

Tax Shelter Report – Issue 172 – February 2011

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This issue:

Baronsmead VCT 5 new shares

VCT Fund Raising

Our website www.taxshelterreport.co.uk details the latest "Funds Raised" information and is regularly relied upon by the national and trade press as a reference guide. The table below is accurate, insofar as it reflects the extent to which we have been provided with 'Funds Raised' information. It excludes reservations, commitments or additional underwriting from other sources. The status as far as we are aware as at 28 February 2011 is as follows:

	Closing Date (10/11)	Status	Raised (10 /11) £m	Target (10/11) £m
VCT Offers				
Generalist VCTs				
Albion VCTs Linked top-up	5 April	Open	6.2	15.0
Baronsmead VCT 5 new shares	5 April	Open	2.6	15.0
British Smaller Companies VCT & VCT 2 new shares	29 April	Open	4.5	15.0
Committed Capital VCT plc	31 May	Open	0.75	25.0
Downing Absolute Income VCT 1 'C' Shares	28 April	Open	3.3	20.0
Elderstreet VCT new shares	30 April	Open	1.6	7.0
Foresight Clearwater VCT	30 June	Open	0.5	20.0
Matrix VCTs Linked Offer	30 April	Open	6.9	21.0
Maven Income and Growth VCTs 1 - 4 Linked top-up	29 April	Open	1.15	6.4
Northern VCT new shares	28 April	Closed	15.0	15.0
Octopus Titan VCT 5	28 April	Open	2.0	30.0
ProVen Growth & Income VCT new shares	31 May	Open	1.4	15.0
AIM VCTs				
Amati VCT	10 Jan 2012	Open	0.7	18.0
Hargreave Hale AIM VCT 1 & 2 Joint Offer	8 March	Open	2.8 (0.8) *	10.0 (8.0) *
Octopus AIM VCT	30 April	Open	6.0	10.0
Octopus Second AIM VCT	30 April	Open	2.5	10.0
Unicorn AIM VCT top-up	30 June	Open	0.75	15.0
Specialist VCTs				
Foresight VCT 3 & 4 Linked Offer	30 June	Open	7.0	20.0
IBIS Media VCT 1 top-up	30 June	Open	0.0	5.0
Longbow Growth and Income VCT	30 June	Open	0.7	10.0
Limited Life VCTs				
Downing Planned Exit VCT 2011 General Shares	28 April	Open	3.3	20.0 **
Downing Planned Exit VCT 2011 Low Carbon Shares	28 April	Open	2.0	20.0
Downing Planned Exit VCT 2011 Structured Shares	28 April	Open	1.7	20.0 **
Edge Encore VCT	24 June	Open	0.4	10.0
Edge Performance VCT 'G' shares	3 June	Open	9.2	10.0
Foresight Solar VCT	30 June	Open	19.5	40.0
Hazel Renewable Energy VCT 1 & 2	30 April	Open	0.0	40.0
Ingenious Entertainment VCT 1 & 2 'E' & 'F' shares	5 April	Open	1.8	20.0
Ingenious Solar UK 2011 VCT 1 & 2	N/A	Suspended	N/A	N/A
Investec Structured Products Calculus VCT 'O' top-up	12 Dec 2010	Closed	0.9	10.0
Investec Structured Products Calculus VCT 'C'	30 April	Open	0.0	25.0
Matrix Clean Energy VCT 1 & 2	N/A	Withdrawn	N/A	N/A
Octopus VCT 2	28 April	Open	1.7	30.0
ProVen Planned Exit VCT	31 May	Open	1.0	25.0
Puma VCT VII	5 April	Open	2.7	30.0
Triple Point VCT 2011	29 April	Open	1.1	50.0
Total offers launched during 2010 – 2011			109.6	650.4

Venture Capital Trusts Ratings Overview

Key

L Low

M Medium-Low

L

M Medium

M Medium-High

H

H High

Features

A Includes some form of asset backing or level of underwritten return

B

L Limited Life – intention to wind up, or at least provide a viable exit route within set timeframe

L

Important: A detailed guide to this VCT assessment matrix is contained within issue 108 of the Tax Shelter Report. Advisers and sophisticated investors should not base any investment decision on the following scores and ratings alone. A high rating does not mean a particular VCT will be suitable for all investors. Individuals should read our reviews in full to see where other VCTs might better suit individual needs rather than simply picking VCTs with our highest scores.

