

Smith & Williamson

Downing Structured Opportunities VCT 1

Venture Capital Trust Review

29 December 2009

Introduction

Rating: **n n n n**

- | This is a new share offer to Downing's existing Limited Life VCT which launched last year under the name 'Protected Opportunities'. It has subsequently been renamed Structured Opportunities and is seeking to raise £20m.
- | The VCT will initially invest up to 90% of the Company's funds in Structured Products; with a progressive switch over a three year period to ensure in excess of 70% of assets are held within qualifying investments.
- | The Structured Product portfolio will be managed by Brewin Dolphin who will look to make 7-25 institutional Structured Product investments. Counterparty risk will be monitored on an ongoing basis and limited to 20% exposure to any one counterparty. Examples of currently acceptable counterparties would be UK Government (Gilts); Citigroup; Morgan Stanley; Barclays Bank; HSBC Bank and Nationwide Building Society.
- | Investments will be sought in UK trading companies with substantial assets such as children's nurseries, health clubs and pubs. Investments will also be sought in companies with predictable revenue streams which ideally will have contracts pending or in place. The VCT will generally seek to take a charge over the investee company's assets.

Track Record

Rating: **n n n n**

- | The Downing Protected VCT 1 is Downing's only 'evergreen' VCT to date 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 shareholder 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

Track Record

Rating: **n n n n**

- | VCTs 8 & 9 were launched in 2008 and at this very early stage had a NAV of 88.8p on 30 June 2009, and having paid a first dividend of 2.5p.
- | The original share class of the Protected Opportunities VCT was launched last year and raised £10.5m. At this very early stage it has a NAV of 100.4p and has paid a dividend of 2.5p
- | The offer includes an intention to pay 5p annual dividends to shareholders. This will of course be subject to 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 have a reputation for raising finance for tax efficient investments and have 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.
- | The company has a co-investment agreement with all of Downing's 1-9 VCT, together with their IHT and EIS funds.

People

Rating: **n n n n**

- | There is an investment team of 10, which has been expanded from last year with the addition of Michael Hughes, following 7 years at Close Investments Limited, and Judith MacKenzie, who was previously a partner at Acuity Capital Management LLP with responsibility for AIM quoted VCT and IHT investments.
- | The core team is experienced and they have worked together for a number of years. The Directors and the Management Team (including spouses) will be investing at least £140,000 under the Offer on the same terms as Investors. This will bring the total commitment by the Management Team in the Downing Structured Opportunities VCT to approximately £1.7million.

Costs

Rating: n n n n

- | The AMC is 1.5%, inclusive of VAT.
- | £65,000 per annum plus VAT, which is RPI linked, for administration services.
- | The TER is capped at 3.5%.
- | 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. The maximum performance incentive is limited to 1.25% of Net Assets per annum.

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 organised 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 planned exit strategy at NAV 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.

**Tax Efficient Solutions is a division of
Smith & Williamson Investment Management Limited
which is authorised and regulated by Financial Services Authority.**