The Association of Investment Companies

Feeding the fledgling economy

VCT 2015 investment review

October 2016

www.theaic.co.uk

About the AIC

The Association of Investment Companies (AIC) represents closed-ended investment companies whose shares are traded on public markets.

AIC members include 62 Venture Capital Trusts (VCTs), which manage some 96% of the sector's £3.5 billion of assets.

To discuss the issues raised in this paper please contact:

Guy Rainbird
Public Affairs Director
guy.rainbird@theaic.co.uk
020 7282 5553

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1 Chief Executive's foreword

Venture Capital Trusts (VCTs) continued to deliver much needed growth capital to small businesses during 2015. This was in spite of uncertainty created by rule changes introduced towards the end of the year.

The sector's record is even more striking when the disruption caused by these changes is taken into account. The last quarter saw the number of transactions reduce as VCTs considered the implications of the new rules and, where necessary, took steps to adapt their investment approach. This meant that a number of deals which could have been expected towards the end of the year were not completed. Nonetheless, overall investment levels for the year nearly matched what was achieved in 2014.

The UK Government has committed to reopening discussions with Europe to allow VCTs to buy shares from existing investors. Such purchases were stopped by the 2015 changes. Allowing VCTs to buy shares already in issue can be invaluable in restructuring the ownership of a small and medium-sized enterprise (SME) to allow a transaction to be successfully completed. I very much hope early progress will be made on this matter. The UK's impending withdrawal from the EU following this year's referendum may also create opportunities in the longer term to reduce compliance burdens and facilitate a greater range of investments in entrepreneurial businesses.

VCTs will continue to produce strong results for SMEs and their own shareholders

These are important issues for the future, but even without such changes VCTs remain confident they can continue to support UK SMEs. This was illustrated by another strong round of fundraising, with the sector this year raising the third highest amount over the 20 years of the scheme.

As ever, I am grateful to the VCT fund management teams for providing the data and case studies that make this report possible. Its findings make a compelling case for the benefits provided by VCTs as they help small businesses grow, create jobs, innovate and secure exports.

I remain confident that VCTs will continue to produce strong results for investee businesses and their own shareholders whatever challenges they face as the commercial, regulatory or economic environment develops in the future.

