Manager's Report

Introduction

As stated in the Chairman's report, the global recovery from the depths of the early years of the millennium continued apace last year and into 2007, driven by improved corporate performances and low interest rates which has fuelled a wave of opportunistic buying, principally private equity driven. The increased merger and acquisition activity has now filtered down to the better quality 'small cap' stocks and this has allowed us to make some profitable realisations and also increased the value of the portfolio generally. However, the flip side is that these higher valuations make finding new opportunities on AIM harder to find at a reasonable price and often when we do decide to invest we are scaled down considerably as other investors struggle to get into the same company.

Despite the favourable economic background our performance benchmark, the AIM index, decreased 6.2% during the year to 28 February 2007 providing a difficult backdrop for the Company which had 47% of its funds (by value) in this sector. By comparison the FTSE 100 index increased by 5.6% and the FTSE-All Share by 7.3% over the year. At the year end we had some 22% by value of investments in FTSE 100 equities and some 17% in unit trusts investing in large and mid-cap stocks and these benefited our performance.

Once again AIM itself made exceptional progress with over £15.7 billion raised in 2006 and now over 1600 companies traded. Unfortunately many AIM companies are not eligible for VCT investment as their activities relate to the resources or other non–qualifying sectors. Despite this, our net asset value continued the improvement established in the previous years with a 6.1% (2006: 5.7%) gain including dividends paid and proposed.

Investment Policy

The companies selected for investment by us are mainly traded on 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;
- have 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 81 proposals from AIM and unquoted qualifying companies.

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. During the year we increased our exposure to fixed income securities which now account for some 11% of net assets to retain liquidity and provide higher income as yields have improved relative to equities.

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 had reached this target and have maintained this level throughout the year in respect of all funds raised. Our "qualifying percentage" calculated in accordance with Section 842 AA of ICTA shows a minimum value of 75.63% across all funds raised prior to 28 February 2005. The board is confident of maintaining this level in the future as well as reaching the qualifying targets for funds raised in the 2005 and 2006 Offer for Subscriptions for which some £5 million will need to be invested by 28 February 2009. At the current investment rate we believe this should be achieved.

Qualifying Investments

During the year we invested £1,749,000 in five qualifying companies (2006: £1,304,000 in nine companies), all of which were on AIM. All five companies were new to the portfolio as follows:

Bruline (Holdings) plc – was founded in 1990 and is the leading UK provider of data monitoring systems, both hardware and interpretative software, for the measurement of draught drinks sales in the licensed on-trade. The systems enable landlords and management to accurately monitor the volume and revenue value of sales. A complementary product is also being introduced to monitor the quality of the drinks at the point of sale. Punch Taverns and Enterprise Inns are both large customers. The company raised £7 million of which we invested £162,000 on its Initial Public Offering (IPO) in October 2006, to fund working capital and further product development.

Hasgrove plc – was incorporated in 2004 as a holding company for the development of a communication services group specialising in public relations, graphic design, advertising and on-line marketing. Prior to floating on AIM in November 2006, the group comprised three businesses including a leading UK design agency, Chase based in Manchester, and Interel which is a leading continental communications consultancy based in Brussels with other offices in Antwerp, Berlin, Paris and Prague. The company raised £6 million of which we invested £500,000 on flotation in order to help fund further acquisitions.

Manager's Report

Hexagon Human Resources plc – was established in 2004 and floated on AIM in February 2007, raising £10 million of which we invested £400,000. Hexagon is one of the UK's leading providers of senior interim executive management and executive search business with a strategy to 'buy & build' having made four acquisitions in the past two years, the most recent of which was BIE Interim Executive Ltd in December 2005, for which part of the flotation proceeds were utilised in repayment of debt. The company expects to make more acquisitions in the recruitment sector which is benefiting from the high demand from companies looking for experienced executives to fill key management positions.

Individual Restaurant Company plc (IRC) – floated on AIM in December 2006 raising £2.5 million from VCT's, of which we subscribed £403,000, in December 2006 via a reverse takeover of Bank Restaurant Group plc which itself had floated on AIM in 2003 and operated five restaurants under the 'Zinc' brand. IRC added their 16 restaurants, mainly based in the North of England, to the group of which 12 operate under the 'Piccolino' and four under the 'Restaurant Bar & Grill' brands. The enlarged group intends to roll out the Piccolino and Restaurant Bar & Grill formats with an opening programme of six to eight new openings each year so as to capitalize on the 'eating out' trend.

Telephonetics plc – was established in 1993 and floated on AIM in 2005. The company is a leading provider of advanced speech recognition applications in the UK used, for example, by the cinema industry to provide an information and booking service as well as an intelligent call-routing service for local government and the health service. In June 2006 they placed £5 million of new shares, of which we invested £250,000, to acquire Voice Integrated Products Ltd which also sells a telephony application to the public and financial sectors, thereby broadening their customer base and allowing for cost savings in research and development and marketing as well as achieving greater critical mass to approach overseas markets.

