ShareSoc Campaign Update: VCTs

The webinar will begin shortly

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ShareSoc Campaign Update: VCTs

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Presentations at ShareSoc Events

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Welcome to ShareSoc

- Not-for-profit
- 7,000 members
- We campaign
- We inform
- We educate
- We create networking opportunities
- We save you money

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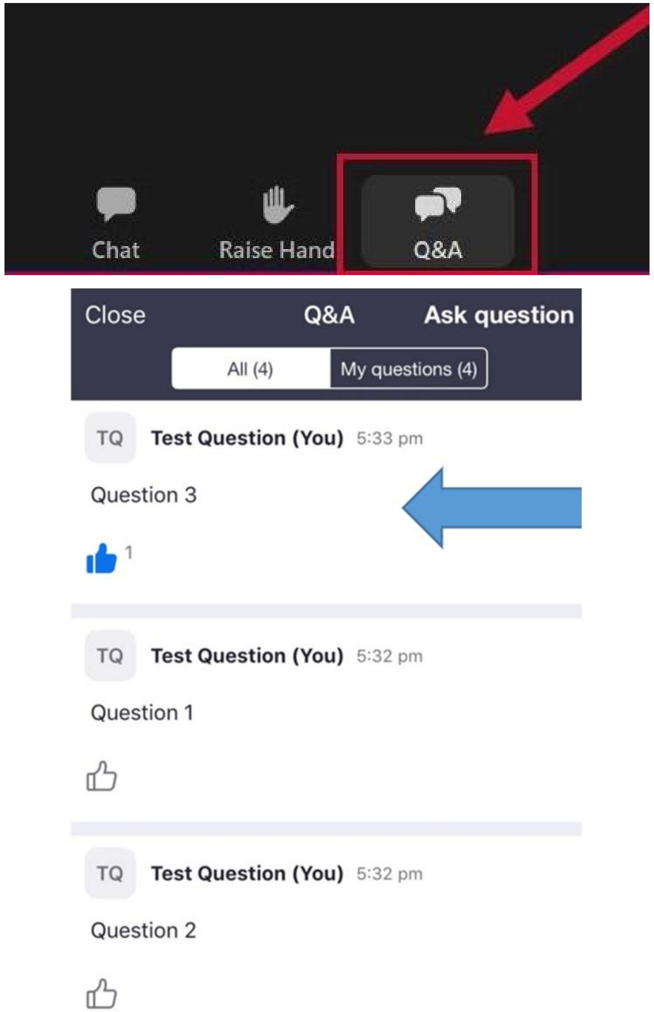
Asking questions & upvoting



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Agenda

- Introduction and welcome – Cliff Weight
- Some background by Mark Lauber “Is it worth it?”
- 2020 review
  - Edge - Robin Goodfellow
  - Ventus - Nick Curtis
- 2021 issues and plans
- Panel discussion and questions from the audience
- Sum up and hopefully agree key actions

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VCT Investors Group Campaign

The Purpose of the Group is to improve the returns of investors in VCTs

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Goals of ShareSoc VCT Investor Group

1. To provide guidelines of what Group members think is best practice, e.g.
   a. Management fees,
   b. Performance fees
   c. Directors' tenure and
   d. Directors' independence.

2. To provide advice for investors on specific VCTs, by
   a. Identifying investors who are interested in specific VCTs and willing to spend time in collaborating with others to share knowledge and identify areas of concern and to make recommendations
   b. Providing mechanisms to exchange information
   c. Publicising our views to the VCT Boards, investors and others who may be able to influence the Boards of specific VCTs

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VCTs are they worth it?

ShareSoc VCT event 23 March 2021

Mark Lauber

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Positives and Negatives

Positives

- 30% initial tax relief
- Tax free dividends
- Access to diversified portfolio
- No tax reporting

