example, the most important metric in measuring social impact, and one that we have always regularly asked companies, is what staff turnover they have had in the most recent reporting period, broken down by skill set such as developers or salesmen, as it is an important indication of the health of the business and its quality as an employer. We have never attempted to tabulate this data but have sold positions where it seems unreasonably high. Again, there is subjective judgment required here, because staff turnover is inevitably higher from time to time in locations such as San Francisco and Cambridge, when big companies are growing fast and paying expensively to hire.

In the current environment most companies face a challenge to find, hire and retain employees across all skill sets. We believe many of these young companies employ a diverse workforce out of competitive necessity. Companies are conspicuously having to offer attractive benefits, flexible working, pay rises and share-based payments to address this issue. In the technology sector, more than the media sector, there is a conspicuously small proportion of women in senior positions, which in turn means there is shortage of appropriately qualified female non-executive directors in most geographies.

We are inclined to avoid companies where the returns of the business will disproportionately benefit directors and employees rather than shareholders. Meanwhile generally we are not attracted to low-cost labour companies because companies that compete on price rarely have attractive margins and thereby fail to deliver adequate returns for outside shareholders.

Operating in a heavily regulated industry there are a multiplicity of international laws and regulations that govern our interactions with other investment managers. We are fearful of breaching such rules and it is only after careful consideration, and when we believe it is clearly in our clients' interests, that we enter into dialogue and collaborate with other investors. This is a difficult and complex area and over the years we have become more wary about acting collaboratively as the regulatory complexity increases. We recognise the increased expectation and need for collaboration (especially due to the fragmentation of UK company share registers). In the UK engagement with the investee companies' brokers or Nomads is normally sufficient to raise and resolve issues.

Principle 3

Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first.

REPORTING EXPECTATIONS

Context

Signatories should disclose their conflicts policy and how this has been applied to stewardship.

Conflicts – policy

Our policy is to have different client mandates so as to minimise conflicts. Indeed, to avoid potential conflicts, approaches to manage segregated funds making investments within the remit of Herald Investment Trust PLC have not been pursued.

Our staff dealing rules prohibit direct investment in stocks in the TMT remit except in exceptional circumstances with prior written permission from the Managing Director or Herald's Board.

Hence, by design, in a typical year there are very few conflicts of interest that require managing.

A summary of Herald's conflict of interest policy is available on its website.

https://heralduk.com/wp-content/uploads/2022/02/Conflicts-of-Interest-Policy-Disclosure-February-2022.pdf

Activity

Signatories should explain how they have identified and managed any instances of actual or potential conflicts related to stewardship.

Identifying and managing conflicts

Clear procedures have been established for staff to follow to report actual or possible conflicts of interest concerning stewardship – or any other matter – to the Compliance Officer. If the Compliance Officer's initial review indicates a likelihood of impacting a client's interests, then steps to avoid, mitigate or resolve the conflict are considered. The Compliance Officer will document the relevant details in a conflicts of interest form. These forms are reviewed and approved by Herald's Chief Executive and presented to the board. If the conflict cannot be avoided, it will be disclosed to the client and discussed with them to ensure an equitable resolution.

Reluctant capital provider for long term strategic reasons

In 2022 a small UK company, Trackwise Designs, raised money to build a plant to supply an electric vehicle manufacturer. The key customer reneged on its contract, and the company had not received the necessary sales to become self-funding. There had been a break-down in the UK smaller companies market, and necessary money could only be raised at very distressed levels, which diluted the management's stake. We sought and received permission from the Board to invest above our normal 10% limit of outstanding capital. We further made it a condition of our investment that management receive options over 12% of the enlarged capital. It remains a high-risk situation, but it is encouraging that the company is in talks to win significant contracts in the electric vehicle market from major OEMs.

Clients co-investing

Historically some venture investments were or became public, and the investment trust co-invested. Co-investment conflicts are always disclosed and discussed with the independent board of the relevant investment funds.

Outcome

Signatories should disclose examples of how they have addressed actual or potential conflicts. Conflicts may arise as a result of:

Ownership structure.

Benefits of independent ownership

Herald benefits from an independent ownership structure and is not exposed to many of the conflicts that might affect financial conglomerates.

Investing in small quoted companies is not scalable. As Manager we have been energetic in buying shares in the investment trust for cancellation. Buybacks could be perceived as a conflict because it reduces the Manager's fee. As Manager, we take the long-term view that investors' performance and liquidity are more important than maximising the short-term fee income.

Business relationships between asset owners and asset managers, and/or the assets they manage.

Focused management
Herald's concentration solely on providing investment management services for only three client funds whose remits differ considerably reduces the scope for possible conflicts with its clients.

Differences between the stewardship policies of managers and their clients.

As client fund boards discuss, review and endorse our stewardship practices and policies, this has not been an issue.

Cross-directorships.

There are no cross-directorships between Herald and its clients. Herald does control the Ventures LP's through their general partners, and group entities and staff have holdings and other indirect interests in those partnerships. These partnerships are currently in run-off and realising their few remaining holdings.

Bond and equity managers' objectives; and

Herald only manages equity holdings limited to the technology, media and telecommunications sectors, so there are no conflicts with any bond managers' objectives.

Personal dealing.

Personal dealing in stocks within the target TMT sectors is prohibited. In extreme situations this is only waived with written permission from the Managing Director or Herald's Board. This avoids any scope for front running or selling shares ahead of a client.

Client or beneficiary interests diverging from each other.

The objectives and mandates of Herald's client funds are clear, stable and transparent. The primary role of the independent boards of the client funds is to ensure that the investment manager invests the assets in accordance with the mandate and that the assets are held securely in safe custody.

Beneficial owners have sufficient information to give them a clear understanding of the investment management approach, underlying investments and key risks to the portfolio. They have the opportunity to invest or divest on a daily basis in Herald's listed investment vehicles. The boards of the listed client funds regularly report to their shareholders and their non-executive directors are subject to re-election annually.

Possibilities for conflicts exist but are limited and already highly visible. No material conflicts occurred in 2022. One minor conflict example arose due to a shared Directorship between Herald Investment Trust plc and a company that Herald Investment has invested in on behalf of the Investment Trust. It isn't a significant conflict but the example does illustrate the open manner in which we interact with our clients and investee companies.

Thruvision Group – Managing a potential conflict of interest

Herald Investment Trust is a 10% shareholder in Thruvision plc, a small (£32m market capitalisation, £8m revenue) AIM company. Tom Black is the founder and Executive Chairman of Thruvision and also the Non-Executive Chairman of Herald Investment Trust plc, Herald Investment Management Limited's largest investment client. Herald is careful to consider whether there may be any real or perceived conflicts of interest when voting Herald Investment Trust's shareholding in Thruvision.

Prior to the Thruvision AGM in October 2022, Herald reviewed the ISS voting report recommendations. Herald was concerned to note that ISS was recommending voting against the remuneration report and abstaining on the re-election of Tom Black as a director. Both ISS recommendations were surprising. On further investigation we realised that ISS had taken exception to a one-off £20,000 strategy bonus paid to CEO at the discretion of the remuneration committee. Herald regards executive pay and share-based remuneration in general as at a very reasonable level at Thruvision. and regarded the ISS voting recommendation against the remuneration report as unmerited and box ticking. The other ISS issue was that they disapproved of the Executive Chairman Tom Black sitting on the audit and remuneration committees and recommended abstaining on his re-election. Tom Black is the founder, a 9% shareholder and an executive director at Thruvision, but is only paid £40,000 pa a non-executive scale rate. Herald has known Tom Black for 20 years and respects his judgement and ethics and is confident that he will behave responsibly in protecting Thruvision's minority shareholder interests. We believed his re-election was clearly in the interests of all Thruvision shareholders. Due to the potential for a perceived conflict of interest, Herald sought the view of another independent HIT Director - Henrietta Marsh. Henrietta commented that she agreed with the Herald voting approach, that Thruvision is a very small company that needs agility on pay and she supported Herald's proposed to vote in favour of all resolutions. The issues highlighted by ISS were also raised directly with Tom Black, who commented that other shareholders had suggested he drop Executive from his Executive Chairman title to address the technical ISS issues, and that he was in principle happy to do this as it was a historical legacy rather than a true reflection of the executive chain of command. Another investment manager had suggested that Tom Black does not formally sit on the Remcom and Nomcom as he is not defined by ISS as independent, but that Tom could still attend the meetings but just not formally be a committee member. Tom was happy to consider this suggestion. We believe it was an issue blown out of proportion but given the following which ISS commands it might be prudent to accept their approach. In April 2022, the board independence and diversity at Thruvision was in fact improved through the addition of another Independent Non-Executive Director, Katrina Nurse. Furthermore, Katrina joined the Audit and Nomination Committees and chaired the Remuneration Committee from the conclusion of the AGM in October 2022. We do not have any fundamental concerns with regards to governance at Thruvision.

Principle 4

Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system.

REPORTING EXPECTATIONS

Activity

Signatories should explain:

How they have identified and responded to market-wide and systemic risk(s), as appropriate.

Herald is a small investment manager with approximately 20 staff based within an open plan office in London. Within the investment team, at least 6 members have multiple decades of experience in investing in small technology companies. They have experience of managing investments through many economic, market and technology cycles. They discuss emerging risks and their implications for investor returns with each other on a daily basis. Daily investment analysis activities are carried out on existing and new investments, in conjunction with conversations undertaken in over 1,500 company meetings a year, highlighting a huge gamut of potential risks. Where new risks are identified, additional analysis is typically carried out and where these are market wide or systemic the potential implications are shared with investment clients.

Herald and its client funds maintain risk maps/registers which are discussed and reviewed on a continuing basis at board levels. This process identifies the major risks and how the outlook for these risks is changing and includes approaches to mitigate risk where possible.

Identifying and responding to market-wide risks

The key risks Herald have identified are as follows:

Strategic Risk

There is a risk that public markets become unattractive to investee companies due to a number of factors including burdensome regulations and taxation, and fewer investors allocating capital to small public companies. In the UK for example defined benefit pension schemes, insurance companies and index trackers do not typically provide primary equity capital and wealth managers rarely do. This could result in a smaller investible universe and orphan portfolio stocks. Herald engages with external bodies such as the Quoted Company Alliance (QCA) in the UK to influence government and regulatory policy to support smaller quoted companies. The portfolio is globally diversified, and the manager has the ability to move capital to more favourable markets.

Market risk

The clients' assets consist mainly of listed securities and the success of delivering on the clients' objectives is therefore market-related and exposed to market risk (comprising price risk, currency risk, interest rate risk, liquidity risk and credit risk).

As a specialist investor in TMT and small cap stocks, Herald's clients' assets are exposed to more volatile share price movements than those of the general market and, on occasion, it may be difficult for the manager to achieve sales of investments at market prices. The risk rating of market risk has been increased from that of last year to reflect the possibility of increased market volatility.

There is a liquidity risk that the manager is unable to realise profits on significant positions in the portfolio and unable to redeploy them in sufficient sizes in new positions. Some clients may also invest in unquoted securities which generally have greater valuation uncertainties and liquidity risks than securities listed or traded on a regulated market. The manager reports regularly to its clients' boards on liquidity risk. For Herald Investment Trust (HIT), investment risk is spread by having a diversified portfolio of over 300 holdings. The holding in any one company is generally restricted to less than 10% of the portfolio company's shares in issue and the manager would usually start taking profits before a holding reaches 5% of the portfolio. The risk rating has been raised from that of last year to reflect the deteriorating liquidity in certain markets for some smaller stocks.

Having the right fund structure is key. HIT, which accounts for over 90% of the assets Herald manages, invests in illiquid smaller quoted companies. HIT is a closed-end vehicle listed on the London Stock Exchange. Unlike an open-ended vehicle, HIT does not need to be a forced seller of its portfolio investments when shareholders want to sell their investment. Shareholders can sell at any time on the stock exchange, including times of market stress when the liquidity of HIT's underlying investments may deteriorate. Companies require permanent capital and investors want liquidity. An investment trust is an appropriate structure to balance these sometimes conflicting requirements. Liquidity risk is generally moderate for the client funds investing in larger companies.

Economic risk

Interest rates, exchange rates, inflation, recession, taxes and changes in supply and demand can all pose a threat to the future of portfolio companies. The threat from these risks has increased since last year, reflecting rising inflation and the possibility of increased interest rates and tax rises.

Geopolitical & natural disaster risks

Political developments can create risks to the value of clients' assets. For example, US-China-Taiwan trade tensions could disrupt technology supply lines, or energy prices could be inflated by political developments in the Middle East and Russia.

The majority of companies in the portfolio depend on the use of computers. Ultimately the supply chain is heavily dependent on manufacturing in China, and semiconductors in Asia. Any prolonged disruption to this supply chain could cause an adverse effect. The greatest perceived risk would be an earthquake in Taiwan, a geopolitical dispute between China and Taiwan or a virus not being contained in any key component supplier. The lead time to build new semiconductor fabrication plants and other manufacturing capacity is long, and the skillset deep and hard to migrate. The manager considers the above risks on an ongoing basis and reports on a regular basis to its clients' boards, including reporting on the composition and diversification of the portfolio by geography, sectors and capitalisation along with sales and purchases of investments. Individual investments are discussed with the fund manager together with the investment team's general views on the various investment markets and sectors. The clients recognise that the potential for mitigation is likely to be limited other than through diversification given the continuation or amplification of various factors such as the shrinkage of the investee universe, the uncertainty over interest rates, and the intervention by governments in markets, all of which have raised the risk rating from that of last year.

Global pandemic risk

The pandemic is an ongoing risk with both primary and consequential negative effects, such as supply chain disruption. Its impact has been significant with restrictions to movement of people and disruption to business operations affecting global portfolio company valuations both positively and negatively and potentially affecting the operational resilience of Herald and its clients' service providers. Market volatility has also been heightened. During the year, Herald and the boards of its clients continued to monitor the market and operational risks associated with the Covid-19 pandemic and the ongoing economic impact on the underlying investee companies. The manager and the key service providers have in place robust plans and infrastructure to minimise the impact, including remote working. The manager's inability to meet company management in person, particularly overseas, was somewhat detrimental to the quality and quantity of investment decision making. Throughout 2022, the world progressively opened up and this risk has receded. Inevitably some members of the team have had health issues, and we are grateful for the willing spirit that has ensured tasks have been covered as necessary.

Climate change risk

The financial risks from climate change are typically classified as physical or transitional risks. Physical risks are those arising from specific weather events (such as wildfires) and transitional risks are those arising from changes to regulations, such as the move to net-zero carbon. The portfolio is well diversified to mitigate against physical risks.

Changes in climate change focused regulation, governing both Herald and its clients and investee companies, will create some uncertainty. A number of investments address the challenges arising from climate change and may benefit. However, if climate change has a significant adverse impact on the wider economy, Herald and its clients could be negatively affected.

In comparison to the broader economy, the portfolio has a relatively low carbon footprint. Both Herald's board and clients encourage the manager to consider environmental, social and governance factors when selecting and retaining investments and this has been a major topic of discussion in the past year. Over the past decade and before, Herald has invested in green technologies such as tidal, hydrogen and solar. Furthermore, power efficiency is a critical feature for many of the investee companies' products – this is particularly the case for semiconductors. Herald has increased the resources evaluating green/ sustainability issues and has an analyst focused on evaluating such companies. Herald has evaluated and uses various ESG templates, in general we are sceptical of such a tick box approach and in many cases there is limited data available.

Herald's response to market risks

There are over 5,000 quoted companies in the Herald TMT remit globally and there are few, if any, individual risks that impact on these companies at the same time. Even in a global pandemic, some investee companies have benefited from greater demand and improved financial performance. The technology sector in particular benefits from supplying the consumer, governments and enterprises in all sectors across the globe, with different demand cycles.

Clients face investment risk due to market volatility. There is always the risk of markets de-rating and this de-rating risk could be amplified by companies whose profits are adversely affected by economic conditions, emerging competitors and other factors. We encourage investors in our funds to take a long-term view and make them aware of conditions across the market cycle.

Herald's response to increased market-wide risk has been to diversify the portfolio, generally limit ownership of investee companies to less than 10%, and keep a cash buffer (and currently no leverage) to support investee companies who require further capital and to deal with our investment mandates' liquidity requirements. Throughout 2022, this cash buffer was maintained as the impact of war and increased economic and geo-political risks weighed on stock market valuations. With more of these risks now priced in, valuations are more attractive, but the outlook remains difficult. When capital is deployed, it is done particularly cautiously and judiciously. Herald continues to pay relatively high rates of commission to incentivise brokers to execute often difficult and illiquid trades.

Identifying and responding to systemic risks

Illiquidity is the most significant systemic risk to the investment trust portfolio managed. Being forced sellers can have an extremely adverse effect on realisable values.

To mitigate this risk we rarely take stakes above 10% for liquidity reasons and do not generally take stakes of more than 5% in loss-making businesses. HIT is a closed ended fund so will never be a forced seller to satisfy redemptions.

HWTF invests in large companies where liquidity is much less of an issue.

The decline of the public markets

We have identified the longer-term risk that the companies we would like to invest in do not choose to float on public markets. 2020-21 was the first time for several years that the number of companies in the core markets of the US and UK had not reduced, with more IPOs than takeovers. In 2022 our scepticism that this reversal of the trend would be sustained was merited. Although, somewhat apparent at the time, the relatively poor quality of the business models of many of these IPOs and SPACs (mainly US) has been revealed, with huge percentage losses from the IPO or SPAC price common place. Herald was very concerned about poor disclosure and potential frauds encapsulated within the US SPAC craze at the time. We also warned about the risks arising from the LSE and a portion of the UK investment communities promoting the model within the UK. In recent years private equity has gained assets and market share from public markets. It benefits from reduced regulatory costs, but lack of regulation poses other risks. In addition, private equity benefits from more efficient tax structures and utilises more financial leverage. Governments could choose to change the tax benefits as financial leverage adds risk. For companies to flourish long term they need stable permanent capital, while investors prefer the potential to sell at any time. Private equity offers neither, and for the wider economy it is an inferior form of ownership compared with the permanent capital that the public markets have offered for extended periods.

Warren Buffet's comments on private equity at the Berkshire Hathaway AGM are succinct.

https://www.youtube.com/watch?v=r3_41Whvr1I

Regulation is itself a systemic risk

The ever-increasing burden of regulation is raising costs for all participants in public markets. It is deterring many companies from seeking a public listing, leading to a fall in the number and quality of quoted companies. A reduction in the number of investors willing to invest in and support small quoted companies means an increasing number of companies are owned by private equity or venture capital, often using a capital structure with significant debt levels. This became an issue in the United States following the introduction of Sarbanes-Oxley and is increasingly evident in Europe. As interest rates rose globally throughout 2022, the cost of debt has increased, and availability of debt financing significantly reduced. Following decades of low inflation and interest rates, the full implications of much higher inflation and interest rates are likely to be profound.

