GUIDE TO
VENTURE CAPITAL TRUSTS

For information on our current VCTs please contact your financial adviser or call Octopus today on **0800 316 2347**

OCTOPUS INVESTMENTS

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OCTOPUS INVESTMENTS

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OCTOPUS
INVESTMENTS

WELCOME

Over the past eight years, Octopus has built a reputation for creating innovative and successful investment products that meet the needs of individual investors.

It's why we're now one of the fastest growing fund management companies in the UK, with more than 18,000 investors and over £600 million under management across our range of products.

Our reputation for excellence means that we've attracted some of the most experienced investment professionals within the industry to invest your money. So, if you're looking for award winning performance, look no further. Our products have been shortlisted for or won **'VCT of the Year'** every year since 2004 and independent financial advisers voted us **'Best VCT Provider of the Year'** in 2007 and 2008.

"Octopus is unlike any of the other companies I deal with. Your people are knowledgeable, intelligent and relaxed. This is refreshing."

Peter Hirsch, VCT Investor.

We've designed this guide to help you and your adviser select the right VCT for you. If you have any questions, or if it would help to speak to one of our fund managers, please call us on **0800 316 2347**.

Simon Rogerson
Chief Executive

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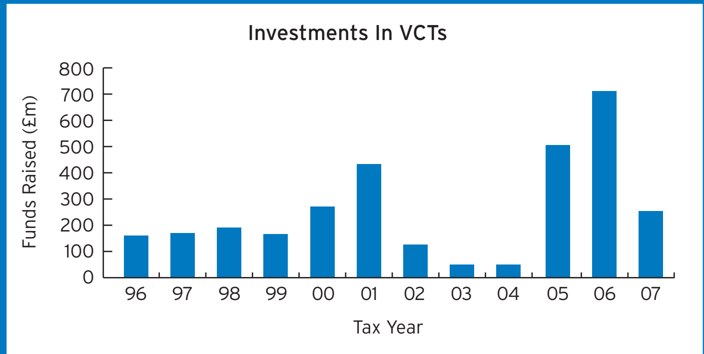
WHAT IS A VCT?

VCTs are one of the least understood investment products in the market. Yet, for the right investor, they are also one of the most attractive, combining the potential for good returns with substantial tax advantages.

BACKGROUND

VCTs were introduced by the UK Government in 1995 to encourage individuals to invest in UK smaller companies. The Government achieved this by offering investors in VCTs a series of very attractive tax benefits. As a result of these tax benefits, more than £3.4 billion has been invested in VCTs between 1995 and 2008.



(Source: Octopus)

STRUCTURE

All VCTs are companies listed on the main market of the London Stock Exchange. As such, all VCTs have independent directors whose objective is to protect the interests of the individual investors in the VCT.

30% tax relief on money invested in a VCT

A VCT will typically raise between £10 million and £30 million from thousands of individual investors. The VCT will then invest this money in a diversified portfolio of between 20-40 companies. These companies will either be AIM listed or private (see page 10 for a number of examples).

A further benefit of VCTs is that, as the value of the investments rise, profits can be paid out as a stream of tax-free income.

TAX BENEFITS

VCTs offer a series of tax advantages unmatched by any other kind of investment product in the UK.

- Upfront income tax relief of 30% on the amount invested (provided that you hold the shares for five years and subject to a maximum investment of £200,000 per person per tax year)
- Dividends paid to you by VCTs are tax-free
- Capital gains when you sell your shares in a VCT are tax-free

This means that if you invest £10,000 in a VCT, you will get £3,000 knocked off your income tax bill. In other words, your investment of £10,000 only costs you £7,000, providing you with an effective return, after initial charges, of 35% before the first investment is made.

OBTAINING THE INCOME TAX RELIEF

Obtaining the income tax relief is both quick and easy. First, the VCT fund manager will send you a share certificate and a tax certificate a few weeks after you make the investment. You then have two options on how to reclaim the relief:

EITHER
You can write to your HM Revenue & Customs Office and ask them to change your tax coding under the PAYE system (this is the system that calculates how much tax you pay each month).

You will then receive your income tax relief on a monthly basis through your pay cheques.