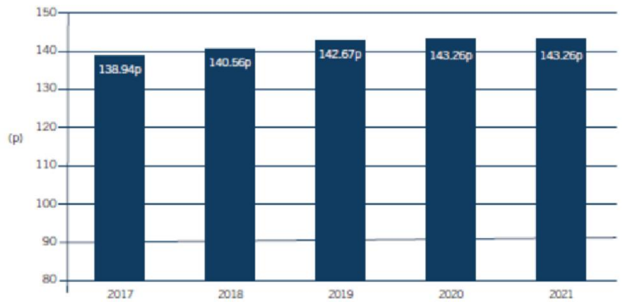
Mixed

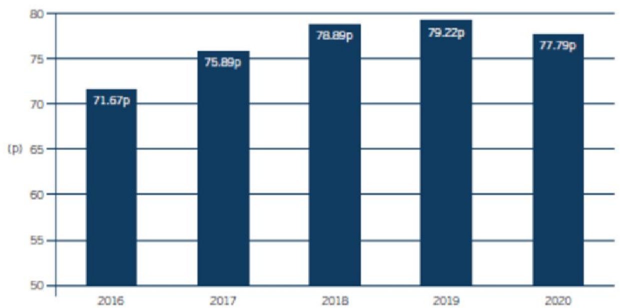
- Gains/losses outside of CGT

Negatives

- Locked in for 5 years
- Shares can be very illiquid thereafter
- Performance
- Fees
- No IHT relief despite underlying
- Traps
  - Risk of loss of relief (upon sale or admin problem at VCT)
  - 6m rule

Typical returns

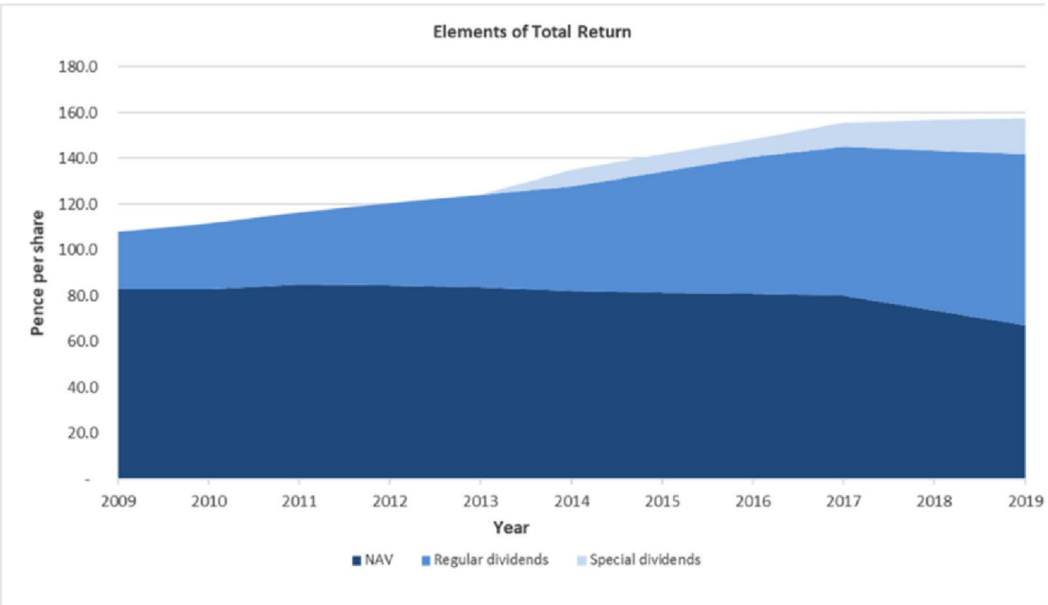




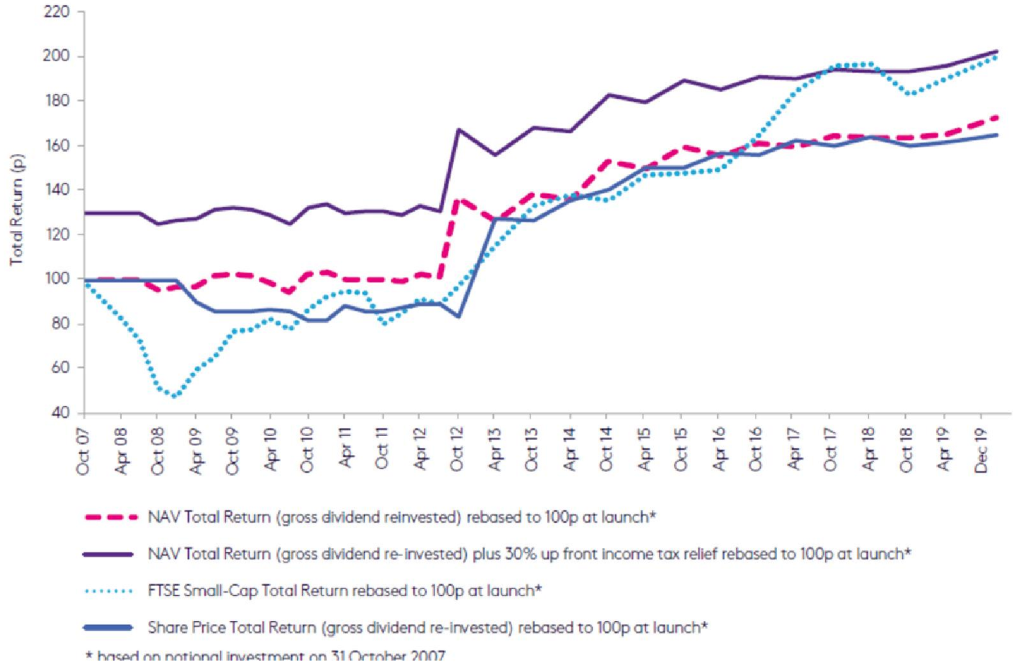
Year ended (as at 30 September)	Total net assets £m	Net asset value p	Net asset value total return since launch* p
2020	164.8	71.4	**396.7**
2019	151.1	75.05	**382.42**
2018	175.5	91.47	**423.65**
2017	180.7	93.05	**396.46**
2016	150.6	87.09	**363.36**
2015	85.1	102.56	**353.10**
2014	83.1	98.62	**318.80**
2013	75.8	100.63	**288.19**
2012	72.4	101.10	**252.04**
2011	65.0	95.15	**231.26**
2010	63.7	94.79	**208.25**
2009	61.2	89.06	**183.81**
2008	54.8	91.68	**184.02**
2007	68.7	112.19	**209.62**