How they have worked with other stakeholders to promote continued improvement of the functioning of financial markets.

Promoting a well-functioning financial system – our participation in the Quoted Companies Alliance

Herald is a member of the Quoted Companies Alliance (QCA), which champions the interests of small UK companies and has raised concerns about the effective functioning of smaller company equity markets with stock exchanges and regulators, the press and the government for many years. In general, the success of such representations in promoting the importance of small companies and the technology sector and ensuring a benign investment environment has been limited. Small company equity markets continue to remain under pressure, and we are concerned that there is a temptation for the most exciting new technology companies to remain in private ownership for longer. This limits the opportunity for wider society to participate in the ownership of and benefit from the growth of dynamic companies and may reduce support for the capitalist approach to wealth creation.

There is a constant stream of regulations and legislation written with large companies in mind that is generally disproportionate when applied to smaller early-stage companies. Herald contributes to the development of the rules that govern smaller companies through its participation in various QCA committees including the QCA secondary markets group and the QCA remuneration committee, which produces the guide outlining best practice for UK small companies to follow. We believe that regulation should be flexible and proportionate. The QCA Corporate Governance Code, the code generally followed by small companies trading on the AIM market, is a leading example of such an approach that can suit growth companies.

The role they played in any relevant industry initiatives in which they have participated, the extent of their contribution and an assessment of their effectiveness, with examples; and

Paying for research under MiFID II

We believe that we were central to the amendment to MiFID II enabling companies to pay for research. We feared small companies could become orphaned with no secondary market liquidity if insufficient research on them was available.

QCA remuneration
We have participated in drafting the QCA's remuneration guidelines.

Responding to consultations and suggesting systemic improvements
In 2021 and 2022 (initiatives often span multiple years) Herald responded directly or significantly contributed to QCA or Institutional Investors Group on Climate Change (IIGCC) responses to the consultations below. Each proposal typically runs to tens or hundreds of pages and the issues are typically complex necessitating the involvement of experienced members of staff.

- Department for Business, Energy & Industrial Strategy (BEIS) consultation 'Restoring trust in audit and corporate governance: consultation on the Government's proposals.
- FCA consultation to extend TCFD rules to asset managers, life insurers and FCA-regulated pension providers. FCA responded to QCA January 2022 – accepting a number of Herald / QCA points.
- QCA letter to BEIS on impact of TCFD reporting requirements for small companies
- HM Treasury: Wholesale Markets Review -
- FCA – Diversity on company boards and executive committees
- HM Treasury – UK Secondary Capital Raising Review – initial contribution Autumn 2021- meetings Spring 2022 – final review published July 2022 – implementation ongoing incorporating many suggestions.
- FCA Primary Markets Effectiveness Review – Herald / QCA suggested new growth market structure
- FCA Sustainability Disclosure Requirements Consultation Paper – Herald raised some concerns with QCA on the potential impact for smaller companies.
- As a member of the Bank of England's Decision Making Panel, Herald takes part in monthly surveys which inform the Bank of England's Monetary Policy Committee on the state of the UK economy

In general, we aim to highlight where regulation could become unnecessarily burdensome on small quoted companies and propose practical solutions. On occasion it is possible to propose fundamental reform. In 2021 we discussed our optimism of some systemic benefit coming from the HM Treasury – UK Secondary Capital Raising Review (UKSCRR), which was underway at the time. Herald had a representative on the QCA UKSCRR working group which drafted the bulk of the QCA response. In 2022 the QCA UKSCRR working group met with HM Treasury's appointed head of the review to take some of the proposals forward. Contributing to the amendment and creation of regulations and legislation governing the structure of the small quoted companies' market is a slow process and success or failure not easily measured within a year. In this case the SCRR review was published in July 2022, and, as we had hoped, incorporated many Herald/ QCA suggestions. Many of the recommendations are fundamental, with implementation of some having been commenced and a realistic timetable in place for others. The key changes include: increased flexibility in use of pre-emption rights (particularly for growth companies); more relevant, more effective but less onerous documentation for secondary fund raisings; quicker more flexible fund raising structures; improved digitisation of shareholder registers (in particular to help companies track their beneficial owner) which will improve communication between companies and their shareholders and facilitate stewardship.

In July 2022 Herald / QCA provided input into the FCA Primary Markets Effectiveness Review. We aren't very optimistic of a positive outcome for listed growth companies from this review. The review seems to propose minor tinkering with existing rules governing the standard listing and a one-size-fits-all approach by throwing all companies into one segment. Herald / QCA highlighted how stock markets in some other countries such as the US and Japan have segments targeted at "Growth" companies with significantly more flexible rules and regulations. Herald / QCA proposed such a listed growth market for UK companies. It is not evident that the FCA is the correct organisation to lead the design of a UK stock market structure that will prove commercially attractive to companies and investors.

Historically we have had some but limited success in securing amendments to European legislation such as MIFIDII; we are optimistic that we will be more effective in influencing HM Treasury led reviews that seek to improve the functioning of capital markets.

Given the predominantly small company nature of the investment holdings and the typically, less detailed reporting they deliver, adoption of international reporting frameworks is patchy, varying significantly by geography. Leading geographies in the use of frameworks such as UN Social Development Goals, Science Based Targets and TCFD reporting include Taiwan, laggards include Australia and the USA. Where companies make such information available Herald makes use of it in their analysis. The absence of such reporting is not necessarily indicative of a "good" or "bad" company more often it reflects the size and maturity of the company, furthermore companies with the greatest environmental challenges often dedicate greater resources to environmental reporting than those that have few issues. We are also conscious of enormous green washing efforts, where hyperbole and impressive long-term targeting setting may be accompanied by minimal short term activity. We firmly believe that much of the technology investment portfolio is low environmental impact and many companies are developing solutions to make the world a better place. Given the relatively limited reporting that small, growth companies offer proving it is a challenge.

How they have aligned their investments accordingly.

Maintaining liquidity

As stated above, for liquidity reasons we rarely take stakes over 10% and do not generally take stakes of more than 5% in loss-making businesses to ensure we can reinvest and have other co-investors to participate in follow-on funding. Where we believe liquidity in a market is declining, regulations have become excessively burdensome and the prospects of small quoted companies raising growth capital become more difficult, Herald will try to reallocate capital accordingly. Liquidity is particularly challenging in the UK market where our weightings are heavier. For this reason alone, we have been reducing our UK weighting and continued to increase the allocations to international equities, this is despite there being interesting companies on sensible valuations on offer in the UK market.

Outcome

Signatories should disclose an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.

The closed-end structure of the smaller companies' fund has enabled us to provide capital to companies in times of stress, while maintaining a cash buffer to be deployed in times of market dislocation. This has helped us outperform the markets in times of recovery following the 2000-2001 downturn and the 2008-9 financial crisis. This has also enabled us to provide essential primary capital to growth companies when it is most needed.

Since the founding of Herald Investment Trust in 1994, Herald has provided £645m of growth capital, with £21m in 2022 of which £15m was in the UK.

Herald has contributed to numerous reviews and consultations on regulations and legislation impacting the functioning of quoted company markets. We believe that Herald is effective in identifying and responding to market-wide and systemic risks and that we do our best to promote well-functioning financial markets. Our success or otherwise in having an impact to improve the functioning of capital markets is ultimately driven by the willingness of legislators and regulators to accept and act upon the advice that we offer. We have had some success in the past and it is possible that with the return of some legislative and regulatory responsibilities from the EU to the UK, that this may improve in future. In 2022, we contributed a significant number of suggestions to the UK Secondary Capital Raising Review (partially based on our experience of the functioning of the Australian equity market), we can see that many of these were included in the final review and are currently being implemented. Other activities to improve the functioning of UK smaller companies' equity markets are listed above, although we are confident that we lobbied effectively it is not always clear to what extent our suggestions are understood, whether they will be acted on and in what time frame.

Market-wide risks are those that lead to financial loss or affect overall performance of the entire market and include but are not limited to:

Changes in interest rates.

Minimal or no leverage is currently used within the funds managed. Portfolios are invested almost entirely in equities; fixed interest investments for liquidity management are only made in short-term Government securities. Lending is minimal, invariably to portfolio companies at fixed rates. Changes in borrowing rates have little effect on the portfolio. However, unexpected changes in interest rates may impact equity market valuations.

Some companies in the underlying portfolio have borrowings; in aggregate debt levels are lower than many other sectors. Banks do not lend readily to companies against intellectual property, which is dominant in the portfolios. Increasingly the cost of technology for an enterprise is incurred as a recurring operating cost. For example, capacity is rented in a datacentre rather than a lumpy capital investment. Other sectors such as property and automotive are more exposed to interest rates because higher interest rates reduce demand.

Geopolitical issues.

The manufacturing supply chain is generally in Asia. Growing tensions between the United States and other Western economies and China pose a risk to this. Perhaps the greatest risk arises from increased sabre rattling between China and Western backed Taiwan leading to a Chinese invasion. It is increasingly evident that separate East and West focused supply chains are slowly developing to reduce this risk.

Brexit is not considered a material risk. Although a significant element of the portfolios are in UK listed companies, much of the technology sector, such as computers and computer services, is zero-rated under WTO rules. A large part of the hardware supply chain sits in Asia, outside of the European Union.

The growth in social media is a concern because it gives powerful communication tools to disruptive minorities, who are undermining traditional lines of authority. It is difficult to determine how this will unfold, but the trends seem to be anti-wealth creation. Corporation and National Insurance tax rises have already been announced in the UK and tax rises may well follow elsewhere affecting corporates and investors alike. We believe that for the small quoted companies in the UK, the rise in costs associated with regulatory changes, in the broadest sense, will have a greater short-term adverse impact on profits than corporation tax.

The coronavirus epidemic's economic damage is further increasing the probability of adverse tax changes, but at least all economies are similarly affected.

Cyber terrorism and warfare are a growing risk, but for the TMT remit provide opportunities as well as challenges.

UK strikes, such as railwaymen, are unhelpful. At least many people can work from home but for those that struggle without trains, both within Herald Investment Management and in investee companies, it is frustrating when we were trying to resume normality post covid.

Currency rates.

The funds are denominated in sterling, but the US dollar is the dominant currency for many portfolio companies. We do not hedge currencies because the portfolios are diverse; furthermore many investee companies have either natural hedges due to the nature of their business models or appropriate hedging strategies.

Other market risks.

Systemic risks are those that may lead to the collapse of an industry, financial market or economy and include but are not limited to:

Climate change.

The financial risks from climate change are typically classified as physical or transition risks. Physical risks from climate change arise from a number of factors and relate to specific weather events (such as heatwaves, floods, wildfires and storms) and longer-term shifts in the climate (such as changes in precipitation, extreme weather variability, sea level rise, and rising mean temperatures). Transition risks may arise from the process of adjustment towards a net-zero carbon economy.

Herald monitors significant climate related events and takes appropriate action when deemed necessary. The clients' portfolios are well diversified to mitigate against such events.

The boards of the client funds also monitor new events and changes in climate and consider the likely impact on the portfolios, typically discussing these with Herald, the investment manager and updating their risk management documents as appropriate.

Numerous investee companies assist in improving the world environmentally and Herald have invested client assets in many companies that produce products where a key focus has been to reduce power consumption or to generate or store energy in a more environmentally friendly manner. The largest component of the portfolio is software, which provides efficiencies for enterprises, governments and consumers. Technology also provides energy efficient communications, entertainment and more; and we firmly believe that capitalism and technological innovation combined are the central requirements to address the environmental challenges we face. The majority of investments in the technology and media sectors have a low carbon footprint and the carbon emissions of the portfolios are estimated to be a fraction of those relative to the major indices in the UK and US. Furthermore, much of the world's most advanced technology and intellectual property tends to reside in the wealthiest and most advanced economies, which themselves have strict environmental standards. On occasion the assets of some companies within the portfolio have been damaged or threatened due to climate, for example, because of flooding in Thailand or wildfires in Australia or California. The diversified nature of the portfolio and the disaster recovery plans of investee companies have meant that such individual disasters have historically had a modest overall impact on the assets of the company at the portfolio level. There will clearly be climate transition risks for many companies in the wider economy and the investment manager has highlighted the increasing challenge of complying with environmental regulation and reporting requirements. Some companies within the portfolio are likely to see their revenues grow as they produce products that facilitate a reduction in CO^2 emissions and mitigate the damage caused by climate change. Valuation and price risks may be created by government intervention with regards to climate change legislation. For example, climate change legislation is rapidly driving new investment into the relatively small parts of the economy focused on sustainability products; this influx of capital is in some areas driving up the prices of some "sustainable" investments which may in time lead to a reduction in the returns available to future investors in such technologies.

In the previous year's Stewardship Report we highlighted that the most evident current challenge economically was the spike in the cost of gas and electricity now that coal generating capacity has almost been phased out in the UK, and much reduced elsewhere, and renewable energy is intermittent. We also discussed our concern that in the UK the focus has been on carbon emissions more than on security of supply, and gas storage capacity has shrunk while the dependence on gas for the time being has grown. At the same time investment in natural gas extraction has slowed globally in reaction to Covid and the trend towards renewables. We also highlighted how China, Japan and others have been increasing demand for natural gas, and how much of the world's reserves are in Russia. The UK had already seen huge price inflation and price spikes bankrupting numerous UK energy companies. Russia's subsequent invasion of Ukraine and proxy war between the West and Russia during the remainder of 2022, massively exacerbated these energy price shocks, led to soaring inflation and interest rates, ballooning Government budget deficits and may lead to recession in many countries in coming months. Transitioning to a carbon free economy will be expensive and painful. Even with a small percentage of European energy consumption (<5% perhaps) reliant on wind power, the impact of periods where the wind does not blow can be disruptive. Herald has approximately calculated the proportion of UK energy coming from nuclear power and renewable energy such as wind. We believe it is approximately 12%, with renewables alone (mainly wind) accounting for just 8%. So, if the UK was reliant on wind alone, we would need approximately 15x the capacity installed to date. The impact of no wind days in winter would be particularly severe. Clearly nuclear power, solar and enormous energy storage capacity will be required – probably through the use of hydrogen or batteries. The economic impact from replacing gas heating will be particularly challenging with the price per KWh of electricity being much higher than that of gas.

Few of Herald's investments have high energy requirements, the biggest being datacentre costs. Fortunately, the hyperscale datacentres are leading the charge to renewable sources of supply.

Although not directly climate change related, perhaps the greatest perceived risk to the global economy and to Herald's technology focused portfolios would be a natural disaster or earthquake in Taiwan, or a political event such as war with China (China invading Taiwan), which would disrupt the all-important semiconductor supply chain. The Chinese, US, European and Japanese Governments are committed to 100's of billions of semiconductor capex subsidies to mitigate these risks to their domestic economies. However, the lead time to build new semiconductor fabrication plants is long and the skillset not immediately portable across borders.

The need to reduce carbon emissions is a driver to growth for parts of the sector in which we invest. The TMT sector is naturally lower carbon and below the market average for carbon emissions. We have directly invested primary capital in the renewable supply chain, power-efficient semiconductors etc.

We are evangelists, believing that capitalism will continue to allocate capital and labour to effectively alleviate the production of carbon emissions by using technical innovation to produce clean energy and reduce consumption.

In last year's stewardship report, we commented that Herald participated for the eighth time in 11 years in a fund raising for ITM Power – a UK PEM hydrogen electrolyser company. The funds raised will be used to significantly expand electrolyser manufacturing capacity in the UK. We also commented that following the UK government green commitments that the stock market had woken up to the investment opportunity this presents, we also highlighted the signs of a "green bubble" which poses a risk to investors. With this context it is interesting that the placing price for the ITM fund raising mentioned above was 400p which contrasts with a market price of less than a 100p now – a 75% loss for investors who only participated in that "expensive round". Herald's average in price is much lower. There are risks from climate change but also from crowding too much investment, too quickly into green investments. Herald has raised concerns about crowding too much investment into green investments with regulators, as it poses risks to investors capital. Investor returns and a company's cost of capital are two sides of the same coin – in many cases it will not be possible to reduce the cost of capital for green investment without reducing an investor's returns. We are apprehensive of regulators that are guardians of investor protection steering capital to topical/favoured areas. We are aware that very high proportion of new fund flows across Europe have flowed into "sustainable" investment funds. Picking sustainability winners can also be a challenge as in many cases the companies are developing green products that may not be commercially viable without government support and intervention for many years. Government energy policy has been poorly thought through for decades, it is highly unstable and energy ministers change often. There are significant risks on committing investment based on government pronouncements. There are also risks arising from competitive government subsidies, that seek to support domestic producers at the expense of foreign suppliers. Recently in December 2022 European MEPs have been debating how the EU will handle the massive tax breaks to companies producing sustainability products in the US, a scheme that potentially puts European companies at a disadvantage. Within the US Inflation Reduction Act $370 billion of spend aims to build a new green economy, by giving subsidies and tax credits to companies which manufacture with local parts or produce in the US. This is to the detriment of UK and European manufacturers and in potential breach of World Trade Organisation (WTO) rules.

Other systemic risks.

Evidently the global pandemic that caused economies to become locked down was a risk to markets and corporate profitability. However, the technology sector was to some extent a beneficiary, due to the opportunities arising from the resulting increased use of technology. In 2022, the supply of some such technology caught up with pent-up demand, which aligned with some softening of consumer end demand and there have since been some inventory corrections, causing revenue and profits of some technology companies to weaken.

Principle 5

Signatories review their policies, assure their processes and assess the effectiveness of their activities.

REPORTING EXPECTATIONS

Activity

Signatories should explain

How they have reviewed their policies to ensure they enable effective stewardship;

The fund managers and compliance team have collaborated in reviewing and revising the firm's stewardship approach and policy with an additional contribution from Herald's board.

Furthermore, the independent boards of Herald's clients have actively engaged in the review of stewardship policies and practices. In the case of the investment trust investing in smaller companies a Director reviews in detail all voting activity – in particular proxy voting activity that differs from management recommendation (typically <5%) and ISS recommendation (approximately 25%).

Herald's stewardship approach and policy has been updated to reflect the FRC's revised 2020 Stewardship Code and will be periodically reviewed and amended as and when appropriate. Stewardship, compliance and governance policies are typically amended, for example: when legislation or corporate governance rules change; at the request of a client fund or underlying investor; when the values of society in general alter; if perceptions of investment risk faced by investors change, or when an internal review identifies areas for improvement in existing policies. Most policies are reviewed on an annual basis. Within the last year Herald significantly updated its Conflicts of Interests Policy Disclosure. Following significant revisions to stewardship and ESG integration policies in recent years, substantive changes were not made in 2022. The boards of the client funds have the opportunity to suggest amendments to these policies at any time. Herald has been investing on behalf of each of its two principal client funds for over twenty-five years, both of which have a deep and thorough understanding of the investment and stewardship activities Herald undertakes on their behalf.

