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Tax-Advantaged Investments

VCT Review

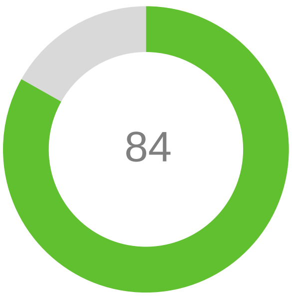
Downing Four VCT Healthcare Shares

January 2017

Downing LLP ("Downing" or "the Manager") is seeking, via a new share issue, to raise up to £10 million, and a further £10 million using an over-allotment facility, for Downing Four VCT Healthcare Shares ("the VCT" or "the Fund") for the tax year 2016/2017.

The offer is open to new and existing shareholders and was launched on December 8 2016.

Score Card



Fund Type	Evergreen
VCT Strategy	Specialist - Healthcare
VCT AUM (Pre-offer)	New Share Class
Manager AUM	£946m
VCT Risk Level	Medium-High Risk
Potential for Large Distributions	High
Potential for Consistent Distributions	Medium

Investment

Minimum subscription	£5,000 lump sum or £500 per month
Maximum qualifying subscription per tax year	£200,000 lump sum or £16,666 per month
Early bird discount	Yes*

* Conditions apply as detailed later in the report.

Contents

Closing Dates

2016-17 tax year	5 April 2017
2016-17 tax year	30 Sep 2017

Risk Warning for VCT Schemes

Individuals should always read and bear in mind the risk warning notices that are included within providers' investment offer literature/documentation, including prospectuses, information memorandums, securities notes, brochures and other related marketing literature. Whilst the following list is not exhaustive, some of the main risks to be aware of include:

- Investments are in small, unquoted companies and should be considered as high risk
- An investment in a VCTs should be viewed as a long-term investment and should only be considered if you can afford to tie up capital for long periods;
- Legislation, along with the nature and level of tax reliefs is subject to change. There can be no certainty that investments will be eligible or remain eligible for VCT Relief;
- Historic investment performance may not be a guide to future performance, and any given investment may fail completely causing you to lose the full amount invested;
- Managers of VCTs will have inherent conflicts of interest as a result of inter alia existence of legacy holdings, investments in other funds managed by the same manager, the potential to earn performance related fees and the existence of different schemes with identical or very similar mandates;
- VCT investments should only be undertaken by sophisticated investors who understand, and have given careful consideration to, the underlying investment strategy and associated risks. For help in determining potential investment suitability, professional advice should be sought;
- There can be no certainty that VCTs will continue to pay out their current level of income or indeed any income;
- Investors will usually not be eligible for compensation if things go wrong.
- Although VCTs are listed there is generally little or no secondary market for the shares and investors are likely to be reliant on share buybacks to get their money back.
- In order to retain the tax benefits, shares need to be held for a minimum of five years. Investors who are not able to commit to a five-year investment could consider investing through the secondary market which generally trades at a discount.

Executive Summary

Offer: Downing LLP ("Downing" or "the Manager") is seeking to raise up to £10 million with an over-allotment facility of a further £10 million through the launch of the Downing Four VCT Healthcare Share Class ("the VCT" or "the Fund"). Assuming the Offer is fully subscribed and the over-allotment facility fully utilised, the maximum net proceeds of the Offer will be approximately £19.6 million after deducting the initial costs (but before allowing for arrangement fees).

Manager: Downing is one of the longest-established investment managers in the tax-efficient market, with current investments across a broad range of Venture Capital Trusts ("VCTs"), Enterprise Investment Schemes ("EISs") and Business Relief schemes ("BRs"). It has established itself as a notable name in the tax-efficient market with a long track record and strong fundraising capabilities. As at September 30 2016, Downing had total assets under management of approximately £946 million, spread across 17 VCT Share Classes, 16 EISs, 3 IHTs and 3 OEICs, 11 BPRAs and Enterprise Zone Trusts.

Product: Downing Four VCT Healthcare Share Class ("The VCT" or "the Fund") is an evergreen VCT seeking to take advantage of investment opportunities within the healthcare and biotechnology sectors. The Manager has identified four broad investment areas (Drug Discovery, Medical Devices, Diagnostic Technology and Medical Data (the "Sub-sectors")) and is considering several investment opportunities across these Sub-Sectors. The targeted return on the underlying investments is a 3x to 5x money multiple over a four to five-year investment horizon (net of annual management charges).

BioScience Managers Pty Ltd ("BioScience") are the investment adviser for this offer. BioScience is a life science investment firm, headquartered in Melbourne, Australia, but with offices in Vancouver, London and Switzerland. The BioScience team has a combined experience of over 170 life science investments, more than 40 IPOs/reversals and a diverse skillset specific to the bio-based industries.

Summary Opinion: Downing have an established track record of launching VCTs, investing funds raised within the required time frames, delivering on dividend payment targets and returning funds to investors. The investment strategy targets a clear market opportunity and has the potential to deliver considerable upside for investors. However, we note that the challenges faced in bringing new products (particularly new drugs) to market in the healthcare sector and the potential to overrun on research and development costs, create a high level of exit risk and refinancing risk within the portfolio. Consequently, we perceive the Fund to be at the higher end of the risk spectrum in comparison with other VCTs, albeit that this is reflected in the target return. The investment team, including the investment adviser, have the relevant mix of experience required to effectively deal with the various challenges expected en route to the commercialisation of the underlying investments. Additionally, the investment process appears to be exhaustive and we have observed evidence of a comprehensive level of due diligence, governance and risk management. The Manager has indicated the portfolio is likely to have a good balance between the Sub-sectors; nevertheless, this a specialist strategy and by design there will be a healthcare sector concentration risk. Accordingly, investors should consider this VCT as part of a wider portfolio of investments.

We note that the Fund is exposed to a significant level of key man risk; the continuity of the Strategy is somewhat reliant on maintaining a working relationship with BioScience and more specifically with Jeremy Curnock Cook, the managing director at BioScience. We understand that

BioScience will earn a share of all fees earned by the Manager and as such the interest of both entities are somewhat aligned.