Typical returns

Elements of Total Return



NAV and share price total return since launch against the FTSE Small-Cap Index total return[1]



Longer term performance

- Trustnet 5y total return performance varies between 74% and -64%, with a median at 27%.
- That's an IRR of about 4.9%, which is similar to previous slides.
- Yields can be higher, but with NAV decay
- Factoring in the tax benefit is critical (4.9% becomes 13.5%)
  - -70, 4.9, 4.9, 4.9, 4.9, 104.9, however there are other frictions
  - And that tax shield belongs to you, and could be profitably used otherwise (SIPP contributions, EIS, and sometimes carried back)
- Holding longer than 5y reverts to the ~5% return net of costs
  - And with often difficult liquidity

A VCT strategy

- Assuming current levels of cost and average returns

- Buy and get tax relief. Choose wisely.
- Hold for 5y
- Sell into a liquid market*
  - Pay premium to NAV to get in, accept discount to get out
- Recycle proceeds into a different VCT*
- 5% premium to get in, 10% discount to get out, reduces return from 13.5% to **9.8%**. This is while consuming your tax capacity. (Possible to make savings here)
- Initial costs, ongoing costs, and exit discount eat a lot of your return.
- TER typically 2.5% to 3.5%, versus Investment Trust about 1%.
- BIIAH strategy returns 7.4% IRR (70 to 100 in 5y)

Questions?

- Thank you

An update after last year's successful Edge Performance VCT Action Group

ShareSoc VCT event, 23 March 2021

Robin Goodfellow

What do investment company shareholders want ?

.....according to the AIC Code of Corporate Governance

- The best possible **return** with an acceptable **level of risk** consistent with the objectives of the company
- Clear objectives and **transparent investment policies** so that they can understand what they are buying and the risk/reward dynamics that apply
- An **appropriate level of costs** consistent with incentivising performance and quality service
- **Good liquidity** so that they can sell (or buy more) shares easily
- Timely and clear **communication** from the board, managers and other agents
- The board to have regard to the company's wider objectives and **stakeholders**

Also there is a board requirement to **monitor the discount** and take steps to reduce it

Does the ShareSoc VCT group think this an appropriate list?

Do you want an annual vote on the reappointment of the VCT manager (like directors and auditors)?

Should there be a VCT continuation vote for mature VCTs (caveat 5 year rule)?

The best possible return with an acceptable level of risk consistent with the objectives of the company.

- **<u>Edge I Class 73.1m shares currently & (H Class 11.6m shares)</u>**
- 2005-2012 **Planned Exit** classes returned 28p (4x 7p) as dividends in first 4 years
- **Wind up dates missed**. Total **NAV return below 100p issue** at that stage (2012)
- 16m new I shares issued at 100p in **2012 launch** (also 2.2m H shares at 100p)
- **2016 merger** with C, D, E, F & G rump turned I Class into a **very different concentrated portfolio**
- Intent (2011) written off in 2019, a **£13.5m loss** on investment
- Coolabi (2010) **investment of £17.7m peaked in value around £30m** (2015-2018)
- Thereafter value (under EIL stewardship and David Glick chairmanship) **declined to £9.8m in 2020**
- Coolabi sole significant I class asset for last 2 years. **Class costs of £1.2m pa (excessive fees & admin)**
- VCT share of Coolabi declined faster than other investors due to **death spiral financing**
- **I class 5 year life missed by 4 years**. Shareholders just want out asap but at optimum value
- Wind up gives an I Class exit at 12p with **total NAV return of just 47p** vs prospectus **“underpin” of 70p**

Clear objectives and transparent investment policies so that shareholders can understand what they are buying and the risk/reward dynamics that apply.