VCT Name	Offer Size (£m)	Closing Date	Features	VCT Risk Level	Potential for Large Distributions	Potential for Consistent Distributions	Strategy, Outlook & Prospects	Management and Track Record	Score
Generalist VCTs									
Albion VCTs Linked top-up	15	5 APR	AB	Med	Med	Med-High	43	43	86
Baronsmead VCT 5 new shares	15	5 APR		Med	Med	Med	43	44	87
British Smaller Companies VCT & VCT 2 new shares	15	29 APR	-	Med	Med	Med	42	42	84
Committed Capital VCT	25	31 MAY			REVIEW PENDING				
Downing Absolute Income VCT 1 'C' shares	20	28 APR			REVIEW PENDING				
Elderstreet VCT new shares	7	30 APR	-	Med	Med	Med	42	42	84
Foresight Clearwater VCT plc	20	30 JUN			REVIEW PENDING				
Matrix Income & Growth VCTs Linked Offer	21	30 APR	-	Med	Med	Med	43	42	85
Maven VCTs Linked top-up	6.4	29 APR			REVIEW PENDING				
Northern Venture Trust new shares	15	28 APR	-	Med	Med	Med-High	43	43	86
Octopus Titan VCT 5	30	28 APR			REVIEW PENDING				
ProVen Growth & Income VCT new Shares	15	31 MAY	-	Med	Med-High	Med-Low	43	43	86
AIM VCTs									
Amati VCT new shares	18	10 JAN			REVIEW PENDING				
Hargreave Hale AIM VCT 1 & 2 Joint Offer	10	8 MAR	-	Med	Med	Med	42	42	84
Octopus AIM VCT	10	30 APR	-	Med	Med	Med	42	40	82
Octopus Second AIM VCT	10	30 APR	-	Med	Med	Med	42	40	82
Unicorn AIM VCT	15	30 JUN			REVIEW PENDING				
Specialist VCTs									
Foresight VCT 3 & 4 top-up	20	30 JUN			REVIEW PENDING				
IBIS Media VCT 1 top-up	5	30 JUN			REVIEW PENDING				
Longbow Growth and Income VCT	10	30 JUN			REVIEW PENDING				

VCT Name	Offer Size (£m)	Offer Size (£m)	Features	VCT Risk Level	Potential for Large Distributions	Potential for Consistent Distributions	Strategy, Outlook & Prospects	Management and Track Record	Score
Limited Life VCTs									
Downing Planned Exit VCT 2011 General shares	20	28 APR							REVIEW PENDING
Downing Planned Exit VCT 2011 Low Carbon shares	20	28 APR							REVIEW PENDING
Downing Planned Exit VCT 2011 Structured shares	20	28 APR							REVIEW PENDING
Edge Encore VCT	10	24 JUN							REVIEW PENDING
Edge Performance VCT 'G' shares	10	3 JUN	AB/LL	Med-Low	Med-Low	High	42	41	83
Foresight Solar VCT	40	30 JUN	AB/LL	Med-Low	Low	High	43	42	85
Ingenious Entertainment VCT 1 & 2 'E' & 'F' shares	20	05 APR	AB/LL	Med-Low	Med	High	43	40	83
Ingenious Solar UK 2011 VCT 1 & 2	20	05 APR							REVIEWED, BUT OFFER NOW SUSPENDED
Investec Structured Products Calculus VCT 'O' top-up	10	12 DEC 2010	LL	No Rating	Med-Low	High	43	41	84
Investec Structured Products Calculus VCT 'C'	25	30 APR	LL	No Rating	Med-Low	High	43	41	84
Octopus VCT 2	30	28 APR							REVIEW PENDING
ProVen Planned Exit VCT	25	31 MAY	AB/LL	Med-Low	Med-Low	High	42	42	84
Puma VCT VII	30	05 APR	AB/LL	Med-Low	Med-Low	High	42	42	84
Triple Point VCT 2011	50	29 APR	AB/LL	Low	Low	Med-High	43	42	85

Tax Shelter Review

Baronsmead VCT 5 new shares

ISIS EP LLP is looking to raise **£15 million** for this, its fifth generalist VCT via an issue of new Ordinary shares. The amount of shares received by an investor will be calculated according to a pricing formula – based on the latest reported net asset value. The minimum individual subscription is **£3,000** and the closing date is **5 April 2011**.