Ian Sayers
Chief Executive, AIC

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2 Executive summary

Investments between
£50,000 and £5 million
in 2015

Sectors receiving the greatest support in 2015


Business services


Digital, creative and information services


Retail


Manufacturing

On average
£1.19 million
dedicated to R&D per company

Non-UK turnover of
£6.7 million
on average for exporting SMEs

Average turnover increase of
£2.9 million
per £1 million of investment

Over
20,000 new jobs
reported in VCT backed businesses

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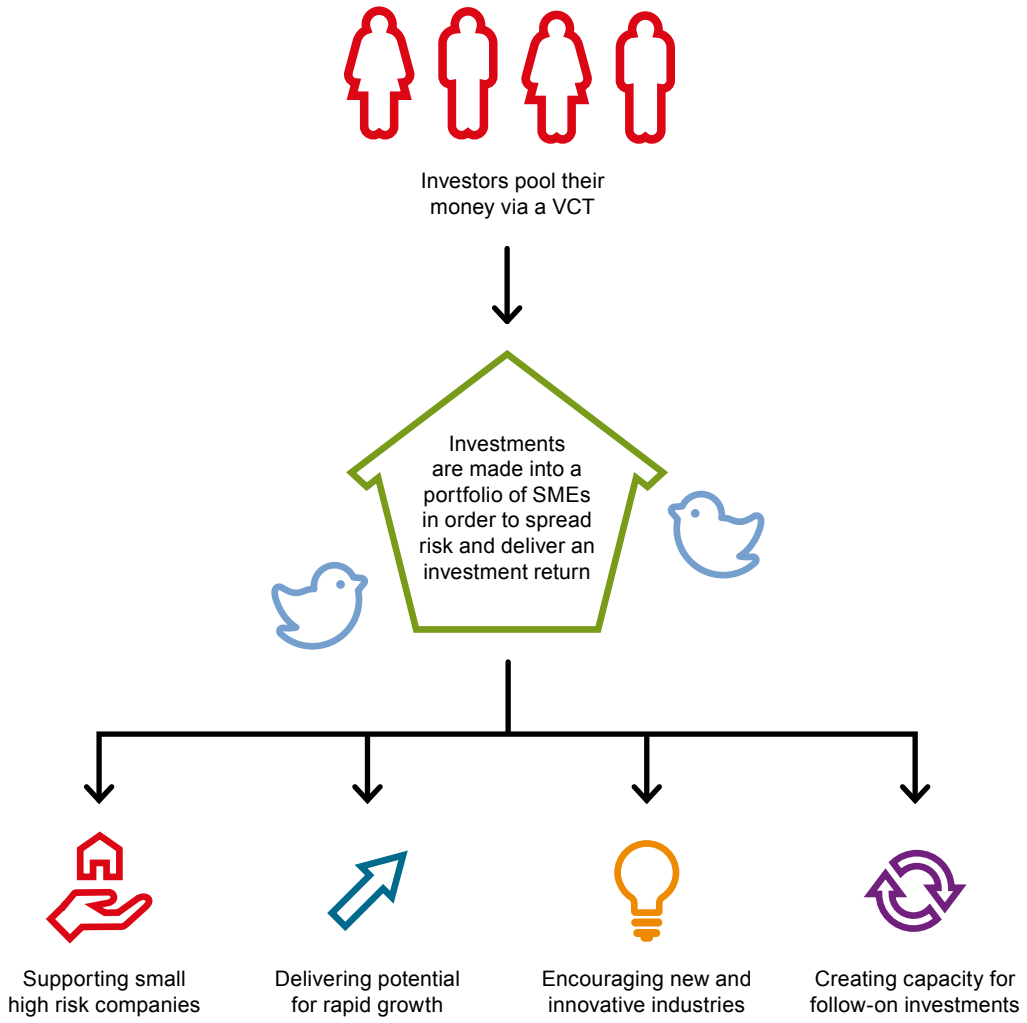
3 An extra source of money and help

Entrepreneurs can struggle to secure finance. VCTs make a real difference by providing money which would otherwise not be available.

They pool the savings of retail investors, most of whom would not have the skill or experience to identify businesses with growth potential. Investors benefit from due diligence undertaken by managers to check that investments are what they seem. The fund structure also means that investors do not put all their eggs in one basket.



VCTs take an active interest in making business a success. Two thirds of companies supported by VCT money in 2015 had a VCT representative join the board.

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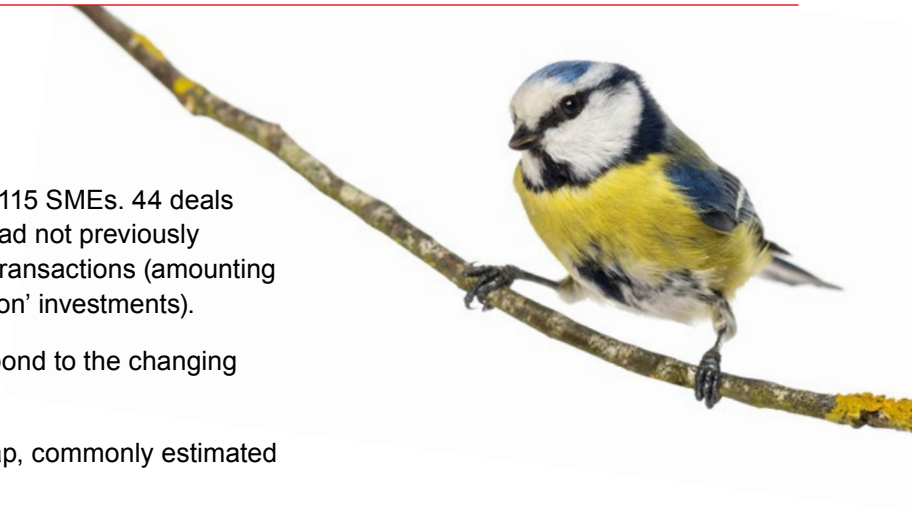


