

# Transforming small business

VCT investment review



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## About the AIC

The Association of Investment Companies (AIC) represents closed-ended investment companies whose shares are traded on public markets.

The AIC's members include 54 Venture Capital Trusts (VCTs), which manage some 93% of the sector's £4 billion of assets.

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### Important information

This document has been prepared using data collected from VCT managers. The AIC accepts no responsibility for any errors or omissions in this document or for any loss occasioned to any person or organisation acting or refraining from action as a result of any material contained in this document or any omissions. This document is based on our current understanding of law and practice. This can change over time and information contained within this document is based on our understanding as at time of print.

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## 1 Foreword

The way that we consume everyday products and services has been transformed in less than three decades.

In 1995 Amazon sold its first book online. The same year saw the release of Toy Story, the first full-length computer animated feature film. AuctionWeb, which evolved into eBay, made its first sale – apparently, a broken laser pointer! A few thousand very early adopters had got their hands on the first primitive ‘smartphone’ but the world-beating iPhone was still over ten years in the future.

Today we take for granted internet distribution, e-books and streamed music, sophisticated computer animation and anytime-anywhere handheld access to a vast store of information and entertainment. Yet companies built around these concepts were far from guaranteed successes. Each had to develop their business model and find backing from intrepid investors willing to risk capital to support their founders’ vision of creating disruptive, transformational businesses.

VCTs, also launched in 1995, were a bold initiative to encourage the public to invest in small businesses with the capacity to transform the markets they operate in. Since then VCTs have supported thousands of companies operating in markets as diverse as healthcare, retail, manufacturing, information technology and even space technology. In each instance, entrepreneurs have benefited from the attention of expert fund managers seeking out the commercial potential of new technology, changing markets or, especially, people with the ambition to make a difference. VCTs remain an essential way in which small businesses secure access to long-term finance.

The government rightly prioritises investment in companies seeking growth. The Patient Capital Review will ensure taxpayer support is well targeted and I am confident that VCTs will continue to be viewed as an important vehicle to deliver transformational change for smaller UK businesses.

**Ian Sayers**  
Chief Executive, AIC

VCTs remain  
an essential  
way in which  
small businesses  
secure access to  
long-term finance

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## 2 Overview



80% of VCT funding targeted the 'finance gap'  
with total investments between

**£2 million and £10 million**



Every £1 million of investment has been  
accompanied by an average increase of

**£2.2 million in turnover**



Across the entire VCT portfolio, the sectors  
receiving the most funds have been:



Digital, creative and  
information services



Business services



Information technology





## 46% of companies

receiving investment were outside  
London and the South East



Businesses currently receiving VCT backing now employ

## 50,000 staff



## 41% of VCT-backed

businesses reported export earnings



In 2016 the average R&D expenditure reported was

## £1.46 million per company



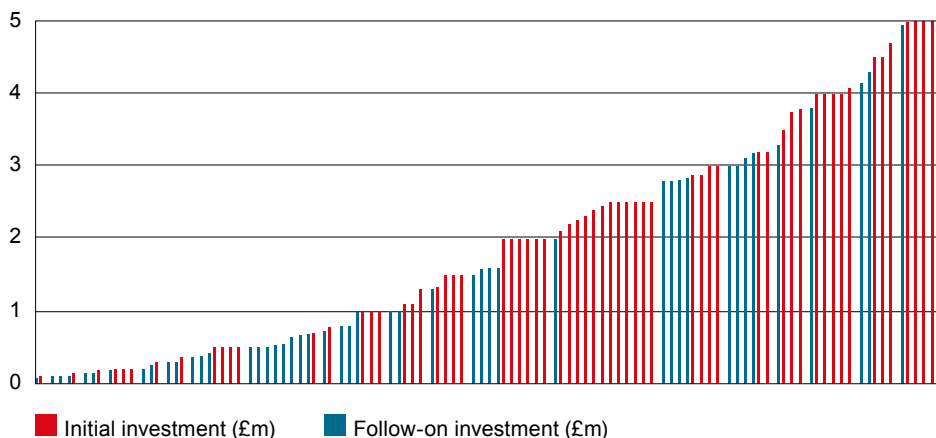
### 3 VCT investment today

The rules governing VCT investment changed towards the end of 2015. Since then, the industry has successfully retargeted its activity to meet the new requirements.