Conclusion

The Baronsmead series of generalist VCTs has been at the forefront of the VCT industry practically since its inception; reaching a decade and a half in terms of performance, consistency and diversity. VCT 5 is the youngest of the funds, differing from its four predecessors in that it has been managed from launch in March 2006 until December 2010 as an AIM-focused VCT. After a comparatively disappointing performance relative to VCTs 1 to 4, and the underlying fact that on average, the management's unquoted investments have apparently proved significantly more profitable than its quoted holdings, the strategy has now been changed. Going forward, the VCT will be managed as a generalist portfolio, in line with the management's existing VCTs.

The moneys raised will facilitate the expansion and evolution of the portfolio, and also free up the existing, older funds that were raised under an older and less restrictive legislative regime. It is reasonable to assume that, due to the existing make-up, the portfolio will, for a number of years, contain a significantly greater proportion of AIM quoted holdings than Baronsmead VCTs 1 to 4. However, the VCT should co-invest alongside the others into all new investments (unquoted and quoted), meaning that gradually, the portfolio will take on a more generalist weighting. Eventually, the intention is that unquoted companies should significantly outweigh those listed on AIM in terms of portfolio exposure.

The performance of Baronsmead VCTs 1 to 4 has consistently been amongst the best in their peer groups. Individuals should note the decline in NAVs a couple of years back, but understand that this was attributable to the sizeable portion of AIM quoted holdings, for what are categorised as generalist VCTs. A regular stream of profitable realisations has funded an attractive flow of dividends from each of the portfolios. In the case of VCT 5, quoted company realisations helped the management generate a stream of 4p p.a. for the past four years. The intention is to maintain this level while the unquoted portfolio is created.

The Baronsmead VCTs are managed by a large, proven team. However, we remain somewhat disappointed that ISIS introduced, and then increased the participation extent of its management co-investment scheme for the VCTs. Although perhaps only slightly dilutive, we are uncomfortable with the idea that managers can potentially benefit from the geared investment returns made possible by leveraging against shareholder capital. However, we do understand that such schemes are common in the private equity market, as well as the rationale behind implementation - we accept the argument that it is beneficial in terms of key staff recruitment and retention.

While we believe it may take at least a few years before VCT 5 begins to show signs of replicating the on-going performance of its predecessors, we are very optimistic for its long-term prospects. The key factor remains consistency - in terms of positive returns generated across multiple generalist funds, over a number of years. In our view the offer is well worth close consideration by those who have yet to gain exposure to a Baronsmead VCT.

Score	87
VCT Type	Generalist
Features	
Strategy, Outlook and Prospects	43
Management and Track Record	44
VCT Risk Level	Med
Potential for Large Distributions	Med
Potential for Consistent Distributions	Med

Overview and Strategy

ISIS EP LLP (formerly ISIS Equity Partners plc) is responsible for five Baronsmead VCTs, all of which are now generalist in nature. These accounted for assets of approximately £265 million as at 31 December 2010, although ISIS also manages Limited Partnership funds on behalf of institutional clients, bringing total assets under management to around £680 million.

Baronsmead VCT 5 (formerly named Baronsmead AIM VCT) was launched in March 2006. Until recently it was managed as an AIM-focused VCT - co-investing alongside its four generalist predecessors into in AIM listed companies. However, in December 2010, shareholders approved a change in the VCT's investment strategy to mirror that of the management's other existing VCTs. In future, it is intended that the VCT will be managed alongside VCTs 1 to 4 according to a generalist philosophy.

As at 31 December 2010, the VCT comprised of assets valued at approximately £18.7 million, with a portfolio of 40 AIM quoted companies. The funds to be raised under the current offer should enable the management to co-invest into the same businesses as its other VCTs, expanding the portfolio with new unquoted companies as well as additional AIM quoted holdings. Over the coming years, the expectation is that the portfolio will come to represent a mix of both unquoted and AIM quoted holdings.

The management's multiple VCT-spanning generalist strategy has remained unchanged over the years – namely, to manage a large, diversified portfolio of growth companies, predominantly unquoted, but including a significant proportion of AIM or other quoted businesses. The management co-invests from each of its VCTs into each deal, and in doing so is able to target larger, management buy-out type investments than some other managers could consider pursuing alone.

