The Association of Investment Companies

Going for growth

A guide to Venture Capital Trusts

November 2017

www.theaic.co.uk

Venture Capital Trusts provide finance to some of the most dynamic small businesses in the UK to help them grow.

This guide explains the benefits and risks of investing in VCTs, and takes a closer look at some of the exciting businesses that VCTs have helped to flourish.

New to investment companies?
Read 'A guide to getting started' to learn the basics

Available at www.theaic.co.uk or by calling 0800 707 707

Introduction

Young, innovative businesses often struggle to raise finance to help them expand. They may still be developing their products or services, so haven't been able to generate any profits from sales yet. They may be pioneers in new technologies or services which are relatively untested. They may not have been around long enough to generate a strong financial track record, which lenders often look for when deciding which businesses to support.

These businesses can therefore find it hard to raise finance from traditional sources such as banks, something that has been made worse by the banking crisis. However, they often need a lot of capital in these early stages, well beyond the means of most individual investors. VCTs help to bridge this 'finance gap' by allowing smaller investors to pool their resources and invest in a diversified portfolio of investments to spread risk.

Though the companies VCTs invest in start small, and are high risk, they can become household names in the future, helping to create jobs and economic growth. So the Government offers generous tax benefits to compensate you for the risks involved. But you should not invest in a VCT just for these tax benefits and should make sure you fully understand all the risks. If you are in any doubt, you should take independent financial advice.

This guide is aimed at retail investors aged 18 or over who are UK income tax payers.

Seeds of potential
Although the companies VCTs invest in start small, they can become household names

Firefly Learning

The business

Firefly Learning is an education technology company. Conceived by two GCSE students to help them revise for exams, Firefly allows schools to set homework, track progress, create rich resources and engage parents. The result is teachers have more time to focus on what matters most – teaching – and students can learn in ways that work best for them.

The opportunity

After launching in 2009, Firefly was already a successful business by 2016, trading profitably and doubling its revenue year on year. However, it was seeking funding to grow and reach the next stage of its development.

How VCTs helped

In November 2016, the ProVen VCTs, managed by Beringea, provided £1.5 million of funding. The investment helped Firefly develop its product through research and development, enter new geographic markets, and expand its offices in London, Brighton, Sydney and Singapore.

The results

Since the investment, the business has expanded its offices in London and opened an office in Singapore. Firefly is currently one of the leading providers of educational technology in the UK and employs over 66 staff. The Firefly product is used by 500 schools in 35 countries, helping some 400,000 students.

www.fireflylearning.com

firefly proven

Simon Hay,
Co-Founder, Firefly

"Beringea's ability to provide patient capital has allowed us to develop the Firefly product to be as effective as possible for the needs and wants of teachers, students and parents all around the world."

Simon Hay

The basics of VCTs

In many ways, VCTs are like other investment companies. They give you access to a diversified portfolio of investments managed by a professional manager.

However, they differ in a number of ways:

- they invest most of their money in small, up-and-coming businesses
- in return for the higher risks, they offer additional tax benefits
- the way you normally invest in them is different

The businesses VCTs invest in

VCTs are required to invest in small, private businesses. They can also invest in similar investments traded on the Alternative Investment Market (AIM), which is the London Stock Exchange's market for smaller growing companies.

There are limits on the size of companies VCTs can invest in. Most VCT investments must be in small companies (up to £15 million in size). These businesses are much more risky than the large, established companies other funds tend to invest in. Some of these companies will struggle even with the support of VCT investment, and may fail altogether. However, those that succeed can develop into some of the most exciting businesses in the UK.

Rich variety
A VCT can give you exposure to a range of up-and-coming companies

The tax benefits

To compensate you for the extra risks of investing in small, growing businesses, there are a number of tax benefits available when you invest in a VCT.

For example, you will pay no income tax on any dividends you receive, and no capital gains tax on any profits you make when you sell your shares. These two reliefs are available at all times, irrespective of how much you invest, how you buy the shares or how long you hold them.

