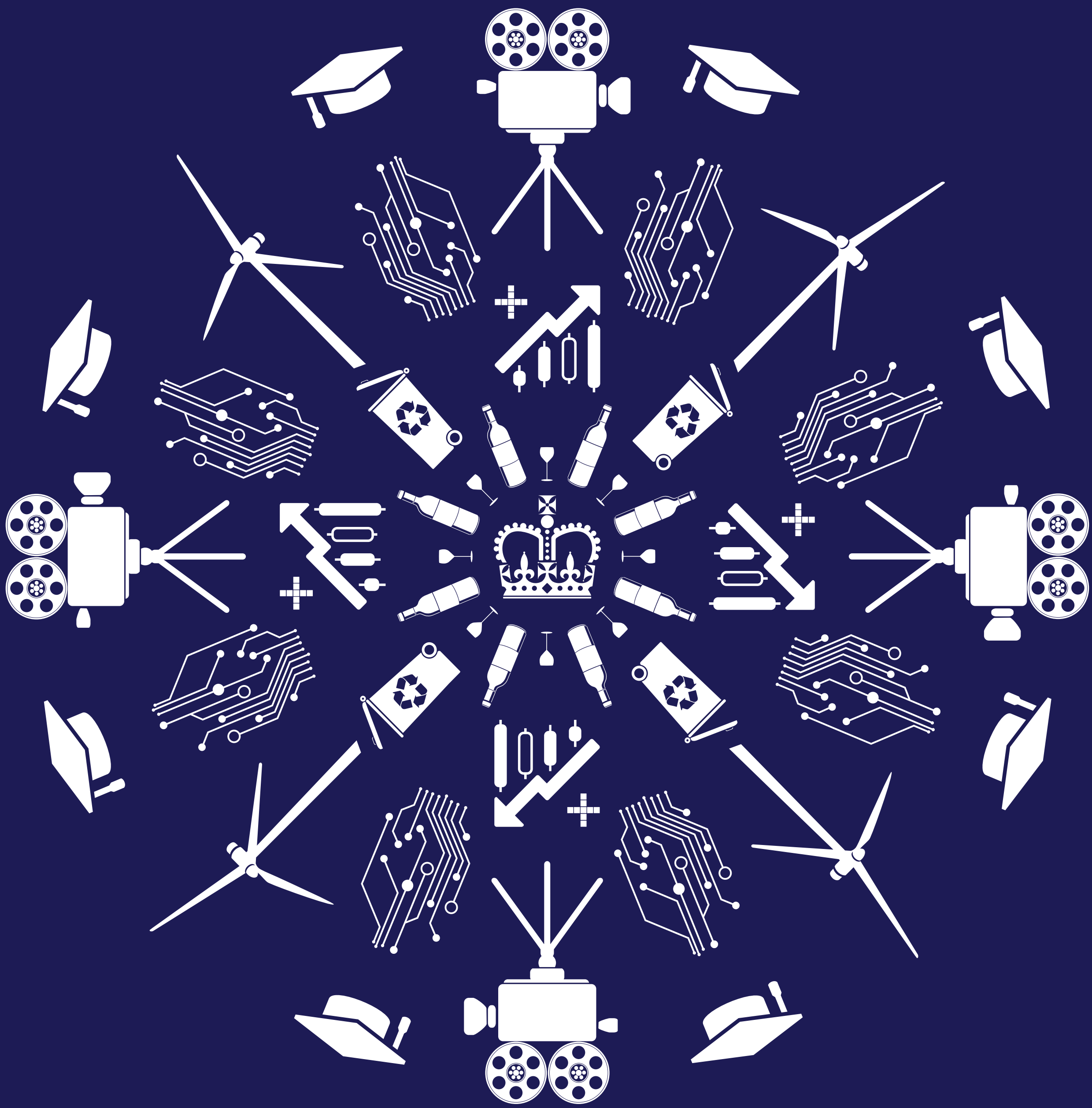
AiR 15/16

ALTERNATIVE INVESTMENT REPORT



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VCT INDUSTRY REPORT 2015/2016

FOREWORD

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Welcome to the first industry report focused purely on VCT.

Over £5.5 billion has been raised by some 200+ VCTs (Venture Capital Trusts) since their launch in 1995. These funds have supported Small and Medium Sized Enterprises (SMEs), the smaller companies that are the lifeblood of the UK economy.

This money has a measurable positive impact: according to the Association of Investment Companies (AIC) on average each SME increases turnover by £12.71 million and adds 51 new employees post VCT investment.

Investors have benefited as well: The sector has delivered a +81% return over the last ten years and currently yields +8.2% (AIC).

So VCTs are a good news story. So why are some advisers wary of recommending them to their clients? Perhaps because they also have a reputation for high costs and often trade at a discount to their NAV. These sorts of things can be hard to explain to clients.

This is a shame, because the tax breaks on offer (30% Income Tax relief up front, tax-free dividends and tax-free growth) are generous and the stock market listing offers higher levels of transparency and liquidity than other Tax-Advantaged Venture Capital Schemes such as the Enterprise Investment Scheme (EIS). New pension limits also mean advisers are looking for additional tax-advantaged investments for suitable clients.

For these reasons we think many advisers will be reassessing their stance on VCTs and investing more of their clients' money in them than in previous years.

This report has been written with those advisers in mind. We want to provide a timely and accurate snapshot of where the VCT market is today; examine how well the industry is coping with the latest round of rule changes, help advisers get to grips with the whole-of-market, give our readers meaningful insights into the VCT industry and provide some ideas for how VCTs can be utilised. Our objective is to help advisers make informed decisions about this sector.

Guy Tolhurst
Managing Director
Intelligent Partnership

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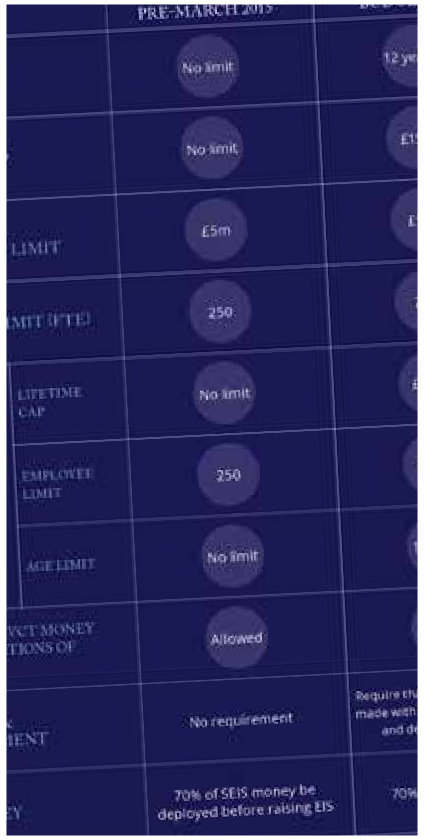

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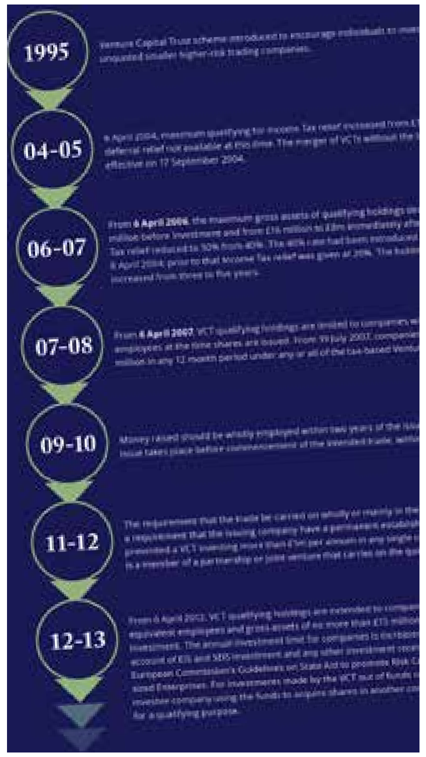

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* Please note: unless otherwise stated, all charts and graphs have been provided by Intelligent Partnership

Intelligent Partnership is committed to the very highest professional standards as embodied by its accreditation and membership to these industry associations.

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AMPS

FSC® is a non-profit international organisation established to promote the responsible management of the world's forests. Products carrying the FSC® label are independently certified to ensure consumers that they come from forests that are managed to meet the social, economic and ecological needs of present and future generations, and other controlled sources.

OPENING STATEMENT

2015 was the Venture Capital Scheme's 20th anniversary. A Government initiative established to deliver investment to SMEs across the UK, the scheme has grown from just three funds at its launch to nearly 70 in 2015. The success and maturity of the scheme today is unsurprising given that VCTs are able to offer retail investors access to a unique asset class, with generous tax reliefs to compensate them for the higher risks involved.

VCTs provide finance and support to some of the most dynamic small businesses in the UK to help them grow. They give clients exposure to a diversified portfolio of investments in small and up-and-coming companies managed by a professional manager. Though the companies VCTs invest in start small and are high risk, they can become household names in the future, helping to create jobs and future growth.

VCTs have generally performed well over the long term, with a £100 investment in the average VCT growing to £158 over five years and £179 over ten years. In addition, as the sector has matured, many VCTs are offering consistent and attractive yields. The average yield for the VCT Generalist sector, which as the name suggests invests in a range of investments in different sectors, is 8.9%. The average yield for the VCT AIM Quoted sector, which invests in companies listed, or about to be listed on AIM, is 5.6%.

These returns, whether in the form of dividends or capital profits, are free from any Income or Capital Gains Tax. Combined with the 30% upfront Income Tax relief available when subscribing for new shares, this makes VCTs an attractive prospect for tax-efficient portfolio planning for clients for whom VCTs are suitable, one that is likely to become even more relevant for higher earners facing further pension restrictions.

It is not just the benefits to investors that make VCTs so special. They also make a significant contribution to the UK economy by providing finance to smaller companies that find it difficult to raise finance from traditional sources such as banks; something that has been made worse by the banking crisis. These growing companies often need a lot of funding in these early stages, well beyond the means of most individual investors. VCTs help to bridge this 'finance gap'.

The broader benefits for UK employment are also clear. A recent AIC survey of VCT investments revealed that, on average, 51 jobs have been created at each company supported by VCT investment. In total, 13,508 new jobs have been created since the start of the VCT scheme.

The Government's recent announcement that it had secured State Aid approval from the European Commission provides certainty over the future of the scheme and also makes clear the UK's continued support for the growth and development of the VCT industry. In order to gain State Aid approval some of the VCT scheme rules have changed. Though not all of these changes are welcome, adaptability is one of key strengths of the sector. The sector has faced such challenges in the past and has coped well with them and we are confident it will do the same again.

A new development in the latest round of State Aid negotiations was the introduction of the concept of 'knowledge intensive' companies. These provisions seek to direct support to companies that employ a significant number of highly skilled professionals and have high levels of research and development (R&D) expenditure. There are clearly public policy benefits to this move, but they may also refocus the attention of VCT managers on businesses with unique potential for future growth.

The popularity of VCT shares with retail investors is clear, as is demonstrated by the strong round of fundraising in the most recent tax year (2014/15), when £429m was raised. In a recent development, the rules have also changed to allow VCT shares to be offered via platforms. The take-up of VCT shares by adviser platforms is something we expect to see grow in the future.

To help advisers and wealth managers gain a better understanding of VCTs, the AIC runs both face-to-face and online training sessions dedicated to the sector. These sessions are free and open to all, with the next series of face-to-face seminars taking place in January and February 2016. Bespoke training can also be arranged by interested firms on request.

We very much welcome this initiative by Intelligent Partnership to produce a report that focuses on the opportunities that VCTs offers investors and to raise awareness of the scheme among advisers. We hope you find the content both stimulating and relevant and that it helps provide you with the information you need when considering VCTs for your clients.

Ian Sayers, Chief Executive,
The Association of Investment Companies

ACKNOWLEDGEMENTS AND THANKS

We couldn't do this without the help and support of a number of third parties who have contributed to writing this report; their contributions range from inputting into the scope, sharing data, giving us their insights into the market, providing copy and peer reviewing drafts.

So a **big thanks** to: Adviser Home, the AIC, Bovill, Portunus Investments, St James's Place, Ram Capital and Transact.

Their input is invaluable, but needless to say any errors or omissions are down to us.

The report is made possible by our sponsors, who have contributed copy to the report on pages 74 to 83 and supported us by helping to meet production and printing costs. They are acknowledged in the *Providers in Focus* section.

KEY FINDINGS

Over **£5.5 billion** has been raised by VCTs since their launch in 1995

1995 2015

New rules excluding MBOs and Company Acquisitions will change the risk profile of VCTs

The average investment size is **£2.31 million** per company

£2.31m

85% Of initial investments into companies address the finance gap identified by Government

April 2014 **66 VCTs** raised £440 million in the year to April 2014

The number of VCTs managing funds peaked at **131** in 2007-08

97 VCTs MANAGING FUNDS 2013-14

VCTs paid out aggregate dividends of over **£240 million** in the year to March 2015

8.9% **Generalist VCTs** Currently yield **8.9% p.a.** on average

5.6% **AIM VCTs** Currently yield **5.6% p.a.** on average

32 PROVIDERS IN THE MARKET (Dec 2015)

60% **Generalist VCTs** account for more than **60%** of the market (Dec 2015)

£1 For every £1 of initial tax relief, an average investee company sees its turnover rise by **£6.46**

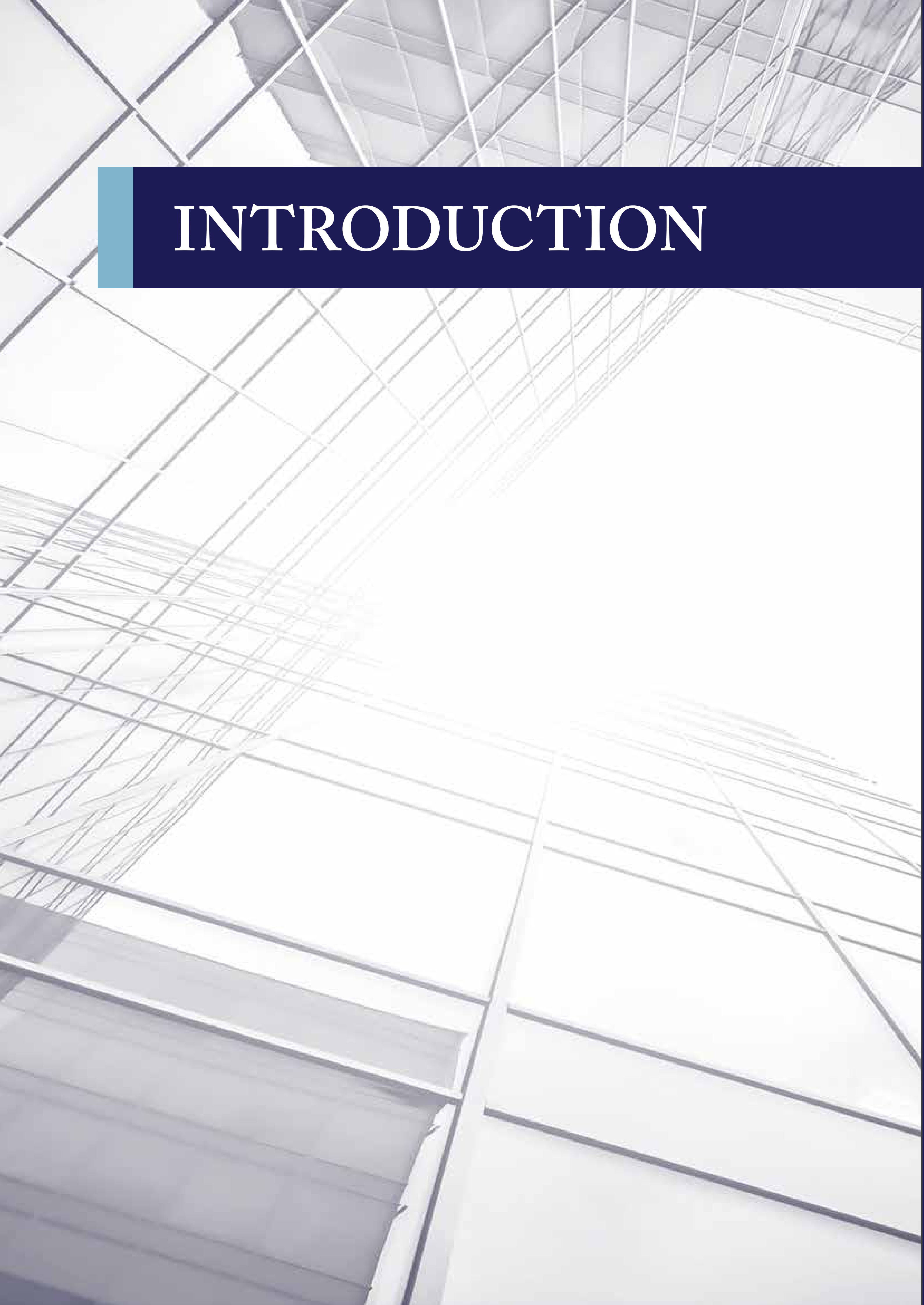
£3.5 billion TOTAL ASSETS OF THE SECTOR (AIC)

67% of the advisers we surveyed recommended VCTs to their clients 67%

44% of advisers recommend VCTs to both HNW and ordinary retail clients 44%

Investors were split 50:50 when asked if they would **invest more** in VCTs in the **next 12 months**

Only **9%** of advisers expected to recommend fewer VCTs in the next 12 months



INTRODUCTION

VCTs are a well-established and well-known asset class that has been around for more than 20 years now. But considering their generous tax advantages and the strong track record of some VCTs, it could be argued that they have not received the levels of investment that they should have.

Have advisers been under-weighting an investment that could deliver real value for their clients? Has a lack of knowledge or a fear of the non-mainstream held advisers back? Is it down to the marketing advantages that Open-Ended Investment Companies had pre-RDR, when they could pay advisers commission? Or perhaps advisers have been right to be wary of these higher risk vehicles where information on the underlying investments is more opaque.

Whatever the reasons, this report is going to look at the investment case for VCTs again. With lower limits on the amounts that can be invested in pensions, changes to the rules on how dividends are taxed and consumers demanding more from their advisers, VCTs could be an important tool in advisers' kit bags. Interest rates look set to stay low, so assets that can provide high yields are in demand. But with new changes to the VCT regime announced in the summer Budget to ensure ongoing compliance with European State Aid rules, advisers also need to be mindful of how those changes will impact the sector and what they are likely to do to the risk profiles of VCTs. We've got an in-depth look at this on page 30.

We'll outline the tax breaks for investors (on page 16), the qualifying rules for investee companies (page 17), the range of investment strategies and different types of VCT on offer (page 19), the historical performance (page 33) and the outlook for the sector (page 87). We'll capture all the regulatory and compliance information in one place (page 48), take a look at the risks (page 27), consider the due diligence advisers and investors need to undertake to try to ensure those risks are mitigated and think about compliance and suitability (page 48 to 51). And, as we do with all of our reports, we've also surveyed advisers, investors and providers to give us a sense of where the market is at right now (page 59).

The report starts off with the basics and then goes into more detail as we go on. It's not necessary to read it from start to finish in the conventional way - readers might prefer to dip in and out of sections that interest them - and we've supported our copy with charts, tables and visuals so that you can swiftly and easily grasp the information we present.

For readers who just want a quick overview, the executive summary is on page 10, the key findings are on page 7 and our conclusions and outlook are on page 87.

We've included our analysis of the sector and our market research towards the end, from page 52 onwards. It's this research and analysis that forms the backbone of the report and drives a lot of our copy. We DON'T assess individual offers - for that level of analysis we recommend advisers sign up to one of the dedicated review sites - our focus is on delivering a top-down, whole-of-market view.

And that's it! 30,000 words over 90 pages that aims to bring our readers up to date with the VCT sector. Hopefully readers of the report will find all of the information they need to assess and consider the VCT market here.

Experienced advisers will be able to refresh their technical knowledge, stay up-to-date with the latest developments and by reading our market analysis, get a sense of what is out in the market for investment today.

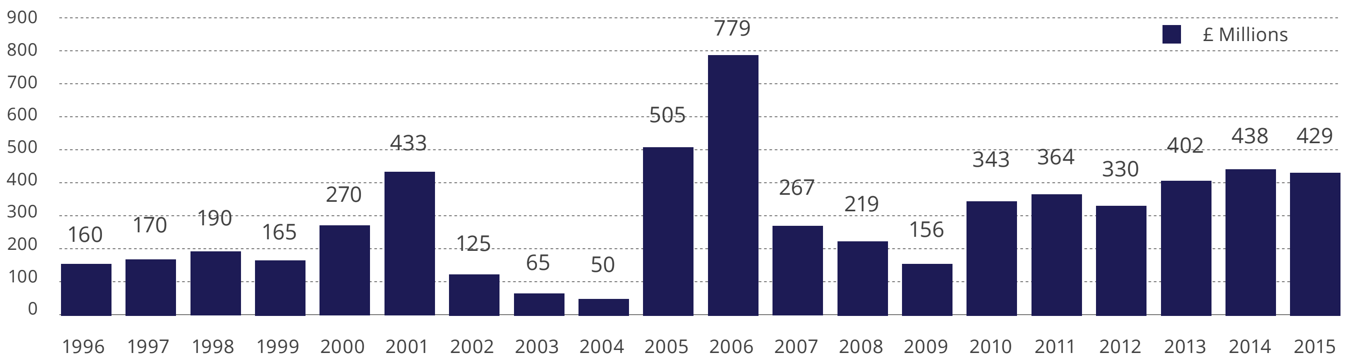
Less experienced advisers, who are perhaps approaching the sector for the first time, will be able to quickly get up to speed and approach the market and speak to clients about VCTs with confidence.

Even those advisers who don't feel that VCTs have a place within their investment proposition will be able to say that they reached that conclusion from an informed position.

EXECUTIVE SUMMARY

FUNDRAISING IS STRONG AND THERE'S A GOOD INVESTMENT CASE

VCT FUNDRAISING SINCE INCEPTION (1996–2015)

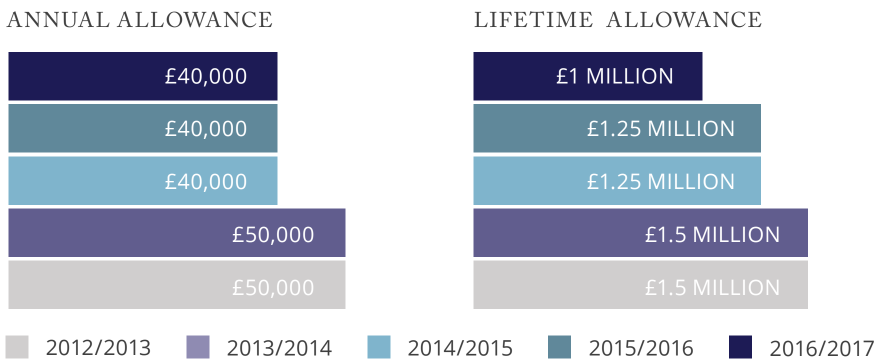


VCT Fundraising has been consistent and growing steadily since the 2009 recession Source: AIC (2015)

Three events have shaped the picture of historical fundraising into VCTs: the bear market in the early 00's after the dot com boom, the bear market after the financial crisis in 2008 and the "boost years" of 2005-06 when the upfront Income Tax relief available to investors was lifted to 40%. If you can ignore those three events though, the picture is one of steady and consistent growth. We think this is a sign of a healthy industry that is here is to stay. We look at the growth and development of the VCT market on page 21.

LOWER PENSION LIMITS MEAN THAT MORE ADVISERS ARE CONSIDERING VCTS

AMOUNTS THAT CAN BE SAVED INTO PENSIONS BY TAX YEAR

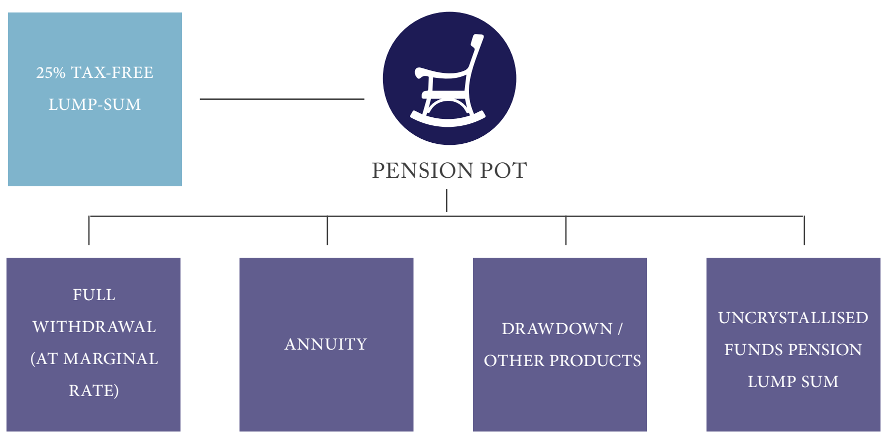


Pensions limits have been decreasing for some time Source: HM Treasury

We'll look at the impact of changes to the pension limits and what they mean for investors on page 42. But what is clear is that a number of investors are going to max out what they can save in ISAs and pensions, and are therefore going to look to their advisers to find other tax-efficient investments such as VCTs.

PENSION FREEDOMS COULD HAVE A SIMILAR IMPACT

OPTIONS AT RETIREMENT POST PENSION FREEDOMS



The "Pension Freedoms" announced in the 2014 Budget may require more sophisticated investment planning

The new pension freedoms that came into effect this year may mean that many more investors defer buying an annuity and use a drawdown solution. This will undoubtedly mean that other sources of tax-free income will be welcome to supplement the (taxable) income from the pension pot and preserve the capital left in there. Tax-free dividends are perhaps VCTs strongest selling point - the current average yield is over 8% according to the AIC.

We cover how they can be used to develop tax-efficient decumulation strategies on page 44. The changes to the way dividends are taxed, announced in the July Budget, may also make VCTs relatively more attractive.

"The high demand for VCTs is in part due to alterations to limits for pension contributions, is also a reflection of growing investor confidence, and the strong performance of good Generalist VCTs over the last few years" **Stuart Veale, Beringea LLP**

THE 2015 SUMMER BUDGET MEANS MAJOR CHANGES FOR SOME PROVIDERS

There were several changes to the rules governing VCTs in the 2015 summer Budget. The introduction of a seven year age limit and £12 million cap on investment seemed to get most of the attention, but as is often the case the devil was in the detail. The ban on using money raised by VCTs to fund management buy-outs or company acquisitions will eliminate one of the lower risk business models employed by some VCT providers. The picture is more nuanced than the headlines though - the government are keen to encourage replacement capital - so we examine this in more detail on page 31.

THE KEY IMPACT OF THE 2015 SUMMER BUDGET

Management Buy-Outs and Company Acquisitions are no longer allowed

DESPITE THE CHANGES, THERE IS NO DOUBT THAT THE GOVERNMENT SUPPORTS THE SCHEME

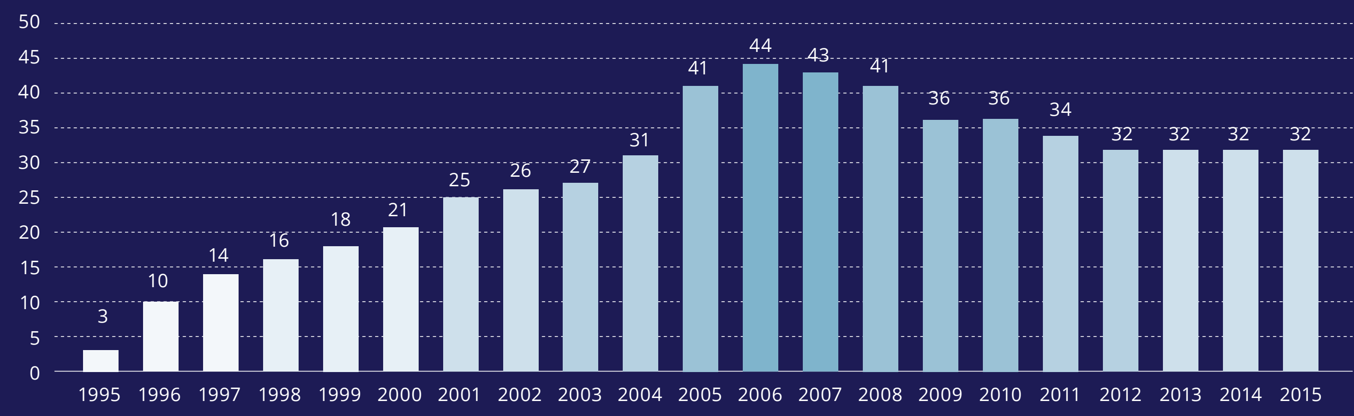
However disruptive the changes the July Budget delivered, they were made with the intention of securing ongoing compliance with European State Aid rules. As David Gauke's comment indicates, the government is determined to see the VCT scheme (and its counterparts EIS, SEIS and SITR) continue. The VCT scheme has been in place since 1995 and has enjoyed support from successive governments of all political persuasions. However many rule changes there might have been, the scheme is well established and looks set to be around for a lot longer.

"The government's aim is to make Britain the best place in Europe to do business. The tax-advantaged Venture Capital Schemes continue to be an important part of meeting this aim, providing valuable support to small and growing businesses seeking finance to develop and grow."

David Gauke, The Treasury

THERE ARE BARRIERS TO ENTRY FOR NEW PROVIDERS

NUMBER OF OPERATING VCT MANAGERS (1995-2015)



There are barriers to entry for new providers Sources: Intelligent Partnership and the AIC

There's a feeling in the industry that there can be barriers to entry for new entrants. With the high costs of setting up and running a VCT new players would struggle to compete on price and a new, untested strategy would have to be very compelling to persuade investors to part with their money. While there is certainly enough competition between the existing providers, there's no quick and easy way for newcomers to enter this space.

"There can be other risks hidden under the bonnet of VCTs that advisers need to be cognisant of: how liquidity is provided, the provider's ability to maintain the discount to the NAV and the interaction between fundraising and deployment"

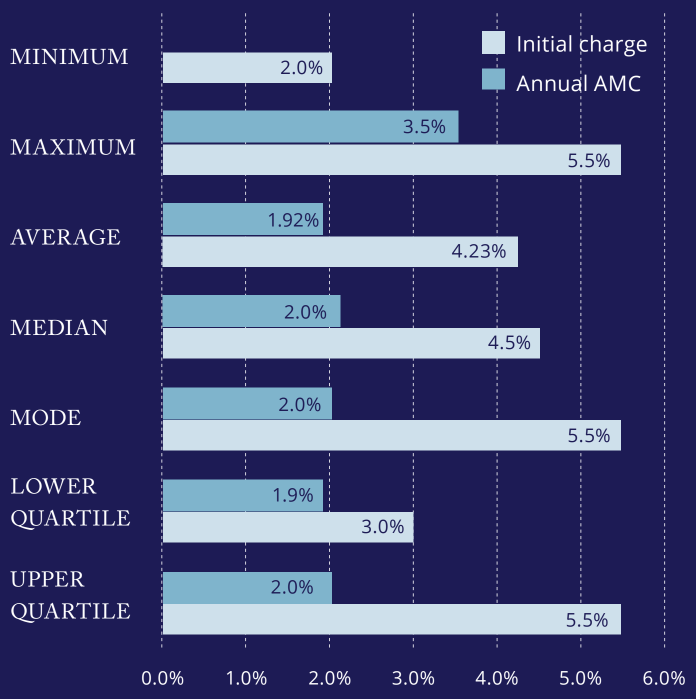
VALUE FOR MONEY?

As specialist investments, higher charges than stock market based funds can be justified for VCTs. Specialist investment teams need to put lots of time and effort into doing deals with smaller companies where the flow of information is limited, the firms are illiquid and the risks are high. Not all of these deals come off, but the resource-intensive process still needs to be paid for. Doing it well can pay handsomely, but the expertise doesn't come cheap. These charges are taken in the form of initial fees, ongoing charges and bonuses for good performance, although some VCTs charge investees rather than investors.

It's also important for advisers to note that some VCTs may also charge arrangement and deal monitoring fees, fees for placing non-executive directors on the board of their investee companies and depository or custodian fees. They may also charge the underlying investee companies. These underlying costs should be flagged in the prospectus and it's important that as part of their selection process advisers examine them and take a view on whether they represent good value for money.

The concern is that between the initial costs, annual costs and discount on the NAV at exit, perhaps as much as half of the 30% Income Tax relief could be wiped out. We look at the issue of fees and incentives (and ensuring they align the managers' interests with investors') on page 58.

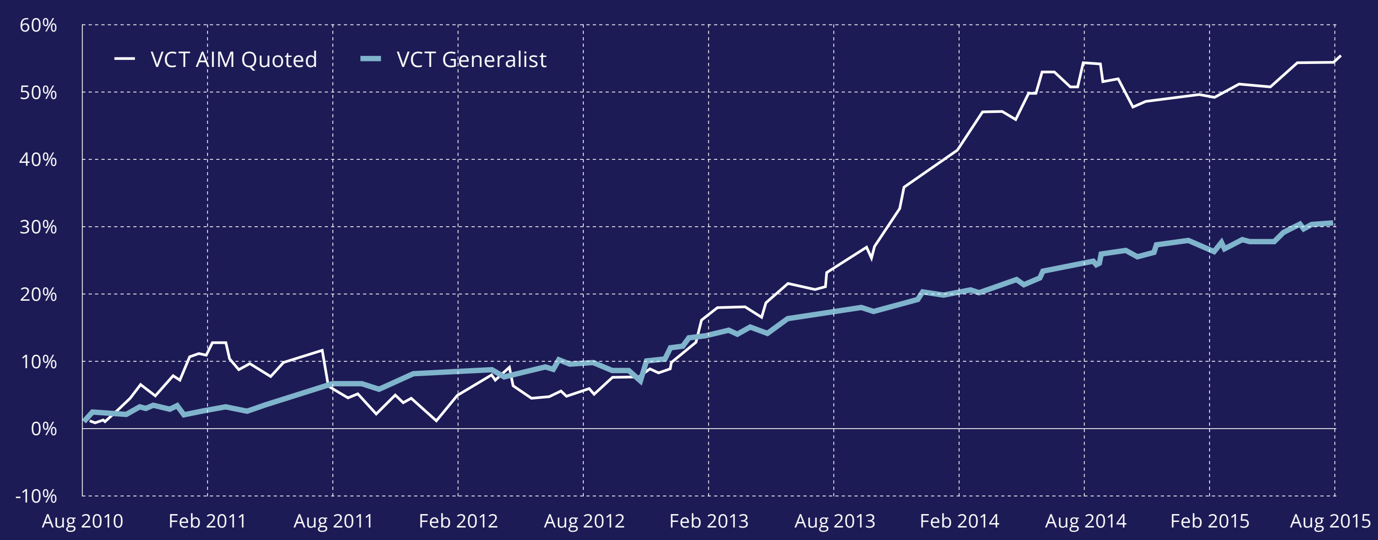
VCT CHARGES (2015)



Percentage charged against initial investment where the charges are applied to investors

ADVISERS MUST LOOK UNDER THE BONNET

VCT PERFORMANCE (2010-2015)



Volatility is not the only risk to consider with VCTs Source: FE Trustnet (2015)

The majority of advisers will be familiar with the risks of investing in smaller companies, be they AIM listed or unquoted. Smaller companies can often (but not always) have weak or unproven business models, less financial resilience and be overly reliant upon a handful of big customers.

However, there can be other risks hidden under the bonnet of VCTs that advisers need to be cognisant of: how liquidity is provided, the provider's ability to maintain the discount to the NAV and the interaction between fundraising and deployment are all examples of nuts and bolts issues that require a little more digging during the due diligence process. We outline the challenges for advisers and how they can overcome them on page 40.

"Small firms accounted for 99.3 per cent of all private sector businesses in the UK, 47.8 per cent of private sector employment and 33.2 per cent of private sector turnover (2014)"
Federation of Small Business

VCTs SUPPORT THE ECONOMY

The Octopus High Growth Small Business (HGSB) Report (2015) picked out some key statistics emphasising the importance of small businesses:

MORE THAN **70%** of HGSB turnover comes from outside London

LESS THAN **1%** of UK companies are HGSBs

ALMOST **20%** of the economic growth (measured as increase in GVA) was thanks to HGSBs

3x the number of new jobs created by the FTSE 100 companies

GENERATES NEW JOBS FOR **4,500** people every week

1 in 3 jobs created were created by HGSBs in 2014

3/5 HGSBs are located outside London and the South East

ONLY **15%** of HGSBs want the UK to leave the EU

ONLY **1 in 10** HGSBs is a technology company

Source: The Centre for Economics and Business Research

UK SMEs ACCOUNT FOR (2014)

"A VCT can provide investors with an opportunity to invest in some of the UK's most exciting smaller companies and the chance to play an important and active role in supporting the next generation of UK businesses" **Paul Latham, Octopus Investments**

THERE ARE A VARIETY OF VCT INVESTMENTS

Most investors and advisers are going to be attracted to the sector by the tax benefits, which of course are the same for all VCTs, and they are all governed by the same set of rules which ensures the capital is employed with small and medium sized enterprises. However, the underlying investments, the strategies that the managers employ, the risk profile and the objective of the VCT can all vary greatly. Some are focused on high potential, high growth firms and offer the prospect of higher returns if the investor is prepared to take on more risk. Some specialise in particular sectors, or in AIM listed companies; others look to invest in larger, more established businesses that are asset backed, or have secure revenues. These are lower risk, but have lower potential returns than their high growth cousins. Many VCTs have long investment horizons, putting 'patient' capital to work for long periods of time; other Limited Life VCTs choose to invest in assets they know they can liquidate soon after the minimum holding period required for the Income Tax relief, giving investors a clearly defined exit. We look at Limited Life strategies on page 38.

CONCLUSIONS

INCOME TAX RELIEF

TAX-FREE GROWTH

TAX-FREE INCOME

GENERALIST

LIMITED LIFE

SPECIALIST

AIM QUOTED

VCTs are a well-established asset class with a solid track record of growth and income that play an important role in supporting the UK's vibrant SME sector, which is crucial for growth and job creation. They also have attractive tax reliefs for investors - reliefs that are increasingly important as pension limits are lowered. Finally, they are a source of tax-free income, which is a unique attraction of VCTs.

However, the regulator and Financial Ombudsman Service (FOS) certainly considers VCTs to be higher risk investments than many mainstream stock market based funds. Charges are higher, there is less liquidity, and the rules governing the sector are frequently changed. Investors need to accept an additional level of risk to access the returns and tax reliefs on offer.

There are many different VCT investment options out there with some very attractive opportunities, but investors and advisers have to pay attention to the details if they are to navigate the sector successfully.

KEY POINTS

- VCTs are well-established and enjoy ongoing government support
- VCTs support SMEs, which are a vital part of the UK economy
- The tax reliefs are attractive and may be more in demand as pension limits are lowered
- Charges are higher than stock market based funds

"Following the heyday for VCT fundraising in the early 2000's, performance was pretty variable and many clients were left nursing significant capital losses. The sector was still relatively immature during this period. But today advisers are able to discuss, with suitable clients, the potential of investing in individual VCTs that have long established and successful track records. Such clients are likely to have been affected by recently imposed restrictions on annual pension contributions and the reduction in the Lifetime Allowance. For some of these clients, investment in a carefully chosen VCT could provide an attractive, alternative, tax efficient solution"

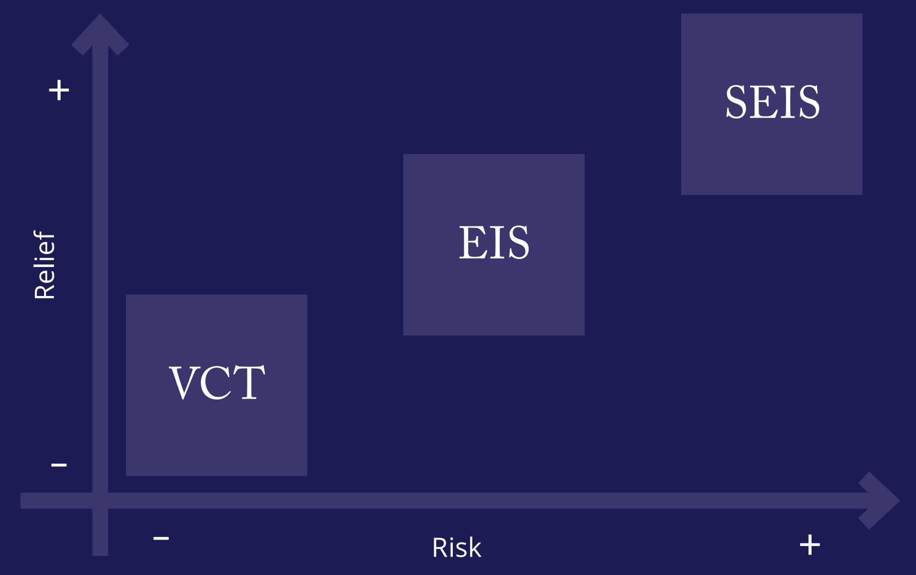
Chris Hutchinson,
Unicorn Asset Management

VCT IN FOCUS

WHAT ARE VCTs

TAX RELIEFS

	EIS	VCT
INCOME TAX RELIEF	30%	30%
MINIMUM TERM	3 YEARS	5 YEARS
MAXIMUM ANNUAL INVESTMENT ELIGIBLE	£1m (plus £1m carry back)	£200,000
DIVIDENDS	TAXED	TAX EXEMPT
GROWTH	TAX EXEMPT	TAX EXEMPT
CGT DEFERRAL	YES	NO
LOSS RELIEF	YES	NO
IHT RELIEF	100% after 2 year holding Period	NO



Venture Capital Trusts (VCTs) are a type of Investment Trust launched by the government in 1995 to encourage investment into small UK businesses.

Investors are shareholders in the trust, which is a collective investment overseen by an independent board and run by an investment manager who will invest in smaller UK companies on behalf of the shareholders. They are governed by regulations that define the sorts of underlying investments they can make and subject to the UK Listings Authority rules.

There are attractive tax incentives and investors can purchase up to £200,000 VCT shares per tax year. (Technically, they could purchase more than this, but they would not get the initial Income Tax relief on purchases over this amount.)

They are one of three Tax Advantaged Venture Capital Schemes that use tax reliefs to encourage retail investors to invest in smaller businesses. The other two are the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS). As a rule of thumb, VCTs are lower risk than EIS investments, which in turn are lower risk than SEIS investments. A VCT offers access to a range of companies on a pooled basis, whereas with EIS and SEIS clients become a direct shareholder in the underlying company.

TAX RELIEFS

There are three major tax reliefs:

- Income Tax relief of 30%
- Tax-free dividends
- Tax-free capital gains

The Income Tax relief is clearly attractive. A £10,000 investment would knock £3,000 off the investor's tax bill and the relief is paid up front. The relief can be claimed against both earned and unearned income (for example, income from a rental property).

There are some subtleties to note though - it can only be offset against the Income Tax bill - you can't get relief against tax you never paid unfortunately! And some VCTs invest net of charges. So to take a simplistic example, if you pay £10,000 and only £9,500 is invested after charges, this is the amount that the relief can be claimed on. Other VCTs pay charges out of the VCT itself, so investors would get the relief on the full £10,000 invested.

- The Income Tax relief is only available when purchasing primary issues of VCT shares
- It is not available on share purchases made in the secondary market
- The shares have to be held for a minimum of five years, or HMRC will claw back the Income Tax relief

"VCTs provide access to a wide-ranging portfolio of investments, offering exposure to companies at various stages of maturity and which operate in a variety of industry sectors" **David Stevenson, Amati Global Investors**

- Shares purchased on the secondary market still count towards the £200,000 annual allowance
- Secondary market purchases still pay dividends tax-free and are also Capital Gains tax-free

The minimum holding period is five years. If the shares are disposed of earlier than this, the investor has to repay the rebate.

