Downing ONE VCT

VCT type:	Hybrid	**Charges:**	
Issue details:	Top-up offer	Annual Management Charge	1.8%
Max sought:	£30m	Standard Initial Charge	4%
Min investment:	£5,000	EQ Investors Discount	2.25%
Offer Closes:	5 April 2016 29 April 2016		

EXECUTIVE SUMMARY

Downing is seeking to raise £15 million into Downing ONE VCT, with an over-allotment facility of up to a further £15 million.

The Downing ONE VCT is classified as a Hybrid VCT, an investment strategy combining investment in high growth Alternative Investment Market (AIM) listed companies with income generating asset-backed opportunities. The latter investments essentially take first charge on assets owned by the investee company, either in the form of bricks and mortar, such as health clubs or pubs, or in the form of a predictable revenue stream.

The advantage of this top-up offer is that investors who participate will gain immediate access to a mature and diverse portfolio of approximately 90 underlying investments accounting for 77.4% of the overall portfolio. In addition, the portfolio currently includes a number of investments that are no longer deemed qualifying to new VCT money, such as renewables, increasing its appeal to new investors.

The funds raised in this top-up offer will focus on younger growth companies, given the implications of the recent changes to VCT regulations detailed later within this report. While this may introduce a slightly higher risk profile for new investments, we do not believe the impact to be substantial over the medium term.

Downing ONE VCT targets a 4% dividend per annum, which is a lower income target than many peers in the generalist VCT universe. Therefore, we would be encouraged to see that capital growth of the NAV is strong to ensure that the total return is in line with competitors.

BACKGROUND

Downing ONE VCT was formed in November 2013, following the merger of six Downing VCTs: Downing Distribution VCT, Downing Absolute Income VCT 1&2 and Downing Income VCT, VCT 3 and VCT 4. While Downing Absolute Income VCT 1 was the first VCT Downing launched in 1997, it has not managed all of these merged VCTs since their respective inception dates.

At this time, the VCT shares underwent a consolidation such that the newly created Ordinary shares had a net asset value of 100p. The performance data presented within this report is from this date (8 November 2013).

VCT	Launch date	Size (Millions)
Downing ONE VCT	November 2013*	£82.6

*Since merger and share consolidation

Pros	Cons
The VCT follows a hybrid investment strategy, offering investors an element of income and capital growth	We are unable to accurately analyse performance of the VCTs prior to the merger in November 2013, leading to a short track record
This is a mature portfolio, with a substantial allocation to asset-backed companies, deemed to be at the lower end of the risk spectrum and a strong source of income generation	As one of the largest VCTs, we would expect a high degree of diversification. However, 50.8% of the portfolio is invested in 21 companies
The portfolio currently includes a number of investments that are no longer deemed qualifying to new VCT money, including a 14% allocation to renewable energy	New investments are likely to be higher risk, following the recent changes in regulations
In the last 12 months, the VCT has bought back shares at an average discount of 5% to net asset value	The VCT targets a 4% annual dividend, which is lower than many competitors

Impact of latest regulations

The investment strategy has not been significantly impacted by the recent changes in regulations relative to other generalist VCTs, who can no longer invest in management buy-out investments. The two most relevant changes to this portfolio include the decision that investment in any renewable opportunity is no longer deemed a VCT qualifying investment, as well as the age limit on qualifying investment. With regard to the latter regulation, the most recent Report & Accounts states that "*while there may be a slightly higher risk profile for new investments, less opportunity for quoted investments and some restrictions on follow on investments in existing portfolio companies, the Board considers that the effect on the Company as a whole is not likely to be substantial in the medium term.*"

ORGANISATION & MANAGEMENT

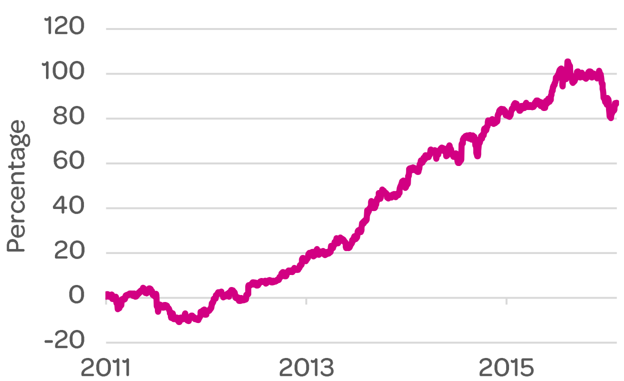
Downing was founded in 1986, and now has over £700 million of assets under management across six VCTs, a number of EIS schemes, an estate planning service and investments within renewable energy and the Alternative Investment Market (AIM).