The largest client of Herald Investment Management Limited, namely Herald Investment Trust plc (HIT) has been listed on the London Stock Exchange since 1994. HIT has an independent board and has published fully audited annual accounts every year since. The accounts include appropriate corporate governance disclosures encompassing stewardship. This approach ensures that Herald's investors and shareholders are also well aware of Herald's policies.

What internal or external assurance they have received in relation to stewardship (undertaken directly or on their behalf) and the rationale for their chosen approach; and

The independent boards of Herald's clients receive reports and presentations on Herald's governance and stewardship activities at board meetings. Herald is a signatory to the UN PRI. We believe that the technology sector possesses many positive long term environmental, social and governance (ESG) drivers. Herald's first PRI Report was submitted for approval in February 2021. Due to fundamental issues with the PRI reporting framework, impacting all PRI investment managers, Herald's PRI 2021 Report evaluation / scorecard was not received back until August 2022. In the relevant modules Herald scored above median with either a 4 or 5 star rating. These modules were: Investment and Stewardship Policy, Direct Listed Equity – Active Fundamental – Incorporation and Direct Listed Equity – Active Fundamental – Voting. The detailed PRI scoring feedback was shared with the Board of Herald's largest client and a gap analysis was performed to identify areas in which Herald could have scored even more highly.

Herald's UK Stewardship Code Report for 2021 was submitted in Spring 2022 and Herald was accepted as a signatory in Autumn 2022. In the feedback received, there were a number of areas highlighted where improvements could be made, and Herald has sought to address these issues and to make continuous progress.

How they have ensured their stewardship reporting is fair, balanced and understandable.

Herald's stewardship reporting is produced by the investment management team, reviewed by management, compliance and the board of Herald Investment Management Limited prior to being shared with the independent boards of Herald's two main clients. For example, the boards have been provided with written explanations as to why we have voted against management, and why we have voted against external recommendations. In addition to the regular stewardship reporting, on request the clients can have access to further stewardship and engagement information. The stewardship and PRI reports are both submitted for external review after which they are publicly available. The management of Herald record and review regularly voting and management engagement activities.

Outcome

Signatories should explain how their review and assurance has led to the continuous improvement of stewardship policies and processes.

Candidly the considerable effort thus far has been articulating the practices we have always undertaken and improving record keeping. Albeit we have consistently voted and maintained records of so doing. Further effort has been made on assessing the use of third-party data.

We decided to subscribe to ISS for 3rd party research on governance issues in 2020. We found it to be of some use on proxy voting issues and it is helpful in generating reports for clients, which include a summary of why we have voted against management or ISS recommendations. We have investigated their ESG Norms and controversial weapons research but have found little added value for us because they do not cover many of the small companies in which Herald's funds invest.

We have also analysed the ESG data reported through Bloomberg and Refinitiv Eikon. There are varying degrees of data on c75% of the holdings in HWTF but only c25% of the holdings in HIT, so in aggregate a third of the investments held. Within 2022 we performed additional analysis on the availability of ESG data sets and metrics for small companies, from different suppliers. In all cases only a minority of the portfolio had good ESG data coverage and in many cases the data itself was unreliable. Herald worked directly with Bloomberg's machine learning model developers to try to improve the accuracy of the greenhouse gas data in their emissions estimates. Although, some improvements in accuracy were achieved, for the small companies' portfolio in aggregate the estimates are so inaccurate as to make them unusable at present. We are also unsure about the extent we should push smaller companies to publish more information, and in what form. It is clearly inefficient for numerous investors to ask the same questions, and we do not want to squeeze out commercially important issues for box ticking in the short timeframe we have to engage with investee companies' management. In 2022 we attended a presentation from the Taiwan Stock Exchange covering Governance and ESG reporting – they have clearly made efforts to assist small companies with ESG reporting. We have suggested to the LSE and QCA that the UK should learn from and potentially replicate such activity. We hope that there will be some identifiable standards that emerge, and for the time being will concentrate our efforts on companies where our influence is greatest i.e. where our stake exceeds c4% of outstanding capital.

Within the year and as a test to fully evaluate the availability of ESG metrics for small companies, a detailed ESG analysis was carried out on two of the most significant holdings within the smaller companies' portfolio. We chose two manufacturing businesses, listed in jurisdictions with above average reporting (UK and Taiwan), that were relatively energy and chemical use intensive, with staff located in less developed areas (China and Sri Lanka). In both cases we were pleased with the rigour and quality of ESG reporting and the continuous improvement in a range of ESG metrics - in particular energy and water use. This is reflective of a trend we have identified, which is that the most energy intensive manufacturing companies carry out detailed environmental reporting, whereas very small companies, with less of an environmental impact, invest fewer resources on such reporting. The governance and management of both companies, both of which Herald has invested in for over a decade, has always been good – well run companies typically have good ESG policies. The Herald bias towards quality and the nature of the remit naturally avoids the worst ESG offenders.

We are aware for example that the big technology companies, who are at the vanguard of reducing carbon emissions, often seek suppliers to have a B Corp certification, while more companies are clearly going to address the requirements of the Task Force on Climate-related Financial Disclosures standard (TCFD). The climate change data is clearly evolving, and we shall adapt as the availability of data emerges and climate change reporting requirements evolve.

It is conspicuous that almost all companies now include an ESG slide, and we are concerned about how much time, effort and money is being spent. For small companies £0.5m to £1.0m in extra costs is not unusual, which is a material headwind to profits and/or investment in the future of the business. It appears that there will be manifest improvements for the wider economy in terms of lower emissions albeit at a material economic cost to shareholders.

Internal assurance may be given by senior staff, a designated body, board, committee, or internal audit and external assurance by an independent third party.

The non-executive directors on Herald's board, and the independent boards of the funds managed review our stewardship processes and policies.

Principle 6

Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

Context

Signatories should disclose:

Their client base, for example, institutional versus retail, and geographic distribution.

Clients

Our direct clients are investment funds and have an underlying investor base of retail and professional clients. Each investment fund has a public and clearly defined investment objective, investment strategy and stewardship approach with good governance assured by an independent board of directors, an auditor and a custodian / depositary. The vast majority of client assets managed are for Herald Investment Trust plc which has all the positive governance elements expected from a fully listed UK investment company. The primary responsibility of the independent boards of the client funds is to ensure that the assets are securely held and managed in accordance with the funds' investment mandates and stewardship policies. Herald provides regular, quarterly reporting to these boards to provide them with the assurance that they require.

Underlying investors

At 31 Dec 2022 investors in HIT, which accounts for over 95% of our assets under management, were estimated to be 75% regulated professional investors, and approximately 19% on retail platforms and 6% in ETFs and index trackers. These underlying investors are predominantly UK residents. The minority of overseas investors are principally professional investors from the United States investing in HIT (circa 17%).

Most assets invested in our funds are under discretionary management by wealth managers, followed by institutional investors; the proportion held by retail investors may increase as the platforms gain clients. HWTF has recently been listed on several retail platforms, which now account for c10% of the share register, and we are actively marketing it to wealth managers and a number of retail brokers.

Geographies

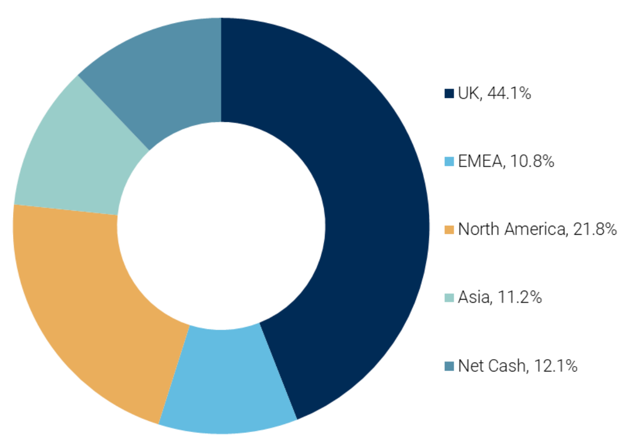
HWTF is domiciled in Ireland and HIT in the UK.

Assets under management across asset classes and geographies.

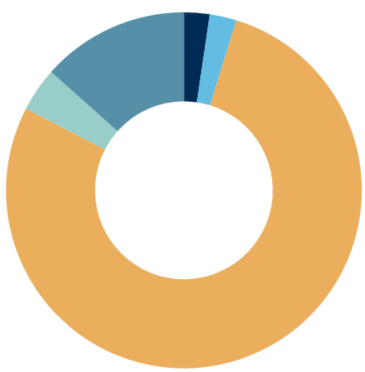
Portfolio investments are mainly held in quoted equities, which comprise approximately 90% of assets under management. Other investments include some unquoted equities and some 'simple' equity derivatives, such as warrants, convertibles and rights. Herald had £1.4bn under management at 31 Dec 2022 comprising a UK listed investment trust (£1.31bn) and a Irish based UCITS (£61m). The investment remit for these funds is the technology, media and telecommunications (TMT) sector globally.

The geographic breakdown of investments is as follows:

Herald Investment Trust (Assets: £1,305m)



Herald Worldwide Technology Fund (Assets: £61m)



The length of the investment time horizon they have considered appropriate to deliver to the needs of clients and/or beneficiaries and why.

Long-term investment horizon

All Herald investment portfolios are managed with a long-term time horizon, by this we mean at least 5 years. The investment team typically consider periods longer than this timescale. Within the portfolios, individual investments are often made where we expect the greatest returns to be generated well beyond 5 years. The size and timescale of potential returns is particularly uncertain when providing primary capital to a small, nascent company developing a new technology or product. In such a case, the initial investment is made in the knowledge that it may be likely that multiple funding rounds will be required over many years before a company achieves profitability. This long-term approach is reflected by the holding period of the largest holdings within the investment trust portfolio, on average the largest 10 holdings have been held for 12 years. The long-term nature of our investment strategies reflects the long-term investment horizon of our clients, many of whom are investing their assets to meet multi-year investment objectives - for example to fund retirement. The closed end nature of the investment trust enables individual investors to access their capital by selling to other investors – whilst the capital can remain invested in a company. The investment trust itself has three year continuation votes, which have historically been comfortable supported.

The long investment time investment time horizon also reflects Herald's belief that to generate sustainable investment returns from equity an investor should invest for a reasonably long period of time.

We offer clients specialist management and expertise in the TMT sectors. Companies in these sectors operate in rapidly changing industries and Herald offers the opportunity, using a portfolio approach, to diversify some of the risks of holding individual technology companies. Given the manager's sector focus, a degree of volatility in the portfolios is to be expected, and we would expect our clients and their investors to have a long-term investment horizon.

Recommended holding period

For Herald Investment Trust, with its additional smaller company focus and desire to invest in and grow small businesses over many years, investors must appreciate the long-term timescale commensurate with the investment strategy and the more limited liquidity available in the underlying portfolio. In times of market stress, the share price can trade at a wider discount to net assets/share exaggerating a market decline, so investors should endeavour to avoid having to sell at such times. In context no new capital has been raised since 1996. The fund has grown through investment returns to c£1.31bn having raised outside capital of £65m in 1994 and £30m in 1996, and having returned c£236m to shareholders through buy-backs. Shares are traded on the London Stock Exchange and beneficial owners trade shares through regulated channels independent of the manager and the trust. Marketing consists mainly of investor relations to update investors.

The Irish UCITS fund has core long-term investors, but the majority of trades are through the retail trading platforms. The communication is through the website. The focus is to invest in larger capitalisation companies where liquidity is good.

Activity

Signatories should explain:

How they have sought and received clients' views and the reason for their chosen approach.

Clear mandates, and independent client boards
The investment trust and UCITS fund that Herald delivers investment management services to have clear public objectives and investment mandates and are governed by independent boards. Our equity funds regularly report to their investors on Herald's success in implementing the investment strategy and stewardship approach. The manager is available for regular meetings with investors or their representatives.

The manager is available to meet the institutional investors and does so on a regular basis. Peel Hunt and N1Singer are joint brokers to the investment trust and they periodically organise roadshows to update investors and provide feedback to the independent board.

How assets have been managed in alignment with clients' stewardship and investment policies.

This is clearly stated in the Annual Financial Reports which are publicly available and explained to HIT Shareholders at the AGM. The manager reports quarterly to the independent boards of the client funds on how the assets have been managed in accordance with the funds' investment objectives and stewardship policies.

Similarly, for the UCITS fund accounts are published on the website biannually, and factsheets monthly.

What they have communicated to clients about their stewardship and investment activities and outcomes to meet their needs, including the type of information provided, methods and frequency of communication to enable them to fulfil their stewardship reporting requirements.

The boards of the client funds have primary oversight and reporting on stewardship and investment management activities is on the agenda for the funds' board meetings. The funds themselves have independent auditors and independent custodians of the funds' assets. On a six-monthly basis the funds publicly report to their investors on the fund's results and the degree to which the investment manager has successfully met the funds' investment objectives. In addition, monthly fact sheets and daily net assets/share are published. For the quoted funds, the investment manager also meets with underlying investors in the client funds regularly and will be aware of any issues.

Further ESG and stewardship information, including the manager's annual voting record is available on our website.

Outcome

Signatories should explain:

How they have evaluated the effectiveness of their chosen methods to understand the needs of clients and/or beneficiaries.

As stated under Principle 1 above Herald's governance and stewardship structure has been in place for 25 years and has delivered over a long-time frame. The investor base is very stable, with the turnover of shares in the client funds very low. The objectives of the funds, investment and broad stewardship approach have been stable over many years and are clearly and publicly communicated. There are quarterly board meetings of Herald's investment management funds, at which the manager presents on how the funds have been managed in accordance with the funds' stewardship and investment policies. The funds' board of directors give direct feedback at these meetings on the extent to which Herald is managing assets in alignment with these policies.

How they have taken account of the views of clients and what actions they have taken as a result.

Shareholders in HIT and investors in HWTF have the opportunity to raise issues publicly, but to date, no remedial action has been required. The mandates of the funds are clear and we believe that investors are well aware of the features of the funds they are invested in. A shareholder in the trust suggested dividends could be paid out of capital, if the Articles of Association were appropriately changed. Consultation with other shareholders accounting for a much greater proportion of the register clearly rejected this proposition.

Throughout the year, Herald Investment Management met with many of the largest underlying investors in the client funds and sought their views on its success in managing client funds in accordance with the funds stewardship and investment policies. Investor views were also sought and discussed on Herald's Stewardship and ESG policies and whether investors believed that any change was required. No material changes have been requested by investors in such policies.

Our perception is that the professional investors including wealth managers are motivated to adhere to stewardship guidelines as we are, but that there is little desire or motivation from underlying private investors to accelerate the drive to net zero at the expense of investment returns. Anyway, the big drivers are outside the control of most investee companies i.e. increasing the national capacity for clean energy.

Where they have not managed assets in alignment with their clients' stewardship and investment policies, and the reason for this.

Nothing to report
Herald has not had any such failures to follow client stewardship or investment policies to report.

Principle 7

Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities.

REPORTING EXPECTATIONS

Context

Signatories should disclose the issues they have prioritised for assessing investments, prior to holding, monitoring through holding and exiting. This should include the ESG issues of importance to them.

Assessing: focus on the calibre of senior management

We rarely invest in companies without meeting management. The highest priority is to invest in competent management. Competent management will have competent ESG policies.

As the only investments we make are in the TMT sectors, and we focus on companies with intellectual property and pricing power, environmental issues are rarely severe.

A significant proportion of time is spent with companies which are seeking to raise primary capital. In 2022 Herald participated in 33 fund raisings contributing £21m of equity capital. Since 1994, over the life of Herald Investment Trust, we have provided £645m of growth capital, of which £516m has been in the UK, this is material in relation to the £95m of outside equity capital raised within Herald Investment Trust itself. Further analysis shows that in 2022 we participated in 1 IPO and 32 follow on funding rounds where we are typically continuing to support existing investment holdings. These numbers are significantly lower than 2021, given the deteriorating economic and market environment, and a belief that valuations would be lower as interest rates normalise. We are pleased to have delivered satisfactory returns for our investors whilst enabling the creation of added value jobs and wealth for entrepreneurs. Invariably, we would have meetings with the management to understand their use for the capital and assess whether their ideas have merit. This is at the heart of what Herald does, acting as a provider of growth equity capital to technology and communications companies, assisting them to evolve from a small business to a larger one and on occasion to survive.

We pay particular attention to the balance sheet and associated filings to assess the quality of revenues, and to share-based compensation to ensure the company is being run with appropriate management costs. It can be important in a technology company to see that sufficient resources are being deployed on research and development to sustain and grow its market position. We tend to dislike excessive sales and marketing costs which can flatter growth but destroy profitability. There are regional differences here. For example, UK companies often spend too little on sales and marketing to flatter profits and cash flow, while US companies spend too much to flatter growth rates. We observe that there are now material staff lay-offs in US technology companies in recent months, and hope that this reflects a better balance between revenue growth and profitability, which should deliver lower sales growth, but better profitability, which is more sustainable. These are important flags for sustainability, sound business practice and governance.

Some of our investments have been at the vanguard in terms of energy efficiency and renewable energy. These companies operate in the field of hydrogen, fuel cells and solid-state batteries. Other investments supply components to wind turbines, energy-efficient power supplies and so on.

In HWTF Apple, Alphabet and Microsoft have all been purposeful in using renewable energy in datacentres and reducing power consumption in products.

Monitoring through holding and exit

If we subsequently find our confidence is misplaced our first reaction is to sell the shares but this cannot always be achieved in illiquid smaller companies. In such rare instances we encourage management change.

The focus of our investment is in developed markets which have high social standards. In the technology sector in particular, few women have board positions, so there is an acute shortage of suitably qualified women to undertake non-executive roles. In smaller companies we think it inappropriate to vote against boards without diversity as long as we are confident that there is appropriate commercial and governance expertise among the independent non-executive directors.

The composition of boards by gender within the Herald Investment Trust portfolio is as follows:

	Average percentage of male directors on the board	Number of companies with no women on the board
Australia	78%	5
China	100%	1
Europe	76%	10
Hong Kong	73%	0
Israel	79%	0
Japan	89%	13
Korea	98%	9
North America	74%	2
Singapore	100%	1
Taiwan	85%	2
UK & Ireland	80%	33
Average % or total	80%	76

Source: ISS/ company reports. Based on 342 quoted portfolio holdings.

In reviewing past poor investment decisions, we observe that the poor commercial judgment of certain non-executive directors has damaged businesses in which we invest.

Monitoring share-based compensation

The most important area where we exercise influence is in approving share-based compensation schemes. This is focused on UK smaller companies where the % of outstanding capital owned is sufficient for us to have influence. We particularly dislike the trend towards nil-cost options, with varying performance targets, where it becomes hard to quantify the cost to shareholders of running the company. We appreciate it is in shareholders' interests, and the interests of the investee company, to have properly rewarded and motivated management to retain an appropriate skillset. Still, dilution is a heavy cost to pay for this.