The Income Tax relief can be claimed by completing the SA101 additional information form issued by HMRC along with the standard self-assessment form. The investor just needs to enter the total value of the VCT investment on the form. The amount of tax they have to pay will be reduced accordingly.

Alternatively, investors who pay their tax by PAYE can write to HMRC requesting that they adjust their tax code, so the amount of tax they pay each month will be reduced. Investors who do this will need to include their national insurance number, a P60 form if they have one and a copy of their VCT tax certificate.

RULES FOR QUALIFYING INVESTMENTS

Of course, those tax reliefs are designed to encourage investments into smaller companies that would ordinarily struggle to obtain finance. There are strict criteria around the types of companies that can be invested in, the amounts that can be invested and the structure of the investment itself.

QUALIFYING COMPANIES

There are a number of rules governing the types of firms that VCTs can invest in. The main ones at the time of writing (November 2015) are that the company must not have net assets of more than £15 million at the point of investment, and must have fewer than 250 full-time equivalent (FTE) employees at the point of investment. The investee companies are either unquoted, or listed on AIM or the ISDX. There is an annual investment limit of £5 million and a lifetime limit of £12 million (these limits are based upon the total amount of funding received from all three of the UK's Tax Advantaged Venture Capital Schemes: SEIS, EIS and VCT). There have been some changes to the rules around qualifying companies recently - we'll go into more detail on page 30.

Some trades are excluded from VCTs, such as: dealing in land, property, financial instruments; farming, forestry; legal and accountancy services; managing guest houses, hostels, care homes; shipbuilding, coal and steel production and renewable energy production benefiting from Feed-in-Tariffs or Renewable Obligation Certificates.

In addition, they must be an independent company - they cannot be a subsidiary of a non VCT qualifying firm.

At least 70% of the VCT has to be invested in qualifying investments, which are tested on various rules such as the requirement that the investee firm must have a permanent UK establishment, or the financial health requirement. It's part of the VCT manager's job to ensure that they are investing in qualifying investments, and it's worth advisers challenging the manager on just how they do this. The precise details governing qualifying companies are available on the HM Revenue & Customs website.

THE REGULATORY QUARTET

- HM Treasury – Sets out the rules that govern VCTs
- HM Revenue & Customs – Ensures that VCTs are compliant with the rules
- Financial Conduct Authority – Regulates the advice process
- Financial Ombudsman Service – Assesses any consumer complaints

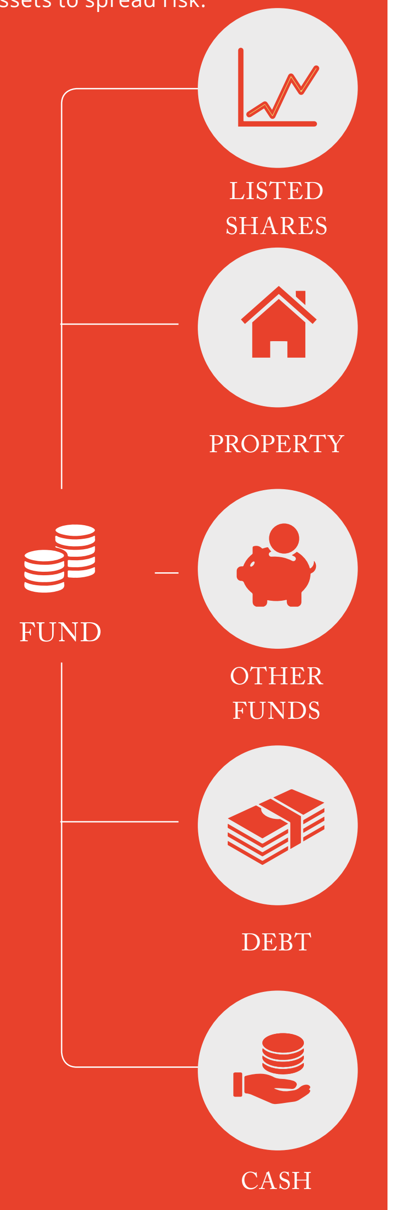
THE VCT VEHICLE

The VCT itself is a collective investment, very similar to an Investment Trust – a listed investment company. However, VCTs are also governed by some additional rules. Of course, as an investment company, VCTs will be a closed, rather than open-ended fund.

As closed-ended funds, trusts have some advantages - and some disadvantages - compared to OEICS. It's worth taking a moment to remind ourselves of some of those so that we can see why a closed-ended structure is better for the types of investments VCTs make.

COLLECTIVE INVESTMENTS

Investors pool their money and invest in a fund. The fund manager invests this money in a portfolio of assets to spread risk.



Source: AIC (2015)

Collective funds can be open and closed-ended, pool multiple investors' money and provide professional management

"Liquidity for VCTs is based on the demand for their shares on the market, so they can afford to invest in more illiquid assets compared to open-ended funds. However, advisers need to be cognisant of how liquidity is provided, looking at the risks hidden under the bonnet" **Mark Wignall, Mobeus Equity Partners**

LIQUIDITY

Investment Trusts sell their own shares on the market, so they don't have to pay as much attention to their investors' activity as their open-ended counterparts - the liquidity is based upon the demand for the fund's own shares. Open-ended funds have to have more liquidity within their fund in order to meet any requests for redemptions. If they don't, in a falling market they may be forced to sell some of their underlying positions in order to meet liquidity flows. In an Investment Trust, these flows can be absorbed by the discount (i.e. - the discount widens or narrows according to the supply and demand dynamic).

What does this mean in practice? It means Investment Trusts can afford to make investments in more illiquid assets - such as unquoted companies in the case of VCTs (or property or infrastructure in the wider closed-ended fund universe for example).

We should also note here that very often Investment Trusts will also buy their own shares back off investors, offering an additional exit route. Investors do not have to rely solely upon the secondary market, and in fact buybacks are probably the most common way to exit.

NAV VS. SHARE PRICE

A corollary to this is that an Investment Trust's share price is a reflection of the supply and demand for its shares, and not necessarily a reflection of the value of its underlying portfolio of investments.

Very often, demand for shares in the trust on the secondary market can be low because investors prefer to make purchases of new issues to obtain the Income Tax relief. Therefore the shares tend to trade at a discount to the Net Asset Value (NAV) of the fund. This can be a frustration for current investors who want to exit - the price they achieve will not reflect the true exposure to the underlying assets. This is where the buybacks mentioned above become so important. Most Investment Trusts will undertake to buy shares back at an agreed level of discount - often 5% - giving investors some protection if the discount is any deeper than that.

Trading at a discount can also be interpreted as an opportunity for buyers in the secondary market. And of course it can work the other way around: if demand for shares in the trust is high, then the shares will trade at a premium to the NAV.

SMOOTHING DIVIDENDS

Another benefit is that Investment Trusts can retain income. This means that dividends can be smoothed over time and continue to be paid out, or even increased, in a falling market. This a great benefit for investors who are looking for income and another advantage over OEICs.

CORPORATE GOVERNANCE

Another feature of Investment Trusts is their corporate governance structure. This is an important positive point for VCTs. Investors are also shareholders in the trusts (not just customers) and their interests are represented by an independent board of directors. The board has the power to appoint the investment management company who will manage the assets within the trust, and will monitor their ongoing performance. If they feel that the manager is underperforming, they can be sacked and replaced.

The board also examines the charging and fee structure and incentives for the manager. This structure provides a unique layer of governance that has responsibility to act in shareholders' interest at all times, a feature that is lacking in OEICS and (S)EIS.

Unsurprisingly, these additional rules mean that there are some additional considerations: in particular how the non-qualifying 30% of the portfolio is managed (although the rules on this were tightened in 2015) and how new money will be managed before it is deployed (potentially three years after the investment), so advisers need to look beyond the headline activity of the VCT. There's more on due diligence on page 49. The three year rule also means that the managers have to think carefully about their fundraising - raising more than they can deploy within the timeframe could put them under undue pressure.

Compliance with the additional rules is vitally important, complicated and labour intensive. This is one of the reasons why VCTs cost more than mainstream funds.

ADDITIONAL RULES FOR VCTs

There are some additional rules for VCTs to ensure they are meeting the objective of funnelling capital to smaller companies (and representing value for money for UK taxpayers).

- At least 70% of their investments must be in qualifying investments – small companies (maximum size £15 million) that are unquoted or traded on the AIM rather than the main stock market
- They must invest in the companies within three years of raising new money. Keep in mind that they may invest elsewhere while making these decisions, so the risks can be different
- They can't invest more than 15% of their total investments in any one company
- They can't retain more than 15% of the income from the underlying asset

TYPES OF VCTs

Although all VCTs are structured as Investment Trusts and the types of investments that they can make are all governed by the same rules, they still have a very broad universe to invest in. As a result there are several different varieties of VCT to choose from.

GENERALIST VCTs

Generalist VCTs focus on investing in a broad range of unquoted companies. The management identify small companies looking for investment they think have excellent growth prospects and this can be viewed as a private equity style investment.

Their strategies can vary. Some invest in early stage companies, providing 'development' or 'expansion' capital and seeking high returns. Others will use a mixture of loans and equity, looking for more secure opportunities, or possibly asset backed opportunities, and sacrificing potential returns in exchange for lower levels of risk. Others simply look for larger, better established firms to invest in, with less risk and a more stable return profile.

SPECIALIST VCTS

Specialist VCTs operate in the same way as Generalists, but focus on investing in niche areas where the management team has experience. Examples of industries that Specialist VCTs have focused on include media, technology and renewable energy.

AIM VCTS

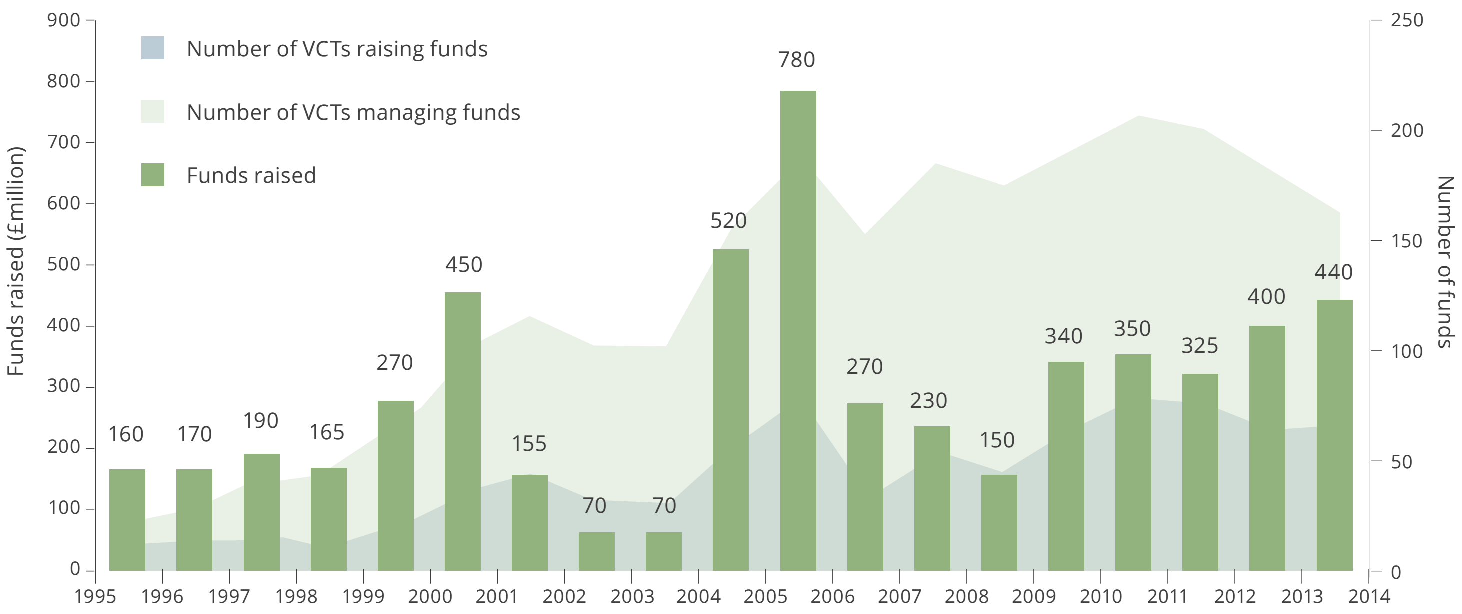
As the name suggests, AIM VCTs focus on investing in companies that are listed on the Alternative Investment Market, the junior market to the London Stock Exchange. These VCTs are closer to traditional stock market based funds.

LIMITED LIFE VCTS

Limited Life VCTs (sometimes known as Planned Exit VCTs) aim to give their investors a much more defined exit soon after the five year minimum holding period. These tend to be more conservative funds with a focus that is as much about capital preservation as it is about growth, and for this reason they may use loan notes in conjunction with equity investment.

HISTORY OF VCTs

VCT MARKET GROWTH (1995-2015)



VCT Fundraising has waxed and waned in response to market conditions and policy changes

Source: HMRC (2015)

VCTs were launched in 1995 and were designed to encourage individuals to invest indirectly in a range of small, higher risk trading companies whose shares and securities are not listed on a mainstream stock exchange.

The market grew steadily for the first five years of its life, but then fundraising suffered badly in the collapse following the dot com boom of 2000, where smaller companies found themselves out of fashion. The "boost" years of 2004-05 and 2005-06, where the upfront tax relief was increased to 40% gave fundraising a much needed lift. Unsurprisingly, fundraising dropped off again once this incentive was normalised at 30% relief once more in 2006-07, and the years 2007-09 were also comparatively lean thanks to the financial crisis and subsequent recession. The £440 million raised in 2013-14 was the fourth highest ever total, and the second highest if the boost years are discounted. The total assets of the sector are estimated to stand at over £3.5 billion (AIC).

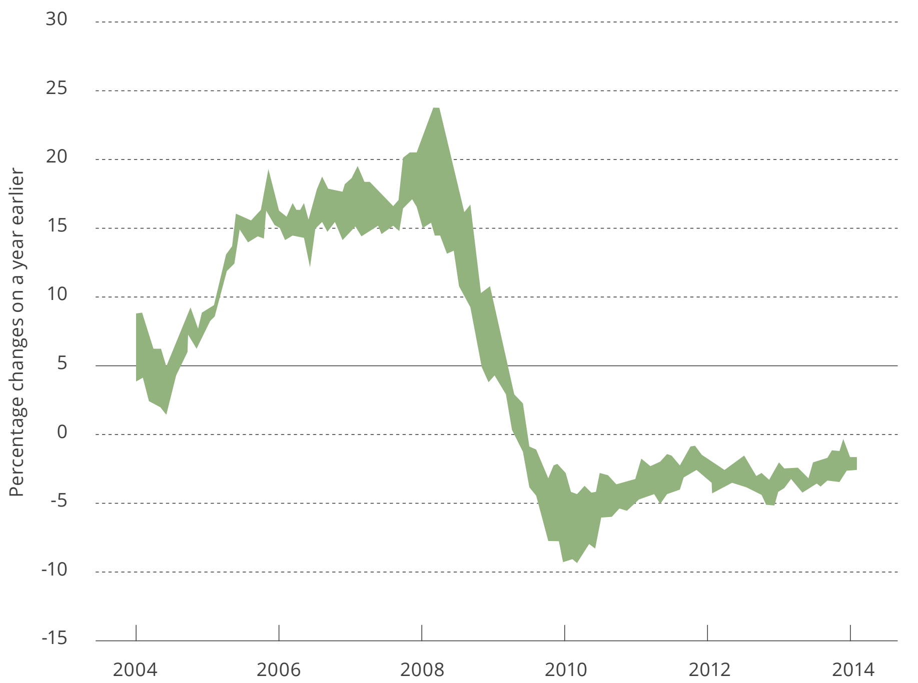
A full list of the key policy changes that have impacted on VCTs are included in the appendix on page 88, but there were some very positive changes in 2013:

- The lifting of the gross assets test to no more than £15 million, up from £7 million previously
- The lifting of the maximum a VCT can invest in an individual company to £5 million, up from £1 million

There were also big changes announced in the 2015 summer Budget - which we discuss on page 30.

Another positive development for VCTs has been the banks' retrenchment from lending post 2008. Prior to the crash, some banks would lend at 98% loan-to-value with no covenants, securing a lot of the best deals and leaving the VCTs with lower levels of deal flow. Since 2008 VCTs have been able to move in and pick up some of the slack and this is reflected in the strong fundraising figures - and again, emphasises the role they play supporting growing SMEs.

LENDING TO UK BUSINESSES (2004-2014)



Source: Bank of England (2015)

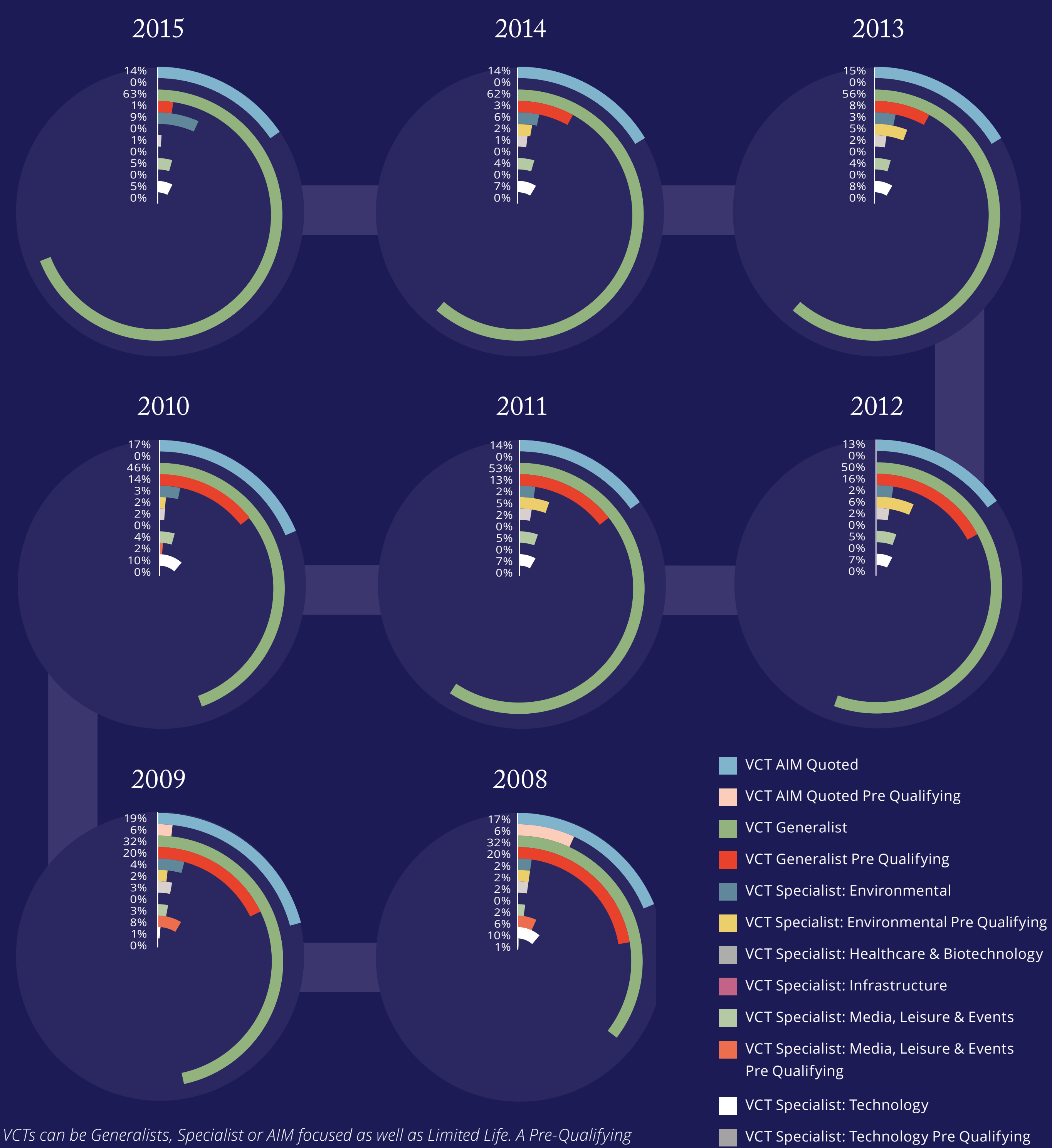
Banks have withdrawn their supply of lending to UK small businesses since 2008

MARKET DEVELOPMENT

The first VCTs to launch were Generalist VCTs, which are still the most popular type of VCT today. According to our research, the first AIM VCT launched in 1996, but there were no other AIM VCTs until 1999. More have launched since then and there have been about a dozen in total.

The first Specialist VCTs were launched in 1997 and 2000 and were focused on technology, aiming to take advantage of the dot com boom. Several other specialists have launched since and their chosen industries include healthcare, media, infrastructure and the environment. Renewable energy, which until recently could be held in a VCT and still benefit from subsidies such as the Feed-in-Tariffs, has been a very popular sector for investment. Limited Life offerings began in 2005 and have very popular over the last decade.

DISTRIBUTION OF VCT SECTORS (2008-2015)



VCTs can be Generalists, Specialist or AIM focused as well as Limited Life. A Pre-Qualifying VCT has provisional approval for VCT status from HMRC, but has not yet deployed its funds

Source: the AIC (2015)

IMPACT OF VCTs

Before we move onto discussing investing in VCTs in more detail, it makes sense to examine if they are meeting their stated purpose of helping smaller companies secure investment - and if that investment is then subsequently put to work by the investees; creating jobs, growing the economy and making the VCT scheme good value for the UK taxpayer.

DEPLOYING MONEY

Research from the AIC highlights some key metrics and is a good source for readers who want to explore more about this topic. The report looks at a sample of £1.04 billion (£722 million in initial support and £315 million in follow on investment) of VCT investment into 404 SMEs.

Today the average investment size is £2.31 million per company and in 2013 85% of the initial investments VCTs were in the finance gap identified by the government (SMEs seeking between £250,000 and £5 million) where banks have been reluctant to lend since the financial crisis in 2008. (That number fell to 80% in 2014, perhaps indicating the beginnings of a change in direction for the banks). 128 companies received £255.99 million of new and follow investment in 2014.

82% of companies see an increase in turnover post investment, and the average increase in 2014 was £12.71 million. 80% of companies see an increase in employment, and the average increase was 51 new employees. 76% of investee companies have a representative of the VCT management team on their board (Source: AIC, Going for Growth and Nurturing Success, Delivering Growth).

VALUE FOR MONEY FOR THE TAXPAYER?

Since investors get 30% Income Tax relief when they invest in a VCT, this makes the UK taxpayer the biggest stakeholder in the success of the VCT scheme, and obviously the government is determined to ensure that this investment represents good value for money for taxpayers.

According to the AIC, information provided by 208 VCT investee companies showed they paid £352 million in tax in 2013. This is equivalent to 89% of the total tax relief paid, in just one year of operation. One can conclude that when corporation tax, national insurance contributions, Income Tax and VAT are taken into account (for both the firm and its employees) it's not hard to imagine that the tax receipts from successful firms over the course of their lifetime can more than offset the tax reliefs.

GOING FOR GROWTH

2014	2015
£2.6m INVESTMENT Average VCT investment per SME	**£2.31m** INVESTMENT Average size of initial VCT investment per SME
£9.8m TURNOVER Average turnover increase in each SME since VCT investment	**£12.71m** TURNOVER Increase in each SME since VCT investment
49 NEW JOBS Average number of new employees per SME since VCT investment	**51** NEW JOBS Average number of new employees per SME since VCT investment
32% EXPORTS Proportion of SME investee companies who exported in 2013	**2014** LARGEST SECTORS: TECHNOLOGY AND IT BUSINESS SERVICES MANUFACTURING & ENGINEERING
26% RESEARCH & DEVELOPMENT Proportion of SME investee companies invested in R&D in 2013	

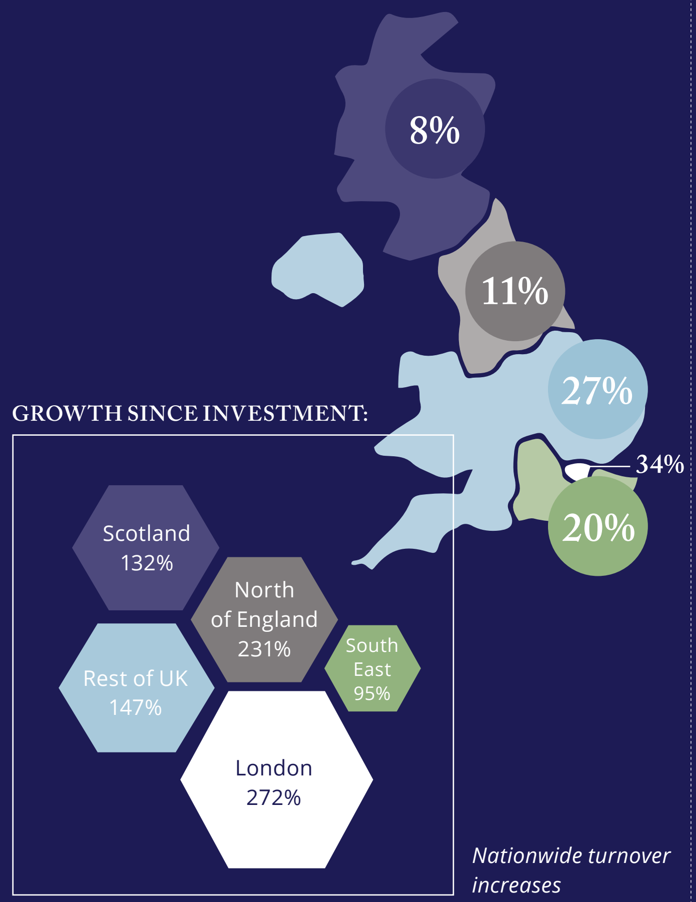
Source: AIC (2014 and 2015)

TURNOVER GROWTH* (£m)	2012	2013	
	119.4	165.8	= 39%

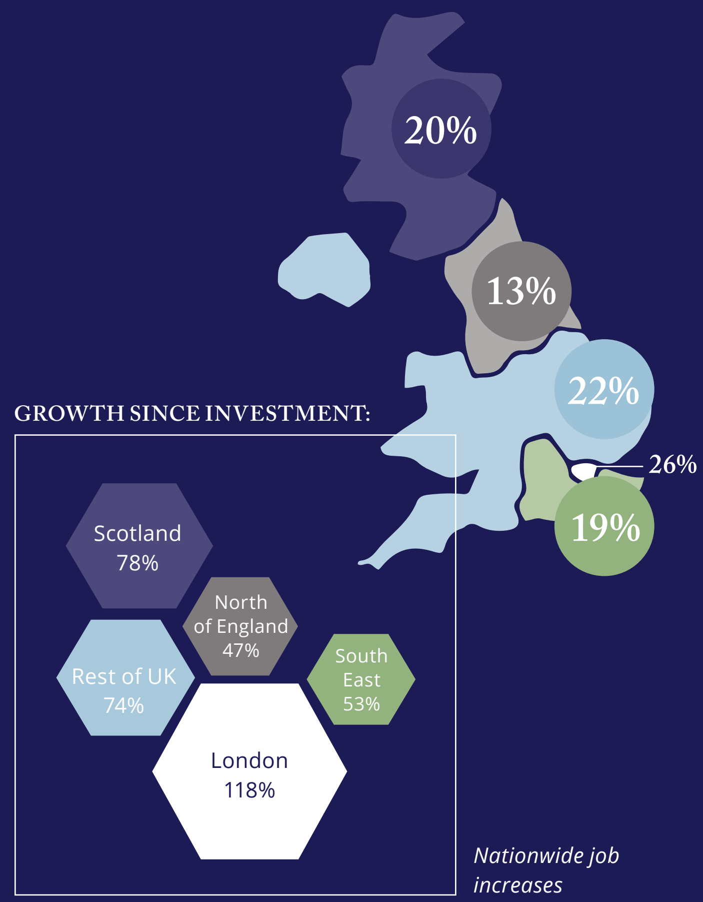
EMPLOYMENT GROWTH*	2012	2013	
	1,598	1,937	= 21%

CHANGES IN REGIONAL FOCUS:

INVESTMENTS PRE 2014



INVESTMENTS 2014



Investments (and their subsequent benefits) are distributed around the UK

Source: AIC, Nurturing Success, Delivering Growth (2015)

CONCLUSIONS

VCTs are clearly here to stay and serve an important purpose in the investment universe - incentivising investment into smaller companies that would otherwise struggle to secure the financing they need to grow. This is important for the UK economy, as it is this same cohort of smaller companies that is the engine of job creation. Octopus Investments paint a compelling picture of the importance of small business to job creating in their "High Growth Small Business Report (HGSB)". HGSBs created 68% of employment growth between 2012 and 2013, while accounting for just 2% of total employment.

VCT fundraising has experienced some great years when the reliefs were increased and some poor years following market volatility, but overall it has grown strongly since 1995, reflecting increased demand from investors and more supply - in terms of deals available for VCTs - since the retrenchment in bank lending post 2008. We'll talk about some of the drivers we think will lead to increased demand in the future, in later sections.

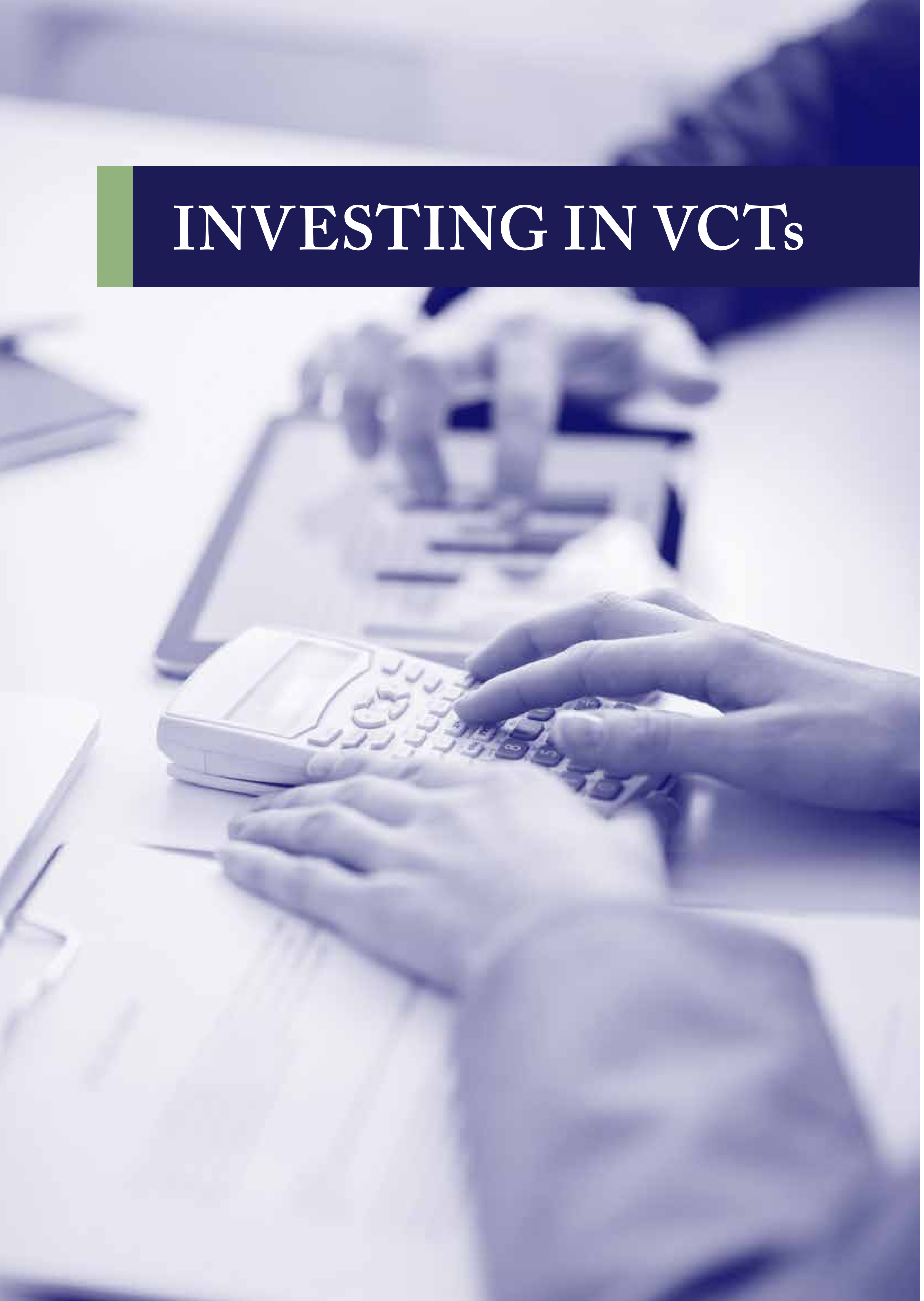
The closed-ended structure VCTs use is absolutely the right structure for the kinds of investments they make. The ability to think long-term and make investments into less liquid assets is exactly what managers need when investing in smaller companies, and is not something that open-ended structures engender. But there is still plenty of choice within the sector as managers have developed niche products, particular specialisms and the Limited Life options that attempt to address the issue of how investors can successfully exit. We'll look at these investment options and their pros and cons in the following section.

KEY POINTS

- VCTs are a particular type of closed fund governed by special rules
- They are usually less risky than EIS and SEIS investments
- Fundraising has been strong, and they have helped to plug the funding gap as banks withdrew from small business lending post 2008
- The evidence suggests that they have a net benefit for the Treasury

* Growth in 2013 for companies receiving first VCT investments in 2012

INVESTING IN VCTs



THE INVESTMENT CASE

There's a multi-faceted investment case for VCTs - as there is with most investments. Of course the tax benefits are very attractive and provide a great incentive for investment, but the old adage that the "tax tail should not wag the investment dog" applies here - the investment has to make sense in its own terms and not just as a tax planning exercise. With this thought in mind, we're going to leave the tax reliefs to the end and look at the other aspects of the investment case first.

SMALLER COMPANY INVESTING

There's a good case for investing in the kinds of smaller companies that are VCT qualifying (new shares of privately owned or AIM listed companies with fewer than 250 full-time equivalent (FTE) employees and gross assets of no more than £15 million). It's smaller companies that go on to be the giants of tomorrow, and depending upon where we are in the business cycle, they can offer a lot more value than bigger companies. They are less researched than larger listed firms, so there is more opportunity for investment managers to identify bargains and find ways in which they can help to grow business.

So the first point in favour of smaller company investing is the opportunity to identify the kind of value that is much harder to find (or some might say impossible to find) in the mainstream market today.

As the businesses grow, the VCT might seek to exit, either through a trade sale or listing, realising the value of their investment. For example, over the last three years (to August 2015) AIM VCTs have generated a total return of 26%, excluding income. Over a similar period, the AIM index returned around 7%. However, price performance is patchy with wide distributions, so we'll look at this in more detail on page 33.

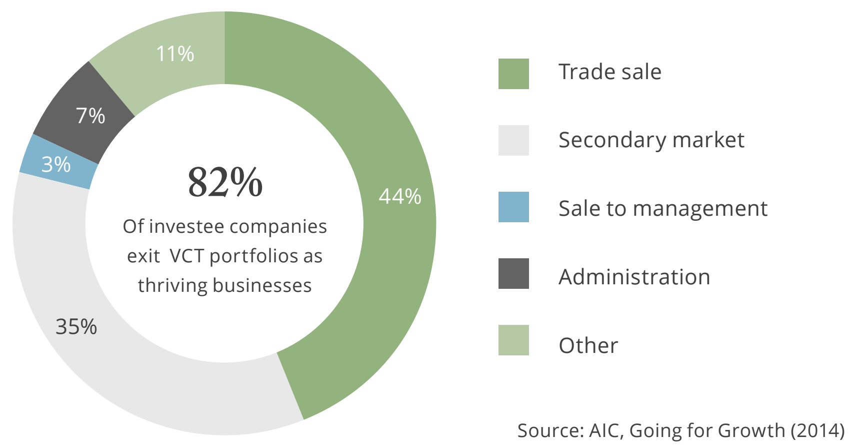
But not all VCTs are just looking for profitable exits. Many VCTs are focused on generating income for their investors. The average VCT yield at the time of writing is 8.5% (although of course as with all averages that number hides a huge amount of variation, ranging from zero to the high twenties). Often these yields are achieved by Generalist or Limited Life VCTs providing loan notes to larger companies, securing healthy income streams, or investing in established firms with regular distributions of profits. It's also worth noting that while VCTs' share prices will correlate with the markets, very often their underlying NAV and ability to generate income is not.

As we see when we examine the investment performance information on VCTs, the income is the major component of the total return for many of them. Selecting a high yielding VCT and then reinvesting the income appears to be the best way of maximising the return (consider that the income is not taxed).

So another reason to invest in smaller companies is to capture yields that would be difficult to find elsewhere - with interest rates set so low, bonds and other fixed income investments are much less attractive than in a normal environment, and high yielding mainstream large cap equities are also considered to be overvalued by some measures.

The final reason to invest in smaller companies is less about investment returns and more closely connected to the impact on the investee companies we were talking about in the *VCTs in Focus* section.

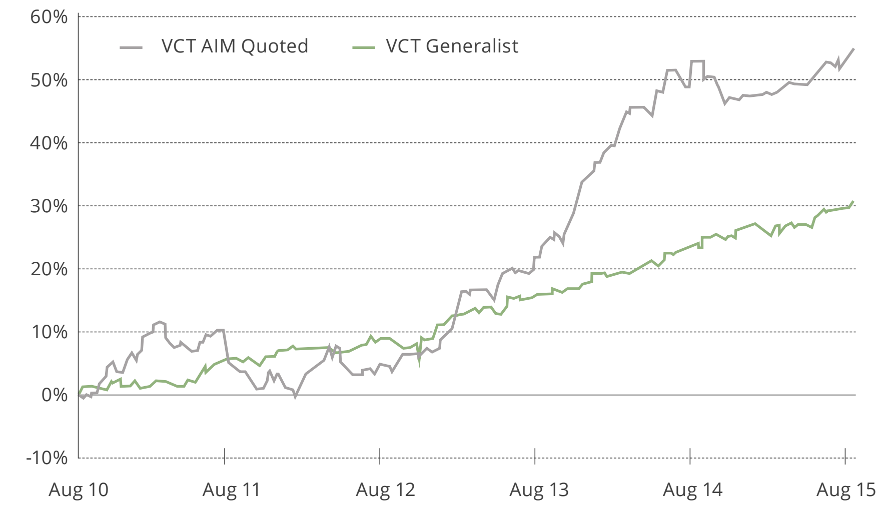
VCT DIVESTMENT (2014)



Source: AIC, Going for Growth (2014)

There are a number of exits routes for VCTs investing in smaller companies

VCT SECTOR PERFORMANCE (2010-2015)



Performance over the five years to August 2015 (rebased, income reinvested) Source: FE Analytics

BENEFITS OF SMALLER COMPANIES:

HIGHER YIELDS THAN OTHER ASSETS

MORE ECONOMIC GROWTH AND JOB CREATION

HIGHER INVESTMENT GROWTH THAN OTHER ASSETS

Fledgling businesses need access to finance, but since 2008 banks have been reluctant to provide it, stifling growth. VCT investors might take some satisfaction that they are helping to plug the funding gap and support a vital part of the UK economy. This isn't solely altruistic though - the reluctance of banks to lend means that there are more opportunities and better value deals available for the VCT managers, and investors in those deals should be well placed to benefit from economic recovery.

Considering them as an asset class, smaller companies can offer:

- Higher investment growth than other assets
- Higher yields than other assets
- More economic growth and job creation than other assets

These benefits come with more risk than other assets though, something which we'll examine later. The level of risk does mean that in the vast majority of cases, VCTs will only be suitable for investors willing to accept a higher level of risk for this portion of their investment portfolio. That said a well-diversified VCT may well have lower levels of volatility than mainstream equities.

THE TAX BENEFITS

Assuming that the investment case for a VCT makes sense, how much should the tax reliefs influence any investment decisions? Let's remind ourselves of the tax breaks for purchases of new VCT share issues:

- Income Tax relief of 30% on amounts invested up to £200,000 per person, per year
- Tax-free dividends
- Tax-free Capital Gains

Most planners would focus on using up the majority of their pension and ISA allowance before considering VCTs. These two tax wrappers would account for approximately £55,000 of investible funds each year.

Lower pension limits mean that many more people will find themselves looking for alternatives sooner than they would have previously. Some quick back-of-the-envelope calculations tell us that (for example) a 30 year old earning £45,000 a year, assuming a 3% annual pay rise, 12% net pension contribution and 7% investment growth, would reach the £1 million lifetime limit before the age of 60.

This means at the height of their earning power in their late 50s, a time of life when they will be focused on investing for their retirement, they have to look for other tax-efficient options. In our example above, the potential investor would be paying around £46,000 Income Tax a year - so an investment that gave them the chance to get some of that back, and provide a tax-free source of income to supplement their pension in the future would be attractive.

It's a hypothetical example, but shows how the pension lifetime limit is not extraordinary anymore and many people will reach it before they finish accumulating assets. (Note that in our example the hypothetical investor didn't get anywhere near the £40,000 annual limit at any point.)

Finally, pension and ISA limits notwithstanding, anybody who pays a lot of Income Tax may very well be a candidate for VCT investment in order to make use of the relief. This isn't just the super wealthy. The average investment into VCTs is £15,000, and the minimum is £5,000, which does suggest that the mass-affluent are using these products.

We'll look at some other examples relating to both accumulation and decumulation, especially in the light of the new pension limits and freedoms, later on.

Changes to the way that dividends are taxed are also worth a mention here. Under the rules announced in the July 2015 Budget, although the first £5,000 of dividend income a year will be tax-free for everybody, sums above that allowance will be taxed at 7.5% for basic rate taxpayers, 32.5% for higher-rate taxpayers and 38.1% for additional-rate taxpayers. The new tax takes effect on April 6, 2016. No tax will be deducted at source; taxpayers must use self-assessment to pay any tax due.

Dividend income is still included in the personal allowance (£11,000 at the time of writing) and another back-of-the-envelope calculation tells us that a portfolio with an annual yield of £5,000 would be worth in the region of £130,000 if it had a 3% yield. Investors who are disadvantaged by this change might consider the tax-free dividends VCTs offer as a good alternative. There are also planning ideas here for business owners who pay themselves via dividends - they could use a VCT to offset the tax they pay.

SUMMING UP

There's no need to overcomplicate the investment case for VCTs. They offer the prospect of both capital growth and income. They support an important part of the UK economy where traditional sources of finance have withdrawn from the market and therefore there are a lot of investment opportunities at valuations that favour investors. And on top of it all they provide attractive tax benefits, both at the point of investment, ongoing and at encashment.

The investment case on its own is not enough though of course: when it comes to individual investors it will depend upon their attitude to risk, capacity for loss, tax position, levels of wealth and "sophistication", as well as their current asset allocation.

The asset allocation point is an interesting one, and there are two views on this. One is that, for appropriate clients, every portfolio should have an allocation to higher risk alternative investments, and that VCTs should form part of this allocation. The other view is that tax-advantaged investments should be looked at on a case by case basis, depending upon each individual client's tax circumstances and preferences. Certainly, although the regulators will view VCTs as higher risk investments, there are lower risk options such as Limited Life VCTs.

We'll examine these concepts in more detail in the following sections. And of course there are risks around the underlying investments, the way VCTs are run and the rules that govern them.

RISKS OF VCTs

There are a number of different risks advisers and investors should bear in mind when considering VCTs.

INVESTMENT RISK

Smaller companies are generally more risky than their mainstream counterparts.

However, it can be argued that AIM shares and that more established firms or project-based opportunities are ways to make qualifying investments that may be less exposed to these risks than earlier stage companies.

