

# DOWNING INCOME VCT 3 PLC

## INVESTOR GUIDE

### Key Points

- **Tax Relief:** 30% income tax relief subject to circumstances and five year holding period
- **Generalist VCT:** seeking to take advantage of the growth potential of attractive businesses currently available because of the lack of alternative sources of finance
- **Regular Income:** 7.1% p.a. tax-free target income on net of tax cost

### Important Notice

An investment in Downing Income VCT 3 plc ("the Trust") is suitable only for investors who are capable of evaluating the risks (see overleaf) and merits of such an investment and who have sufficient resources to bear any loss that might arise. Investors are advised to take appropriate financial advice before investing in the Trust.

### Introduction

Venture Capital Trusts ("VCTs") were introduced by the Government to encourage individuals to invest in a high risk portfolio of unquoted small businesses, by offering them substantial tax benefits.

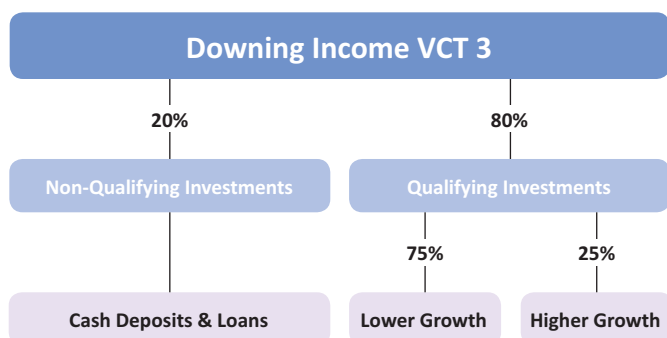
The Trust is seeking to raise up to £20 million by issuing E Shares ("Shares") to invest in a blend of lower and higher growth investments. The Trust has an objective of paying dividends equivalent to 7.1% p.a. on the net of tax cost of investment, which should be attractive in this low interest rate environment.

### Investment Strategy

As a Generalist VCT, the Trust has the potential to generate more growth from investments, compared to planned exit VCTs, by having greater flexibility to hold investments until the most opportune time to exit.

Downing is continuing to see a strong flow of investment opportunities, which is being enhanced by the lack of alternative sources of finance.

The funds raised under the Offer will be invested over three years and it is anticipated that by 31 March 2015 the asset allocation will be as follows:



### Non-Qualifying Investments

Non-qualifying investments will comprise cash deposits and short-term loans to businesses, typically secured by a charge over assets held by the borrower.

### Qualifying Investments

#### Lower growth investments

The Trust will invest in companies that own substantial assets. These investments are likely to be structured with significant levels of loan stock and/or preference shares in order to generate income for the Trust. The businesses' ability to borrow from other parties will be restricted in order to reduce risk.

**Example:** Alpha Schools

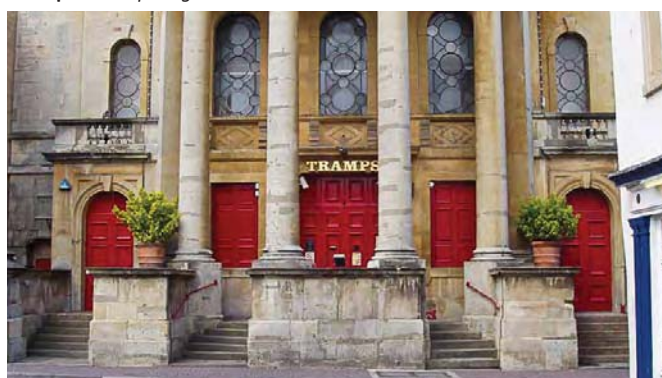


Downing's VCTs have made a £3m commitment to invest in an existing profitable prep schools business based in Buckinghamshire, at a cost equivalent to 7x EBITDA (earnings before interest, tax, depreciation and amortisation) for the freehold assets. The business already owns four private prep schools, with a traditional approach to teaching, and the investment will support its expansion. Downing's priority return is 10% p.a. plus potential upside. Investment risk is reduced by the VCTs holding a charge on freehold assets.

#### Higher growth investments

The Trust will usually target capital gains rather than high levels of income from its higher growth investments. These investments will be higher risk than the lower growth investments.

**Example:** Tramps Nightclub



Downing's VCTs have made a £2m investment in Tramps Nightclub, which comprises a bar, lounge and nightclub complex in Worcester. The business operates from leasehold premises (22.5 years remaining at investment) and the cost was equivalent to 2x EBITDA. This is a higher risk investment because of the leasehold (rather than freehold) assets and by virtue of Downing's funds providing 98% of the finance. Downing's VCTs' target return is high at over 15% p.a. and risk is managed because we backed the existing management team (over 20 years' experience within the business), there are local barriers to entry and the business has stable revenue streams.

**Note:** the examples above are provided to illustrate the types of lower and higher growth investments that may be considered by the Trust. It is unlikely that the Trust will invest in the same companies.

## Tax-free target income of 7.1% p.a.

The Board has a stated objective of paying annual tax-free dividends of 5p per Share and set out below is a table illustrating the yields at this level of dividend. It should be noted that dividend levels are not guaranteed. The first half yearly dividend is expected to be paid by September 2012.