Dilution of 10% over 10 years is acceptable, but there are occasions in small cash-constrained businesses when a higher level of dilution has to be accepted. This requires investment management judgment. We are inclined to sell shares or vote against boards who are issuing egregious packages, and not considering shareholder views.

Activity

Signatories should explain:

How integration of stewardship and investment has differed for funds, asset classes and geographies.

Exercising stewardship globally

Following the closing of our venture partnerships which invested in unquoted companies, the remaining two Herald client funds focus on investment on global equities within the technology sector. More than 90% of client assets are in the investment trust which focuses on investing in technology companies with market caps of less than $3bn – with a typical market cap of $200m. Percentage ownership here is often between 0.5% and 10%, typically being a few percent. The remaining client assets are held within the Herald Worldwide Technology Fund which primarily invests in mid and large cap companies. In this case a typical ownership percentage in an underlying is often much less than 1%. Although similar ESG risk factors are considered for both funds, there are differences, in particular smaller companies are more illiquid, require more funding and have less sophisticated ESG reporting. Engagement also varies, we have a much more powerful voice as a key shareholder and continuing provider of capital to a UK small company than we do as a 0.0003% shareholder in Microsoft. We also feel a greater responsibility to act proactively when we are one of the investee company's larger shareholders.

For small quoted companies we are on occasion asked to suggest or provide references for potential candidates for executive or non-executive roles. We are especially proactive in engaging with smaller companies held in the investment trust because we have a more significant proportion of the outstanding capital so our influence can be material. Furthermore, our voice carries more weight in the UK market, where our reputation with other investors is more widely known, than in overseas markets. In contrast in the large companies held in the UCITS fund our votes and influence are not as great.

Whilst appreciating that there are significant differences in approach to reporting and corporate governance by different regulators and jurisdictions Herald's stewardship approach is broadly similar globally. The greater difference is driven by the investee companies' size and maturity and the scale of Herald's shareholding.

There are regional variations. Share based compensation is highest in North America, and we cannot buck the market by voting against management with share-based payment we would find unacceptable in other regions. However, it has led to a smaller allocation to these companies.

The processes they have used to:

a) integrate stewardship and investment, including material ESG issues, to align with the investment time horizons of clients and/or beneficiaries; and

Herald's approach to responsible investing and ESG

We believe that good ESG practices are consistent with delivering better financial performance, albeit in the short term the increased reporting requirements is increasing costs so visibly a headwind to profits growth. It is hoped that as things settle down there will not be such a large diversion of top management time.

One CEO of an investee company was angry to have spent £1m on its initial ESG assessment and concerned that the UK standards give an uncompetitive cost base particularly in relation to employees in emerging markets. He has since acknowledged that important customers like Amazon and Tesla require the same standards, so the playing field is level versus their competition.

The UK Stewardship Code and the UN-supported Principles for Responsible Investment (PRI) recognise that institutional investors have a duty to act in the best long-term interests of their beneficiaries. Herald shares the belief underlying the PRI, namely that ESG issues affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). At Herald, we believe that successful investing is about identifying and owning for the long-term, companies that can sustainably generate excess returns on capital for years to come. Our objectives are to achieve attractive returns over the medium-to-long term whilst minimising the risk of permanent capital loss for our clients. To achieve this, we seek to identify and invest in high quality companies that are trading below our assessment of their value. It is within our assessment of a company's quality that ESG factors play an important role. As long-term investors, an assessment of ESG risks and opportunities is an inherent part of our investment process, as gaining a robust understanding of these issues is a key part of assessing the outlook for future cash flow generation and risks of an investment. As long-term owners, we aim to act as responsible stewards of our clients' investment by exercising our proxy voting rights and having open dialogue with portfolio companies on a broad range of issues, including ESG-related issues. Over the years, we have taken steps that highlight our commitment to responsible investing and we will continue to review and evolve our approach. We have been abiding by the UK Stewardship Code since 2010 and in January 2020, we became signatories of the United Nations-sponsored Principles of Responsible Investment (PRI), the globally recognised accord for responsible investment. Herald's PRI 2021 Report evaluation / scorecard received back from the PRI in August 2022. In the relevant modules Herald scored above median with either a 4 or 5 star rating. In autumn 2022, the FRC confirmed that Herald again met the expected standard of reporting as a signatory to the UK Stewardship Code. Herald was provided with constructive feedback by the FRC which we have endeavoured to address.

Objectives

Herald's ongoing responsible investment objectives are:

• To assess material ESG risks as part of the investment process; and

• To act as responsible owners by engaging with portfolio companies where a material ESG issue exists and exercising our proxy voting rights where appropriate.

Integration of ESG into the investment process

For Herald's actively managed portfolios and investments, Herald's investment team undertakes in-depth company research, seeking to identify sustainable competitive advantages that enable businesses to generate excess returns on capital and predictable cash flow. As bottom-up fundamental investors, we consider ESG risk alongside other risks faced by companies we own and investigate. ESG risk analysis is integrated in our investment process and is not a separate function. We are active investors who interact closely with the management of the companies in which we invest as well as their suppliers and customers where possible. We recognise that ESG considerations, such as a company's board structure, environmental practices, or labour policies, can affect a company's valuation and financial performance. Therefore, our investment team incorporate ESG issues into their research and decision-making process. Investment research includes an assessment of a company's inherent quality based on the following quality criteria:

• Economic Moat – Assessment of the sustainability of a company's competitive advantage(s)

• Agency Risk – Assessment of the extent to which management will act in the best interest of shareholders

• Business Risk – Assessment of the predictability and reliability of future cash flows and earnings

• Re-Investment Potential – Assessment of a company's ability to reinvest profits back into its business at high incremental rates of return.

Analysis of ESG factors forms part of the suite of issues that affect the Agency and Business Risk of companies. Gaining a robust understanding of these issues is a key element in the assessment of the outlook for, and risks to, the sustainability of future cash flow generation. Importantly, Herald is focused on materiality. Herald's investment team will determine which ESG risks are material for each company.

Communication, consulting and debate on stewardship, both policy and application to individual companies occurs daily. With the exception of one investment team member based in New York all of the remaining members work in an open plan office in London. Information flows freely and consultation amongst team members is informal and frequent. Herald has deliberately avoided the rigid and formulaic structures adopted by other organisations and prefers a more entrepreneurial and flexible structure – this often replicates the approach of the dynamic small technology companies in which Herald often invests. Herald is a focused TMT (Technology, Media and Telecommunications) investor and has one of the largest dedicated technology investment teams in Europe. Investment team members typically have a geographic and global technology sub-sector focus – technology is a global industry and collectively we try to know more and have a greater understanding of listed technology companies large and small than other investors. Sharing of knowledge and cross pollination of ideas is vital.

Assessing a company's corporate governance practices is, and has always been, an important aspect of Herald's investment process. We recognise that there is no one single indicator with global application that identifies when companies are failing to adopt best corporate governance practices, and that different markets may adopt different practices and structures of corporate governance. Therefore, our approach to corporate governance may change according to a company's local laws, regulations, and established guidelines. Specifically, as it relates to environmental issues, we recognise the growing importance that these factors play in our global economy. While the importance of these factors will differ by company, sector, or region, as our investments are focused in the technology, media, and telecommunications sectors, these companies tend to be enablers of environmental efficiency rather than contributors to environmental risks. Although no industrial sectors are currently explicitly excluded from the remit, the nature of the Technology, Media and Telecommunications (TMT) sectors that Herald focuses on, implicitly limits investment in a number of the most environmentally damaging sectors, such as coal mining or generating energy by burning fossil fuels. The fund's focus on TMT sectors inherently limits exposure to some key environmental risks.

Proxy Voting

Herald considers that proxy voting rights are an important power, which if exercised diligently can enhance client returns and should be managed with the same care as any other asset managed on behalf of its clients.

Herald will assess shareholder proposals on a case-by-case basis and consider whether the shareholder proposal will enhance the certainty of long-term cash flow generation that we expect from the company.

Engagement

As a long-term investor, Herald is committed to engaging with all portfolio companies on a broad range of issues. Matters of strategy, capital structure, performance and risk, etc are the responsibility of the fund manager and investment team and are the subject of regular engagement. Herald focuses its engagement on material issues, particularly those which could affect future cash flows. We are also focused on safeguarding against short-term actions, by either companies or their shareholders, which may not be in the best interests of our clients. The level of engagement on ESG issues is also considered in the context of the relative size of Herald's shareholding. Engagement in relation to ESG issues can take a number of forms and does not necessarily involve Herald seeking to effect change. For example, many companies conduct annual shareholder outreach programs as a forum to discuss general corporate governance, sustainability, executive compensation, any changes or initiatives a company has made throughout the year; these provide the opportunity for a company to solicit shareholder feedback and discuss views provided by other shareholders. Herald may also seek engagement to achieve a better understanding of the management of material ESG issues or to seek clarity in relation to a specific proxy proposal. In many cases, engagement is a result of proxy voting. For example, depending on the materiality of the issue and the size of Herald's holding, where Herald has determined to vote against management's recommendation, Herald may engage with a company outlining its rationale for the vote and providing advice on what the company should do to remedy the issue. When seeking change, Herald will typically begin engagement with company management, or through investor relations. Herald may seek to escalate engagement from management to committee Chairs, Senior Independent Directors and/or Chair of the board. Herald is cautious of collaborating with other shareholders due to concerns about breaking concert party rules or insider trading regulations but on occasion may do so when it is believed to be in the clients' interests. Herald also recognises the limitations of our influence as a minority shareholder and in cases of strong disagreement our ultimate action may well be to sell the investments.

Fund managers actively engage with management to foster or improve companies' behaviours and governance and monitor the sustainability of the business model. In particular, we always encourage management to worry about optimising the share price in 5-10 years, and not a shorter-term horizon. Equally, we regularly make investments in the knowledge that a short-term return is unlikely but where we believe there is long-term potential.

b) ensure service providers have received clear and actionable criteria to support integration of stewardship and investment, including material ESG issues.

Not applicable.

There are no intermediate service providers between Herald and the companies over which it exercises stewardship

Outcome

Signatories should explain how information gathered through stewardship has informed acquisition, monitoring and exit decisions, either directly or on their behalf, and with reference to how they have best served clients and/or beneficiaries.

We have regularly avoided investment in companies where we have seen management operate inappropriately in previous roles, which is an advantage of having a narrow sector focus, and an experienced team.

There were over 200 sell transactions in 2022 in the portfolios. The majority by value were due to take-overs. We sold out of 39 positions of which 22 were take-overs, and we reduced our holding in a further 34 companies. Other than take-overs the positions were reduced or sold because either the valuations had become too high or the outlook for the business had deteriorated. A number of stocks we have avoided because of excessive share dilution from management incentives. We have minimal exposure to the gambling industry and have generally avoided the sector.

We have continued to be providers of equity capital to growth companies in 2022, contributing to 33 fund raisings contributing £21m. Over the life of the investment trust we have provided £645m of growth capital, of which £516m has been in the UK; this is material in relation to the £95m of equity capital we have raised.

Portfolio carbon footprint and climate change

Environmental issues are both a challenge and an opportunity for the investment portfolios managed. The difficulty lies in the fact that on the environment, data can be hard to come by, in particular in the smaller company's portfolio, where the number of portfolio companies reporting emissions data is small as a percentage. In addition, once analysed, the available information is not always as clear cut as one might envisage.

Early-stage or high growth businesses can often have misleading figures. For example, data on CO^2 emissions per unit of revenue can appear inflated due to low production levels. Once data is available, it can be difficult to normalise. Whereas larger US technology companies, such as Apple or Microsoft, possess the capital to spend on achieving carbon neutrality, smaller companies are often capital constrained. They must preserve their investment dollars for their core operations.

The outsourcing of supply chains complicates the analysis further. Semiconductor companies, who outsource their fabrication production plants, will outperform their integrated peers when only raw metrics are reviewed. However, their product cannot exist without the manufacturing capacity offered by others.

We do not take a formulaic approach and exclude companies that screen poorly based on reported or estimated data. We prefer to think holistically on each topic and engage with management on long-term environmental and sustainability issues. Where risks are identified, a dialogue approach enables us to consider the direction of travel and the problem in the broader context of global social and environmental issues. Evaluation and analysis can involve discussions many years before any relevant or regulatory-driven emissions data might become available, i.e. before the launch of a new product or prior to building a new facility.

The sector in which we invest is inherently low carbon, and as a manager, we have also chosen to invest in some specific companies that promise to contribute to decarbonising the global economy. However, the data on smaller companies' carbon emissions is sparse, and reporting requirements vary by market and geography.

Only a fraction of our holdings report carbon emissions data. Using Bloomberg as the source, we were able to obtain actual reported carbon emissions data for a minority of holdings; estimated data was available for additional holdings. Unfortunately, the estimated emissions data from Bloomberg for small companies seems unreliable, potentially off by a factor of 8-20x for an individual company, hence we do not believe that the estimated data gives an accurate representation. We have raised our concerns as to the accuracy and availability of emissions data for small companies with UK regulators that are keen to mandate such reporting at the portfolio level. Furthermore, we are continuing to engage with Bloomberg to understand and hopefully improve their estimated emissions data for small companies in the future. In 2022 Herald discussed Bloomberg's emissions data for small companies with senior Bloomberg ESG and machine learning experts, although some improvements to the data were made, in aggregate at the portfolio level the data is inaccurate by a factor of several times. Although we contacted other emissions data estimate providers, we found that none had reliable emissions data for as much as half of the companies in smaller companies' portfolio. The best proxy for now is to continue to use actual data for the small percentage of the portfolio that report it.

We have also employed an ESG consulting firm, Inspired ESG, to advise on managing down and reporting our emissions in line with TCFD recommendations. Clearly scope 3 emissions dominate. Estimated emissions for investee companies on a sector average basis are inconsistent with the companies that have published data, so work has to be done on developing more reliable emissions data.

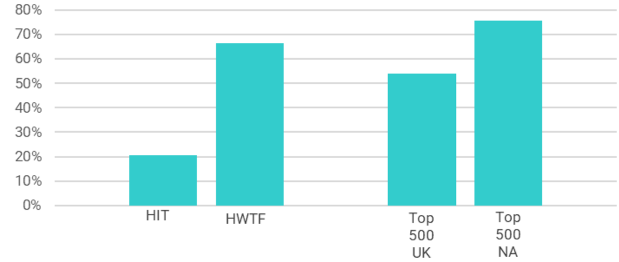
The first two graphs that follow illustrate the availability of actual emissions data both by number of companies and by market value. These graphs in particular demonstrate poor data availability for the small companies' fund – Herald Investment Trust plc (HIT). The number of companies reporting GHG emissions in the portfolios managed by Herald seems to be growing steadily but modestly each year. The GHG emissions (Scope 1 and 2) coverage by number of companies reaching 21% for HIT (smaller companies focused) and 67% for HWTF (skewed to larger companies). By value, the data coverage for the larger companies' fund – Herald Worldwide Technology Fund (HWTF) is better at around 76%.

Using the part of the portfolios with actual reported CO^2 equivalent data, both client portfolios have low emissions relative to the largest 500 listed companies in the UK and North America respectively.

In addition to CO^2 data, we also monitor which companies have adopted environmental policies such as those that have an emission reduction policy and net zero targets. The entire list of tracked policies and the percentage of companies which have adopted these in each portfolio can be seen in the ensuing pages.

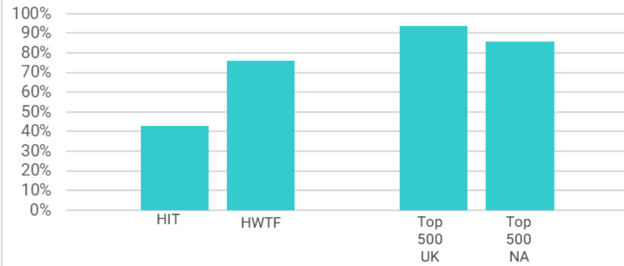
Given the limited availability and reliability of the data set, these graphs should only be viewed as indicative.

