

Manager's Report

Introduction

What a difference a year makes! After our gloomy statement last year equity markets reversed their downward spiral as confidence in the long-term future of UK plc returned during 2003. Smaller companies dominated the recovery, which was hardly surprising considering they had suffered most. It is therefore pleasing to note the improvement in our net asset value ('NAV') and that BWD Aim VCT's performance is currently ranked in the upper quartile of VCTs established in the tax year 1999–2000*.

As stated last year, we have maintained a cautious investment approach and have only committed such funds as are required to comply with the VCT legislation. We predominantly invest in established, profitable and relatively low-tech companies, which offer more stability to the portfolio. We still maintain a substantial amount of shareholders' funds in unit trusts and blue-chip equities but have reduced our exposure to gilts as, with increasing interest rates likely as the UK economy recovers, direct exposure to equities offers better upside potential.



Investment Policy

The companies selected for investment by us are usually traded on the Alternative Investment Market ('AIM'), or hope to join within the next 12 months, and:

- have a good track record;
- operate in growth markets;
- offer superior services or products to their competitors with sufficient funds to finance growth;
- have experienced, committed (in terms of share ownership and options) and balanced management teams; and
- have, or are likely to have, good liquidity to enable their shares to be traded.

Prior to making an investment we spend considerable time researching the company and the sector in which it operates. We always meet the management team and often cross-reference our views with other VCTs. During the year we reviewed over 107 proposals from AIM and unquoted qualifying companies.

VCT Status Targets

We must invest at least 70% of new funds raised in any one accounting period into qualifying companies within three years. We are pleased to confirm that we reached this target by 28 February 2003 and maintained this level throughout the year in respect of all funds raised prior to and including the year ended 28 February 2001. The Board is confident of maintaining this level in the future as well as reaching the qualifying targets for the small amount of funds raised in 2003 and 2004 by the due dates.

Qualifying Investments

During the year we invested £830,000 (2003: £2.5 million) in five qualifying companies, all of which are on AIM and two of which, Computer Software Group (formerly Software for Sport) and AdVal Group, were existing investments.



* Source: Tax Effective Investor (April 2004)

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continued

The new companies backed during the year were:

- **Cobra Bio-Manufacturing plc** was established in 1993 as a production division of Therexys, the UK's first gene therapy company. It was acquired by ML Laboratories plc in 2000 and subsequently floated on AIM in June 2002 raising £7 million to help develop its production facility at Keele Science Park. The company is a leading international manufacturer of products for large pharmaceutical companies helping them to develop new drugs for the treatment of many diseases including various forms of cancer, hepatitis and Aids. BWD Aim VCT invested £130,000 in a fund-raising in June 2003 when £5.2 million was raised to fund a second production facility based in Oxford scheduled to be operational later this year. The company had to issue a profit warning in February of this year saying that expected growth in 2004/05 would be delayed but this has been followed by encouraging progress on the granting of new patents in the US and a collaborative agreement with AstraZeneca.
- **Quadnetics Group plc** is a market leader in the UK CCTV market. It is involved in the development, design, integration and control of high complexity security and surveillance systems for a broad range of public sector and blue-chip private sector businesses. The company has recently acquired Look CCTV, largely funded by a placing which raised £8 million, of which some £150,000 was subscribed by BWD Aim VCT. Look CCTV is the dominant supplier of CCTV systems for use in buses in the UK and fits well with the rest of the group's activities. Look CCTV had a turnover of £4.7 million with profits before tax of £1.2 million for the year ended 31 January 2003 and has been acquired for a consideration of up to £6.8 million dependent on subsequent performance. For the year ended 31 May 2003 Quadnetics' turnover was £20 million with profits before tax of £1.4 million and shareholders' funds of £5.5 million.
- **Huveaux plc** was established in 2001 as a vehicle for building a group in the media and publishing sector with the first acquisition of Vacher Dod being made in July 2002 for £4.5 million. Vacher Dod is the UK's leading publisher of parliamentary directories and handbooks sold to both private and corporate buyers in either hard copy or through subscription on-line. The second acquisition was made in March 2004 when Huveaux raised £6.5 million on AIM to help acquire Longfellow, marketed under the Lonsdale brand, which is a leading publisher of study and revision guides for the UK schools market. BWD Aim VCT participated in the funding round investing £250,000. Since then, Huveaux has continued to be busy building the group, adding three more companies and strengthening the management team along the way.



By the year end we had invested £11.5 million in 39 qualifying companies, of which 35 are on AIM and 4 are unquoted with a total valuation of £8.0 million. We also realised over £1.3 million resulting in a net profit of £326,000 from the sale of Giardino and part of our shareholdings in a number of AIM investments including Glisten, Huveaux and PM Group. Unfortunately, our investment of £200,000 in Synigence has been written off during the year following the company entering into a creditors' voluntary arrangement. As we had previously valued this investment at £20,000 this had little impact on our NAV. Furthermore, a technical issue has led to our investment in First Artist Corporation becoming non-qualifying during the year.

At the year end our ten largest investments by valuation, with a book cost of just under £3.4 million, had a valuation of £4.7 million, representing just over 30% of total net assets.

Non-Qualifying Investments

At the year end some 25% of net assets were invested in unit trusts managed by BWD Rensburg Unit Trust Managers Limited. A further 10% of net assets were held in blue-chip equities managed by BWD Rensburg Limited and 12% were in short dated gilts and cash pending investment and the payment of the dividend.

During the year we raised some £1.5 million from the sale of part of the quoted equity portfolio, gilts and non-qualifying AIM investments realising a £5,000 net gain.

Outlook

We are much more confident than this time last year. Our target market, AIM companies, are enjoying tremendous growth. Virtually all flotations are coming to AIM giving us plenty of choice in selecting investments, although many do not qualify under VCT rules. In 2003, AIM companies raised over £2 billion (2002: £975 million) and at 31 December 2003 there were 754 companies (2002: 704 companies) trading on AIM with a total market capitalisation of over £18 billion (2002: £10 billion). Many established AIM companies are raising further funds to finance their expansion giving us new opportunities to invest. However, we are aware that valuations have increased dramatically over the past few months so, as always, we concentrate only on companies which offer us good value and upside potential, hence the low level of investment activity in our second half.

We believe that the recently announced changes to VCT legislation and in particular, the enhanced 40% tax 'break' will be of considerable interest to the three million higher rate taxpayers in the UK. Many will see VCTs as an opportunity to gain exposure to AIM and smaller companies whilst gaining a substantial income tax benefit, thereby reducing the net cost of their investment.

We are therefore currently considering issuing a new prospectus in the autumn to enable existing and new investors to subscribe for shares and this will, if successful, enable us to add to and diversify our portfolio further. It will also provide the funds to repurchase shares from those investors who wish to realise their VCT investment.

Barry Anysz

Chief Executive
Capital for Companies

19 May 2004