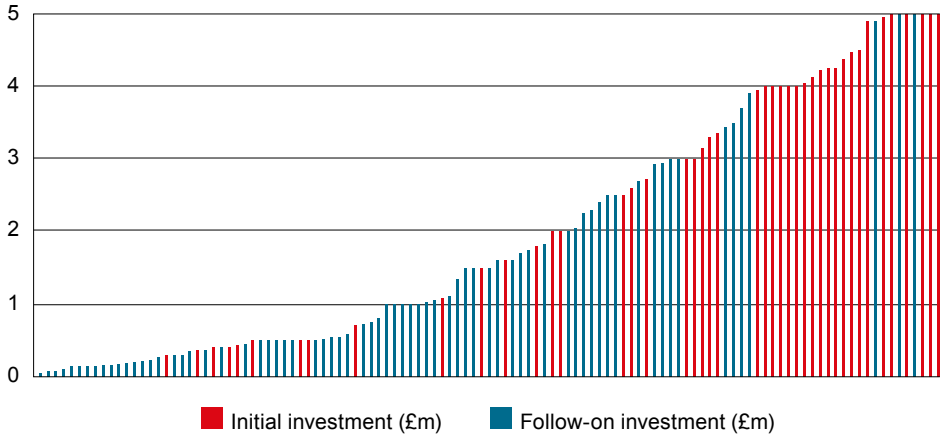
4 Investments in 2015

In 2015 VCTs provided £225 million of funds to 115 SMEs. 44 deals (totalling £131 million) were in companies that had not previously received VCT funding ('initial' investments). 71 transactions (amounting to £94 million) provided further finance ('follow-on' investments).

Providing follow-on funding allows VCTs to respond to the changing needs of businesses as they grow.

VCTs successfully targeted the SME finance gap, commonly estimated as between £2 million and £10 million.

VCT investments in 2015 (ranked by size)



The record of investment in 2015 shows that VCTs do not focus only on larger, more cost effective, transactions. They help businesses at a variety of stages of development.

Investments ranged between **£50,000** and **£5 million**

Average initial investment of **£2 million**

Average follow-on investment of **£1.5 million**

Sector focus 2015

The top sectors supported received £114 million, invested into 50 companies. This amounted to just over half of all VCT funds provided in 2015. Those receiving the greatest support were:

- Business services
- Digital, creative and information services
- Retail
- Manufacturing

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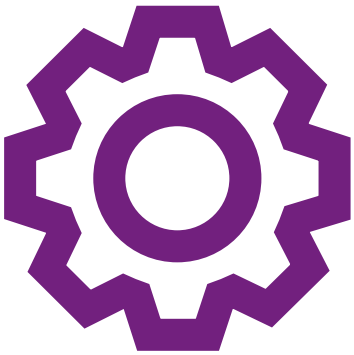
Other sectors receiving significant levels of investment included Health and social care, Financial services, and Information technology. 2015 saw significant continuity. Investments were broadly targeted on the sectors which had been supported in previous years.

The largest sectors held across all VCT portfolios, irrespective of the year of investment are:

- Business services
- Information technology
- Digital, creative and information services
- Manufacturing



Research and development 2015

VCTs identify innovative companies as targets for investment. They seek out those most likely to disrupt existing markets and achieve significant growth.

Recent HM Revenue and Customs research found that three quarters of SMEs supported by VCTs (or Enterprise Investment Schemes) had undertaken some form of innovation as a result of their investment. This was reflected in the survey findings.

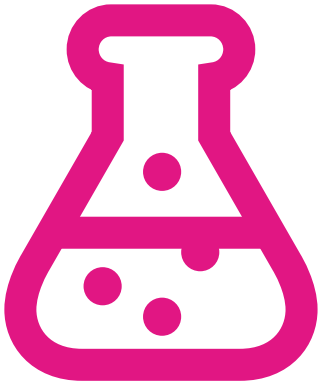
37% of SMEs reported research and development (R&D) expenditure during 2015.

The sectors spending most on R&D were:

- Digital, creative and information services
- Information technology
- Health and social care
- Manufacturing

During 2015 VCT backed SMEs invested **£181 million** in R&D

Average amount dedicated to R&D was **£1.19 million** per company



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abcodia

Abcodia Limited (Abcodia) develops processes for the early detection of cancer, including pancreatic, lung, colorectal and oesophageal cancers. It has developed a test for ovarian cancer, and aims to develop others.