% Companies With Reported Scope 1 and 2 CO2e Emission Data 2022



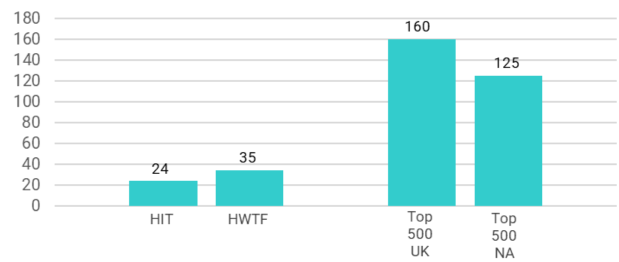
*Using last reported actual data for scope 1 and 2 CO2 emissions compared against top 500 listed companies in the United Kingdom and North America. Source: Bloomberg

% Market Value Of Equity Portfolio With Reported Scope 1 and 2 CO2e Emission Data 2022



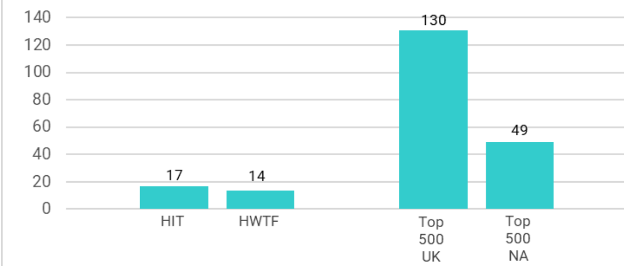
*Using last reported actual data for scope 1 and 2 CO2 emissions compared against top 500 listed companies in the United Kingdom and North America: Source: Bloomberg

Weighted Average Carbon Intensity 2022 (Tonnes CO2e/£Million Revenue)*

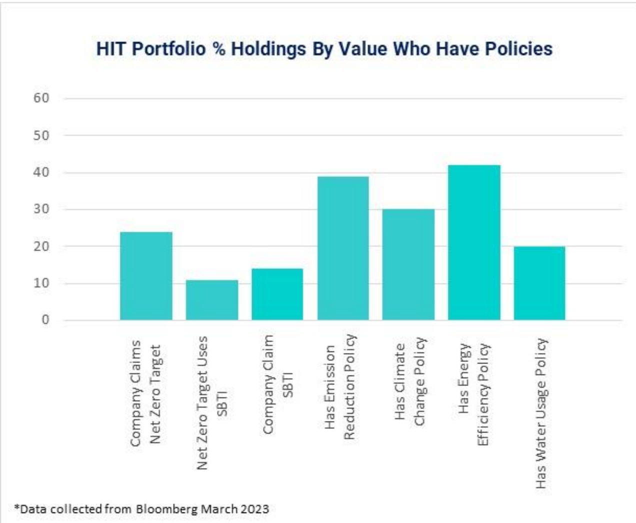


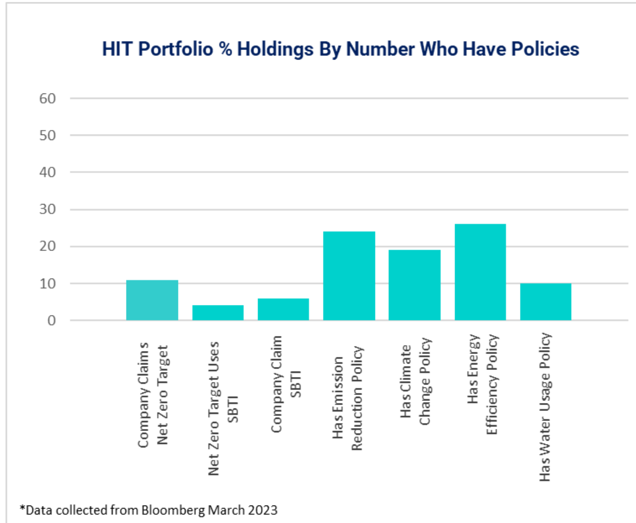
*Using last reported actual data for scope 1 and 2 CO2 emissions compared against top 500 listed companies in the United Kingdom and North America. Source: Bloomberg

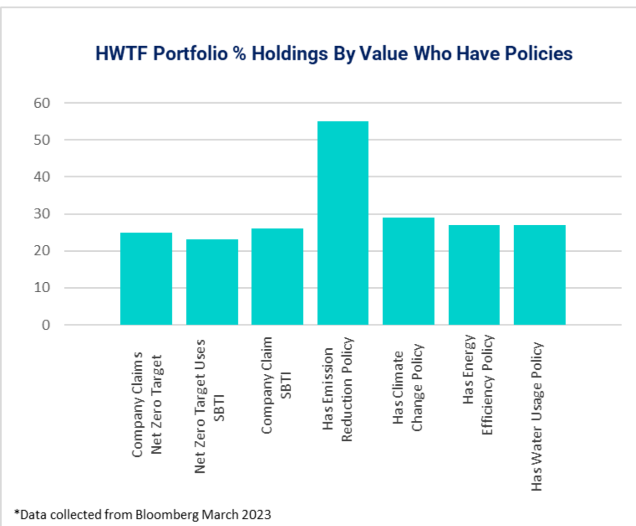
TCFD Carbon Footprint 2022 (Tonnes CO2e/£Million Invested)*

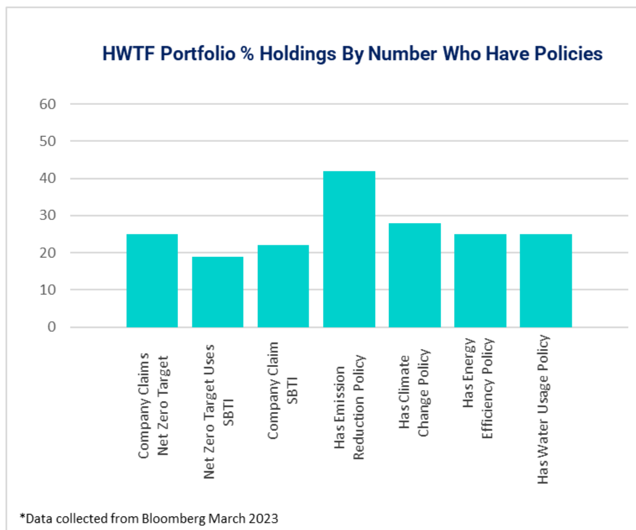


*Using last reported actual data for scope 1 and 2 CO2 emissions compared against top 500 listed companies in the United Kingdom and North America. Source: Bloomberg









SBTI = Science Based Targets Initiative

Principle 8

Signatories monitor and hold to account managers and/or service providers.

REPORTING EXPECTATIONS

Activity

Signatories should explain how they have monitored service providers to ensure services have been delivered to meet their needs.

Disruption to or failure of a fund administrator's accounting systems or those of other third-party service providers could lead to an inability to provide accurate reporting and monitoring or a misappropriation of assets.

The administration and custody for the funds are undertaken by BNYM and Northern Trust. However, Herald maintains a parallel fund accounting system which enables asset valuations to be produced daily and reconciled to the net asset values per share calculated by the respective administrators. Accounting and settlement issues are therefore identified and resolved promptly.

In depth operational and financial due diligence is undertaken on appointment and subsequently for all external service providers. The operational resilience of these providers is also evaluated continuously.

Herald and the third-party administrators have comprehensive business continuity plans which facilitate continued operation of the business in the event of a service disruption or a major disruption event. Reports on internal controls and the reports by other key third-party providers are reviewed by Herald in its role of investment manager.

Outcome

Signatories should explain:

The action they have taken where signatories' expectations of their managers and/or service providers have not been met.

Periodic Reviews.
There are periodic reviews with BNYM in particular. The board in Dublin reviews Northern Trust, but Herald staff have visited one of their offices, Limerick, to discuss issues.

For example:

Asset owners monitoring asset managers and investment consultants to ensure that assets have been managed in alignment with their investment and stewardship strategy and policies; or

Not applicable
Herald does not make investments on its own account other than to support its own funds

Asset managers monitoring proxy advisors to ensure, as far as can reasonably be achieved, that voting has been executed according with the manager's policies; and

Not currently applicable
We have not previously used or accessed the services of proxy advisers. The focus on small companies means that some flexibility is required. It is a key tenet of the Herald investment process that fund managers can exercise their judgment in voting. It is an abdication of responsibility to delegate this. However, in 2020 we started to subscribe to the ISS voting service, to view their voting recommendations, potentially speed up the voting process and ensure that any issues have been identified. We use ISS, an electronic voting service, to exercise our voting rights and responsibilities, rather than a service provider.

Towards the end of 2021, we were surprised to discover that we had only successfully registered votes for 97% of meetings. This was because for a few of the annual meetings of Herald's Swedish holdings, the votes the investment managers had submitted to ISS were invalid. This was due to missing Power of Attorney forms at BNYM the custodian of Herald Investment Trust plc. This situation was resolved in 2022. Unfortunately, by the time remedial action was put in place, the deadline for a number of Swedish votes had passed, but fortunately no motions were contentious. This was the primary reason that 5 out of 446 meetings were not voted in 2022, hence 99% of meetings were voted. There was also one meeting where we communicated with the company and deliberately abstained.

Asset managers monitoring data and research providers to ensure the quality and accuracy of their products and services.

Monitoring data and research providers to ensure quality and accuracy

The engagement with ISS is recent and the quality and coverage of the analysis they provide with regards to small companies in different jurisdictions around the world is under review. Given the limited information provided by small companies operating in international jurisdictions, the information that systems such as ISS or Bloomberg capture may often be limited. Whilst ISS research may assist Herald's process, Herald continues to exercise voting decisions on behalf of its clients using its own judgement.

Principle 9

Signatories engage with issuers to maintain or enhance the value of assets.

REPORTING EXPECTATIONS

Activity

Signatories should explain:

The expectations they have set for others that engage on their behalf and how.

Not applicable.
Herald does not engage third parties for this purpose

OR

How they have selected and prioritised engagement (for example, key issues and/or size of holding).

Aim to meet all management.
Engagement is primarily focused on periodic updates, but it can relate to raising further capital, making acquisitions or discussing takeover approaches. Generally, we try to support companies in their aims. If we are disinclined to support them, we sell the shares. This is not always possible, or in the interests of our shareholders. If there is a disagreement, we prefer to keep discussions private.

The portfolios are periodically reviewed to identify the companies with whom we have not had direct engagement over the last 6-12 months, and direct calls or meetings are generally arranged for the investments in HIT.

In 2022 we participated in 33 fund raisings with an aggregate value of £21m. Of the 33 fund raisings, one was an IPO, 27 were follow-on placings or rights issues for existing investments, and five were placings in secondary offerings, but where we were not previously shareholders. We had meetings or virtual meetings with them all. A number were rescue funding, while others were to fund acquisitions or make organic investments. Of the 33 fund raisings participated in, 23 were in the UK.

How they have developed well-informed and precise objectives for engagement with examples.

There is a regular cycle of meetings with companies in the portfolios which helps provide a mosaic of information on the target sectors to aid stock selection. Published information and research on smaller companies can be limited, hence the need for regular meetings. Furthermore, emerging companies cannot be valued solely by using historical numbers. The future potential weighs significantly, as does the degree of confidence we have in management meeting their objectives. The number of companies met focused on TMT helps the manager build up a mosaic of information including cross-referencing between competitors, customers and suppliers. For example, management can portray an image that they provide a unique solution when companies with similar solutions have already been seen; it makes it easier to determine which companies have a differentiated product or service.

For the largest companies in HWTF, we rarely meet top management except in a group forum. However, the quality and availability of published information is generally higher, and small companies are often suppliers or customers of large companies, which provides vital feedback. From Herald's specialist perspective, we find it difficult to see how managers focussed only on larger companies can obtain the same level of in-depth understanding as our specialist approach. We rarely try to understand technology from first principles, but understand it sufficiently to know who will provide relevant referencing.

There were 28 new investments in 2022 with an average book cost of £1.5m. One new UK investment exceeded £5m with six new investments between £2m and £3m, four of which were in the United States and two in the UK.

What methods of engagement and the extent to which they have been used?

Meeting company management worldwide, preferably in person

Meeting management teams is central to Herald's investment process. Over the last five years, we have undertaken more than 1,500 meetings face to face with companies globally each year. Generally, we see management from investee companies twice a year, and many other potential investee companies. This includes private companies who might go public, and we often see companies in a market sounding phase. These meetings include regular visits by the investment team to North America, Europe and Asia as well as meetings in the London and New York offices. The latter is connected to the London office with a point-to-point video link.

During the lockdown associated with coronavirus, the level of interactions has been maintained, but over the telephone or video conferencing, rather than meeting in person or visiting companies. The quality of interaction is much reduced but was manageable for a temporary period. In 2022 lockdowns have eased and the team is travelling more widely again, some restrictions remain in a few Asian countries.

As small investment manager, we rarely meet with top management in the large companies held in HWTF, but there is much more publicly available information on these companies, and professional investor relations departments, who are of some use. Most importantly, we learn so much from comments from smaller companies about the sector at large. We consider ourselves privileged to spend so much time interacting with top management in small companies and have received feedback that our global perspective can provide helpful economic and market insights to managements in smaller companies.

The reasons for their chosen approach, with reference to their disclosure under Context for Principle 1 and 6; and

Research

For smaller growth companies, an appropriate valuation is difficult to determine based on historical numbers. The future market opportunity has to be considered alongside management's ability to execute. The company also needs sufficient financial resources. Analysis of financial statements is also a vital tool. Sometimes they speak for themselves, but sometimes explanations are required, and we assess whether management grasp the details of their own business.

How engagement has differed for funds, assets or geographies.

Engaging with overseas companies

We utilise conferences heavily in overseas markets, where we can see many companies in a short time frame (c50/week). We also typically add on a number of days of direct company visits, it is often insightful to meet with a company at their premises, however with the travelling time between meetings – perhaps 30 meetings / week is typically achievable. Visiting companies overseas has become more important in recent years as reduced trading commissions and regulatory requirements to split research costs from trading have made it uneconomic for overseas brokers to bring companies to London. Although Covid limited travel for a couple of years, small companies globally are using virtual/ video conferencing much more than in the past. This facilitates frequent discussions between Herald and executive and non-executive directors of small companies. Given time zone differences, in some cases meetings occur outside of normal office hours for both Herald and the investee companies – there is typically willingness on both sides to facilitate this. Face to face meetings are preferred as communication is clearer and relationships more easily built, we regard virtual meetings as additive not a replacement. Overseas brokers rarely come to London now and the majority of our annual research payments of c.£1m go to overseas brokers. Conference access is more expensive than written research, but also more added value in helping our investment decisions. As explained above involvement with small companies is direct, which covers 90% of assets managed, and less so with large companies held in HWTF. Other than the logistics challenges the approach to engagement is similar across the geographies. The level of engagement varies more with company size and percentage of Herald ownership as has been discussed previously.

Engaging with UK companies
UK companies regularly visit our office. The majority of our UK investments are on the AIM market. The corporate advisers are an important go-between between investors and companies. It is the advisers that incur our wrath if they fail to respect pre-emption on share placings, endorse capital with preferential voting rights or fail to contain egregious remuneration schemes.

Examples of engagement methods include but are not limited to:

Meeting the chair or other board members.

Meetings with the chairs and non-executive directors are much less frequent (c40/year) than with executive management and generally relate to remuneration discussions or, more rarely, when there are management difficulties.

Holding meetings with management.

We maintain an audit trail of our dialogue with companies by retaining notes on nearly all meetings and all voting activity. This enables us to monitor the effectiveness of our engagements and set priorities for future engagements. Reporting and regulation has become a more common topic than in the past. We now frequently discuss the progress a company is making on reducing its environmental impact and how they plan to evolve their environmental reporting in coming years.

Writing letters to a company to raise concerns; and

In a number of cases within the year email communication has been sent to company management and NEDs. Typical topics included the level of dilution, design of management incentive schemes, board experience and independence.

Raising key issues through a company's advisers.

Generally, issues would first be raised with the company, secondly with a company's adviser and the last resort would be to vote against resolutions at a general meeting. A broker can usefully collate information from a number of shareholders, which can be more effective than one shareholder acting alone.

Outcome

Signatories should describe the outcomes of engagement that is ongoing or has concluded in the preceding 12 months, undertaken directly or by others on their behalf.

Engagement through the provision of equity capital
In addition to the specific engagements discussed below, probably Herald's greatest long-term impact comes from its engagement with companies as part of their fund raising activities. Over the last three decades Herald has provided hundreds of millions of pounds in growth capital of primary capital to small growth companies. In 2022 Herald participated in 33 fundraisings for primary capital in 2022. In other cases, we offered to participate, but there were insufficient other investors, in some of these instances the companies were therefore unable to raise the required capital.

How engagement has been used to monitor the company.

Throughout this report, we have commented on the hundreds of meetings held with investee companies and the extensive use of internal and external research resources used to inform investment and engagement decisions. Below we summarise examples where Herald engaged with companies and attempted to effect change:

How outcomes of engagement have informed investment decisions (buy, sell, hold), or escalation:

Intellicheck – Improving the diversity and experience of the Board

In late April and early May 2022, whilst reviewing the re-election of the Independent Non-Executive Directors at the AGM for Intellicheck (a microcap US identity software provider) Herald reviewed the independence, diversity and tenure of the NEDs on the Board. We felt that the Board was filled with retired political and military appointments, that the Board lacked diversity in background, certain members had been with the Board for a long tenure, and there was a lack of sufficient relevant commercial expertise. Herald was supportive of the new executive appointments and the CEO. On 9th May 2022 Herald engaged with the Company and communicated that we felt the Board lacked sufficient relevant commercial expertise, certain members have been with the Board for a long tenure, and we felt the board would benefit from a more diverse background of experience. Intellicheck informed us that similar views had been shared by other shareholders and employees within the Company. Having explained its position in advance Herald decided to abstain on the re-election of two directors within our proxy. We left it to the Board to decide the best path forward and timeline for any changes to the Board of the Company.

On the 13th May 2022 a new CFO was announced with an operational SAAS and cyber security background. The CFO was not appointed to the Board of directors. On 28th June 2022 – Herald had a meeting with the executive management team and discussed issues raise by the proxy vote in particular the concerns raised at the time of the AGM. Intellicheck repeated the fact that several shareholders had questioned boards reliance and tenure of a number of directors. The CEO said he would pass on our comments again to the Chairman. We hoped that Board of Intellicheck would be able to settle the issue internally and that we did not want to be unnecessarily aggressive. We believed that our comments were taken in a constructive manner and Herald's recently increased shareholding was noted. We remained supportive through our shareholding and wanted the best outcome for shareholders and the Company. We offered to have a call with the Chairman if it was desired. On 14th September 2022 – Intellicheck announced two new board members with relevant industry, commercial and customer experience.

"Intellicheck an industry-leading identity company delivering on-demand digital and physical identification validation solutions, today announced the appointment of Dondi Black and Greg Braca to the company's board of directors. Black is Senior Vice President, Chief Product Officer at TSYS. Braca is the former CEO and president of TD Bank.

"We are very excited to add Dondi Black and Greg Braca to our board of directors. Their deep fintech and banking knowledge and experience make them valuable additions to the Board. We are confident they will make important contributions in support of the Company's strategic vision for continued growth as the Company continues its focus on furthering adoption of our innovative technology solutions across key market verticals," said Chairman of the Board Guy L. Smith."

Herald believes that its constructive engagement with Intellicheck helped in facilitating a strengthening of the capability, governance and board of Intellicheck.

Sopheon – Engaging to improve the independence and experience of the Board

In 2021 Herald engaged with the Chairman of Sopheon a small company on the AIM in the UK and highlighted our concerns that there was insufficient independent NED representation on the Board. Sopheon responded that the hoped to find 2 candidates to be NEDs from one of two acquisitions that they were making. In advance of the AGM in June 2022 AGM Sopheon contacted Herald and explained that they had in fact acquired 2 businesses since the prior year, but neither of a scale that brought in an individual that we felt was right to be a new director and that accordingly the board composition remains unchanged. Sopheon specifically acknowledged the issue in the AGM notice as follows: "The Board is committed to maintaining high standards of corporate governance and applies the Quoted Companies Alliance's Corporate Governance Code for small and mid-size quoted companies (the "QCA Code"). A key feature of the QCA Code is the need for at least two independent non-executive directors. The Board is satisfied that its current makeup fosters an appropriate attitude of independence of character and judgement, even though most board members have been in post for many years. In line with the QCA Code guidance in such circumstances, all three non-executive directors have been put forward for annual re-election, even if not due for rotation under the Company's Articles. In addition, the Board believes it will be appropriate to further strengthen its independence with an additional non-executive director, ideally in conjunction with a future acquisition." Sopheon explained that they appreciated that this is not the same as adding another director but, as in the past, we are trying to project responsible board management in the context of a smaller business executing on its strategy.