- Investment policy of **Planned Exit** classes drifted from small, low risk to large, high risk investees. Was that anticipated in the prospectus?
- **Planned Exit** became “couldn’t” exit
- Coolabi/Intent follow on investment risks not well explained. **Good money after bad?**
- Coolabi **death spiral financing** structure not explained. 15% VCT rule prevented more funding
- Coolabi management **incentivised** (@ 15% sale value) primarily **at VCT expense**
- **Evergreen** H class funding not refreshed annually after 2016; now looks like a **Planned Exit** at maturity
- Delta DNA sale to Unity and its float on NYSE transformed H Class. **NAV 128p plus 12p divs**
- No VCT continuity vote for shareholders to give views; **board sacked in 2019 but returned!**

Would shareholders have an expectation of having a vote on the future of the VCT, an H class fundraising and a wind up vote for the I Class?

An appropriate level of costs consistent with incentivising performance and quality service

- Initial mgt & performance fees were **relatively competitive**
- As **Planned Exit** portfolios declined though dividends and poor performance , cost ratios increased
- Extraordinary request for **improved performance fee** defeated by shareholders
- Extraordinary request for **increase in cost cap** surprisingly granted by board but inexplicably not put to shareholders
- Other **Planned Exit** VCTs had moved to **reduced fees after initial 5 year period**
- **Cloth ears** by board and manager in final years of I Class
- **Correct level of fees and costs** still not achieved with the new IMA

Update : Sorting out the past

- Joined board in July 2020 after Accounts issued but before AGM
- Established credibility as a constructive, independent and knowledgeable director
- Ensured that Coolabi sale process was proceeding properly
- Reviewed half year valuations, reduction in Coolabi
- New fairer accounting policy on common cost sharing on a quarterly NAV basis
- Requested independent legal opinion on incorrectly witnessed cost cap agreement and why it was not put to shareholders being an increase in a related party contract

Update : Positioning for the future

- Pressing for better H class dividend and start of buybacks, now VCT has cash
- Ensure no backsliding on commitment to return all Coolabi cash to I class shareholders
- Detailed review of half year and quarterly accounts.
- Last old board member stood down, replaced by Chairman of ITV
- Took new board through VCT investment history and past board and manager performance issues.
- Currently evaluating manager performance and his plan for the future

Some I Class shareholders believe the manager should be asked to rebate a significant part of his fees (£900k pa) for last 2-4 years. Do you agree?

Would you consider investing in the next Edge offer?

Ventus and Ventus 2 VCT

Update on ShareSoc Campaign and Continuation Vote

Nick Curtis

23 March 2021

Background to the Funds

- Ventus and Ventus 2 were formed in 2005 and 2006 respectively, raising over £50m from investors each across six classes of shares.
- Funds co-invested in same Investee Companies keeping ownership < 50%
- Separate boards
- Invested in 16 wind, hydro and landfill gas assets with a gross capacity of 115MW benefiting from long term government support
- Originally conceived by Climate Change Capital who were replaced as manager by Temporis Capital in 2010
- Initially made bad investments biomass and landfill gas but over the past 10 years have settled down with the benefit of reduced discount rates keeping NAV stable.   Current combined market cap of all share classes is £74m
- Pays a stable 8% dividend

The ShareSoc Campaign

- High Management Fees: The Funds had moved from development to operational phase but little fee reduction. Temporis fees alone averaged £2m p.a for 2017-2019
- Total Management Fees in 2019 were 59% of dividends paid to shareholders
- Performance Fee: Paid in perpetuity – even if manager removed.
- Long service of the directors: Some directors had been in place for >13 years.
- Additional Fees: Fees being charged to Investee Companies by Temporis through a subsidiary called Thalia Power and not disclosed.
- Other Costs: Approximately £400k incurred by the funds excluding audit, directors' fees and taxation.
- Longer term strategy: Lack of industry knowledge was inhibiting discussion on strategic options and alternative management structures

The Performance Fee

- Ventus sold the Craig wind farm in 2015 and paid a special dividend to shareholders in August 2016. Due to past losses, the IMA had not yet reached its threshold for the payment of performance fees.
- BUT in the desire to reach the threshold Ventus directors agreed to add the earnings in the year together with the dividend that was paid from the earnings to reach the threshold and permit a performance fee to be paid.
- Shareholders questioned the calculation and were advised it was all ‘calculated’ correctly.
- ShareSoc first became aware of the issue in Jun 2017 with repeated questions asked at 2018 and 2019 AGMs
- Temporis responds aggressively claiming ‘defamation’ and requiring ‘questioning’ shareholders to sell their shares.