Positives

At the Manager level:

- Downing is one of the longest established managers in the tax-efficient market. It was launched in 1986 and established its tax-efficient business in 1991;
- Downing is highly profitable and has consistently delivered a strong positive financial performance. It has a healthy balance sheet and a good level of recurring gross income. As an LLP, the Manager is required to distribute all its profits to the Partners, though the Partners retain sufficient working capital in the business each year;
- The Head of Investment has 30 years of experience in the VCT and Private Equity markets and has worked in other large VC teams in the industry (Octopus, Beringea and BridgePoint);
- The Manager has a reasonably strong track record of raising capital for investment. Downing has raised over £1.6 billion in funds since inception, and is currently managing assets of over £940 million. Capital raising initiatives have been consistent across the product range and, over the last five years, Downing had raised at least £100 million per annum;
- Downing has been very transparent with our due diligence requests;
- The governance structure is strong with comprehensive and detailed documentation;
- Investor communications are thorough, supported by a sizable investor relations team, with regular updates offered to investors.

At the Product level:

- The BioScience team has a combined experience of over 170 life sciences investments, more than 40 IPOs/reversals and a diverse skillset specific to the bio-based industries. Additionally, they have an extensive network of contacts that they can leverage in the execution and management of the strategy;
- We note that a recent BioScience managed fund was run with a similar strategy and delivered a gross IRR of 22.5% (pre-fees) over a 6-year period implying a money multiple of approximately 3x over the period. However, investors should note that past performance is not necessarily an indication of future performance;
- The proposed portfolio is likely to have a good balance between the higher risk drug discovery companies and the more moderate to relatively lower risk exposures;
- The investment team appears to have a strong pipeline of potential investments, although we note that the Manager was unable to quantify how much of the current pipeline will filter into the portfolio;
- All the members of the Board of Directors of the VCT are independent and have extensive experience in venture capital and private equity investing;
- We understand that the Downing Ventures EIS fund ("the EIS Fund") will provide a good source of immediate pipeline for the VCT;
- The 25% long-term exposure to the Micro-Cap Funds provides a good source of liquidity for the portfolio and some predictability on future cash-flows, thereby enhancing the Fund's ability to meet dividend payment targets;
- We note that the Manager is offering a nil discount share buyback policy, which is unusual in this market and provides some liquidity to investors;

- Downing adopts a sufficiently comprehensive investment process with a good level of due diligence, a sufficient level of governance around decision making and a diverse deal sourcing channel;
- The Manager has several processes in place to ensure early identification of issues affecting the performance of the underlying investments;
- HMRC advanced approval is sought to ensure that each new investee company is VCT-qualifying at the time the investment is made;
- Follow-on funding is typically done in conjunction with an external third party investor. We consider this to be good practice as it helps to fairly manage conflicting interest between new and existing investors;
- Downing have an established track record of: launching VCTs (they currently have over £200 million of VCT funds under management), investing funds raised within the required time frames, delivering on dividend payment targets and returning funds to investors.

Issues to consider

At the Manager level:

- Downing LLP is 100% owned by its 17 partners. However, we note that Nicholas Lewis the founder, and his family own a majority and controlling interest, followed by Tony McGing, the CEO. Hence, the ownership structure of the business is relatively concentrated;
- A very significant part of the Manager's revenues is generated from tax-efficient products which means the Manager is vulnerable to changes in legislation, although this is spread evenly across VCT, EIS and IHT and some ISA, with most of the revenue being generated from recurring income, which will protect against the short-term effects of legislation change. Also, we note that the Manager has increased its non-tax-efficient offering in recent years.

At the Product level:

- This is a specialist healthcare strategy and by design there is a healthcare sector concentration risk in the portfolio; the overall portfolio performance will be sensitive to changes in general factors affecting the outlook of the healthcare sector;
- The Manager does not have any formal limits regarding portfolio construction. Consequently, whilst the Manager has indicated the portfolio will be spread across the four Sub-sectors there is no certainty it will be;
- We consider the requirement for the investee companies to have to obtain regulatory approval, and the potential to overrun on research and development costs, to create a high level of exit risk and refinancing risk within the portfolio;
- The deployment period is likely to be closer to the three year VCT limit and so investors could suffer a drag on returns due to the relatively slow deployment rate. Additionally, investors will not receive any dividend payments in the first three years following the launch of the Fund. However, this is partly mitigated with the management of all undeployed capital by the Downing Public Equity team in Downing's Micro-Cap quoted funds;
- The agreement between BioScience and the Manager is non-exclusive and as such there could be potential conflicts of interest with regards to the sourcing of deals for the Fund;
- The Fund is exposed to a significant level of key man risk issues; the continuity of the strategy is somewhat reliant on maintaining a working relationship with BioScience and more specifically with Jeremy Curnock Cook (biography in the appendix to this report);

- This is a new product offer and consequently there is no performance track record to evaluate, though the team has an impressive track record in the industry;
- We note that the exit timetable for the existing fund run by Bioscience was closer to six years than the four indicated by the Manager and at a 3x multiple;
- Historically the performance of the Manager's VCTs has been mixed with a third in the bottom quartile and the better performers in the top two quartiles;
- The Manager has suggested that the VCT might make follow-on investments in companies held by other products managed by the Manager and investors would need to satisfy themselves that the conflicts this creates can be fairly handled;
- Fees are at the higher end of our peer-group of comparable VCT products.

