Investment Manager's Report

This report covers the third quarter of the 2016/17 financial year, 1 April 2017 to 30 June 2017.

Investment Report

Global equity markets had a reasonable quarter as economic data was generally positive. President Trump's promises to cut taxes and reduce business regulations were well received by US equity markets, which hit new highs. In the UK, the Bank of England put through a small upgrade to their projections for economic growth this year, principally because of stronger than expected consumer spending, although we have since witnessed some signs of consumer retrenchment in the face of higher inflation and decreases in real wage growth.

As is the way these days, each quarter brings with it new challenges and risks. Brexit chat is not a regular feature in our company meetings beyond the implications of weakness in Sterling, although we expect it to re-emerge as a talking point once we get a better feel for the mechanics and implications of our exit from the European Union. We remain cautious on certain sectors such as financials and consumer discretionary; however, we still see ample opportunity for growth within our investee companies, particularly those with strong product differentiation and/or structural growth in their end markets. Weaker companies are vulnerable, particularly those in consumer discretionary, traditional retail or where there is a high risk of substitution. We continue to find interesting investment opportunities in qualifying companies.

Performance

In the three months to 30 June 2017, the NAV increased from 78.12p to 78.43p. A total of 1.75 pence per share was paid in dividends, giving investors a total return of 2.06 pence per share, which translates to a gain of 2.6%. During the same period the FTSE AIM All-Share Total Return gained 4.3%, whilst the FTSE 100 Total Return gained 1.0%.

The qualifying investments made a net contribution of 0.91 pence per share with thirty-one out of the eighty-two making gains, twelve unchanged and thirty-nine losing ground. The balance was the net of non-qualifying portfolio gains, running costs and investment income.

Hardide was the top performing qualifying investment (+100.0%, +0.63 pence per share). The company backed up the recent award of global approved supplier status by Airbus with an upbeat half-year trading update that pointed to a year-on-year doubling of sales to the Oil & Gas sector, which helped the shares to a three year high. Eagle Eye also performed well (+56.6%, +0.41 pence per share), announcing a new three-year contract to use their technology in support of John Lewis' digital strategy. This was followed by a £6.0m fundraise to strengthen their balance sheet and allow further investment in operational and marketing resource. Abcam (+17.6%, +0.29 pence per share), Faron Pharma (+35.5%, +0.21 pence per share) and ULS Technology (+26.8%, +0.18 pence per share) were all also significant contributors over the period.

The biggest losses within the period came from K3 (-42.0%, -0.38 pence per share) after they announced that longer sale cycles and contract delays would lead to a significant reduction in revenues, profits and cashflows for the year ended 30 June 2017. Other losses in the period came from TLA (-57.1%, -0.37 pence per share), Animal Care (-14.5%, -0.29 pence per share) and Idox (-12.9%, -0.20 pence per share).

We invested £2.34m into seven qualifying investments over the period, including four further investments into existing listed qualifying companies, one IPO and two new investments into listed companies.

Within the qualifying portfolio, we exited our investments in Audioboom, Directa Plus and Haydale Graphene following prolonged periods of underperformance. We also exited our investment in FreeAgent. We reduced our investments in ECSC, Faron Pharma and Gfinity following very strong runs.

Portfolio Structure

The VCT is comfortably through the HMRC defined investment test and ended the period at 85.83% invested as measured by the HMRC investment test. By market value, the VCT had a 55.7% weighting to qualifying investments.

The allocation to non-qualifying equity investments decreased marginally from 18.9% to 17.9%. We continued to make use of the Marlborough Special Situations Fund as a temporary home for proceeds from fundraising; the allocation marginally increased from 10.2% to 10.8%. The non-qualifying investments contributed +1.34 pence per share to the overall gains. Cash decreased from 18.8% to 15.9%.

The HMRC investment tests are set out in Chapter 3 of Part 6 Income Tax Act 2007, which should be read in conjunction with this section of the interim management statement. Funds raised by VCTs are first included in the investment tests from the start of the accounting period containing the third anniversary of the date on which the funds were raised. Therefore, the allocation of qualifying investments as defined by the legislation can be different to the portfolio weighting as measured by market value relative to the net assets of the VCT.

Buybacks

In total, 468,997 ordinary shares were purchased between 1 April 2017 and 30 June 2017, at a total value of £361,388. Since the period end 75,822 ordinary shares were purchased at a total value of £57,472.

Dividends

An interim dividend of 1.75 pence per ordinary share was paid on 30 June 2017.

Post Period End Update

Deal flow has been good since period end and we have made one follow on investment in Surface Transforms and two new investments in Honest Brew and Gousto. We also have several deals in the pipeline which we expect to complete in the coming weeks.

For further information, please contact:

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