Downing launched its first VCT, Downing Absolute Income VCT 1 in 1997, following the introduction of the scheme in 1995. It has therefore built up an 18 year track record in VCT investing, and now manages approximately £231 million of assets within these structures.

Given the hybrid strategy followed by the Downing ONE VCT, there are a number of Downing teams responsible for the management. The investment team is led by Chris Allner, who joined Downing in 2012. The income generating investments, primarily asset-backed unquoted companies, is headed by Jonathan Boss while the renewable exposure is overseen by Colin Corbally.

The growth portfolio, which consists primarily of AIM listed companies, is managed by Judith Mackenzie, Head of Public Equity at Downing and partner of the firm. In addition to this, Judith has managed the PFS Downing UK Micro Cap Growth fund since February 2011, the performance of which is highlighted in **Figure 1**.

Figure 1: Performance of the PFS Downing UK Micro Cap Growth fund since February 2011



INVESTMENT STRATEGY

Downing ONE VCT follows a hybrid investment strategy, attempting to provide both income and growth. This is achieved by constructing a portfolio combining higher risk investments in unquoted or AIM listed companies with asset-backed companies or those with predictable revenue streams.

The investment in growth opportunities, essentially those that have the potential to generate higher returns, is focused on "*unquoted companies where there are reasonable prospects of a trade sale or clear exit strategy over a five to seven year time horizon and the prospects of a reasonable level of capital growth*". While the VCT will not typically invest in start-up companies, it may invest up to 5% in early-stage companies. In addition to unquoted investments, the universe includes "*those companies already quoted on AIM, or the ISDX Growth market, or being admitted to the AIM or the ISDX market*". This component of the portfolio adds an element of flexibility and liquidity to the VCT as the listed underlying companies can be traded in the secondary market.

The asset-backed companies, or those with predictable revenue streams provide significant income to the VCT, and are deemed to be at the lower end of the VCT risk spectrum. This is because these investments essentially take first charge on assets owned by the investee company, whether this be a Bricks and Mortar asset or an income stream with similar characteristics.

Initially, the funds raised will be allocated to non-qualifying investments, which include fixed income securities "*consisting of bonds issued by the UK government, major companies and institutions*", as well as non-qualifying listed investments, pooled funds, secured loans and potentially non-qualifying unquoted investments.

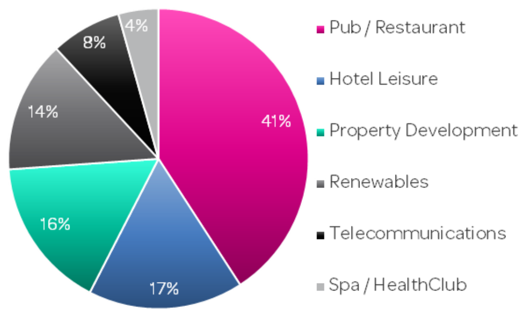
PORTFOLIO CONSTRUCTION & ACTIVITY

As of September 2015, the existing portfolio consisted of 88 underlying companies, accounting for 77.4% of net assets. The Downing ONE VCT previously had approximately 100 underlying investments and while it appears to have remained diversified, it is interesting to note that 50.8% of this, approximately £42 million, is invested in 21 companies, highlighting a large tail of smaller investments. In addition, the portfolio has 21.9%

in cash, which is set to increase as additional funds are raised. As mentioned, the VCT will invest in both growth opportunities and income generating, asset-backed investments. The portfolio currently has 58% allocated to unquoted income focused investments, with the remaining 42% in companies with high growth potential, the majority of which are listed on AIM.

The Downing ONE VCT is diversified by sector, highlighted in Figure 2. Significantly, the portfolio currently has 14% invested in renewable energy opportunities. In our opinion, this is a key appeal of the top-up offer, given that investment in any renewable opportunity is no longer deemed a qualifying investment. The implication of this however, is that the percentage held in the portfolio will be diluted over time as new funds are raised and deployed elsewhere.

Figure 2: Current portfolio split by sector (September 2015)



RECENT ACTIVITY

Downing VCT 1 made 12 new investments in the sixth months to the end of September 2015, totalling capital deployment of £8.2 million. Of these 4 were new investments and 8 were follow on. There were also a significant number of realisations, including a number of partial exits from quoted and unquoted holdings. As mentioned the number of holdings in the portfolio has reduced from over 100 to 88 (September 2015).