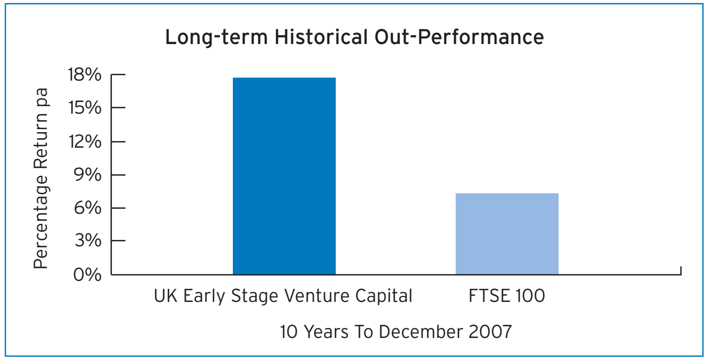
OR
You can wait until you fill in your tax return at the end of the tax year.

WHY INVEST IN VENTURE CAPITAL?

The fundamental rationale for investing in venture capital is to enhance the risk and reward characteristics of your investment portfolio. This can be achieved in a number of ways:

- Long-term historical out-performance
- Absolute returns
- Portfolio diversification

LONG-TERM HISTORICAL OUT-PERFORMANCE
The long-term returns of venture capital have been higher than the returns from investing in UK larger companies.



(Source: PwC and BVCA Performance Measurement Survey 2007)

Please remember that past performance is no guide to future performance.

Historically, venture capital has only been accessible to institutional investors (like pension funds) and very wealthy investors. The introduction of VCTs has allowed individuals to access this type of investment, while at the same time limiting risk through a combination of portfolio diversification and upfront income tax relief.

ABSOLUTE RETURNS

The only reason a venture capital fund manager will invest your money in an individual company is because they believe that the company in which they are investing is undervalued. This is in marked contrast to most investment funds, which are designed to deliver a return against a stock market benchmark, irrespective of which way that benchmark moves. This leads to the absurd situation whereby most traditional fund managers will consider they have done well if they have lost 15% of your money so long as the index against which they are judged is down by 25%.

PORTFOLIO DIVERSIFICATION LOWERS RISK

Introducing venture capital into your portfolio should improve diversification as venture capital tends not to move in the same cycles as other investments. An investment in venture capital should also help to lower the overall risk profile of the portfolio.

For example, if you have £100,000 invested in traditional investment products, there is a high chance that your portfolio will closely track the performance of the FTSE (ie if the market falls or rises by 10%, the portfolio will probably move within a few percent of this). If you now received another £20,000 you might think that the low risk strategy would be to invest this money in large FTSE 100 companies. In reality, this would increase the risk of your portfolio as it would be further concentrating your assets in a narrow market.

WHAT ARE THE VCT RULES?

The Government designed a set of rules for VCTs to ensure that the funds are invested into certain types of companies (eg property and financial services are excluded).

These rules are fairly technical, so we've included details of some portfolio companies on page 10 to provide you with real examples of the kind of businesses into which a VCT can invest.

The main rules are:

- VCTs have to invest 70% of the funds they raise in UK 'qualifying' companies within three years. To be qualifying, a company must be private or AIM listed (and not in one of the excluded sectors). The three year period means that VCTs will initially have a very high proportion of the money raised invested in low risk assets, like cash or cash equivalents.
- A VCT must have a diversified portfolio. No one holding can be more than 15% of the VCT at the time of the investment.
- A VCT can't invest more than £1 million into any one company in any one tax year.
- A company in which a VCT invests must not have gross assets of more than £7 million at the time of investment.
- A company in which a VCT invests must have fewer than 50 employees at the time of investment.

INVESTMENT EXAMPLES

One of our latest VCTs is managed by a highly experienced team, with an excellent track record of investing in private companies. Indeed, the team managing the Octopus Titan VCT 3 has delivered an average return of more than 29% per year since 2000. We've listed below some of the team's previous investments.

The Key Revolution (TKR), a spin out from Vodafone, has developed the 'Mobiu', which provides computer users with simple, secure and encrypted access to their files using any online computer, without the need for their own computer network.

Users can store their own documents on a secure and remotely hosted TKR server as part of the service, so that when the device is running they can access their own documents.

True Knowledge is a search engine internet site which can be used to add knowledge, answer direct questions, and can be used just like a conventional search engine.

Finding information on the internet currently involves a process of guessing keywords hoping that a search engine retrieves a document with the desired information. True Knowledge has devised technology that sidesteps this fundamental problem by providing the world's knowledge in a form that computers can understand and process, for ordinary internet use.