The research and statistics on smaller company angel investing are revealing. According to research by innovation charity NESTA 56% of investments return less than cost, 33% returned 1-5x cost and 9% return 10x cost or greater. This is an argument for diversification, and for most people that may well mean choosing to use a manager to provide professional stock picking and portfolio construction. To put it another way, if you are looking for exposure to smaller companies, then a professionally run VCT with the associated tax reliefs is probably one of the best ways to do it. However, note that not all VCTs are based around having a very diverse portfolio. Some have a strategy of concentrating on just a handful of firms that they feel represent low risks and reliable income. Of course this is also a good strategy, but a pitfall to watch out for here is the possibility that there is not enough potential growth in the portfolio to overcome a catastrophic failure of one or two of the larger investments.

Many VCTs also offer advice, mentoring, access to their network and other forms of non-financial support for their investee companies: 76% of investee companies have a representative of the VCT manager on their board (AIC, Going for Growth).

We need to be clear though - although many VCTs are focused on these kinds of small, early stage companies, many others are not, and instead are focused on providing expansion or replacement capital to bigger, better established firms. Conventional wisdom suggests that these bigger firms are still more risky than their listed, large cap counterparts. Certainly they have more difficulty raising capital. However, consider that they are not exposed to the volatility of the stock market - good quality firms in this part of the investment universe can represent very good value, low risk opportunities, particularly if the objective is income rather than growth.

LIQUIDITY

One of the biggest issues that VCT investors have had in the past is the ability to exit the VCT itself. They are certainly more liquid than their EIS and SEIS counterparts as they are traded on the main market, but the discount to the NAV often makes this liquidity feel a little worthless...We'll look at some of the ways managers try to address this issue in the *Depth and Detail* section, but for now we'll focus on painting a broad brush picture.

LIQUIDITY IN THE UNDERLYING INVESTMENTS

Smaller companies are inherently less liquid than bigger ones. Investments in unquoted companies usually have to be held for the long term until an exit can be achieved, and any kind of exit is likely to be a binary event - a trade sale, management buyout or stock market listing either happens or it doesn't. There can be big rewards when these exits are achieved, but it takes a lot of time and effort to make them happen and if they fall through then the situation reverts back to square one.

"AIM based VCTs typically have a more diversified portfolio than other types of VCT, likely to be invested in larger more established companies, with transparent market pricing and reasonable liquidity" **Dr Paul Jourdan, Amati Global Investors**

Holdings on AIM do have more liquidity in theory, but in practice volumes in certain shares can be thin, spreads can be wide and disposing of a large investment could be problematic. However, for patient buy and hold investors these issues do not impact VCTs very often. AIM shares also value daily and do not have long closed accounting periods, so striking the NAV and facilitating buybacks is much easier for AIM VCTs.

In general we would suggest that AIM should be considered more liquid, but some VCT managers make investments in unquoted firms with a very definite plan for exiting them and - providing the business can deliver on the plan - some commentators consider that these kinds of investment are actually more liquid than AIM.

The point about the business delivering on the plan is important. In unquoted businesses it is important that the management has a desire and drive to sell and eventually exit. A complacent management might sit tight, happy to run a reasonably successful business, and leave their investors in limbo. This is another area where the VCT manager should be adding value by careful vetting of the management team and maintaining ongoing monitoring and involvement. Its also important that the VCT manager strikes a good deal with the investee that keeps them motivated, rather than simply trying to wring as much out of the deal as possible. It's vital to interrogate the manager's investment and due diligence process and get a feel for the house philosophy. More on due diligence on VCTs on page 49.

These risks won't impact VCT investors directly, but they will impact the ultimate performance of the VCT, and they would constrain the manager's ability to close out losing positions - investors have to be prepared to hang on and ride out a downturn in the market or the wider economy without expecting the investment manager to re-weight the portfolio into more defensive assets.

VCT DISCOUNTS / PREMIUM: 12 MONTHS TO AUG 2015

	DISCOUNT ONE YEAR HIGH %	DISCOUNT ONE YEAR LOW %	DISCOUNT ONE YEAR AVERAGE %
VCT AIM QUOTED	-4.1	-12.5	-8.3
VCT GENERALIST	0.8	-17.5	-9.1

Investors need to be aware of that most VCTs will trade at a discount to their NAV

Source: Morningstar (August 2015)

LIQUIDITY OF THE VCT

As noted above, the biggest liquidity risk to investors is really the prospect of a discount to the NAV, and sometimes this can be quite large. Because the share price is driven by demand for the shares, this can be quite severe in times of market distress. VCT providers attempt to address this by operating 'buyback' policies. These are promises to buy the shares back at a certain level - say a 5% discount to the NAV. On the face of it this solves the problem (a 5% discount after 30% Income Tax relief is probably going to feel acceptable) but the strength of the promise needs to be examined - wording such as "we will endeavour" might not be worth much when everything is nose-diving. The VCT board can only agree to buy shares back for as long as they have the cash to do so and it is not detrimental to the remaining investors. Investors must be clear that they probably won't be able to exit at anything like the NAV if there is a panic. This shouldn't be a showstopper though – it's really true of any stock market based investment.

At the time of writing (November 2015), the VCT Generalist sector was at an 8% discount to the NAV and the VCT AIM sector was at a 7.9% discount in the secondary market (note - these figures do not apply to buybacks where the VCT purchases shares back from investors at a smaller discount, as described above).

It's also worth remembering that this lack of liquidity can be an advantage for the fund manager. Worried investors who run for the exits can be absorbed by the discount and the manager is not forced to sell assets at low prices to meet redemption requests. This seems fair - why should investors who are prepared to stay the course be penalised by those who lose their nerve?

"The abolition of stamp duty on purchases of AIM stocks has inevitably led to greater demand for shares in quality companies, which works to the advantage of those investors who identify them early" **Oliver Bedford, Hargreave Hale**

LIQUIDITY AND LIMITED LIFE VCTs

We examine them in more detail on page 38, but Limited Life VCTs address the issue of liquidity from a slightly different perspective. Rather than operate a buyback policy, they will seek to liquidate the VCT and return capital and income to investors after a predefined period (never less than five years). To do this they invest in assets that they reasonably expect to be able to sell at a profit within that time frame, rather than growth companies, so investors have to sacrifice some potential returns in exchange for more certainty around their exit. For many investors, this is a perfectly acceptable sacrifice when they take the tax benefits into account.

LOSS OF VCT QUALIFYING STATUS

If a VCT were to lose its status as a qualifying investment because it breached the rules, investors would lose the tax breaks they had been enjoying - potentially leaving them in an investment where they did not feel compensated for the risks they were bearing and certainly out of pocket. To date no VCT has ever lost its status, but Oxford Technology did come close due to an inadvertent breach back in 2014 when HMRC withdrew qualifying status from Oxford Technology following a breach of one of the VCT rules; the 15% maximum threshold that a VCT fund can invest in any one company. Oxford Technology crossed this threshold with its holdings in AIM-listed, oncology specialist, Scancell. Scancell has a vaccine for melanoma which is in clinical trials and is quoted on AIM.

In 1999, Oxford Technology invested in Scancell Holdings Plc when it was a start-up company. In December 2003, by which time some progress had been made within the company, Oxford Technology invested a further £150,000 in Scancell. They made subsequent investments to support the growth of Scancell and in August 2013 took up rights to purchase additional shares in Scancell as part of a discounted rights issue. This brought the total invested by Oxford Technology to £400,000, less than 10% of the total capital raised by OT3VCT. However, because Scancell's share price had increased significantly, this investment resulted in a breach of the 15% rule. This rule is not a simple as it sounds. Under the rule Oxford Technology had to revalue all the early shares to the value of the latest investment. Because the share price had increased so much due to the company's success, this caused the value of their holding as a whole to breach the limit. If Scancell had done badly and had had a low share price, there wouldn't have been a problem. And any other VCT could have invested in Scancell with no problem. Oxford Technology reported the breach to HMRC as soon as they realised what had happened.

On 13 March 2014 HMRC took the (somewhat extreme) decision to revoke VCT status on account of the breach. However, the decision didn't last long. A formal appeal was filed by the end of March and Oxford Technology entered discussions with HMRC to renegotiate qualifying status. In June, HMRC announced that it would reconsider the decision and VCT status was temporarily restored. Permanent VCT status was reinstated for Oxford Technology in September 2014.

An Oxford Technology statement read: "We are now pleased to be able to confirm that the corrective steps proposed by our legal advisors have been successfully completed and HMRC have been so informed.

We have received formal acknowledgement from HMRC that the corrective action taken has been sufficient and that we will now retain VCT status going forward subject to continued compliance with VCT rules."

The reality is that the risk of a VCT losing its qualifying status is very low. The Oxford Technology example is the only one in twenty years of the scheme's operation, and their appeal was upheld.

Note: a VCT can hold more than 15% in a company if it is a result of the firm's organic growth.

SUMMING UP

This overview of the risks means that we can now weigh up the investment case.

INVESTMENT CASE:

- Growth
- Income
- Tax Reliefs
- Support SMEs

RISKS:

- Investment risk
- Lack of liquidity

We'll examine the investment case, the risks and how they can be mitigated in more detail in the following two sections - this is where we really try and get into the nuts and bolts of VCTs and after reading these two sections advisers should be in a strong position to make informed decisions about how they will approach the VCT market.

"Planned Exit VCTs typically make investments in the form of equity and secured loans to qualifying companies. While this limits the upside it also allows the manager greater control over the timing of exits from the fund's investments and therefore a greater ability to achieve cash distributions to investors, on a defined time horizon"

Eliot Kaye, Puma Investments

DEPTH AND DETAIL

How do these risks and benefits interact, how do the managers try to mitigate the issues they face, what are some of the additional, existential risks, what are some of the unique considerations that advisers and investors need to keep in mind?

LEGISLATIVE CHANGES

This section has been promoted to give it more prominence after the July Budget. The VCT sector has always been subject to rule changes as the Treasury has tweaked the scheme to ensure that it represents value for money for the UK taxpayer (see Policy Changes Timeline on page 88 for a full list of the changes since inception), but perhaps the most sweeping changes to qualifying companies were announced this year in order to comply with European State Aid rules. These changes represent significant upheaval for some VCT managers.

OUTLINE OF THE CHANGES PROPOSED IN 2015

		PRE-MARCH 2015	BUDGET 2015	SUMMER BUDGET
AGE LIMIT		No limit	12 years*	7 years*
LIFETIME CAP		No limit	£15m	£12m
ANNUAL INVESTMENT LIMIT		£5m	£5m	£5m
EMPLOYEE LIMIT (FTE)		250	250	250
KNOWLEDGE INTENSIVE COMPANIES	LIFETIME CAP	No limit	£20m	£20m
	EMPLOYEE LIMIT	250	500	500
	AGE LIMIT	No limit	12 years	10 years*
USE OF EIS & VCT MONEY FOR ACQUISITIONS OF BUSINESS		Allowed	Allowed	New rules to prevent EIS and VCT funds being used to acquire existing businesses
GROWTH & DEVELOPMENT		No requirement	Require that all investments are made with the intention to grow and develop a business	Require that all investments are made with the intention to grow and develop a business
SEIS MONEY		70% of SEIS money be deployed before raising EIS	70% limit removed	No limit
EXISTING SHAREHOLDERS		No restriction	For EIS only, a requirement that investors are independent from the company at the time of the first share issue (excluding founder shares)	For EIS only, a requirement that investors are independent from the company at the time of the first share issue (excluding founder shares)

*Unless total investment represents more than 50 per cent of the company's turnover over the preceding five years

"Government regularly makes changes to VCT legislation to ensure that they meet their policy objectives. The changes will mean that some managers may need to alter the investment mandate of certain VCTs" **Paul Latham, Octopus Investments**

WHAT IS STATE AID?

State Aid is any advantage granted by public authorities through state resources on a selective basis to any organisations that could potentially distort competition and trade in the European Union. Some State Aid is illegal under EU rules because it distorts competition in a way that is harmful to citizens and companies in the EU. But where it is unavoidable, State Aid can be given legally by:

- Using one of a set of approved EU mechanisms for State Aid
- Getting approval for the particular scheme from the EU Commission

The EU State Aid Risk Capital Guidelines were updated in May 2014, and the UK Government had to apply for renewal of State Aid approval of the VCT scheme. The outcome of this was two Budgets that proposed changes for VCTs, one in March 2015 and one in July. The new rules proposed in July were much stricter than the rules proposed in March - we can only assume that the EU took a look at what the Treasury was proposing and decided that it didn't go far enough. The new rules were confirmed when the Finance Bill was given Royal Ascent in the autumn of 2015.

These changes have introduced a couple of new concepts:

Knowledge Intensive Companies have research and development costs amounting to at least 15% of their total operating costs, create intellectual property and have at least 20% or more of their workforce with relevant Masters or equivalent higher degrees.

Independence. For EIS relief only, investors must be independent from the company at first share issue. So, if an investor wishes to be involved in a company in an official capacity, then they must first invest and then, at a later date become a director.

The £12 million lifetime investment limit includes any acquisitions of subsidiaries that had previously received tax advantaged venture capital funding and it must be recalculated if during that period, monies are used to acquire a subsidiary or trade that had also received tax-advantaged venture finance. This will require stringent record keeping.

There are some exceptions to the seven year age limit. It doesn't apply if:

- The company had relevant risk finance investment within seven years of first commercial sale, or
- The current investment is at least 50% of average turnover for last five years AND the monies will be used for a new product or geographical market, or
- A previous investment met the turnover test

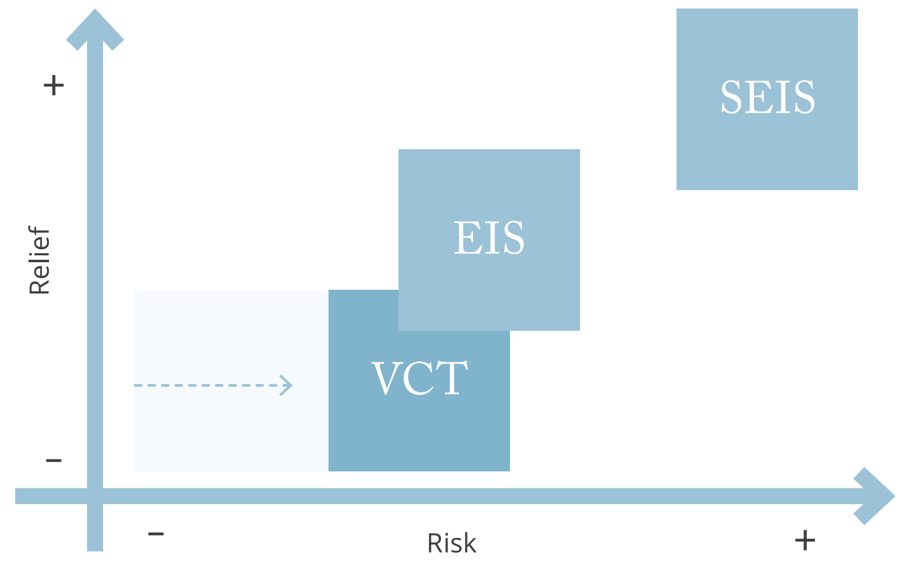
On a positive note, removing the requirement to spend 70% of SEIS money before raising EIS money does smooth the passage between the two schemes out a bit for the investee companies. In fact it is possible to raise funds under both schemes concurrently now, provided the shares under each scheme are issued on different days.

All three of the tax advantaged venture schemes now have a ten year sunset clause, so they will be reviewed again in 2025 – this does suggest that we will now have a decade of stability, although HM Treasury reserve the right to amend this date.

One other issue to note unique to VCTs: There will be no grandfathering of "protected money", meaning that the new rules will apply to all undeployed funds, not just any new money the VCT raises.

All of this means that some VCTs' risk profiles will change. The new age limit on investee companies means that the focus will be much more on early stage investing, and disqualifying Management Buy Outs and company acquisitions means that money will be deployed more as development capital rather than expansion capital. VCT managers who were already focused on these areas of the market and these kinds of activities will not be impacted much (and indeed may be looking forward to securing a larger share of the market), but other VCTs will have to change their business model and may be seeking to acquire early stage investment experience. All VCTs will need to carry out thorough due diligence and have a clear understanding of what the actual trade being funded is to ensure compliance with the rules, but of course this is nothing new for VCTs.

IMPACT OF THE CHANGES PROPOSED IN THE SUMMER BUDGET



Some VCTs will now have to change their business model - in general the lower risk VCTs that acquired businesses

"AIM is home to more than 1,000 small companies, including many that are well insulated from potential shifts in public or fiscal policy – many young and dynamic, in emerging sectors or developing new technologies, with growth potential irrespective of the UK's political landscape" **Oliver Bedford, Hargreave Hale**

We would expect it to have some impact on the fundraising season in 2015. As Jason Hollands, managing director at Tilney BestInvest put it:

"Potentially lower fund raising activity due to a narrower set of investment opportunities ironically comes at a time when potential demand for VCTs from investors might otherwise have been stronger than ever as a result of the reductions in the lifetime pension allowance and the tapering away of pension tax allowances for higher earners"

However, investments that have already been made into VCTs aren't impacted, and therefore a specific VCT won't initially look any different to the shareholder after the legislation comes into force.

Interestingly most commentators feel that AIM VCTs won't be impacted, but with a seven year age limit for investees, and firms needing to be at least three years old to list on AIM, it could narrow their investment universe - but anecdotally we've been told by providers that over 80% of the investments they made over the last 12 months would have qualified under the new rules. If this is true of the entire AIM VCT industry, then compliance will not require many changes.

Our view is that the driver for these changes was of course complying with EU State Aid rules, and that this is not necessarily a positive for the economy, as we posted in our blog:

"The government's stated aim is to ensure that the schemes continue to support economic growth and provide value for money for the UK Taxpayer. We're not sure that the:

- *Age of business criterion,*
- *Cap on total investment, and*
- *Limit on number of employees for the investee companies*

Serve either of these objectives.

An arbitrary seven year limit on funding doesn't seem to serve any logical purpose. It penalises firms with long R&D periods, or firms that have traded on a small scale for a number of years but then identified the potential to grow.

The cap on total investment penalises firms where there is a need to raise very substantial amounts of working capital to finance a long term development programme before investors see a profit, or where expensive capital assets need to be acquired in order to commence business.

And the size of a company's workforce will be a reflection of the type of trade carried on by the business, not an indication of its stage of development and how easily it can access finance.

Removing or amending these rules could let more capital flow to where it is needed – plugging the equity gap for SMEs and helping to create jobs. At the moment, the rules are putting a brake on economic growth and therefore they do not represent good value for money for taxpayers.

However, these rules are not down to the UK government's decision making. They are there to ensure compliance with European State Aid rules. As the Policy Network identified in its recent publication "Supporting Investors and Growth Firms", although the UK's schemes are well regarded on the continent, politicians shy away from them as they fear that they will be perceived as giving tax breaks to the rich at a time of austerity for the majority".

The changes were discussed in Parliament on the 14th October 2015 and the Financial Secretary, David Gauke MP, stated that:

- State Aid approval has been formally granted by the European Commission. Full details of the Commission's decision will be published in due course, but it is in line with the UK's proposals and the changes currently being legislated for in the Finance Bill
- The government is keen to introduce increased flexibility for the schemes to be used for 'replacement capital', where the amount invested in newly issued shares is at least equal to the amount invested in secondary shares. The intention is for this change to be introduced through secondary legislation at a later date, subject to State Aid approval.

The Finance (No 2) Act 2015 made the proposed changes law when it was given Royal Assent on November 18th 2015.

RENEWABLE ENERGY

A more benign example of legislative risk is the renewables story. For a time, renewables that qualified for government incentives such as Feed-in-Tariffs or Renewable Obligation Certificates were also eligible to be held in VCTs (as well as other tax-advantaged schemes such as EIS). This dramatically lowered the risk profile of these investments as revenues were certain, provided the technology worked (and renewables technology has become very reliable) and there were a number products developed that were dedicated to the renewables sector. This came to an end in April 2015 when the government excluded companies benefiting from the subsidies from VCTs.

However, in this instance the change was not unexpected and most managers were prepared for it. This was a change that had a much bigger impact on the EIS industry, where renewables had been a very popular investment. One could argue that this was an example of good policy - incentives encouraged investment into a new industry that the government was keen to see develop, and once the objective was achieved the incentives were removed.

SUMMING UP

Though the VCT regime is subject to frequent rule changes it is a versatile and flexible industry that has always found ways to innovate. From the advisers' point of view, they need to have an awareness of how changes might alter the business model and risk profile of certain VCTs. Whenever there is a change they need to ascertain which managers and which VCTs are impacted, what that impact is and how severe it will be. Their best sources of information to do this will be the managers themselves, followed by independent review sites and industry watchers such as MICAP, Tax Shelter Report and Tax Efficient Review and firms that consult to the industry, such Roberston Hare, RW Blears, BDO, DWF and PwC.

And there is a positive aspect to legislative changes - they do demonstrate the Government's determination to retain the schemes by ensuring they stay within State Aid guidelines, and ensuring they continue to represent good value for money for taxpayers. We also suspect that the changes this year will be the last for a while and will usher in a period of stability for the VCT industry.

PERFORMANCE MEASUREMENT

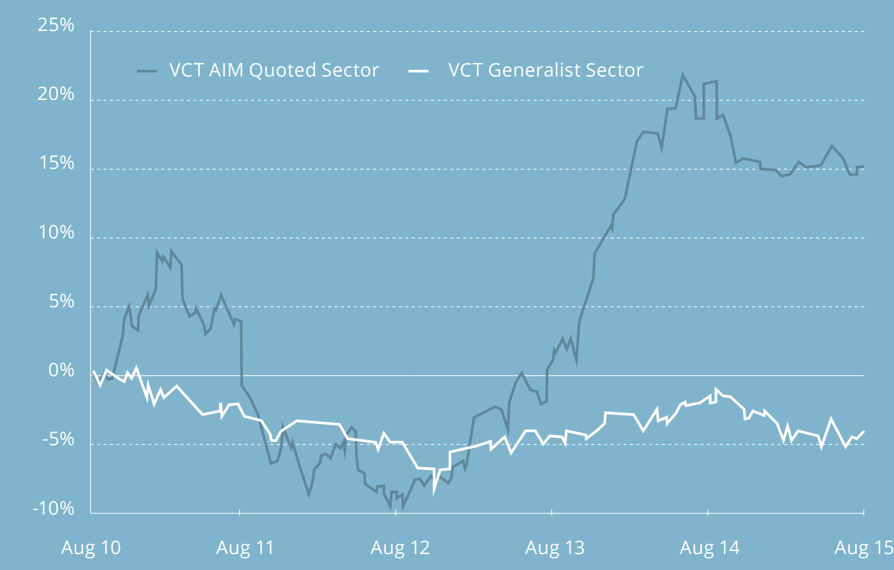
"Past performance is not a guarantee of future returns" is the all too familiar risk warning for consumers. It is however, one of the few objective indications of an investment manager's competence (or lack of it), so it would be remiss not to examine VCT performance here.

In the *Investment Case* section we showed a favourable performance chart for the two main VCT sectors, VCT AIM Quoted and VCT Generalist. The chart above is the same data, but without reinvestment – so when we compare the two we can see what an important part income and reinvestment plays in the performance of VCTs.

And we can see by looking at the ten year picture that (along with all other asset classes) there was a severe downturn in 2008. This is the period when discounts to the NAV would have widened, and exiting at a fair price would have been problematic. What is encouraging is that we can see that investors who held on were eventually rewarded (and investors smart enough to buy near the bottom of the market would have done well). It also tells us that VCTs are not, generally, diversifiers from mainstream assets - their performance in the crash of 2008 mirrors the main market.

"Advisers should be looking for established managers that successfully weathered difficult markets and been able to adapt to State Aid rule changes. A track record of delivering consistent and growing dividend payments, with genuine capital growth should be a key attribute" **Chris Hutchinson, Unicorn Asset Management**

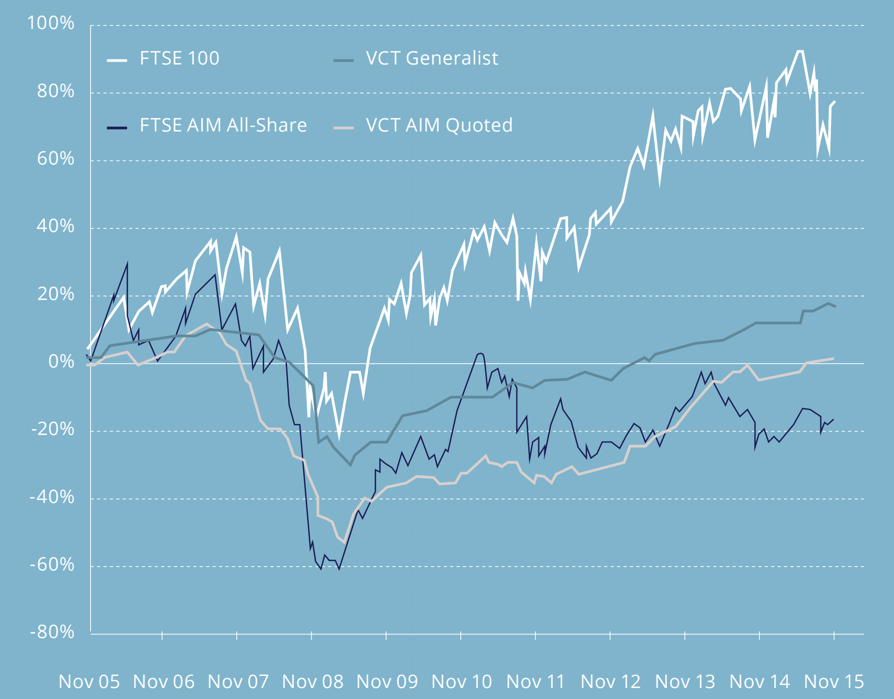
VCT SECTOR PERFORMANCE (2010-2015)



Performance over the five years to August 2015 (rebased, income not reinvested)

Source: FE Analytics

VCT SECTOR PERFORMANCE (2008-2015)



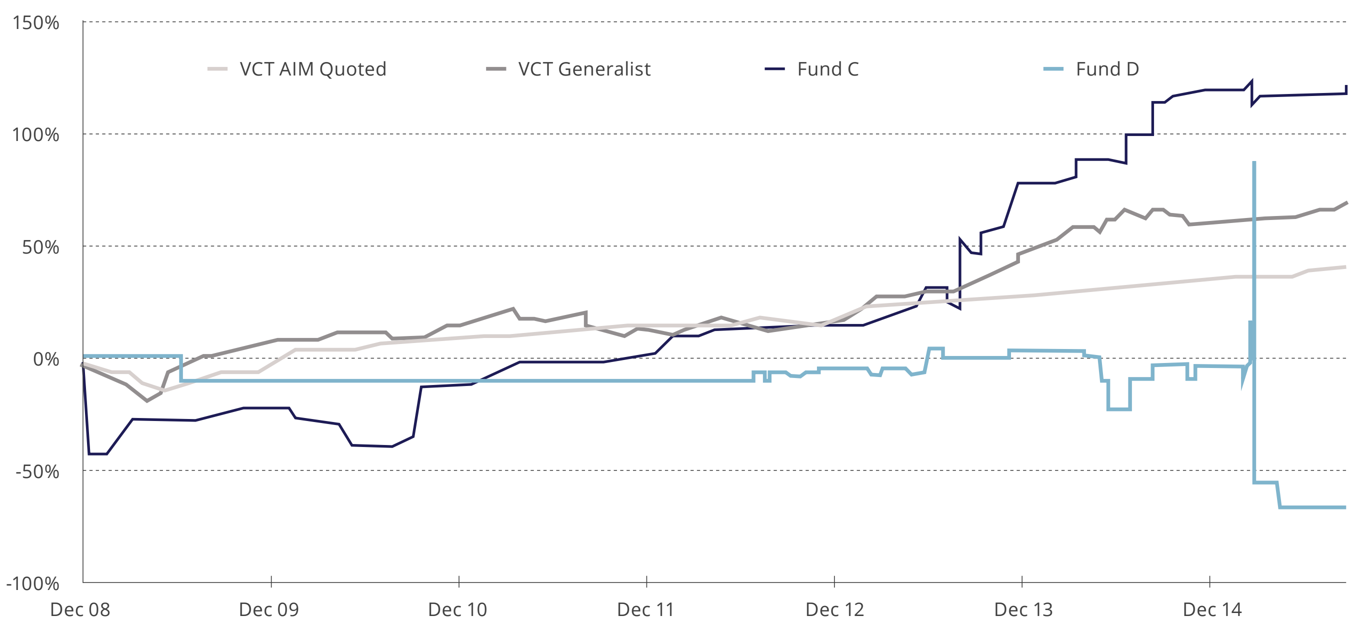
Performance over the ten years to August 2015 (rebased, income reinvested)

Source: FE Analytics

"As a respected market commentator once said, "Elephants don't gallop" – larger companies do not have the same propensity for growth as smaller companies. The potential returns available through VCT investments may therefore be significantly higher in the long-term, which makes them an attractive investment for those comfortable with the risks associated with smaller company investing" **Paul Latham, Octopus Investments**

"A lot of clients and some financial advisers do not understand that VCTs are based on a private equity and venture capital operation, where a balance must be struck between having cash available and being able to actually deploy it" **Mark Wignall, Mobeus Equity Partners**

VCT SECTOR PERFORMANCE (2008-2015)



Performance over the five years to August 2015 (rebased, income reinvested) Source: FE Analytics

And by adding in just two individual funds, we can see that the sector averages mask a wide range of performance from their constituents (and a high degree of volatility in some funds).

Now, we suspect that none of this will be new news for many readers, and it's certainly not really any different from examining mainstream fund performance. Indices are not representative of individual fund performance, managers can have good spells followed by lean spells and performance can look stunning or average depending upon the measurement period. Funds need to be judged on their own merits, in the context of their stated objectives, asset class and risk profile. But we do think that there are two key issues that merit extra attention when it comes to VCTs. One is the importance of income to the returns achieved. The other is (again) the issue of the NAV versus the share price.

Not only is the NAV frequently higher than the share price, but it is also a much more opaque measure. This is really something to be queried in due diligence. Who calculates the NAV, how often do they do it and how independent are they?

The NAV is of course dependent upon the valuation of the underlying investee companies, so the accuracy of these valuations needs to be taken into account. Established valuation guidelines are followed by VCT managers, but within these there is room for interpretation - small, unlisted companies are hard to value and so there is an element of human judgement in the process. The timing and frequency of valuations can have an impact, and the actual realisation obtained for an investment may differ materially from a valuation, depending on the motives of the buyer and the VCT manager.

This is, of course, much more of an issue for Generalist VCTs and much less of an issue for AIM VCTs, where the valuation of the underlying holdings is down to the raw market forces shaping AIM.

Lower levels of transparency are something that goes with the territory when investing in smaller companies and this is one of the reasons why VCTs are considered high risk. It requires an awareness that performance is harder to measure, and that it can then be hard to realise the value of that performance (liquidity again). This is another area where the active VCT manager hopefully earns their money - by establishing and maintaining genuine valuations for the underlying firms, and therefore providing a transparent way to invest in a less transparent market for their investors.

PORTFOLIO MANAGEMENT AND PORTFOLIO RISKS

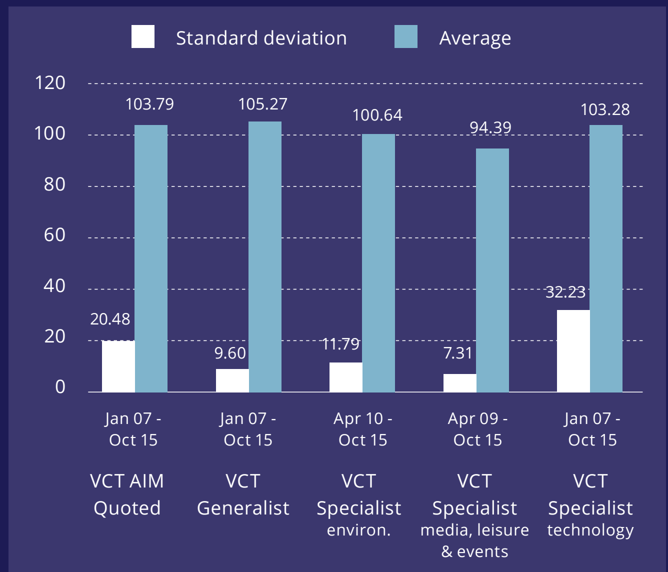
There are a couple of issues around the construction and running of VCT portfolios that are worth examining, as they can impact upon the performance, liquidity and risk of the investment.

DEAL FLOW AND FUNDRAISING

This is a problem across the fund management sector - paid a percentage of Assets Under Management (AUM), funds can be tempted to operate as asset gatherers rather than asset managers. Having raised more cash than they have the capability or deal flow to deploy, fund managers might be rushed into making poor quality deals. This links to the point about transparency we made above. It would be very difficult to identify early on if bad deals were being made - not because of some subterfuge on the part of the manager, but simply because of the nature of investing in unquoted equity. (And we note that past performance is the biggest driver

MEASURING VOLATILITY

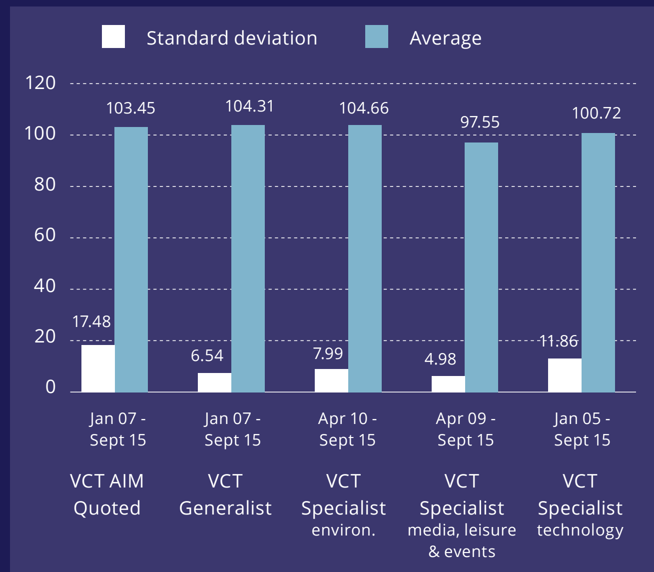
1 YEAR TOTAL SHARE PRICE RETURNS



Source: AIC and Morningstar

The average share price is a good heuristic for expected return, but does not show what the variance has been. The standard deviation of the returns gives a better indication of the volatility of the total share price returns. On average, the Generalist sector has had the highest returns over the period with fairly low volatility. We can also see the standard deviations for AIM Quoted and Technology sector has been extremely volatile. Media, Leisure & Events Specialists VCTs have the lowest variance in share price. Many of these companies may have more predictable returns but the ability to generate higher returns is likely to be more difficult with these companies.

1 YEAR NET ASSET VALUE TOTAL RETURN



Source: AIC and Morningstar

NAV total return is also worth examining, as NAV total return shows performance which isn't affected by movements in discounts and premiums, and also takes into account that different VCTs pay out different levels of dividends. Volatility for all of the sectors is much lower when looking at the NAV return, and the average return is very similar to the share price.

The NAV total return assumes the average weighted, by the starting shareholder funds of each company, performance on a theoretical £100 assuming any net income was reinvested. The chart shows that environmental VCTs offer a similar average NAV total return than VCT generalist but just as with the share price total return, the standard deviation for specialists is higher. On the other hand, it is worth noting that the AIM VCTs sector has the highest standard deviation for the NAV total returns.

of inflows - perhaps another reason to favour closed-ended funds over OEICs, as inflows drive the share price up, but a good manager can still keep control of the amount of funds they raise for investment.)

The ideal is for managers to match their fundraising to their anticipated deal flow, and we think that the majority do this quite well. There are rarely unusually big spikes in funds raised, and managers are generally happy to explain them when they occur.

CASH MANAGEMENT, CASH DRAG (AND MORE ON THE DISCOUNT)

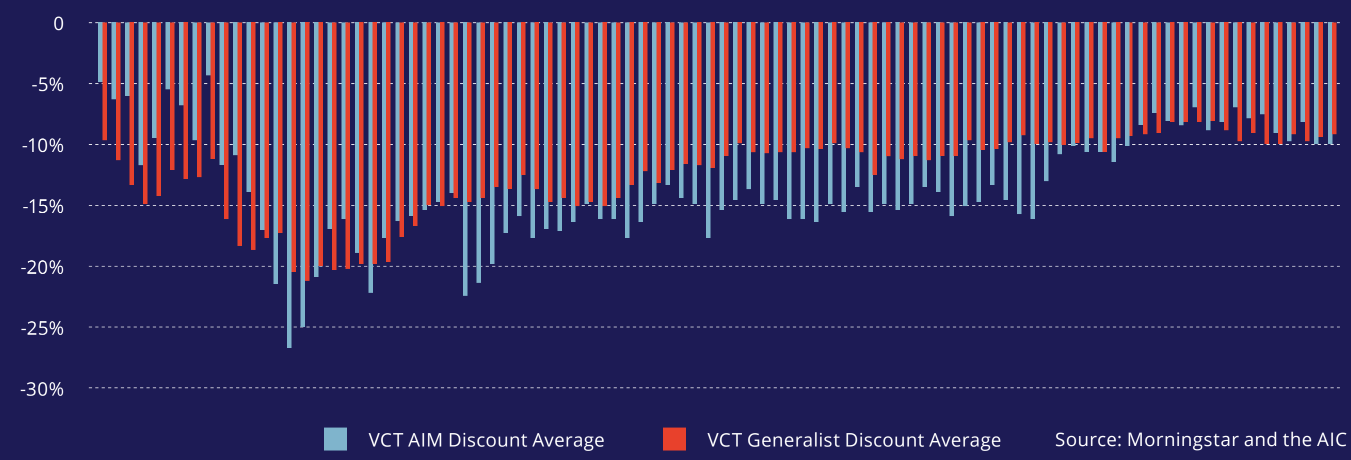
Unlike open-ended funds, VCTs are not obliged to pay all of their profits out to investors. This is actually a very big advantage, as cash can be retained and then used to smooth out dividend payments, even in a falling market. So VCTs can pay out dividends tax-free and (if they manage their cash position well) continue to pay those same dividends even in times of market distress - many established VCTs maintained their dividend throughout the downturn in 2008. This is a very appealing proposition.

Holding onto cash has its downsides though, as the low return on cash can reduce the overall performance of the VCT ("cash drag"). Analytics sites, such as Morningstar, Trustnet for the AIC, can be used to check the cash position of individual funds (as can the funds' own documentation).

As of August 2015, the average net cash position of both Generalist and AIM VCTs was 13%, but this hides huge variations - VCTs at different stages of their life will hold very different amounts of cash.

"A good Generalist VCT looks for companies that thrive in industries undergoing fundamental change – often driven by new technology or consumer behaviour" **Shane Elliot, Beringea LLP**

AVERAGE DISCOUNT TO NAV (2008- 2015)



Source: Morningstar and the AIC

And as we noted earlier, advisers should be clear on how and where VCTs invest their cash and near cash.

There's also another point about the discount to the NAV. If a fund used its cash to maintain the discount at an acceptable level (say, 5%) that would make it very hard to identify a run of redemptions on the fund. We think (but we can't evidence this at the moment) that would mean that the discount would fall very steeply once the fund suspended its buyback policy. Again, this point is not a showstopper, but it's another reason to be clear that the investment must be made for the long term, and should be considered an illiquid investment.

PORTFOLIO VOLATILITY

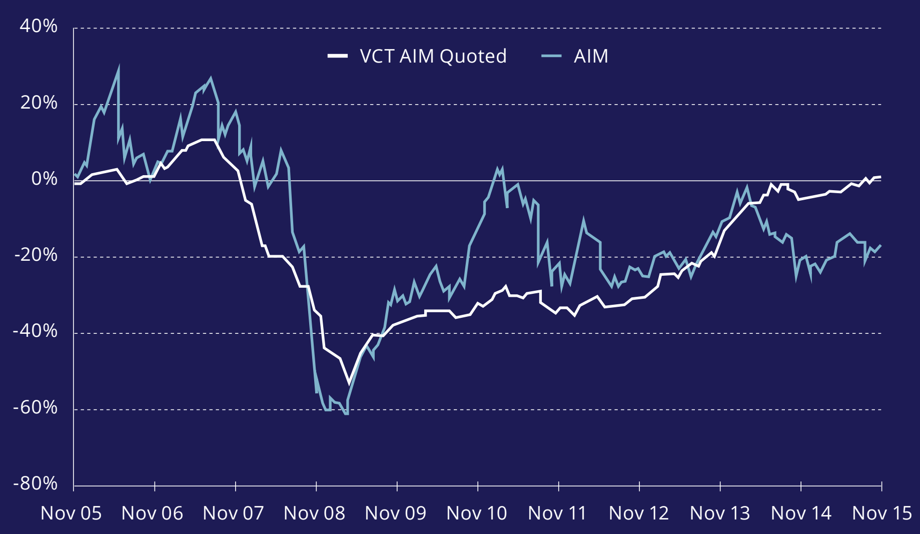
Of course the portfolio will experience some volatility. Volatility in the share price will be driven by supply and demand for the shares. Volatility in the NAV will be driven by acquisitions, realisations and the timing of valuations. Therefore both the share price and the NAV can be quite erratic. It's worth considering this, if only for a moment: VCTs are subject to two sources of volatility.

AIM quoted VCTs can be very volatile, and at least some of that volatility will simply be a reflection of the volatility on the AIM market itself. Generalist VCTs tend to be less volatile as their underlying investments are valued less frequently.

PORTFOLIO VOLATILITY (2010 - 2015)

This is a Specialist VCT investing in a high risk sector Source: FE Analytics

AIM VS. AIM QUOTED VCTs (11/2005 - 11/2015)



AIM Quoted VCT Sector mirrors the volatility on AIM itself Source: FE Analytics

"VCTs have the ability to structure some investments as convertible loans, which serves to reduce overall volatility and increase income" **Douglas Lawson, Amati Global Investors**

As the second chart on the previous page demonstrates, Specialist VCTs with higher concentration risk, operating in industries where sentiment can change rapidly can be very volatile.

We think that the take-away is the same in every case: don't let short term volatility influence your decision making. Don't try and time your entry, or panic and exit at the bottom.

SECONDARY MARKET

The report has been focused on buying newly issued shares (the primary market) but we should take a brief look at the possibility of buying shares on the secondary market. Purchases of shares on the secondary market do not attract the 30% Income Tax relief but are still Capital Gains Tax free and they still pay tax-free dividends (purchases on the secondary market also count towards your £200,000 annual allowance). Buying at a discount might be a good strategy if you expect the share price to catch up with the NAV in the future. It's also a way to invest in popular funds if they are not doing any fundraising or if you have missed the window to invest. However, the spread (difference between the buying and selling prices) may be wide on some thinly traded shares – another transaction cost to watch out for.

It's not immediately clear how deep the secondary markets are: because many VCTs buy back their own shares, it's next to impossible to ascertain how much demand there is beyond that. We know that many VCT providers are keen to encourage the development of the secondary market as they know that a successful secondary market will mean a successful primary market as investors will no longer be deterred by the lack of a definite exit.

THE OPERATION OF BUYBACKS, CLOSE PERIODS AND OTHER WAYS OF RETURNING CAPITAL

The purpose of buybacks is to offer exit opportunities to investors. As we noted above, it's hard to gauge the depth of the genuine secondary market for VCT shares, but it is probably safe to say that it is very limited, so the buyback policies are vital for the functioning of the market. Buybacks take the form of either the VCT operating as the buyer of last resort for a market maker, or by dealing with investors directly.

