January 2019

Editor
Martin Churchill
BSc (Econ) FCA

Tax Efficient Review

ISSUE 355

VCT

Review of Generalist VCT

Draper Esprit VCT plc Ordinary Share Offer

VCT RISK WARNINGS

RISK WARNINGS AND DISCLAIMERS

This communication is provided for informational purposes only. This information does not constitute advice on investments within the meaning of Article 53 of the Financial Services and Markets Act (Regulated Activities) Order 2001. Should investment advice be required this should be sought from a FCA authorised person

Tax Efficient Review' (the "Review") is issued by Tax Efficient Review Limited ("TER"). The Review is provided for information purposes only and should not be construed as an offer of, or as solicitation of an offer to purchase, investments or investment advisory services. The investments or investment services provided by TER may not be suitable for all readers. If you have any doubts as to suitability, you should seek advice from TER. No investment or investment service mentioned in the Review amounts to a personal recommendation to any one investor.

GENERAL RISK WARNINGS

Your attention is drawn to the following risk warnings which identify some of the risks associated with the investments which are mentioned in the Review:

Fluctuations in Value of-Investments

The value of investments and the income from them can go down as well as up and you may not get back the amount invested.

Suitability

The investments may not be suitable for all investors and you should only invest if you understand the nature of and risks inherent in such investments and, if in doubt, you should seek professional advice before effecting any such investment.

Past performance

Past performance is not a guide to future performance.

Legislation

Changes in legislation may adversely affect the value of the investments.

Taxation

The levels and the bases of the reliefs from taxation may change in the future. You should seek your own professional advice on the taxation consequences of any investment.

ADDITIONAL RISK WARNINGS

Venture Capital Trusts

1. An investment in a VCT carries a higher risk than many other forms of investment.
2. A VCT's shares, although listed, are likely to be difficult to realise.
3. You should regard an investment in a VCT as a long term investment, particularly as regards a VCT's investment objectives and policy and the five year period for which shareholders must hold their ordinary shares to retain their initial income tax reliefs.
4. The investments made by VCTs will normally be in companies whose securities are not publicly traded or freely marketable and may therefore be difficult to realise and investments in such companies are substantially riskier than those in larger companies.
5. If a VCT loses its Inland Revenue approval tax reliefs previously obtained may be lost.
6. No investment can made by the VCT in a company whose first commercial sale was more than 7 years prior to date of investment, except where previous State Aid Risk Finance was received by the company within 7 years (10 years for a 'knowledge intensive' company) or where a turnover test is satisfied; and
7. No funds received from an investment by the VCT into a company can be used to acquire another existing business or trade.

Tax Efficient Review is published by
Tax Efficient Review Ltd
35 The Park
London
NW11 7ST
Tel: +44 (0)20 8458 9003

Draper Esprit VCT Ordinary share offer

Type	Generalist VCT. The VCT will invest as a syndicate partner into investments of Draper Esprit plc, a listed Venture Capital manager
Size	£7,000,000 non-prospectus Top-up offer into the existing share class
Manager	Elderstreet Investments Limited with Draper Esprit co-investment
Promoter	RAM Capital LLP & Elderstreet Investments Limited
Tax Adviser	Philip Hare and Associates LLP
Focus	Unquoted companies - new investments will usually be into early stage and larger growth companies with high growth potential. Because of the new VCT rules it is likely that a higher percentage of investments than in the past will be in companies which have not yet reached profitability
Funds initially invested	Cash on deposit
Minimum subscription	£6,000 spread over two tax years
Closing	5 April 2019 for the 2018/19 tax year, 31 May 2019 for the 2019/20 tax year or when fully subscribed
Commission	Initial costs are capped at 5.5% (variable 3%-5.5%) including commission of 2.5%. For advised sales the effective cost is 3.0% (assuming the IFA waives 2.5% commission). There is an Early Bird offer of up to 1.5% until 28 February. For execution only platforms there is additional trail of 0.25% for 5 years

Table 1: Tax Efficient Review summary of offering Pros and Cons

PROS	CONS
• The involvement going forward of Draper Esprit is a major plus but will take time to be visible in results	• Large proportion of VCT currently in cash needing investing
• Relatively large distributable reserves which should support an on-going dividend for the foreseeable future, irrespective of any future disposals.	• Not clear how long it will take to sell down the current holdings
	• How realistically is the legacy portfolio valued
	• Four companies make up 91% of the legacy pool

Disclaimer **This communication is provided for informational purposes only. This information does not constitute advice on investments within the meaning of Article 53 of the Financial Services and Markets Act (Regulated Activities) Order 2001. Should investment advice be required this should be sought from a FCA authorised person**

Table 2: Elderstreet Funds under Management
Data Source - Elderstreet Investments 31 June 2018

	Net assets	Elderstreet Annual Management Charge	Fund Status	Cash and Gilts
VCT Funds				
Draper Esprit VCT	£41.6m	£832,000	Evergreen	£16.3m
NON VCT funds than can co-invest with VCTs				
TSC EIS funds	£2.5m	£25,000	Evergreen	Fully Invested
TOTAL	**£44.1m**	**£857,000**		

VCT legislation changes

There have been significant recent announcements regarding the legislation governing investments by VCTs.

In 2015 the main changes were (1) investee companies were not be able to buy existing businesses (includes MBOs), (2) first commercial sale by the investee company must be in the last seven years (with certain caveats) and (3) there is a lifetime investment limit of £12m (£20m for knowledge intensive companies).

In 2017 (from April 2018) the main changes were:

- 70% qualifying holdings condition increasing to 80% (post 6th April 2019)
- at least 30% of all new funds raised after 5 April 2018 will need to be invested in qualifying holdings within 12 months of end of the accounting period in which the VCT issues its shares
- A number of "grandfathering" provisions for VCTs will be removed:
  - The requirement for VCTs to hold at least 30% of qualifying investments in "eligible shares" ordinary equity) from funds raised prior to 6 April 2011 will be withdrawn
  - Qualifying trades and employee limits – VCT funds raised prior to 6 April 2008 can no longer continue to invest in companies carrying on certain trades (such as nursing homes, hotels, farms, property development, shipbuilding, and coal and steel production).
  - The employee limit will also apply to all VCT investments; currently that limit does not apply to VCT funds raised before 6 April 2007
- VCTs can invest part of their qualifying investments in loans which have a term of at least five years. From Royal Assent to the Finance Bill (expected Spring/Summer 2018) any new loans will have to be made on an unsecured basis. Returns on loan capital above 10% are required to represent no more than a commercial return on the principal, and should not be used to return equity capital to investors

VCT market changes

In our view the above changes as they impact portfolios over time (as mainly MBO focussed portfolios wind down and are replaced by more early stage and riskier holdings) mean that the VCT market will change.

