VCT RESEARCH REPORT

DOWNING ONE VCT

www.hl.co.uk
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HEAD OF INVESTMENT ANALYSIS

Generalist

Generalist VCTs primarily invest in unquoted companies in a wide variety of sectors and stages of development.

This VCT is diversified across a variety of sectors and types of company, with the aim of providing a stable income and some capital growth.

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 you could get back less than you invest. Tax and VCT rules can change and tax benefits 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.

Their place in a portfolio
We feel VCTs should account for no more than 10% of an equity portfolio. They 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 only suitable for sophisticated long-term investors with significant portfolios. They are unlikely to be suitable for investors who may need access to their money in the short term, or for whom loss of the investment will cause hardship. We assume you will 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.

OFFER SUMMARY

Fund	Downing ONE VCT
Amount seeking	£15 million
Minimum investment	£5,000

OUR VIEW

This VCT combines Downing's approach of focusing on unquoted businesses with significant tangible assets (usually freehold property); renewable energy projects; and AIM-listed companies. It could appeal to an investor looking for a 'one-stop shop' – a VCT that is well-diversified across a variety of sectors and types of company, with the aim of providing a stable income and some capital growth.

Downing ONE was created in November 2013 when Downing merged six VCTs. The merged VCTs previously had exposure to a number of other VCTs which Downing had taken over from other managers, some of which had performed poorly and needed turning around. The Downing team believes they have made good progress selling and reducing exposure to poor performing investments. They are confident the Downing ONE portfolio consists of investments with good prospects which will deliver the target returns, although there are no guarantees.

We are encouraged by the progress made so far, but would like to see a longer track record of strong performance from Downing ONE before becoming more positive.

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Downing places an emphasis on finding talented entrepreneurs and management teams with a track record of running successful businesses.

PHILOSOPHY

This VCT is managed using a hybrid approach, aiming to generate a stable income from asset-backed investments and renewable energy projects; and capital growth from investments in AIM-listed companies. Regardless of the type of company Downing places an emphasis on finding talented entrepreneurs and management teams with a track record of running successful businesses.

CHANGES TO VCT LEGISLATION

Investors should be aware that a number of changes to the rules governing VCTs have recently been made. The new rules in effect impose stricter limits on the investments which may be made by VCTs. As with any legislation the full details are complex. The most significant changes include VCTs no longer being able to invest in companies more than 7 years old; the prohibition of certain types of transaction; and VCTs cannot invest more than £12 million in any one company.

The amended rules will affect different VCTs to different extents, depending on the manager's approach. Downing are affected to a lesser extent than many other VCT managers as they have not historically engaged in the transactions that are now prohibited. However, their investment universe will be reduced and new investments might be made in younger companies, which are higher risk. Further details of the legislative changes can be found in the prospectus for the offer and on the VCT section of our website: www.hl.co.uk/vct

WHAT ARE GENERALIST VCTs

Generalist VCT's are relatively broad-based, usually investing in a range of unquoted companies across a wide variety of sectors. Some target companies which are already established and profitable, while others have a bias towards very small businesses at an early stage of their development. Most aim to provide steady dividends to investors with the potential for higher payments if and when they sell successful investments. They also aim to maintain or steadily grow capital over the long term.

Investors should ensure they are comfortable with an individual VCTs approach before investing. We believe building a portfolio of different VCTs is sensible as the diversification reduces risk. Starting by selecting those focusing on more mature, established companies; and then adding higher risk VCTs targeting early-stage companies to an already diverse portfolio could be wise. While you must hold the VCT for five years to benefit from the tax relief, we believe 10 years plus is a more realistic time horizon.