LoveFilm is Europe's leading online DVD rental and movie download company with nearly 500,000 active household subscribers making it one of the top three most visited UK sites in Entertainment and Movies. It has the UK's largest range of DVDs with over 65,000 titles. It is estimated that the company has over 20% of the total DVD rental market.

In the last two years, Lovefilm launched in Sweden, Denmark, Norway, and Germany making it market leader in digital film delivery with the largest movie download catalogue in Europe.

Another of our current VCTs, the Octopus Protected VCT 2, takes a different approach. It aims to make around 20 investments, but in a way that minimises risk to investors. We've listed below some of the team's previous investments.

Based in Wolverhampton, Hydrobolt is one of the UK's leading manufacturers and distributors of high integrity fasteners for the oil, gas and power generation markets.

Hydrobolt manufactures quality and safety critical products for use in hostile environments, where extremes of temperature and pressure are encountered. The Group (Hydrobolt and sister company Studbolt) specialises in working to bespoke designs using exotic metals. The Group supplies a large and diversified customer base, both nationally and internationally, through sales offices in the US, Canada and Singapore.

Bruce Dunlop and Associates 'BDA' is the UK's leading broadcast design agency. It provides promotion and design services to broadcasters and advertisers worldwide, and also creates brand films and internal communications for leading UK corporations.

Since the launch of the business ten years ago, the three founders have grown the company significantly with offices in London, Munich, Dubai, Singapore and Sydney. The company has a range of blue-chip customers including Hallmark, Barclays, Discovery and Sony.

RISKS

There are a number of issues you should be aware of when selecting the right VCT for you including:

- Unquoted companies
- Liquidity issues
- Fund management company risk
- Fund size
- Market timing risk

UNQUOTED COMPANIES

VCTs invest in private and AIM listed companies. Obviously these companies, individually, carry an above average level of risk. The benefit of investing in a VCT is that you reduce that risk by having a diversified portfolio of such companies. Also, fund managers will usually take a board seat and will be able to exert influence over the management of the business.

Please remember that the value of an investment in a VCT can fall as well as rise and you may not get back the full amount invested.

LIQUIDITY ISSUES

Most investors view their VCT as a long-term investment.

This assumes, however, that the fund is performing and that they are happy with the level of tax-free income they are receiving from the fund.

If it isn't performing, you want to make sure that you have maximum flexibility by being able to sell your shares. As selling VCT shares through the stock market can be difficult, a number of VCTs have share buyback schemes, whereby the manager will arrange to re-purchase your shares, usually at no more than a 10% discount to the net asset value.

FUND MANAGEMENT COMPANY RISK

As with any fund, it is important that you focus on the track record and the experience of the fund manager. A reassuring point in respect of VCTs is that they are publicly quoted companies with an independent board of directors.

Octopus specialises in VCTs

FUND SIZE

Last tax year, more than £215 million was raised by approximately 20 VCT fund management companies. Of this money, more than £30 million was raised by Octopus.

Octopus raised £30m for its VCTs last tax year

Conversely, a number of managers in the market failed to raise £10 million and a few years ago, some managers were forced to withdraw their offerings. For investors in VCTs which only raise a small amount of money (less than £15 million), there are a number of potential disadvantages, including higher charges and less portfolio diversification.

MARKET TIMING RISK

Another difference between a VCT and a traditional fund is that a VCT will invest gradually over time. Unlike a unit trust which typically would be fully invested at all times, a VCT can spend up to three years investing clients' capital. This means that for at least the first year and a half of the VCT's life, the majority of the fund will remain largely in cash, earning interest on behalf of investors.

By investing your money over three years, a VCT reduces the risk to you

WHO IS A VCT SUITABLE FOR?

VCTs could be suitable for people seeking:

- To reduce their income tax liability
- A highly tax efficient alternative to other types of funds that invest in UK smaller companies
- To potentially reduce the overall risk of their investment portfolio by including a fund which typically does not follow the same cycles as stock markets
- An additional source of retirement income (VCTs are more flexible than a pension, as you are not locked in and the full value can pass to a spouse upon death)
- An alternative to an ISA

You should think carefully about whether an investment in a VCT is suitable for you. You should also make sure you've read and understood the risk warnings contained in the prospectus. If you are not sure, you should seek advice from an authorised financial adviser.

QUESTIONS AND ANSWERS

Q: How much can I invest in a VCT?
A: You can invest between £3,000 and £200,000 in a VCT in any one tax year.