It also facilitates third-party research by providing access to a 'biobank'. This facility, run by University College London, comprises five million samples collected over a ten year period as part of an ovarian cancer study.

Albion VCTs invested £2.3 million in Abcodia between 2011 and 2016.

AVID technology

AVID Technology Group (AVID) produces systems to improve vehicle efficiency to reduce emissions. They are used in vehicles as diverse as buses and off-highway machinery to hybrid and electric supercars.

NVM Private Equity VCTs invested £2 million in July 2016 to help AVID expand its engineering and manufacturing capability, and to fund its research and development programme.

DYSIS®

Dysis Medical Limited (Dysis) develops products for early diagnosis of cervical cancer. Its technology detects approximately 90% of cervical cancer cases compared to around 50% for the current standard process.

Albion VCTs invested £5.1 million between 2009 and 2016. This money helped Dysis develop its products and secure regulatory approval in Europe and America. Its technology is now used across the USA, Europe and Asia.

SiS
SCIENCE IN SPORT

Science in Sport (SiS) develops nutritional supplements for professional and amateur athletes. Amati VCTs invested £1.5 million in 2014 and 2015 to help fund SiS's e-commerce and international sales. SiS products are manufactured in Lancashire.

SiS works with leading athletes, such as the Team Wiggins cycling team, the GB rowing team and the All Blacks rugby team. SiS is currently an official partner to Liverpool Football Club.

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Exports 2015

Within the survey, 194 companies reported exports with a value of £1.2 billion. This represented 40% of their total sales (of £3 billion).

This is a significant level of exports for smaller businesses and is indicative of their appetite for growth and their potential value to the UK economy.

The top 5% of VCT backed SMEs making exports achieved a total turnover of £720 million, with exports making up 67% of their combined sales.

The top sectors for exports by VCT backed SMEs in 2015, making up three quarters of all non-UK sales, were:

- Business services
- Retail
- Health and social care
- Manufacturing

Average non-UK turnover of **£6.7 million** per SME

Half of SMEs surveyed made exports

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The GP Service (GPS) is an innovative platform that allows individuals to consult a GP online and have their prescription delivered direct to a local pharmacy. All the doctors used are UK-based and registered. GPS is responding to consumer demand for a service they can tailor more conveniently around hectic work and family schedules.

Maven VCTs invested £2.5 million in May 2016. This capital will be used to roll out the company's activities into new areas of the country and develop additional services.

LoopUp provides remote meeting facilities. Amati VCTs invested £960,000 when the company floated on the Alternative Investment Market (AIM) in August 2016. In all, LoopUp raised £8.5 million to fund its further expansion.

Without VCT backing the public offer may not have been cost-effective or raised sufficient funds to meet the company's business objectives. The business is headquartered in London, with offices in the US, Hong Kong, and Barbados.

Third Bridge

Third Bridge supplies research for private equity firms, hedge funds, institutional investors, management consultants and corporations seeking investment opportunities. Founded in London in 2007 it now employs over 250 members of staff and has offices in North America, Europe and Asia.

The ProVen VCTs, managed by Beringea, invested £3 million in Third Bridge in 2012. This helped accelerate the company's international expansion and strengthen its senior management team.

MONICA VINADER

Monica Vinader is a jewellery business which sells over the internet, through UK department stores and in its own boutiques.

The ProVen VCTs, managed by Beringea, invested £2.1 million between 2010 and 2014. A Beringea representative joined the company's board to help develop its strategy and grow the senior management team. In the last three years sales have tripled to over £20 million and the company now has around 170 employees.

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Nurturing business growth

As SME investment is risky, not all VCT backed companies will be fly-away successes. Nonetheless, the performance of VCT backed businesses is impressive.

A year after investment, VCT funds are already helping secure growth. On average, each £1 million of investment has supported an increase in turnover of £2.9 million.

Where the investment is less than five years old, each £1 million of VCT funds supported an average of £1.2 million in increased turnover. Where the money has been working for over five years, the average increases to £5 million.