DISCOUNT CONTROL MECHANISM

It is stated that the Downing ONE VCT "*intends to pursue an active share buyback policy*", at a discount of 5% to the latest published Net Asset Value, subject to "*applicable regulations, market conditions at the time and the Company have both the necessary funds and distributable reserves available for the purpose*". This stated buyback target is competitive relative to peers, where discounts will typically range from 5-10% to net asset value. In practice, in the year to September 2015, Downing ONE VCT bought back approximately £1.67 million shares at an average price of 90.6p, a 5% discount to Net Asset Value at the time of purchase.

HISTORIC RETURNS

The Downing ONE VCT was formed in November 2013, following the merger of six Downing VCT, at which time the VCT shares underwent a consolidation such that the newly created Ordinary shares had a net asset value of 100p. Therefore, we have highlighted the performance of the VCT since this time in the data provided below. This includes the total shareholder return, detailed in Figure 3, as well as the annualised total return data, which allows for like-for-like comparison of VCTs with different inception dates.

Figure 3: Total returns to shareholders since Downing ONE VCT was formed in November 2013 (Data as of September 2015)

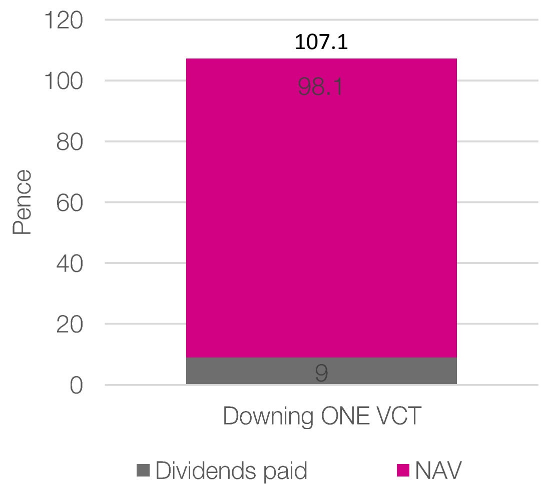
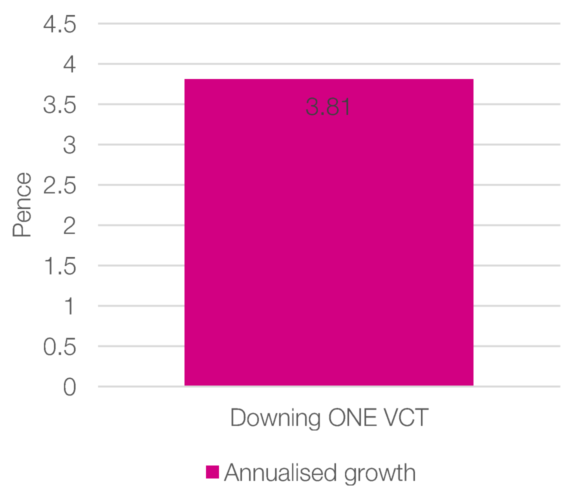


Figure 4: Annualised total returns since Downing ONE VCT was formed in November 2013 (Data as of September 2015)



FUTURE RETURNS

The Downing ONE VCT has a "*stated objective of paying an annual dividend of at least 4% per annum based on its NAV, subject to the availability of sufficient distributable profits, capital resources and compliance with the VCT regulations*".

Investors should note that there is a dividend reinvestment scheme in place, which can be elected for via the application form. The participation in this scheme can be cancelled at any time.

Risk Warning

The value of investments, and the income derived from them, can go down as well as up and you can get back less than you originally invested. Past performance is not a guide to future performance. This report does not constitute personal advice. VCTs should be regarded as higher risk investments, suitable only for experienced investors who are able to withstand losses. If you are in any doubt as to whether this is a suitable product for you, you should seek professional advice.

VCTs are only suitable for UK resident taxpayers who can tolerate higher risk and have a time horizon of greater than five years. Owing to the nature of their underlying assets, VCTs are highly illiquid. Investors should be aware that they may have difficulty, or be unable to realise their shares at levels close to those that reflect the value of the underlying assets. Tax levels and reliefs may change and the availability of tax reliefs will depend on individual circumstances. You should only subscribe for new VCT shares on the basis of the relevant prospectus and must carefully consider the risk warnings contained in that prospectus.

Next steps:

To download an application form please visit:

eqinvestors.co.uk/vct/offers

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