Q: Who qualifies for the income tax relief?
A: You must be UK resident and aged over 18. The 30% income tax relief is available irrespective of whether you are a lower, basic or higher rate taxpayer, but you can't claim back more income tax than you've actually paid, or are due to pay, in the tax year you make your VCT investment.

Q: How long do I have to hold my shares?
A: Although you can sell your shares at any time, you must hold them for five years to retain the initial 30% income tax relief. You should regard a VCT as a longer-term investment.

Q: What happens if I want to exit my investment?
A: VCTs are companies listed on the main market of the London Stock Exchange. As such, their shares are traded like any other quoted company. Some VCTs offer share buyback schemes, so it is sensible to contact the fund management company before deciding to sell.

Q: What happens if I sell my investment in the first five years?
A: You will have to repay the upfront income tax relief.

Q: What happens if I make a capital gain on sale of my VCT shares?
A: This gain will be tax-free.

Q: What happens if I die?
A: The shares form part of your estate for inheritance tax purposes. Even if you die before the five year minimum holding period is reached, your estate will not have to repay the income tax relief.

If you have further questions, or if you feel that it would help to speak to one of our fund managers, please call Octopus on **0800 316 2347**.

APPENDIX 1
2008/09 TAX CALCULATOR

To benefit from the 30% upfront income tax relief, you must be resident in the UK and aged over 18. You do not have to be a higher rate taxpayer. The examples below are for illustrative purposes only and you shouldn't rely on them for calculating your own income tax liability.

EXAMPLE 1

Mr Jones has an income of £45,000 per year. After deducting his personal allowance (£6,035), the next £34,800 at the standard rate of 20% and the remainder of his salary (£4,165) will be taxed at the higher rate of 40%.

	Tax Rate	Tax Due
Personal allowance of £6,035	0%	-
Next £34,800	20%	£6,960
Remainder £4,165	40%	£1,666
Total Tax Due		**£8,626**

If Mr Jones chose to invest in a VCT the tax due would depend on the amount invested as follows:

VCT Investment	Tax Relief	New Tax Bill	Reduction
£3,000	£900	**£7,726**	10%
£5,000	£1,500	**£7,126**	17%
£10,000	£3,000	**£5,626**	34%

EXAMPLE 2

Mrs Smith has an income of £75,000 per year. After deducting her personal allowance (£6,035), the next slice (£34,800) will be taxed at the standard rate of 20%, with the remainder of her salary (£34,165) taxed at 40%.

	Tax Rate	Tax Due
Personal allowance of £6,035	0%	-
Next £34,800	20%	£6,960
Remainder £34,165	40%	£13,666
Total Tax Due		**£20,626**

If Mrs Smith chose to invest in a VCT the tax due would depend on the amount invested as follows:

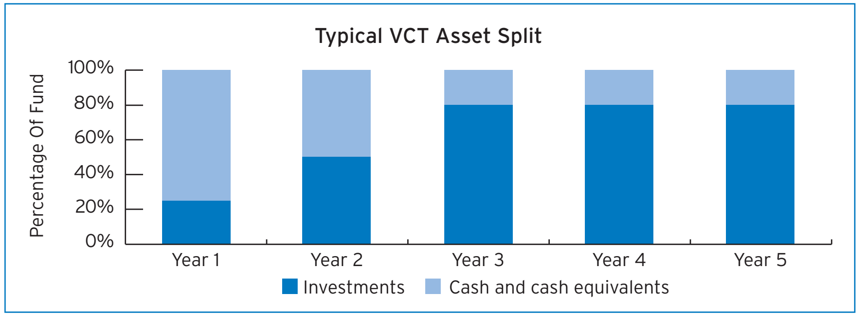
VCT Investment	Tax Relief	New Tax Bill	Reduction
£5,000	£1,500	**£19,126**	7%
£10,000	£3,000	**£17,626**	14%
£25,000	£7,500	**£13,126**	36%

If you are unsure as to whether or not you will be able to benefit from the tax reliefs obtained by investing in a VCT, you should seek independent financial advice. Please remember that you also need to hold your VCT shares for a minimum period of five years in order to keep the upfront income tax relief.

APPENDIX 2
HOW INVESTMENT STRATEGY IMPACTS RETURNS

INVESTMENT PERIOD
The minimum holding period for a VCT is five years. This is because if you sell your shares before this, you'll have to repay the 30% upfront income tax relief you have already received. Most people would regard a VCT as a medium to longer-term investment.

CASH HOLDINGS
The investment risk is reduced significantly over the first three years as the majority of the VCT will remain in cash, earning interest on behalf of investors.