However, if you buy shares issued on the launch of a VCT or when it raises new money, then further tax relief is available to reduce your income tax bill, providing you hold the shares for a minimum period of time and subject to certain limits and conditions. This is known as ‘initial’ (or ‘upfront’) income tax relief.

Although the tax benefits are generous, you should not invest in VCTs just for tax reasons

Current ‘initial’ income tax reliefs, limits and conditions

Rate of income tax relief	**30%**
Maximum investment eligible for income tax relief	**£200,000**
Minimum time investor must hold VCT shares to qualify for income tax relief	**5 years**

How you buy VCT shares

Like all investment companies, you can buy existing VCT shares through the stock market. You will still benefit from tax-free income and capital gains, but you won't get any further income tax relief. If you want to benefit from initial income tax relief, you will have to invest in new shares either on the launch of a VCT, or when it raises new money.

The VCT will issue a prospectus, which is a document that provides a lot of information about the VCT and the risks involved. You can apply for VCT shares directly via the prospectus, or you can use an independent financial adviser to help you decide which VCT would be best for you and help you make an application. There are also other financial firms that can help you to apply for VCT shares, though they do not provide advice as part of this service.

Whichever route you choose, you should read the information provided carefully and make sure you understand the risks involved. You should also consider the costs and make sure you are happy with them.

The economic benefits of VCTs

VCTs are a boost to the UK economy providing vital finance and expertise to smaller British companies and stimulating high levels of job creation. VCT-backed businesses have high levels of exports, indicative of their potential value to the UK economy.

Weedingtech

The business

Weedingtech designs and manufactures herbicide-free weed control systems. Its core product, Foamstream, kills weeds and moss using close to boiling water, encapsulated in environmentally friendly, organic foam.

Weedingtech responds to environmental and health concerns raised by certain chemical herbicides, such as glyphosate. After five years of trading, its products were being sold in Continental Europe, North America and the UK.

Leo de Montaignac,
Chief Executive, Weedingtech

The opportunity

Increasingly, governments and regulators around the world had begun banning the use of certain chemical herbicides amid concerns about the risks they pose to human health and the environment.

The global herbicide market is estimated to reach $31 billion by 2020. With glyphosate accounting for around three quarters of this total, Weedingtech saw huge potential to grow their operations.

How VCTs helped

In December 2016, Calculus VCTs and other Calculus funds invested £3 million in Weedingtech. The investment helped Weedingtech expand its sales into new markets, grow its sales team and boost its manufacturing and product development capabilities.

The results

Since (and as a result of) the investment by Calculus, Weedingtech has been able to launch a new model of its core product which is smaller and better than the machine previously being sold and incorporates remote diagnostics, which improves the customer experience and reduces service requirements.

www.weedingtech.com

"Calculus Capital's investment is an endorsement of Weedingtech's continued growth potential, as we reach new markets, increase our share in existing ones and develop new herbicide-free weed control technologies."

Leo de Montaignac

The risks

As with all stock market investments, when you invest in VCTs your income and capital is at risk and may fall as well as rise. You should not invest in VCTs if you need a guaranteed income or if you cannot afford to lose any of your money. There are also some other specific reasons why VCTs are considered to be higher risk.

- **VCTs invest mostly in small, younger companies**
  These tend to be much more risky than well-established public companies, which may have large cash resources to fall back on in tougher times.

- **The value of the underlying investments can be uncertain**
  Unlike companies that are traded on public markets, shares in private companies do not have an exact market value. A VCT will use well-established valuation methods to estimate the value of any investments they have in private companies, but they can only be estimates. Given the work involved in performing these valuations, VCTs will often only value the portfolio every three or six months and so any valuation may have been calculated some weeks, or even months, earlier.

- **Compliance with tax rules**
  VCTs have to meet strict tax rules in order to obtain their preferential tax status. If the VCT does not meet these conditions, you could lose your income and capital gains tax benefits.