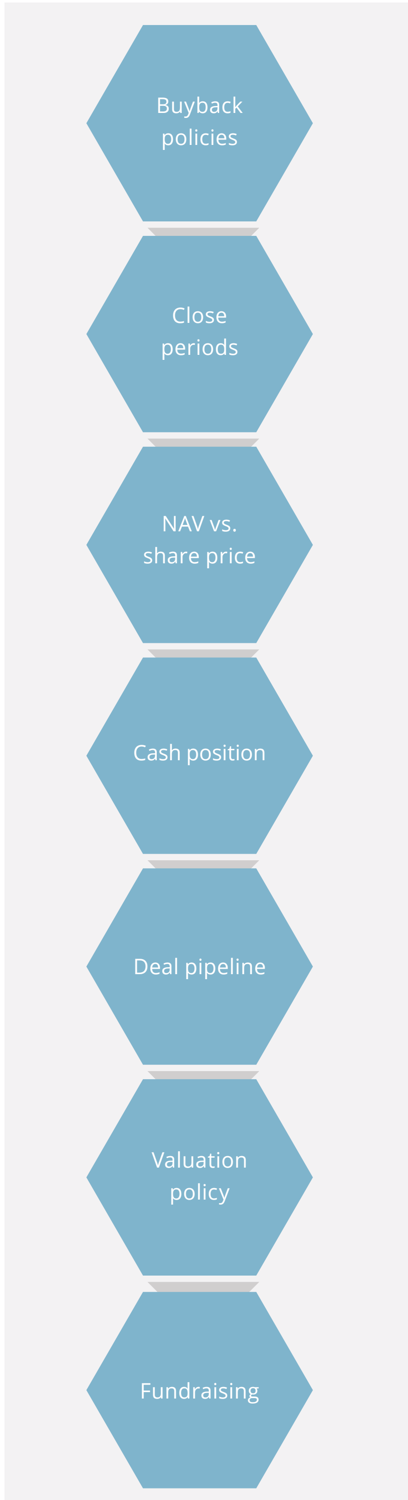
There have been cases in the past where the buyback policy was abused by investors who would exit, reinvest in a new issue in the same fund, or with the same provider, and then claim Income Tax relief again on what was essentially the same investment. Some VCTs facilitated this, and the schemes were known as "Enhanced Buybacks." Some even gave investors who committed to reinvesting their money a more favourable price. Even more sophisticated versions of this - "cascade" arrangements - would use the VCTs cash reserves to continually repurchase small tranches of shares, recycling all of the investors' money without ever raising new funds.

These kinds of arrangements were deemed to be exploiting, rather than operating in the spirit of, the rules, and so in 2014 the government legislated to prevent these kinds of arrangements.

The wording of buyback policies needs to be examined in detail. Very often it will use phrases such as "subject to the availability of distributable reserves" and/or "subject to board approval". This is reasonable - the board has to operate in the interests of all of its shareholders, and as we noted earlier shareholders should not be disadvantaged just because other investors want to get out. For these reasons most boards can't commit to a full buyback policy, but it is worth looking at their track record and 'business as usual approach'. However, it does mean that the buyback policy is likely to be suspended just when people need it the most - in times of market distress. Once again, we emphasise that these are long term investments. (We do note that OEICs can and do put a soft close or exit fee on their funds when there is a period of high redemptions, so one shouldn't assume these sorts of issues are limited to VCTs).

Advisers and investors also need to be aware of "close periods" - the time between a financial period end and the announcement of the results to the end of that period. VCTs are not permitted to buy shares back directly from investors during close periods.

ADDITIONAL CONSIDERATIONS



"Limited Life VCTs will typically offer investors an opportunity to vote on winding up the VCT after the fifth anniversary, which means not having to worry about selling their shares in the VCT on the secondary market" **Eliot Kaye, Puma Investments**

FOCUS ON LIMITED LIFE VCTS

One of the most interesting ways of returning capital to investors is by winding-up the VCT itself. The VCTs assets are liquidated and the capital and income are distributed to the investors. This is the basis of Limited Life (sometimes known as Planned Exit) VCTs.

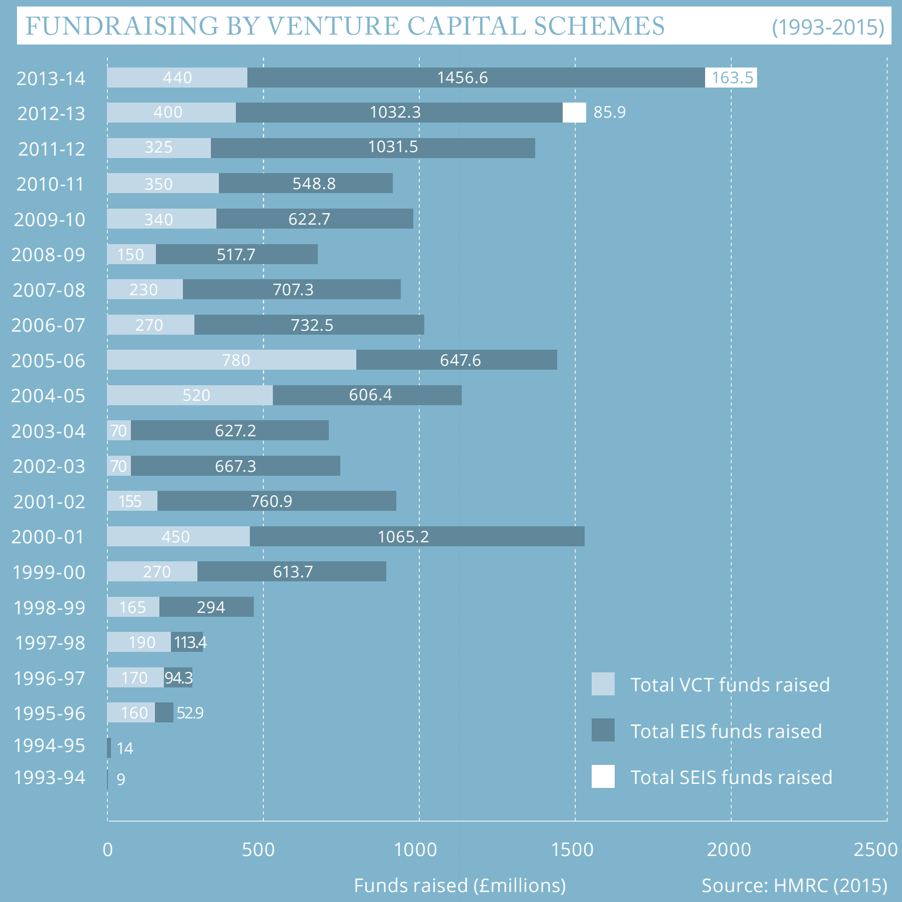
They follow a low risk investment strategy backing companies with favourable characteristics:

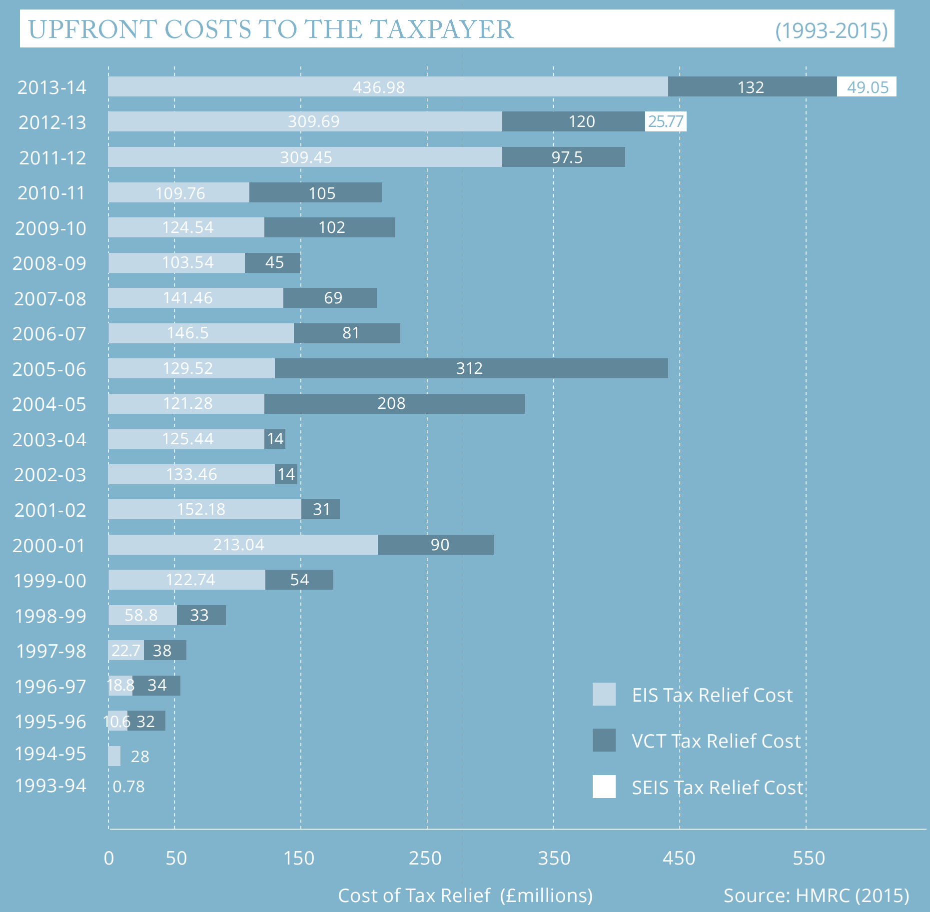
- Substantial assets
- Experienced management
- Secure or contracted revenue streams
- Clear exit

Often Limited Life VCTs will invest in loan notes, taking a first charge over the assets and/or revenue streams, as well as investing equity. Essentially, they are looking for secure and predictable asset backed revenues. The potential returns are lower, but the risks to investors should be lower too. When the VCT comes to the end of a predefined term (never less than five years, to ensure investors secure their Income Tax relief) the board will propose a special resolution for the shareholders (the investors in the VCT of course) to vote on process of winding-up the VCT. This can be an efficient way of returning capital to investors, without relying upon the secondary market and having to grapple with the issue of shares trading at a discount to the NAV.

DISTRIBUTIONS FROM CASH OF RESERVES

We've already discussed the ability of a VCT to use its cash reserves to pay dividends - and thus "smooth" them out over time - as a positive feature. However, VCTs do use this feature to pay dividends out of the funds they have raised rather than out of their investment profits: essentially returning investors' capital to them (tax-free). The government looked into this to see if this was being exploited, but found that abuse was not widespread and therefore made a simple rule change to prevent VCTs returning capital that does not represent profits within three years of the shares being issued.





"VCTs, with their associated tax breaks, provide investors with valuable exposure to small, growing unquoted UK Companies" **Will Fraser-Allen, Albion Ventures**

COSTS AND BENEFITS TO THE TAXPAYER

Although we constantly praise VCTs and the other tax-advantaged Venture Capital Schemes, what can be sometimes forgotten is that these schemes actually come at a cost to the taxpayer – the reliefs represent money that the government could have chosen to spend elsewhere. Therefore it's important to measure - or at least attempt to measure - the value for money these schemes give to the taxpayer.

We collated all the data that HMRC published on these schemes in their annual statistics reports and tried to come up with an estimate of what the upfront cost is to the taxpayer, based on the prevailing Income Tax relief that year, for each of the Tax-Advantaged Venture Capital Schemes.

Note - this is the upfront cost and does not consider CGT relief, loss relief or IHT relief - all of which are available through one or more of these schemes.

There has been a significant amount of fundraising in each sector since inception. EIS has raised £12.2 billion, VCTs a slightly smaller £5.5 billion and SEIS has raised just under £250 million in 2 years. This is for a total of about £18 billion across all the schemes since 1993.

This represents investment into small businesses, in the expectation that some of these companies will drive economic growth and job creation in the UK. However, at the moment it is very difficult to know how well companies that have benefited from the schemes are doing (we asked HMRC and they do not collect this data at the moment).

What we can see is that the upfront cost to the taxpayer. Approximately £4.45 billion of Income Tax Relief could have been claimed by investors since 1993.

If the sample of investee firms the AIC used in their "Going for Growth" report is indicative of the success of other recipients of funding via these schemes (89% of the tax relief was returned in just a single year of operation), then this represents a very good investment by the Government into the UK economy.

"Providing Growth capital to dynamic UK businesses that we believe offer real potential for rapid expansion has always been at the heart of the ProVen VCT's investment strategy. This approach is also totally consistent with the central objective of the new VCT regulations introduced at the behest of the European Commission, which is that all VCT investments made under the new rules should be for the "Growth and Development" of the company receiving the investment."

Stuart Veale, Beringea LLP

ADVISING ON VCTs

Clearly, due to their risk profile and tax benefits, VCTs are not going to be suitable for everybody. Not everybody will have the requisite tolerance for risk or capacity for loss, and not everybody will have maxed out their other, lower-risk tax-efficient investment options. But, because of their unique features, VCTs can have a role to play at any stage of a financial plan: accumulation, at retirement and decumulation.

SUITABILITY

It makes sense to start by placing VCTs in the context of the other tax-efficient investment options that are out there:

COMPARING TAX-EFFICIENT INVESTMENT OPTIONS

	ISA	PENSION	VCT	EIS	SEIS
ANNUAL CAP	£15,240	£40,000	£200,000	£1m	£100,000
LIFETIME CAP	x	£1.25m / £1m	x	x	x
INCOME TAX RELIEF	x	√	30%	30%	50%
LOSS RELIEF	x	x	x	√	√
IHT RELIEF	x	Depends	x	√	√
CGT FREE GROWTH	√	√	√	√	√
CGT DEFERRAL	x	x	x	√	√
TAX-FREE INCOME	x	x	√	x	x
TAX-FREE LUMP SUM	√	25%	√	√	√

As a rule of thumb, as you move to the right-hand side of the table, you will be looking at riskier investments. Note income in ISAs is taxed at 10%, which does represent a significant saving for higher rate taxpayers

The focus should be on the conventional first - using up the ISA and pension allowances. These are lower risk options (or more accurately they can be depending upon what is invested in - they are only wrappers for allowable investments) that provide tax reliefs and form the backbone of saving and investing plans. Pensions have recently become much more attractive from an estate planning perspective as well, with the removal of the punitive 55% "death tax". Ordinarily you would expect to see extensive ISA and Pension investments made before VCTs are considered.

However, new lower annual and lifetime pension investment limits, new limits on what people earning greater than £150,000 can save and the threat to higher rate tax relief are all going to mean that more people than ever before are going to have to look beyond pensions for other tax-efficient investments. And consumers looking to offset particularly high Income Tax bills will be attracted by the upfront relief regardless of whether they are at or near their pension and ISA limits.

At the other end of the spectrum, EIS and SEIS investments are usually - but not always - more risky than VCTs. Like VCTs, they invest in smaller companies, but they are unquoted vehicles with very low levels of liquidity. They have more generous tax reliefs than VCTs, pensions and ISAs to reflect the fact that they are more risky.

As a consequence, all things being equal you might expect to see VCTs, as the lower risk option among the Tax-Advantaged Venture Capital Schemes, being used in clients' portfolios before EIS were: however, the higher annual investment limit and additional benefits around IHT relief and CGT deferral often mean that EIS are preferred to VCTs.

Of course the major attraction of VCTs is the upfront Income Tax relief, but investors can only claim relief on what they have paid. Therefore it is unlikely that VCTs are often going to be suitable for basic rate taxpayers - the relief is unlikely to be great enough to justify the risk.

"For the last 20 years, VCTs have provided financial advisers with an effective retirement planning option for their clients" **Will Fraser-Allen, Albion Ventures**

We think that this means that VCTs **should be considered** for investors who are:

√

SUBJECT TO THE HIGHER (40%) OR ADDITIONAL (45%) RATES OF INCOME TAX

√

ALREADY HOLDERS OF PORTFOLIOS OF MAINSTREAM INVESTMENTS, PROBABLY WITHIN A PENSION

√

LIKELY TO BE ALREADY FULLY UTILISING THEIR ANNUAL ISA ALLOWANCE (£15,240 IN THE 2015/16 TAX YEAR)

√

CONTRIBUTING TO A PENSION (IF WORKING)

And bearing in mind the likely investment horizon and the higher risk of VCTs, investors should be:

- Prepared to hold their investment for the long term (at least five years but potentially much longer)
- Comfortable with taking on a higher level of risk than mainstream stock market based investments

Finally, we can conclude that VCTs are **not suitable** for:

X

NON-TAXPAYERS (SINCE THE INCOME TAX RELIEF AVAILABLE ON NEW SHARE SUBSCRIPTIONS IS AN IMPORTANT FEATURE)

X

THOSE WHO CANNOT STAY INVESTED FOR A MINIMUM OF FIVE YEARS (SINCE THEY WOULD HAVE TO REPAY THE TAX RELIEF IF SOLD EARLIER)

X

INVESTORS UNCOMFORTABLE ABOUT TAKING A HIGHER LEVEL OF RISK THAN MAINSTREAM STOCK MARKET BASED INVESTMENTS

X

NOVICE INVESTORS

We've referred to "mainstream, stock market based investments on the left (and in several other places in the report) because it gives us a reference to compare VCTs to when it comes to risk, but we admit this is a pretty vague concept. Many stock market based investments will be much more risky than VCTs. We're really using this term as shorthand for the sorts of popular equity based funds that invest in large cap stocks in developed markets that will form the backbone of most investors' portfolios (and of course these funds themselves are by no means risk-free).

And of course as higher risk investments VCTs should only comprise a small part of an investor's' total portfolio, depending upon their attitude to risk and level of wealth.

Much of this can be summed up in the old adage "don't let the tax tail wag the investment dog". Investors must be comfortable with the risk they are taking on, comfortable with the lack of liquidity and they must have capacity for loss before considering VCTs. The tax reliefs don't completely outweigh these risks - they only make them more tolerable. The point is that if investors can tolerate these risks, there are potentially big rewards for them if the VCT performs well.

It's also worth noting that FOS will closely scrutinise the suitability of an investment if they receive a complaint, even if the tax was the primary basis for investing.

ACCUMULATION

Of course, as investments in smaller, high-growth companies VCTs can form part of an accumulation strategy. Tax-free dividends and tax-free gains mean that, if those dividends are reinvested, investors are exposed to the compounding effect tax-free. Compounding is the often the key to a successful investment strategy over the long term.

The impact of compounding tax-free returns is quite startling: We used a simplistic example, but if we assume a yield of 6% (reinvested), annual growth

"Appetite to invest in VCTs has been strong recently as investors have sought attractive tax-free yields in an environment of low returns for savers and limits on pension contributions for higher earners"

Mark Wignall, Mobeus Equity Partners

of 6% and invested £10,000 for ten years, the return (excluding the impact of fees and the upfront 30% Income Tax relief) is £31,058 or 211%.

If we made the same investment, but this time the dividends were taxed at 38.1% (the rate for higher rate taxpayers today), the return would be £25,270 or 153% a difference of £5,788.

This suggests that participating in the Dividend Reinvestments Schemes (DRIS) that many VCTs run is perhaps the best way of investing for the long run.

AT RETIREMENT - HOW DO VCTs INTERACT WITH THE NEW PENSIONS FREEDOMS?

It's worth considering VCTs and pensions, and how they interact with each other - especially in the light of so many recent changes to the rules and regulations governing pensions.

LIFETIME ALLOWANCE

We've already mentioned the first change to consider - the reduction in the lifetime allowance. This has come down from a peak of £1.8 million in 2011 to just £1.25 million* at the time of writing, soon to be lowered again to just £1 million.

£1 million might sound like a lot of money, but at current rates it would buy an annuity worth approximately £33,000 a year (before tax) for a 65 year old - for many people that might not be enough for the lifestyle they want.

The two charts on this page and the following page show that advisers will have many clients who will potentially reach, or breach, the £1.25 million limit (note that both assume no further contributions).

Of course, what the reduction in the lifetime allowance means is that many savers and investors will have to look for other tax-efficient options, beyond pensions and ISAs - such as VCTs.

LIFETIME ALLOWANCE (2006-2015)

Source: HM Revenue and Customs

The limit will be reduced even further to £1m in 2016/17, and then linked to the Consumer Price Index. Interestingly, if the original £1.5 million had been linked to RPI, the limit would be approximately £2 million

ANNUAL GROWTH RATE REQUIRED TO FUND FOR £1.25m

EXISTING FUND VALUE	TERM TO RETIREMENT			
	5 YEARS	10 YEARS	15 YEARS	20 YEARS
£100,000	65.72%	28.73%	18.34%	13.46%
£200,000	44.27%	20.11%	13.00%	9.60%
£300,000	33.03%	15.34%	9.98%	7.40%
£400,000	25.59%	12.07%	7.89%	5.86%
£500,000	20.11%	9.60%	6.30%	4.69%
£600,000	15.81%	7.62%	5.01%	3.74%
£700,000	12.30%	5.97%	3.94%	2.94%
£800,000	9.34%	4.56%	3.02%	2.26%
£900,000	6.79%	3.34%	2.21%	1.67%
£1,000,000	4.56%	2.26%	1.50%	1.12%
£1,100,000	2.59%	1.29%	0.86%	0.64%
£1,200,000	0.82%	0.41%	0.27%	0.20%

Source: HM Revenue and Customs

*Note that technically this allowance can be exceeded, but anything above the allowance will be subject to a hefty 55% tax charge.

"VCTs provide valuable tax-free income at a time when tax-free income is scarce"

Will Fraser-Allen, Albion Ventures

POSSIBILITY OF PENSION FUNDS REACHING THEIR LIFETIME ALLOWANCE

YEARS TO RETIREMENT	FUND GROWS AT:			
	2%	4%	6%	8%
3	£ 1,177,902.92	£ 1,111,245.45	£ 1,049,524.10	£ 992,290.30
5	£ 1,132,163.51	£ 1,027,408.88	£ 934,072.72	£ 850,729.00
7	£ 1,088,200.22	£ 949,897.27	£ 831,321.39	£ 729,362.99
10	£ 1,025,435.37	£ 844,455.21	£ 697,993.47	£ 578,991.86
15	£ 928,768.41	£ 694,080.63	£ 521,581.33	£ 394,052.13
20	£ 841,214.17	£ 570,483.68	£ 389,755.91	£ 268,185.26

A recent Freedom of Information request by Suffolk Life gives us an insight into just how many people have breached the lifetime allowance over the last few years - the data below shows the tax take from the tax charge on assets held in pensions above the lifetime allowance:

TAX YEAR	TOTAL
2009/10	£24,858,248
2010/11	£31,404,737
2011/12	£46,953,535
2012/13	£52,995,280
2013/14	£98,013,014
2014/15	£94,200,118

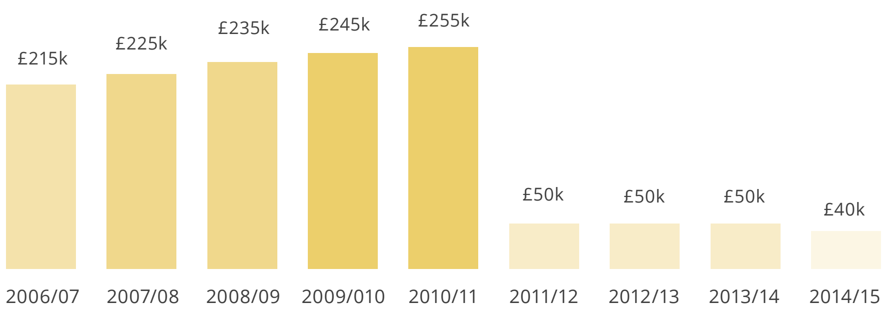
Source: Suffolk Life

The rise in the tax take may indicate that as the lifetime allowance has declined, more investors have been caught out by it - this is the group that should have been utilising other investment options such as VCTs.

ANNUAL ALLOWANCE

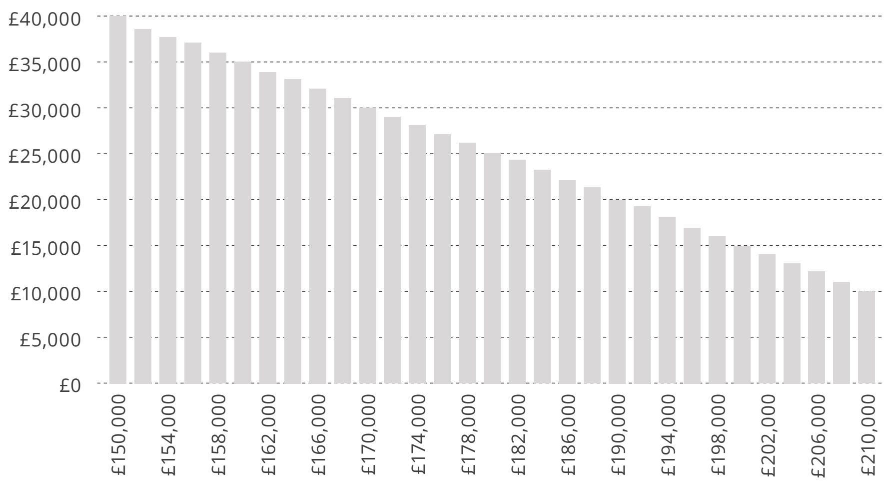
At the same time, the annual allowance has been reduced quite dramatically. This might have the effect of making it less likely that today's younger savers will reach the lifetime limit, but it does mean that some wealthier investors could well find that they need to look for other tax-efficient investments as they are fully utilising their pension and ISA limits each year.

ANNUAL ALLOWANCE FOR PENSIONS (2006-2015)



Source: HM Revenue and Customs

ANNUAL ALLOWANCE - SLIDING SCALE FOR HIGHER EARNERS



Source: HM Revenue and Customs

HIGHER EARNERS

Recent changes mean that anybody earning between £150,000 and £210,000 have a reduced annual allowance and anybody earning greater than £210,000 have an annual allowance of just £10,000.

So although pensions higher rate tax relief has survived for the moment at least, this sliding scale of reduction in the annual allowance significantly reduces the opportunity of pensions for higher earners and once again makes other tax-efficient options, such as VCTs, more attractive.

"With a sizeable net asset base and the right balance between generating capital growth from the underlying investments, while successfully building a steady and increasing income stream from dividends: then you can potentially have an interesting proposition" **Chris Hutchinson, Unicorn Asset Management**

DECUMULATION

The new pension freedoms that came in from April 2015 give people much more flexibility when it comes to taking their pension at retirement, and for many VCTs could play a role in planning for a retirement without purchasing an annuity, and to ensure tax-efficient decumulation.

SATELLITE PORTFOLIO

The simplest strategy to consider is to have a satellite portfolio of VCTs alongside the pension - in the previous section this is what we were implying could be an option for clients who are at, or near to, maxing out their pension limits. With upfront tax relief, tax-free gains and tax-free income, VCTs have some similar features to pensions when it comes to tax-efficiency. Of course they do not have the same flexibility of investment as pensions and will generally be invested in much higher risk underlying assets, but as a rule of thumb investors who are near to maxing out their pension are more likely to have the requisite capacity for loss, sophistication and attitude to risk (of course this is not a given though and must be ascertained and evidenced by the adviser).

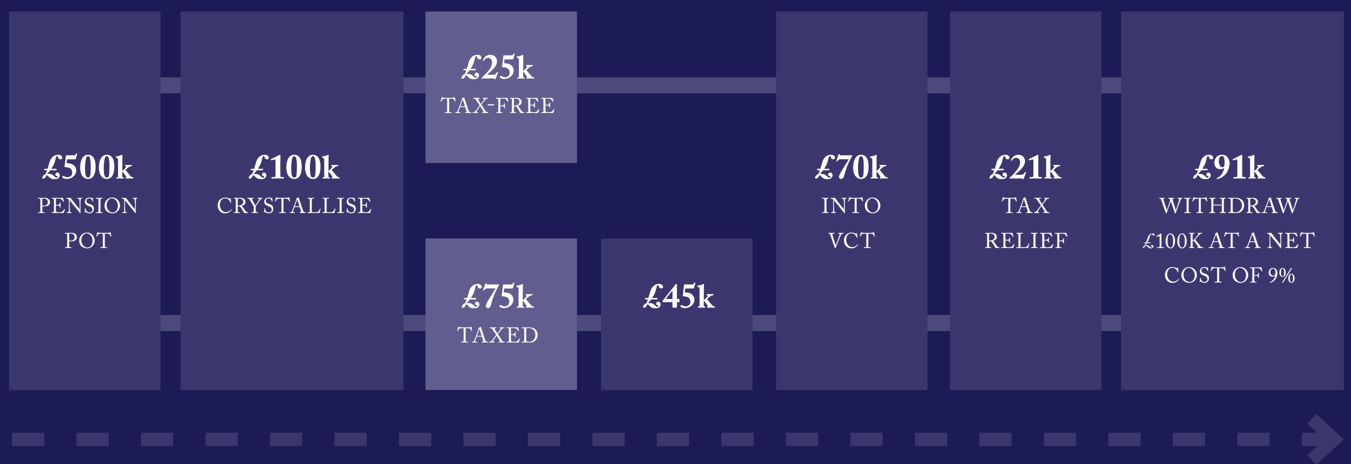
A small satellite portfolio like this can grow alongside a pension, or provide a tax-free yield to supplement pension income.

TAX-EFFICIENT STRATEGIES FOR DECUMULATION

VCTs can also be used in a more sophisticated way to provide tax-efficient decumulation. We've included some ideas on how this could be done below and on the following page.

#1 CRYSTALLISING £100K

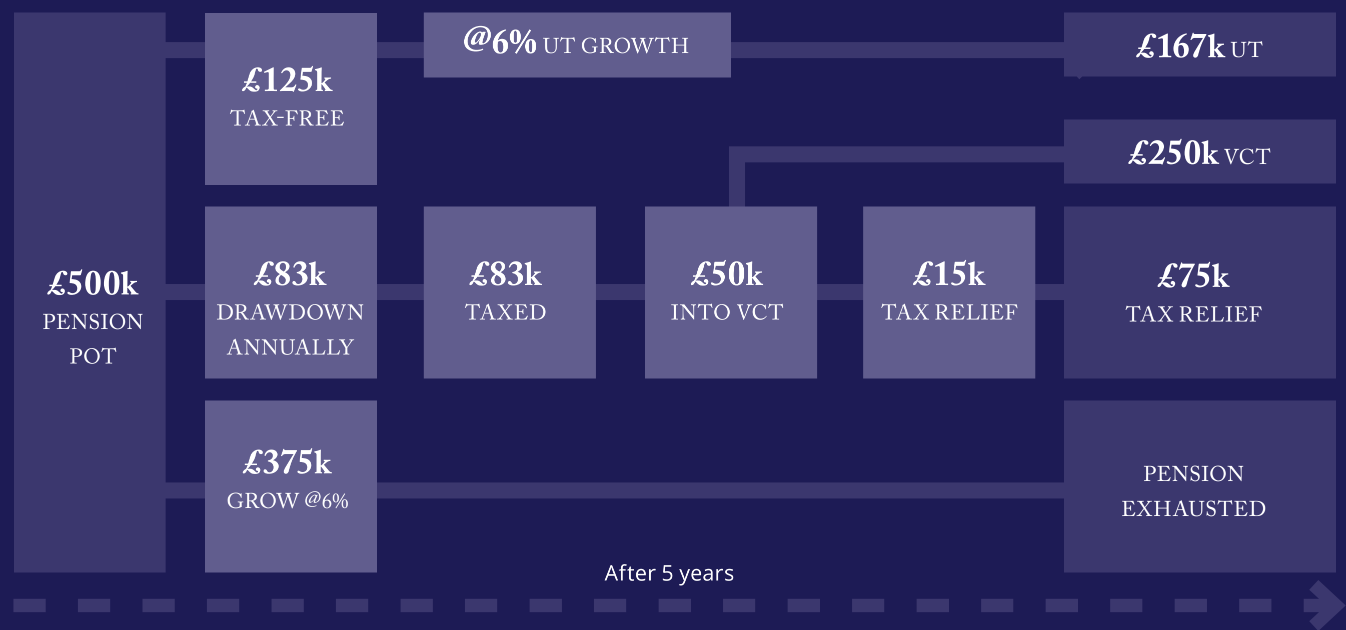
In the example below, the upfront Income Tax relief from the VCT investment is used to offset the tax payable on the funds that have been crystallised (over and above the £25,000 tax-free lump sum).



This means that the net cost of withdrawing £100,000 from the pension pot is £9,000 instead of £30,000. Of course, this also means that £70,000 of that £100,000 has to be invested for a minimum of five years. The example assumes the client is a higher rate taxpayer is suitable for VCT investments and can afford to go without the income the £100,000 that is withdrawn from the pension pot could provide.

#2 FLEXI ACCESS DRAWDOWN

In this example, the client is a higher rate taxpayer using flexi access drawdown and a combination of VCTs and Unit Trust investments to invest their £500,000 pension pot in over a five year period. This is based on the assumption that the client doesn't need to spend the money in their pension pot over this time frame.



The 25% tax-free pension commencement lump sum is taken out in year one and invested in a Unit Trust portfolio, and £83,000 is drawn down from the pension in each of the five years, taxed at the marginal rate of 40% and then the net amount is invested into a VCT portfolio.

Assuming that both the Unit Trust portfolio and the pension pot grows at approximately 6% per annum, and that the VCTs do not grow at all, after five years the pension pot will be exhausted, but the sum of the Unit Trust portfolio, VCT portfolio and tax relief will be approximately £492,000.

A simpler idea would be to assume 0% growth in any of the assets. £125,000 would be taken tax free. £75,000 would be drawndown from the remainder each year and (assuming 40% tax) the net amount of £45,000 could be invested in VCTs, providing £13,500 of tax relief. After five years, the pension pot would be exhausted, but there would be a VCT portfolio of £225,000 paying dividends and an additional pot of £67,500 received in tax relief.

FUND SELECTION

The obvious place to start looking for distinguishing criteria is the fund's investment objective and the sector it will be investing in. The online comparison engine and review site MICAP define the objectives as either:

- CAPITAL PRESERVATION
- CAPITAL PRESERVATION & GROWTH
- CAPITAL PRESERVATION & INCOME
- GROWTH
- GROWTH & INCOME
- SUPER GROWTH

For the VCTs listed on their platform at the time of writing, they all fell into either: 'Growth and Income', 'Capital Preservation' and 'Growth and Income' or 'Capital Preservation and Income' categories.

MICAP also lists the sector and sub sector the VCT will be investing in: Financial Services, Food and Drink, General Enterprise, Industry and Infrastructure, Media and Entertainment, Multi Sector, Pharmaceuticals/Biotechnology, Renewable Energy, Sport and Leisure, Technology, and Transport.

COMMON VCT CLASSIFICATION: AIM QUOTED | GENERALIST | SPECIALIST | LIMITED LIFE

Sub sectors give more granular detail, such as "Asset Backed Businesses and Renewable Energy" or "Energy and Infrastructure".

Tax Efficient Review use a different taxonomy that combines the Objective and Sector as well as providing some information on the track record and investment structure:

- AIM based
- Clean/Green
- Early Stage Generalist
- Evergreen with a capital preservation investment mandate
- Generalist
- Generalist based on convertible loan notes
- Generalist without a track record
- Generalist seeking early stage investments without full disclosure of investment portfolio
- Hybrid asset backed and AIM based
- Planned Exit
- Sixteen year clean/green with a capital preservation investment mandate
- Specialist

Allenbridge and many sites like Morningstar, FE Analytics or the AIC site use the widely accepted definitions:

- AIM Quoted
- Generalist
- Specialist
- Limited Life

These are a mixture of objectives and (very high level) sectors.

Clients looking for growth would obviously look to the funds in any of the "growth" categories. These funds will be investing in the equity of high potential firms, either on AIM or unquoted, and there will be Specialist VCTs that fit the bill as well. Expect them to be well diversified and run by an experienced team – look for specific successes in business and investment, rather than generic statements about time served in financial services.

More defensive clients who want to make a lower risk (but not low risk - VCTs are not low risk investments) investment should look for VCTs in the capital preservation categories. These funds are likely to be making a majority of asset backed investments, or they will be focusing on securing income as the major component of the return. Many of these funds may actually invest in debt by issuing loan notes and taking a first charge on assets or some other form of security. (This information is often only obtained from the Investment Memorandum and other official documents).

Clients who sit somewhere in between ('balanced') would previously have been well served by VCTs that funded MBOs or company acquisitions. This is a more risky strategy than the asset backed approach and is more risky than buying a stake in a steady, established company that pays predictable dividends, but is less risky than buying equity in small, high growth companies.

However, the changes proposed in the July Budget 2015 and given Royal Assent in autumn 2015 now mean that this strategy is ineligible for VCTs.

TRACK RECORD

The majority of VCTs have been around for some time and, while past performance is no guarantee of future returns, their track record is one indication of how robust and successful the management team's strategy and stock picking skills are. It's worth carrying out some basic checks when you look at past performance: has the fund manager been the same all the way through the period you are assessing, has the fund always followed the same strategy and how have they performed in comparison to their peers?

Another check needed this year: if the fund had an MBO or acquisition strategy prior to autumn 2015 (even if these are only part of the investments that comprise the fund), its track record may not be an indication of how it will perform post the changes in the 2015 Finance Bill.

It's also worth checking that the fund has been following its stated strategy and has not drifted from it at any point - leaving unwary investors in unsuitable investments. Funds that raise too much money are susceptible to this as they then have to look further afield to deploy it.

TYPE OF FUNDRAISE

Investors and their advisers also need to be mindful of the type of fundraise they are investing in. Fundraising and investment opportunities basically fall into three categories:

- Top ups on existing VCT share classes. Here the investor is investing into an existing pool of assets based on the NAV, with an established cost structure. The investor gets exposure to the existing portfolio and can start earning tax-free dividends straight away.
- New share classes within existing VCTs. The VCT will create a new share class, which will invest in a new portfolio of investments. These will be kept separate from the existing shares (although they may merge eventually). The VCT's costs can be spread over the larger asset base created by the fundraising.
- New VCTs. A new VCT, raising new money and incurring costs for the first time, although most new VCTs are launched by existing providers. Commentators suggest that at least £7-10 million needs to be raised to make the VCT economically viable and allow sufficient diversification.

As a general rule of thumb, top ups are less risky than new shares as the pool of assets is already established and the performance to date can be assessed. Both top ups and new shares would usually be considered less risky than a new VCT - this is one of the barriers to new market entrants.

"Not being able to purchase new shares in a VCT through a platform or nominee was a major headache for advisers, and resolving this issue would remove a significant source of friction in the investment process for advisers and investors, and hopefully pave the way for increased inflows"

A COUPLE OF PRACTICAL CONSIDERATIONS

Professional Indemnity Cover and Independence: For firms seeking to remain independent, the regulator has stressed the need for them to hold PI insurance which covers them for the 'full range of retail investment products' they need to consider. (Or where any product types were excluded under the terms of their policies, to hold additional capital as insurance).

This means finding PI insurance that will cover the more esoteric investments independent advisers might consider for their clients, such as VCTs. Our understanding is that to remain independent advisers don't need to pay for PI cover or research on products that are not relevant for their client bank or target market, but that they do need to be able to advise on these products should the need arise. And advisers must consider the risks in not including these products - the regulator or client might ask why they were excluded from the opportunity.

VCTs on Adviser Platforms: According to Transact, it is estimated that platforms have over £350 billion in assets under administration and up to 80% of new retail investments are now made via an investment platform. Today almost all advisers use at least one platform, and in surveys both advisers and consumers cite the functionality, ease of use and ability to get a consolidated picture of their total portfolio as key benefits.

Before the changes in the Finance Bill in 2014, it was not possible to purchase new shares in a VCT through a platform or nominee – in other words, investments had to be made in the client's own name in order for them to claim the Income Tax relief. It was possible to transfer existing VCT investments, via a stock registration process, to those adviser platforms that could facilitate this type of transfer and hold CREST shares.

It was recognised that this was a major headache for advisers, and resolving this issue would remove a significant source of friction in the investment process for advisers and investors, and hopefully pave the way for increased inflows.

The situation has begun to change. Changes announced in the 2014 Finance Bill allowed shares in VCTs to be bought by a nominee and still qualify for the tax reliefs. Nominee ownership is a key requirement in enabling financial advisers to manage their clients' investments on platforms and in April 2015, Octopus announced that it had completed a development with Transact to enable shares in its VCTs to be brought and held on the platform. Puma Investments followed swiftly afterwards and its VCT 12 is also available on Transact.

This was a relatively big project for Transact, Octopus and Puma but it may be that now they have undertaken much of the heavy lifting, it will be easier for other platforms and VCT providers to follow suit.

Intelligent Partnership held a roundtable discussion between Transact, Octopus and small group of VCT providers in September 2015 to discuss the issue. Transact were of course keen to get more providers on board, as were Octopus: they both want to see this become a new route to market for VCTs, give investors more choice as to how they want to buy and hold their VCT investments, and to create a genuine marketplace for VCTs on advisory platforms.

The other VCT providers were also very keen to get onto platforms, recognising the benefits that being able to transact in this way would bring. As Brendan Llewellyn of Adviser Home (who gave a short presentation on the topic) put it, when it comes to winning over new advisers "business process empathy is crucial." The providers see acceptance on a platform as not only a way to make life easier for existing IFAs, but also as an opportunity to engage new IFAs. If the market grew, the platforms would presumably invest in developments such as publishing NAVs as well as share prices and reminding investors when five year minimum holding periods are coming to an end. It's easy to see how this could be a positive evolution for the VCT industry.

There are some logistics to iron out as well: providers and platforms need to work closely together to manage their pipelines to ensure that offers are not oversubscribed (an issue for all closed funds on platforms); the distribution lists for ongoing communications to investors will be impacted now that the central share register cannot be relied upon (as VCTs would be held in the platform's name); the process for selling shares in the secondary market has to be closely monitored to ensure investors are getting the best possible price; and Dividend Reinvestment Schemes are harder to administer. These are all logistical issues that will be overcome as we see more take up on VCTs on platforms.

Often the process will hinge upon the interactions between the platform, receiving agents and registrars, rather than between the platform and the VCT provider. With little commercial interest in this development, there may be some inertia on their part that also needs to be overcome.

However, perhaps the biggest stumbling block is the time and effort involved. As market leaders, Octopus and Puma can afford to put resources into these projects (and kudos to them for doing what a market-leader should do and leading the way). Many other VCT providers outsource the role of receiving agent and registrar and/or do not have the operational scale to approach these projects in the same way. Of course, some of the other VCTs are also distracted by the recent rule changes as well, or the independent boards are not yet convinced by the argument to purchase through platform.

Nevertheless, we're confident that as more platforms and VCT providers work together, any friction in the on-boarding process will be minimised and it will be easy enough for the small guys to follow suit. We think there could be a handful on Transact in 2015/16 and a lot

"From advisers' point of view, they simply want the convenience of being able to access VCTs in the same way as the majority of other retail investment products"

more VCTs across a couple of the most flexible platforms (not the old fund supermarkets) the following season.

Now, most of these issues are for the industry to work out. From advisers' point of view, they simply want the convenience of being able to access VCTs in the same way as the majority of other retail investment products. However, there are two deeper issues that advisers would be wise to bear in mind as well.

Firstly, the issue of suitability. This was a fear expressed by some providers (and some advisers we spoke with). They see platforms as a mass-market product and VCTs as a niche market product and therefore feel uncomfortable with VCTs listing on platforms. Ultimately, of course, suitability is something that will sit with the adviser and not the platform or provider - so it must be hoped that if VCTs do become commonplace on platforms it doesn't lead to complacency or misconceptions about what these products are on the part of some advisers.

There will also be a responsibility on providers to market themselves honestly as well. Of course, with a new audience of IFAs (and potential investors) to try and reach, some of the providers may well be tempted to position their product as close to mass market as they dare.

This brings us onto the second issue: if platform acceptance does potentially open up a new cohort of advisers to market to, the providers with the biggest marketing budgets will be the most successful. They will bring in more customers, but one hopes that this is not at the expense of the smaller VCTs who have some of the most interesting (and best performing) offers. Advisers who are coming to VCTs for the first time should keep this in mind when they are being bombarded with marketing messages in the near future.

A final consideration is something that often comes up in relation to platforms: there is a cost to the client, but is it the adviser who really accrues the benefits of convenience and a consolidated view?