The old VCT market can be summarised as:

- Management Buy-Out based
- large debt component could support running yield and regular annual dividends
- large single investment amounts, no follow-on funding usually needed
- sold to investors as pension alternative with regular yield profile

The new VCT market can be summarised as:

- more NAV volatility
- more equity risk as investments have lower debt component
- most investments could require follow-on so VCT market in future needs to support this as biggest risk to investors is that VCT cannot follow its money
- more support needed from VCT manager to investee companies
- no running yield on debt component to support dividends
- yield can only come from capital growth
- there will most probably be early losses not offset by early exits
- investor focus will shift to total return not NAV
- do not expect regular smooth "yield" although distributable reserves will still allow VCTs to smooth dividends for a time
- Metric should be increase on total return in the year over opening NAV.

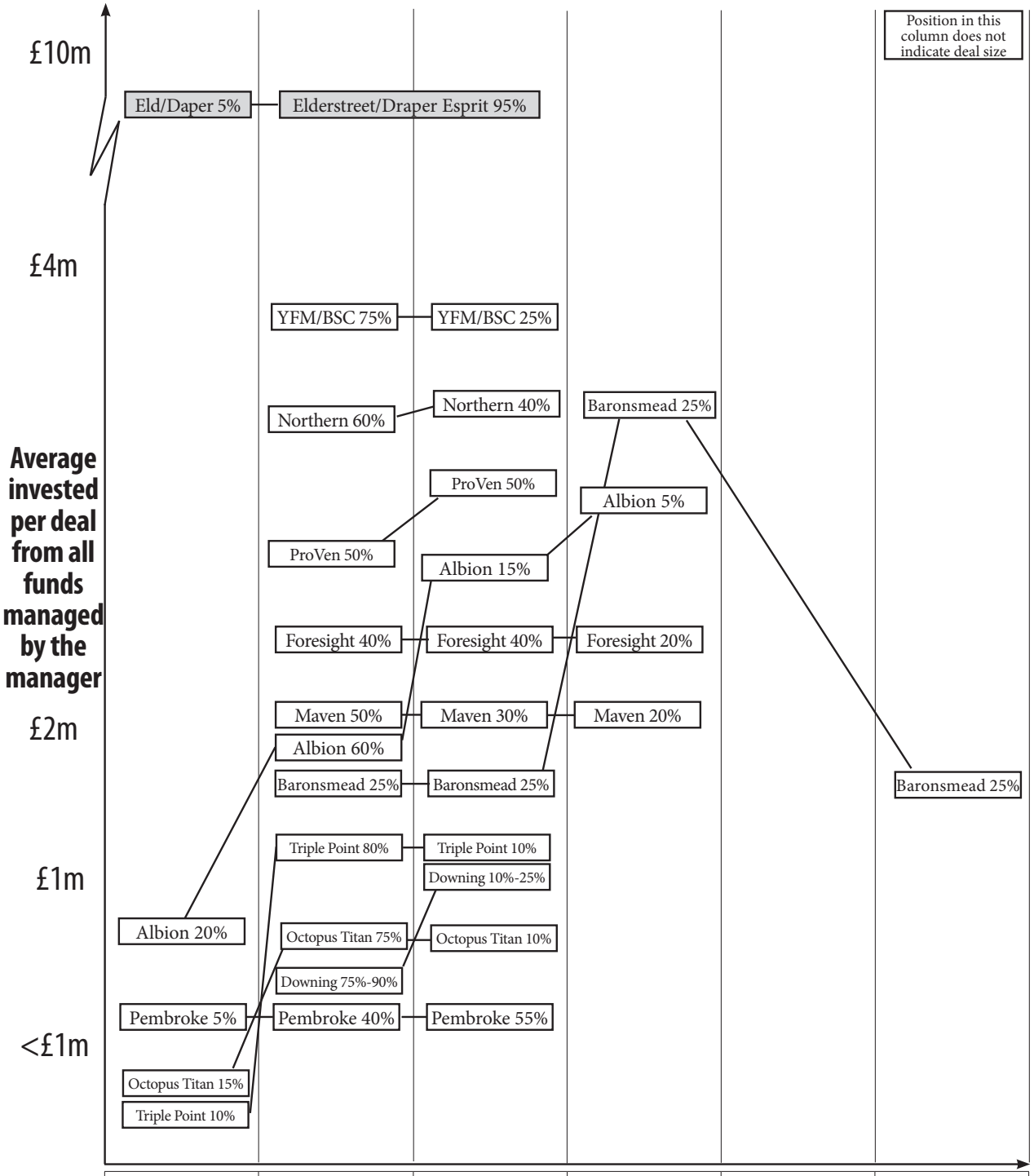
Key issue for investors is that going forward the VCT asset class will not behave as it has in the past.

As an example, the Elderstreeet VCT results for the year to 31 March 2018 includes the following *"... the delivery of good returns to Shareholders in the future will depend on major successes from at least a small number of investments, which can offset losses from the inevitable failures which we expect to suffer."*

Review based upon

This review is based upon a meeting with Elderstreet and the Draper Esprit VCT document dated 11 January 2019 (in the Chairman's letter).

Diagram 1: Investment strategies of Growth VCT managers (reflecting ongoing earlier stage focus for post-2015 rules)
Source: Fund Managers (% figures refer to funds invested in qualifying companies, not funds raised)



Seed capital/ Early stage	Pre-Profit	Post-Profit	Larger Development Capital Deals	Asset backed opportunities	AIM stocks
	High Growth and Development capital				
- high risk with hopefully high return - all equity investment - should have potential for rapid growth 08/01/19	- should have potential for rapid growth and exit within 3-5 years - some VCT loan interest may be deferred until exit - usually no bank debt because of lack of assets for security and companies may not be able to support interest payments - focus on high growth market sectors in which company growth should be less dependent on the performance of the whole economy		- relatively low returns but should be lower risk - companies usually profitable - companies should be able to sustain loan interest payments - profitable companies seeking capital for expansion	- low return and should be low risk - should be able to support interest on debt	-some stocks are dividend paying - limited liquidity - potential volatility