The investment approach is distinctly 'top-down', 'sector-driven'. All opportunities are reportedly screened initially on the basis of the business environment, followed by the industry sector. Finally the specific business is considered according to various selection criteria. In particular, the management states that it has more detailed experience and understanding of six broad sectors: consumer markets, energy and environmental, healthcare and education, financial services, business services and IT & media. By focusing exclusively in these areas, the management expects to be able to assist businesses with their expansion.

Individuals should note that in the region of £16.8 million of the assets currently held within the VCT were derived from moneys raised under less restrictive legislation on the VCT's launch in the tax year 2005-06, when, for example, VCTs could invest in companies with up to £15 million of gross assets. A further £12 million was raised in the tax year 2006-07 under legislation that, while slightly more restrictive, remains significantly less stringent than that applicable to monies raised in the current tax year. The management anticipates however, that additional money raised under the current offer should enable the continued preservation of the 'older regime' pools of capital, rather than have them dwindle in size due to costs and dividends etc. The management is confident that any future prospective deal flow available to its other VCTs should also prove viable for qualifying investment by VCT 5. We are informed that if £15 million were to be raised, the management anticipates that this same amount should be used to provide for dividends and management fees within approximately three years. All new qualifying investments could therefore feasibly be made under older rules. If the offer was increased to £20 million, it would mean that some investments would be made under the latest qualifying rules. The management does not believe this would be a problem considering that about 20% of all its qualifying deals reportedly qualify under the 'new' rules anyway.

Initially, funds raised will be predominantly be held as cash and fixed interest securities. In due course the management expects to invest at least 90% of the VCT's capital in growth businesses, with approximately 75% allocated to qualifying companies. The companies selected will be established, profitable at the point of investment (£1 million plus) and perceived to offer significant potential for capital growth. No early stage investments will be included. Investing across the management's combined range of VCTs and Limited Partnership funds, the total amount invested (deal size) in individual companies tend to range from around £2 million up to a capability of approximately £6.5 million. This assumes there is no third party bank debt involved – which is something that we understand the management anticipates over the next few years, because of Banks' attitude towards lending to small and medium sized businesses. The intention will be to expand the portfolio across a range of sectors.

ISIS has one of the largest generalist VCT management teams in the market, with offices in Birmingham and Manchester, in addition to London. The team benefits from deal-flow through the usual channels, but it also takes advantage of a large proportion of opportunities which are sourced independently - we understand it has individuals dedicated to such activities, which, the management argues, enables more advantageous pricing levels. Prospective deal-flow is reported to have improved on the back of lower asset prices, with businesses' alternate sources of finance relatively restricted - because of the economic downturn. We are informed that the team holds around 200 or more meetings with prospective investee companies each year.

Investors are able to participate in a dividend re-investment facility, although these will not be newly-issued, but rather second-hand shares that have been bought back, and held in Treasury rather than cancelled - and as such will not qualify for initial income tax relief. The boards operate a buy-back policy, subject to liquidity, but historically at around a 10% discount to NAV.

Individuals will subscribe for a number of Ordinary shares to be determined according to a pricing formula – which is the latest reported NAV, divided by 0.945 (to allow for issue costs of 5.5%) rounded up to the nearest 0.1p per share.

Team

Board

John Davies, Chairman, is a director of BlackRock Smaller Companies Trust plc. Previously he was MD of 3i Asset Management Limited and a member of the London Stock Exchange working party that established AIM in 1995.

Charles Pinney has been a director of Barclays Private Bank Ltd and a director of the Association of Private Client Investment Managers and Stockbrokers. He qualified as an accountant and began his career at Dunlops before joining Lazard Brothers. He is a former consultant to Rathbone Investment Management and currently chairman of ProVen Health VCT and a director of Amati VCT.

Gillian Nott is also a director of Baronsmead VCTs 2 & 3 and a deputy chairman of the Association of Investment Companies (AIC). She is a former director of the FSA and chief executive of ProShare (UK) Limited. Previously she managed a venture capital portfolio for the BP Group. Currently she sits on the board of various investment trusts and the Liverpool Victoria Friendly Society plc.

Investment Team

ISIS EP LLP is controlled by seven individual partners, six of whom have worked together since 2000. The leading members of the team are detailed below:

Wol Kolade is the managing partner and leads the 25 member investment team. He joined ISIS in 1992 from Barclays Bank where he worked in strategic planning and credit analysis. He is a former chairman of the BVCA.