Herald do not believe that it is difficult to consider the NEDs as independent as they are either previous executives or have a tenure well over 9 years. Abstaining on the re-election of two of the NEDs as they have served on the Board for 19 years and 29 years with the average tenure of the 3 NEDs being over 25 years. The two NEDs currently sit on both Audit and Remuneration committees. Herald did not believe that this was sufficient and abstained on the re-election of two of the NEDs in question. In June 2022 we again communicated the concerns with regards to Board independence to the Chairman and that there is insufficient "Independent" board representation. We also stated that we understand that Sopheon are seeking to add an independent NED and we welcomed this initiative. In December 2022 Herald again communicated its desire for change and reminded the Chairman of the public commitments Sopheon had made to add additional independent NEDs. The Chairman responded and confirmed that Sopheon had been active in recruiting independent NED's, with a desire to identify such a candidate as part of their M/A activity. Sopheon had closed on two such M/A transactions however did not find a NED candidate with suitable experience relevant to the future growth strategy. In parallel, Sopheon have conducted searches independent of their M&A activities and continue to pursue qualified NEDs. Finding NEDs with technology industry experience to go on small listed UK technology company boards has become increasingly challenging in recent years as the regulatory, compliance and risk burdens are high and rewards are very limited. Herald directly approached a strong potential NED candidate – the response received was as follows "at the moment the risk/return calculation for public companies vs private companies puts me off a little though, I'm afraid." The Chairman of Sopheon asked if we had any ideas for NED candidates to include in the active pool for consideration. Herald suggested four names that the Chairman found to be interesting with a strong potential fit. The NED recruitment process continues.

Intercede Plc – Supporting the introduction of an unconventional Value Creation Plan and re-election of highly competent but long serving NEDs

In July 2022 the Non-Executive Chairman of Intercede plc asked Herald to comment on a new management incentivisation scheme a Valuation Creation Plan. Herald was and is a 5% shareholder in Intercede. Intercede is a small (£30m market capitalisation and £11m revenue), AIM company.

Herald initially responded in writing and, whilst Herald has known and respected the Chairman for well over 25 years, whilst he operated in different roles, raised a number of concerns. These included:

• Herald dislikes cliff edge VCPs with share price only as the trigger (as opposed to strategic or financial metrics). We highlighted the challenges that Future had with obtaining shareholder approval of its VCP and queried if Intercede may run into similar issues. In general Herald dislikes all or nothing value creation plans with aggressive share price targets that may or may not be met. Whilst Herald recognised that the overall pound value was not excessive and management do have to deliver a significant increase in share price, but in a small illiquid company the share price will be volatile and can easily be moved by newsflow. Such an approach is generally not favoured by institutional investors. In particular, cliff edge vesting can create tension between management, NEDs and shareholders in the event a share price target is narrowly missed or achieved but not on a sustainable basis. Herald referred to a number of documents that highlighted the key principles that UK shareholders expect to be followed in designing management share-based incentive schemes can be found in documents from The Investment Association, the UK Corporate Governance Code and the QCA Remuneration Committee Guide. We also suggested alternate share-based remuneration structures.

• Intercede confirmed that whilst they were consulting with the major shareholders comprising close to 50% of the shareholder base that there would not be a shareholder vote on the VCP. This is not in line with the strong recommendation in the QCA Remco guide. Herald has very strong fundamental belief that shareholders should be given the opportunity to vote on share-based management incentive plans that dilute their shareholding and will be very disappointed in NEDs that do not facilitate such votes.

We also explained that Herald recognised that Non-Executive Directors have a challenging role in setting management remuneration and engaging with shareholders. Herald does not believe that we should be entirely prescriptive in what remuneration structure is appropriate. NEDs have far greater access to the intelligence to permit them to make informed judgements on the trade-offs that often have to be made. Herald would generally aim to be supportive of NED views on remuneration, especially when we are consulted in advance and our comments and suggestions at least acknowledged, even if not always 100% accepted.

Subsequent to the written discussion, Herald met with the Chairman, who clarified the challenges he had in retaining top management capable of developing and selling complex security software products into major US and UK government agencies. In particular he highlighted that private equity backed companies were often willing to offer significant equity based compensation and that the VCP structure was partially designed to compete with such offerings.

On reflection Herald commented that we appreciated the difficult compromise that has to be made by NEDs between UK corporate governance norms and retaining talented management in small companies that can create significant shareholder value. On balance and, despite some reservations, Herald decided to support the Chairman with the design of the VCP. We were disappointed that no shareholder vote on the VCP would occur but were somewhat reassured that the largest shareholders compromising close to 50% of the base were consulted.

At the AGM in September 2022, Herald voted in favour of all resolutions and the election / re-election of all directors. This was in some cases contrary to the guidance of ISS, which typically does not support NEDs with more than 9 years tenure or NEDs that represent shareholders. Herald noted that the independence and diversity of the board had been improved by the appointment of a new NED in July 2022.

KRM22 – Limiting the use of performance related pay for NEDs

Prior to the May 2022 AGM of KRM22 a small (£16m market capitalisation, £4m revenue), AIM company Herald noted that ISS reports were recommending voting against the re-election of two NEDs. On further investigation the basis of the decision was that the two NEDs in question had received options on joining the company and were therefore regarded as not independent by ISS which created an issue as they sit on the audit and remuneration committees.

We emailed the Chairman and informed him that ISS were recommending voting against the re-election of two of his NEDs. We explained that in principle UK investors have reservations about option awards for NEDs, as it can create bad incentives and conflicts. We noted that in the case of KRM22, a small and loss-making Company, that NEDs and executive directors have had given up cash pay for options in exchange the past, due to limited cash resources. The scale of

NED remuneration is in general modest: two non-execs in question were paid £25-30k each in cash and approximately £10k each in options. Contrary to ISS Herald said that it would not vote against the NEDs re-election on this occasion but will suggest that if the Company is cash constrained in future that the non-execs take some of their pay in straight shares rather than options as the alignment is better with shareholders, furthermore straight shares would not be deemed to be performance related pay or create perverse incentives for non-execs. The Chairman responded to Herald and explained that to attract such high profile, industry expert non-executive directors to a small start-up Company he had negotiated a starting package including a modest number of options, that were partially conditional on non-execs also buying shares directly. Herald reiterated that performance related pay for NEDs is generally disliked by UK investors and the Chairman understood the issue and stated that there was no intention to award further options to the non-executive directors in future.

GetBusy – Working with NEDs to introduce a new management incentive plan.

In December 2022 a GetBusy NED, who is Chairman of the remuneration committee contacted Herald to discuss management incentivisation plans. This followed a previous discussion around a February 2021 proposal that Herald broadly supported but was in the event not implemented by GetBusy. On the most recent proposal, Herald has provided detailed written commentary, had a meeting with the NED and secured agreement to clarify a key aspect. The final outcome is not yet certain so it will be most appropriate to elaborate further in a future Stewardship report.

Future Plc – Multiple engagements concerning management value creation plan, unconventional remuneration and the challenges for NEDs in bridging the gap between the desires of company management and shareholders.

In June 2022 the Chair of the Future plc Remuneration Committee asked Herald to comment on their remuneration policy following relatively weak support of their remuneration policy at the prior year's AGM. In particular, the resolution to approve the 2021 Remuneration Report at the February 2022 AGM was not supported by the simple majority required for it to be passed.

ISS disapproved of the full vesting of departing CFO incentive awards and cash payment. The CFO left in October 2021 post 1 ½ years' tenure. Future has been an enormously successful investment for Herald. Strictly enforcing the most stringent interpretation of the incentive plan rules seemed onerous and unfair and we believe that the Non-Exec Directors are in full possession of the facts and best placed to make these decisions over negotiating staff departures and recruitment. Clearly there had been a complex and protracted negotiation with the departing CFO that outside shareholders are not fully party to, due to confidentiality agreements. The amount was not material in the scale of the company and, although they did not explain fully, at the time the Remco explained that the value of upwards discretion applied the PSP award was offset more than 3 times over by downwards discretion applied to her outstanding VCP awards at the time. The Remco recognised they could have explained this better in the FY2021 Annual Report. Herald had taken the view that clearly there had been a negotiation between the departing CFO and the NEDs and that they had negotiated a compromise deal they believed to be appropriate. Furthermore, the size of the payment did not seem egregious or material in the context of the company and so it supported the vote in favour of the Remuneration Report against the guidance of ISS. We viewed the ISS approach as unnecessarily prescriptive and box ticking with a number of points that they disliked being quite technical and not substantive.

The Chairman of the Remco also explained that a consequence of the resolution to approve the Remuneration Report not being passed at the 2022 AGM Future had a requirement to submit the Directors' Remuneration Policy to a binding vote at the 2023 AGM. The Committee therefore spent time starting to consider how best to structure our Executive Director pay arrangements going forward, mindful of the direct feedback received by the

Committee and changes in market practice since the Policy was last approved. The Committee was keen that executive remuneration decisions at Future are taken in a transparent and responsible manner.

Herald decided to reply to the requests for commentary on the proposals for management remuneration. We explained the historic background to Herald's voting on remuneration at Future plc including that for the original vote on the Future VCP when Herald voted in favour in February 2021. Furthermore, we explained that Herald also supported the resolution to approve the 2021 Remuneration Report at the February 2022 AGM, which was not supported by a majority of Future plc shareholders. Although, on balance Herald supported the VCP plan we highlighted a number of concerns at the time.

By way of background, for the original vote on the Future VCP Herald voted in favour in February 2021. Herald also supported the resolution to approve the 2021 Remuneration Report at the February 2022 AGM. We did have some reservations highlighted in Herald's internal discussions from February 2021 which concluded as follows:

"Our initial understanding is that the Future Value Creation Plan (VCP) may prove controversial, although it has been discussed with the largest shareholders. The remuneration and the VCP is discussed from page 80 onwards in the Annual Report. It is unusual. It is not the way I would have done it but is it excessive or bad? There are caps related to salary but set at quite a high level, and requirements to maintain a significant shareholding for execs for 2 years after leaving are positive features. On balance if the Future Value Creation Plan pays out, we as shareholders will have done well."

In June 2022 following the vote against the Remuneration Report, and a request for shareholder input Herald gave feedback as follows…

"The points we would make are:

1. That whilst we supported the Board's Future VCP proposal in Feb 2021, we recognised that it was an unusual scheme and that it was likely to prove controversial. The inherent characteristics of the VCP were very significant payoffs to executives in the event they generated material increases in shareholder value. It was very much all or nothing, cliff edge vesting with only share price as the criteria. Such an approach is generally not favoured by institutional investors. Future's Board clearly believed that this was the approach they wanted to adopt. There were obvious pros and cons to the VCP as it was formulated. In particular, cliff edge vesting can create tension between management, NEDs and shareholders in the event a share price target is narrowly missed. In aggregate Future's shareholders having originally supported the VCP now find it to be unacceptable.

2. We understand that the Future Board are now designing a new Performance Share Plan, comprising the principles that UK shareholders expect to be followed in designing management share-based incentive schemes, which can be found in documents from The Investment Association, the UK Corporate Governance Code and the QCA Remuneration Committee Guide (attached). Structuring suitable share-based schemes that align shareholder and management interests is a complex, sensitive and difficult area. The design of schemes needs to vary depending on whether the goal is employee retention, alignment of employee interests with shareholders (on the up and downside), attracting new employees, or offering a level of reward appropriate for significant value creation - whilst not incentivising excessive risk taking. Herald has contributed to the QCA guide, which offers some practical suggestions and discusses the advantages and disadvantages of different approaches to remuneration, and considers simplicity and clarity to be important characteristics. Amongst Herald's prime concerns are: the overall level of dilution and cost, cliff edge vesting where share price is the sole trigger, that there are caps on individual value awarded that relate to salary. Furthermore, for material share-based schemes that are focused on rewarding high performance we would emphasise the attractions of market price vesting for options (or modest discount to market price) as opposed to nil cost. There can be positives from incentivising long term share ownership of shares by staff and facilitating staff to use an element of their bonus to acquire shares at a discount, possibly even

buy one get one free can be attractive. Malus and clawback clauses are important, as are minimum holding periods for equity incentives. A minimum employee shareholding target can also be a condition of continued participation in share-based incentive schemes.

3. Herald recognises that non-executive directors have a challenging role in setting management remuneration and engaging with shareholders. Herald does not believe that we should be entirely prescriptive in what remuneration structure is appropriate, because NEDs have far greater access to the intelligence to permit them to make informed judgements on the trade-offs that often have to be made. Herald would generally aim to be supportive of NED views on remuneration, especially when we are consulted in advance and our comments and suggestions at least acknowledged, even if not always 100% accepted.

4. We have read the consultation letter and are broadly supportive of the proposals and the move to a PSP. Herald would be happy to comment on the new PSP scheme that the Future Remuneration Committee are currently designing."

On 20th September 2022 Future plc noting press speculation and a fall in its share price said that Chief Executive officer Zillah Byng-Thorne had informally indicated she would like to step down by the end of 2023. The U.K. digital media group said that Ms. Byng-Thorne has indicated an intention to step down next year after nine years at the company, though she remains committed and hasn't resigned, in response to a Sky News article published on Monday.

The tension between shareholders following ISS recommendations, the NEDs and the Executives at Future plc seems to have become difficult, which is leading to the departure of a well-regarded female CEO of a leading technology and media company, who has been instrumental in its success. The valuation of Future plc now seems quite low, with a PE of less than 10x based on current analyst forecasts. Given the economic environment there are obvious risks to forecasts, but on the other hand the company may well prove an attractive takeout candidate for private equity. Such a takeout may well prove to be at a significant premium to the current price but still at a significant discount to underlying value. We have concerns that some institutional investors, in their need to demonstrate activism, are potentially damaging the underlying value of their clients' investments. There is clearly a big debate on the meaning of stewardship and the boundaries of the responsibilities of shareholders and NEDs, which is leading to increasing conflict. We believe that building growth companies relies on a partnership between shareholders, NEDs, executives, customers and staff and that unnecessary or excessive confrontation may prove detrimental to shareholder value creation for long term investors.

Wallix – Improving board structure and experience through engagement. Advising on shareholder communication strategy

Herald clients own close to 5% of Wallix share capital. Wallix is a small (€71m market capitalisation, €24m revenue), French privileged account security software company. Over the last few years Herald has repeatedly discussed board structure and composition and with Wallix Herald's primary concerns were around the small board size, composition and experience.

In June 2022 Wallix announced significant changes to the board including moving to a unitary board structure, adding three new credible and experienced non-executive directors and an additional external deputy chief executive director. Herald believes its constructive suggestions encouraged the changes to the Board. Within the last year Herald has engaged with Wallix on its investor relations and communications strategy. In the past, Wallix has been overly optimistic in its guidance to shareholders, especially around the setting of long-term targets. Herald has encouraged Wallix to be more realistic in setting expectations and not to promote excessively aggressive long term aspirational targets which can cause investor disappointment when not achieved. Although actual revenue progression and results have been quite good in recent years – in a tough economic environment – shareholders have been disappointed that results have not met inflated expectations. This has caused volatility in the share price. Herald has encouraged Wallix to focus on delivery within the business, to let the results speak for themselves and accelerate the speed of financial reporting. Swift and clear financial reporting is typically indicative of a well-run business. Herald continues to engage with Wallix as it progresses on its growth path.

B3 Consulting – Advising board on shareholder views on capital allocation and shareholder returns

Herald clients own around 3.5% of B3 Consulting share capital. B3 Consulting is a small (SEK1.4bn (GBP105m) market capitalisation, SEK1.1bn revenue), Swedish digital transformation and business development consulting company. In October 2022 at their capital markets day in Sweden, Herald met with the chairman of B3 Consulting alongside another significant shareholder and provided input to the discussions with regards to capital allocation and shareholder returns.

B3 Consulting is taking a mainly organic approach to growth but will look to bring in small teams and make small bolt-on acquisitions where they want to add specialist skills. We discussed the integration and incentivization of these teams and the issues with getting the organization focused on cross selling their skills. Following this conversation, the company decided to introduce a buy-back policy to acquire shares for distribution to key executives as an incentive plan but also to ensure their focus on the group's performance rather than just their division. The company had initially thought about increasing their dividend pay-out ratio but decided not to change the existing policy and introduce a buy back instead.

Principle 10

Signatories, where necessary, participate in collaborative engagement to influence issuers.

REPORTING EXPECTATIONS

Activity

Signatories should disclose what collaborative engagement they have participated in and why, including those undertaken directly or by others on their behalf.

The regulatory constraints on collaboration
We rarely collaborate with other investors for fear of breaching concert party rules, market abuse and competition law. This can be a frustration when rescue funding is required, and we rely on brokers to mediate. The UK system of corporate brokers is helpful in doing this, but it is more difficult in overseas markets.

Investments in quoted companies
In quoted investments within HIT we generally hold stakes between 1-10% of the outstanding capital, so our vote can be material in any contentious issue. In the UCITS fund, our holdings are small and immaterial, but the liquidity is greater so we can always sell.

Investment through our venture capital partnerships
The venture capital partnerships managed by Herald can and do hold substantial and sometimes controlling shareholdings in investee companies. In such cases, we seek to act, as far as possible, in shareholders' collective interest.

Outcome

Signatories should describe the outcomes of collaborative engagement.

We are proud that the reputation we have built leads companies to appreciate our loyalty as shareholders, and we believe we constructively influence management in an amicable way in the majority of cases.

For example:

LiveTiles – Keeping a listed company quoted, collaborating with other shareholders and a potential acquirer to initiate board changes and a reappraisal of strategy at an underperforming investment

In July 2022 LiveTiles – an Australian employee engagement/ intranet software company - announced that the company wished to voluntarily delist from the Australian Stock exchange (ASX). Herald is focused on investment in public markets and did not believe it was in Herald's clients' interests for LiveTiles to delist. Another shareholder contacted Herald to discuss the strategic future of LiveTiles and a number of confidential proposals were discussed. After consideration, although there were positive elements and Herald agreed with much of the analysis, Herald did not on balance believe that the fellow shareholders' proposals should be fully supported. Both shareholders did agree that it was preferable that LiveTiles remained listed. Herald also subsequently discussed the advantages and disadvantages of LiveTiles delisting with the CEO of LiveTiles. Ultimately, Herald decided to vote against the LiveTiles Board proposal to delist LiveTiles. At the LiveTiles EGM in May 2022 shareholders voted 57% against the delisting proposal and LiveTiles remained listed. Herald has a holding in BigTinCan - a sales enablement software company – operating in an adjacent technology space. Over a number of years Herald had discussed the pros and cons of a merger between the two businesses with BigTinCan. On the 3rd October 2022 Live Tiles announced that it had been approached by BigTinCan with an indicative proposal to acquire LiveTiles at A$0.07 per share. Within the constraints of insider and concert party rules, Herald engaged with both companies to understand the benefits of such a takeover for Herald's client funds. The situation at LiveTiles is dynamic with some concerns over going concern issues raised in the recent annual accounts, an ongoing operational review, resignation of CFO, significant Board changes with two senior NEDs (which previously sat on the Audit, remuneration and Risk committees) having resigned. The company is currently seeking new NEDs, including a Chairman and a new CFO. The Board is now not sufficiently independent and needs rebuilding. The situation is difficult and complex, the company, board and balance sheet need restructuring. LiveTiles has publicly reported that it has had a number of takeover approaches, whether these will be appropriately evaluated is difficult to know given the Board structure. Herald is a 1.64% shareholder in LiveTiles.