Money will only be invested as and when the fund management company is confident that the investment opportunities found will generate a better return than is available from cash.

APPENDIX 3
ABOUT OCTOPUS TITAN VCT 3

VCTs provide the opportunity to enjoy significant tax advantages with the potential for good returns. Not all VCTs are created equal however and we believe that the Octopus Titan VCT 3 offers a number of advantages over other VCTs available.

- **TRACK RECORD**
  The team managing the Octopus Titan VCT 3 has an excellent track record. Indeed, over the last seven years, this team has generated an average return of more than 29% per annum. In other words, in seven years they've turned £10,000 into almost £60,000.

  It's the strong performance of our funds, combined with our commitment to customer service, that meant that independent financial advisers voted Octopus **'Best VCT Provider'** in 2007 and 2008.

- **TAX-FREE INCOME**
  One of the great advantages of VCTs is that they can pay out any profits they make as tax-free dividends. The Octopus Titan VCT 3 will be targeting high returns and expects to pay out significant income to investors from year three.

- **INVESTMENT OPPORTUNITIES**
  Octopus is one of the largest VCT managers in the UK, and accounted for almost 15% of all inflows into the market last year. This means that we tend to see a very large number of investment opportunities and are able to select the very best for our funds.

If you have further questions, or if you feel that it would help to speak to one of our fund managers, please call Octopus on **0800 316 2347**.

APPENDIX 4
ABOUT OCTOPUS PROTECTED VCT 2

The Octopus Protected VCT 2 has been designed for the lower risk VCT investor.

- **INVESTMENT POLICY**
  Investments will be made into companies where the Octopus team is confident that there is a high level of capital security. The companies will operate in sectors where there is a high degree of predictability, ideally with contracted revenues from financially sound customers. The fund will target total tax-free dividends of 10p and a Net Asset Value of at least 110p by the end of year five.

- **LIQUIDITY**
  Subject to shareholder approval, we intend to convert the Octopus Protected VCT 2 into an Investment Trust after five years (the minimum holding period for investors to retain their 30% income tax relief). We believe that this will make the Fund more appealing to a broader range of investors which, in turn, should improve liquidity for Shareholders. It will also provide Octopus with greater flexibility in how the Fund is managed, which should lead to the potential for higher long-term returns.

APPENDIX 5
OCTOPUS AWARDS

AWARDS

September 2004	Eclipse VCT 1 voted **'New Venture Capital Fund of the Year 2004'** in the Investor AllStars Awards
September 2005	Phoenix VCT shortlisted in the 2005 Investor AllStars Awards
September 2006	Octopus Investments VCT Fund shortlisted in the 2006 Investor AllStars Awards
October 2006	Octopus shortlisted for the Customer Excellence Award in the Growing Business Awards
January 2007	Octopus voted **'Best VCT Provider of the Year 2007'** in the Professional Adviser awards (voted for by financial advisers)
September 2007	Eclipse VCT and Phoenix VCT joint winners of VCT of the Year at the Investor Allstars 2007
January 2008	Octopus voted **'Best VCT Provider of the Year 2008'** in the Professional Adviser awards (voted for by financial advisers)

Please remember that past performance is no guide to future performance.

IMPORTANT NOTICE

This guide is a short summary and is not intended to be comprehensive. Tax reliefs referred to in this document are those currently in force. Shares in a VCT must be held for five years in order to retain the upfront income tax relief. A VCT should be regarded as a longer-term investment. The levels and bases of taxation and of reliefs from taxation may change. The value of reliefs depends on personal circumstances. If the conditions required for any relief to be given and maintained are not satisfied, the relief in question could be subsequently withdrawn.

This guide is not an invitation, or a solicitation of such an invitation, to subscribe for shares in any VCT. The value of an investment in a VCT may fall as well as rise, and an investor may not get back the full amount invested. The market for VCT shares may be limited and it could be difficult for an investor to realise their holding. An investment in a VCT may not be suitable for all potential investors and advice should be sought from an independent financial adviser authorised under the Financial Services and Markets Act 2000. An investment in a VCT should only be made on the basis of information contained in the prospectus issued in connection with the offering. The information in this guide should not be construed as investment advice on the merits of investing in any particular VCT. This document has been issued and approved by Octopus Investments Ltd, 8 Angel Court, London EC2R 7HP which is authorised and regulated by the Financial Services Authority, 25 The North Colonnade, London E14 5HS.