Table 3: VCT Performance of ELDERSTREET fund raisings				
Launch year	Net Asset Value/Date	Total Dividends to date	Total return (dividends plus latest net asset value)	Annual IRR post initial tax relief/Position in peer group
Elderstreet VCT ord share (1995/96 investors in Gartmore VCT, name changed July 2000 to Elderstreet Millennium VCT, merged with Elderstreet VCT Nov 2006 with each share being converted to 0.381 Elderstreet share plus dividend of 22.5p per share) TIDM EDV TER Ref 57				
1995/96	23.46p 30/09/2018	87.13p	110.59p	3% 5th out of 8
Draper Esprit VCT ord share (1997/98 investors in Elderstreet Downing VCT which raised £15.1m at 100p, merged with Elderstreet Millennium 28 Nov2006) TIDM EDV TER Ref 56				
1997/98	61.6p 30/09/2018	99p	160.6p	5% 5th out of 8

Table 4: Generalist VCT provider comparison - Net Asset Values are latest announced		
VCT manager	Percent Ranking (Higher number is better see Note 1)	Net Asset Value dates used in calculations
GRESHAM HOUSE (Baronsmead VCTs)	81%	31/08/2018 , 31/07/2018
MOBEUS	77%	30/09/2018 , 30/06/2018
NVM	69%	30/09/2018
ALBION	56%	30/09/2018
MAVEN	52%	31/05/2018 , 30/06/2018 , 31/07/2018
YFM (British Smaller Cos VCTs)	51%	30/09/2018
BERINGEA (Proven VCTs)	50%	31/08/2018
ELDERSTREET	36%	30/09/2018
FORESIGHT	28%	31/08/2018

Source: Tax Efficient Review calculation based on data from public accounts
Note 1: Each provider has launched a large number of fund raisings over many years, so we use "Percent Ranking" as a way of comparing results for each provider. "Percent Ranking" is the rank of a value in a data set as a percentage of the data set. For each fund raising the data set are the Generalist VCTs launched in the same year. A figure of 100% means the fund raising from the manager ranks ahead of all others in the data set, so the higher the figure the better.
Figure is an average of all fund raisings where the manager has managed the fund since launch, raised more than £6m and launched in tax year 2013/14 or before. Performance for launches after that period are not included as they will be distorted by the initial tax break.

Introduction

A £7m non prospectus offer into the existing Ordinary share class in a generalist VCT which has evolved:

- The Elderstreet VCT raised £15 million for ordinary shares at launch in 1998
- In 2007 Elderstreet VCT merged with Elderstreet Millenium VCT
- A further fundraise took place in 2006 and from then to November 2017 the Company raised approximately £33 million (after expenses) through further issues of Ordinary Shares and the reinvestment of dividends
- Name changed December 2017 to Elderstreet Draper Esprit VCT
- £14.8m raised in tax year 2016/17
- £7m raised in tax year 2017/18
- Name changed December 2018 to Draper Esprit VCT on launch of this offer

Since the involvement of Draper Esprit in December 2017, nine new investments have been completed totalling £7.5 million with a further five new deals committed (signed investment agreements awaiting HMRC clearance) totalling £3.8 million. Taking into account the deals awaiting HMRC clearance the VCT is split

- 40% is still in legacy Elderstreet investments. Four companies make up 91% of the legacy pool. Two of these investments are quoted on AIM and the other two are profitable engineering businesses.
- 30% cash, and
- 30% in Draper Investments completed and committed awaiting HMRC clearance

Income from investments and proceeds of profitable realisations have enabled the Board to pay cash dividends of £25.8 million, a total of 99.0p per Ordinary Share to original investors who subscribed at £1.00 (80 pence after the initial tax relief) at the Company's launch in 1998.

In total the Company has raised approximately £53.8 million (after expenses) since 1998, paid dividends of £25.8 million, and has an unaudited net asset value of £41.6 million. The Company is now invested in 24 trading companies (source: unaudited interim accounts as at 30 September 2018).

The objective of the Company is to provide good long term tax free returns to Shareholders through a combination of dividends and capital growth. Every VCT has this objective but as can be seen from Table 3, Draper Esprit VCT has a mixed track record of providing returns for its Shareholders. Original investors who subscribed at £1.00 (80 pence after the initial tax relief) at the Company's launch in 1998 have done moderately well with a total return of 159.1p (making an annual return including initial tax of 5% placing them fifth out of the eight Generalist offers that year). The other offers that year included Baronsmead Venture Trust (9% annual return), Baronsmead VCT 2 (9% annual return), Northern Venture Trust VCT (7% annual return) and British Smaller Companies VCT (6% anuual return)

The aim of the VCT is to build a diversified portfolio in the technology sector of mainly unquoted companies requiring growth capital. Funds awaiting investment will be invested in cash.

The shares are expected to be issued at a price of 61.9p, assuming, for the purposes of the Pricing Formula, a NAV of 60.1p per Ordinary Share (being the NAV as at 30 September 2018 adjusted down for the 1.5p dividend paid in October 2018) and a maximum Promoter's Fee of 5.5% (with no Adviser Charge or commissions payable).

In November 2016 the Manager, realising that small VCTs were becoming sub optimal in the market, sold an initial 30% stake to Draper Esprit with an option to acquire 100% in the future. At the same time a co-investment agreement was entered into to share deal flow, management experience, and investment opportunities going forward. Draper Esprit is a venture capital investor involved in the creation, funding and development of high-growth technology businesses with an emphasis on digital technologies in the UK, the Republic of Ireland and Europe. Draper Esprit floated on the AIM market in June 2016 and at the time of writing has a market capitalisation of £500 million.

This agreement has benefited the Company and new subscriptions increased by a further £21m since 2016. Additionally since raising the new funds the Company has committed to invest in fourteen new investments totalling £11.2m of which twelve have now completed at the time of writing, and two are subject to receiving HMRC advanced Assurance. One of these portfolio companies has been written up by 112% (StreetTeam Software trading as Verve) and the remaining portfolio is valued at cost.

Table 8 shows these investments at 30 September 2018.

Without this take-over by Draper Esprit, the Draper Esprit VCT was really going nowhere. It was a relatively small VCT with very mediocre performance (see Table 3), a very ageing set of legacy holdings (average age of unquoted holdings is over 13 years and for AIM holdings is 10 years) and it could not raise enough funds each year to allow it to secure deals going forward.

Its saviour was Draper Esprit.

The Draper Esprit team has a wealth of experience. The team has now operated for eleven years and, prior to that, its members worked in leading firms within the venture capital industry. In aggregate, the team has been involved in investing over US$1 billion into more than 200 technology businesses. Since Draper's IPO in June 2016, they have grown their team, invested in 22 new high growth companies, realised £57 million in cash and raised in excess of £100 million on the public market.