SUITABILITY REPORTS

Every adviser and advisory firm will have their own process and format for suitability reports - but points that are specific to VCTs are summarised below:

OBJECTIVES

- Reduce or eliminate income tax liability of up to 60,000
- They have a requirement for tax-efficient investment for capital growth

PROFILE

- They have surplus capital
- They are aware of the potential to lose all of the investment
- They are aware the reliefs could be withdrawn or clawed back

WARNINGS

- No market for the shares
- Likely to trade at a discount to the NAV (true value)
- 5 years qualifying for income tax relief
- Tax relief isn't excuse for high risk nature

There are obvious benefits to the client and adviser at the investment stage – no cheque, application form or additional Anti Money Laundering checks. But following that, is there more benefit to the adviser and the platform in retaining all the assets on platform and earning a custody fee / AMC on the client's overall portfolio? For a client it's an investment that will be held for at least 5 years, so if we do see VCTs on platforms there may have to be some adjustments to the pricing from both the VCT and platform to balance out the cost to the client.

THE REGULATORY CONTEXT FOR VCTS:

VCTs are regulated by a quartet of organisations:

HMT – Sets out the rules that govern VCTs. The Treasury has a handful of objectives when it comes to VCTs: to ensure that the schemes continue to support economic growth, provide value for money for the UK Taxpayer and comply with European State Aid rules. These objectives can sometimes be conflicting. We're not sure if the changes announced in the 2015 summer Budget, which ensure ongoing compliance with the State Aid rules, are optimal for ensuring that the scheme supports economic growth. Read our opinions on page 32 for more detail on the dilemma HMT faces.

HMRC – Ensures that VCTs are compliant with the rules. HM Revenue and Customs are responsible for administering the tax reliefs and ensuring the ongoing compliance of the VCT funds - their biggest intervention to date has been the temporary removal of qualifying status from the Oxford Technology VCT, detailed on page 29.

FCA – Regulates the advice process. Back in 2012/13, the Financial Conduct Authority issued a policy paper on Unregulated Collective Investment Schemes (UCIS) and "Non-Mainstream Pooled Investments" (NMPI). At the time

"There are a number of resources available to advisers who want more information on VCTs"

there was a possibility that VCTs would be caught by the new rules (PS13/3). However, the regulator concluded that VCTs and EIS, as well as exchange traded products and offshore investment companies, will not be caught by a ban on promotion to most retail investors, unless they are structured as UCIS.

At the time the Association of Investment Companies director general Ian Sayers said: *"We very much appreciate confirmation of the FCA's policy intention to exclude VCTs and offshore investment companies from the marketing restrictions. This is important for the investment company sector and allows ordinary retail investors to continue to access the benefits of VCTs and offshore investment companies. We look forward to working with the FCA to make sure the rules deliver this policy intention."*

FOS – Assesses consumer complaints. We know that there are examples of the Financial Ombudsman Service refusing to acknowledge the 'preferential tax status' element of an investment when adjudicating a complaint. Their focus is on the suitability of the investment itself and the tax reliefs may be seen as secondary to that consideration. Although this may have been a one-off, once again the adage about tax tails and investment dogs seems to apply.

PROMOTERS AND ADVISER RESOURCES

There are a number of resources available to advisers who want more information on VCTs. The three major sites are Tax Efficient Review, Tax Shelter Report and MICAP. All three provide individual investment reviews, allowing advisers to access independent third party due diligence on VCT offers. MICAP also offers online functionality, allowing users to filter, search and compare open offers according to their chosen criteria, using a lot of granular detail often buried within the prospectuses.

Morningstar and FE Analytics both collect top-level performance data on VCT performance that can be accessed free of charge.

The Association of Investment Companies has a lot of information on VCTs available for advisers, including face-to-face training and webinars, both live and pre-recorded.

There are also some promoters operating with advisers in the VCT marketplace. The three most established are RAM Capital, Portunus Investments and LGBR Capital, with Kin Capital being a new entrant in this space. These firms will work with a small portfolio of VCTs and do the leg work of going out and engaging with advisers on behalf of their VCTs. From the VCTs' perspective, this saves them time and effort spent on non-core activities and from the adviser's perspective, the promoters offer product training, an additional layer of due diligence and a single point of contact for their VCT business. Of course, VCTs who don't work with promoters do all of this work themselves. The industry has made a lot of effort to engage advisers over the last few years by running seminars, webinars, providing extensive due diligence and education and developing knowledgeable business development teams.

DUE DILIGENCE AND PANEL CREATION STEPS FOR ADVISERS

We have set out on the next page a proposed due diligence framework. This is only one example and it's not comprehensive: it's beyond the scope of this report to go into granular detail on due diligence, but we want to give readers guidance on what due diligence might involve. The amount of work involved may seem daunting - but as we pointed out above, independent review sites such as MICAP, Tax Efficient Review and Tax Shelter Report provide independent third party reviews for advisers.

As we stated, the list on the next page isn't comprehensive. Advisers will need to combine this type of assessment with a review of the issues we noted in the previous section: the objective, the strategy, the manager's performance track record and the type of fundraise.

Additional areas that we've only hinted at, but still need to be looked at closely, would be any use of gearing, the policy on discount management, the size, scope and capacity of the manager to adapt to changes in the rules, the level of fees and performance payments and how the manager's incentives are aligned with the investor's.

The weighting given to each aspect or individual issue in the overall analysis will vary from adviser to adviser and client to client, depending upon the unique circumstances.

USING A PANEL

The issues are different for sole traders and large nationals, and for independent and restricted advisers, but many advisory firms will use a somewhat ad hoc VCT product selection and due diligence process at the moment, with no defined procedure or selection criteria that they can point to. They may not be certain that they are looking at the whole-of-the market and the process is often reactive, responding to adviser requests or client needs as and when they are identified, rather than proactively selecting VCT investments.

Creating a panel of VCTs requires an upfront investment of resources, but can save time and effort later on and ensures compliance with a centralised investment proposition throughout a firm.

Building a process and implementing a panel of approved products would ideally:

- Save time and effort over the long run (usually for key personnel)
- Give more advisers confidence to recommend VCTs (they are familiar with the panel and can introduce it to the right clients)
- Provide more robust due diligence on the managers and products (their experience and capabilities, financial strength and structure, investment process and objectives and performance track record)
- Enable the firm to form a relationship with the managers on panel
- Ensure the firm is compliant with the regulations
- Ensure the firm is picking the most suitable investments for their clients

The high level steps a firm would have to go through to create a panel are outlined on page 51.

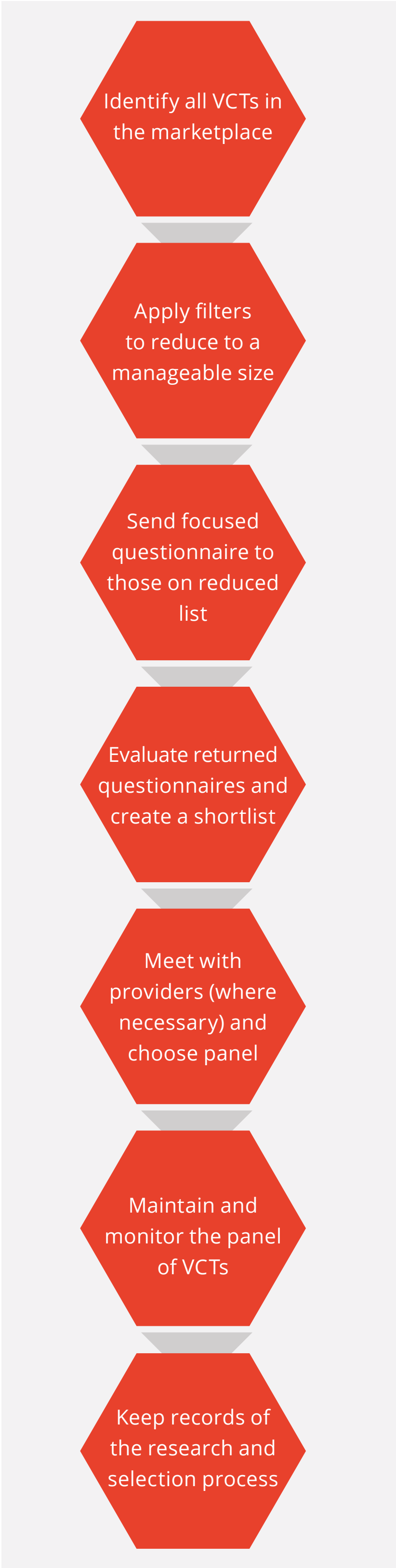
"Creating a panel of VCTs requires an upfront investment of resources, but can save time and effort later on and ensures compliance with a centralised investment proposition throughout a firm"

DUE DILIGENCE: AREAS TO QUERY

ASPECT	DESCRIPTION	WHAT SHOULD BE MEASURED?
FINANCIAL	Asset coverage	Nature / level of unencumbered assets and giving investment security
FINANCIAL	Income (at investee company level)	Certainty of income
FINANCIAL	Control and influence (at investee company level)	Ability of the Manager to control and influence
FINANCIAL	Certainty of co-investment and follow on funding	Requirement and visibility of follow on funding
DIVERSITY	Investment portfolio	Diversity of portfolio in terms of number of different companies invested into
DIVERSITY	Sector spread	Diversity of portfolio in terms of number of different sectors invested into
DIVERSITY	Portfolio maturity	Maturity of portfolio as a measure of security
VCT MANAGER RISK	Operational history of Manager entity	Depth of experience (in years) of Manager
VCT MANAGER RISK	Manager's number of employees	Size of Managing entity
VCT MANAGER RISK	Manager's net staff numbers and retention	Stability of operations
VCT MANAGER RISK	Manager / senior employed team longevity managing VCT products	Depth of experience specific to VCT market
VCT MANAGER RISK	Investment sector experience of Manager / senior employed team	Depth of experience specific to investment sector
VCT MANAGER RISK	VCT assets under management	Quantum of VCT assets under management as a measure of presence and experience
LIQUIDITY	Type of product	Ability to access funds at any time defined by product type / liquidity mechanisms
LIQUIDITY	Underlying nature of investment	Ability to access funds at any time defined by nature of underlying investment
LIQUIDITY	Estimated liquidity time frame and nature of any discount management policy	Time frame and conditions stated in IM for giving liquidity if investor wishes to access funds
EXIT	Nature of exit	The likely complexity of anticipated exit
EXIT	Manager track record of exits (general)	The Manager's experience of providing exits in general
EXIT	Manager has track record of exits (specific to asset class)	The Manager's experience of providing exits specific to this asset class
EXIT	Anticipated realisation period (where relevant)	The amount of time that the manager anticipates realisation will take
TAX	HMRC pre-clearance status (pipeline investee companies)	The level of HMRC pre-clearance
TAX	Manager track record of achieving tax relief	The Manager's track record of achieving tax reliefs for investors
TAX	HMRC challenges (if any)	The amount and level of challenge the Manager has faced from HMRC on the tax reliefs
TAX	Ongoing monitoring systems and controls	The level of ongoing tax monitoring of the portfolio
REGULATORY	Manager Regulatory Permissions	The status of the Manager's FCA Regulatory Permissions and compliance function as a measure of accountability / professional standards
REGULATORY	FCA Status of product/offer	The level of Regulatory scrutiny of the product /offer

"Reductions in the amounts that can be saved into pensions and threats to the tax relief available in pensions have increased the need for tax-efficient investment options"

PANEL CREATION STEPS



Creating a panel of VCTs requires an upfront investment of resources, but can save time and effort later on and ensures compliance to a centralised investment proposition throughout a firm

The key steps where external expertise could be valuable would be deciding on the correct filters to apply to reduce the panel size, and developing a DDQ questionnaire that is sufficiently detailed and covers all of the issues that need to be considered when sourcing VCT products - it might look similar to the high level due diligence areas listed in the chart (left).

The purpose of monitoring the panel is: to continually review the selection criteria and ensure that they are right for the client bank; to assess any new products that meet the criteria (and remove any products that no longer do so); to review sales data and MIS (management information statistics) to see if there are any products that the advisers are not selecting (or those that have too much money going into them); to identify any advisers that could do more VCT business (or those that might be doing too much); and to review and act upon adviser feedback.

Putting the panel together and the ongoing monitoring will probably be the job of either the investment committee, a sub committee convened specifically to look at alternative investments such as VCTs, or the equivalent body at an advisory firm. The role of the investment committee in relation to the panel would comprise:

- Ongoing review of panel selection criteria
- Final decision on investments that go onto the panel
- Review of current panel
- Review of MIS (management information statistics) to ascertain whether the panel meets adviser needs
  - a) Volumes and amounts (£) sold
  - b) Breakdown by manager
  - c) Breakdown by product
  - d) Breakdown by adviser
- Review of any new market developments (news, legislation, press coverage, new entrants, etc.)
- Collect and review of adviser feedback
- Report back to the full investment committee or board

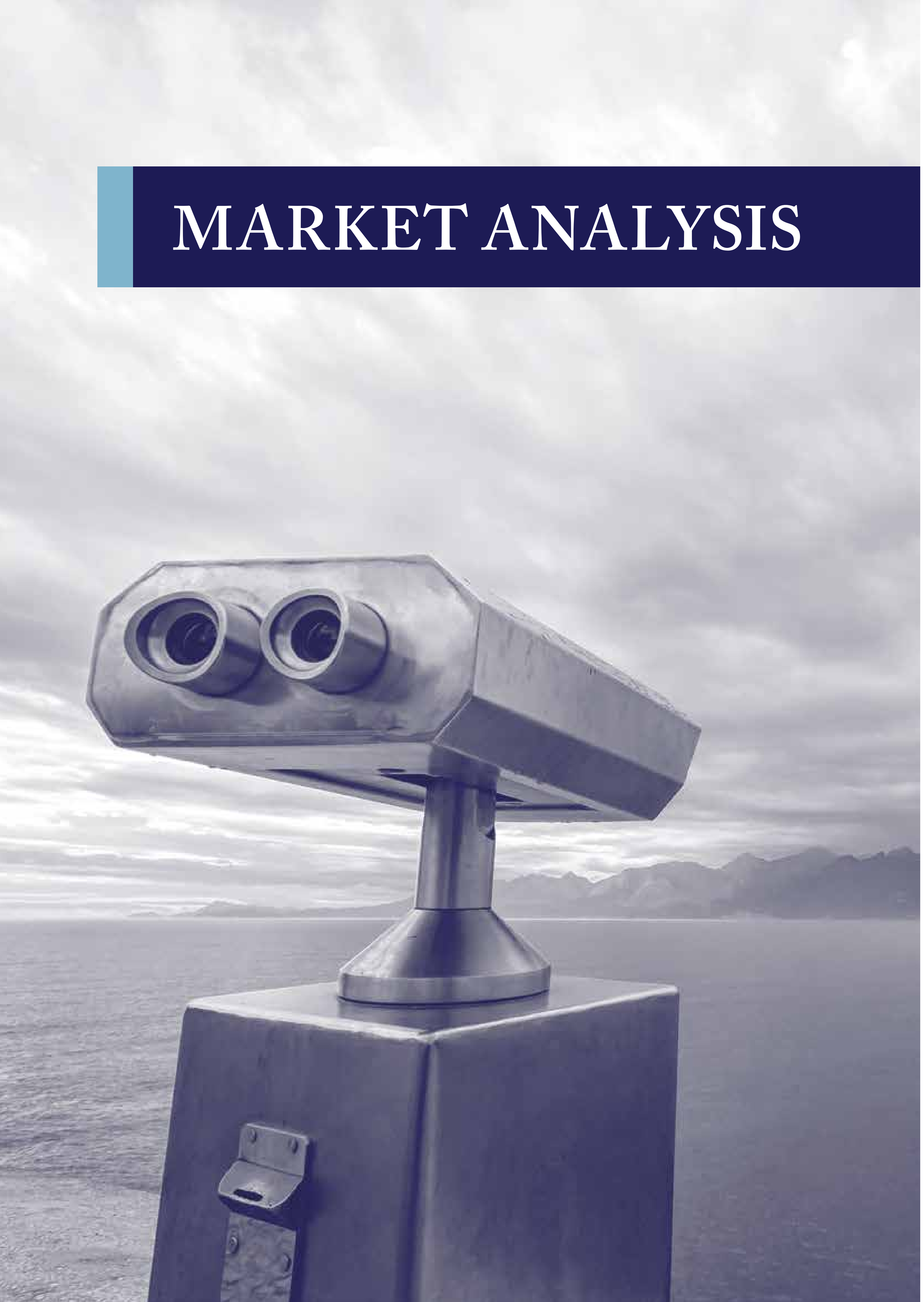
CONCLUSIONS

As we've seen, reductions in the amounts that can be saved into pensions and threats to the tax relief available in pensions have increased the need for tax-efficient investment options. Pension freedoms may require advisers to use more sophisticated decumulation strategies, longer lives demand more tax-efficient accumulation products and in our low interest rate environment nearly all investors are still searching for higher yields. There are a lot of good reasons to consider investing in VCTs.

The big caveat is that advisers must ensure that they only use VCTs for the right clients, and that the right VCTs are selected. Of course this comes down to appropriateness and suitability, assessing the whole-of-the-market, carrying out comprehensive due diligence and having a thorough understanding of the products that are recommended. For advisory firms who foresee that they will be doing a lot of VCT business, using third party review and comparison sites and setting up a panel would probably save a lot of time and effort on their part over the long run.

KEY POINTS

- Suitability should primarily be based upon the underlying investments and not the tax reliefs
- VCTs can be used to construct tax-efficient decumulation strategies
- Advisers' due diligence has to cover a lot of ground and consider features that are unique to closed funds and VCTs. It will be a longer process than due diligence on conventional OEICS
- Using a panel and a third party comparison and review service can save firms time and effort

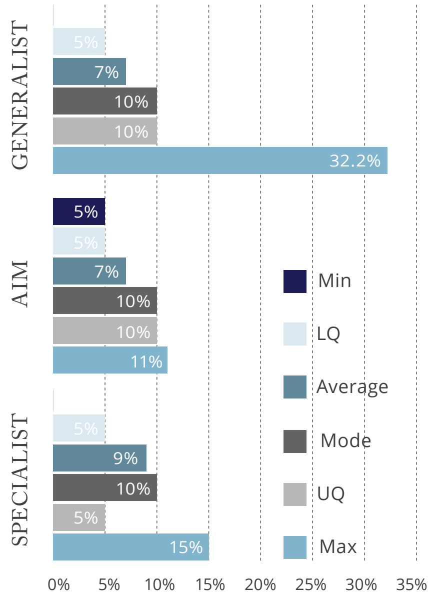


MARKET ANALYSIS

OVERALL ANALYSIS

In this section we help readers get their arms around the whole of the VCT market by compiling and examining some of the available data on VCTs, both historically and for today's open offers. Much of the data has come from MICAP Ltd, the online platform and comparison engine for tax-efficient alternative investments. Intelligent Partnership is a part of the same group of companies as MICAP.

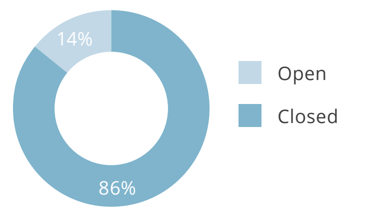
SHARE BUYBACK POLICIES



At the time of writing the difference between the NAV and share price range from a 150% premium to a 70% discount. Many VCT shareholders will not want to rely on selling their shares on the secondary market for an exit and instead, providers offer investors the opportunity to sell back their shares after a certain time frame at a given discount or discount range. Some will buy back shares at a nil discount to NAV, but the most common policy in the market is to buy back at a 10% discount.

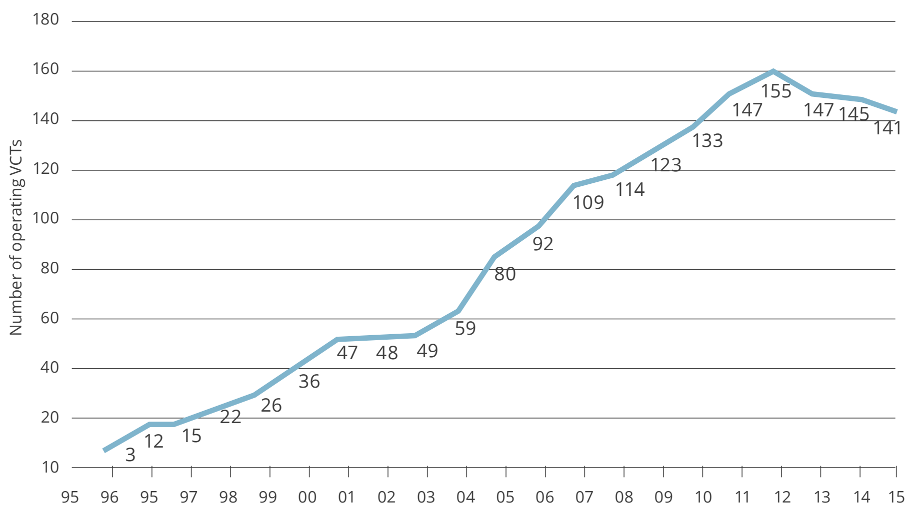
As we noted earlier, these policies are subject to the VCT having the funds available to buy-back shares.

OVERALL VCT STATUS



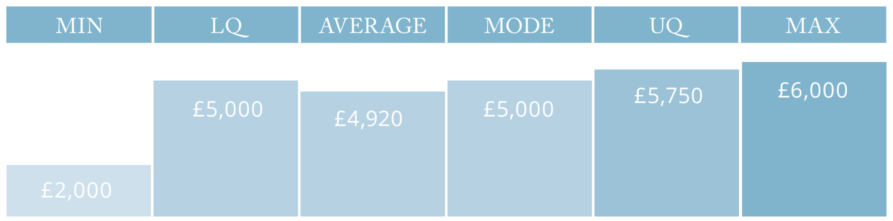
A substantial majority of VCTs are closed for new investment at around 86%. Only a small portion (14%) of the overall VCT market is open for new investment. However, Evergreen VCTs open and close periodically for top-up offers or by way of new share class. This allows advisers and investors to choose from a range of established products and invest at the time tax benefits are needed.

OVERALL VCT MARKET GROWTH (1995-2015)



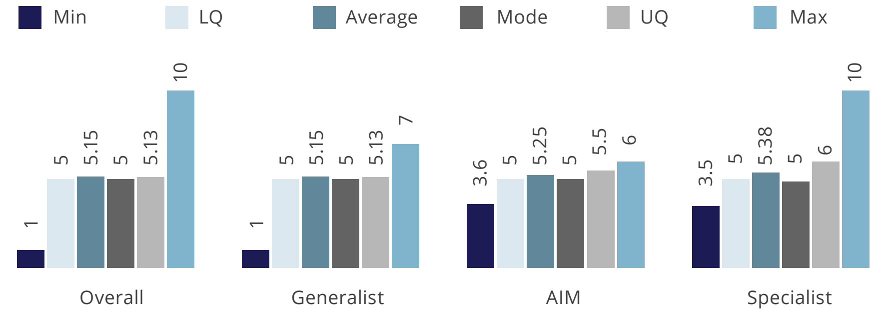
The VCT market development shows consistent growth in the market until 2012. Since 2012 there has been some consolidation in the market, with several mergers in 2013. The consolidation of the market is a positive result from the rule changes seen in the VCT sector; limits on VCTs lifted allowed for companies to merge and become more cost effective and competitive.

MINIMUM INVESTMENT (2015)



Minimum investment levels are consistent across the whole market. The most common entry level is £5,000, but the highest minimum investment level is only £6,000. In cases where investment managers are offering shares in several VCTs or VCT share classes, they may allow investors to split their investment across several VCTs, lowering the minimum investment per VCT and allowing greater diversification benefits. The minimum investments are higher than mainstream stock market based OEICS, but lower than more risky EIS and other venture capital and private equity funds.

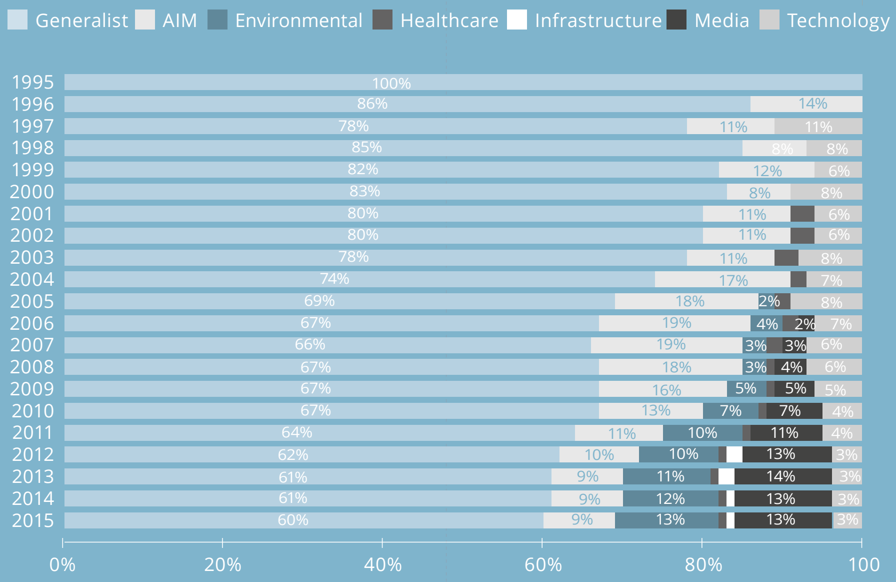
TARGET DIVIDEND RETURNS (PENCE PER SHARE) (2015)



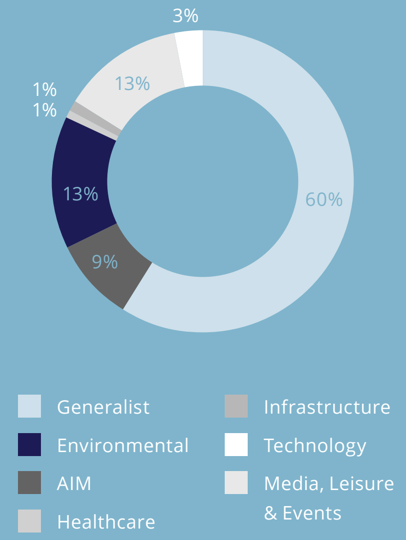
Tax-free dividends are possibly the most attractive feature of VCTs and many funds state what levels of dividends they will be targeting for their investors. The yields are attractive compared to many other assets (although of course the additional risks and costs must be taken into account).

SECTOR ANALYSIS

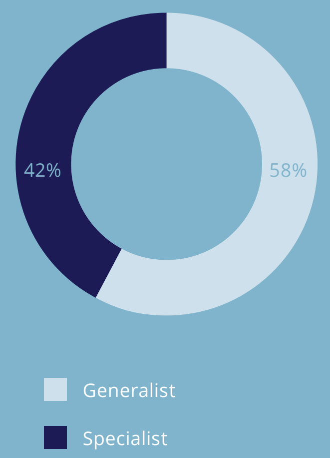
SPECIALIST SECTOR GROWTH BY SUB-SECTOR BY No. OF VCTs



MARKET BY SECTOR (2015)



LIMITED LIFE SECTORS



Limited Life VCTs can be either generalist OR specialist, but we have not seen any examples of Limited Life VCTs investing on AIM.

Generalist were the only game in town when VCTs were launched. However, their share of the market has steadily decreased to 60% today. The Specialist sector has proven popular over the past 5 years with a current market share of 31%, driven by the market for renewables as discussed previously.

The smallest sector over the past five years has consistently been the AIM sector. The number of AIM VCTs has been declining from a high of 20% in 2007. We can see that the financial crisis of 2008 had a big negative impact on this sector.

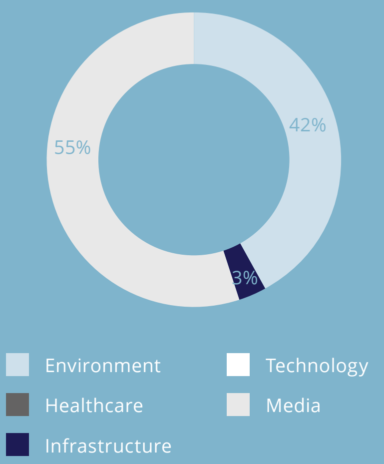
Environmental and Media's cumulative growth has been the most noteworthy among the five sub-sectors of Specialist VCTs. They have both witnessed consistent and substantial growth since 2007.

The Generalist sector represents the majority of VCTs (60%). Generalists invest in a variety of companies across different sectors in order to achieve greater levels of diversification.

Specialist VCTs represent 32% of the market. As the name suggests, these VCTs specialise investing in companies operating in different sectors of the economy. The Specialist sector consists broadly of five sub-sectors. The two most popular are Environmental (43%) and Media (41%), followed by Technology at 9%, Infrastructure (5%) and the Healthcare sector (2%). Although the environmental sector holds the largest market share, we expect that to decrease over the coming years now that renewable subsidies no longer qualify.

AIM VCTs represent the smallest sector of the market. Although the investment universe is well- known, it is limited with just over 1,100 companies listed, and not all of those will be VCT qualifying.

LIMITED LIFE SPECIALISTS

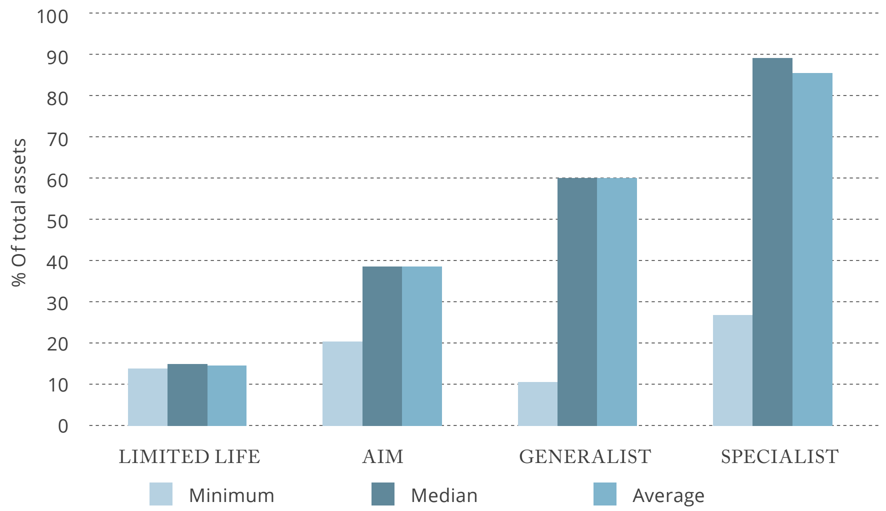


No. OF INVESTEE COMPANIES PER VCT (2015)

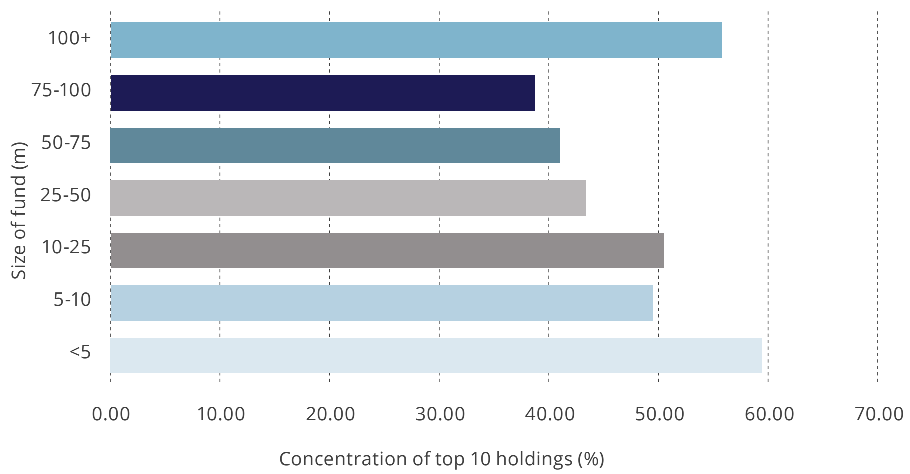
No. OF INVESTEE COMPANIES PER VCT					
	MIN	LOWER Q.	AVERAGE	UPPER Q.	MAX
GENERALIST	7	10	25	39	84
AIM	20	39	56	69	109
ENVIRONMENTAL	2	11	8	14	32
MEDIA	3	9	5	9	26
TECHNOLOGY	9	10.5	15	20	21
LIMITED LIFE	3	10	16	22	32

"Greater diversification will protect investors should one company perform poorly. While diversification cannot protect against systematic risk, it can protect against systemic risks"

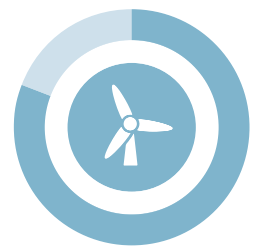
TOP 10 HOLDINGS (% OF TOTAL ASSETS) (2015)



TOP 10 HOLDINGS BY SIZE OF FUND (% OF TOTAL ASSETS) (2015)



TOP 10 HOLDINGS IN SPECIALIST VCTs (% OF TOTAL ASSETS) IN 2015

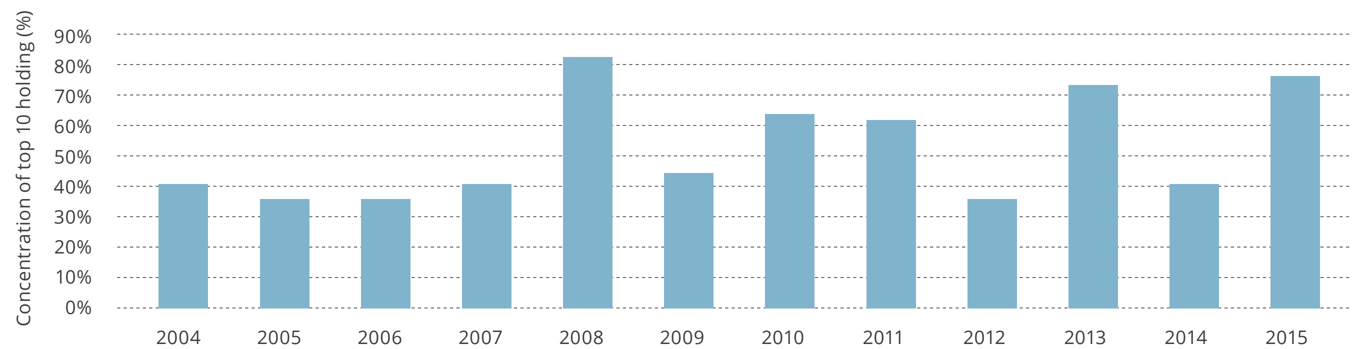


81.5%
ENVIRONMENTAL

86.5%
MEDIA, LEISURE & EVENTS

87%
TECHNOLOGY

TOP 10 HOLDINGS BY LAUNCH YEAR (% OF TOTAL ASSETS) (2004-2015)



It is also important to take a view on the underlying investee companies. Greater diversification will protect investors should one company perform poorly. While diversification cannot protect against systematic risk, it can protect against systemic risks. It is easier for Generalist and AIM sectors to diversify across a large number of companies with 25 and 56 investee companies being the averages across the sectors respectively.

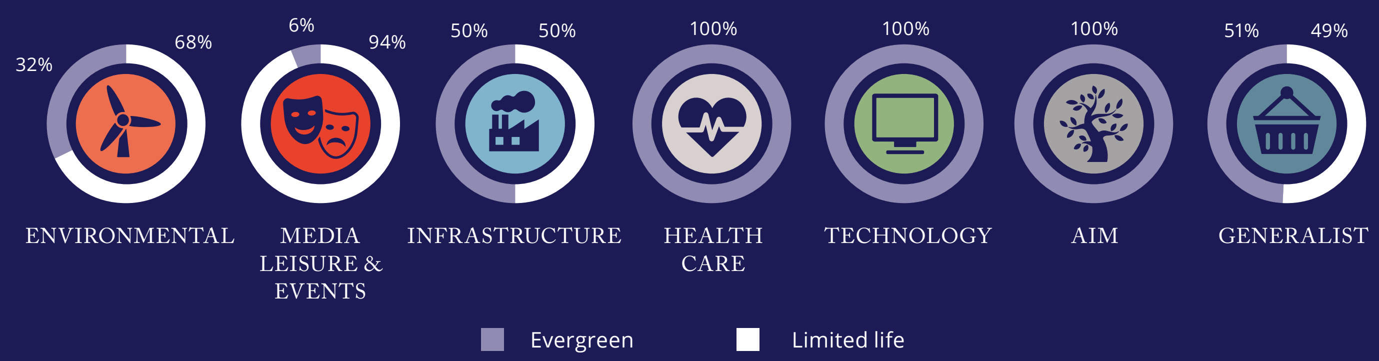
Specialists will obviously have a more difficult task of diversification and will be more susceptible to industry specific risks. In addition, as we noted earlier capital preservation and asset backed VCTs with lower levels of diversification may not have enough growth potential in the portfolio to overcome any losses.

STRUCTURE ANALYSIS

VCT STRUCTURE:

Unlike Limited Life, Evergreen have no set wind-up date but most offer a share buyback policy after the minimum five years holding period or investors can look to sell on the secondary market. In 2015, the market was split 48% Evergreen and 52% Limited Life.

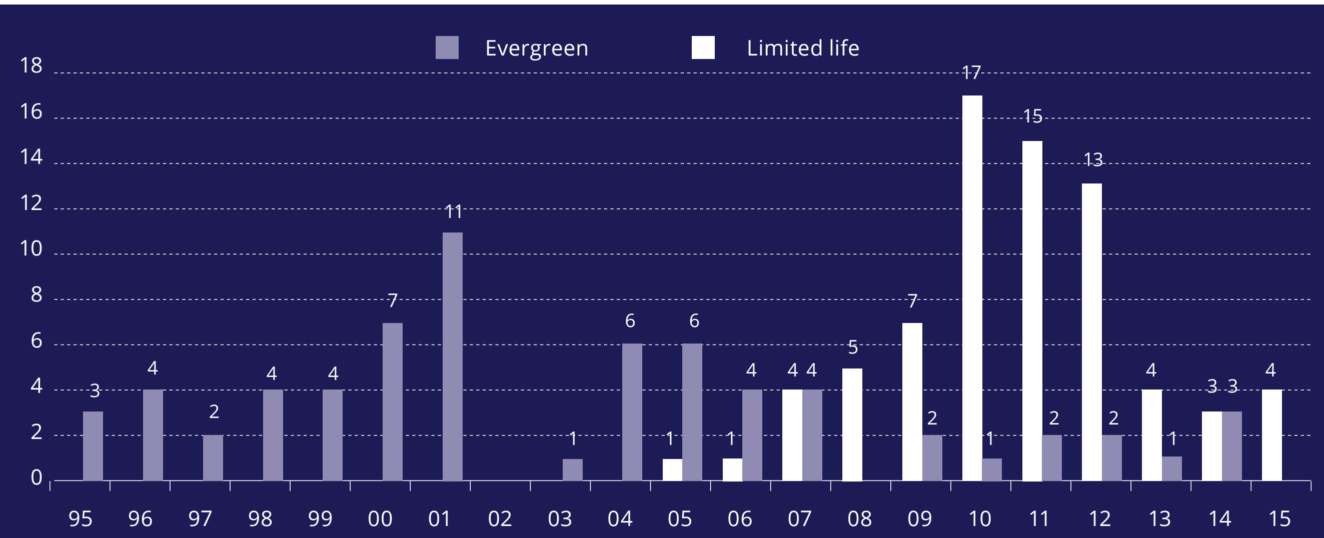
SECTOR SPLIT BY STRUCTURE:



All of the AIM VCTs are Evergreen and Generalist VCTs are evenly split between Limited Life and Evergreen (49% and 51% respectively).

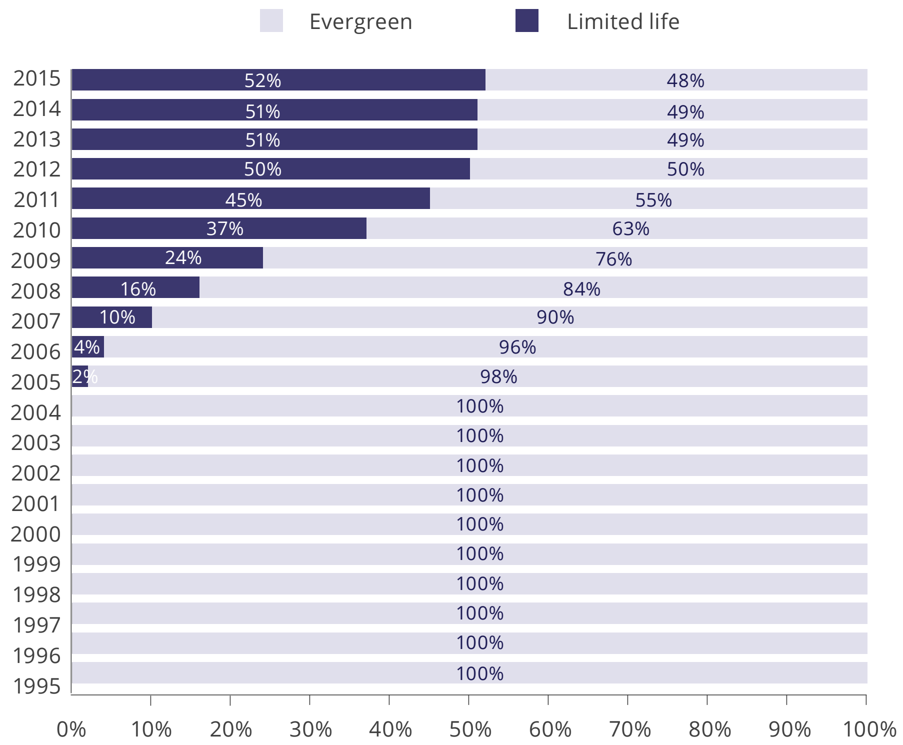
Among the five main sub-sectors of Specialist VCTs, Technology and Healthcare VCTs are Evergreen. Environmental focused VCTs are mostly Limited Life (68%) as many green energy projects have a predictable investment life. Lastly, Media focused VCTs are overwhelmingly Limited Life at 94%, with only 6% being Evergreen. Again, media investment has a predictable life cycle, productions can be resold and projects return to cash very quickly. Technology and Healthcare require longer investment horizons to achieve sustainable profits.

PRODUCT LAUNCHES BY STRUCTURE (1995-2015)



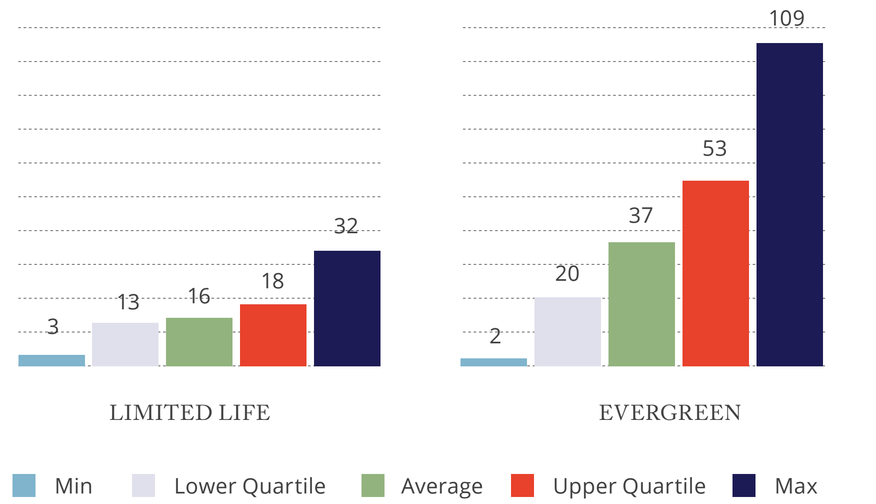
"Many Limited Life VCTs place significant focus on capital preservation, helping to ensure downside protection by allocating capital to asset backed investments" **Sam McArthur, Puma Investments**

MARKET SHARE BY STRUCTURE (1995-2015)



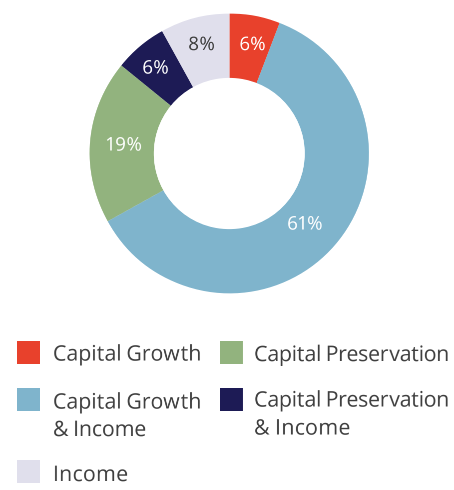
Since 2008 investors have become more concerned with liquidity and Limited Life funds have grown in popularity. There is also less of a need to launch new Evergreen products, as there are established funds with track records that periodically open for new investment, making life harder for new market entrants.