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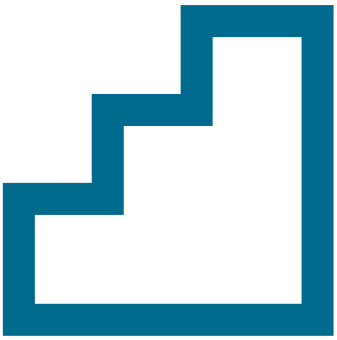
The 5% VCT backed SMEs showing the greatest turnover growth saw sales rise by £1.5 billion. This accounted for nearly half of the increase achieved by all the SMEs in the survey.

All but two of the 18 companies in the top 5% had been supported by the VCTs for longer than five years.

Long-term support by a VCT helps deliver substantial growth

Business services delivered 34% of 2015 turnover growth

One SME saw turnover up from £25 million at investment to **just over half a billion pounds**



Creating jobs

HM Revenue and Customs' research reported that 71% of SMEs had grown employee numbers since VCT (or Enterprise Investment Scheme) investment. 8% saw their headcount reduce. 90% of respondents in the HMRC research attributed at least part of this growth to these investments.

13% of SMEs in this study reported fewer employees since VCT investment. 71% reported an increased headcount.

VCT backed businesses averaged an increase of 60 employees per company. Rates of job creation tended to increase over time.

Where investment had been made less than five years ago the average increase in employees per company was 24. Where investment had been present for over five years the average increase in jobs was 103 per company.

The top sectors:

- Business services
- Retail
- Digital, creative and information services
- Information technology

The number of employees in VCT backed businesses in the survey increased by over **20,000** since investment

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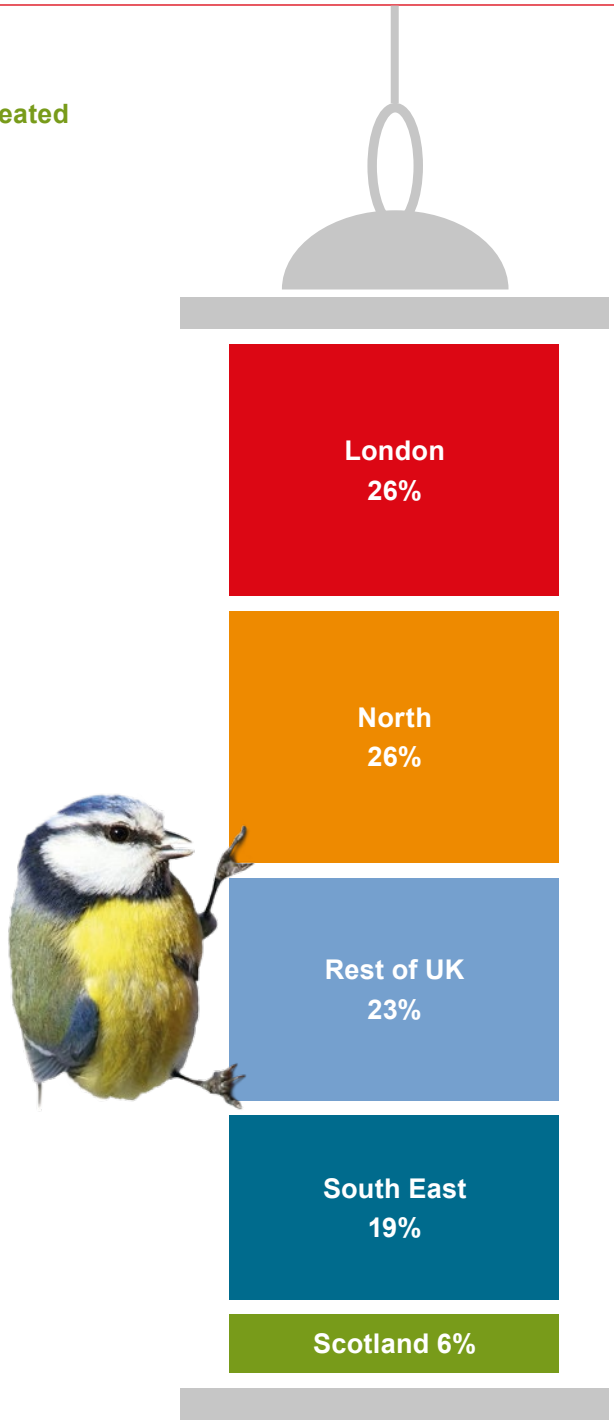
Distribution of jobs created



5 Value for money intervention

The Government is the largest single investor in VCTs via the tax reliefs it provides. It is essential that the scheme delivers value to the taxpayer.