The VCT is transitioning to a technology portfolio and the Managers believes the ability to join a funding syndicate of Draper Esprit funds will bring access to larger deals in companies that enjoy higher revenues and which operate in high growth sectors. These more developed companies can

Table 5: Realisations in last five years Source Elderstreet

Name	Fulcrum Utilities Ltd	Sparesfinder Ltd	AngloInfo Ltd	Lyalvale Property Ltd	Ridee Ltd	Interquest plc	Concord Technology Solutions	SMART Education	Wessex Advanced Switching
Exit date	Jul-18	Aug-18	Aug-18	May-18	Nov-17	Aug-17	Apr-17	Dec-15	Apr-14
Structure	Equity	Equity	Equity and Debt	Equity	Equity	Equity	Equity and Debt	Equity and Debt	Equity and Debt
Industry Sector	Gas Utilities	Software	Digital	Property	Digital	Recruitment	Software	Recruitment	Aerospace Engineering
Stage of investment	AIM	Early Stage growth	Early Stage growth	Early Stage Growth	Early Stage growth	AIM	Early Stage growth	Early Stage growth	Mature stage, MBO
Board Seat	N	N	Y	Y	n/a	N	Y	Y	Y
Cost	£114,126	£103,535	£3,527,255	£300,194	£489,860	£225,200	£1,649,944	£1,805,820	£484,174
Profit/(loss)	£518,698	(£42,707)	(£3,527,255)	(£300,194)	(£489,860)	(£53,300)	£0	£3,652,643	£9,747,312
Annual Internal Rate of Return	24%	LOSS	LOSS	LOSS	LOSS	LOSS	0%	20%	34%
Length of investment	8.0 years	19.0 years	11.9 years	4.5 years	1.5 years	11.3 years	5 years	10.2 years	15 years

Table 6: Draper Esprit VCT unquoted holdings as at 30 September 2018 Sorted by valuation size Source Elderstreet

Investee name	Cost of Investment at 30 Sept 2018 £	Current Carrying Value Sept 2018 £	% of equity held	Date of first investment	Syndicated	Lead investor	Structure of investment	Industry sector	Financing stage	Valuation methodology
Fords Packaging	2,432,856	5,765,532	49%	Dec-13	N	Y	Equity & Loan	Engineering	Early Stage	Market Comparable
Lyalvale Express	1,915,204	2,856,300	44%	May-98	Y	Y	Equity & Loan	Engineering	Development	Market Comparable
StreetTeam Software (t/a Verve)	1,285,712	2,735,558	<5%	Dec-17	Y	Y	Equity	Technology	Early Stage	Market Comparable
IESO Digital Health	1,500,027	1,500,027	<5%	Nov-17	Y	Y	Equity	Technology	Early Stage	Cost
Endomagnetics	912,143	912,143	<5%	Jul-18	Y	Y	Equity	Technology	Early Stage	Cost
Pod Point Holdings	860,000	860,000	<5%	Jul-18	Y	Y	Equity	Technology	Early Stage	Cost
Evonetix	792,657	792,657	<5%	Jun-18	Y	Y	Equity	Technology	Early Stage	Cost
IXL PremFina	755,608	755,608	<5%	Jul-18	Y	Y	Equity	Technology	Early Stage	Cost
Push Dr	724,379	724,379	<5%	Mar-18	Y	Y	Equity	Technology	Early Stage	Cost
Baldwin & Francis	1,534,332	421,500	49%	Nov-04	N	Y	Equity & Loan	Engineering	EarlyStage	50% secured loans
Cashfac	260,201	394,040	2%	Jul-99	Y	Y	Equity	Technology	Early Stage	3rd party share sales
Appux (t/a Droplet)	325,500	325,500	5-10%	Mar-18	Y	Y	Equity	Technology	Early Stage	Cost
Light Blue Optics (t/a Kaptivo)	311,111	311,111	<5%	Mar-18	Y	Y	Equity	Technology	Early Stage	Cost
Macranet (t/a Sentiment)	1,037,169	259,293	20%	Jan-14	Y	Y	Equity	Technology	Early Stage	75% provision
Servoca	333,334	240,000	1%	Jun-07	Y	N	Equity	Services	Early Stage	Price at AIM delisting
Edo Consulting	125,000	48,398	< 2%	Oct-00	N	Y	Equity	Digital Media	Early Stage	3rd party valuation
Sift Digital	125,000	41,901	< 2%	Oct-00	N	Y	Equity	Digital Media	Early Stage	3rd party valuation
QSS Group	268,204	0	44%	Nov-01	N	Y	Equity	Services	Dev Cap	100 % Provision
Infoserve	127,500	0	< 0.5%	Jun-07	Y	N	Equity	Digital Media	Early Stage	100 % Provision
RB Sport & Leisure	187,500	0	< 0.5%	Aug-02	Y	N	Equity	Leisure	Dev Cap	100 % Provision
TNSN	500,919	0	< 0.1%	Nov-99	N	Y	Equity	Digital Media	Early Stage	100 % Provision
	£16,314,358	£18,943,949								

Table 7: AIM holdings as at 30 September 2018 Source Elderstreet

Aim	Cost £000	Valuation 30/09/18 £000	Year of investment
Access Intelligence plc	2,333,022	4,448,423	29-Oct-08
Fulcrum Utilities limited	385,948	1,993,889	12-Jul-05
Location Sciences Group plc	859,941	92,000	8-Dec-14
Kellan Group plc	656,700	3,110	03-Dec-04
TOTAL	**£4,235,611**	**£6,445,514**	

Table 8: Draper Esprit VCT unquoted holdings since VCT co-managed by Draper Esprit as at 30 September 2018
Sorted by valuation size Source Elderstreet

Investee name	Cost of Investment at 30 Sept 2018 £	Current Carrying Value 30 Sept 2018 £	Industry sector	Financing stage
Completed investments since VCT co-managed by Draper Espri				
StreetTeam Software (t/a Verve)	1,285,712	2,735,558	Technology	Early Stage
IESO Digital Health	1,500,027	1,500,027		
Endomagnetics	912,143	912,143		
Pod Point Holdings	860,000	860,000		
Evonetix	792,657	792,657		
IXL PremFina	755,608	755,608		
Push Dr	724,379	724,379		
Appux (t/a Droplet)	325,500	325,500		
Light Blue Optics	311,111	311,111		
	£7,467,139	**£8,916,985**		
Committed investments Note 1				
Resolving Limited .	799,468		Technology	Early Stage
Push Doctor Limited (tranche 2)	775,618			
Apperio Limited	500,000			
Roomex Limited	612,561			
BackOfficeTechnology Limited (t/a Form3)	700,000			
Crowdcube Limited	400,000			
	£3,787,647			

Note 1: Three of the committed deals have been completed at the time of writing.

scale very quickly and have the potential to IPO, exit, or attract further funding rounds more quickly than lower revenue companies.

