Amati VCTs top up

VCT RESEARCH REPORT

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This report is designed for sophisticated investors who want more detailed VCT research. It therefore assumes a high level of knowledge and understanding, and for this reason it uses technical terms and expects readers to fully appreciate the particular risks of VCTs. It is not a substitute for reading the prospectus, and any decision to invest should be made purely on the basis of the prospectus.

VCTs
Their risks and place in a portfolio
Risk factors - The value of your VCT will fall as well as rise. Some smaller companies that the VCT invests in could struggle or fail altogether, so you might not get back the full amount invested. VCTs are exposed to substantially higher risks than mainstream equities. The share price is unlikely to reflect the full value of the underlying assets and the manager could find the underlying investments difficult to sell. There might only be one market maker for the shares meaning investors might have difficulty selling at a reasonable price or in extreme circumstances any price. VCTs tend to have higher charges than other types of fund. Tax and VCT rules are subject to change and tax benefits will depend on your 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 of the VCT as a whole.

Their place in a portfolio - VCTs are only suitable for sophisticated investors with significant investment portfolios who can afford to take a long-term view and are comfortable with higher risks. The FCA suggest a sophisticated investor is somebody with an annual income in excess of £100,000 or investable assets of more than £250,000. VCTs are unlikely to be suitable for mainstream investors who may need access to their money in the short term, or for whom loss of the investment may cause financial hardship. However, as we are not offering advice Hargreaves Lansdown allows you to make your own assessment of your expertise and the suitability of a VCT for your circumstances. If you have any doubts you should seek expert advice. If you choose to invest in a VCT through us you will be accepting full responsibility for the appropriateness of a VCT for your situation and portfolio. We feel VCTs should account for no more than 5% to 10% of an equity portfolio and must be held for a minimum of five years in order to retain the income tax relief. A ten-year view would be better as dividends are the primary source of returns as the VCT portfolio matures.

Aim

AIM VCTs primarily invest in companies that are listed or are about to list on the Alternative Investment Market.

IN BRIEF
Amati is headed by the experienced smaller company specialist, Dr Paul Jourdan. The AIM market as a whole has been a poor place to invest and AIM VCTs as a whole have struggled to deliver, although performance has improved recently. Yet with the right fund manager there are opportunities in entrepreneurial companies listed there. These VCTs have wide ranging, mature portfolios including some international exposure, so whilst sentiment towards the AIM market will undoubtedly play a role in dictating returns, we believe the manager is highly capable and this is a VCT offer to consider.

PHILOSOPHY
Paul Jourdan believes his portfolio should be like a fine musical instrument: made of the best available materials and built to last. In constructing it he seeks out well-managed, growing businesses with high barriers to entry. The portfolio is diverse and he uses the non-qualifying part of the fund for exposure to themes difficult to access within the remit of the VCT rules, such as emerging markets and natural resources. He also makes use of convertible bonds to help mitigate risk and provide the fund with income.

PORTFOLIO CONSTRUCTION
This offer comprises top ups to Amati VCT and Amati VCT 2, both large VCTs with around £37m and £34m respectively in assets prior to the fundraising. In the offer investors can choose which they invest in. Although they are managed in the same way, and have the same investment objectives, there are some differences in the current portfolios, largely as a result of VCT 2 retaining some legacy holdings from previous management.

Amati VCTs top up

Although around 60 companies are represented in each VCT, they are relatively concentrated portfolios with the top 20 companies representing around 60% of NAV for each VCT. This concentration increases risk. As you would expect there is considerable overlap between the two VCTs in terms of the investments included. The largest sectors are industrials, healthcare and technology and there is an international flavour to the portfolios with around half of exposure (in terms of the underlying sales of investee companies and production in the case of commodity producing companies) from outside the UK.

Whilst most investments are purely equity, unlike most AIM VCTs the managers also make use of convertible bonds, which provide regular income for the VCT and help control risk. Although convertibles retain an equity upside due to their right of conversion, they tend to be less volatile than ordinary shares.

Amati VCT has over 20% in convertible bonds whereas Amati VCT 2 has around 7%. Amati VCT 2 does have more invested in established smaller companies over £50m in value, which may be less risky than the higher growth companies also held. Derivatives may also be held with the aim of reducing volatility.