Manager Quality

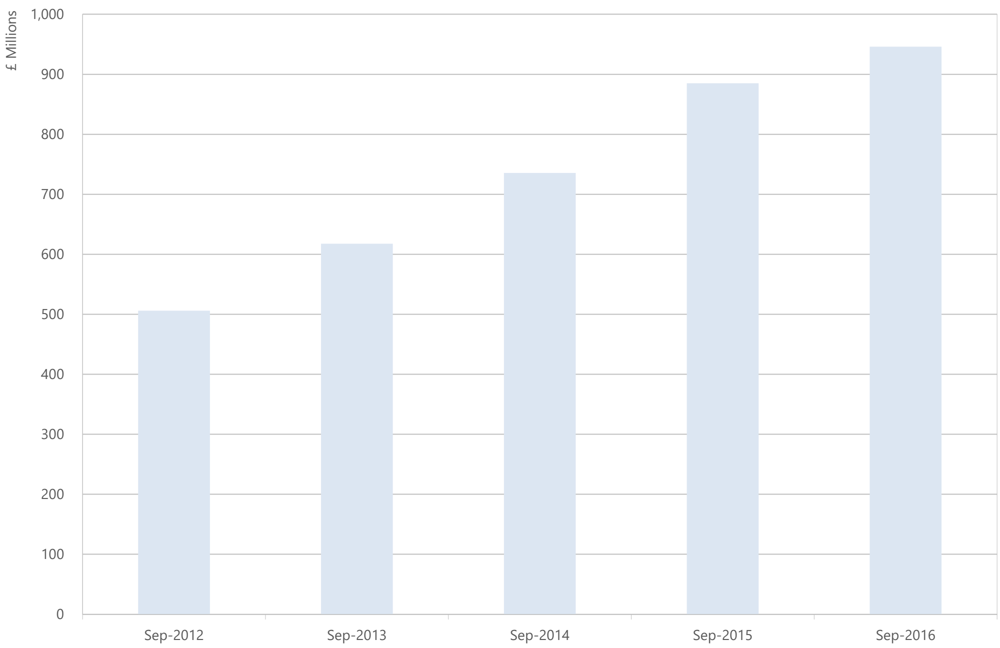
Manager Profile

Downing Corporate Finance Limited ("DCF") was originally launched in 1986 by Nicholas Lewis as a corporate finance business entity and has been carrying out the management and promotion of tax-efficient products since 1991. In June 2011, DCF transferred its business to its wholly owned subsidiary, Downing LLP ("Downing" or "the Manager"). As at November 2016, they employ some 100 partners and employees overall and have offices in London (main), Chester and Bristol.

The Manager offers investments across a range of sectors, including renewable energy, care homes, pubs, health clubs, and children's nurseries. At the time of writing, Downing's principal business activity is to offer management of tax-efficient investment products, including VCT, EIS, BR IHT and other investment funds or services. Downing is authorised and regulated by the FCA. As such they are subject to FCA Rules which require them to manage conflicts of interest fairly and in the best interests of investors.

The Manager's assets under management ("AUM") surged by more than 15% in early 2013, mainly because Downing had successfully raised a total of £102 million during the year to May 2013 through its tax-efficient products. Since then, Downing's AUM has steadily risen (as depicted below). As of September 2016, Downing had £946 million of assets under management, spread across a wide range of VCTs, EISs, IHTs and other tax-efficient and non-tax-efficient investment vehicles. The magnitude of operations and the growth in AUM provide a competitive advantage to Downing versus some of the smaller managers.

CHART 1:
FIRM AUM AS AT SEPTEMBER 2016

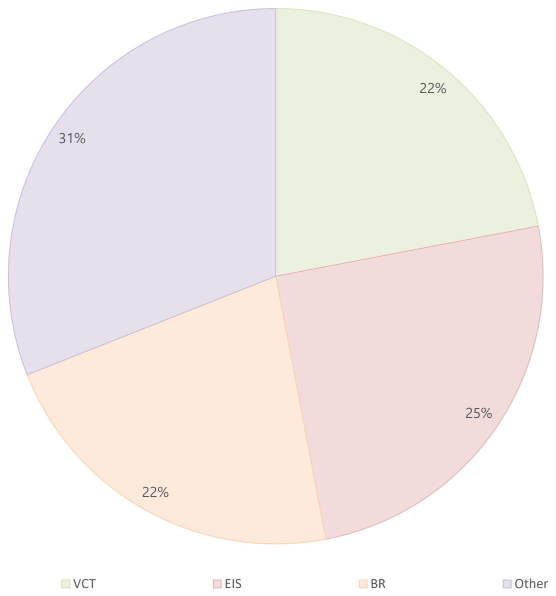


Source: Downing; AllenbridgeIQ

As shown in the chart below, the largest constituents of the Manager's AUM are EIS and IHT products (which together made up 47% of overall AUM as at September 2016), followed by VCT funds (22% of overall AUM) and the OEIC product range accounting for 11%. We note that in March 2016 Downing Crowd was established, applying a crowd-funding model to appropriate investment opportunities.

CHART 2:

ASSETS UNDER MANAGEMENT BREAKDOWN AS AT SEPTEMBER 30 2016



Source: Downing; AllenbridgeIQ

Note: "Other" is made up BPRA (18% of overall AUM), Quoted (11% of overall AUM), 'Crowd' (1% of overall AUM) and Enterprise Zone Trusts ("EZT") business (1% of overall AUM).

Downing has a ten-strong client services team dealing with all elements of investor administration and reporting. Portfolio valuations and updates will be sent out regularly (for VCTs as per listed company rules, for EIS and IHT on a six–monthly basis).

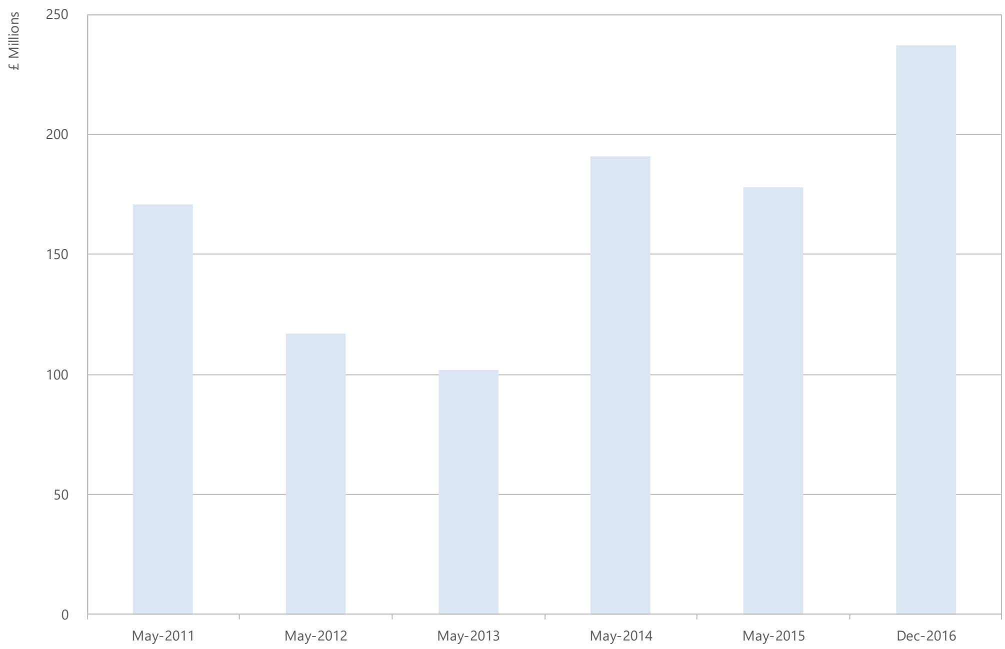
As required by the FCA, Downing has a formal procedure to handle written complaints. We reviewed this procedure and found it to be detailed and robust. According to the Manager's disclosure, as provided to Allenbridge during our review, the Manager had a relatively low level of complaints given the size of its investor base.