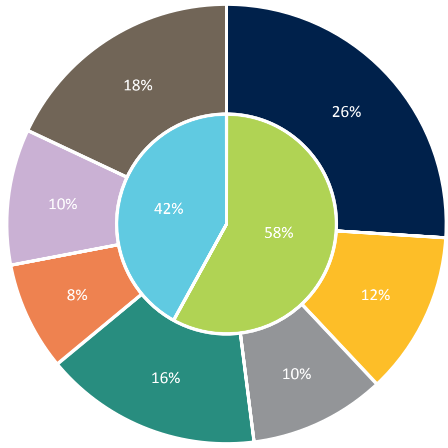
PORTFOLIO CONSTRUCTION

Income-generating investments will tend to account for between 50% and 75% of the portfolio. The majority will be unquoted investments with an emphasis on asset-backed deals. This will include companies trading from freehold premises, such as pubs, health clubs and children's nurseries. Companies in the leisure, real estate and healthcare sectors lend themselves to this type of VCT as investments can be secured against the property they own.

Growth-focused investments will tend to account for 25% to 50% of the qualifying portfolio. These will predominantly be AIM-listed companies, but also some higher risk unquoted companies where the team believe there are good prospects for capital growth.

The chart to the right shows the breakdown of the investment portfolio by category and sector, as at 30 September 2015:-

Investment portfolio breakdown



Source: Downing LLP as at 30 September 2015

COMPANY CASE STUDIES

Kidspace Adventure Holdings: an owner and operator of children's play centres. Downing invested £1.5 million in 2011 to fund the acquisition and development of the company's third site. The main attractions of the investment included:-

- A strong and proven management team
- A high-quality product with growing demand
- A business that is established and profitable

Since opening the third site, near Epsom, it has performed beyond expectations and currently attracts around 350,000 visitors a year. The Kidspace team is in the process of finding new sites to develop in conjunction with Downing.

Sprue Aegis: an AIM-listed company which designs, sells and markets smoke and carbon monoxide detectors. The following attributes attracted Downing to the company:-

- Dominant market position in the UK and products that are endorsed throughout Europe
- Significant investment in new technology, products and brands is benefiting the company

PERFORMANCE & DIVIDENDS

There is a dividend target of 4% a year based on the NAV. Dividends are expected to be paid twice each year in February and August. Since the launch of this VCT in November 2013 dividends totalling 9p per share have been paid. The next dividend of 3p per share will be paid on 26 February 2016 to shareholders on the register at 5 February 2016. Over the long term the team also hopes to generate some capital growth. There are no guarantees target returns can be met.

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, including a dedicated renewable energy specialist. 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. A team of three individuals is responsible for analysing and selecting investments for the AIM portfolio. Downing estimates there will typically be between 20 and 25 AIM-listed holdings and upwards of 70 unquoted holdings in the portfolio.

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. 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. They also 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 AND FEES

The initial charge is 4%. Hargreaves Lansdown is able to offer a discount of 2.25% off the initial charge. In addition, for applications accepted before 29 January 2016 there is a further discount of 1%, which reduces to 0.5% for applications accepted before 26 February 2016. The following net initial charges therefore apply (please note discounts are paid in the form of additional shares):-

	Net initial charge
Applications accepted before 29 January	0.75%
Applications accepted before 26 February	1.25%
Applications accepted after 26 February	1.75%

The annual management charge is 1.8%. There are also other fees and expenses. Unusually for a VCT there is no performance-related fee which we view as positive. Full details of the charges and fees can be found in the prospectus. Investors should ensure they are comfortable with the charging structure and risks before investing.

SHARE BUY BACK POLICY

Downing will aim to maintain a maximum discount to NAV of 5% although share buybacks are at the discretion of the Board and there are no guarantees the target can be met.

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 Hargreaves Lansdown website or by calling 0117 900 9000.

The signed application and a cheque for the amount you wish to subscribe 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 for you to benefit from our discount.

We will acknowledge your application and your share certificate and tax certificate 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 your application. Shares will be issued according to the most recently announced NAV per share of the VCTs, adjusted for the costs of the offer.

You can elect for dividends to paid into your bank account, otherwise they will be paid by cheque. There is also a dividend reinvestment scheme. Please see the relevant section of the prospectus and application form for further details.