David Thorp has extensive venture capital experience of over 30 years. Chairman of the BVCA until June 2001, he joined 3i in 1971 and was a regional director from 1984 to 1991. He joined ISIS in 1995 and is a director of the Association of Investment Companies (AIC) as well as Chairman of the AIC VCT forum which communicates with HM Treasury and HM Revenue & Customs regarding VCT legislation.

Andrew Garside joined ISIS in April 2005. Previously he spent 14 years with 3i. He leads the unquoted VCT investment activity in London, Birmingham and Manchester.

Pete Clarke joined ISIS in 2002 having built private equity experience with Rio Tinto, Electrocomponents and KPMG. He has responsibility for unquoted portfolio investments in the North.

Adam Holloway, head of portfolio management joined ISIS in 1999 from Deloitte & Touche where he worked on corporate recovery and venture capital.

Sheenagh Egan joined ISIS in 1997 and is chief operating officer. She is a chartered accountant having previously worked for Deloitte LLP and PricewaterhouseCoopers LLP. Beforehand, she spent time with Grant Thornton LLP, advising on corporate finance and private equity transactions.

Henrietta Marsh is the day to day lead manager for the AIM quoted investments across all five Baronsmead VCTs. She joined ISIS in September 2005 having previously spent 14 years working for 3i, where from 1997 to 2002 she was responsible for the 3i Smaller Quoted Companies Trust (now Merrill Lynch British Smaller Companies Trust plc). She also has private equity experience and was appointed a director of 3i in 2001.

The boards and management intend to invest an undisclosed amount under the terms of the offer, in addition to their existing shareholdings.

Management Track Record

VCT	Net Asset Value (pence)	Dividends per share (pence)	Total return (NAV + dividends)	Bid Share Price (pence)	Bid Discount to NAV (%)
Baronsmead VCT	73.64	106.05	179.69	69.50	-5.6
Baronsmead VCT 2	92.91	78.9	171.81	87.00	-6.4
Baronsmead VCT 3	103.52	55.8	143.9	96.50	-6.8
Baronsmead VCT 4	95.9	45.0	140.9	89.00	-7.2
Baronsmead VCT 5 (formerly Baronsmead AIM VCT)	69.54	18.2	87.74	62.00	-10.8

Baronsmead 1 & 2 NAVs as at 31 December 2010

Baronsmead 3 - 5 NAVs as at 31 January 2011

Bid share prices as at 25 February 2011

Notes:

1. We adjust NAVs to take account of dividends announced but not yet paid. The 'Dividends per share' column includes any dividends announced.
2. Share prices and their discounts to NAV do not necessarily reflect the price and discount at which shares may actually be re-purchased.

VCT	Rate of return % per year	Rate of return % p.a. assuming 20% initial income tax relief	Rate of return % p.a. assuming 30% initial income tax relief	Rate of return % p.a. assuming 40% initial income tax relief
Baronsmead VCT	5.6	7.9	9.4	11.3
Baronsmead VCT 2	5.6	8.1	9.7	11.7
Baronsmead VCT 3	5.6	8.5	10.2	12.4
Baronsmead VCT 4	4.3	7.3	9.2	11.4
Baronsmead VCT 5 (formerly Baronsmead AIM VCT)	-2.9	2.1	5.2	8.9

The original Baronsmead VCT was launched in November 1995. Over the 15 year period since the VCT was launched it has produced very good returns, outperforming all but a select few of its peers across the industry. The key point to emphasise is the level of consistency which ISIS has achieved with the fund. Whereas numerous other management teams have either disappointed, produced sporadic performance, or have generated positive returns over a more recent period, the management of Baronsmead VCT has maintained predominantly positive returns to shareholders year-on-year practically since the outset. Individuals should note, however, that since 2007 its NAV slipped, from being consistently above 90p down around 70p per share in late 2008. This was attributable to the wider economic environment, and specifically, the fall in the AIM Index, to which the VCT had considerable exposure. Other VCTs with AIM holdings, by and large, suffered similarly. However, its NAV has proved more resilient of late, increasing somewhat. Meanwhile, the management has maintained an attractive dividend pay-out level, amounting to 6p in each of the past two years. Baronsmead VCT 2, launched in 1998, has, on the whole performed broadly similarly to its predecessor. The long-term consistency of returns has been excellent, despite a decline in NAV during 2008 for the same reasons as VCT 1.