Prior to the LiveTiles AGM in November 2022, Herald appreciated that there was a proxy battle taking place between LiveTiles and some of its largest institutional investors. A confidential discussion was held and Herald voted against the recommendations of the LiveTiles Board at the AGM on 30th November 2022. Herald explained to the company's proxy advisor and board and raised the following queries….

"Are the Board fulfilling its fiduciary responsibilities in protecting the interests of minority shareholders? That although there have been Board changes, we are not convinced that the proposed Board at the AGM will be sufficiently independent or represent the interests of minority institutional shareholders. We are worried that some of the recent acquisitions for shares are of uncertain merit but clearly dilute the holdings of institutional investors and increase the block of votes aligned with management. We also encourage the LiveTiles board to engage with BigTinCan which had expressed an interest as a potential acquirer. I am disappointed that I do not feel comfortable offering greater support to the LiveTiles board at the upcoming shareholder meeting, Herald would be typically regarded as a supportive investor, typically holding shares for many years through multiple funding rounds. We are not activist and very rarely vote against the guidance of company Boards and we only do so with the greatest reluctance. Please pass these comments to the Chairman of LiveTiles. Whatever the outcome of the upcoming shareholder votes, for the good of the staff and investors, the LiveTiles Board and its shareholders need to come together, to agree the best future strategic direction of the company and to either the company's sale or that the company has sufficient capital to ensure that the company has a viable future as a stand-alone entity."

Unfortunately, the vote outcome at the AGM was not in alignment with Herald's voting activity with typically only around 27% of votes cast against Board recommendations. There were 54% of votes cast against adoption of the remuneration report which was a second strike (2 years running) and this led to the evaluation of the Board Spill Meeting resolution – unfortunately this was lost. There is a public announcement by Regal (an institutional investor) of a 249D notice to call a general meeting to remove 2 Directors and replace with 2 Regal nominees. Given the outcome of the voting at the AGM, the success of this activity looks uncertain. The EGM date has recently been set as 20th January 2023.

At some point the divided shareholder base will need to come together, LiveTiles be sold, or dissenting shareholders sell their holdings. LiveTiles' board have a strategic review underway. We continue to monitor the situation and are considering the best way forward. Herald has engaged with LiveTiles and to some extent collaborated with other LiveTiles shareholders and tried to encourage a potential acquirer. Clearly there are conflicting agendas and there have been significant disagreements amongst the board and major shareholders. Overall a fluid, difficult situation and it is a challenge to decide on the best approach or to evaluate what the outcome will be. Determining the appropriate level of engagement is challenging, potentially becoming an insider or part of a concert party seeking to appointment new NEDs might compromise our ability to exit a difficult situation and realise the value of the investment. Herald continues to attempt to achieve the best outcome for its investors.

Collaborating with other investors to engage an issuer to achieve a specific change; or

It is our policy to be supportive long-term shareholders, and not to be activist investors. This generally means, for example, we stand our corner or more in fund raisings. If we do not want to support management, the first course of action is to sell the shares. It is only in problem situations where this would entail the destruction of value for our investors that mediation would take place, firstly through corporate brokers. It is only in extreme instances that collaboration with other investors has been desirable. In rare instances we have collaborated to remove directors, but that was not the case in 2021.

Working as part of a coalition of wider stakeholders to engage on a thematic issue.

QCA

We actively engage in the QCA, where more general issues are discussed.

Herald played a key role in the committee that rewrote the QCA Remuneration Committee Guide (2020). In the UK, most smaller companies follow the QCA Corporate Governance Code and this guide, targeted at remuneration committee chairs and members, aims to assist them in being effective in their roles. The guide sets out the QCA's views of good practice and is a companion to the QCA Corporate Governance Code. It takes account of the interests of shareholders, executives, the wider workforce and other stakeholders in small and mid-sized quoted companies. In particular, Herald focused on the controls that non-executives and shareholders have over the magnitude of share-based payments (for example, salary related caps) and encouraged consideration of ESG factors in remuneration policies. Herald also advocated the importance of remuneration committees designing schemes with the flexibility to reduce or clawback payments when a remuneration committee felt they were not fully deserved. Herald contributed significantly to the chapter discussing shareholder communication and the importance of consulting shareholders to discuss remuneration – especially when shareholders' economic interests were being diluted through the use of share-based payments and that shareholders should vote on such proposals.

Herald also requested that in future that there be greater cross-referral between the QCA Corporate Governance Code and the QCA Remuneration Committee Guide, to add to the influence of the latter.

Hundreds of UK quoted companies will use the QCA quoted companies guide as a key input when writing their remuneration policies over the next few years. Hence, it will have a material impact on behaviour for some years to come.

Herald's continuing participation on the QCA Secondary Markets Committee entails regular interaction with UK and European regulators and includes contributing to the feedback given by the QCA to numerous UK and EU policy proposals. In 2021 and 2022 Herald collaboratively contributed to responses to the following consultations:

- Department for Business, Energy & Industrial Strategy (BEIS) consultation 'Restoring trust in audit and corporate governance: consultation on the Government's proposals.
- FCA consultation to extend TCFD rules to asset managers, life insurers and FCA-regulated pension providers. FCA responded to QCA January 2022 – accepting a number of Herald / QCA points.
- QCA letter to BEIS on impact of TCFD reporting requirements for small companies
- HM Treasury: Wholesale Markets Review -
- FCA – Diversity on company boards and executive committees
- HM Treasury – UK Secondary Capital Raising Review – initial contribution Autumn 2021- meetings Spring 2022 – final review published July 2022 – implementation ongoing incorporating many Herald suggestions.
- FCA Primary Markets Effectiveness Review - Herald/ QCA suggested new growth market structure
- FCA Sustainability Disclosure Requirements Consultation Paper – Herald raised some concerns with QCA on the potential impact for smaller companies.
- As a member of the Bank of England's Decision Making Panel, Herald take part in monthly surveys which inform the Bank of England's Monetary Policy Committee on the state of the UK economy

Herald remains a member of PRI and a signatory to the TCFD.

Herald’s agenda is in general that rules should be clear and proportionate for smaller companies to follow. Herald continues to be an evangelist for smaller companies' importance as engines for economic growth and promotes the importance of quoted company capital markets as a key funding source.

Principle 11

Signatories, where necessary, escalate stewardship activities to influence issuers.

REPORTING EXPECTATIONS

Activity

Signatories should explain:

The expectations they have set for asset managers that escalate stewardship activities on their behalf.

OR

How they have selected and prioritised issues and developed well-informed objectives for escalation.

No formal process – each issue is viewed on a company by company basis, within the investment team as discussed earlier - the avenues open to escalation are:

1) Internal escalation – often, where judgment is complex, issues are discussed internally between fund managers.

2) External escalation (Informal, Formal) – meeting with management teams and communications with the Board of Directors, or for UK companies engaging with the company's broker or NOMAD.

3) Board Review and Escalation - Both pre and post-vote. Contentious or conflicting areas of governance can be escalated to the client (fund board) for approval or discussion. Voting records are reviewed and discussed regularly.

Our preference is to have discussions with executive management, enabling us to build an effective relationship with companies. However, where it is necessary to protect and enhance our clients' long-term investment returns, we will escalate our stewardship and engagement activities. Where for an investee company there are wider issues of policy, concerns over Governance, management remuneration, board structure, experience and independence engagement are typically escalated by Herald communicating with the Non-Executive Chairman or the head of the audit or remuneration committees. In the event that these discussions are not fruitful on occasion we will vote against resolutions at a company's general meeting and not vote to support the re-election of Directors.

Management teams and the broader market are respectful of Herald's investment judgment, and managements are generally motivated to ensure that we remain supportive shareholders.

When they have chosen to escalate their engagement, including the issue(s) and the reasons for their chosen approach, using examples; and

Where we have concerns about, among other things, strategy and performance, board structure and management quality, or damaging conflicts of interest or lack of independence on an investee company's board, we would generally sell the shares.

We will consider escalating our activities where (i) we are unable to sell the shares, (ii) selling shares could only be made at a distressed valuation (iii) a management change could resolve the issues, (iv) executive remuneration is excessive, (v) minority shareholder rights are being compromised or (vi) in any other situation where we consider that shareholders' interests may be at risk. Such escalations may include:

- meeting with management and/or board members to discuss our concerns.
- In UK companies, discussing the situation with the corporate broker or Nomad would generally be the first choice of escalation. They also hear other shareholders' views and can speak for a broader base of shareholders to the executive and non-executive board members. This is more difficult in overseas markets who do not have formal advisers, but works well in the UK.

How escalation has differed for funds, assets or geographies.

Half the assets under management are in the UK. They have a median market capitalisation of £87m of which average ownership is c3.5% of the outstanding capital. Given our weightings in these stocks, we have more influence on issues such as remuneration. We feel our presence in the UK market (we own c.2% of TMT stocks on AIM) means we have an important role in influencing behaviour. Typically, Herald's voice is respected and listened to by the small companies around the world in which we invest. Furthermore, we initially usually engage in discussions with the Chief Executive, Chairman or Senior Independent Director – in the vast majority of cases they are responsive and even when not – often the only remaining opportunity to escalate further is either to sell the shares or to use our proxy votes at general meetings to vote against items such as the adoption of the report and accounts, a management incentive plan or not in favour of the re-election of a Director. For some years, we have felt an obligation to actively participate both directly with companies and in wider governance discussions. There are examples of both activities throughout this report. On average ownership of overseas holdings in HIT is c.1% and our UCITS fund even less, so our votes overseas have less impact.

Outcome

Signatories should describe the outcomes of escalation either undertaken directly or by others on their behalf.

We do not believe it is necessarily in our investors' or employees' interests to make public the outcomes of escalation.

However, a number of the engagement examples we provided within Principle 9 and 10 which contain instances of significant escalation – for Herald escalation nearly always involves engagement or collaboration. Particularly relevant examples of engagement that include escalation mentioned here would be in regard to Intellicheck, Sopheon and LiveTiles.

Principle 12

Signatories actively exercise their rights and responsibilities.

REPORTING EXPECTATIONS

Reporting expectations for listed equity and fixed income investments are below.

The vast majority of the investments - by number and value – in respect of which Herald exercises rights and responsibilities are in listed equities. Fixed income investments, typically in sovereign debt, are of limited duration and made only for liquidity or risk diversification purposes as an alternative to cash.

In addition, signatories should report on how they have exercised their rights and responsibilities across other asset classes they are invested in, where they have the ability to do so, as disclosed in their reporting against Principle 6.

The venture capital partnerships managed are being wound down and now hold only a handful of unlisted companies with minimal value.

Apart from the asset classes mentioned the only other asset classes managed are a few 'simple' derivatives related to listed equity holdings, such as rights, warrants and convertibles, and some debt in the form of loans extended to investee companies.

Context

Signatories should:

Explain how they exercise their rights and responsibilities, and how their approach has differed for funds, assets or geographies.

All of Herald's voting decisions are taken internally by the investment team responsible for making voting decisions.

In gathering information and making our final voting decisions, we endeavour to engage with companies and their advisers. When voting clients' shares, we consider whether investee companies' proposals have complied with local best practice and corporate governance codes, for example, on remuneration. If not, we satisfy ourselves that exceptions are in our clients' best interests before voting.

We usually advise investee companies on those occasions where we plan to vote against management and communicate our views to the company's brokers or advisers. Publicising criticism could damage shareholders' interests when private admonishment can be effective anyway.

In addition, for listed equity assets, signatories should:

Disclose their voting policy, including any house policies and the extent to which funds set their own policies.

In all cases, our clients delegate voting discretion to Herald under the terms of their investment management agreements and do not set policies. Clients' independent boards have, however, reviewed and agreed Herald's stewardship approach.

Given the range of governance jurisdictions and levels of company maturity, the context in which a company operates is critical in informing voting decisions. Herald makes its voting decisions based on its interactions with investee companies, analysing publicly available information, broker research and information from corporate governance analysis services provided by businesses such as ISS and Bloomberg.

Herald's Stewardship Approach and Policy is available on Herald's website – heralduk.com

(https://heralduk.com/wp-content/uploads/2022/06/Herald-Investment-Management-Stewardship-Approach-and-Policy-Spring-2022.pdf).

This document includes the core principles which Herald follows when voting on behalf of its client funds. Herald regularly reviews this policy and welcomes client suggestions as to how it should evolve over time.

State the extent to which they use default recommendations of proxy advisors.

In its voting, Herald does not use the default recommendations of proxy advisors. The voting recommendations of ISS are available to the investment managers as one input of many into proxy voting decisions. The ISS system generates proxy voting reports on Herald's overall voting record which indicate whether or not voting has been in line with management or ISS policy recommendations.

Report the extent to which clients may override a house policy.

Herald's two major clients are independent entities with their own boards and ultimately have the power to override any decision of the investment manager, but it would be most unusual for this to happen and indeed it has never happened. Herald's stewardship and proxy voting policy is shared with and agreed by the boards of Herald's two major clients.

Disclose their policy on allowing clients to direct voting in segregated and pooled accounts.

Not applicable.
Herald does not manage segregated or pooled accounts. If a client fund had a strong preference to have their shareholding voted at an individual meeting, in a particular way they would be able to ask Herald to do this. We do not believe that a client fund has ever found this to be necessary.

State what approach they have taken to stock lending, recalling lent stock for voting and how they seek to mitigate 'empty voting.

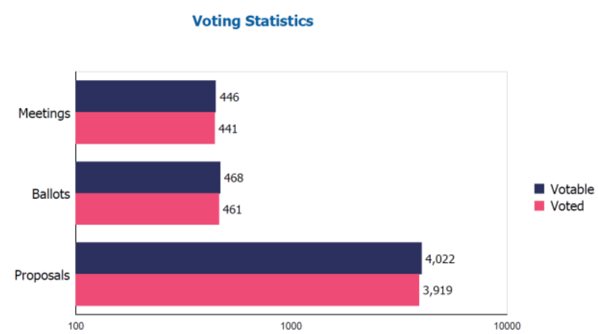
Not applicable.
Herald has never engaged in stock lending for any purpose.

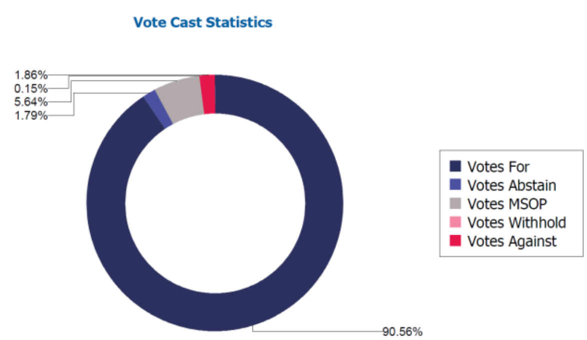
Activity

For listed equity assets, signatories should:

Disclose the proportion of shares that were voted in the past year and why.

The historic voting record is disclosed annually on Herald's website; we have consistently aimed to vote all our client shareholdings, whether listed or not. In the last year 99% of the investee company meetings were voted at. Nearly all votes not successfully voted, had votes submitted by Herald, but were not successfully instructed due to legal complexities in the Swedish market. Herald is working to resolve these issues. Herald voted against management recommendation for 3% of votes and against ISS recommendations on 14% of votes. ISS often applies a tick box approach to governance which is often derived from larger company corporate governance rules. We find the ISS approach is often too inflexible and displays a lack of understanding of the challenges and compromises that small growing companies sometimes have to make. Since founding in 1994 Herald has made its own voting decisions and continues to do so.





Provide a link to their voting records, including votes withheld if applicable.

A summary table listing the aggregate number of votes cast for and against resolutions will be disclosed annually on the Herald website. Please see:

https://heralduk.com/wp-content/uploads/2023/02/Herald-Proxy-Voting-Record-2022.pdf

Explain their rationale for some or all voting decisions,

We aim to disclose the rationale behind votes that have been withheld or voted against to the boards of the relevant funds, but we will not as a matter of course disclose this publicly. We prefer to address issues privately, because we do not want to risk unnecessary damage to our clients' investments. We believe that in acting in the best interests of our shareholders, we also act in the best interests of the wider shareholder base. In the Outcome section below, we provide a number of examples that include examples of our voting rationale.

Explain the extent to which voting decisions were executed by another entity, and how they have monitored any voting on their behalf; and

Voting decisions are made by Herald and executed for listed equity assets via ISS.

Explain how they have monitored what shares and voting rights they have.

ISS proxy exchange links directly to the custody systems that hold Herald's clients' shares. The system tracks upcoming votes, stores ISS voting recommendations and the votes submitted. There are a wide range of reports available to analyse Herald's voting record on behalf of its clients. Some of these reports are periodically shared with clients and clients are welcome to request a voting analysis report at any time.

Herald's GENEVA accounting system reports shares/voting rights consolidated across all client holdings daily. Where a change in an investment position means that a threshold has been reached that requires disclosure it is made according to the local jurisdiction.

Outcome

For listed equity assets, signatories should provide examples of the outcomes of resolutions they have voted on over the past 12 months.

Herald does not generally believe that it is in clients' interests that the detail of its voting record with regards to individual company votes is made public. However, some examples are provided below.

PagerDuty – Voting against excessive stock based compensation

At the AGM of Pager Duty, a US listed technology company, Herald voted against the Advisory Vote on Executive compensation. Large grants were made to the CEO and executive officers without Long Term Performance criteria, 83% of the CEO's awards were time based. There was a large increase in the CEO's LT grants. The overall level of dilution for the Company also remains too high.

Given our small percentage holding, we emailed the Company and asked for our feedback to be passed on to the compensation committee. Herald highlighted their belief that the scheme is overly reliant on Time Based Awards for the CEO and other Named Executive Offices. Herald urged the company to think about how to effectively use their equity and attempt to reduce overall level of dilation within the company. Currently Herald views the level of dilution as too high, and we would support the board in efforts to temper share issuance and limit dilution.

When PagerDuty responded to Herald they explained that….

"they employed a compensation program that is rigorous and reasonable, rooted in the compensation philosophy of driving a tight alignment of pay with performance and stockholder interests. Furthermore, the Compensation Committee works closely with independent compensation consultants including to review and update the compensation peer group, obtain competitive market data for that peer group, understand market trends, and review competitive market design and practices for performance based awards. In this highly competitive market for executive talent, it was critical to provide compensation in line with the peer group, with a strong RSU award plus the introduction of performance awards, to retain the CEO and other key executives for an extended period of time. As you know, PagerDuty takes pay equity very seriously as part of its ESG commitments and priorities, and the compensation decisions reflect this value, in comparison to the peer group.

All compensation decisions are rooted in the philosophy that PagerDuty is committed to pay-for-performance. This philosophy holds executive officers accountable for business results and rewards them for consistently strong corporate performance and the creation of shareholder value. This is why a substantial portion of the Named Executive Officers' annual compensation is variable in nature and "at risk." As noted, this was the first year in which PSUs were introduced into the equity pay mix, and we would expect to continue to expand the use of performance-based equity in our compensation programs."