With regards to fundraising performance we note that the Manager has raised over £1.6 billion funds since inception, typically raising funds annually on a product-by-product basis with VCT/EIS/BPR products.

As shown below, although funds raised have varied from year to year, Downing had raised at least £100 million per annum in the past five years.

CHART 3:

FUNDRAISING TRACK RECORD AS AT DECEMBER 2016



Source: Downing; AllenbridgeIQ

Note: Downing raised £162 million between May 2015 and May 2016, and an additional £75 million between May 2016 and December 2016

Nonetheless, Downing doesn't always reach its fundraising target for each product. Notably, in the 2013/14 Downing One VCT offer, it raised only £5 million with an initial target of £10 million plus an over-allotment facility of £10 million. According to our discussions, Downing was re-structuring its business and had fewer resources to deploy and hence was unable to achieve its target. In its more recent Downing One VCT offering in 2014/15, the Manager raised £11 million, exceeding its initial target of £10 million.

Financial & Business Stability

Downing is a profitable and growing business that is mainly dependent on tax-efficient products. It currently manages 17 VCT share classes (excluding the new Healthcare and Generalist share classes), 16 EISs, 3 IHTs, 3 OEICs, 11 BPRAs (Business Premises Renovation Allowance products), EZTs (Enterprise Zone Trusts) and a crowd-funding platform with total net assets valued at approximately £940 million as at September 2016.

Downing's balance sheet is healthy, has no external debt obligations and has a good level of liquidity. Downing maintains capital in accordance with the FCA rules. The Manager intends to retain a minimum of £2 million of liquid resources for operating purposes.

In the table below, we present the key financial metrics of Downing LLP, as a presentation of its financial stability.

TABLE 1:
KEY FINANCIAL METRICS SUMMARY

	2013	2014	2015	2016	3 yr. CAGR
Revenues	12,954,754	16,098,880	20,013,000	21,982,000	19%
Revenue growth (%)	*2.13*	*24.27*	*24.31*	*9.84*	
Administrative Expenses, Cost of Sales and Members' Remuneration	8,598,119	11,683,053	13,926,000	10,699,000	8%
Cost to Income ratio	*0.66*	*0.73*	*0.70*	*0.49*	
Operating Profit	4,356,635	4,415,827	6,087,000	11,283,000	
Net Profit	4,437,658	4,591,208	6,285,000	11,382,000	37%
Net Profit Margin (%)	*34.26*	*28.52*	*31.40*	*51.78*	
Net Assets	4,308,648	3,514,498	4,665,000	6,339,000	
Current Ratio	*2.85*	*2.11*	*1.85*	*2.51*	
Total Debt/Equity	*0.00*	*0.00*	*0.00*	*0.13*	
Total Assets/Liabilities	*1.32*	*2.35*	*2.60*	*1.95*	

Source: Downing LLP's annual reports for the years ending May 31, 2012-2016.

Downing has a reasonably strong financial position, with a robust stream of recurring gross income (e.g. management contracts) which accounts for approximately 80% of the total revenue. The rest of the revenue comprises one-off fundraising income and investment arrangement fees across the funds managed by the Manager. Downing LLP has performed strongly over the last few years and has remained profitable in every year since inception.

As mentioned earlier, DCF transferred its business to Downing LLP on June 1 2011. Since then, there have been no corporate changes. We understand that the Manager foresees no change in corporate ownership and envisages that it will continue to operate using the same entity. Downing moved into a new office in June 2014 to accommodate its growth in headcount. At the time the Manager took the opportunity to update and upgrade its physical infrastructure and software systems. Downing is again looking to secure larger offices from 2018 as its headcount continues to grow.

It is worth noting, however, that an LLP structure distributes profits to members as they arise. This can make it difficult to put in place long-term incentive schemes, such as employment shares, that are available to companies, seen as best practice under the FCA's remuneration code. However, Downing does operate a non-member deferred remuneration system within the business.

Quality of Governance and Management team

Downing LLP is 100% owned by its 17 Partners. Nicholas Lewis, the founder, and his family, hold a majority and controlling interest, followed by Tony McGing, the CEO, and the remainder is spread across the other partners.

The ultimate decision-making entity is the Manager's Board of Partners (the "Board"), comprised of ten members, all of whom are executive members. The Board is chaired by Nicholas Lewis and is well resourced and balanced. The Board meets regularly to discuss and review the firm's accounts and practices to ensure compliance with FCA requirements. The biographies of the Board members are provided in the Appendix.

The Manager also has an Investment/Valuation Committee and a Senior Partner Advisory Committee, which have various business functions and are an integral part of the decision-making process. The oversight committees are detailed below.

TABLE 2:
OVERSIGHT COMMITTEES

Committee	Details
Investment Committee	- Mandate: Review and approve the investment proposals - Members: Chairman, CEO, Head of Investment, Head of Renewable and relevant investment professionals - Frequency: Monthly, and as required
Valuation Committee	- Mandate: Review and approve valuation of each Fund - Members: Chairman, CEO, Head of Investment, Head of Portfolio, Portfolio Director, Head of Renewable and a relevant investment professionals - Frequency: Monthly
Senior Partners Advisory Committee	- Mandate: Challenge the strategic direction of Downing and advise on ad hoc operational matters - Members: Chairman, CEO, CFO, Head of VCT admin/IT, Head of Investments, Head of Renewables, and two non-executive external advisors - Frequency: Quarterly
Board	- Mandate: The ultimate decision-making entity that has responsibility for the strategy - Members: Chairman, CEO, CFO, Head of Investment, Head of Renewables, Head of VCT Administration/IT - Frequency: Quarterly, and as required
Head of Departments Committee	- Mandate: To oversee and lead the operational and day-to-day activities of the firm - Members: CEO, CFO, Head of VCT Administration/IT, Head of Fund Administration/Compliance, Head of Investment, Head of Renewables, Head of Asset-Backed Investment, Head of Sales - Frequency: 6-7 times a year

Source: Downing; AllenbridgeIQ

Downing's team expanded significantly over the past several years and had a headcount of 100 as at November 2016, including more than 30 new hires in 2016. The senior management team is also strong, and has been relatively stable. Its Head of Investment has 30 years of experience in the tax-efficient product market and has worked in other large VC teams in the industry, such as Octopus, BridgePoint and Beringea. Downing also hired a full-time IT Director earlier in 2015 and replaced its manual portfolio management system with a solid IT system, Baxon, which helps the Manager to monitor and value investee companies.