In addition our shareholding in MacLellan Group was acquired by Interserve plc, a company listed on the London Stock Exchange (LSE) but under VCT rules this remains a qualifying holding for two years from acquisition. Also Connaught graduated to a full listing on the LSE and remains qualifying for now. We do detect a trend of larger AIM companies moving to the official list of the LSE which whilst it usually increases value does mean we have to sell the investment within five years following listing.

At the year end we had investments in 43 qualifying companies of which 38 are on AIM and 5 are unquoted with a total valuation of £16.3 million (cost: £14.7 million). During the year we realised nearly £1.8 million from the sale of the entire or part of our holdings in qualifying investments in seven AIM and one unquoted companies, resulting in a net gain of £153,000 (2006: £25,000) Amongst the 'winners' were a partial sale of our holding in Computer Software Group for a profit of £162,000 and the entire holding in Systems Union Group for a gain of £145,000. On the 'losers' board we incurred a £161,000 loss on the sale of CRC Group, £152,000 on the sale of Independent Media Support Group and a write-off of £178,000 on Adval, which was placed in administration. At the year end our ten largest investments by valuation, with a book cost of £5.9 million had a valuation of £9.7 million, representing 29% of net assets.

Since the year end, offers for our remaining shares in Computer Services Group and PM Group have been accepted, which have produced substantial gains in the first half of the year to 28 February 2008.

Also, since the year end we have made two further qualifying investments costing £450,000. The investments are in Epistem, which we first backed in 2005 as an unquoted company and has recently graduated to AIM, the first of our unquoted companies to do so. This, together with the new subscription of £100,000 in support of the placing on AIM has increased the value of the investment as shown in the Accounts at 28 February 2007. We also invested £350,000 in Claimar Care Group in a secondary offer on AIM in support of its expansion plans. More recently we have committed to invest £0.6 million in three further AIM companies, all of which should complete shortly.

Non Qualifying Investments

At the year end some 17% of net assets were invested in unit trusts managed by Rensburg Fund Managers Limited. It is pleasing to note that at the year end our unit trust portfolio is now showing a net gain of £1.3 million (2006: £888,000) on a cost of £4.4 million. A further 22% of net assets were held in blue-chip equities managed by Rensburg Sheppards Investment Management Limited, which was showing a gain of some £600,000 on cost of £6.8 million at the year end and 10.8% were in fixed interest securities with a further 2.5% in cash pending investment and the payment of the dividend.

During the year we raised some £4 million (2006: £1.2 million) from the sale of part of the unit trusts and quoted equity portfolio, gilts and non-qualifying AIM investments, realising a net gain on historic cost of £614,000 and £178,000 shown in the current year income statement. Additionally, we do derive some income from writing calls on blue chip equities, which in a 'bull' market does sometimes reduce the upside potential of these securities but provides some compensation when the market moves sideways or falls.

Outlook

As stated above AIM has enjoyed another remarkable year in terms of new companies joining and money raised and our overall performance was good in relation to our benchmark AIM index, with NAV increased for the fourth successive year. The yield on our shares is consistently higher than could be obtained from an average of FTSE 100 listed companies and is, of course, entirely free of income tax. The Board is now proposing an increased dividend which if passed by

Manager's Report

continued

shareholders will provide a yield of 5.7% tax paid based on the year end share price, equivalent to 9.5% to a 40% tax payer.

The recent trend of private equity backed vehicles acquiring AIM and fully listed companies seems to be continuing and this should provide further exit opportunities, realising cash which could support our dividend policy and share buy-backs. However, as stated last year we are aware that IPO valuations have increased dramatically and as conservative investors we concentrate only on companies which offer us good value and upside potential, which is why our 'conversion rate' of new investment proposals remains very low.

As predicted, the amounts raised by VCT's in the last tax year slowed dramatically with only some £240 million compared to over £700 million in 2005/2006, as a result of the Government reducing the income tax relief from 40% to 30% on subscription for new VCT shares. Together with other adverse changes in the 2006 Finance Act and 2007 Budget we believe the supply of VCT funds to AIM will reduce over the next few years giving us better opportunities in the future once the current imbalance in supply and demand diminishes. Also, it is possible with no further supply of new VCT shares to the market, existing shareholders will benefit as investee companies mature and are sold realising funds for further investment and distributions.

Further, the secondary market for VCT shares may finally become established as the relatively high income yields become apparent to commentators, institutions and the public. This should reduce the traditional discount to their market price at which VCT shares trade and improve liquidity, which must be in shareholders best interests. Certainly we do not intend to issue any new shares at the current time so our shares may achieve some 'scarcity' value.

With some £34 million of net assets at 28 February 2007 we have a VCT with sufficient liquidity, assets, resources and a streamlined cost base to provide a worthwhile return to investors over the next few years, economic and market conditions permitting. We are therefore confident of our future prospects.

Barry Anysz
Senior Investment Director
Rensburg Sheppards Investment
Management Limited

30 May 2007