The Campaign – Learning points

- Engagement with the directors was not productive. Low level of historic voting had not highlighted any issues to the directors
- Direct Communication with the shareholders was started – assisted by 60% of the shareholders being on the share register and therefore able to be contacted directly
- Shareholder website was created clearly setting out the issues
- Protest votes (refusing to sign off on the accounts) of little value therefore decision to propose wholesale change to the board of directors.
- New directors recruited with industry and VCT experience
- Two direct mailings were required
- Over 50 hand-written letters sent to larger shareholders
- Total cost of campaign c. £6,000

Ventus Defence Tactics

- Decided that they needed quickly to bring in fresh blood and recruited largest shareholder to the V2 board bringing a large ‘block vote’ of support.
- Immediate reduction in management fee from 2.0% to 1.5%
- Positioned the vote as a removal of the manager and change in strategy – ‘your investment is at risk’
- Utilised the feeder network of IFAs and RAM Capital to contact shareholders
- Utilised Boudicca Proxy Consultants at c. £50k to contact shareholders
- Withheld names of shareholders using Nominee accounts until days before the vote.
- Closely monitored the votes and targeted those that had not voted or they could change.
- The vote was very tight and only decided at the AGM.   The Temporis linked director, Paul Thomas, was removed and given the extent of the protest vote the existing directors were required to engage with shareholders
- The directors ‘strongly and unanimously’ urge you to reject the shareholder resolution….to. Errr… remove us…..

Back to the Performance Fee….

- The wording of the IMA was reviewed and found to be badly drafted. Temporis worked with a 'select' group of directors to give an interpretation favourable to themselves. This double counted the profit from the Craig Wind Farm and the special dividend.
- No legal advice was sought by the Ventus directors on the interpretation of the IMA and possible alternative options
- Remaining directors claim that they were not involved and therefore not responsible
- Wording has since been clarified to calculate the Performance Fee based on Earnings – which was the obvious interpretation
- Resulted in £625k of additional fees paid to Temporis.
- Temporis stated to shareholders and FCA that the 'calculation' had been reviewed by the Auditors and Independent Lawyers but.. The Auditors only reviewed the arithmetic behind the Temporis interpretation…. And the Independent Lawyers were appointed by Temporis…..

Continuation Vote

- The Funds are obliged to hold continuation votes every 5 years with the 2020 vote delayed due to CV-19
- On the 1st March the Ventus Funds issued an RNS where the directors unanimously recommended that the funds dispose of their assets.
- Due to VCT tax changes the funds can no longer invest in renewable generation and are therefore increasingly subscale
- Although the funds pay an 8% dividend yield, the NAV is due to decline as the subsidy period ends and technical life of the assets decline.   Capital Loss is not tax deductible.
- Currently a very strong ‘bid’ for the assets from Infrastructure funds
- The ability of the funds to manage either life extension or repowering is limited.
- Temporis will return for higher fees, (justifiable in this instance) as they will be doing more work.
- The cost ratio of the the funds will increase further as NAV declines.

Learning Points

- Dialogue is better than direct action – if possible
- Shareholder inaction/apathy does not help
- Removing directors or whole boards is hard. Even passive directors will fight hard and spend shareholder funds to protect their positions.
- Directors generally have good corporate governance skills, can appoint the auditors and develop risk matrices etc. but may have little knowledge of the sector. This is often to the advantage of the manager
- VCT results have little link to the underlying performance as earnings are only reported from investee companies when paid up as dividends
- Directors are able to dissemble and cover their tracks when they wish.

Reminders

- Recording will be on the website shortly
- PLEASE PROVIDE FEEDBACK!
- Future ShareSoc Events:
  - 25th March, 5pm – Listed Private Equity Masterclass
  - 31st March, 12 noon – Halma Plc (HLMA)
  - 20th April, 5pm – Strix (KETL)
  - 27th April, 5pm – Diurnal (DNL)
  - 13th May, 5pm – Central Asia Metals (CAML)

Visit www.sharesoc.org/events for more information or to register

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