VCT RESEARCH REPORT

DOWNING TWO VCT

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Limited Life
Limited life VCTs have a fixed life and typically aim to wind up after 5-6 years.

First and foremost Downing seeks talented entrepreneurs and management teams with a track record of running successful businesses.

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.

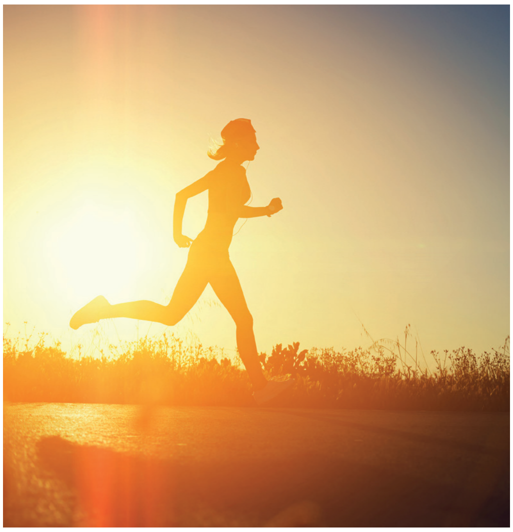
Risk factors
VCTs are substantially higher risk than mainstream equities. They invest in smaller companies, which can be prone to failure.

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 TWO VCT 'K' Share Issue
Amount seeking	£15 million
Minimum investment	£5,000



OUR VIEW

Downing has managed this type of VCT for a number of years and 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.

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 using some 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.

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WHAT IS A LIMITED LIFE VCT

Limited life VCTs, as the name suggests, have a fixed life. Five to six years after launch 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 your capital is guaranteed. The bulk of any return from this type of investment is likely to come from the tax relief. Limited life VCTs tend to be considered by more cautious VCT investors.

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

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.

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, fixed-income securities and cash. 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 to other Downing TWO VCT share classes. Examples of previous investments made by the team include 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.

PERFORMANCE & DIVIDENDS

There is no annual dividend target for the 'K' shares. The main aim is to sell the investments in the VCT between 2021 and 2023 and return the proceeds to 'K' shareholders as tax-free dividends. The VCT is targeting a return of 110p for every 100p invested. There are no guarantees the target return can be met or that the VCT will wind up and distribute 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 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 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 'K' Shares in the first five years from launch (to 31 December 2020) 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 'K' Share buybacks and the level of discount to Net Asset Value at which they are undertaken should any take place. Please refer to the prospectus for full details of the policy.

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 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 be paid into your bank account, otherwise they will be paid into by cheque. Please see the relevant section of the prospectus and application form for further details.