The CFO, Chris Lewis, a qualified chartered accountant who has worked in audit and advisory at KPMG and Ernst & Young, handles all matters of human resources. The firm seems adequately staffed. Of the firm's total employees, 17 were Partners and 31 were in the investment team. Downing expects an average increase of 15%-30% in employee numbers over the next three years, depending on the increase in AUM. The Manager indicated that there are no material corporate changes expected, at the time of writing. Downing also has a detailed Code of Ethics which includes policies on confidentiality and standards of business conduct by which employees have to abide.

Our view is that Downing exhibits strong governance characteristics in general. Overall, Downing's structure and approach to governance appears strong. One element of the structure is that Mr Lewis' family are involved in the ownership and management of the company. Mrs. Lewis, Nicholas Lewis' wife, is the second-largest shareholder and Chris Lewis, a member of Nicholas Lewis' extended family, is the CFO, as mentioned above. Our understanding is that Mrs. Lewis is not actively involved in management. Although we believe that the Manager is well run and that its CEO Tony McGing is responsible for the day-to-day management of the company, and that there is a sufficiently broad set of individuals at senior levels with the Manager, this ownership issue is nonetheless something to consider as it could affect the governance of the Manager.

Product Quality Assessment

Investment Team

The Investment Team ("The Team") comprises members from two separate entities: two members from Downing and a team of seven professionals at BioScience Managers Pty Ltd ("BioScience"). The execution of the healthcare and biomedical technology strategy ("the Strategy") will be predominantly driven by the team at BioScience who have been hired by the Manager to act as advisers to the Fund. The in-house team at Downing is headed by Kostas Manolis who has had 15 years' experience in private equity and M&A in addition to healthcare investment experience at Downing. Kostas also has a strong scientific background, having studied Biochemistry at university and attained a PHD in Molecular Genetics. Jeremy Curnock Cook is the founder and managing director of BioScience with over 30 years of healthcare investment experience. He has founded and grown biotechnology companies, as well as having been an active investor in the sector. He is the former head of the life science private equity team at Rothschild Asset Management.

BioScience is a life science investment firm, headquartered in Melbourne, Australia, but with offices in Vancouver, London and Switzerland. The BioScience team has combined experience of over 170 life science investments, more than 40 IPOs/reversals and a diverse skillset specific to the bio-based industries. Additionally, the BioScience team is assisted by an external network of ten sector specialists ("the Consultants"), predominantly based in the USA.

We note that the agreement between BioScience and the Manager is non-exclusive and as such there could be potential conflicts of interest with regards to the sourcing of deals for the Fund. Additionally, we note that the Fund is exposed to a significant level of key man risk; the continuity of the Strategy is somewhat reliant on maintaining a working relationship with BioScience and more specifically with Jeremy Curnock Cook. We understand that BioScience will earn a share of all fees earned by the Manager and as such the interests of both entities are somewhat aligned.

The key members of the BioScience team have worked together for over five years with low employee turnover; it appears to be a stable team. The senior members of the team all have over ten years of investment/fund management experience within bio-based industries. Additionally, the BioScience team has an established track record of investing in, and selling, bio-based companies. Consequently, they have developed an extensive network of contacts that they can leverage in the execution and management of the strategy. This is evidenced by their network of specialist consultants, who in our opinion will enhance the investment process. Overall, we are satisfied that the Team is very well-resourced and has the relevant mix of experience required to deal with the various challenges expected en route to the commercialisation of the underlying investments.

We have included key individuals' bios in the Appendix.

Investment Strategy & Philosophy

The investment philosophy focuses on delivering capital growth, whilst aiming to provide a consistent 4% dividend annual pay-out rate (net of fees excluding performance fees) following the third year of the Fund. The investment strategy centres on providing development and expansion funding to innovative healthcare and biomedical businesses headquartered in the UK. We understand that the Fund will target opportunities with a potential to deliver a target return of 3x to 5x money-in (net of management fees) within a four-to-five-year holding period. We note that upon positive exits of the underlying investments, capital above the dividend policy will be re-invested into the Fund.

The healthcare investment universe can be divided into four broad sub-sectors ("the Sub-sectors") as follows:

1. Drug Discovery: focus on diseases where there is either no treatment, or current treatments are imperfect. For example, septic shock, Alzheimer's, chronic pain and various cancers.
2. Medical Devices: such as replacement knees and hips, cardiovascular stents, robotic exoskeletons and sleep management systems.
3. Diagnostic Technology: examples of medical applications of such technology include the swift diagnosis of infections, choosing the most effective treatment, the diagnosis and identification of cancers, and the visualisation of problems (i.e. high resolution X-rays, MRI etc.).
4. Medical Data/E-Health Technology: to enhance the interrogation, collection and collation of information about individual patients, review patient adherence to prescribed drugs and the improvement of medical practices.

The Manager aims to create a portfolio of VCT-qualifying investments in unquoted companies working on disruptive solutions across the Sub-sectors. We understand that the Team will be actively filtering away investments they consider would present significant levels of regulatory risk and or other challenges on route to commercialisation. We note that the portfolio will be heavily tilted towards companies operating within the Medical Devices and Diagnostic Technology space; these companies typically require less capital and time to reach a stage at which an exit is plausible. We note that the Manager plans to invest between £0.5 million and £5 million in each portfolio company, with an average investment size of £1.5 million. Additionally, we note that there will be a tendency to co-invest with other external funds with similar investment objectives. The Manager states that this is an effective approach to ensure investors with similar objectives have enough control of the portfolio company to effect material change as and when required.

We understand that the non-qualifying proportion of the VCT's portfolio will be invested in Downing's Micro-Cap quoted fund ("the Micro-Cap Fund") run by Downing's Public Equity Team. The MI Downing Micro Cap Growth Fund is an open-ended investment company ("OEIC") which has increased its NAV by 129% over the last 5 years. The Micro-Cap fund will offer daily pricing and liquidity. Additionally, any fees incurred will be rebated back to the VCT to ensure subscribers are not charged twice by Downing for the same service.