The Manager does not see any issue with deploying newly raised capital.

The focus of the VCT is to continue to invest predominantly in a diversified portfolio of companies, with a particular emphasis on smaller unquoted companies, through investments which will usually have the following characteristics:

- Companies which meet the VCT criteria with proven sales and the ability to grow, which are seeking growth capital
- A strong, balanced and well-motivated management team
- Investments where Draper Esprit plc and Elderstreet Investments Limited can typically act as lead investor and have an active involvement in the business through a board position

The Company currently has a general portfolio mix by sector and, whilst its average deal size measured by initial investment cost is approximately £0.9m, the Company is able to syndicate deals of up to £10 million with the Draper Esprit co-investment funds. Going forward, Elderstreet says that the average initial deal size is likely to rise to £1.5 million with a focus on the following technology sectors:

- Consumer Technology – companies with exceptional growth opportunities in international markets that are underpinned by new consumer facing products, innovative business models and proven execution capabilities.
- Enterprise Technology – companies developing the software infrastructure, applications and services that drive productivity improvements, convenience and cost reduction for enterprises.
- Hardware and Deep Tech – companies developing different technologies that underpin advances in computing, consumer electronics and other industries.
- Healthcare and Wellness – companies leveraging digital and other technologies to create new products and services for the health and wellness market.

The co-investment right alongside the Draper Esprit plc institutional and EIS funds will be broadly based on the liquid funds available, the EIS/VCT qualifying status of each investment, the existing asset allocation within each pool of funds (i.e. conflict issues around investing in a potential competitor to an existing portfolio company), and for the VCT, the current percentage of VCT qualification in each of its pool of VCT funds. This co-investment right and allocation will be reviewed on a periodic basis.

The VCT Board is independent of the Manager and Draper Esprit and while the Manager or Draper Esprit may recommend deals on the above basis the Board has the right to decline to invest in any

Table 9: Matrix of individual responsibilities
Data Source William Horlick December 2017

NAMES	Michael Jackson	William Horlick
VCT RELATED WORK		
Deal origination %	15%	10%
General enquiries %	0%	10%
New deal doing %	5%	35%
Investee board seats No.	6	1
Sitting on Boards/Monitoring %	60%	10%
Fund raising %	5%	15%
Internal issues %	0%	10%
Exits %	see Boards	See Boards
NON VCT WORK		
Non-VCT work %	20%	10%
TOTAL	**100%**	**100%**
Years in venture capital	30	20
Years involved with VCTs	20	20
Years with current team	27	20

The Draper Esprit Team consists of 17 investment professionals with a range of operational and venture capital experience. The Draper Esprit CEO Simon Cook previously worked as a Partner at Elderstreet and knows the current team well. The VCT has entered into a co-investment agreement with Draper Esprit based on the liquid funds available to each fund entity at the time of investment. This agreement should enhance the VCTs ability to invest newly raised funds into new and larger deals

such deal.

In summary, investors will be buying into an ageing portfolio of companies which will be liquidated over time and replaced by new investments chosen by Draper Esprit, deals that VCTs now have to invest in and not the MBOs of the past.

The key issue for potential investors in this fund raising is whether the valuations are prudent and how long it will take to exit the current portfolio and replace it. We asked Elderstreet for a comment on each major holding

Company	Cost	Valuation
Fords Packaging	£2,432,856	£5,765,532

"Fords is a profitable established engineering business with global customers selling capless sealing solutions to the world's food and beverage industry for more than 90 years. Fords recently won the 2018 World Beverage Innovation Award for Best Closure for their bottle neck and cap design."

Lyalvale Express	£1,915,204	£2,856,300

"Lyalvale was established in 1983 and is a leading producer of shotgun ammunition in the UK. It has developed a range of more than 30 different models of cartridge suitable for both game and clay shooting. Its products range from premium products such as that used by Richard Faulds to win an Olympic Gold Medal in Sydney, to popular everyday products."

StreetTeam Software	£1,285,712	£2,735,558

"Founded in 2012, StreetTeam's software platform enables customers to turn their most influential fans into ambassadors who promote their events and sell tickets to their friends in return for rewards. Its platform allows customers to recruit ambassadors, manage their community and share content within it, and also enables digital payment processing and sales reporting."

Four holdings have been exited in the last 12 months which is positive. One realised a profit of £0.5 million, one a small £42,000 loss, one a large £300,000 loss, and one was a very large £3.5m complete write-off. This leaves four companies representing 91% of this legacy pool, two of which are AIM traded so are subject to market valuation, the remaining two are engineering businesses which have been profitable for the last fifteen years and pay annual dividends.

The past twelve months investment run rate of Draper Esprit has help dilute any risk from the existing portfolio. The Manager tells us further realisations can be made but a 'trade-off' exists with the qualifying percentage also needing to be maintained.

While Elderstreet has trailed the strongest top performing VCTs, all the fund raisings since inception that have now time qualified for VCT status have made a profit for investors without the initial tax breaks.

Tax Efficient Review Strategy rating: 28 out of 30

Track record

Our approach to comparing track records between providers is to use the Internal Rate of Return (IRR) for all relevant VCT fund raisings. The IRR on an investment is the "annualized effective compounded return rate" or "rate of return" that makes the net present value of all cash flows (both positive and negative) equal to zero. We calculate it on a daily basis using the net of income tax relief original cost (a negative cash flow), the flow of dividends on the date they were paid and the net asset value published in the latest quarterly report from the VCT (both positive cash flows). We favour the IRR over measures such as Total Return as it factors in the "time value of money" and rewards early distributions of cash.

As Elderstreet have only raised small amounts (no fund raising was larger than £4m) in the last few years (excluding last year's £18m raise), we consider only two fund raisings should be included in their performance calculation (see Table 3). Neither of the two fund raisings is highly placed in their peer groups.

Since our last review there have been four further realisations (one trade sale, two into administration and one from the AIM Holdings.

The average holding period of the remaining two meaningful active unquoted portfolio is a very long fifteen years (Lyalvale Express where Michael Jackson, founder and executive chairman of the VCT manager Elderstreet, is a director; and Cashfac) and for the AIM stocks it is an equally long nine years. This could indicate that realising the current portfolio could prove a lengthy task although the Manager states this is a trade-off between maintaining qualifying while building the new Draper Esprit portfolio.

As to realisable value in the portfolio, it should be noted that the portfolio now has minimal VCT portfolio loans and therefore the level of historic loan income has dropped to a de-minimis level.

