Smith & Williamson

Downing Planned Exit VCT 2 & 3 – New Share Issue

Venture Capital Trust Review

29 December 2009

Introduction

Rating: n n n n

- This is a new share issue to the existing Downing Planned Exit VCT 2 & 3 (Downing has recently re-named all their range of 'Protected VCT's' as 'Planned Exit'). They are seeking £20m split between the two VCTs. The aim is to provide an annual dividend of 5p per new share per annum with all proceeds having been distributed to shareholders within six years.
- Investments will be sought in UK trading companies with substantial assets including pubs, children's nurseries and health clubs. Investments will also be sought in companies with predictable revenue streams which will ideally have contracts pending or in place. The VCT will generally seek to take a charge over the investee company's assets.
- The non-qualifying element will be invested in secured loans and/or fixed income securities.

Track Record

Rating: n n n n

- The Downing Protected VCT 1 is Downing's only 'evergreen' VCT thus far and has returned a total of 139.6p to date. They are launching a new evergreen fund for the 2009/10 tax year.
- VCTs 2 & 3 were launched in 2005 and have largely completed the return of proceeds to shareholders. To date a total of 89p has been returned for each VCT, with a residual value of 1.2p per share. This was achieved after approximately four years against a six year target of £1.
- VCTs 4 & 5 were launched in 2006 and have a NAV of 89.6p and 89.7p at 31 August 2009 and have each issued dividends of 6p. Capital is due to be returned to shareholders from December 2009.
- VCTs 6 & 7 were launched in 2007 and have a NAV of 87.3p at 1 August 2009 and have issued dividends of 3.75p.
- VCTs 8 & 9 were launched in 2008 and at this very early stage had a NAV of 88.8p on 30 June 2009, having paid a first dividend of 2.5p.
- The new offer includes an intention to pay 5p annual dividends to shareholders. This will of course be subject to there being sufficient liquidity or the realisation of underlying investments.
- As with previous offerings Downing intend to operate a share buyback policy at a discount of 10% to NAV.

Management Group

Rating: n n n n

- Downing was set-up in 1986 by Nick Lewis. Colin Corbally is the lead fund manager for the Protected VCTs (c£130m in total). Downing has a reputation for raising finance for tax efficient investments and has raised over £400m for VCTs, although it is only the Downing VCTs that they manage directly.
- There has clearly been a long-term commitment from Downing to the VCT market and their reputation within it is extremely important to them.
- Deal flow is likely to come from the contacts and exertions of the managers, who have operated in this area for some time.
- There will be co-investment opportunities via the previous VCT offerings.

People

Rating: n n n n

- There is an investment team of 10 which is experienced and has worked together for a number of years.
- The board of directors and management team (including spouses) will invest £85,000 into these VCTs taking their total investment in the Downing Protected VCTs to over £1.7m.

Costs

Rating: n n n n

- The AMC is 1.35%, which is low compared to its peers.
- The TER is capped at 2.9%, which is very competitive.
- The hurdles for the performance incentive fee are that shareholders must have received distributions equal to 100p (excluding tax relief) and the VCT returns must exceed 7% per annum compound.

Exit Strategy

Rating: n n n n

- This VCT is designed to return all of its assets to shareholders and a resolution to wind up each company will be put to shareholders, after approximately six years from the close of the Offers.
- This will be done through share buy-backs and tender offers as and when investments are realised. Investors are effectively being asked to trade most of their upside potential for the security of the asset backing and other risk reduction techniques. It is therefore likely to appeal to those interested in the current VCT tax regime who would like their capital returned to them in the medium term.
- The clear exit strategy and timescale will also appeal to investors.

Disclaimer

This note does not constitute a personal recommendation to invest and may not be suitable for everyone. Reasonable care has been taken in the compilation of this review but its accuracy is not guaranteed and all facts stated should be independently checked. No investment decision should be based on this note. Investors should review the prospectus for a VCT carefully and take appropriate financial advice from a person authorised and regulated by the Financial Services Authority to give such advice before investing. Bases and rates of tax relief are subject to future change. As such, their value depends on individual circumstances. VCT shares must be held for a minimum of 5 years to attract tax reliefs. VCTs should be seen as high risk and only suitable for individuals who can endure losses and take a long term perspective, as their value can fall as well as rise and an investor may lose all of his investment. The market in VCT shares is illiquid and it may be difficult or impossible to sell shares. Past performance should not be seen as an indication of future performance.

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