NUMBER OF INVESTEE COMPANIES BY STRUCTURE (2015)



Looking at the number of investee companies held by each structure also tells us that it is harder to achieve maximum diversification in a Limited Life fund, as these companies have to aim to wind up as soon as the proposed investment term is up (usually five years). Lower levels of diversification are accepted in exchange for a more defined exit.

INVESTMENT OBJECTIVE



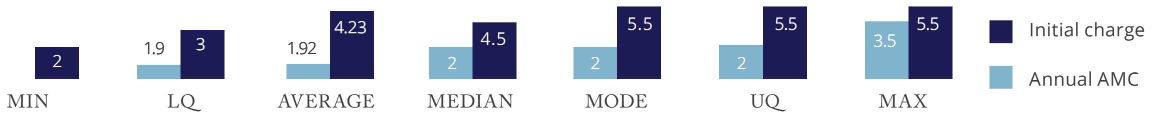
The majority (61%) of VCTs are focused on capital growth & income. Dividends received are tax-free and the nature of the underlying investments of VCTs goes hand in hand with the capital growth objective. The second largest segment is aimed at capital preservation (19%). Although this focus may seem unusual considering the inherent risk that comes with VCTs, Limited Life VCTs aim to wind up and distribute assets after a target holding period.

FEES AND CHARGES

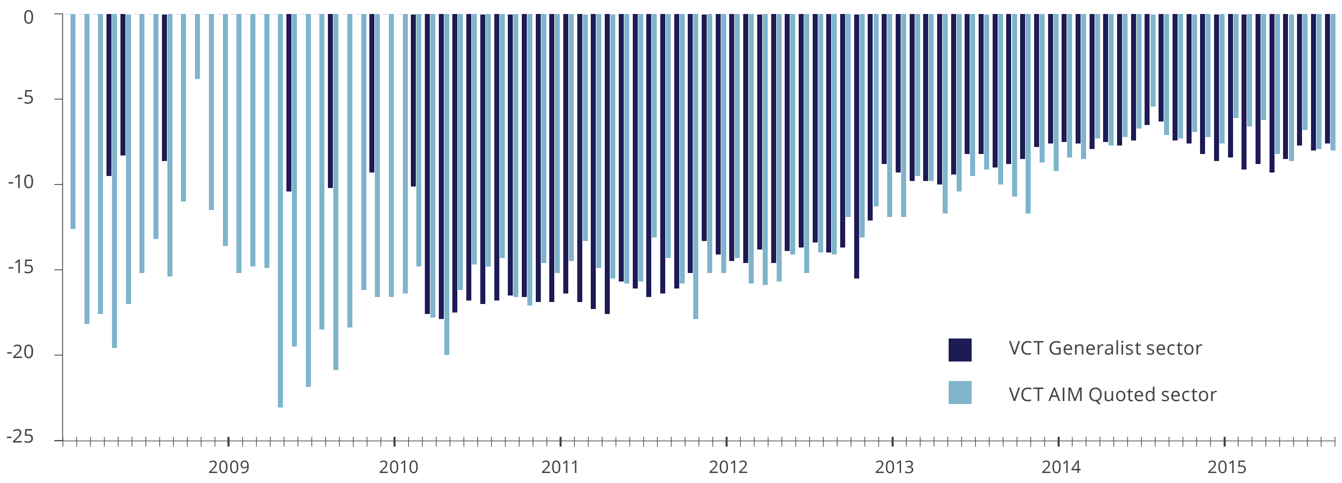
Fees and charges are an important consideration for advisers and investors. This section takes a look at the investments that were open to new investment in November 2015. There are two main charges associated to VCTs when first making an investment: the initial charge and the annual management charge. Initial charges range from 2% to 5.5% of the initial subscription amount and the annual management charge range from 0% to 3.5% of the net asset value.

The charges for VCTs are very similar to that of EIS investments. VCTs, along with EIS, require a large amount of research and due diligence by the managers when investing shareholders' funds (even more so with the new legislation), one of the many reasons why charges are higher than mainstream funds.

VCT CHARGES (% OF INITIAL INVESTMENT):



VCT DISCOUNTS



VCT PERFORMANCE AND HURDLE FEES

Normally this section would show the typical performance fees and hurdle rates that are seen in the VCT market, with some charts to show you at a glance what to expect. However, our normal data collection exercise of digging through annual reports, third party reviews and investment prospectuses, found that although performance fees are described as "in line with normal VCT practice", it seems that there actually is no normal VCT practice for calculating the performance hurdles.

However, we should also note that not all VCT providers charge a performance fee. Our analysis is based upon those that do, but readers should be clear that it is possible to find VCTs that only charge the initial and ongoing fees, without taking a share of the investors' returns.

Performance fees are meant to align the interest of managers and investors and to motivate managers to generate higher returns by meeting a particular hurdle rate and taking a percentage of that return above the hurdle rate. Some have criticised the industry for not targeting performance that is worth rewarding.

Now the performance fees aren't the difficult part to calculate – the industry ranges from 10% to 30% of returns made above the hurdle rate, with the most common hurdle rate set at a return of 20%.

It was examining the hurdle rate where we encountered some problems. There is not an industry standard and very few are easily comparable. Some depend on a certain distribution per share each year, some on a certain distribution amount and increase in NAV, some just an increase in NAV, total returns that beat inflation plus a certain percent, the list goes on. The most common way in which VCT managers calculate a hurdle is through distributions to investors, but as we say, don't just trust that this is what you're signing up for: check the IM and speak to the manager.

There seems to be a trend for Evergreen funds to use dividends or total distributions as a hurdle rate, which makes it simpler. Limited Life VCTs set their hurdle rates based on the total distribution to investors when they close the fund.

VCT DISCOUNTS

We examined the average discount over time for the Generalist and AIM Quoted sectors. Looking at the Generalist sector discount, although we have some areas of missing data, we can see the discounts have ranged from 7.9% to 6.3% since 2008. For AIM VCTs the discount has ranged from 3.8% to 23.1% in April 2009.

According to the AIC, the average investment company discount at the time of writing was near record low levels of 5.2%, even after the volatility in the market during the summer of 2015.

According to the AIC, currently 60% of investment companies in the industry have discount control policies. The investment companies that do not have them mainly invest in illiquid assets, like property and private equity, which would be difficult to liquidate at a particular time. The most widely used discount control policy for VCTs are redemption offers, although there are other types such as tender offers and continuation votes.

Remember that the NAV can rise or fall depending upon the frequency of valuations and the timing of any realisations or acquisitions of underlying assets.

CONCLUSIONS

The market analysis shows us how the VCT industry has developed over time, introducing more products such as AIM Quoted, Limited Life and Specialist VCTs. We can see that there are differences in the level of diversification that these products tend to have, and it is interesting to see how the discount changes over time. Charges are higher than more conventional investments, which we think is reasonable given the nature of their investment universe, but it is difficult to assess and compare the potential impact of performance fees.

KEY POINTS

- Discounts have been as much as -23.1% in the AIM Quoted sector, and -17.6% in the Generalist sector
- 75% of VCTs are either focused on growth, income or a combination of both
- Specialist VCTs have a much higher concentration of assets
- Average min. investment is £5,000

ADVISER SURVEY

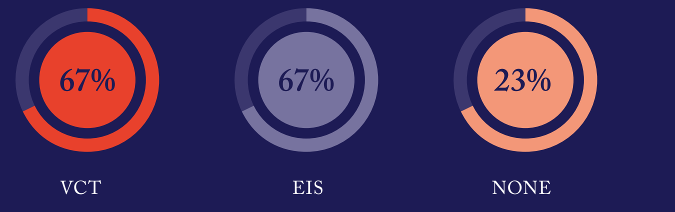
As with all of our industry reports, we conduct surveys of the market participants to build a picture of how the market works – how much business is being done, which segments are successful and what obstacles stand in the way of progress.

For our first annual VCT report we have undertaken three surveys; one focused on financial advisers and wealth managers, one on private investors and one on the VCT investment providers. The objective is to see how the advisers and investors understand and use VCTs and see if the providers are meeting those demands.

Each survey was short and took less than 10 minutes to complete, with straightforward questions to give both quantitative and qualitative answers. All of the results are kept anonymous and treated in the strictest confidence. We do not share underlying data with third parties or publish it anywhere.

We regularly conduct surveys with the intention of gaining insight into how advisers perceive the different sectors we cover. This survey was carried out over 10 days in October 2015 and was distributed through our media partners, as well as the report sponsors' adviser communities. Overall we had 124 responses. The intention of the survey was to gauge how and why advisers use VCTs in their clients' portfolios, the factors that are important to them when considering a VCT product and what their concerns are.

DO YOU RECOMMEND ANY OF THE FOLLOWING INVESTMENTS TO YOUR CLIENTS?



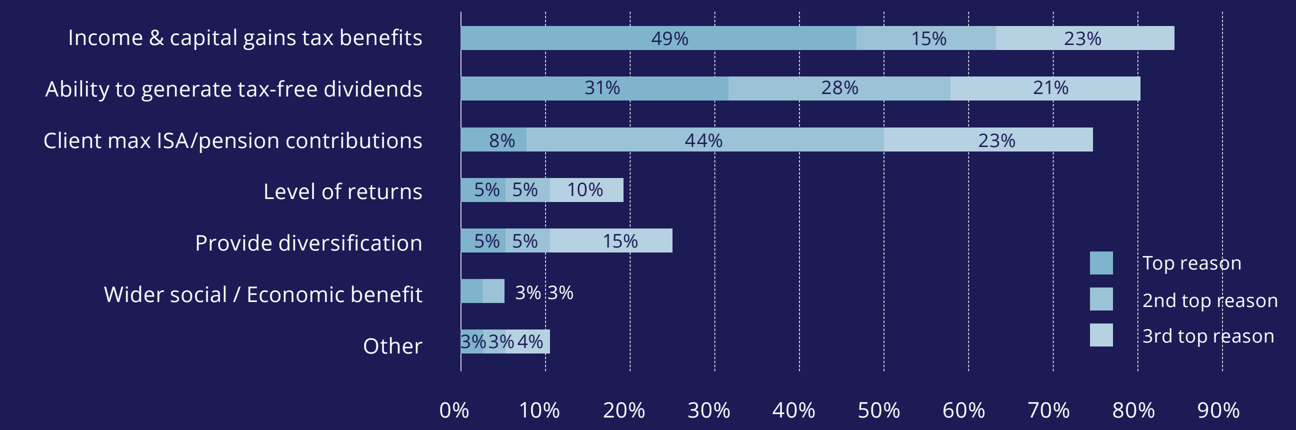
We wanted to determine the sentiment of financial advisers towards these investments. 67% of respondents recommended either VCTs or EIS to their clients. Only 23% of advisers did not recommend any of these two types of investment to their clients. Note that there is some bias in these results as the adviser community we reach out to are already involved in alternative investments.

WHAT SEGMENT OF CLIENTS DO YOU RECOMMEND VCTs TO?

Of those that recommend VCT investments, 44% felt that VCTs would be suitable for both retail and HNW clients. Although this is still a quite significant figure, it is an interesting trend that differs from our BPR and EIS research – 63% of advisers surveyed recommended BPR products to both categories of clients, and in the EIS Industry Report 2014, only 16% of advisers felt retail clients could be suitable for EIS investments. This indicates where all three of these tax-advantaged schemes sit with advisers in terms of client suitability.

The next section of questions focuses on the advisers currently recommending VCTs to their clients. An overview of why the advisers that responded that they do not recommend VCTs will be examined later in this section.

WHAT ARE YOUR TOP 3 REASONS FOR RECOMMENDING VCTs?



The most common reason cited by advisors for recommending VCTs (87%) was Income & Capital Gains Tax benefits. The ability to generate tax-free dividends was the second most common reason (80%) for recommending VCTs. Client maximisation of ISA / Pension contributions (75%) also scored highly and is perhaps linked to ever-lower pension limits.

Providing diversification and wider social or economic benefit were not seen as particularly important by respondents with 25% and 6% respectively. Other reasons cited included using VCTs to get funds from the corporate into the personal space in a tax-efficient manner.

AGE OF TYPICAL INVESTOR:

<40 3%

40-60 84%

>60 13%

WHAT PERCENTAGE OF A CLIENT'S TOTAL PORTFOLIO WOULD YOU RECOMMEND IS PLACED IN VCTs?

When asking advisers the percentage of a portfolio they would recommend be placed in a VCT, 41% believe it depends on the client. These respondents were asked to give an explanation and the responses made clear that there are many factors that influence an adviser's decision, such as their client's objectives, attitude to risk, need for income, capacity for loss, and security of their income. 47% of the survey respondents recommend 5%-10% of a portfolio, and 12% of advisers had a more conservative response with them recommending clients to hold less than 5% of their portfolio in VCTs. Finally, none of the financial advisers recommended investors have more than 10% invested in VCTs.

WHAT AGE IS YOUR TYPICAL INVESTOR FOR VCT?

The typical age of a VCT investor is between 40-65 years old. These investors are usually at the peak of their working life, and will probably be building up their savings for when they retire. They have had time to build some wealth and feel more able to target greater returns by investing in riskier investments such as VCTs.

Only 3% of advisers recommended VCTs to investors below the age of 40. These individuals may have other financial goals, such as saving for a family or buying a home, and higher risk investments may not fit into their plan at the moment. However HNW clients in this age bracket may be suitable, as they still have many working years ahead of them and could afford to take more risk.

13% recommended VCTs for investors above 65 years old. They are likely to be more focused on capital preservation.

WHICH TYPE OF VCTs DO YOU RECOMMEND?

The VCT investment market offers a range of different type of investments. As previously mentioned, VCTs can be categorised by the sector of the investment (Generalist, Specialist or AIM Quoted), and the lifespan of the VCT (Evergreen or Limited Life).

88% of advisers recommend Generalist VCTs that invest in unquoted companies in a range of different sectors. This type of investment allows investors to benefit from wider range of investee companies, potentially offering greater diversification, and advisers may feel more comfortable recommending these VCTs.

68% of advisers recommend AIM Listed VCTs. These investments are seen as more liquid compared to Generalist, because the underlying company shares can be sold on the secondary market as an exit strategy, although the ability to achieve a good price or to meet investors' demands if they all decide to withdraw at one time may be limited.

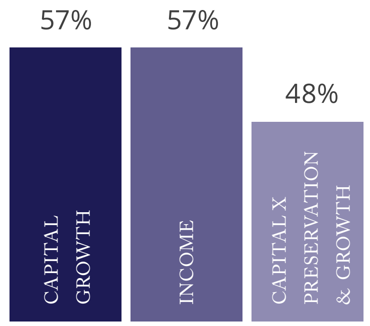
57% of advisers recommended Specialist VCTs which invest in companies focused in specific sectors and therefore could be more risky since they only focus on one area of the market and lack diversification. On the other hand, projects that return to cash quickly could be said to be less risky. Clients may have a particular interest, such as film for example, and a VCT may be a tax-efficient way for them to access this sector.

45% of advisers recommend Limited Life investments that usually look to repay the capital back to investors after the minimum 5 year holding period and 43% of advisers recommended Evergreen investments.

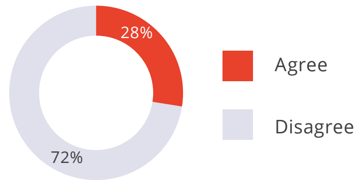
"The majority of advisers believe that VCTs can coexist alongside Pensions and ISAs as they offer additional benefits"

WHICH VCT INVESTMENT STRATEGIES DO YOU RECOMMEND TO YOUR CLIENTS?

These are top level strategies, in which advisers may favour certain investment managers, sectors or opportunities at a certain time. The majority of respondents (58%) recommended investment strategies for capital growth or income. These two options provide clients with the opportunity of gaining higher than average returns and increase their income due to the income or Capital Gains Tax relief. 48% of advisers recommended capital preservation as a strategy to invest in VCTs. This is the strategy most commonly associated with Limited Life VCTs.

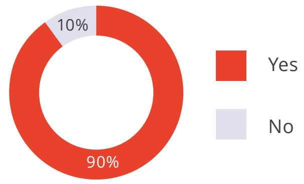


"VCTS ARE ONLY APPROPRIATE WHEN BOTH ISA AND PENSION ALLOWANCES HAVE BEEN MAXIMISED"



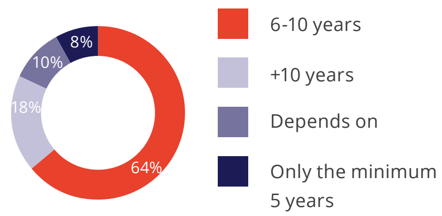
Only 28% believed that VCTs investments only become appropriate once ISA and Pensions contributions have been maximised. The majority believe that VCTs can coexist alongside these other options as they offer additional benefits, such as diversification and ability to achieve higher returns.

DO YOU THINK IT IS IMPORTANT TO USE MORE THAN ONE VCT PROVIDER?



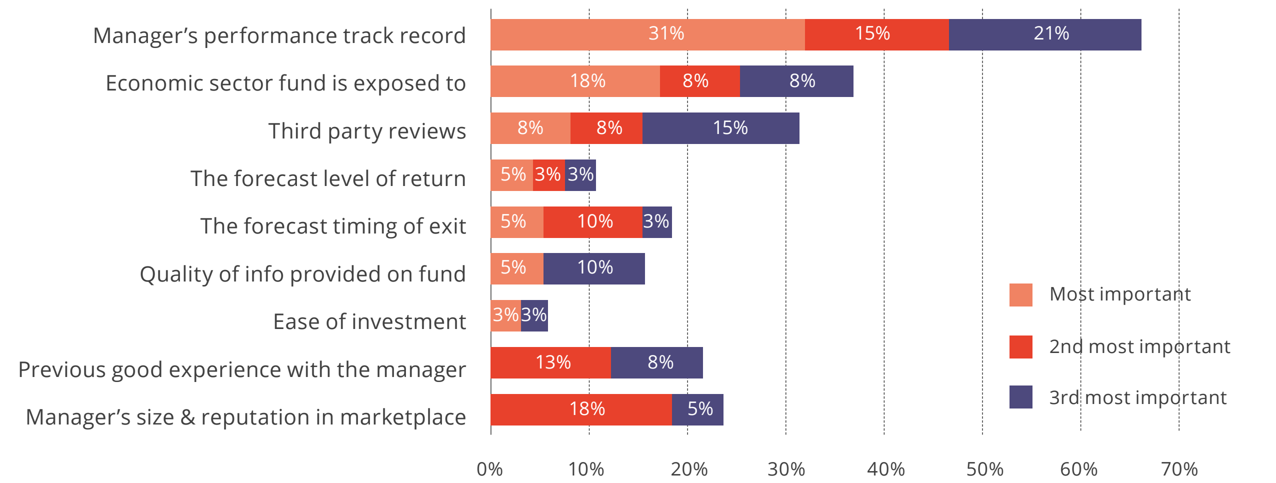
90% of financial advisers believe it is important to use more than one VCT provider. By choosing different managers advisers can diversify across different styles of investment, different sectors and companies at different stages of development. Most VCTs will usually invest in around 10 to 30 companies. Therefore, greater diversification is difficult to achieve without investing across several VCTs and VCT providers.

HOW LONG SHOULD A CLIENT EXPECT TO HOLD THEIR SHARES BEFORE LOOKING TO EXIT?



The majority (64%) of financial advisers feel that their clients should hold onto their VCTs for at least 6-10 years. While the minimum holding period to achieve the tax benefits is only 5 years, it will often take longer to exit. Advisers seem to be very aware of this issue, and are appropriately making clients aware. Using Limited Life VCTs would be one way to address this issue if it was a concern.

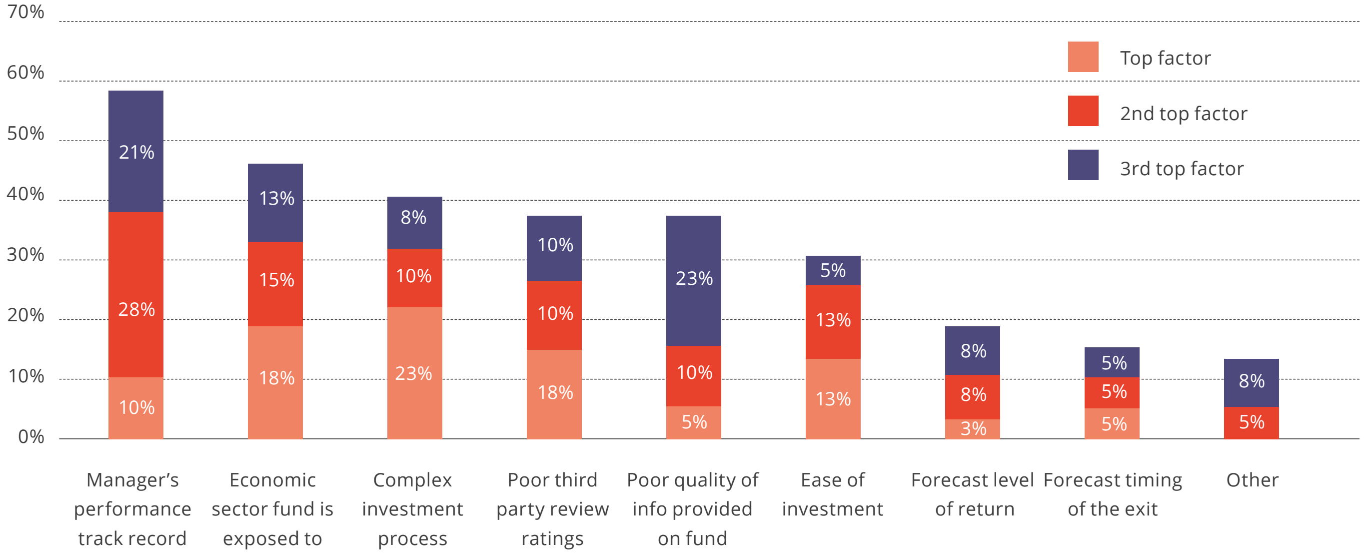
WHAT ARE THE 3 MOST IMPORTANT CRITERIA WHEN CHOOSING A VCT?



The most important criterion (67%) when choosing a VCT is the managers' performance track record. 34% and 31% of respondents cited the economic sector the fund is exposed to and third party reviews respectively, as the second and third most important criteria when choosing a VCT. Manager's size and reputation (23%), previous good experience with the manager (18%) and the forecast timing of exit (18%) were also important criteria. Referring back to a point made earlier in the report about the barriers to entry for new VCT providers; the importance of track record and previous experience with manager further demonstrates how it is difficult for a new provider to enter this space.

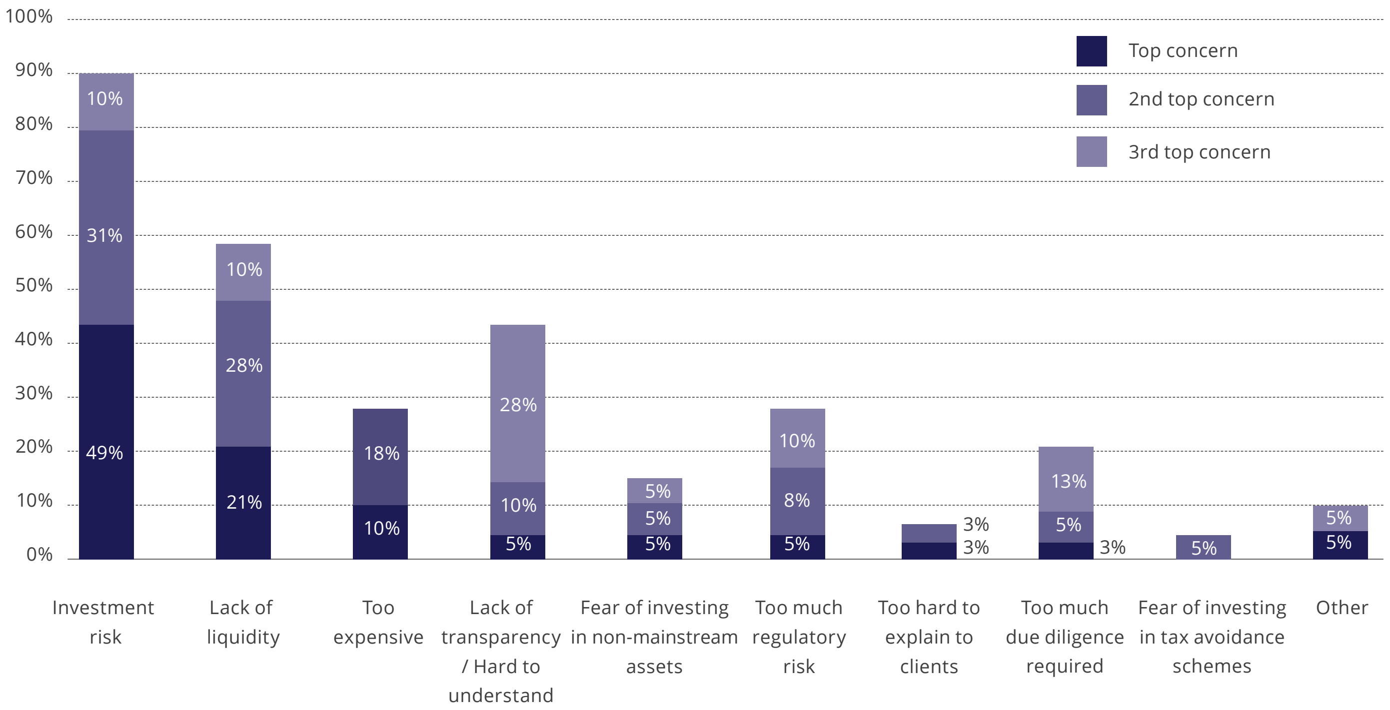
"The complex investment process is seen as another important consideration for advisers (41%). VCTs involve a lot of paperwork which can put advisers off. Perhaps the move onto advisory platforms will address this"

WHICH 3 FACTORS ARE MOST LIKELY TO MAKE YOU HESITATE ABOUT RECOMMENDING A VCT?



The most common factor cited that would most likely make advisers hesitate about recommending VCTs is the manager's performance track record (59%). The economic sector the fund is exposed to (46%) is the second most common reason to make advisers hesitate in recommending VCTs. The complex investment process is seen as another important consideration for advisers (41%). VCTs involve a lot of paperwork which can put advisers off. Perhaps the move onto advisory platforms will address this. The poor quality of information provided on the fund and the poor quality of the party review ratings were also concerns for 38% of respondents.

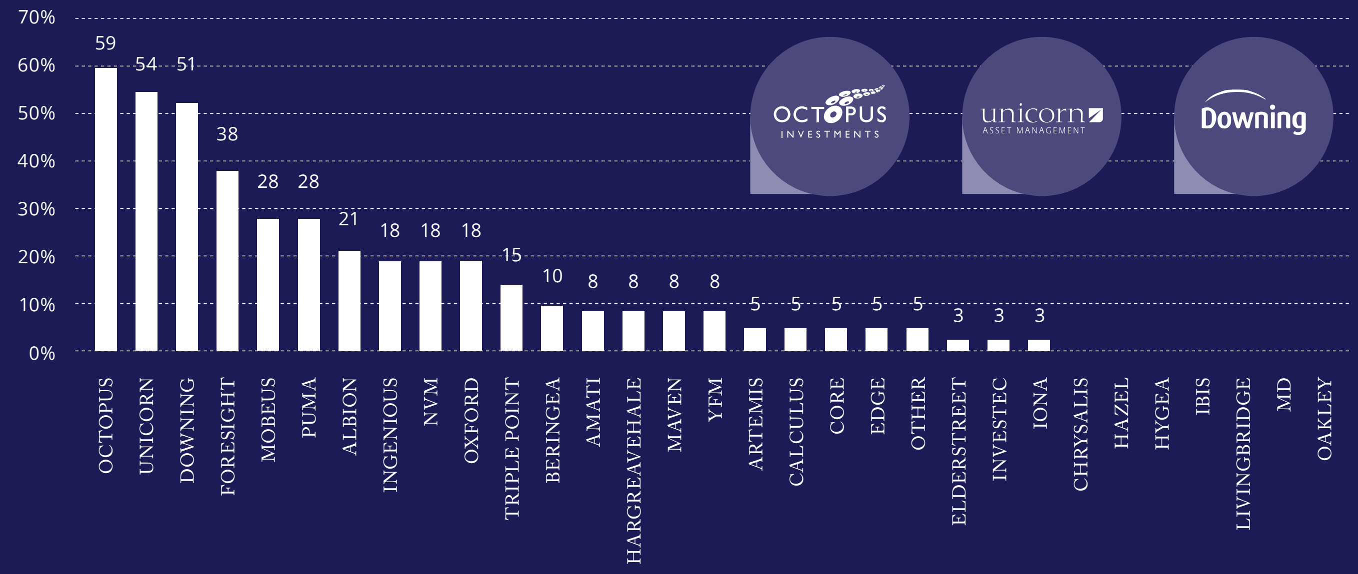
WHAT ARE YOUR TOP 3 CONCERNS WHEN RECOMMENDING A VCT?



Investment risk (90%), lack of liquidity (59%), lack of transparency (43%) and expense (28%) are the top concerns for advisers when they recommend VCTs to their clients.

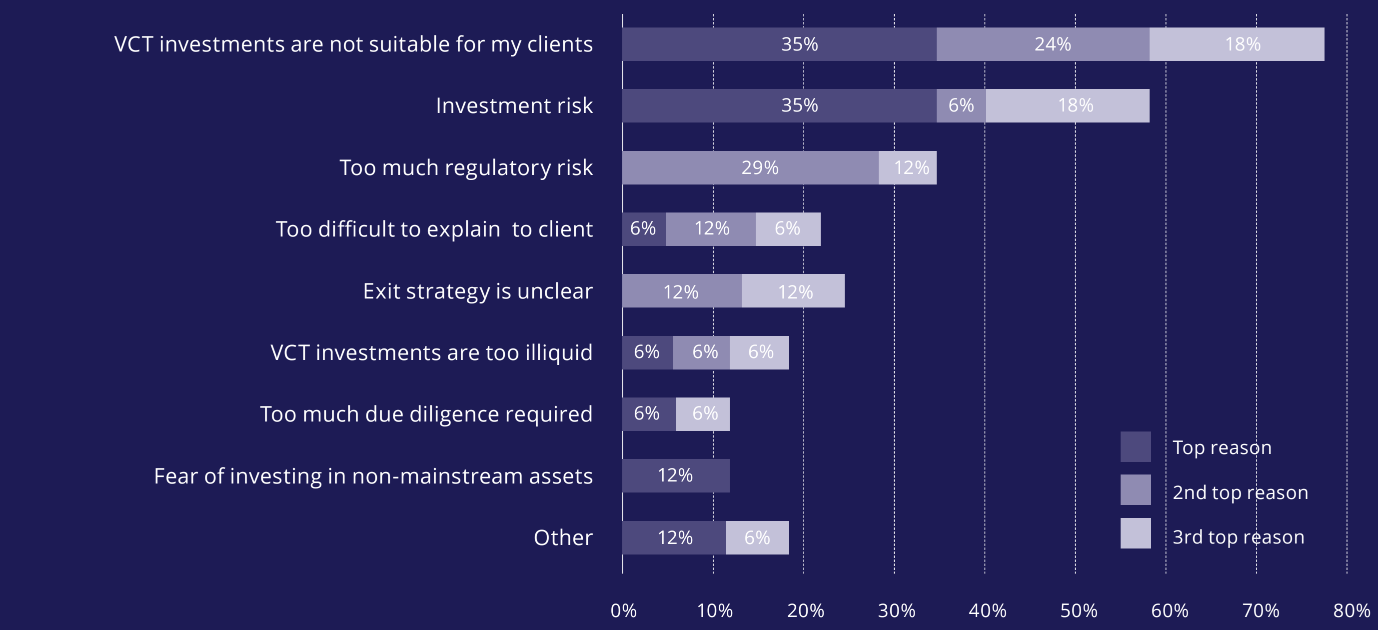
"There was a feeling from the advisers we surveyed that most clients' needs are satisfied by using ISA and Pension allowances, or that EIS are more useful for tax relief purposes than VCTs"

WHICH VCT PRODUCT PROVIDERS DO YOU TYPICALLY USE?



Note that the sponsoring managers sent out this survey to advisers they already work with, so that introduces an element of bias. However, respondents were able to select more than one provider. It does give somewhat of an indication of who advisers are doing business with. And as previous good experience with a fund manager is an important consideration for the respondents, it indicates who they are likely to be doing repeat business with.

WHICH ARE YOUR TOP 3 REASONS WHY YOU DO NOT RECOMMEND VCT INVESTMENTS TO YOUR CLIENTS?



The main two reasons cited by advisers for not recommending VCT investments to their clients are that VCT investments are not suitable for their clients (77%) and the investment risk (59%).

There was a feeling from the advisers we surveyed that most clients' needs are satisfied by using ISA and Pension allowances, or that EIS are more useful for tax relief purposes than VCTs. Although, this opinion seems to contradict what is said by financial advisers that do recommend VCTs – 73% consider that you do not need to complete your ISA and Pension before investing in VCTs. Other reasons given by advisers are that VCTs investments have too much regulatory risk (41%) and that it is difficult to explain VCTs to their clients (24%).

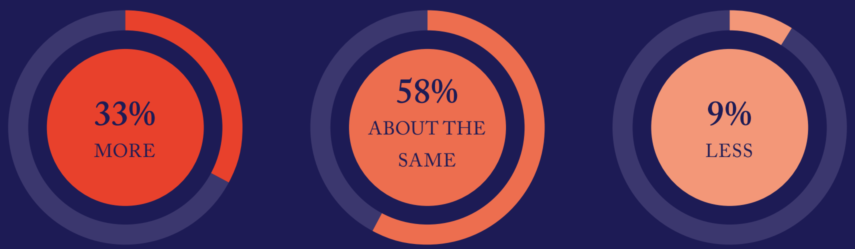
"There seems to be a general feeling that more education and information is needed to enable advisers to feel more confident when recommending VCTs to their clients"

These final questions bring together all the advisers to understand how they feel about the future and how the market might improve.

WHY DO YOU THINK THE EIS SECTOR HAS RAISED OVER £12.2 BILLION IN FUNDS COMPARED TO JUST OVER £5 BILLION IN THE VCT SECTOR?

When posed this question, advisers had several different opinions suggesting the reasons why the EIS sector had raised more funds than VCT sector. The most resounding reasons given were EIS has a shorter holding period than VCTs for additional tax reliefs and a greater investment limit. Advisers also mentioned IHT planning advantages, Capital Gains Tax deferral and a greater availability of EIS investments as a reason.

DO YOU SEE YOUR USE OF VCTs IN CLIENT PORTFOLIOS CHANGING OVER THE NEXT 12 MONTHS?



Despite this survey coming after the tightening of the regulations surrounding Venture Capital Schemes, 33% advisers feel that they will be using more VCTs in their clients' portfolios, with 58% staying about the same.

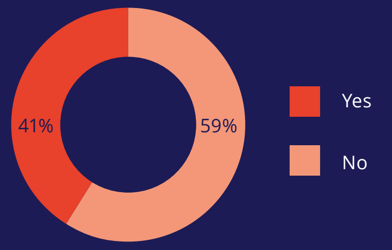
IN YOUR OPINION, WHAT SINGLE CHANGE OR INNOVATION WOULD IMPROVE THE VCT MARKET?

There are several suggestions here that cover different aspects of the market:

- Not having to describe all VCTs as very high risk investments
- Better research on the sector
- More information and clearer communication from providers
- Greater certainty over exit
- Greater tax reliefs and IHT benefits

The main development that advisers want to see is a reduction in the level of risk, and an improved process in the analysis of information and improvements in the secondary markets.

DO YOU FEEL THAT THERE ARE ENOUGH RESOURCES AND INFORMATION AVAILABLE TO ENABLE ADVISERS TO ACHIEVE WHOLE OF MARKET KNOWLEDGE OF VCTs?



It seems that the majority of advisers (59%) believe there is an insufficient amount of information to order to achieve whole-of-market knowledge. There seems to be a general feeling that more education and information is needed to enable advisers to feel more confident when recommending VCTs to their clients. It would seem that now VCTs are becoming more mainstream and compliance obligations have grown since RDR, there is a greater need for more knowledge on the sector.

CONCLUSIONS

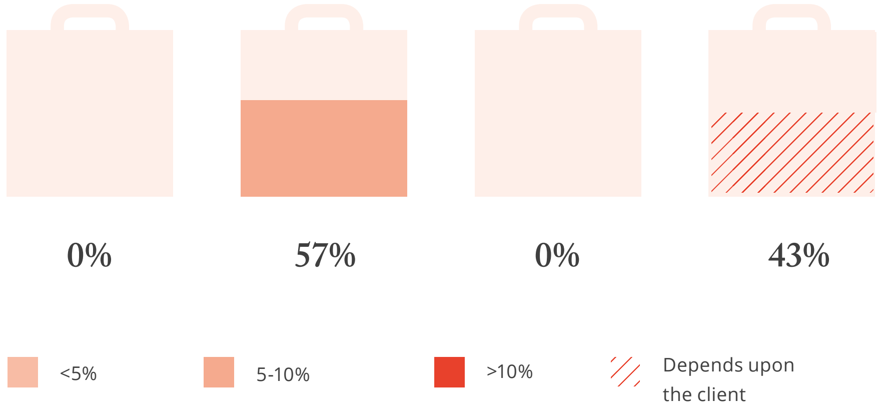
It seems that when it comes to using VCT products, the biggest consideration for advisers is suitability. Unsurprisingly, the most common reasons for recommending VCTs were the Income Tax relief, Capital Gains Tax free growth and the ability to generate tax-free dividends. However, the manager's performance track record and the economic sector the fund is exposed to were the biggest criteria when it came to choosing a manager.

Investment risk, lack of liquidity and lack of transparency around the underlying investments were cited as the biggest concerns with VCTs for advisers.

PROVIDER SURVEY

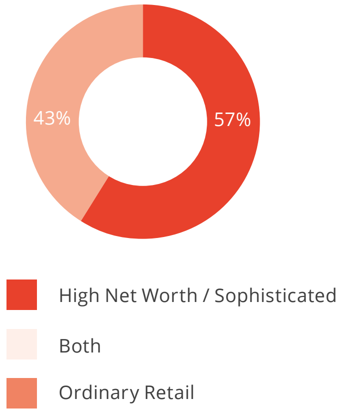
We surveyed nine VCT providers to assess their views of the market and see how their answers compared to advisers and investors.

WHAT % OF AN INVESTOR'S TOTAL PORTFOLIO DO YOU FEEL IS APPROPRIATE TO PLACE IN A VCT?



Again we see providers and advisers are on the same page when it comes to what percentage of an investor's portfolio should be placed in a VCT. The majority noted 5%-10%, and the remaining respondents said it depends on the client based upon their risk appetite, capacity for loss, investment experience and investment horizons.

WHAT SEGMENT OF INVESTORS DO YOU FEEL IS SUITABLE FOR VCTs?

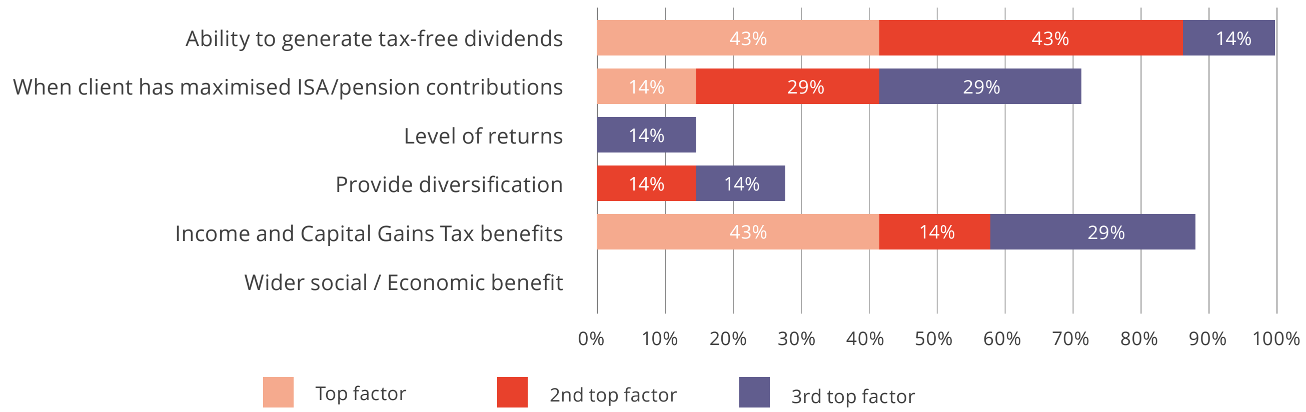


Providers and advisers have similar views on this question. 57% feel VCTs are suitable for HNW only and 43% feel VCTs can be suitable for both HNW and ordinary retail investors.

DO YOU PROVIDE... ?

We can see the providers surveyed ranged across different sectors. This may give providers a different view on what advisers and investors should take a view on when investing in their products, as the underlying investment will be different.

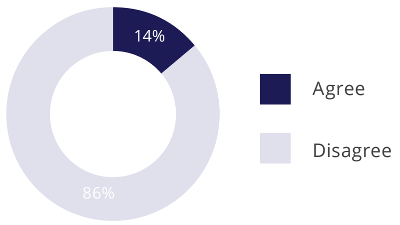
WHAT DO YOU BELIEVE ARE THE TOP 3 REASONS FOR INVESTING IN VCTs?



Once again chiming with the responses from advisers, providers feel that the tax benefits are the main reason why investors consider VCTs, followed by maxing out other tax-free investment wrappers. None of the providers thought that the wider social and economic benefits had any influence, although a small percentage of advisers did include this category in their top three.

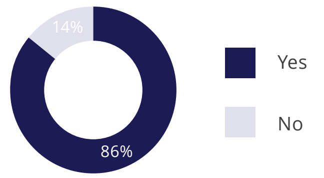
"The majority of providers believe that investors do not need to wait until ISA and pension allowances have been maximised before investing in VCTs"

VCTS ARE ONLY APPROPRIATE WHEN BOTH ISA & PENSION ALLOWANCES HAVE BEEN MAXIMISED



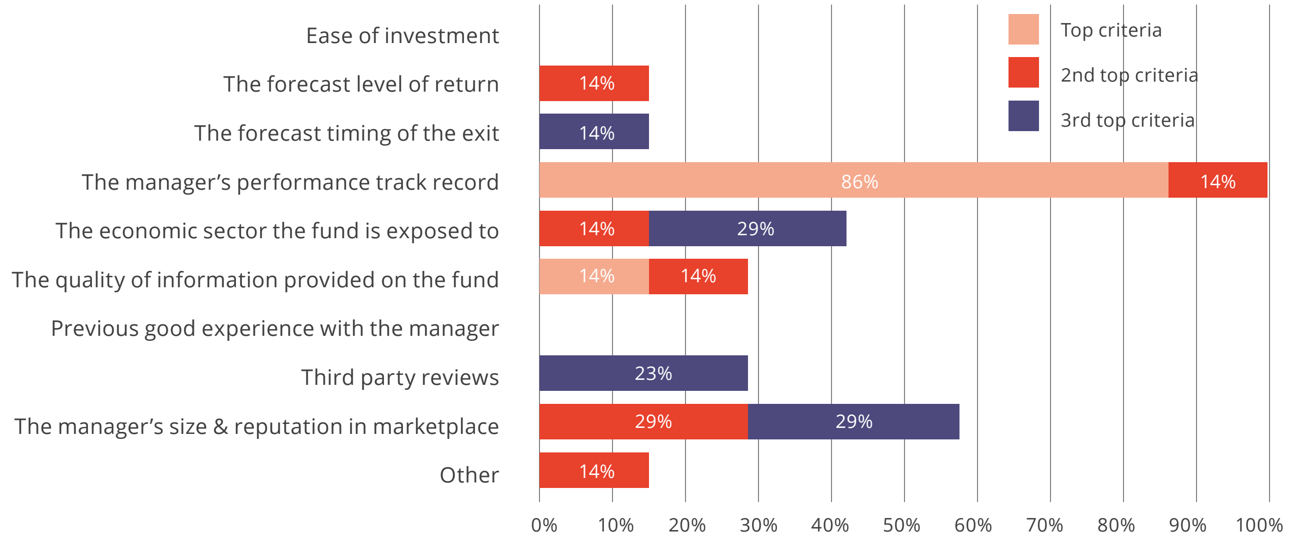
The majority of providers believe that investors do not need to wait until ISA and pension allowances have been maximised before investing in VCTs. However, more advisers agreed with this statement, with 28% stating that the allowances should be maximised before considering VCTs.