Dividends

To cover dividend payments, VCTs have to create income if they are not to dip into special reserves (the share premium account which most VCTs with Court approval convert into a distributable special reserve) which is of course a form of return of capital. We think a useful check on this area is the ratio of Gross Income to Net Asset Value. If this is lower than the dividend payments then the VCT is not receiving cash flow from interest earned on un-invested funds and loan stock and is possibly returning capital.

Elderstreet informs us that £7.3m of dividends were paid in the last 36 months and that 84% was paid from capital and only 16% from revenue. In order to facilitate this, £9.8m was transferred from the share premium account to the Special reserve on 27 February 2013.

As at 30 September 2018 the Company had distributable reserves of £3.5m (was £8.5m) which is the equivalent to just over one and a half years of dividends at 3 pence per Ordinary Share using the number of Ordinary Shares in issue at 30 June 2018. While future dividends are expected to be funded mainly from portfolio exits, a further £16m of distributable reserves will be made available by share premium conversion in December 2020.

It is the Board's objective to maximise dividends to Shareholders, subject to liquidity, the availability of sufficient distributable profits, capital resources and VCT regulations, and to target a dividend return of 3 pence per annum (equivalent to a 6.9% tax free return based on the Estimated Offer Price after factoring in initial tax reliefs, or 12.6% to a higher rate taxpayer).

Buybacks

In the last three years £1.1 million of shares have been bought back by the VCT (£0.9 million in the last twelve months) and as noted above the current share price as at 29 November 2018 is 53.5p, a discount of 7% to the last published March 2018 net asset value of 57.5p. We are told that the Company intends to acquire its own Ordinary Shares in the market four times each year;

once shortly after the publication of the Half-Yearly Report, once shortly after the publication of the Annual Report and again after the publication of each interim management statement at a discount of approximately 7.5% (previously 15%) to the last published NAV, subject to liquidity, VCT regulations and Listing Rules.

It should be noted that having a Board set a buyback policy is not enough - the VCT needs in our view a broker (Draper Esprit VCTs' broker is Shore Capital), the VCTs have to communicate continually with their broker and VCTs have to be ready to purchase shares from the broker, however the Manager states that there is no 'massive sellers overhang' in the market.

Overall Elderstreet has not been a particularly strong performer as a manager. The meaningful legacy VCT unquoted portfolio has a high average length of investment at over fifteen years. The new Draper Esprit portfolio is showing some promise with one early investment having been revalued at a 112% increase on cost.

Tax Efficient Review Track Record rating: 30 out of 40

Manager

The investment team comprises just two members: Michael Jackson (founder and executive chairman of Elderstreet since 1990, also previously chairman of FTSE 100 The Sage Group Plc and a director and investor in many other quoted and unquoted companies, and William Horlick (background in business, Investment Banking and Stockbroking).

The Manager is actively involved with its investments taking non-executive directorships where appropriate. The Manager has Board or Observer seats in three of its four meaningful legacy investments valued above £1m. Going forward all new investments with Draper Esprit will have a Draper or Elderstreet representative.

In November 2016 the Investment Manager signed a significant co-investment agreement with Draper Esprit to share deal flow, management experience, and investment opportunities. Draper Esprit also took a 30% stake in the Manager with an option to acquire 100% in the future. The CEO of Draper Esprit was previously a partner at Elderstreet so both parties know each other well.

The Draper Esprit team (see Appendix A for details on key members) have considerable experience and have operated together for nine years. Prior to that, its members worked for leading firms within the venture capital industry. In aggregate, the team has been involved in investing over US$1 billion into more than 200 technology businesses, exiting companies with a value of US$6 billion from a total enterprise value of US$8 billion. Since Draper's IPO in June 2016, they have grown their team, invested in 22 new high growth companies, realised £57 million in cash and raised in excess of £100 million on the public market. The team is a combination of venture capitalists, entrepreneurs and bankers.The combined Elderstreet/Draper Esprit team which will be over 17 investment professionals has extensive venture capital experience. This experience has enabled them to build up strong long-term business relationships with key introducers. In addition Michael Jackson's network of high level industry and entrepreneur contacts provide good levels of deal flow at an early stage.

The Board of Draper Esprit VCT comprises David Brock as Chairman (formerly a main board member of MFI Furniture Group plc), Nicholas Lewis (founder of Downing LLP), experienced venture capitalist Barry Dean (formerly Managing Director of Dresdner Kleinwort Benson Private Equity Limited), Hugh Aldous (ex-partner of Grant Thornton UK LLP), and Michael Jackson of Elderstreet. The majority of this Board have been in place since inception and given the renewed focus on growth and technology it might be sensible to replace some members with entrepreneurs with more appropriate sector skillsets.

Tax Efficient Review Team rating: 18 out of 20

Costs

Initial costs are variable at 3%-5.5% including commission of 2.5% plus trail of 0.25% for 5 years. For advised sales the effective cost is 3% (assuming the IFA waives their 2.5% commission).

Annual running costs are capped at 3.5% of net assets. In the last three years running costs were 3.2% for 2015, 3.3% for the year to December 2016 and 3.4%. for the extended period of January 2017 to March 2018.

In line with normal market practice the Manager receives a performance fee which is aligned with investors and based on paying regular dividends and maintaining NAV. Performance fees are payable when dividend payments and/or distributions equivalent to not less than 3.5p per annum on each share have been paid and the net assets per share are 70.6p. These fees will be 20 per cent. of the grossed up amount of any dividend. These fees are calculated in respect of each year ended 31 December and are subject to a catch up should any previous years distribution not be met, and approval of the audited accounts by shareholders. Any performance incentive fee payable in any period of 12 months has been capped at 24.9% of the lesser of the Company's current Net Assets, market capitalisation or gross assets.

Elderstreet tell us that the current position on the catch-up on the performance fee is zero to end March 2018 having reached the dividend hurdle every year. It is not envisaged that any performance fee will be due for 2019 and the catch up will be 1p in aggregate.

Elderstreet Investments Limited receives fees of 2% of net assets per annum. The administration fee charged by Downing Management Services Limited is £50,000 plus vat per annum.

Tax Efficient Review Cost rating: 8 out of 10

Conclusion

A £7m fund raise from £41m generalist Draper Esprit VCT.

