VCT RESEARCH REPORT

DOWNING THREE VCT

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Limited Life

Limited Life VCTs often invest in one sector and are normally designed to be lower risk and lower return than other VCTs.

This report is not a substitute for reading the prospectus, and any decision to invest must be made purely on the basis of the prospectus.

Risk factors
VCTs are substantially higher risk than mainstream equities. They invest in smaller companies, which can be prone to failure. VCT shares are difficult to buy and sell – the market price may not reflect the value of the underlying investments.

The value of the shares will fluctuate, income is not guaranteed and investors could lose money. Tax and VCT rules can change and tax benefits depend on individual circumstances. If a VCT loses its qualifying status investors may have to repay any tax rebate. The prospectus will give fuller details of the risks.

Their place in a portfolio
VCTs must be held for five years in order to retain the tax relief, but a ten-year view would be better as dividends are the primary source of returns as the VCT portfolio matures.

VCTs are sophisticated, long-term investments only suitable for inclusion in significant portfolios. The general view is that they should account for no more than 10% of an equity portfolio. It is difficult to access the capital invested in the short term, and anyone considering an investment should ensure they are comfortable with this, and all other risks. We assume investors will make their own assessment of their expertise and the suitability of a VCT for their circumstances. Those with any doubts should seek expert advice.

OFFER SUMMARY

Funds	Downing THREE VCT 'J' Share Issue
Amount seeking	£25 million
Minimum investment	£5,000

OUR VIEW

Downing has managed this type of VCT for a number of years this offer will follow a similar strategy, although there are no guarantees past performance can be repeated. After approximately six years the aim will be to sell the underlying investments in the VCT and return the proceeds to investor as tax-free cash.

We tend to prefer 'evergreen' VCTs, which have no fixed life, and top-up offers into existing portfolios, where investors gain exposure to more mature investments that could be close to sale, as well as exciting new investments. We believe top-ups into mature and established portfolios tend to result in earlier dividends, the main source of returns from VCTs.

WHAT IS A LIMITED LIFE VCT?

Limited life VCTs, as the name suggests, have a fixed life. As this life nears an end the manager will start selling the investments and distributing the proceeds to shareholders as tax-free dividends. The manager generally aims to shelter capital and pay modest dividends through the life of the investment and these VCTs are designed to be lower risk and lower return than other VCTs. This does not mean there are no risks – neither dividends nor the value of capital is guaranteed. The bulk of any return from this type of investment is likely to come from the tax relief, for which the shares must be held for five years.

PHILOSOPHY

First and foremost Downing seeks talented entrepreneurs and management teams with a track record of running successful businesses. In keeping with their relatively conservative approach they focus on businesses with substantial tangible assets (usually property). Deals are then generally structured with a high proportion of loan stock, which pays the VCT a regular income. The loan is also usually secured against assets of the company which can be sold to recover some losses for the VCT should the company fail.

PORTFOLIO CONSTRUCTION

There will be an emphasis on unquoted companies that trade from freehold premises, such as pubs, health clubs and children's nurseries. Companies in the leisure, real estate and healthcare sectors tend to lend themselves to this type of VCT as investments can be secured against the property they own. As well as looking for strong management teams and significant assets the team also looks for businesses with stable revenues or cash flows and a scalable business model.

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Hargreaves Lansdown is offering a discount of 2.25% off the initial charge.

In contrast, early stage and start-up companies will be avoided as will more speculative companies where there are no tangible assets or there is no evidence of a business model capable of sustainable growth.

Prior to qualifying investments being made, and in the non-qualifying portion of the portfolio, funds will be predominantly invested in secured loans and fixed-income securities. If only a small amount of money is raised in the offer it might result in a more concentrated portfolio, thereby increasing risk and costs.

COMPANY CASE STUDY

This share class will be managed using a similar approach other Downing THREE VCT share classes. Examples of previous investments made by the team include Kidspace, which operates award-winning and profitable indoor activity playgrounds. They have a reputation for providing market leading modern play facilities and they have further sites planned.

PERFORMANCE & DIVIDENDS

There is no annual dividend target for the 'J' shares. The main aim is to sell the investments in the VCT approximately six years after it has launched and return the proceeds to 'J' shareholders as tax-free cash. The VCT is targeting a return of 110p for every 100p invested, including the initial tax relief. There are no guarantees the target return can be met or that the VCT will wind up and distribute the proceeds within the planned time frame.

ABOUT THE MANAGER

Downing has specialised in tax-efficient investments for over 25 years. The primary focus has been on investments in businesses that trade from freehold premises (where in the event of poor trading there will usually be value in the property); AIM-listed companies; and more recently renewable energy businesses benefiting from government subsidies (whose performance can be forecast with a certain level of accuracy).

Downing has a 10-strong team that focuses on unearthing new unquoted investment opportunities. Members of this team are responsible for meeting management and conducting due diligence. A 13-strong portfolio team is responsible for monitoring investments on an on-going basis.

As well as looking for strong management teams and significant assets the team also looks for businesses with stable revenues or cash flows and a scalable business model. They generally avoid companies with existing bank debt that would rank ahead of the VCT if the company were to fail. Downing often backs successful entrepreneurs more than once and the relationships they have built over the years have contributed to deal flow remaining strong recently.

CHARGES & FEES

The initial charge is 4%. Hargreaves Lansdown is offering a discount of 2.25% off the initial charge. In addition, for applications accepted before 6 March 2015 there is a further discount of 1%. The following net initial charges therefore apply (please note discounts are paid in the form of additional shares):-

	Net initial charge
Applications accepted before 06 March	0.75%
Applications accepted after 06 March	1.75%

The annual management charge is 2%. There are also other expenses and a performance fee, full details of which can be found in the prospectus. Investors should ensure they are comfortable with the charging structure and risks before investing.

SHARE BUY BACK POLICY

The Company intends to buy back 'J' Shares in the first five years from launch (to 31 December 2019), at nil discount to Net Asset Value, subject to regulations and having sufficient liquidity. From 1 January 2020 onwards the Board will reserve the right as to whether it will undertake any 'J' Share buybacks and the level of discount to Net Asset Value at they are undertaken should any take place. See the prospectus for further details.

HOW TO APPLY

To apply please read the prospectus for the offer and fill out the application form at the back. The prospectus is available to download from the HL website or by calling **0117 900 9000**.

The signed application and a cheque for the amount to be subscribed should be returned to Hargreaves Lansdown. The cheque should be made payable to the VCT, as indicated in the prospectus, but the application and cheque must be returned to Hargreaves Lansdown in order to benefit from our discount.

We will acknowledge applications and share certificates and tax certificates will be sent once the shares have been allotted. Shares are allotted periodically and allotment could take a number of months following the acceptance of an application. Shares will be issued according to the most recently announced NAV per share of the VCTs, adjusted for the costs of the offer.

Dividends can be paid by cheque or into a bank account. Please see the relevant section of the prospectus and application form for further details.