DO YOU THINK IT IS IMPORTANT FOR INVESTORS TO USE MORE THAN ONE VCT PROVIDER?



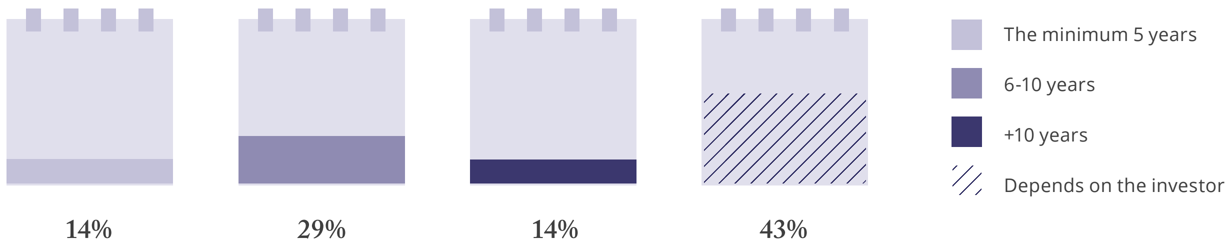
Even the providers aren't ignorant to the fact that to achieve greater diversification, advisers and investors need to look to several VCT providers.

WHAT ARE THE 3 MOST IMPORTANT CRITERIA FOR INVESTORS / ADVISERS WHEN CHOOSING A VCT?



Providers believe that their track record is by far the most important criteria for investors/advisers when it comes to choosing a VCT. Third party reviews, the sector they are investing in and expected level of returns were other important criteria noted by providers, again chiming with advisers' thoughts.

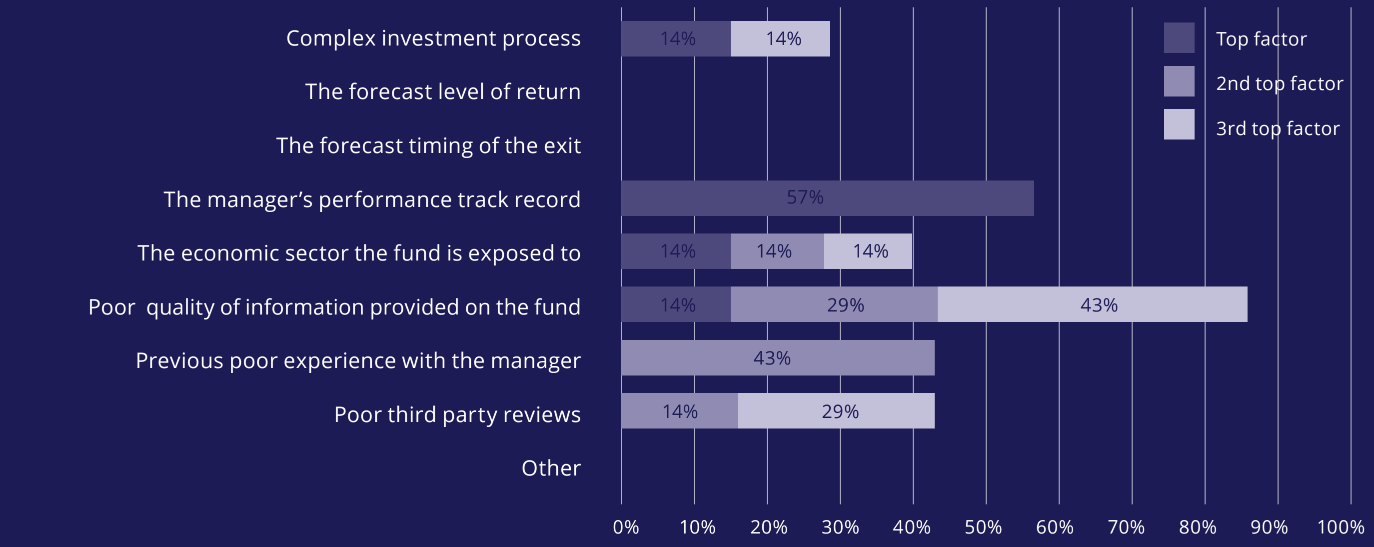
HOW LONG SHOULD AN INVESTOR EXPECT TO HOLD THEIR SHARES BEFORE LOOKING TO EXIT?



This question received a variety of responses, and this is definitely down to what type of VCT the provider offers. Of course Limited Life VCTs aim to exit after only 5 years, whereas AIM or Generalist VCTs would normally be considered longer term investments.

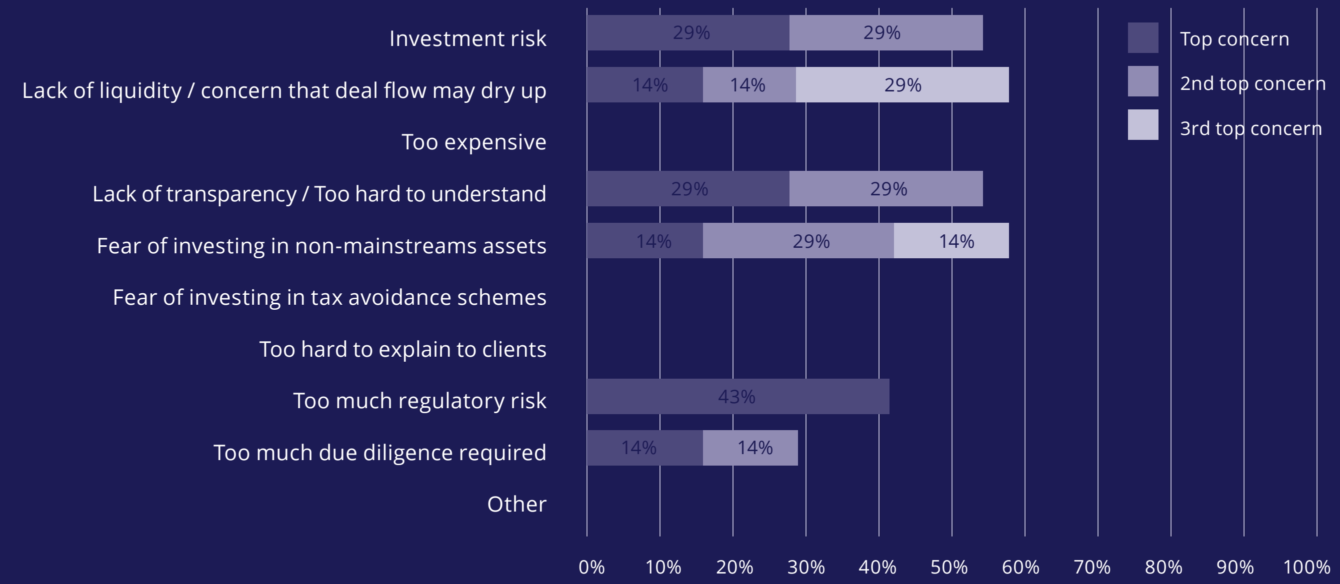
"Poor quality of information, manager's track record and the economic sector were the top factors that providers believe would make an investor or an adviser hesitate about investing"

WHICH 3 FACTORS ARE MOST LIKELY TO MAKE AN INVESTOR/ADVISER HESITATE ABOUT INVESTING/RECOMMENDING A VCT?



Poor quality of information, manager's track record and the economic sector were the top factors that providers believe would make an investor or an adviser hesitate about investing. Advisers noted the complex investment process as their number one factor, perhaps indicating an area that VCT providers can improve on. Acceptance on adviser platforms may address this.

WHAT DO YOU THINK ARE INVESTORS/ADVISERS TOP 3 CONCERNS WHEN INVESTING IN A VCT?



Providers believe that investment risk, lack of liquidity, lack of transparency and fear of investing in a non-mainstream asset class are the biggest concerns when investing in a VCT. While investment risk was the top concern amongst advisers, liquidity and lack of transparency were also noted: once again it appears that the providers understand advisers' concerns.

IN YOUR OPINION, WHAT SINGLE CHANGE OR INNOVATION WOULD IMPROVE THE VCT MARKET?

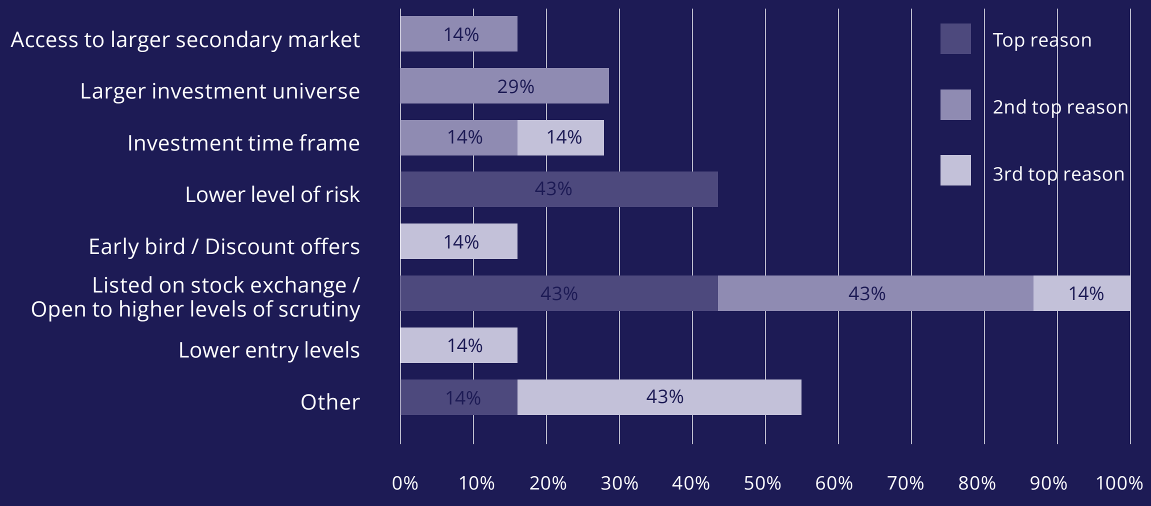
Not many providers had suggestions to improve VCTs, but the ones that did suggested changing the regulations on the secondary market and allowing investors to claim income tax relief, as well as bringing maximum annual investment amounts in line with EIS.

WHY DO YOU THINK THE EIS SECTOR HAS RAISED OVER £12.2 BILLION IN FUNDS COMPARED TO JUST OVER £5 BILLION IN THE VCT SECTOR?

We asked the same of advisers, and while they noted the shorter holding period, additional tax reliefs and larger investment limits, providers added the rise of online platforms to this list.

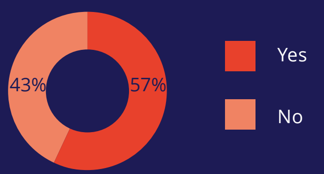
"While only some managers were prepared to open a SITR product, a majority of providers were interested in developing a Social VCT if it was to be approved"

WHICH TOP 3 REASONS DO YOU FEEL ADVISERS/INVESTORS SHOULD CONSIDER A VCT OVER OTHER TAX-EFFICIENT INVESTMENTS, SUCH AS EIS OR SEIS?



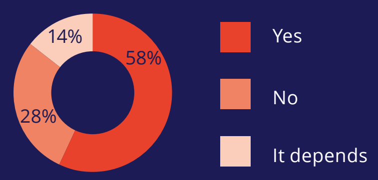
Listed on stock exchange and being open to higher levels of scrutiny were the top reasons why providers felt VCTs should be considered over other tax-efficient investments. Other responses included increased transparency, greater diversity and tax-free dividends.

DO YOU FEEL THAT THERE ARE ENOUGH RESOURCES AND INFO AVAILABLE TO ENABLE ADVISERS TO ACHIEVE WHOLE MARKET KNOWLEDGE OF THE VCT SECTOR?



Providers seems to be more optimistic about the information available in the market, as compared to advisers.

WOULD YOU BE KEEN TO DEVELOP A SOCIAL INVESTMENT VCT PRODUCT IF IT WAS APPROVED?"



We asked this in our survey of EIS providers before our round-table event with Big Society Capital in November 2015. While only some managers were prepared to open a SITR product, a majority of providers were interested in developing a Social VCT if it was to be approved.

*This result was based upon our survey of 20 EIS managers for Big Society Capital, some of whom also operated in the VCT market.

DO YOU EXPECT TO SEE AN INCREASE OR DECREASE IN VCT BUSINESS IN THE NEXT 12 MONTHS?

The majority of providers expect to do more business over the next 12 months, and this was a much higher percentage than advisers expecting to do more VCT business. We don't know how much more business advisers expected to write though.

The respondents were able to provide a reason to their response here and most providers stated that the legislation changes will reduce their competition but demand will increase due to pension reforms.

CONCLUSIONS

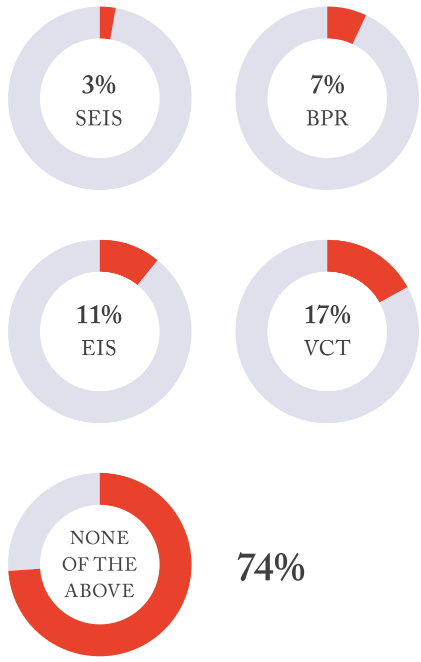
Their responses show that providers appear to be aware of the concerns of investors and advisers, which is of course encouraging for the market. Many of our respondents stated they expect to increase their VCT business over the next 12 months; interestingly many of them stated that they believed this would be down to an expected decrease in competition due to the new regulations and not just down to new net investment as a result of lower pension allowances. It will be interesting to see how this develops and if it does turn out to be the case.

PRIVATE INVESTOR SURVEY

The following survey was carried out on High Net Worth and sophisticated investors, over six days in April 2015. The survey covered all the various tax-efficient investment schemes (EIS, SEIS, BPR and VCTs). The survey was conducted by a third party survey panel of investors and overall we had 92 responses in total.

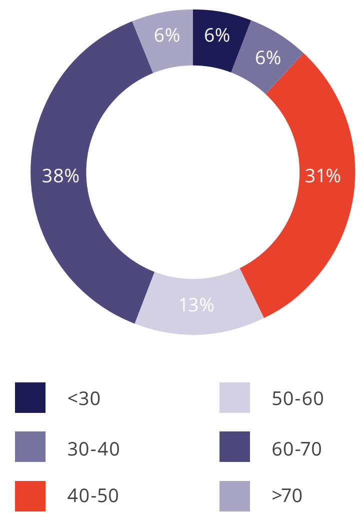
While this survey was conducted previous to the 2015 Budget announcements, we expect that their reasons for investing or not investing given at the time would be similar today.

DO YOU CURRENTLY INVEST IN ONE OF THE FOLLOWING TAX-EFFICIENT INVESTMENTS?



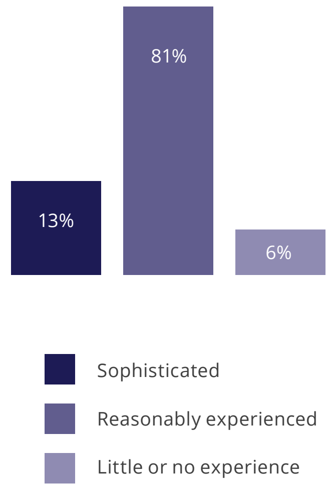
The majority (74%) of our survey respondents do not currently invest in the various tax-efficient investment schemes. However, VCTs were the most commonly invested in (17%), with EIS the second (11%), BPR 7% and SEIS 3%.

WHAT IS YOUR AGE?



VCT investors need to have a higher capacity for loss and therefore much younger investors who are less wealthy may be excluded, as may much older investors who do not have time to overcome any losses. A large number of private VCT investors were 40-50 years old (31%) or 60-70 years old (38%). Considering the answers in the adviser survey, it seems there are private VCT investors in the older age brackets than advised investors.

HOW WOULD YOU DESCRIBE YOUR LEVEL OF INVESTMENT EXPERIENCE?

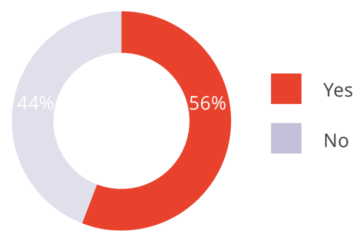


As VCTs tend to be a little more difficult to understand, and even the advisers have stated that they have difficulty explaining them to their clients, we would expect that VCT investors at least have some investment knowledge. 81% of those surveyed would describe themselves as reasonably experienced, whereas only 13% would say they are sophisticated.

WHAT PERCENTAGE OF YOUR TOTAL PORTFOLIO WOULD YOU GENERALLY FEEL COMFORTABLE PLACING IN TAX-EFFICIENT INVESTMENTS?

60% of the investors stated they would feel comfortable placing 5%-10% of their total investment portfolio in tax-efficient investments, including VCTs. This fits nicely with the 46% of the advisers surveyed, who felt the same. A good portion (30%) felt a little more cautious, only comfortable with less than 5% of their portfolio in these investments.

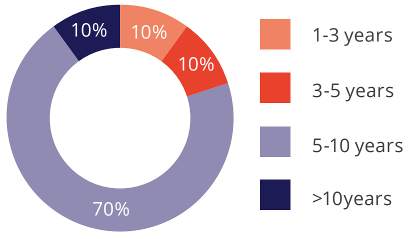
DO YOU HAVE A FINANCIAL ADVISER?



It is interesting to see that a significant number (44%) of these investors are heading into the complicated VCT investment world alone, rather than investing on the advice of a professional (56%).

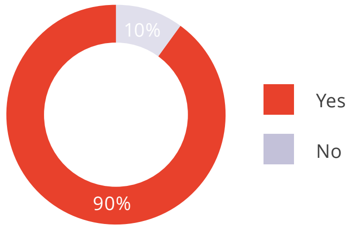
"Investors seem to be on the right track when it comes to their investment horizons. 70% look between 5 and 10 years ahead when making tax-efficient investments"

HOW LONG IS YOUR INVESTMENT HORIZON WHEN INVESTING IN TAX-EFFICIENT INVESTMENTS?



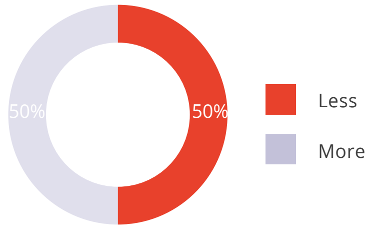
Investors seem to be on the right track when it comes to their investment horizons. 70% look between 5 and 10 years when making tax-efficient investments. It is important to keep in mind that the survey was targeting all tax-efficient investments, not only VCTs – so investors targeting 1 to 3 years may be more focused on EIS or SEIS investments (or at least we hope!).

DO YOU BELIEVE PROFESSIONAL ADVICE IS ESSENTIAL WHEN INVESTING IN TAX-EFFICIENT INVESTMENTS?



It is good to see that 90% of VCT investors feel that advice is important when investing in these products, but as so few of our respondents had IFAs, we must assume that they get advice from other sources such as accountants or tax advisers.

DO YOU EXPECT TO INVEST MORE OR LESS IN TAX-EFFICIENT INVESTMENTS OVER THE NEXT FIVE YEARS?

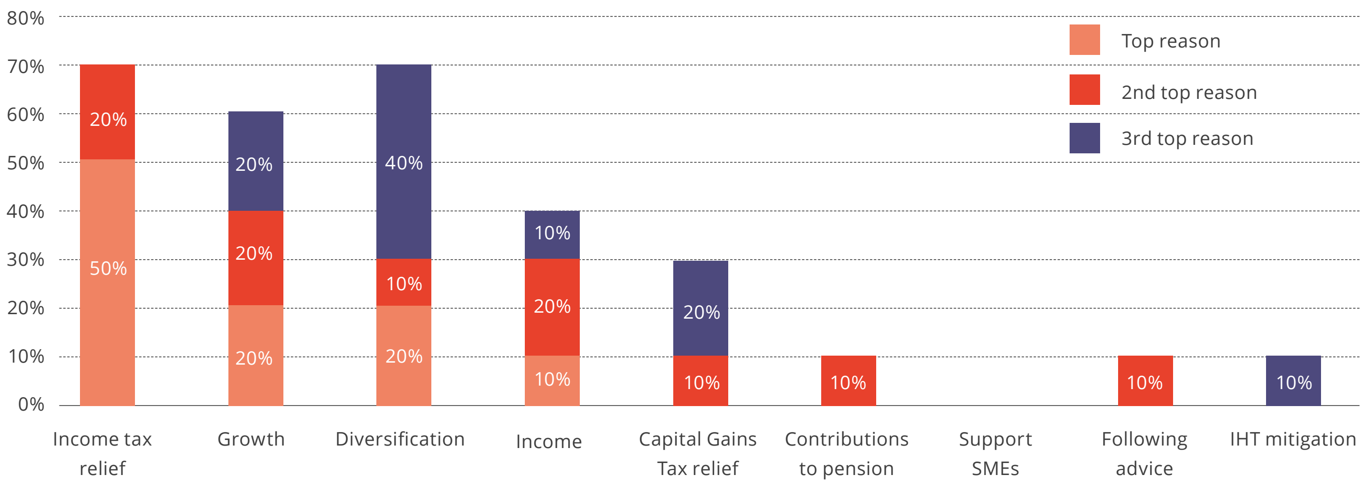


Here we see a 50-50 split of the investors on their future plans for these schemes.

WHEN YOU INVEST IN TAX-EFFICIENT INVESTMENTS, DO YOU INVEST IN:

Looking at the types of companies investors preferred, 50% diversify across quoted and unquoted companies while the other have preferred the transparency of the AIM market.

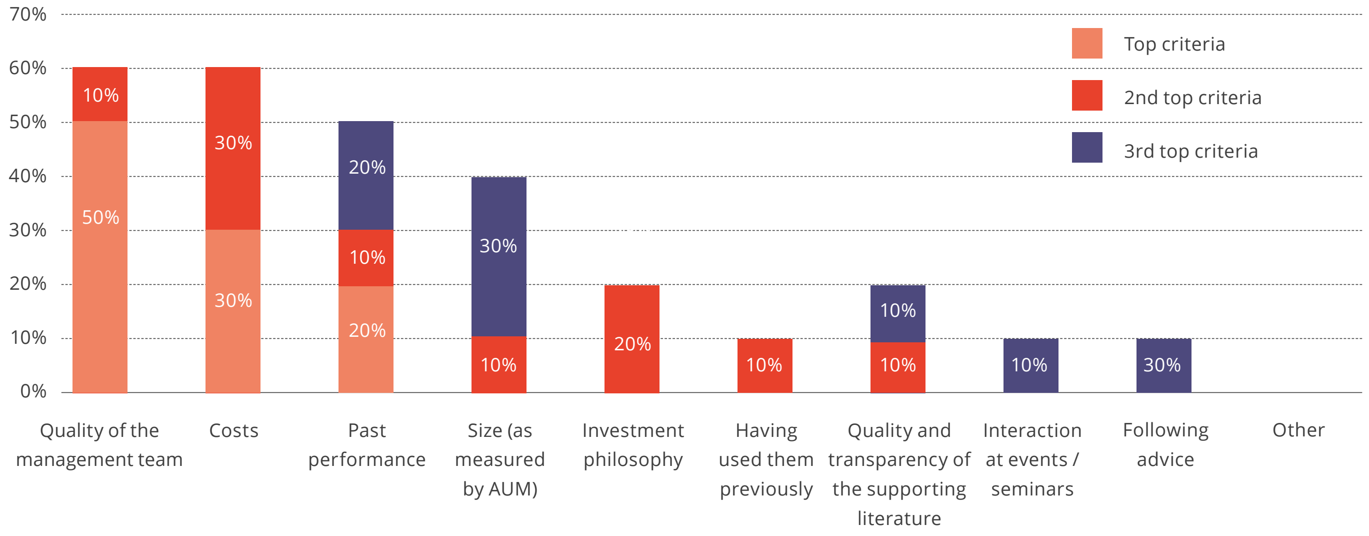
WHAT ARE YOUR TOP 3 REASONS FOR INVESTING IN TAX-EFFICIENT INVESTMENTS?



The top three reasons for investing were the most obvious: tax relief, growth and something that it seems more investors think that they get from tax-efficient investments than advisers do – diversification, which only 25% of advisers ticked as important.

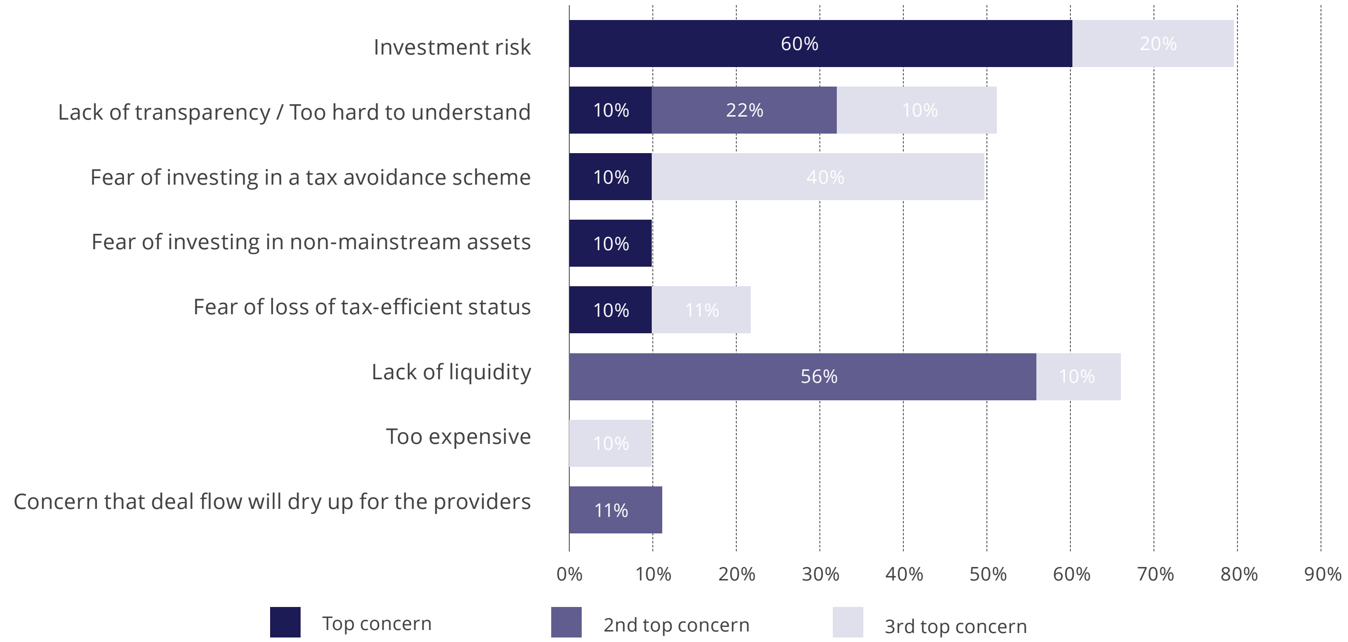
"While it's impossible for fund managers or financial advisers to increase the tax reliefs, making investment materials clearer would help clients invest in these products with more confidence"

WHAT ARE YOUR TOP 3 CRITERIA WHEN CHOOSING A TAX-EFFICIENT INVESTMENT PRODUCT PROVIDER?



Quality of the manager, costs and past performance are important to the investors when making a tax-efficient investment decision. As we saw, many of these investors (44%) are without a financial adviser, so they will have to be doing all the heavy lifting in the due diligence process, or using other sources of advice such as accountants.

WHAT ARE YOUR TOP 3 CONCERNS WHEN CHOOSING A TAX-EFFICIENT INVESTMENT PRODUCT?



Investment risk, lack of liquidity and lack of transparency were among the top three concerns for the investors when choosing a provider.

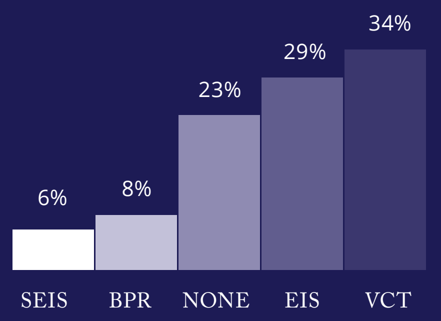
IN YOUR OPINION, WHAT SINGLE CHANGE OR INNOVATION WOULD HELP TO ENCOURAGE INVESTMENT IN TAX-EFFICIENT INVESTMENTS SUCH AS EIS, SEIS, VCTS AND BPR?

Answers here were qualitative and ranged from no change or innovation needed, to greater transparency and clearer information, and more tax relief! While it's impossible for fund managers or financial advisers to increase the tax reliefs, making investment materials clearer would help clients invest in these products with more confidence.

This next part of the investor survey takes a look at those that do not currently invest in any tax-efficient schemes but are aware of VCTs. We surveyed them to find out what is making them hesitate and what could be done to improve the tax-efficient investment market.

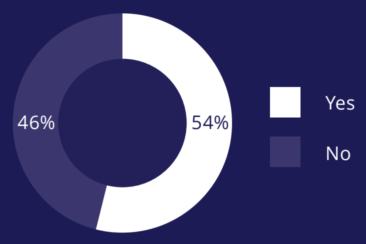
"The same reasons that would make the current VCT investors hesitate are the same ones holding these investors back – investment risk, lack of transparency and lack of liquidity are among the top three reasons for not investing"

ARE YOU AWARE OF TAX-EFFICIENT INVESTMENT PRODUCTS?



Of those that do not currently invest, 34% were aware of VCT products. This was the most commonly known investment product. The rest of the analysis focuses on the 34% of those that are aware of VCTs.

DO YOU ANTICIPATE THAT YOU WILL INVEST IN A TAX-EFFICIENT INVESTMENT PRODUCT IN THE FUTURE?

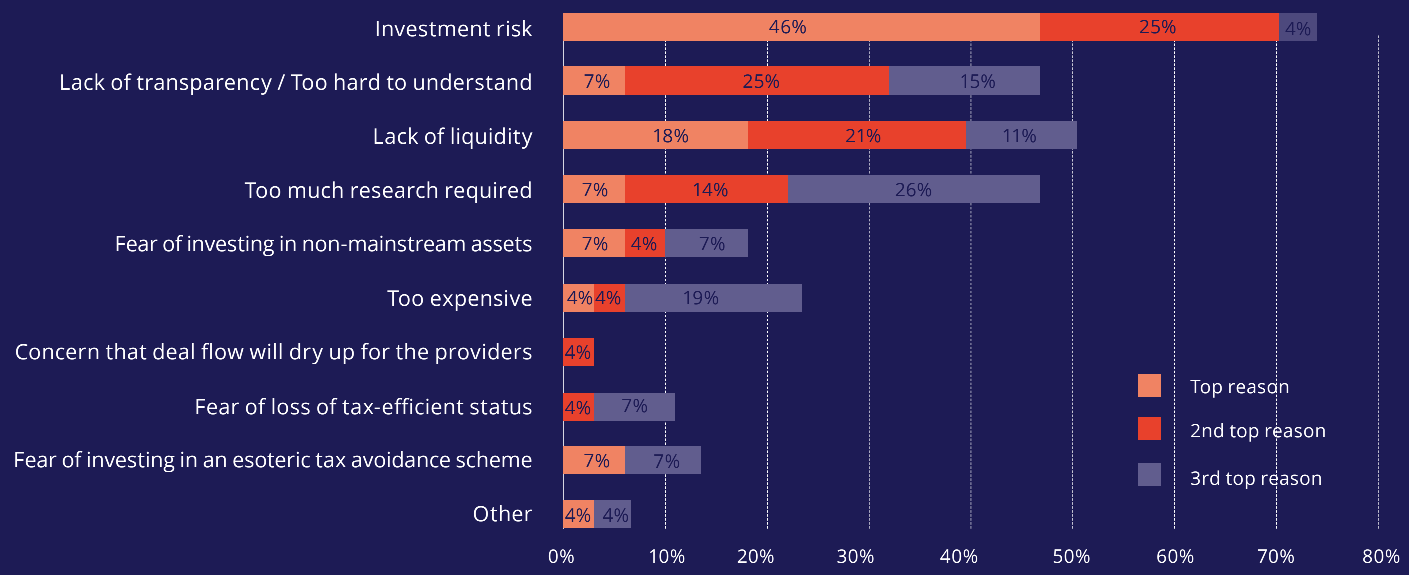


Despite their hesitations, 54% of them do expect to make a tax-efficient investment in the future. This could be due to the maturing market or their growing need to utilise these tax reliefs.

IN YOUR OPINION, WHAT SINGLE CHANGE OR INNOVATION WOULD HELP TO ENCOURAGE INVESTMENT IN TAX-EFFICIENT INVESTMENTS SUCH AS EIS, SEIS, VCTS AND BPR?

Looking at these respondents answers may give us a better indication of what can bring more clients who need these products into the market. Knowledge, clarification and transparency again were the most stated responses.

WHAT ARE YOUR TOP 3 REASONS FOR NOT INVESTING IN TAX-EFFICIENT INVESTMENT PRODUCTS?

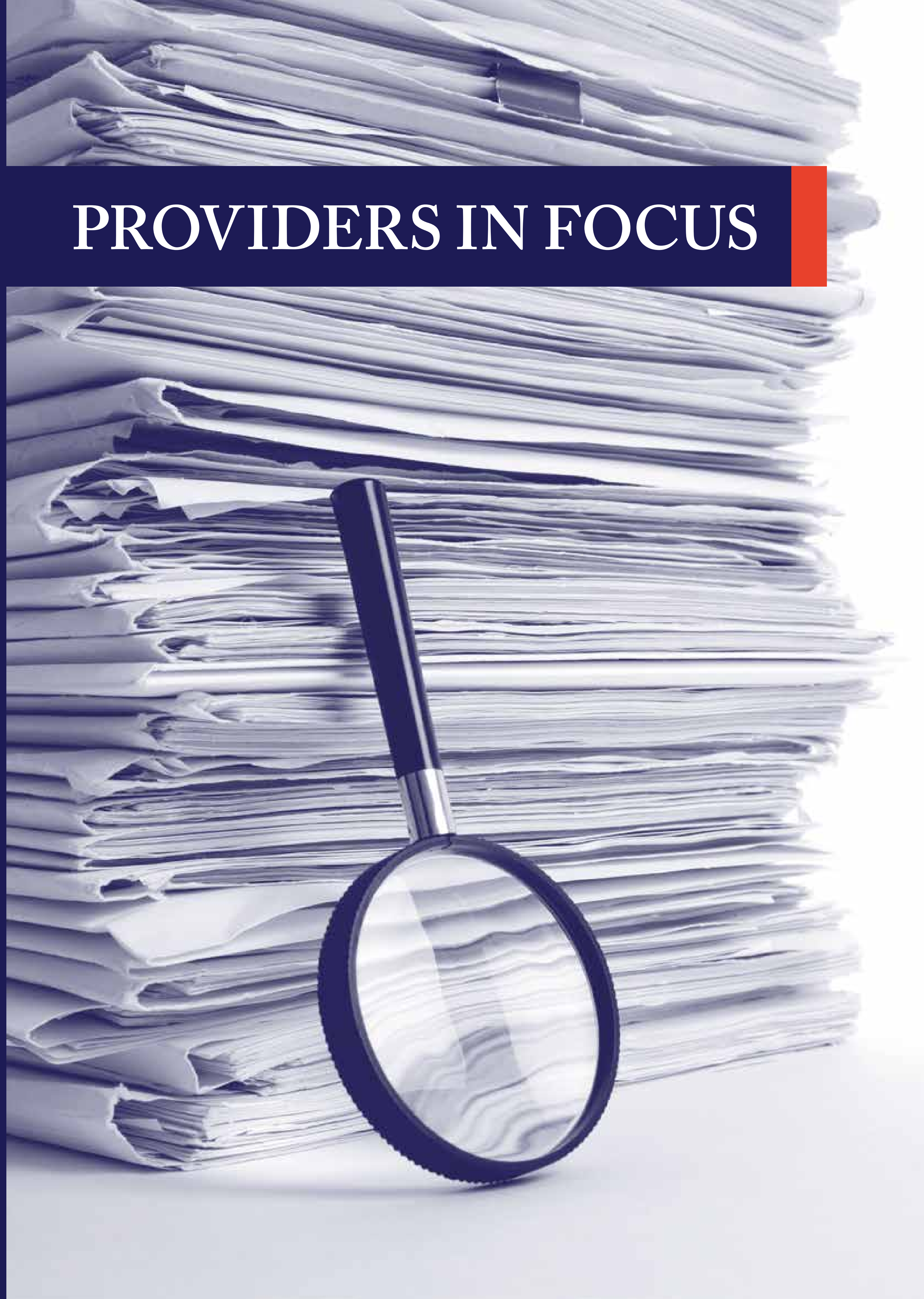


The same reasons that would make the current VCT investors hesitate are the same ones holding these investors back – investment risk, lack of transparency and lack of liquidity are among the top three reasons for not investing. Too much research required was another top reason. It is true that VCTs and other tax-efficient vehicles are going to be more complicated and in turn require more due diligence. It is important that advisers are able to speak to their clients knowledgeably about them.

CONCLUSIONS

Investors are aware of the higher risk of tax-efficient investments, but are also aware that they require more time and research to wrap their heads around them. Financial advisers are key to these investment decisions and should be able to provide investors with a clear understanding of the product. This is also a call to action to the investment providers, to make their investment materials more transparent and easier to understand.

PROVIDERS IN FOCUS



VCT CASE STUDIES

We have included some case studies of VCT investments over the next few pages to help bring to life some of the key points that we have been making throughout this report:

#1 VCT investment is not necessarily about providing seed capital to high risk start-ups. It can be about investing in well-established companies that have their own assets, a large workforce and long-standing customers.

#2 On the other hand, we've also highlighted the additional risk of investing in smaller companies. They are more risky than large, listed companies and mainstream investment funds, and there is less information available to base investment decisions on.

#3 However, for investors who are prepared to do their own research and due diligence in order to bridge this information gap, it is possible to identify fantastic opportunities where the risk/reward ratio is favourable.

#4 VCT investment managers can give investors access to the skills and experience required to carry out the required level of research and accurately assess these opportunities – for a fee of course.

#5 VCT investment managers can also help solve some of the other problems with small company investing. They can exercise influence over the companies they invest in, adding value by offering guidance at the same time as ensuring that their investors' interests are taken into account.

#6 Finally, successful VCT investments have wider benefits that go beyond the investment return: companies grow, pay more tax and employ more people. These are the reasons why the VCT continues to attract strong levels of support from the government.

PARTICIPATION

The VCT managers covered in the following pages have sponsored the production costs of this report and in return we have highlighted some case studies and a short company profile for inclusion here, as well as some general commentary and attributed quotes throughout the report.

ALBIONVENTURES

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Albion Ventures LLP was created in January 2009. We enjoy working with smaller companies and entrepreneurial management teams, seeing our purpose as helping businesses to grow by providing financial resources as well as strategic advice. Our ultimate aim is to realise the full potential of the business invested in and so create returns for the shareholders in our funds. We act with integrity and respect for the people we deal with.

abcodia

2011 - £1.95m
Healthcare & Technology
Cambridge & Boston
15

www.abcodia.com

Abcodia is a specialist company engaged in the discovery and verification of bio-markers for the early detection and screening of cancer. Their mission is to change the way that bio-markers are developed to allow the earlier diagnosis of cancer and help people live longer and healthier lives.

RATIONALE FOR INVESTMENT: The investment fits into Albion's Healthcare (Growth) investment category and is designed to enable the release of value from a unique asset of a large serum bio-bank. The investment provides early stage funding to commercialise the bio-bank, through the development of three revenue streams: a services-based revenue model providing access for commercial partners to the bio-bank; the longer term development of IP from other projects with commercial partners, leading to sustained revenue streams through licensing deals; the development and commercialisation of a screening product for ovarian cancer, with direct product sales in the US and UK / EU.

VALUE ADDED BY VCT MANAGER: Albion Ventures has had close involvement in the evolution of the strategy including the decision to acquire and develop products as well as services; and the implementation of the strategy by building out of the management team and introducing key metrics, milestones and incentive plans.

Albion Ventures was involved closely in initial recruitment of key staff and the expansion into the US market and been instrumental in introducing potential customers and key industry contacts.

Albion Ventures was actively involved in building the board governance structures, expanding the investor base and supporting the management team throughout the building of the company from a start-up situation.

GROWTH IN REVENUE AND EMPLOYMENT: The number of employees has grown from 3 in 2011 to 15 in 2015.

Revenues are undisclosed, but Abcodia has completed several multi-million dollar value licensing and development deals and recently launched an ovarian cancer screening product with annual revenue potential of tens of millions of dollars.

COINVESTORS: Cambridge Innovation Capital, Scottish Equity Partners, UCLB and other private investors.

Radnor House

2011 & 2015 - £17.6m
Education
Middlesex & Kent
140

www.radnorhouse.org

The Radnor House Group of schools incorporates two growing independent co-educational schools, which will educate over 900 students when mature. As the first venture capital funded start-up school in the UK, Radnor House is a 7-18 years independent co-educational day school in Twickenham, located in Alexander Pope's stunning former mansion on the banks of the River Thames. It has achieved an "Outstanding" rating across all categories in its first Ofsted inspection. Combe Bank is a co-educational independent school for students aged 3-18, located near Sevenoaks, Kent, acquired by Radnor House in 2015. It is a unique opportunity to expand the Radnor House model by enhancing the school's culture of academic achievement and first-rate pastoral care, as well as making the necessary investment to provide new facilities and modernise existing ones where necessary.

Radnor House Group is looking for further expansion opportunities.

RATIONALE FOR INVESTMENT: The investment fits well into Albion's "Asset Based" investment category, providing security via first charge over freehold assets, attractive and growing income stream from interest payments and dividends and the potential for a material capital gain on exit.

VALUE ADDED BY VCT MANAGER: Albion Ventures worked closely with the founder to develop the business plan for the school and to negotiate and acquire the initial site in Twickenham, all within a very short time frame. Albion Ventures was instrumental in building a very strong senior team, led by the Chairman, Colin Diggory (previously Head of Alleyns and Latymer Upper School), Barry Martin (previously Head of Hampton School) and Ian Callender (COO of North London Collegiate School). Albion Ventures played a leading role in the acquisition of Combe Bank School.

GROWTH IN REVENUE AND EMPLOYMENT: Since investment in 2010 revenues have grown from nil to £9 million. The number of employees has grown from nil to 140.

Amati Global Investors

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Amati Global Investors is a specialist fund management business based in Edinburgh. It focuses on UK small and mid-sized companies, with a universe ranging from fully listed constituents of the FTSE Mid 250 and FTSE Small Cap indices, to stocks quoted on the Alternative Investment Market ("AIM"). Products include an OEIC – the TB Amati UK Smaller Companies Fund; two AIM Venture Capital Trusts - Amati VCT and Amati VCT 2; and an AIM IHT portfolio service.