- **Selling your shares**
  VCTs are generally smaller than other investment companies and so the amount of shares you can buy and sell at any one time on the stock market will tend to be lower. If you want to sell a large amount of VCT shares, you may have to plan to do this over a longer period of time. Some VCTs also offer to buy back shares to provide you with another way to sell your shares.

Things to consider

Are VCTs suitable for you?

VCTs are generally for more experienced investors who have already built up a solid ‘core’ of other investments and who fully understand the risks. If you are not sure whether, or which, VCTs might be suitable for you, you should take independent financial advice.

What type of VCT?

There are three main types of VCT. Generalist VCTs invest in a wide range of companies in different sectors. AIM VCTs invest mainly in companies quoted on AIM or other similar markets. Specialist VCTs invest in particular sectors, such as the environment, infrastructure, media, leisure or technology.

Need advice?
You should speak to an independent financial adviser

How long can you invest for?

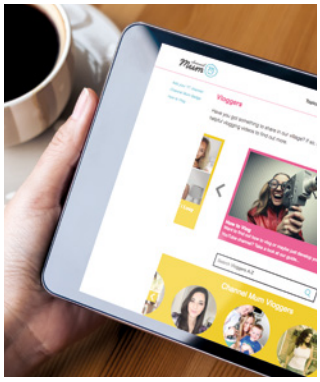
VCTs, like all investment companies, are intended as long-term investments. If you are likely to need the money in the near future, you should not invest in VCTs. Remember that, where the initial income tax relief is concerned, you have to hold onto the VCT shares for at least 5 years.

Some VCTs are 'limited life' ('planned exit'), meaning that there is a specific date when the company will be wound up and proceeds returned to investors. Others have no such fixed life and can continue indefinitely.

The costs

Managing a VCT takes specialist expertise. For example, the VCT manager has to undertake more due diligence when making an investment. They may even appoint someone to the board of the investee company. When they sell an investment, they need to find willing buyers and negotiate with them to get the best price. This additional work means that VCTs often have higher running costs than other investment companies.

Channel Mum



Siobhan Freegard,
CEO, Channel Mum

The business

Channel Mum is the UK's fastest-growing parenting community and website. It allows parents and parents-to-be to communicate and to watch videos from Channel Mum's team of vlogging families.

Channel Mum was founded in 2015 by Siobhan Freegard, the creator of the parenting website, Netmums.

The opportunity

By 2016, it was clear that demand for Channel Mum was significant. The site was offering over 25,000 parenting videos and 750 new videos were being added each week. Channel Mum sought funding to expand the website and build on this success.

How VCTs helped

In September 2016, Northern VCTs, managed by NVM, invested £2 million in Channel Mum to help the company accelerate and grow. NVM's investment helped Channel Mum grow its team, create a network of video vloggers and attract an impressive list of corporate clients.

The results

Channel Mum is now the leading parenting community on social media using video vloggers. After a very short time, the company achieved revenue of just under £1 million in its first year of trading to June 2017 and now employs 20 people.

www.channelmum.com

Support where it's needed
VCTs help young businesses in the UK that might otherwise struggle to obtain finance

Key things to remember

- VCTs help to support some of the most dynamic young businesses in the UK who might otherwise struggle to obtain finance to help them grow. These businesses can grow to become household names, helping to create jobs and economic growth.
- In return for the higher risks, VCTs offer generous tax benefits, but you should not invest in them just for these.
- VCTs are intended as long-term investments and you will have to hold onto the shares for at least 5 years to benefit from some of the tax benefits available.
- Your income and capital are at risk, and you should not invest in VCTs if you need a guaranteed income or if you cannot afford to lose your capital.
- If you are not sure whether, or which, VCTs are suitable for you, you should take independent financial advice.

If you are uncertain about whether, or which, VCTs might be suitable for you, you should take financial advice

Visit the AIC website for news, statistics and comment on investment companies

www.theaic.co.uk

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