We perceive the Fund to be at the higher-end of the risk spectrum in comparison to other VCTs due to the specialist nature of the Strategy. We note that the challenges faced in bringing new products (particularly new drugs) to market in the healthcare sector and the potential for overrun on research and development costs, create a high level of exit risk and refinancing risk in the portfolio. However, we acknowledge that the Team will be able to mitigate some of these risks through their expertise and experience in the sector. We recognise that successful investments in the portfolio will have significant upside potential; however, we note that the overall portfolio return could be affected by potential failures and liquidity drags. We note that a recent BioScience managed fund was run with a similar strategy and delivered a gross IRR of 22.5% (pre-fees) over a 6-year period, equalling a money multiple of approximately 3x over the period. However, investors should note that past performance is not an indication of future performance. Finally, we note that this is an evergreen VCT strategy with exit realisations reinvested into the Fund. Therefore, investors' ability to crystallise any gains from the Fund will be subject to the Manager's liquidity, and hence liquidity risk needs to be considered.

Pipeline/Prospects and Current Portfolio

This is a new share class and as such the composition of the portfolio has not yet been finalised. We understand, however, that the portfolio will comprise qualifying investments (75%) and non-qualifying investments (25%) following the deployment period. We note that upon final close of the offer we expect all undeployed capital to be held across the Micro-Cap Funds with this exposure decreasing to 25% as funds are deployed into qualifying investments. Additionally, we note that a proportion of some investments made in the portfolio will be comprised of secured debt investments (alongside equity) with a five-year bullet maturity profile. The debt will usually be taken as part of a full financing package, focussed mainly on equity. The debt will enable security to be taken over any assets owned by the investee company. We understand that the overall portfolio will likely comprise 10-15% in debt investments.

Downing has indicated that the portfolio will likely comprise a combination of the following four Sub-sectors and their respective proportions: Drug Discovery (20%); Medical Devices (40%); Medical Technology and Data (40%). Hence, the proposed portfolio is likely to provide a good balance between the higher risk Drug Discovery companies and the more moderate to relatively lower risk exposures. However, we note that these weightings are not part of a formal allocation policy, and may therefore differ in reality, at the Team's discretion.

The Team have indicated that they would expect to invest in between three to five portfolio companies within the first 12 months, with the number of investments in the portfolio rising to between 10 and 12 companies over the first three years. Based on the targeted fundraise of £10 million (plus a £10 million overallotment target) and an average investment size of £1.5 million, we would expect the portfolio to comprise between 6 and 13 companies across the Sub-sectors. Therefore, there will be a level of diversification across companies. We note, however, that this is a specialist healthcare strategy and by design there is a healthcare sector concentration risk in the portfolio; the overall portfolio performance will thus be sensitive to a general decline in the healthcare sector.

We understand that the Downing Ventures EIS fund ("the EIS Fund") may provide a good source of immediate pipeline for the VCT. The Team have identified 6 potential businesses in the EIS Fund which could make good candidates for follow-on funding through the VCT.

In our opinion, the Team appears to have a strong pipeline of potential investments, though we note that the Manager was unable to quantify how much of the current pipeline will filter into the portfolio. We note that the Manager has stated a plan to complete between three and five deals a year. Consequently, the deployment period is likely to be slow and close to the three year VCT limit, and so investors could suffer a drag on returns as a result. Furthermore, we note that there is a level of regulatory risk & refinancing risk due to a potential underestimation of the capital required to bring products to market and the consequential dilution of existing investors through follow-on funding rounds, particularly within the Drug Discovery exposures. Accordingly, investors should be in no doubt that this offering is at the high-risk end of the spectrum, albeit the targeted returns reflect this. The 25% long-term exposure to the Micro-Cap Funds and the 30% exposure to debt provides a good source of liquidity for the portfolio, and will reduce the effects of any cash drag.

Investment Process

The Manager has described its investment process as follows in AllenbridgeIQ:

TABLE 3:
INVESTMENT PROCESS

Investment Process	Details
Deal sourcing/origination	"Downing places a strong emphasis on the importance of a strong management team when sourcing potential investment opportunities. Also, we have proprietary access to later stage investments through the Downing Ventures fund where follow-on investments may become available. Additionally, Bioscience Managers Limited (an experienced healthcare investor) will be acting as our healthcare investment advisor." "Deal enquiries will be received by members of the investment team, who should make a preliminary assessment for appetite, liquidity and viability… A business plan and other information will be requested as appropriate… First meetings should typically take place at Downing's offices, having received a business plan. A second Downing executive should be invited to a first meeting. Deals, which are actively being assessed and, on the basis of existing information, look interesting, should be discussed at the weekly Team meeting. A 'One Pager'… intended to encourage a discussion regarding key investment attractions and risks, and to support the commitment of resources to pursuing the deal further [should be circulated prior to the weekly deal flow meeting]. An assessment of 'key risks' should be included. Consideration should also be given to whether the proposed investment qualifies under the rules of the investing fund(s)."
Deal filtering and selection	"A deal that has had a One Pager, and remains active, should be added to the New Deal Tracker ('NDT') and be discussed regularly at subsequent Team Meetings. The NDT should be updated weekly for new additions and when a major development occurs on existing transactions. Any deal of serious interest, with a realistic possibility of completing, should be referred back, periodically, to the Team Meeting for further discussion, as Downir due diligence is undertaken and outline terms are discussed with the company/vendor. 1.3. Visit to investment asset For the majority of investments, a visit to the investment asset(s) should be conducted by the members leading the deal. This should ideally take place before the Heads of Terms have been issued. 1.4. Management Team Presentation The Investment Committee should be given the opportunity to meet management, typically through a presentation at Downing's offices."
Due diligence process	"The due diligence process continues through the investment cycle to the point of completion… It will include work carried out both internally and externally, to validate the investment proposition, covering all aspects of the business, including market, competition, financials, management, insurance, valuation and exit. The nature and extent of due diligence will be considered afresh for each investment and discussed at the Team Meeting and with Investee Committee."