HM Revenue and Customs' research found that SMEs receiving taxpayer supported investment believe that these funds helped the company grow. Over the longer term this should result in these businesses paying more tax, for example, through payroll or corporation taxes.

221 companies within the sample disclosed that they paid £243 million in tax during 2015. The total of VCT investment made into these SMEs amounted to £674 million. The initial tax relief supporting this investment was £202 million.

These companies therefore paid more tax in 2015 alone than they received via the initial income tax relief received by retail investors in VCTs. This is a strong indicator that VCTs offer value to the taxpayer.

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Of course, this analysis can only be indicative. Some tax would have been paid without VCT investment but we consider that this would have been far less as those SMEs would not have had the same capacity to build their businesses. Also, some tax relief helped with other aspects of operating a VCT, for example, paying the running costs of the fund. It is nonetheless valuable as it supports the overall goal of delivering finance to SMEs.

Investors receive other tax relief on VCT dividends and any capital gains when the shares are sold. These reliefs are comparable to those provided via Individual Savings Accounts. It is the initial tax relief which is the key mechanism that mobilises the additional funds for investment in SMEs in the first place.

VCT funds **support SME growth**

Annual tax paid **greater than initial tax relief**

A strong indicator of value to taxpayer

6 Methodology and references

Sector attribution

Respondents self-identified the sector in which the investee company is active.

The sector 'Information and communications technology and precision instruments' has been combined with 'Technology/IT' for the purposes of this report. The combined sector is labelled 'Information technology'.

Research and development

The sample included data for 409 companies. Of these 153 reported R&D expenditure during 2015.

Delivering business growth

The analysis excluded companies where the initial investment was made during 2015 as this provided insufficient time for VCT investment to have an impact.

Overall turnover growth analysis is based on investment in 335 companies (which provided turnover at investment and at the end of 2015). These companies received £1,058 million of VCT investment overall. The aggregate turnover at investment was £2,057 million and £5,133 million at the end of 2015.

The assessment of turnover growth for companies in receipt of VCT funds for less than five years covered 186 companies, with initial turnover of £1,201 million and £1,891 million at the end of 2015. Investment received was £579 million.

The assessment of turnover growth for companies in receipt of VCT funds for over five years covered 149 companies, with initial turnover of £856 million and turnover of £3,242 million at the end of 2015. Investment received was £479 million.

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Creating jobs

The analysis excluded companies where initial investment had been made in 2015 as this timescale does not provide sufficient time for VCT investment to have an impact.

The average increase of jobs in VCT backed businesses was based on returns from 348 companies. They saw the number of employees rise from 20,391 employees at investment to 41,169 at the end of 2015.

The assessment of job growth by companies receiving investment less than five years ago is based on returns from 191 companies. Jobs at investment were 12,557 and 17,118 at the end of 2015.

The assessment of job growth by companies receiving investment more than five years ago is based on returns from 157 companies. Jobs at investment were 7,834 and 24,051 at the end of 2015.

Value for money intervention

The analysis of the amount of taxpayer support for VCTs is based on the assumption that the VCT funds invested received a 30% tax relief.

It is the case that some of the funds received by SMEs may have been raised during periods when the 40% relief was provided (that is, between 2004 and 2006) or when the 20% relief was available (that is, pre-2004).

However, assuming a relief rate of 30% is reasonable. Over half of all funds raised by the VCT scheme were raised in the last ten years, when the initial income tax relief was 30%. 27% of all VCT funds were raised when the initial tax relief of 20% was provided. Only 20% of funds raised by VCTs were supported by an initial income tax relief of 40%.

References

References to HM Revenue and Customs' research are to "The use and impact of venture capital schemes", February 2016, Ipsos MORI, Social Research Institute. Published by HM Revenue and Customs.

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Acknowledgements

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Copies of previous versions of the AIC's annual research into the impact of VCT investment can be found at the following link:

www.theaic.co.uk/vct-research

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Association of Investment Companies

24 Chiswell Street
London EC1Y 4YY

Telephone 020 7282 5555
Fax 020 7282 5556
enquiries@theaic.co.uk
www.theaic.co.uk

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