Baronsmead VCT 3 was launched in January 2001 - a difficult time for small company investment generally, and has outperformed the FTSE All-Share and AIM Indexes by an average of 2.1% and 9.8% p.a. As with its predecessors, its NAV dropped from in excess of 120p per share in 2007 to less than 100p in 2009; however in the past five years it has distributed 35.5p in dividends (not accounting for 4.5p to be paid in April 2011) – an average of approximately 7.1p each year. In our view this seems an attractive yield. Baronsmead VCT 4, launched in December 2001, has underperformed the FTSE All-Share by 1.6% p.a., although outperformed the AIM Index by 3.7% p.a. Its dividend record is also very good, having paid 32.5p since the start of 2006 (not accounting for 4p to be paid in April 2011) – approximately 6.5p each year.

The VCT to which the Offer relates, Baronsmead VCT 5, was originally launched in March 2006 as the management’s first AIM-focused VCT. After a promising start, which saw its NAV increase to 109p in April 2007, it then suffered on the back of the AIM market decline. Having reached low points of (adjusted for dividends) NAV of 63.9p per share in July 2010, it has subsequently recovered slightly alongside the Index. However, despite the decline, a creditable 4p annual dividend has been paid to shareholders over each of the past four years. In December 2010 the decision was taken to change the strategy of the VCT in line with the management’s existing four generalist VCTs.

Outlook and Prospects

Baronsmead VCT 5 comprised investments in 40 AIM and other listed holdings. Below we detail the 10 largest as at 31 December 2010:

Baronsmead VCT 5	Residual Cost (£,000s)	Valuation (£'000s)
Kiotech International plc	900	1,109
Electric Word plc	847	1,050
Fastfill plc	739	946
Green Compliance plc	625	900
Tasty plc	1,195	865
IS Pharma plc	734	759
Accumuli plc	570	702
Clarity Commerce Solutions plc	800	680
Brulines Group plc	800	654
Proactis Holdings plc	554	532
Total	7,764	8,197

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Individuals investing under the Offer will gain immediate exposure to the investments outlined above and the rest of the current AIM-listed dominated portfolio. However, going forward, the VCT will be co-investing alongside the management's other four generalist VCTs into a mixture of both AIM and unquoted companies. By asset weighting, the majority of new investments are likely to be unquoted. Therefore, to give an indication as to the type of investments that may be selected, in the table below we detail the 10 largest investments in the first Baronsmead VCT as at 31 December 2010, which, collectively accounted for almost 43% of the VCT's NAV:

Baronsmead VCT	
Reed & Mackay Holdings Ltd	Business travel management services
Nexus Vehicles Holdings Ltd	Internet based broker system offering corporate car and van rental
Crew Clothing Holdings Ltd	Branded multi-channel clothing retailer
Cablecom Networking Holdings Ltd	Corporate networking solutions
Staffline Group plc	Provider of specialist blue-collar labour outsourced solutions particularly in food processing
Kafevend Holdings Ltd	Drinks vending machine service provider
Quantix Ltd	Outsourced support and maintenance of databases, applications and security
Independent Living Services Ltd	Scottish-based domiciliary care for local authority customers
Fisher Outdoor Holdings Ltd	Supplier of cycle components and accessories
CSC (World) Ltd	Provider of structural engineering software

As a consequence of the co-investment policy, the extent to which cross-holdings occur across the first four Baronsmead VCTs is considerable. We are informed that future unquoted investments will be allocated to each of the five VCTs on an equal basis, and as such, individuals can expect that, over time the portfolio's make-up will see a gradual evolution towards that of a generalist VCT, eventually having a greater proportion of unquoted investments. However, thanks to the legacy holdings, for some time the VCT is likely to retain significantly greater exposure to AIM listed holdings than VCTs 1 to 4. As at 31 December 2010 the VCT contained no exposure to unquoted companies - almost 90% of its assets comprised of AIM quoted companies (including a reported £1.4 million invested in the Wood Street Micro Cap Investment Fund – managed by ISIS to enable the Baronsmead VCTs to gain exposure to larger, more liquid non-qualifying AIM listed and small-cap companies). This compared to an average portfolio weighting of approximately 48% unquoted and more than 25% AIM listed across the other Baronsmead VCTs.