It is a positive step that PagerDuty are expanding the use of performance related stock units relative to RSUs that have no performance related element. We will continue to monitor employee share-based payments and dilution at PagerDuty.

Bottomline – Voting against golden parachutes in the takeover of a long-term investment in payments technology sector

In March 2022, at the special meeting to approve the takeover of Bottomline, Herald voted against golden parachutes for management. The long-term CEO owned close to 0.5m worth of common stock, a holding that was worth over $28m on takeover. Given the CEOs substantial equity ownership - that will be realised upon takeover, the CEO's Golden Parachute payment of $16.5m appears excessive in the context of this takeover. The shares have underperformed on a 3 and 10 year view, even with the takeover premium. Outperformance on a 5 year view was driven by low valuation in 2016-2017 period. After periods of poor execution and continued investment, activists came onto the register and forced the sale of the business. While the takeover price is acceptable in poor stock market conditions, the sale price of $57 per share by a financial buyer represents a realisation of value rather than a strategic premium price. In these circumstances Herald felt that support for the golden parachute was not warranted.

CentralNic – Protecting shareholder pre-emption rights and discouraging use of share options for non-executive directors

Herald has had a shareholding of 3% (at times a little more) in CentralNic for several years, typically meeting with management two or three times a year and supporting several fundraisings. CentralNic is a small entrepreneurial, acquisitive AIM company. Revenues come from domain name registration and online marketing/ advertising. The former revenues are stable and predictable, the advertising revenues are certainly not. Herald has discussed appropriate fund raising structures to protect official and unofficial pre-emption rights. Herald has also discussed ESG issues, for example encouraging the use of green electricity for CentralNic's datacentres, which CentralNic has been progressing. We have also discussed increasing independent board representation where again progress has been made. CentralNic has pushed some of the pre-emption rules to the limit and beyond (e.g. cash box structures when making acquisitions). We raised Board Independence as an issue in 2021, since when Max Royde of Kestrel joined as an independent non-exec director. Unfortunately, ISS view Max Royde as non-independent due to the Kestrel shareholding. This ISS opinion also applies to other shareholder representative directors Sam

Dayani and Horst Siffrin. Herald would not necessarily view NEDs being representatives of minority shareholders as critically compromising their ability to act appropriately for all shareholders. Herald has voted to support the re-election of these Directors.

CentralNic (like many other UK small companies) has found it difficult to swiftly and efficiently raise capital for acquisitions whilst technically staying within guidance of the Pre-Emption Group. CentralNic has used cashbox structures on multiple occasions to circumvent the pre-emption rules. Herald views pre-emption rights as a critical protection for shareholders but also recognises the challenges companies face in quickly raising capital to make acquisitions in competitive situations. We have discussed these challenges and cashbox structures with CentralNic over the years. For the April 2022 CentralNic AGM, Herald abstained on the vote to authorise the issue of equity due to CentralNic's repeated use of cashbox structures. The most recent use was in February 2022 when Central Nic used a cash box structure alongside an open offer to issue 13% of its shares for the VGL acquisition. CentralNic's justification to ISS was that in advance of its use…

"The cash box placing was conducted in consultation with the Company's major shareholders representing c.80% of the share capital in issue. The cash box placing was warranted as the highly accretive and strategic acquisition of VGL took place in a competitive bidding process and the sellers would not grant a window of exclusivity long enough to conduct a standard rights issue or to convene a general meeting. Holder orders were fully filled before allocating any shares to new Shareholders. An Open Offer process has been put in place to allow retail Shareholders to participate at the same terms and conditions as institutional investors. There is little doubt that an EGM, if time would have permitted, would have approved the placing and the acquisition. The outcomes of the placing would not have been materially different in a rights issue. We have only reverted to the exemptions foreseen by the legislator to secure a highly accretive transaction for the benefit of the Company and its shareholders."

Herald was among the 80% of the shareholder base contacted in advance of the cashbox placing. The management did recognise that existing shareholders should be given the opportunity to participate in a preferential manner, not be diluted and in practice those that wished to participate in the placing could participate. The efficiency and effectiveness of the UK secondary market fund raising structure has limitations and there has been a review commissioned by the Treasury to address this. Herald contributed significantly to this review in Autumn 2021 and Spring 2022 through its membership of the Quoted Companies Alliance (QCA).

At one level we strongly dislike the use of a cash box structure to circumvent pre-emption rights, in this specific case the structure enabled CentralNic to move swiftly and close the acquisition and they did informally protect the pre-emption rights of existing shareholders. On balance the management probably did act in the interests of shareholders, even though they circumvented the pre-emption rules. As Herald had previously indicated our dislike of cash box structures, Herald abstained on the future issuance vote as an additional warning shot.

Other governance issues highlighted by ISS at CentralNic included that the option schemes do not vest after 3 years rather over the three years. Since prior to its IPO, CentralNic has consistently operated, with full disclosure to investors, option schemes where options vest in three tranches over three years – CentralNic judges this to be more effective in ensuring continuous performance than schemes where vesting is focused at the end of the period. CentralNic has also issued options to non-shareholder Non-Executive Directors to attract the right calibre of individual and to align their remuneration to shareholder interests, which they view as standard practice among the most successful technology companies globally. The CentralNic Board is of the view that equity-based compensation has not significantly compromised the independence of Non-Executive Directors in the past. Herald does have concerns that NEDs being permitted to benefit from the share-based remuneration schemes that they are designing for executives is a significant conflict and we believe that NEDs should primarily be remunerated in cash or straight equity. CentralNic appreciate these concerns. On occasion as part of a recruitment process for an NED (often the Chairman) of a small company, which the NED is joining to add strategic value to a company, rather than primarily in a governance role, we have reluctantly agreed to approve such share awards or options. At the 2022 CentralNic AGM Herald did not vote against the remuneration report, given that no new non-exec options were awarded in 2021, and we have raised the concerns that such option grants cause for UK investors in the past.

Herald has communicated these views in person and in writing to both executive and non-executive directors and believe we have a constructive and productive ongoing dialogue with CentralNic on numerous ESG issues.

We would also comment that the input we had into the UK SCRR has significantly altered the capital raising process in the UK, which should reduce the need for companies to use cashbox structures in the future.

Science Group – Seeking improvements in management share-based incentive schemes and remuneration disclosures

At the Science Group AGM Herald did not vote in favour of two resolutions. One to approve the financial statements and statutory reports and the second to approve the performance share plan. Herald had engaged with Science Group in the prior year but did not believe that our concerns had been fully addressed.

In the prior year, Herald decided to abstain on resolution 4 and 5 regarding share options as there were a number of features of the PSP/ EEI plan that we had misgivings about, that when viewed collectively made it difficult for us to vote in favour. Herald communicated these concerns to the Company Secretary who undertook to pass them onto the Head of the Remuneration Committee. Herald believes that greater flexibility should be granted to smaller companies with regard to share-based payments and that investors should not be overly prescriptive. The areas that we asked the remuneration committee to consider were:

- The level of disclosure around the granting of options, dilution and the structure of the PSP available to shareholders. Please consider greater remuneration disclosure in the annual accounts and making the PSP scheme document more readily available to shareholders, potentially on the website.
- The limit of 3% for the EEI addendum (which in theory can refresh every 3 years) in addition to the 15% plan limit over the 10-year life of the plan.
- A market price (or discount to market price) exercise price for the options rather than a nominal price.
- Alternative share-based remuneration structures other than options – the QCA remuneration guide has various suggestions.
- Lower individual grant caps in relation to salary for the PSP and introducing salary caps for the EEI scheme.
- Avoiding share price alone as a vesting criterion for option plans. Windfall gains due to temporary aberrations in a share price are possible – equally deserved rewards may not be received. In general, the combination of cliff edge vesting alongside a nominal cost exercise price can cause stress and confrontation if it is marginal whether rewards will or will not be earned. We note the PSP has EPS targets whereas the EEI addendum use share price targets.
- Does 15% cap in the PSP plan at any one time equate to 15% dilution over 10 years given the 10-year life of the plan? Clearly the EEI scheme is in addition.
- The manner in which remuneration guidance has evolved over the last 10 years. The IA remuneration guidance is overly prescriptive for a company of your size but the QCA remuneration committee guide should offer guidance and suggestions appropriate for a small company.

Herald recognised that as an AIM company it is positive that Science Group were voluntarily putting up share-based incentive awards for shareholder approval in line with QCA guidance. Furthermore, there are some positive features, including that the share price targets of the EEI plan are fairly ambitious and the five-year vesting criteria should aid staff retention. The 10-year PSP started in 2013 and standards of corporate governance have evolved since. We expect that Science Group will begin consideration of the replacement plan within the next year and this will give the Board the opportunity to align the plan with current thinking and consult with shareholders. We requested that Herald be consulted on the share-based incentive plan prior to its implementation.

Herald was not subsequently consulted on the PSP in 2022, hence for the May 2022 AGM Herald decided to vote against the AGM vote on the PSP and to abstain on the approval of the financial statement and statutory reports. This was because Herald did not believe that sufficient progress was made on improvements in the PSP for Herald to vote in favour and would have preferred to have reviewed the PSP in advance of the vote. Herald also dislike the combined CEO and Chair roles, and felt that there was insufficient explanation with regard to CEO and NED bonus/discretionary payments - hence abstained on this vote. The combined Chairman and CEO is also a 20.7% shareholder, which is significant when compared to Herald's 4% shareholding. We will continue to raise our concerns surrounding the structure of the share incentive schemes with the Chairman and CEO and ask him to consider improvements.

Ribbon Communications – Engaging and voting due to concerns over the size and structure of a management stock based omnibus plan

Herald has a shareholding in Ribbon Communications, a North American provider of communications technology and IP optical networking solutions that has been digesting the significant acquisition of ECI, which added significant leverage to the balance sheet. In 2021 shareholders voted to approve the CEO joining plan which consumed a large portion of the available shares in the employee incentive plan. During 2021 management failed to meet their performance metrics such as EBITDA margin and revenue growth, partially due to limited component availability. The share price has been weak. The share issuance rate for employee share grants over the last 3 years has been 3-5% pa of the outstanding share grants.

The proxy material for the AGM in May 2022 included a resolution to approve the amended Stock Omnibus Plan. The 10m (6%) share increase in the plan took the number of shares in the employee share plans to 25m shares, equivalent to 16% of the shares outstanding. Herald contacted the Company to discuss their rationale behind the requirement for increased shares. We felt that the dilution that the rate of equity was high relative to the Company's growth rate. We were mindful that the business had a stretched balance sheet following the leveraged acquisition of the ECI Optical business. We had further concerns that the lower share price of $3 at the time of the proxy, in comparison to the $7-8 in 2021, would result in further dilution to ongoing shareholders. Herald arranged a call with the CFO, legal counsel, and head of HR regarding the issue. We pointed out the negative elements of the scheme and the excessive dilution. Unfortunately, the motion was passed, partially as the board are significant shareholders and are closely aligned with some other shareholders in total these interests represented over 50% of the shares. We had a constructive conversation with management and hope that as the investment in ECI matures, the dilution from share issuance to employees will reduce over time. During Q3 2022, we participated in fundraising, helping to provide capital to support growth and maintain flexibility within the balance sheet.

Although, the proxy vote on the omnibus stock plan was passed at the AGM, we felt our vote against it should help the Board push back against future pressure on share dilution. We remain supportive of the management and the Company, evidenced by our ongoing investment.

Corero Network Security – Engaging to maintain nonexecutive director independence and limit option payments to nonexecutive directors

At the AGM of Corero Network Security in June 2022 Herald abstained in voting to accept the Financial Statements and Statutory Reports due to all NEDs receiving options in the last year. Corero is a small, network security company with $21m of revenue, approximately three quarters of revenue is from the Americas. Corero trades on the AIM market in the UK.

Herald explained the decision to abstain on the vote to approve the financial statements of Corero at the upcoming shareholders meeting in an email to the Chairman. Herald stated that the primary reason for Herald abstaining on the vote to approve the financial statements is that in the last financial year 3 NEDs were each awarded 350,000 market price options at an exercise price of 13p. Furthermore, the options granted to executive directors, vested in less than 3 years and seemed to lack performance conditions. For fully listed companies on UK stock market options for NEDs are rarely supported by institutional investors due to concerns that NEDs judgement may be skewed, if they participate in option schemes that they design for executives and staff.

The Chairman responded and explained that whilst the Board appreciated granting options to NEDs is not best practice in the UK, the reverse is the case in the US, and that Corero thought it was unreasonable to assume and highly unlikely that Corero would be able to attract high quality US resident NEDs that can contribute network security industry knowledge and experience without such an NED option policy in place. The Chairman and another NED, as significant shareholders offered to exclude themselves from the option grant and to exclude themselves from any future grants. The Chairman also clarified that they were considering recruiting additional independent NEDs and that limiting options grants for NEDs might limit the scope and addressable market for relevant and talented directors and shut off the US as a credible candidate pool.

Arlo – Withholding Herald's support for the re-election of the Chairman of the compensation committee due to retention payments deemed excessive being made to company management.

We raised our concerns over the level of equity dilution for high compensation with the management when we met with them early in the year, before proxy publication.

The proxy ahead of the June 2022 AGM had large 'retention' grants made to the CEO during the year, with 50% of grants were time based RSUs and 50% PSUs. Large part of the long-term PSUs were for the cash balance at end of 2021 (so a short term metric, that was left undisclosed), and the remainder were for share price targets between $7.57 and $13.2 over the next 4 years. There was no option to vote on executive compensation. We abstained on the re-election of the Chair of the compensation committee, partly due to the design of the scheme, lack of disclosure on targets, and we felt the overall level of shareholder dilution remains too high at the company.

Smoove plc – Vote on re-election of a new Non-Executive Chairman that has received significant option grants.

Prior to the AGM of Smoove plc in September 2022 Herald reviewed the annual accounts and proxy material. Smoove is a small (£25m market cap) company that trades on AIM in the UK. Herald was concerned to note that the Non-Executive Chairman of Smoove was awarded options in the last year, these amounted to 750,000 options with a face value of £397,500. Herald does have concerns that there is conflict if NEDs are permitted to benefit from the share-based remuneration schemes that they are designing for executives. In the UK, institutional investors in larger listed companies typically believe that NEDs should primarily be remunerated in cash or straight equity. Herald raised the Chairman's options with the Smoove Head of the Remuneration Committee, who is also a shareholder representative of Kestrel, an investor HIT shares a number of portfolio holdings with. The explanation provided was that Martin Rowland was integral to the business and far more involved than a normal Chairman. Key points included….

"Martin is a seasoned PE exec who has extensive knowledge of the industry. He was the PE exec at LDC that originally backed ULS before it floated. As a result, he has extensive knowledge of the business and sector that would be very difficult to replicate. He stepped into an Exec Chair role when the previous CEO left and was instrumental in the recruitment of the current CEO who has in turn significantly strengthened the entire team with similarly high calibre individuals. He is very 'hands on' was instrumental in the sale of CAL and in the development of the wider company strategy. Securing Martin's services as an executive chair was a critical step in developing a realistic new strategy for the business that merited some equity upside."

Clearly there has been a difficult management and strategic transition at Smoove/ULS and Martin Rowland was brought in as a temporary Exec Chair for which he negotiated options. This transition is now over, and Martin Rowland has taken an NED role. Herald has encouraged normalisation of the Chairman's remuneration and the Chair of the Remco to eliminate or minimize option grants to NEDs in future. As there was an option grant in the last year to

Martin Rowland, Herald abstained on his re-election this year. If no future NED option grants are made it may be appropriate to vote in favour in future. There is sometimes a conflict when a generally sensible policy on not awarding UK NEDs options comes head-to-head with the reality of a difficult situation.

Feedback plc – Vote to re-elect non-executive Chairman in receipt of options and agreement to limit option issuance to NEDs in future.

Feedback plc is a small AIM company with approximately, £15m market cap and less than £1m revenue. Prior to the Feedback plc AGM in October 2022 Herald engaged with the CEO and Chairman of Feedback plc to discuss the issue of options to the Non-Executive Chairman during the prior year and other aspects of the option scheme design. Herald and the UK investment community typically dislike the conflicts of interest inherent in a Non-Executive that participates in a performance related share-based incentive scheme that is being designed for company executive management and for UK listed companies generally is not supportive of such remuneration. There can be an additional problem that such remuneration can create an incentive for NEDs to take on excessive risk or portray the outlook for the company in an overly positive light, if there is a significant upside for the NED from share-based remuneration.

The other areas discussed in the design of the option scheme were that there was the retesting of some performance criteria throughout the performance period, that award vesting was based solely on share price targets (a metric that has a number of drawbacks) and that the vesting period of the LTIP had a vesting period of less than 3 years.

Feedback's justification of the option awards to the Non-Executive Chairman was that it was primarily for retention purposes. Alongside the executive management team, the Chairman has key relationships with NHS bodies and Community Diagnostic Centres (CDC), potential customers for the Company's product suite. These Options have time-based vesting conditions only and are not linked to share price performance conditions, with one-third vesting on each of the first, second and third anniversaries of grant.

Furthermore, Feedback explained that the historic award of options to the Chairman was aimed both to help the Company conserve cash prior to the fundraise in November of 2021 and also to show the Chairman's confidence in the Company.

On balance Herald decided not to vote against the remuneration report as ISS had recommended, as the Company is small and the NED receiving the options is the Chairman, whom Herald are supportive of and who was previously executive and remains important due to the key relationships he has with customers. Furthermore, the options do not have the same performance terms attached as the executive options. Herald therefore decided to abstain on the vote on accepting the remuneration report.

The other issues were around the technical structure of the option scheme including performance testing and vesting periods. Given the early stage of Feedback, Herald was of the view that some flexibility was appropriate. Herald retains a fundamental belief that in general that NEDs should not benefit from share-based incentive schemes as it can be seen to compromise the NEDs' independence when designing remuneration and share-based incentive schemes for executive directors.

Given that the Chairman is instrumental to the continuing success of Feedback, Herald decided to support his re-election on this occasion despite the reservations we have with regards to his participation in the options scheme.

Herald explained to the CEO and Chairman of Feedback the reservations that Herald holds in general with regards to NEDs being granted options or other share-based incentives, where there is a performance related element. We are less concerned where NEDs are rewarded directly with modest amounts of shares as part of continuing remuneration but would in general favour the simplicity of cash payments and encourage NEDs to purchase shares in the market or via placings alongside other shareholders.

Feedback confirmed that they recognised that the option award to the Chairman was slightly atypical but felt it in the Company's best interest during the period in question. Feedback further stated…

"Now that we are in a strong trading position and following the feedback of shareholders the Board will take this under review and have no future plans to include options as part of non-executive remuneration."