Illustrative yield per Share (after 30% income tax relief)				
Net of tax offer price <sup>1</sup>	Target annual dividends	Tax-free yield	Gross equivalent yield	
			40% taxpayer <sup>2</sup>	50% taxpayer <sup>2</sup>
70.0p	5.0p	7.1% p.a.	9.5% p.a.	11.2% p.a.

<sup>1</sup> The returns listed after 30% income tax relief are based on the Offer Price of 100p multiplied by 70%, to reflect initial income tax relief of 30%. Investors should note that they will be required to pay the full Offer Price and claim the income tax relief separately.

<sup>2</sup> The gross equivalent yield is the yield on a non-VCT UK dividend that would result in a net yield of 7.1% (being a 5p dividend divided by 70p, the issue price of £1 per Share less 30% to reflect initial income tax relief), assuming a 40% taxpayer and 50% taxpayer respectively.

## Taxation Benefits to Investors

The principal UK tax reliefs, which are available on a maximum investment of £200,000 in each of the 2011/12 and 2012/13 tax years, are set out below:

- **Income tax relief at 30%:** of the amount subscribed provided the VCT shares are held for at least 5 years. Relief is restricted to the investor's tax liability.
- **Tax-free distributions and capital gains.**

This is a very brief summary of the current UK tax reliefs on VCTs. Potential investors are recommended to consult their own appropriate professional adviser as to the taxation consequences of their investing in a VCT. All tax reliefs are subject to change in the future and personal circumstances.

## Risk Factors

The key risks are set out below (please read page 1 of the Securities Note for a full list of risk factors):

- **Tax reliefs:** the availability of the tax reliefs depends on the companies invested in maintaining their qualifying status. If the Trust does not maintain VCT qualifying status investors could lose the upfront 30% income tax relief and all other tax reliefs. Please refer to HM Revenue & Customs' website for further guidance on the tax reliefs available on VCT investments.
- **Liquidity:** it may prove difficult for shareholders to sell their shares at a fair price, or at all.
- **Investment performance:** the Trust will invest in small unlisted companies which, by their nature, are higher risk than larger "blue-chip" companies. Shares in such companies may be difficult to sell.
- **Investment restrictions:** the Trust's ability to obtain maximum value from its investments may be limited by the VCT rules. Changes in the VCT rules may be applied retrospectively and may reduce the level of returns for investors.
- **Speculative risk:** the value of shares may go down as well as up and shareholders may not receive back the full amount invested. In addition, there is no certainty as to the level of dividends.

## Charges

Launch costs will be 5.5% of the gross proceeds raised plus 0.5% per annum. Downing will receive an annual management fee of 1.8% per annum, which is included within the Trust's total annual running costs cap of 3.5%. Please refer to the Prospectus for details of the Performance Incentive and other costs.

## Sale of Investment

In order to ensure Investors have visibility when they wish to sell their shares, the Board has a stated share buyback policy. The Trust's policy is to buy Shares at nil discount to Net Asset Value for the first five years and from year eight onwards. Share buybacks in years six and seven will be undertaken at a 15% and 7.5% discount to NAV respectively. This policy is subject to the availability of sufficient financial resources and regulations.

## Track Record

The table below sets out the track record of Downing Absolute Income VCT 1, which is a mature VCT with a similar strategy to that of the Trust.

Track record of Downing Absolute Income VCT 1			
Tax year of launch	Net cost <sup>1</sup>	Total Return <sup>2</sup>	Increase over net cost (%)
1996/97	80.0p	145.4p	+82%

<sup>1</sup> Net cost is the initial offer price of 100p per ordinary share less income tax relief of 20%, which was available to investors at that time.

<sup>2</sup> Total Return is cumulative dividends paid since inception (including the tax credits where reclaimable) plus the most recently announced net asset value of Downing Absolute Income VCT 1 (as at 30 September 2011) in pence per share.

(Source: announcements made by Downing Absolute Income VCT 1)

Downing also manages two other Generalist VCT share classes: Downing Absolute Income VCT 1 (C shares) and Downing Absolute Income VCT 2. They have only recently launched (both within the last two years) and, consequently, it is too early to judge their performance.

It should be noted that past performance is not a reliable indicator of future performance.

## IMPORTANT NOTICE

This document is intended for retail investors and their advisers and has been approved and issued as a financial promotion under the Financial Services and Markets Act 2000 by Downing LLP ("Downing"), 10 Lower Grosvenor Place, London SW1W 0EN. This document is for information only and does not form part of any offer to purchase securities and no reliance should be placed on it. Any application for shares should be made solely on the basis of the Prospectus relating to the Trust, which is available from Downing at the address below. Downing is acting for the Trust and no one else and will not be responsible to anyone other than the Trust for providing the protections afforded to clients of Downing. Downing is authorised and regulated by the Financial Services Authority.

19 December 2011



10 Lower Grosvenor Place  
London SW1W 0EN

Tel: 020 7416 7780

Email: vct@downing.co.uk

Web: www.downing.co.uk

Downing LLP is authorised and regulated by the Financial Services Authority