Bilby

Investment	Feb 2015 - £1,250,000
Sector	Business Support Service
Location	Kent
Employees	80

www.bilbyplc.com

Bilby is an established property services business, focused on the installation and maintenance of gas heating systems, boiler servicing, plumbing, drainage and general building repairs. Its customer base is almost entirely local authorities and housing associations, all within London & SE England. Bilby's services are non-discretionary and driven by legislation and government initiatives covering gas safety, the "Decent Homes Standard" and the "Right to Repair Scheme". The business has grown organically since its formation in 1977, and the purpose of the listing on AIM in March 2015 was to support a buy and build strategy in a fragmented market. Since listing Bilby has raised further financing, at a significant premium to its IPO price, to fund an acquisition of a similar sized electrical, heating, mechanical and property services contractor offering strong synergies with its existing operations.

RATIONALE FOR INVESTMENT:

- Demand for social housing far exceeds supply in the regions in which Bilby operates
- Maintenance work is a legal necessity, which has to be carried out regardless of landlord funding pressures
- With contracted service periods, typically 3-7 years, Bilby has good revenue visibility
- Bilby's concentrated geography and strong client relationships generate attractive margins and the enhanced scale from acquisitions will allow them to meet minimum turnover requirements to bid for larger contracts.

VALUE ADDED BY VCT MANAGER:

Amati became involved in supporting the company through the last stages of the IPO process, particularly in the discussions about pricing the issue. Since then we have been approached by the chairman for advice about specific matters of corporate governance on several occasions.

GROWTH IN REVENUE:

Amati first invested in Bilby at IPO in February 2015, at which time revenues were £8.7m. The consensus forecast for March 2016 is for revenues of £32.6m.

PTSG – Premier Technical Services Group PLC – Niche Specialist Service Provider

Investment	Feb 2015 - £875,000
Sector	Support Services
Location	Castleford
Employees	300

www.ptsg.co.uk

PTSG is the UK's leading provider of building access and safety services. It is also a specialist in the design, installation and testing of lightning protection and electrical systems, and in high level cleaning services. The company operates in regulated markets, driven by annual inspection and insurance requirements. Customers are a diverse range of corporations and facilities managers in the UK, with international clients now also being won. PTSG was founded in 2007 by an experienced management team, which previously built up and sold facilities services provider, MacLellan Group plc, to Interserve plc for an enterprise value of £130m. To date, PTSG has achieved a broadly equal split of organic and acquisitive growth and it listed on AIM in February 2015 to continue the consolidation of its end markets.

RATIONALE FOR INVESTMENT:

- Demand for PTSG's services is mainly non-discretionary
- The company has market leadership in a number of areas, but with significant scope for expansion against highly fragmented competition
- Over 90% of customers currently take only one service, which offers cross-selling opportunities
- With nationwide coverage it has an operational advantage over regionally focused competitors
- In addition to organic potential, the company has an extensive acquisition track record, where its tight operational management has achieved strong synergies, and this will continue to be a feature of the future growth strategy.

VALUE ADDED BY VCT MANAGER:

Amati was involved in detailed discussions with the company about specific aspects of corporate governance during the IPO process.

GROWTH IN REVENUE:

Amati first invested in PTSG at IPO in February 2015, at which time revenues were £18.0 million. The consensus forecast for December 2016 is for revenues of £31.3 million.

BERINGEA

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Beringea is an established growth capital fund manager with a solid track record of successful investment. The group has offices in the UK and the US, with total funds under management of over £350 million. Beringea focuses on investing in companies with the potential for rapid growth, managed by entrepreneurs who are passionate about their business and have the skills, drive and intelligence to succeed. Beringea has successfully partnered with entrepreneurial businesses for more than 25 years.

Watchfinder – Passionate About Watches

Investment	Sept 2014 - £3.2 million
Sector	Retail
Location	London
Employees	180

www.watchfinder.co.uk

Founded in 2002, Watchfinder and Co is the UK's premier reseller of pre-owned fine watches. The company started life online and has become one of the most popular watch-related websites in the world with over 5.8 million people visiting each year.

In 2013, the first bricks and mortar store was added, which accounted for 20% of sales in 2015 - which, to 2015, total £140 million. Watchfinder also operates a certified servicing centre in Maidstone where the company's expert technicians use manufacturer approved machinery to service timepieces. Every watch repair and refurbishment is followed by extensive testing, ensuring that each watch falls within the manufacturer's specified tolerance before being returned to its owner or sold. This allows the business to provide every watch sold with a one year warranty and ensure it reaches the customer in perfect condition.

The ProVen VCT's investment is already being used to broaden the company's inventory of luxury timepieces, support the roll out of a multi-media marketing campaign and further fund the watch servicing centre. Google results show more searches entered for the term Watchfinder than some of the better established watch retailers and some of the top watch brands.

RATIONALE FOR INVESTMENT: Watchfinder is the most trusted UK retailer for authentic pre-owned luxury timepieces, with its own certified servicing centre. This well-established business has proven expertise in this market and its business model can deliver outstanding profitability. The return on inventory and the unit economics are both impressively strong, which together with a strong team makes it a great fit for the ProVen portfolio of fast growing companies.

VALUE ADDED BY VCT MANAGER: Beringea introduced Watchfinder to a number of key players in the luxury and watch industries, helping secure new stores in Bluewater and Leeds, and facilitated meetings with potential acquirers.

GROWTH IN REVENUE AND EMPLOYMENT: Revenues increased from £8.7m in 2012 to £13.6m in 2013 (56% increase), to £20.8m in 2014 (67% increase). Employee numbers increased from 40 in 2012 to 100 in 2015.

COINVESTORS: Institutional co- investors – Piton Capital

Cognolink

Investment	Nov 2012 - £3 million
Sector	Information
Location	London & New York
Employees	163

www.cognolink.com

Cognolink is a provider of primary research services to professional investment firms and their advisers, including hedge funds, private equity, mutual fund managers and management consultants. Cognolink helps its clients to make important investment decisions by connecting them to authoritative market intelligence provided by industry specialists.

Cognolink was founded in London in 2007 and then quickly expanded into international markets, opening a New York office in 2010, followed by offices in Hong Kong, Shanghai, Beijing and New Delhi. The company grew very rapidly from its inception.

The ProVen VCTs invested £3 million in Cognolink in November 2012, to support further international expansion and the development of additional research products.

Since the VCTs invested the company has continued to deliver strong growth, recording turnover of nearly £22.8 million in 2014, an increase of nearly 68% on the previous year. This growth shows no sign of abating and the company recently moved into larger offices in both London and New York to accommodate its growing workforce.

RATIONALE FOR INVESTMENT: The use of expert networks and primary research to support investment decisions only started in the 1990's but has now become embedded in the research processes of asset managers and consultancy firms. Cognolink has established itself as one of the leading players in the sector and is very well positioned for significant growth, supported by this investment from Beringea.

VALUE ADDED BY VCT MANAGER: Beringea have a successful track record backing companies in the information sector, and are actively helping Cognolink expand their global footprint. They are also helping the CEO to strengthen the senior management team.

GROWTH IN REVENUE AND EMPLOYMENT: Cognolink has seen some fantastic growth over the last few years: Revenue growth from £8.7m in 2012; £13.6m in 2013; £22.8m in 2014.

HARGREAVEHALE

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Hargreave Hale is a leading provider of investment management, stock broking and fund management services in the UK. Founded in 1897, the business manages £5.0bn across nine UK branches. Based in London, Hargreave Hale has one of the UK's most respected fund management teams managing in excess of £3.0bn. The team, led by Giles Hargreave, is considered a highly active and well established investor in the UK small and mid cap space.

Quixant

May 2013 - £440,000

Casinos & Gaming

Cambridge

70

www.quixant.com

Quixant is the world's premier company focused exclusively on the design and manufacturing of the most advanced PC based computer systems for the global gaming industry. For gaming machine manufacturers, the sophisticated computer systems that are optimised for casino gaming and slot machine applications are an important enabling technology. They are not, however, a source of profit and do not drive sales. The hardware specification, and compliance to it, is highly regulated and closely monitored. In effect, in-house production of these complex systems creates little value whilst representing a cost centre (that requires working capital) and a source of regulatory risk. Quixant allows manufacturers to short cut their product development cycle, reduce cost and improve their return on capital through the supply of key parts of the system hardware. Quixant supplies systems to blue chip slot machine manufacturers all around the world.

RATIONALE FOR INVESTMENT: Quixant is a profitable, cash generative business that provides a clear value add to the wider industry. Quixant's clients are able to introduce new products to market more efficiently and with less risk. Key to this is Quixant's in-house engineering capability, manufacturing and deep knowledge of the different regulatory regimes in existence globally. These 'know hows' help define Quixant's unique market position. In contrast to the traditional hardware supply chain, which is highly diversified and makes use of layers of subcontractors, Quixant has established an experienced and tightly controlled supply chain that understands the regulatory constraints they must operate within.

VALUE ADDED BY VCT MANAGER: Hargreave Hale does not seek to have an active role in the management of the business. Hargreave Hale simply aims to provide capital to fast growth early stage businesses.

GROWTH IN REVENUE AND EMPLOYMENT: Since Hargreave Hale first invested in Quixant in 2013, revenues have grown from $24.2m in 2013 to $31.9m in 2014. Analysts forecast revenues to the year ending 31 December 2015 to be $41m.

COINVESTORS: The Marlborough Microcap fund, also managed by Hargreave Hale, has invested over £2m into the company. Schroders and Octopus Asset Management are other large institutional shareholders.

Kalibrate

YOUR ADAPTIVE EDGE.

Nov 2013 - £480,000

Application Software

Manchester

142

www.kalibrate.com

Kalibrate provides technology-based price optimisation and planning solutions for the global fuel retail industry. Its solutions have been deployed by hundreds of retailers across thousands of forecourts in 68 counties. Leveraging deep industry experience, Kalibrate combines comprehensive data and robust analytics to deliver dynamic customized insights and solutions to clients through consulting engagements. From executive suite to operational realities, Kalibrate knows how to optimize and grow retail fuel and convenience stores for total profitability, in a market where multiple vendors are in volume driven competition with each other. Kalibrate has a blue chip customer base including BP, Tesco, Safeway and 7-Eleven.

RATIONALE FOR INVESTMENT: Kalibrate is a market leading, profitable and cash generative business operating in a market which is approaching an inflection point. Structural changes, including an increasing number of vendors and regulatory pressures on retails, is helping drive demand in established markets. The eventual de-regulation of markets in India and China will seed additional growth in the long term. Kalibrate's solutions validate clear return on investment for clients, as demonstrated with the impressive list of blue chips. Kalibrate is currently moving its customer base away from software license sales and onto a subscription fee and managed services model, giving the company greater revenue visibility as it enters each financial year.

VALUE ADDED BY VCT MANAGER: Hargreave Hale does not seek to have an active role in the management of the business. Hargreave Hale simply aims to provide capital to fast growth early stage businesses.

GROWTH IN REVENUE AND EMPLOYMENT: Since Hargreave Hale first invested in Kalibrate in 2013, revenues have grown from $24.2m in 2013 to $32.5 in June 15. Analysts forecast revenues to the year ending 31 June 2016 to be $35.8m.

COINVESTORS: The Marlborough Microcap fund, also managed by Hargreave Hale, has invested over £2m into the company. Schroders and Octopus Asset Management are other large institutional shareholders.

mobeus EQUITY PARTNERS

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Mobeus has won the title of VCT Manager of the Year for each of the last four years at the British Private Equity Awards, the industry's pre-eminent honour. The firm has £240m funds under management and invests in privately-owned UK smaller businesses ("SMEs") across all sectors.

Jablite

Apr 2015

Manufacturing

Five UK sites

188

www.jablite.co.uk

Jablite Holdings is made up of two distinct expanded polystyrene ("EPS") brands operating under a common management structure: Jablite is the UK's dominant EPS construction brand, while Styropack is a leading brand in EPS packaging products.

RATIONALE FOR INVESTMENT:

- Jablite Holdings has a strong senior management team, which over the last four years has turned the business around to significant levels of profitability £48 million annual revenues
- Although a recovery in the construction market has helped drive top-line growth in the business in recent years, more than half of the growth in profitability seen during that time has come from a number of fixed and variable cost-saving initiatives successfully initiated and executed by management

VALUE ADDED BY VCT MANAGER:

Mobeus was able to unlock a particularly complex deal by managing:

- The operational carve out of Jablite from its European parent;
- A £15.5m sale and leaseback of the business's five freehold manufacturing sites; and
- The carve out of two legacy defined-benefit pension schemes.

Mobeus provided a combined debt and equity investment of £5m to support management in acquiring the company. The £5m investment comprised a £3.5m loan note with a £1.3m loan note premium attached – this ensures that 97% of the VCT investment is received ahead of any proceeds being distributed to shareholders. The Business has performed very strongly since acquisition. Profitability is expected to almost double in 2015, whilst the investment has already returned £3.5m of the £5m cost to the VCTs within four months of completion.

Entanet

CONNECTING CONFIDENCE

2014 & 2015

Education

Telford

77

www.enta.net

Entanet is a wholesale communications provider based in Telford. It is an established, cash-generative business supplying a range of voice and data services to IT resellers which, in turn, supply small and mid-sized companies. For the year-ended 31 December 2014, Entanet reported revenues of £30m.

RATIONALE FOR INVESTMENT:

- Strong management team headed by a very motivated and capable MD and supplemented by a high calibre Chairman with impressive sector and private equity expertise
- Market for IT services is highly fragmented and characterised by strong growth in the demand for data usage and connectivity services, as well as increasing adoption of super-fast broadband and high-speed leased lines (still at relatively early stages of adoption by SMEs)
- Attractively priced transaction offering a stable, high-yielding return with potential for significant equity upside
- No bank debt in the transaction and a deal structure providing good downside protection, not least because the vendor is rolling over a significant proportion of his value

VALUE ADDED BY VCT MANAGER: The Entanet investment provides a strong running yield, paying a yield of 9.2% per annum to Mobeus Advised VCTs. Mobeus did not use any external bank debt in the transaction, and the investment is characterised by strong downside protection because the deal is structured so that the majority of the VCT's investment is in the form of prior ranking loan stock. Mobeus Advised VCTs also have a significant equity stake to provide significant upside on an exit. This sector is characterised by significant M&A activity and attractive exit multiples.

GROWTH IN REVENUE AND EMPLOYMENT: Entanet provides an important service in the value chain for the provision of communication needs to SMEs. These companies do not want to deal with the large telecommunications companies which tend to focus on residential and enterprise customers, and generally offer poor quality service to SMEs.

OCTOPUS INVESTMENTS

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Octopus is a fund management business with positions in several specialist sectors including healthcare, energy and smaller company investing. Founded in 2000, Octopus manages over £5 billion of funds on behalf of 50,000 investors.

Octopus works with financial advisers to create investment solutions that combine its expertise in smaller company investing with government approved tax reliefs. The core product range currently includes VCTs, EIS and IHT services.

Zynstra

Date / Amount	2013 - $14.4m
Sector	Technology / IT
Location	Bath
Employees	45

www.zynstra.com

Zynstra delivers cloud managed IT infrastructure for Small-Medium Enterprises on a subscription based model, available with the installation of minimal hardware. By leveraging hybrid cloud technologies, Zynstra offers the services of a corporate-grade IT infrastructure at an affordable cost. Zynstra works with Managed Service Providers and IT retailers who re-brand the service and resell it through their distribution channels.

RATIONALE FOR INVESTMENT: Octopus was extremely impressed by the calibre of the management team and their experience given that they are serial entrepreneurs within the enterprise software space. The Zynstra team founded and grew Cramer Systems that they sold for more than $400m to Amdocs in 2006. In addition, the Zynstra technical platform solves a real pain point for SMEs who do not have the in-house expertise to manage complex IT systems.

VALUE ADDED BY VCT MANAGER: Working with Octopus has been a very positive experience. As an investor, they have provided much more than just money, adding valued experience at board level and through their network of portfolio companies. One of their Venture Partners, Ian Perry, has provided us concrete, tangible advice and active support as we build out a global B2B SaaS sales team.

In addition, we've been able to leverage Octopus's network in the technology space on several occasions, allowing us to more easily connect to senior people in relevant organisations, including large global corporates, with positive results.

COINVESTORS: Octopus Ventures and high profile angel investors.

Swoon Editions

Date	May 13, May 14, Jun 15
Sector	Retail
Location	London
Employees	56

www.swooneditions.com

Swoon Editions sells high quality furniture at insider prices. Sourcing direct from factories in India, China and Vietnam, it buys in container quantities and sells direct to consumers. Cutting out the middlemen, shops and warehouses allows Swoon to sell beautifully hand crafted furniture at fair prices.

RATIONALE FOR INVESTMENT: Swoon operates in a large and attractive market and is pioneering a new and disruptive business model for e-commerce. Octopus was extremely impressed by the calibre of the management team, the vision of the company and the innovative business model.

VALUE ADDED BY VCT MANAGER: Octopus is an active participant on the board at Swoon Editions. It has facilitated numerous introductions; has set up numerous press and media opportunities; and advised on debt negotiations.

GROWTH IN REVENUE AND EMPLOYMENT: Swoon has grown its headcount from 15 employees in May 2014 to 56 in October 2015. Revenue has grown 200% per year every year since investment.

PUMA INVESTMENTS

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Puma Investments is a subsidiary of Shore Capital Group Limited, an AIM listed company with a 30 year history. Shore Capital has a network of five offices including London, Liverpool and Edinburgh. The asset management division of Shore Capital, which incorporates Puma Investments, manages approximately £800m. Puma Investments specialises in Inheritance Tax Services, VCTs and EIS. Puma has raised over £250m in tax-efficient investments to date.

Brewhouse and Kitchen

Date / Amount	Dec 2012 - £3.1 million
Sector	Pubs & Restaurants
Location	Across UK
Employees	170

www.brewhouseandkitchen.com

Brewhouse & Kitchen (B&K) is a branded pub business specialising in on-site brewing. In contrast to some of its competitors the brewing operations take centre-stage in B&K outlets and B&K brew a substantial amount of the beer sold. Alongside this sits a quality food offering.

Brewhouse & Kitchen was founded in 2011 by experienced pub sector professionals Kris Gumbrell and Simon Bunn both of whom are shareholders. At the time the UK pub sector was experiencing significant change but Kris and Simon spotted a strategic opportunity in the fast growing Craft beer market and have capitalised on it. In three years B&K has grown to eleven pubs and over 170 employees.

The B&K model sits best within operating freehold units of 4,000 square feet or more. Sales of beer brewed on site enhance margin due to lower excise duties on small scale brewing operations.

RATIONALE FOR INVESTMENT: At the point of investment Brewhouse & Kitchen had raised around £1.5million of EIS equity including substantial sums from the principals. The Puma VCTs supplemented that equity by providing funds to be drawn against approved site acquisitions. As such, the Puma VCTs benefited from fixed charge security throughout their involvement, whilst earning a compelling yield. Puma took comfort from the vision, experience and personal commitment of the management team whilst knowing that their investment was underpinned by this security

GROWTH IN REVENUE AND EMPLOYMENT: Since receiving investment from the Puma VCTs, Brewhouse & Kitchen grew from 0 to 11 sites and from 2 to over 170 staff on a full and part-time basis. Revenues have grown to an annualised level of over £4.7m generating annualised EBITDA across the group of nearly £900,000. The group has acquired valuable freehold sites in key locations across the South of England, including two flagship units in London, and generated significant brand value and positive press.

Opes Industries

Date / Amount	Aug 2014 - £8.8 million
Sector	Materials Recycling
Location	Finmere Quarry, North Oxfordshire
Employees	50

www.opes.uk.com

Opes Industries Limited ("Opes") operates a Materials Recycling Facility ("MRF") on a 70 hectare non-hazardous landfill and aggregates site in Finmere, North Oxfordshire.

The MRF allows Opes to divert the waste arriving on its site away from landfill where it would traditionally have ended up and into several more productive and environmentally responsible channels. These include recycling (and sale) of various sorted metals and bundling of plastics and dried organics into bales or a usable fuel known as SRF or "solid refuse fuel".

Opes has planning permission to develop a waste to energy plant on its site which will use gasification technology to generate electricity directly from the SRF produced from its own throughput. The site also retains significant aggregate reserves.

RATIONALE FOR INVESTMENT: Puma's investment was underpinned by the large freehold site in Oxfordshire. This site has significant value, underpinned by aggregates plus extraction rights, and landfill with intact void capacity. The planning permissions to building a materials recycling facility and a waste to energy plant gave further comfort. The site is well located with good road access.

The sponsors of the deal had contributed significant personal equity and had assembled an experienced management team who were already in place. This team included operational personnel that had been involved throughout the planning stages and had extensive knowledge of the site and market.

GROWTH IN REVENUE AND EMPLOYMENT: Since the initial Puma investment the Opes business has grown from what was effectively a stagnant landfill business to an operating MRF. The development of the company has happened on the back of major capital expenditure on equipment and construction works, substantially funded by the capital injection provided by the Puma VCTs.

unicorn
ASSET MANAGEMENT

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Unicorn Asset Management, an independently owned and managed investment management company, was founded in 2000. Building value over time for our shareholders and clients depends on one factor, and one factor alone – performance: investment performance and business performance. If you believe, as we do, that a 'share' represents a long term ownership claim on a business, then business success and investment success go hand in hand.

abcam® discover more

Investment	2005, 1st Investment (£1.5m)
Sector	Pharmaceuticals
Location	Cambridge
Employees	820

www.abcam.com

Abcam PLC produces and distributes research-grade antibodies via an online catalogue. The Company's customers include universities, research institutes, and pharmaceutical and biotechnology companies in countries around the world. The company's focus is on protein research tools. It has built the most effective antibody distribution platform worldwide, twinning in-house production and OEM sourcing from over 400 suppliers with an e-commerce platform, efficient fulfilment and good customer service.

RATIONALE FOR INVESTMENT: Abcam has a strong track record of delivering earnings growth and is one of the few AIM companies which has consistently delivered earnings growth in each of the last five financial years.

Market share is still relatively low (c. 20%) providing strong growth opportunities – a strong balance sheet with net cash of over £58m and strong free cash generation will enable Abcam to invest in future growth both organically and via acquisition.

GROWTH IN REVENUE AND EMPLOYMENT: Product revenues continue to grow at more than 15% per annum providing opportunities to expand the team.

Abcam now employs over 820 people, has 9 global subsidiary offices and sells into over 130 countries worldwide.

Animalcare

Investment	2007, 1st Investment (£700k)
Sector	Pharmaceuticals
Location	York (UK)
Employees	60

www.animalcare.co.uk

Animalcare Group PLC markets and sells a wide range of pharmaceutical and other premium products and services to vets and vet wholesalers. Animalcare is a leading supplier of generic veterinary medicines and animal identification products to companion animal veterinary markets. It develops and sells goods and services to veterinary professionals principally for use in companion animals; operating through UK wholesalers and distribution and development partners in key markets in Western Europe.

RATIONALE FOR INVESTMENT: Animalcare is a dividend paying, cash generative business that offers defensive growth and is in the early stages of an investment phase to shift towards a greater proportion of revenues from internally developed veterinary pharmaceuticals.

The group has a strong balance sheet with cash balances of over £5m which provides for continued investment in the business together with sustainable dividend payments. Dividend payments are well covered by earnings at almost 2x in FY14 and is forecast to remain the case in FY15.

Continuing investment in new product R&D means that the group's earnings multiple over the next three years will remain high reflecting the significant potential for earnings growth to be generated in future years. Developing 'enhanced generic' drugs is expensive but offers the potential for greater returns over the long term.

GROWTH IN REVENUE AND EMPLOYMENT: Animalcare continues to perform well with its FY15 trading update showing a 5.1% rise in group revenues to £13.54m, driven by an 8.8% increase in Licensed Veterinary Medicines to £8.58m.

Animalcare reports its revenues and gross profit under three operating segments; Licensed Veterinary (61% of revenue), Animal Identification (19% of revenue) and Animal Welfare (20% of revenue). The group consistently generates an operating profit margin of c. 20% which is forecast to increase over the next three years as the benefits of investment in new product research and development are realised.

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Puma VCT 12

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Unicorn AIM VCT

VCT COMPARISON

VCT COMPARISON

		AUM (OCT 15)	CHARGES &FEES	VCT SECTOR	MIN. SUBSCRIPTION TOP UP	INVESTMENT STRATEGY	FUND MANAGER
ALBION VENTURES	VCTs PROSPECTUS TOP UP OFFERS	£270m	3% initial charge/Total running cost cap of 3% (including average annual management fee of 2.15%)	Generalist VCT	£6,000 Close Date: 30 Sept 2016	Conservative investment strategy - achieved by investing in a combination of more stable asset backed investments and higher-growth businesses	Albion Ventures LLP
Amati Global Investors	AMATI VCT	£37.9m	1% for applications via intermediaries (Discounted from 3%) 1.75% AMC No performance fees	AIM VCT	£3,000 (Or £2,500 per VCT if applying for both) Close Date: 30 March 2016 & 15 July 2016	The Amati VCTs have a broad mandate to make qualifying investments in companies quoted on AIM, and companies which are expected to float on AIM. The strategy is to focus on AIM companies which the manager believes can appeal to mainstream institutional investors on the basis of their profits and dividends within a two year time frame. This requires the companies to be well financed and scalable, to exhibit strong growth, and to have high barriers to entry with strong corporate governance. Both VCTs have a policy of paying dividends every year totalling 5-6% of year end NAV	Amati Global Investors Ltd
	AMATI VCT 2	£33.1m	1% for applications via intermediaries (Discounted from 3%) 1.75% AMC No performance fees	AIM VCT	£3,000 (Or £2,500 per VCT if applying for both) Close Date: 30 March 2016 & 15 July 2016	Amati VCT 2 has the same investment strategy as Amati VCT. Non-qualifying investments are made by both VCTs through the TB Amati UK Smaller Companies Fund, which is an award winning open-ended investment company investing in small and mid-sized companies listed in London. They may also invest directly in a small number of small and medium sized full list companies which can diversify risk and add to income generation	Amati Global Investors Ltd
BERINGEA	PROVEN VCT	£64.8 m	3% Initial Charge 2.% Annual management fee	Generalist VCT	£5,000. Close Date: 5 Apr 2016 & 31 May 2016	Providing Growth capital to dynamic UK businesses that we believe offer real potential for rapid expansion has always been at the heart of the ProVen VCT's investment strategy. This approach is also totally consistent with the central objective of the new VCT regulations introduced at the behest of the European Commission, which is that all VCT investments made under the new rules should be for the "Growth and Development" of the company receiving the investment	Beringea LLP
	PROVEN GROWTH & INCOME VCT	£73.6m	3% Initial Charge 2.% Annual management fee	Generalist VCT	£5,000. Close Date: 5 Apr 2016 & 31 May 2016	Providing Growth capital to dynamic UK businesses that we believe offer real potential for rapid expansion has always been at the heart of the ProVen VCT's investment strategy. This approach is also totally consistent with the central objective of the new VCT regulations introduced at the behest of the European Commission, which is that all VCT investments made under the new rules should be for the "Growth and Development" of the company receiving the investment	Beringea LLP
HARGREAVEHALE	HARGREAVE HALE AIM VCT1 & AIM VCT2	£65m across all Hargreave Hale VCTs	3.5% initial charge with 1% rebate for non-advisory applications. 1.5% AMC	AIM VCT	£5,000 split equally between the two VCTs	Sector Agnostic with specific focus on AIM (the funds do invest in some private companies)	Hargreave Hale - Giles Hargreave & Oliver Bedford and rest of HH Fund Management team
OCTOPUS INVESTMENTS	TITAN VCT	£215m	Initial fee: 3%* Ongoing annual charges: 2.3% (incl AMC, Admin and Accounting Charges)	Generalist VCT	£5,000	To fund investments in established and developing portfolio companies, as well as exciting new investments. Octopus Titan VCT features around 50 smaller companies with the potential to grow rapidly, operating in many different sectors. New investors will benefit from immediate exposure to existing portfolio companies. Octopus Titan VCT is targeting an annual regular dividend of at least 4p per share initially, increasing to 5p per share by the year ending October 2017. In addition, the VCT will aim to pay special dividends when there are significant gains from the realisation of portfolio holdings	Octopus Investments
	APOLLO VCT	£134.2m	Initial fee: 2.5%* Ongoing annual charges: 2.3% (incl AMC, Admin and Accounting Charges)	Generalist VCT	£5,000	Apollo targets lower volatility investments with the ability to deliver regular dividends of 5p per annum. Apollo aims to invest in VCT qualifying companies that have an established and successful management team, annual profits of at least £1m, a high level of repeat business and broad customer base, and a competitive advantage that reduces the risk of losing customers	Octopus Investments
	AIM VCT & AIM VCT2	£126m	Initial fee: 3%* Ongoing annual charges: 1.5%	AIM VCT	£5,000	To invest in high-quality established smaller companies listed on the Alternative Investment Market (AIM), targeting potential growth and regular tax-free dividends. Dividend target for AIM VCT: 5p or 5% per year whichever is greater. AIM VCT 2: 3.6p or 5% per year, whichever is greater. Both VCTs aim to pay dividends twice per year	Octopus Investments
mobeus EQUITY PARTNERS	MOBEUS INCOME & GROWTH VCTs			Generalist VCT	No offer for subscription currently	To ensure that the VCTs continues to qualify and are approved as a VCT by HMRC whilst maximising opportunities presented by the current favourable market conditions to steer new investment deals through to completion, to meet the aims of sustaining current investment levels and securing good returns to shareholders from both income and capital	Mobeus Equity Partners LLP
PUMA INVESTMENTS	PUMA VCT 12	New offer	Initial Fee: 3.00% AMC: 2.00% Annual Performance Fee: 20.00%	Generalist Limited Life VCT	£5,000 Closing date: 5 Apr 2016	Implementing a proven asset-backed investment strategy primarily investing in established businesses in the form of ordinary equity together with senior secured loans. Target average annual tax-free dividend of 5p per share commencing from April 2018 over the rest of the life of the investment. It is envisaged that after 5 years, the Directors will propose a special resolution for shareholders to vote on the process of winding-up the Company or similar means of distributing shareholders' capital and income	Puma Investments
unicorn ASSET MANAGEMENT	UNICORN AIM VCT	£112m	2% AMC	AIM VCT	No offer for subscription currently	The Company's objective is to provide Shareholders with an attractive return from a diversified portfolio of investments, predominantly in the shares of AIM quoted companies, by maintaining a steady flow of dividend distributions to Shareholders from the income as well as capital gains generated by the portfolio	Unicorn Asset Management, Chris Hutchinson

* Initial fees: a loyalty discount applies for existing investors and early bird discounts may also apply for new fundraises

CONCLUSIONS

FINAL CONCLUSIONS

The evidence that supports these conclusions is in the report itself, but we've summarised the findings here. There's a more detailed summary in the executive summary on page 10.

- Fundraising is strong and there's a good investment case for VCTs
- Lower pension limits mean that more advisers are considering VCTs
- Pension freedoms could have a similar impact as advisers use VCTs for tax-efficient decumulation
- The 2015 summer Budget means some providers will need to invest in earlier stage companies and / or change their risk profile
- The government supports the VCT scheme, along with the EIS and SEIS schemes
- Expect charges to be significantly higher than mainstream funds, usually with justification, but advisers must check if they represent value for money
- By addressing the funding gap VCTs support small and medium sized businesses which in turn create growth and new jobs
- There is a variety of options for VCT investment to suit a number of objectives and risk profiles, from high growth to income, capital preservation and Limited Life

We think that VCTs are set for an increase in business over the next few years. Perhaps the recent changes will hamper the efforts of some VCTs this fundraising season as they adjust to the new legislation announced in the 2015 summer Budget, but the changes in pension limits, continued low interest rate environment and ongoing economic recovery will see more advisers and investors considering VCTs.

Pension freedoms and the possibility of many more clients at retirement choosing some variety of decumulation and drawdown, rather than an immediate annuity purchase, also mean that VCTs will be in demand as tools to implement tax-efficient decumulation strategies. The lack of financing for SMEs means that there is a lot of deal flow for VCTs, and great value to be found investing in the sector. We think that there could be something of an 'illiquidity premium' over the next few years as patient investors make returns in areas like small and medium sized enterprises, and jumpy investors in mainstream markets are shaken out by regular bouts of volatility. Finally, tax-free income is always going to be attractive – where else can tax-free investment income be secured?

There are a handful of things the VCT industry is doing to take advantage of this favourable situation. Providers will get onto adviser platforms (Puma and Octopus have done so already), which will make the business process much easier for advisers, but may have questionable value for investors. The best VCT providers are also committed to managing their discounts and encouraging the development of a secondary market, both steps that address exit risk and will help encourage new investors into the market. Limited Life VCTs also help to address this issue.

On the negative side, charges remain high compared to mainstream options however, and though these are justified by the work that is involved investing in smaller companies, some of the performance fees might favour the managers at the expense of the investors. Providing more clarity on the fees and incentives might be the biggest step the industry could take to secure the confidence of a new generation of investors, but this has been a complaint about the industry for years – with little sign of progress.

Overall though the outlook is really positive. VCTs support a vital part of the British economy, helping to plug the funding gap and put capital to work in business that really need it, and can turn it into outputs that contribute to the real economy as well as increasing shareholder value.

"VCTs play an important role in financing our country's small companies as they seek to develop new and exciting technologies and products. Supporting these companies is an inherently risky business, something the government acknowledges through a series of generous tax reliefs" **Oliver Bedford, Hargreave Hale**

POLICY CHANGES TIME

1995

Venture Capital Trust scheme introduced to encourage individuals to invest indirectly in a range of unquoted smaller higher-risk trading companies.

04-05

6 April 2004, maximum qualifying for Income Tax relief increased from £100,000 to £200,000. Capital gains deferral relief not available at this time. The merger of VCTs without the loss of VCT tax reliefs became effective on 17 September 2004.

06-07

From **6 April 2006**, the maximum gross assets of qualifying holdings decreased from £15 million to £7 million before investment and from £16 million to £8m immediately after investment. The rate of Income Tax relief reduced to 30% from 40%. The 40% rate had been introduced for a two year period starting on 6 April 2004; prior to that Income Tax relief was given at 20%. The holding period for shares held by VCTs increased from three to five years.

07-08

From **6 April 2007**, VCT qualifying holdings are limited to companies with fewer than 50 full time equivalent employees at the time shares are issued. From 19 July 2007, companies must have raised no more than £2 million in any 12 month period under any or all of the tax-based Venture Capital Schemes.

09-10

Money raised should be wholly employed within two years of the issue of the relevant holding or, if the issue takes place before commencement of the intended trade, within two years of commencement.

11-12

The requirement that the trade be carried on wholly or mainly in the UK was removed, and replaced with a requirement that the issuing company have a permanent establishment in the UK. Restriction that prevented a VCT investing more than £1m per annum in any single company removed (unless the company is a member of a partnership or joint venture that carries on the qualifying trade).

12-13

From 6 April 2012, VCT qualifying holdings are extended to companies with fewer than 250 full time equivalent employees and gross assets of no more than £15 million before investment and £16 million after investment. The annual investment limit for companies is increased to £5 million, and that sum must take account of EIS and SEIS investment and any other investment received via any measure covered by the European Commission's Guidelines on State Aid to promote Risk Capital Investment in Small and Medium-sized Enterprises. For investments made by the VCT out of funds raised by it on or after 6 April 2012, an investee company using the funds to acquire shares in another company will not be regarded as using them for a qualifying purpose.

GLOSSARY

Alternative Investment Market (AIM)	The junior market of the London Stock Exchange (LSE) for smaller growing companies to list shares. Businesses include early stage, venture capital backed and more established companies seeking access to growth capital.
AIM VCTs	New shares of companies that are traded on the Alternative Investment Market (AIM).
Buybacks	The repurchase of outstanding shares by a company to reduce the number of shares on the market.
Closed-Ended Funds	An investment company that issues a fixed number of shares in an initial public offering and invests the proceeds in securities such as common stocks, bonds, etc.
Collective Investment	Consists on combining the assets of several individuals and organisations to create a larger and well diversified portfolio.
Corporate Governance	The set of standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders (FRC, 2015), by which companies are directed and controlled.
Discount	Indicate an asset's price is trading below their net asset value. Showing that the share price is lower than the net asset value (NAV) price.
Enterprise Investment Scheme (EIS)	Government supported initiative designed to help smaller higher-risk trading companies raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.
European State Aid	Defined as an advantage of any type conferred by public authorities through state resources to any organisation that could potentially distort competition in the European Union.
Feed-in-Tariff (FiT)	FITs are payments energy suppliers pay if you generate electricity of your own.
Investment trust	Public listed company designed to generate profits for its shareholders by investing in the shares of other companies.
Limited Life VCTs	Type of VCT that looks to repay the capital back to investors after the minimum 5 year holding period.
Management Buy-Outs (MBOs)	Type of acquisition where a management team purchases the assets and operations of the business they manage.
OEICS	Open Ended Investment Companies are funds where investors' money is pooled with that of other investors in order to be spread across a wider range of investments to spread the risk.
Premium	Indicate an asset's price is trading above their net asset value. Showing the share price is above the net asset value (NAV) price.
P60 Form	Form given to all employees on payroll that summarizes their total pay and deductions for the year.
Renewable Obligation Certificate (ROC)	The main mechanism to support renewable electricity projects in the UK. ROCs are "green" certificates issued to accredited operators of renewable energy stations.
SA101	The self-assessment tax return form usually used by self-employed to inform HMRC about trading losses and business receipts which are to be taxed as income from an earlier year.
Seed EIS (SEIS)	Aims to help small, early-stage companies raise finance by offering tax reliefs to individual investors who purchase new shares in those companies. It complements the EIS and focuses on very early stage companies, offering tax relief at a higher rate than EIS.
Specialist VCTs	Type of VCTs that invest in companies focused in specific sectors.
Venture Capital Trusts (VCT)	Started on 6 April 1995 and is designed to encourage individuals to invest indirectly in smaller higher-risk trading companies whose shares are not listed on a recognised stock exchange or listed on AIM. VCTs are traded on a regulated market and tax reliefs are available to investors.

CPD AND FEEDBACK

CONTINUING PROFESSIONAL DEVELOPMENT (CPD)

Intelligent Partnership has achieved accredited status for AiR from the IFP, CII and PFS.

Members of these professional organisations represent the majority of the insurance and financial services industry.

Readers of the industry report can claim one CPD hour towards their IFP, CII or PFS member CPD scheme for each hour spent on the report, the CPD hours claimed should reflect the length of time spent studying the material.

The review process included an assessment of the technical accuracy and quality of the material against CPD Accreditation standards. Achieving the recognised industry standard afforded by these organisations for this report, and our training, demonstrates our commitment to delivering only balanced, informative and high quality content to the financial services and investment community.

In order to obtain CPD and meet accreditation standards, readers must complete a short questionnaire and provide feedback on the report. This includes twelve multiple choice questions to demonstrate learning and a feedback form to assist in the compilation and improvement of future reports.

To claim CPD please visit:

Intelligent-partnership.com/cpd

FEEDBACK

Intelligent Partnership actively welcomes feedback, thoughts and comments to help shape the development of this industry report, with a particular interest on the topics readers would like to be covered in more detail in interim and future annual reports.

This report is produced on an annual basis and is compiled through the conducting of research and surveys with providers, promoters and practitioners within the alternative investment industry. Greater participation, transparency and fuller disclosure from industry participants should help foster best practice and drive out poor practice.

Feedback can be given on the website or via email:

Intelligent-partnership.com/feedback

Reports@intelligent-partnership.com

Participation and feedback are gratefully received.

ENDORSED CPD PROVIDER

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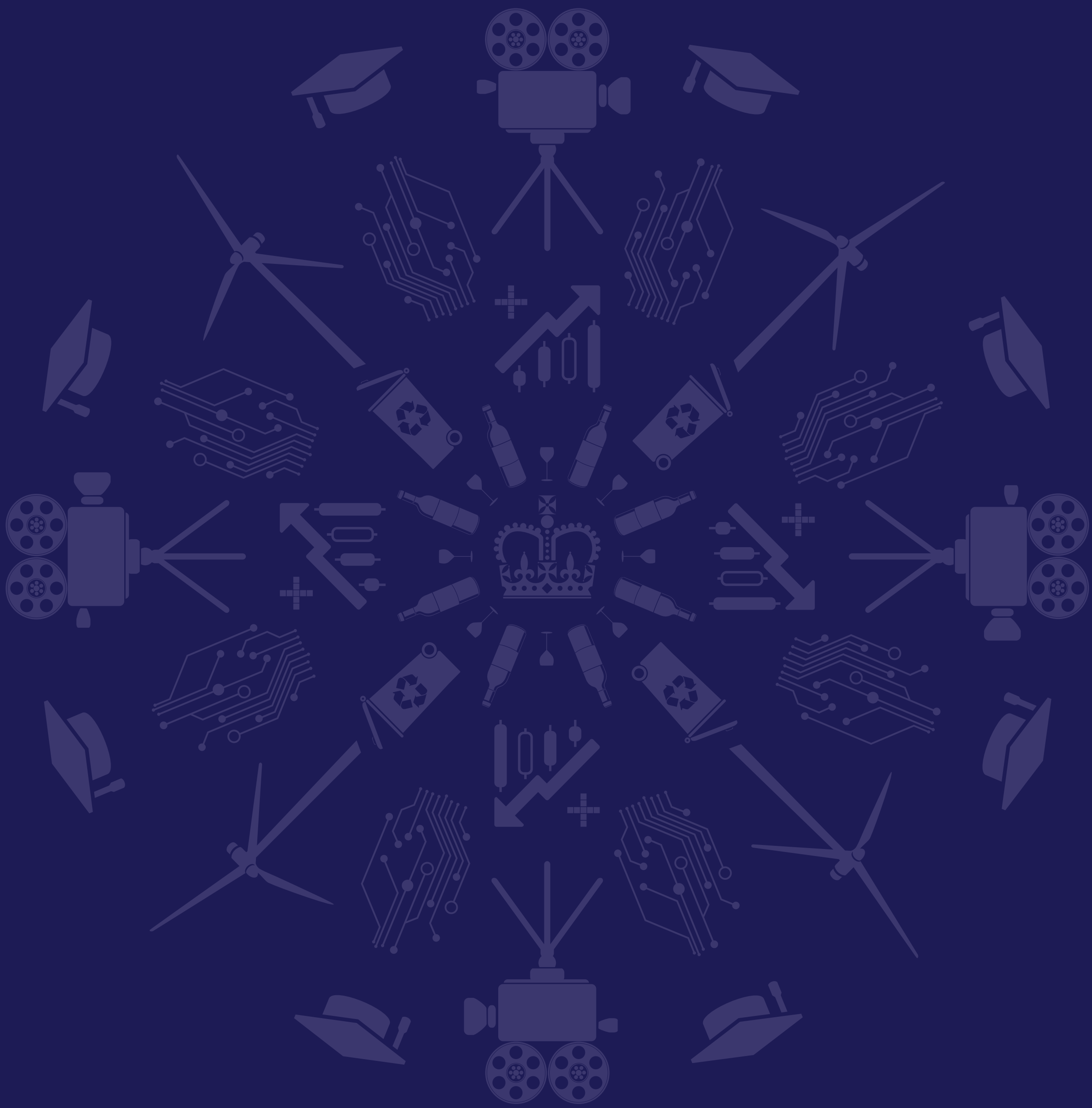
PUBLICATION

The information has been compiled from credible sources believed to be reliable, however it has not been verified and its accuracy and completeness are not guaranteed.

The opinions expressed are those of Intelligent Partnership at the date of publication and are subject to change without notice.

"With lower limits on the amounts that can be invested in pensions, changes to the rules on how dividends are taxed and consumers demanding more from their advisers, VCTs could be an important tool in advisers' kit bags"



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