With five substantial to large generalist VCTs (as well as other institutional funds), ISIS is capable of investing in larger overall deals without the need to syndicate than many other VCT managers. Although the annual limit for investment into a VCT qualifying company is now £2 million, a sizeable proportion of the Baronsmead VCTs' assets were raised under older legislative regimes with less restrictive qualifying rules – meaning they can continue to invest according to the older requirements.

The first four Baronsmead VCTs have long offered shareholders broader diversity and a greater spread of risk than most other VCTs. Such diversity has, in the past, helped to deliver a stable stream of dividends on the back of multiple realisations. VCT 5 has paid a total of 4p for each of the past four years, and although we understand that it has yet to build up any reserves with which to pay future dividends (as has been the case with VCTs 1 to 4), the intention is nevertheless to maintain this level while the unquoted portfolio is being established.

The management suggests that the prevailing venture capital investment climate is one of lower asset prices, partly due to reduced valuations given the recent economic downturn, and also because there is reportedly a current lack of alternate sources of credit to small businesses. It believes that an improvement in market conditions should increase the number of perceived attractive investment opportunities over the next few years, which the VCT should be able to take advantage of.

Management Incentive

The management's performance incentive is two-fold. First, is a payment for which it will qualify, should the VCT's total return exceed an annual hurdle rate of 8%. The payment will be 10% and is capped at 5% of the VCT's NAV in that period. NO payment will be made however, until the total return on the net proceeds of the initial Ordinary share offer exceeds 140%.

The second aspect of the incentive structure is a management co-investment scheme. We originally gave some general thoughts on the various merits and drawbacks of management co-investment schemes in the commentary at the front of issue 102 of the *Tax Shelter Report*. These remain applicable to the scheme that has now been introduced for Baronsmead VCT 5.

ISIS was the first VCT manager to introduce such a scheme for its older VCTs in November 2004. At that point all of the managers were personally required to invest directly in the equity element of all the VCTs' unquoted private equity deals where ISIS is the lead manager. In each case the management were to subscribe for 5% of the ordinary share equity. This has since been modified - from 2007 the percentage increased from 5% to 12%. In our view this seems a little excessive – 12% is a higher level of equity participation than ISIS's other VCT competitors that operate similar schemes. The management points out that the effects of this are offset by the reduction in the standard performance incentive mechanism with the excess over hurdle payment rate reduced from 20% to 10%, although in practice this would depend on the actual returns generated by individual companies relative to the VCT as a whole.

The argument provided in support of the scheme is that, when targeting larger unquoted investments, the management team often finds itself in competition with large private equity houses and limited partnerships etc. In order to attract and retain capable private equity executives, it needs to offer a suitable incentive scheme that is competitive with what may be on offer with rival organisations. ISIS points out that the VCTs' level of co-invest is generally lower than most comparable schemes of non-VCT managers in the private equity industry. It is also the case that some other VCT managers operate similar schemes.

The management may be correct in its assertion that the performance of the VCT should improve, more than offsetting any portfolio dilution (all VCT management co-investment

schemes have the potential to dilute a portfolio), given the higher quality management team that results from having such a scheme in place. However, our major concern centres on the fact that investing in equity elements of structured deals (and thereby only taking on vested interests in specific companies) can create tremendous upside potential for the management. Inherently it provides a gearing mechanism whereby the management can make use of the portfolio to leverage its own investment return. Even if the VCT's overall performance disappoints, if just a few of the underlying investments prove successful, the management might profit. Although the Baronsmead VCTs' boards approve of the scheme, in our view, it, like similar co-investment schemes operated by other VCT managers, has the potential to create a conflict of interests.

Costs

Initial costs are 5.5%. Authorised intermediaries will receive 3% commission, or alternatively 2% initially with trail commission payments of 0.4% p.a. for four years.

The annual management fee is 2% (in line with VCTs 1 & 2), although the fee for VCTs 3 & 4 is 2.5%. However, in the case of VCT 5, the fee will increase by 0.1% as soon as the first

unquoted investment is completed, and then by a further 0.1% on that date each year thereafter – until it reaches 2.5%.

Annual running costs will be capped at 3.5% of NAV (excluding VAT), although assuming the offer is fully subscribed, these are initially expected to reduce from around 3.4% to 3%.

Arrangement and monitoring fees will also be levied.

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