Generally the funds will be fully invested and hold little cash, though proceeds from this top-up issue are to be gradually deployed. Overall, the level of risk is broadly similar to a small or micro-cap unit trust or OEIC, though with the restriction of the VCT rules the manager's universe is smaller for the qualifying part of the portfolio.

INVESTMENT UNIVERSE

The universe of companies the Amati team cover are typically between £15m and £2bn in size and includes fully listed companies, which can be used in the non-qualifying element of the portfolio. Frequently these are companies also held or being bought by TB Amati UK Smaller Companies Fund, an OEIC fund run by the same team. AIM is a relatively small market though the potential advantage over a VCT investing in unquoted businesses is valuation transparency as holdings have a market price that can change daily.

When analysing a company the managers look for a number of attributes including high barriers to entry, a sustainable competitive advantage, revenue visibility and growth, pricing power, balance sheet adequacy and the ability to finance growth. They also look for an incentivised management team with a good track record.

TARGET PERFORMANCE

For both VCTs dividends of 5-6% of NAV per annum are targeted, though this is not guaranteed and given the nature of the investments the actual level of dividends is likely to be variable.

RESEARCH / DEALFLOW

Paul Jourdan and his team are highly experienced and carry out detailed proprietary research into each company as well as analysing the relevant industry. They currently feel investor caution means that only the best AIM deals receive investor funding, so although deal flow is reducing, quality is increasing, both in terms of initial public offerings and secondary fundraisings.

MANAGER / TRACK RECORD

Amati is a small boutique fund manager with £83m under management, £71m of which is in the two Amati VCTs. It was created as a result of a buyout of Noble Fund Managers in 2010 by Paul Jourdan and Douglas Lawson and they remain the principal fund managers of these VCTs. Paul Jourdan joined Noble fund managers as head of equities in 2007 having previously worked at First State and Stewart Ivory, which he joined in 1998. In 2000 he became manager of what is now the CF Amati UK Smaller Companies Fund (an OEIC) and launched this VCT (then called First State AIM VCT) in 2005. Douglas Lawson qualified as an accountant from Ernst & Young in 2002 and subsequently spent 6 years in corporate finance and private equity before joining Paul Jourdan in running the CF Amati UK Smaller Companies Fund and Amati VCT in 2009. David Stevenson joined the team in February 2012 from Cartesian Capital where he managed UK equity funds. Prior to co-founding Cartesian he managed the SVM UK Opportunities Fund.

Amati VCT has paid out 38.3p in dividends since launch in 2005 and net asset value is now around 78 pence based on 100p share price at launch; not a stellar return but it represents a significant outperformance of the AIM Total Return index, which fell over 17% over that period – though past performance is no indication of future returns.

Amati VCT 2 was formerly known as ViCTory VCT, an amalgamation of three Singer and Friedlander VCTs. Amati was appointed manager in March 2010 and in November 2011 Invesco Perpetual AIM VCT was merged into it. It therefore has a far shorter history, though since the current manager took over in March 2010 the NAV rose by 46% to 31st December 2013 versus 23.3% for the AIM total return index. Please remember past performance is no guide to the future.

It is also worth noting the performance of the TB Amati UK Smaller Companies Fund, which, according to our research, has displayed a high level of positive stock selection, though it should be borne in mind this is a more growth-orientated fund than the VCTs.

SHARE BUY BACK POLICY

The VCTs have an active share buy back facility and tend to buy back shares at around a 5% discount to NAV.

CO-INVESTMENT POLICY / STAFF COMMITMENT

Being an AIM VCT it is likely other venture capitalists will also be owners of a number of the investments.

The staff of Amati Global Investors have invested £1.3 million in the VCTs in the past, and intend to subscribe for further shares in the current offers.

CHARGING STRUCTURE AND TERMS

This top up is for up to £3.5m in both Amati VCT and Amati VCT 2. Shares will be issued according to NAV plus the costs of the offer of 2%. The minimum investment is £3000 per tax year per VCT or £5000 (£2500 in each VCT) if applying for both Amati VCT and Amati VCT 2. In each case the annual management charge is 1.75% with overall annual expenses capped at 3.5%. Encouragingly, Amati has taken the decision to waive all future performance fees on both VCTs. Please see the prospectus for full details of the charges for each VCT.

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