Deal Approval	Deals are brought to the Advisory Investment Committee, the purpose of which is "to consider investment and divestment proposals put forwards by the Investment Executives and make a recommendation for approval or otherwise to the Investment Committee ("IC")… The overriding role of the AIC is to ensure that all proposals put forward by the AIC are in the best interests of the investors… and comply with all statutory, regulatory, fiduciary and contractual obligations." If the IC approves the deal, an investment paper is written and final approval by the board of the VCT is sought.
Post-Investment Monitoring	"We work with the management teams, attending board meetings, reviewing management information and making ourselves available to them to assist with any issues. We maintain regular contact and review accounts. We have strategic input, but leave the management to deal with the day to day operations whilst monitoring the situation to ensure things are going to plan. A representative of Downing sits on the Board of the vast majority of investee companies."

Source: Downing; AllenbridgeIQ

We have reviewed the investment process for the VCT and were impressed with the structure and rigour of the procedures followed. Overall, Downing adopts a sufficiently comprehensive investment process with a diverse deal sourcing channel. Their due diligence process operates as a robust filtering system undertaken before the selection of underlying investments. Additionally, the deal approval process provides a sufficient level of governance.

Risk Management

We identify the following as the key risks of an investment in the VCT: failure/poor performance of an investee company, execution risk, liquidity risk, exit risk, sector concentration risk and the maintenance of VCT tax benefits. We have assessed the policies and controls that Management has in place to minimise these risks and have found them to be appropriate for the size and strategy of the VCT.

Risks relating to investee company default are partly mitigated during the investment process through the analysis and due diligence undertaken before an investment decision is made. We note that the Manager does not have any formal limits regarding portfolio construction; consequently, the portfolio could potentially be overexposed to one or two of the Sub-sectors. However, we understand that there is a soft portfolio limit of 15% on individual positions in the Fund. In our opinion, the portfolio construction process would benefit from formal parameters to ensure counterparty and sub-sector diversification.

Execution risk is controlled through an ongoing, active involvement by the Team in the management of the underlying investments. We understand that the underlying investments will be actively monitored against the business plan on the basis of which the initial investment decisions were made. To capture financial information in a timely manner, Downing uses a third-party monitoring system which collects management information directly from investee companies.

A number of processes have been put in place to ensure the early identification of issues affecting the performance of the underlying investments. These include, but are not limited to, weekly portfolio team discussions and monthly logs of issues that are circulated across the team. Additionally, we note that the Manager adopts a tranched funding approach, where possible, with follow-on funding approved subject to the investee company in question meeting pre-agreed milestones. Furthermore, Downing will seek to appoint an investor director, with veto rights, to the board of each investee company. As a final layer of oversight, the portfolio is also monitored by the VCT Board which meets quarterly to discuss the progress of the portfolio companies.

With regards to liquidity risk we note that: i) the Manager has a nil discount share buy-back policy, to facilitate early exits for investors if required (subject to board approval); and ii) the portfolio will have an exposure to the Micro-Cap Funds. This provides a moderate level of liquid resources to manage liquidity demands. However, VCTs are, by design, a relatively illiquid asset class and so investors should consider liquidity risk before investing in the Fund. The nil discount share buy-back policy is uncommon for VCTs, and is a positive feature of the offer.

We note that HMRC advanced approval is sought to ensure that each new investee company is VCT-qualifying at the time of investment. We consider this to be good practice, but investors should be aware that if the investment holding conditions are not met, they will not be entitled to the full tax benefits of VCT investments.

Finally, we present the following as potential conflicts of interest that investors should be aware of:

- The co-investment of capital by different Downing Managed products;
- Asset transfers between Downing products;
- Follow-on funding – we understand that several investments in the EIS Fund could feed the Fund.

We have reviewed the Manager's conflicts of interest policy and are satisfied with it. With regards to follow-on funding, we note that that it is typically done in conjunction with an external third party investor. We consider this to be good practice as it helps to fairly manage conflicting interests between new and existing shareholders.

Key Features

The following fees (numbers 1-4) are those directly payable by the investors and the product fees (number 5) incurred by Downing.

1. Initial and Ongoing Fund Management Fee

The fund management fees payable to Downing include those depicted in the table below.

TABLE 4:
FEES PAID TO THE MANAGER

Initial Fees	On-Going Annual Management Fees	Administration and Accounting Fees
2.0% of the amount subscribed	2.5% of NAV	£40,000 + 0.1% p.a. of funds over £10 million + £5,000 per extra share pool

Source: Downing; AllenbridgeIQ

2. Early bird fees and other discounts

Early bird fees will apply for one-off investments only when applications are received by a certain date, as illustrated in the table below.

TABLE 5:
OFFER DISCOUNTS

Discounts	Details	Closing Date	Applicable Candidates
Early-bird discount	1%	20/01/2017	All whose applications are received by Downing for processing prior to or on the Early Bird close date

Early-bird discount	0.5%	03/03/2017	All whose applications are received by Downing for processing between the previous Early-bird date and the second Early Bird close date

Source: Downing; AllenbridgeIQ

3. Subscription/Application Fees

TABLE 6:
SUBSCRIPTION/APPLICATION FEES

Type of Investor	Initial Application Fee (and initial commissions/initial adviser charges)	Ongoing management charges (and ongoing commissions/ongoing adviser charges)
Direct Application (Investors who make an application, without using a financial adviser or execution-only intermediary)	2%	N/A
Application through an adviser (investors who are professionally advised clients and make an application through a registered financial adviser)	2%	N/A
Application through an execution-only intermediary	4%	0.25% over five years

Source: Downing; AllenbridgeIQ

4. Performance Fee

There is a performance incentive fee of 20%, payable on dividends paid to investors over a 100p hurdle until 2020, after which the hurdle increases by 3p per annum.

5. Product Fees

The detailed fees are listed in the following table.

TABLE 7:
FEE DETAILS

Fees	Details
Administration Fee	£40,000 + 0.1% p.a. of funds over £10 million + £5,000 per extra share pool
Annual Management Charge	2.5%
Arrangement Fee (% of deal)	Up to 3%
Directors' Fees	0.1%*
Monitoring Fees	Capped at the higher of £10,000 p.a. or 0.5% p.a. of the cost of investment
Running Costs	Capped at 3.5% of net assets

Source: Downing; AllenbridgeIQ
Note: The calculation for Directors' Fees is based on the £10 million offer over the total assets.