The aim of the VCT is to build a diversified portfolio of mainly unquoted companies in the technology sector requiring growth finance but the key issues for potential investors include

- how realistic are the valuations of the two meaninghful legacy holdings
- how long it will take to sell down
- is this now the time to invest into a VCT with 40% of its value in cash (assuming the full £7m is raised and adjusted to exclude cash allocated for deals awaiting HMRC clearance)

Overall though we think that the positives from the co-investment agreement with Draper Esprit, the ability to deploy capital, and the combined teams operational and venture capital experience make this a very interesting VCT which is well placed given the new VCT rule changes adopted by HMRC.

The involvement going forward of Draper Esprit is a major plus but will take time to be visible in results.

Tax Efficient Review rating: 84 out of 100

Appendix A: Key members of Draper Esprit investment team

- **Simon Cook** is the CEO of Draper Esprit plc, which IPO'd on the London and Irish stock exchanges in 2016. Simon has been involved with the European VC industry since 1995 and co-founded Draper Esprit in 2005. He has been involved with a number of Europe's most successful startups including Lovefilm (Amazon), Cambridge Silicon Radio (IPO), Virata (IPO), nCipher (IPO) and KVS (Symantec). He currently works with Trustpilot, Graze, Crowdcube, Perkbox and Podpoint. Previously Simon was a partner with Cazenove Private Equity, which Draper Esprit acquired in 2006; a partner at Elderstreet Investments; and an Investment Director of 3i Technology Europe, which Draper Esprit acquired in 2009. He was a computer games developer early in his career and is a Computer Science graduate of the University of Manchester Institute of Science and Technology (UMIST).
- **Stuart Chapman** is the COO of Draper Esprit. Prior to establishing the Draper Esprit group, with Simon in 2006, Stuart was a Director of 3i Ventures in London. Having joined 3i in 1992, he has 25 years of venture capital experience in Europe and the US. He was a founding partner of 3i US, based in Menlo Park, CA from 1999 until 2003. Stuart was responsible for Esprit's investments in Lagan Technology (sold to Verint), Redkite (sold to Nice) and Kiadis (IPO). Stuart currently serves as a director with Resolver, Realeyes and Conversocial and observer with Metalysis and Crate. Prior to 3i, Stuart was involved in software and systems implementations for Midland Bank. He is a graduate of Loughborough University and currently serves on the Strategic Advisory Board for the Loughborough School of Business, and has served as a member of the British Venture Capital Association Venture Committee.
- **Ben Tompkins** is Managing Partner of Draper Esprit and has been working with technology entrepreneurs and their investors in Europe and the US all his career. Prior to joining Draper Esprit, Ben was Managing Partner at Eden Ventures, a European early stage VC investor in UK software companies with international ambitions. Prior to Eden, Ben was a Managing Director at tech investment bank Broadview/Jefferies and co-headed the Global Software Services & Media practice, advising on deals including Blizzard Studios/World of Warcraft, Iris Software (LSE), Kelkoo, Seloger, Musiwave, Loot, Promethean, ICV and uDate. Ben also sat on the Board of Seedcamp, the UK's premier early stage fund. He is a Business Law graduate and a Barrister from Lincolns Inn.
- **Richard Marsh** (EIS Partner – Encore Ventures) has worked in start-ups and venture capital since 1997 and is an experienced entrepreneur as well as a venture capitalist. He founded and built Datanomic, a Cambridge-based software company which was a pioneer of Data Quality software and was acquired by Oracle. As an investor, Richard has worked across software, hardware, mobile and cleantech sectors. He is responsible for the Drape Esprit group's investments in Garlik (acquired by Experian), Green Park Content, GreenPeak Technologies (acquired by Qorvo), Polatis (acquired by Huber and Suhner), Psytechnics (acquired by NetScout), and SportPursuit. Richard is an Engineering graduate of Cambridge University where he also received his PhD. Richard holds an MBA from IMD Business School, Lausanne, where he was a Sainsbury Management Fellow.
- **David Cummings** (EIS Partner – Encore Ventures) has worked for IMI Plc, Lazard and KPMG. His early career at IMI Titanium was as a research and development metallurgist developing superconductors and titanium alloys. From 1986-2002, David worked at Lazard, where he became a partner and the managing director running the TMT group in London. While there he gained a wide variety of experience in corporate finance, M&A, debt restructuring and equity capital markets based on over a decade of transactions in the TMT sector. From 2004-2011, David was a senior director of KPMG Corporate Finance focusing on Business development and relationship building with medium to large corporations in the telecom and technology sectors. David is an active investor in early stage private technology companies and is a member of Cambridge Angels. David is a graduate of Trinity Hall, Cambridge University (Natural Sciences) and London Business School (Msc21).

Reproduction of Key Information Document for Draper Esprit VCT

KEY INFORMATION DOCUMENT

Purpose
This document provides you with key information about this investment product. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses of this product and to help you compare it with other products.

DRAPER ESPRIT VCT PLC

Product: Ordinary Shares of 5 pence each nominal value issued by Draper Esprit VCT plc ("**Shares**")
ISIN GB0002867140
Names of PRIIP manufacturers: Draper Esprit VCT PLC (registered number 03424984) (the "**Company**") and Elderstreet Investments Limited (registered number 01825358) ("**Elderstreet**")
Website for the PRIIP manufacturer: www.elderstreet.com
Call this telephone number for more information: +44(0) 207 831 5088
Competent Authority of the PRIIP Manufacturer in relation to the KID: UK Financial Conduct Authority
Date of production of this Key Information Document: 11 January 2019
Comprehension alert: **You are about to purchase a product that is not simple and may be difficult to understand.**

What is this product?

Type: Venture Capital Trust
Objectives: To provide good long-term tax-free returns to Shareholders through a combination of dividends and capital growth and 30% income tax relief for eligible VCT investors (as long as shares are held for 5 years from the date of allotment and other conditions are met). The Company invests in a diversified portfolio of smaller, unquoted companies with a particular focus on the technology sector.

Bid-offer spread: Shares are bought and sold via markets. Typically, at any given time on any given day, the price you pay for a Share will be higher than the price at which you could sell it.

The recommended holding period: is in the range of five to ten years to allow for underlying investments to mature. The Company is intended to be evergreen and there are no relevant prescribed maturity dates but it is always open for a majority of shareholders to resolve that the Company should be liquidated. If you subscribe for Shares at issue and hold them for less than five years you will lose any tax reliefs for which you may have been eligible in respect of that subscription.

Intended retail investor: a typical investor in the Company will be a UK higher-rate income tax payer, over 18 years of age and with an investment range of between £6,000 and £200,000 who is capable of understanding and is comfortable with the risks of VCT investment.