Performance

We note that this is a new product offer and that consequently there is no performance track record to evaluate. Additionally, we note that the investment strategy is different to those adopted by previous VCTs run by the Team. Consequently, it is difficult to assess the likely performance of this VCT with any degree of confidence. Nevertheless, we note that Downing have an established track record of: launching VCTs (they currently have over £200 million of VCT funds under management), investing funds raised within the required time frames, delivering on dividend payment targets and returning funds to investors.

i. With regards to the track record of BioScience, we present the performance of two of their funds; The International Biotechnology Trust plc ("IBT"), managed by Jeremy Curnock between 1994 and 2000;

ii. the IB Australian BioScience Fund I ("Fund I") launched by BioScience in 2008.

TABLE 8:
PERFORMANCE

Fund	Start	End	No. core investments	Size of Fund	Gross IRR
The International Biotechnology Trust plc	May 1994	August 2000	30	£349.3m	40%
IB Australian Bioscience Fund I	July 2008	November 2014	12	AUS$42m	22.5%[1]

Source: Downing
[1]Net of fees

Fund I focused on businesses within the mid-stage healthcare and life science sectors and has now been fully wound-down. The fund called down AUS $36.5 million and returned AUS $56 million to investors. We note that BioScience launched a second fund in 2012, "The Asia Pacific Healthcare Fund II", a 10-year limited life fund; however, it is too early to assess its performance.

We note that the returns achieved to date by BioScience at a portfolio level are at the lower end of the 3-5x money multiple being targeted at the portfolio company level.

Appendix 1: Key Personnel

Name	Job title	Date started	Biography
Lord Howard Flight	Chairman	2009	Lord Flight has worked in the financial services industry for over 40 years and co-founded Guinness Flight Global Asset Management. In 1998, upon Guinness Flight's acquisition by Investec, he became joint chairman of Investec Asset Management Limited. He was MP for Arundel and South Downs from 1997 to 2005 and Shadow Chief Secretary to the Treasury between 2000 and 2004. He was appointed to the House of Lords in January 2011. He is chairman of the EIS Association and CIM Investment Management Limited; and is a director of Metro Bank plc, Investec Asset Management Limited and a number of other companies in the financial services sector. He is also a Commissioner of the Guernsey Financial Services Commission.
Sir Aubrey Brocklebank	Senior Independent Director	2015	Sir Aubrey Brocklebank (Senior Independent Director) assumed his first role within the VCT industry in 1997, following a career in accountancy, corporate finance and venture capital. Since then he has gone on to become one of the most experienced directors. Aubrey maintains a wide range of business interests and has been a director of six AIM listed companies. He is chairman of Puma VCT 8 plc and Hargreave Hale AIM VCT1 plc.
Russell Catley	Director	2015	Russell Catley has over 30 years' experience in the financial sector and is currently Chief Executive of both Catley Lakeman Securities, the UK's leading provider of institutional structured products and its subsidiary asset manager, Atlantic House Fund Management LLP. Its long-standing clients include JP Morgan, HSBC, Credit Suisse, UBS and Royal Bank of Canada. He was previously a Director at Citigroup Global Markets and AXA Investment Managers UK Limited and was on the Board of AXA World Funds (Luxembourg), one of Europe's largest fund companies from 2001 to 2004.
Kostas Manolis	Partner	2015	Kostas works across the Investment team and he is a member of the Ventures Investment Committee. He has more than 11 years' private equity experience as investor, board director, portfolio manager, advisor and business angel. Kostas worked as a corporate finance advisor at PwC, where he advised institutions and management teams on private equity deals, and later joined the private equity team of Bank of Scotland in 2006. He was a member of the Caird Capital team that led a successful spin out of a £0.5bn private equity portfolio from Lloyds Banking Group in 2010. He has worked with management teams through operational improvement, growth, turnaround and successful exits. Kostas holds a degree in Biochemistry and a PhD in Molecular Genetics and is a Chartered Accountant with ICAEW.

Jeremy Curnock Cook	Investment Advisor	2016	Jeremy Curnock Cook, the former head of the life science private equity team at Rothschild Asset Management and an active investor in the Australian life science sector, is the Managing Director of BioScience Managers. At Rothschild, Mr. Curnock Cook was responsible for the launch of the first dedicated biotechnology fund for the Australian market and the launch of a joint venture with Johnson & Johnson Development Corporation for the creation of Healthcare Ventures, an investment vehicle dedicated to seed stage investments in Europe, as well as the conception and launch of the International Biotechnology Trust (IBT). Jeremy has served on more than 30 boards of directors in the healthcare and medical sciences sector in the UK, Europe, USA, Canada, Japan and Australia.
David Phillips	Investment Advisor	2016	David has spent over 30 years in the healthcare industry, including 14 years in sales and marketing with Glaxo Wellcome, Cephalon Inc, Oxford Molecular Group Plc, and latterly 8 years with SR One (GSK's Corporate Venture Fund). In between these two periods with GSK, David spent 12 years at Board level as Chief Business Officer of Argenta Discovery, The Automation Partnership and BioFocus Plc (prior to the divestment to Galapagos NV where he stayed with the business). David re-joined GSK's SR One in 2008 to pioneer a new function to incubate and spin-out technologies from GSK and in parallel investing in early stage life science companies. He has divested a number of R&D operations and drug delivery technologies. He led the team that divested GSK's Opiates business in Australia in 2015.
Matt McNamara	Investment Advisor	2016	Matt is responsible for deal flow management and evaluation, leading all investment recommendations and due diligence. He has over 25 years' experience in the healthcare & medical sciences sector. After initially being a Molecular Biology Research Assistant, Matt spent 11 years in Sales & Marketing, and General Management with Merck & Co. and Johnson and Johnson Medical Pty Ltd respectively. He has served as SVP Business Development for *e*Bioinformatics Inc and was CEO of a Life Sciences Venture Capital fund, SciCapital Pty Ltd.
Dr Amanda Gillon	Investment Advisor	2016	Amanda has over seven years of life science experience with close familiarity with plant biotechnology and human protein folding diseases. She holds a PhD in Molecular Biology and Biochemistry from La Trobe University together with the agricultural-biotechnology company Hexima Ltd, focusing on a family of novel circular proteins (cyclotides) that possess potent biopharmaceutical properties. Since completing her PhD, Amanda worked for three years as a postdoctoral fellow at Columbia University in New York City identifying new genetic and biochemical pathways that may be directly relevant to a number of human diseases, most notably cystic fibrosis. Amanda has an MBA from Melbourne Business School.

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8 Old Jewry, London EC2R 8DN
Telephone 020 7079 1000

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