Risk Indicator

1	2	3	4	5	6	7

Lower risk **Higher risk**

The summary risk indicator is a guide to the level of risk of this product compared to other products. We have calculated the risk indicator for this product using the prescribed methodology which only takes account of historic share price movements and dividends and classified it as 4 out of 7 being a moderate to high risk class This rates the potential losses from future performance at a moderate to high level and poor market conditions are likely to impact the amount you could get back. The risk indicator assumes you keep the shares for ten years. The actual risk can vary significantly if you sell your shares before the recommended holding period and you may get back less. This investment offers no capital guarantee against credit risk. If the underlying companies in which the Company invests do not pay what they owe the Company you could lose part of the capital you invest (but you do not bear the risk of incurring additional financial obligations or commitments). If you sell your shares before the recommended holding period you may not be able to sell your shares easily or you may have to sell at a price that significantly impacts on how much you get back. This liquidity risk is not contractual but is due to there being a limited secondary market for shares in venture capital trusts. This investment offers no capital protection against future market performance so you could lose all or part of your investment if you sell in a poor market.

Performance Scenarios

The table below shows the money you could realise from selling your shares over the next 10 years under different scenarios, assuming that you invest £10,000. The scenarios shown illustrate how your investment could perform. You can compare them with the scenarios of other products. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies, and are not an exact indicator. What you get will vary depending on how the market performs and how long you keep the investment. The stress scenario shows what you might get back in extreme market circumstances, and it does not take into account the situation where the Company is not able to pay you. This shares may not be easy to sell. This means it is difficult to estimate how much you would receive if your sold your shares before the end of the recommended holding period. You will either be unable sell your shares or you will have to pay high costs or make a large loss if you do.

VCT Income tax relief is available at the rate of 30% to eligible investors that hold their shares for five years (subject to various conditions). No account is taken of this is calculating the scenarios presented below.

Investment Scenarios		1 year	5 years	10 years (recommended holding period)
Stress scenario	**What you might get back after costs**	£539	£4,429	£2,990
	Average return each year	-94.6%	-15.0%	-11.4%
Unfavourable scenario	**What you might get back after costs**	£8,170	£8,112	£9,532
	Average return each year	-18.3%	-4.1%	-0.5%
Moderate scenario	**What you might get back after costs**	£9,941	£13,751	£20,627
	Average return each year	-0.6%	6.6%	7.5%
Favourable scenario	**What you might get back after costs**	£13,367	£25,759	£49,325
	Average return each year	33.7%	20.8%	17.3%

What happens if Elderstreet Draper Esprit VCT plc is unable to pay out?

The value of the Shares and the income derived from them is dependent on the performance of the Company's underlying investments and can fluctuate. Investors could lose all or part of their investment. Your capital is at risk. As a shareholder of the Company you would not be able to make a claim to the Financial Services Compensation Scheme about the Company in the event that the Company is unable to pay out.

What are the costs?

The Reduction in Yield (RIY) in the table below shows what impact the total costs you pay will have on the investment return you might get. The total costs take into account one-off, ongoing and incidental costs. The amounts shown here are the cumulative costs of the product itself, for three different holding periods. They include potential early exit penalties. The figures assume you invest £10,000. The figures are estimates and may change in the future.

Costs over time

The person selling you or advising you about this product may charge you other costs. If so, this person will provide you with information about these costs, and show you the impact that all costs will have on your investment over time.

Investment Scenarios	If you cash in after 1 year*	If you cash in after 5 years*	If you cash in after 10 years
Total costs	£828	£2,119	£4,164
Impact on return (RIY) per year	8.6%	4.0%	3.4%

*This product cannot be easily realised. This means it is difficult to estimate how much you would get back if you attempt to realise your investment early. You will either be unable to realise your investment early or you will have to pay high costs or make a large loss if you do so. You will also lose tax reliefs gained on subscription if you sell within five years.

Composition of costs

The table below shows: the impact each year of the different types of costs on the investment return you might get at the end of the recommended holding period and the meaning of the different cost categories.

This table shows the impact on return per year			
One-off costs	**Entry costs**	5.5%	Elderstreet Investments Limited will charge a promoter's fee to the Company or either 3.0% or 5.5% of amounts invested depending on the category of investor. Stamp duty reserve tax of 0.5% is payable if the Shares are purchased on the secondary market.
On-going costs	**Portfolio transaction costs**	0.0%	The Company's costs of buying and selling underlying investments.
	Other ongoing costs	2.8%	The Company's annual running costs estimated at 2.8% of its net assets but are capped at 3.5%. This includes a management fee to Elderstreet Investments Limited of 2.0% and an administration fee to Downing LLP of £50,000.

How long should I hold it and can I take money out early?

The recommended holding period is a minimum of five years because investing in smaller and unquoted companies involves a higher degree of risk and volatility and investments by the Company which prove to be successful may take longer to mature compared to those which prove to be less successful. Investments are likely to be realised by the sale of Shares back to the Company or in the market. The Company has a policy to buy back shares which its shareholders wish to sell, currently at a discount of 7.5% to the most recently announced NAV but its ability to do so may be limited by available cash, the rules of the UKLA, the Companies Act 2006 and the VCT Rules. Accordingly, it is unlikely there will be a liquid market as there is a limited secondary market for shares in VCTs and Investors may find it difficult to realise their investments.

How can I complain?

As a shareholder of Draper Esprit VCT plc you do not have the right to complain to the Financial Ombudsman Service about the management of Draper Esprit VCT plc. Complaints about the Company or the key information document should be sent to the company secretary: Mr. Grant Whitehouse, Downing LLP, St Magnus House, 3 Lower Thames Street, London EC3R 6HD.

Other relevant information:

The cost, performance and risk calculations included in this KID follow the methodology prescribed by EU rules. Accordingly, performance scenarios and the risk indicator have been based solely on historic share price total return with dividends reinvested and do not take any direct account of the underlying portfolio of assets held by the Company.

Depending on how you buy Shares you may incur other costs, including broker commission, platform fees and Stamp Duty. The distributor will provide you with additional documents where necessary. You are recommended to read the Offer document published by the Company on 11 January 2019 and, in particular, the risk factors set out on pages 25 to 27, before making an investment decision and to confirm with your independent financial adviser that you have the expertise, experience and knowledge to properly understand the risks of investing in the Company. Prospective investors should note that the value of an investment may not get back the amount originally invested. Therefore, you should only make investments in the fund that you can afford to lose without having any significant impact on your overall financial position or commitments. Taxation levels, bases and reliefs may change if the law changes and the tax benefits of products will very according to your personal circumstances: independent advice should therefore be sought. Please note that it cannot be guarantee that the companies invested in by the Company will be qualifying companies or that the Company will maintain its qualifying status as a venture capital trust.