This review identified 111 investments with a value of £213 million made since the rule change. It is too early to judge the commercial impact of these deals but we expect them to continue VCTs' record of delivering growth, creating jobs and supporting exports and innovation.

These deals satisfy a wide range of finance requirements.

#### Amounts invested (since November 2015)



To illustrate the activities VCTs are now supporting, many of the case studies in this report are of investments made since the 2015 rule changes.





Since the rule changes, companies most frequently invested in were active in:



Digital, creative and  
information services



Health



Information technology

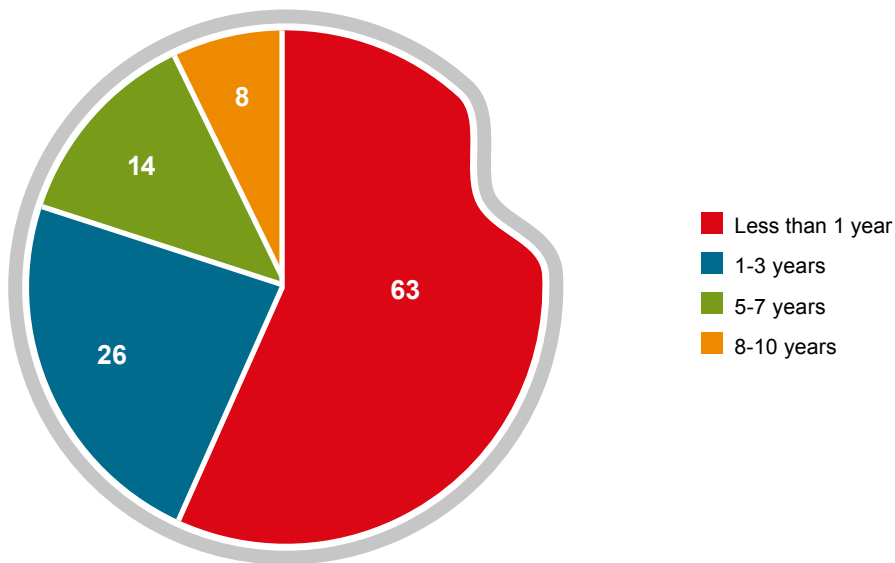


**42% of transactions were follow-ons**, showing VCTs' continuing capacity to provide sustained, long-term support



VCTs are successfully targeting investment on younger businesses. The age of those receiving investment was spread across the range of those eligible.

**Age of company receiving investments (since November 2015)**



Over 60%  
of investee  
companies were  
**under a year old**

Over 90% were  
**under 7 years old**



The VCT rules allow greater investment where the company is 'knowledge intensive'. This is only available where the company meets certain conditions, for example, where it has a high proportion of staff educated to PhD or Master's degree level.

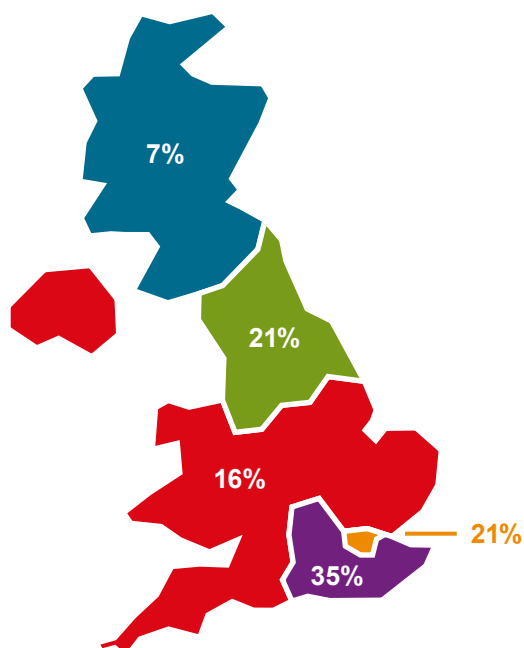
12 companies meeting these thresholds received £18.9 million of finance since the rule changes.

Knowledge intensive businesses most frequently receiving investment were active in:

-  Digital, creative and information services
-  Health
-  Business services

Small businesses receiving finance continued to be widely distributed across the UK.

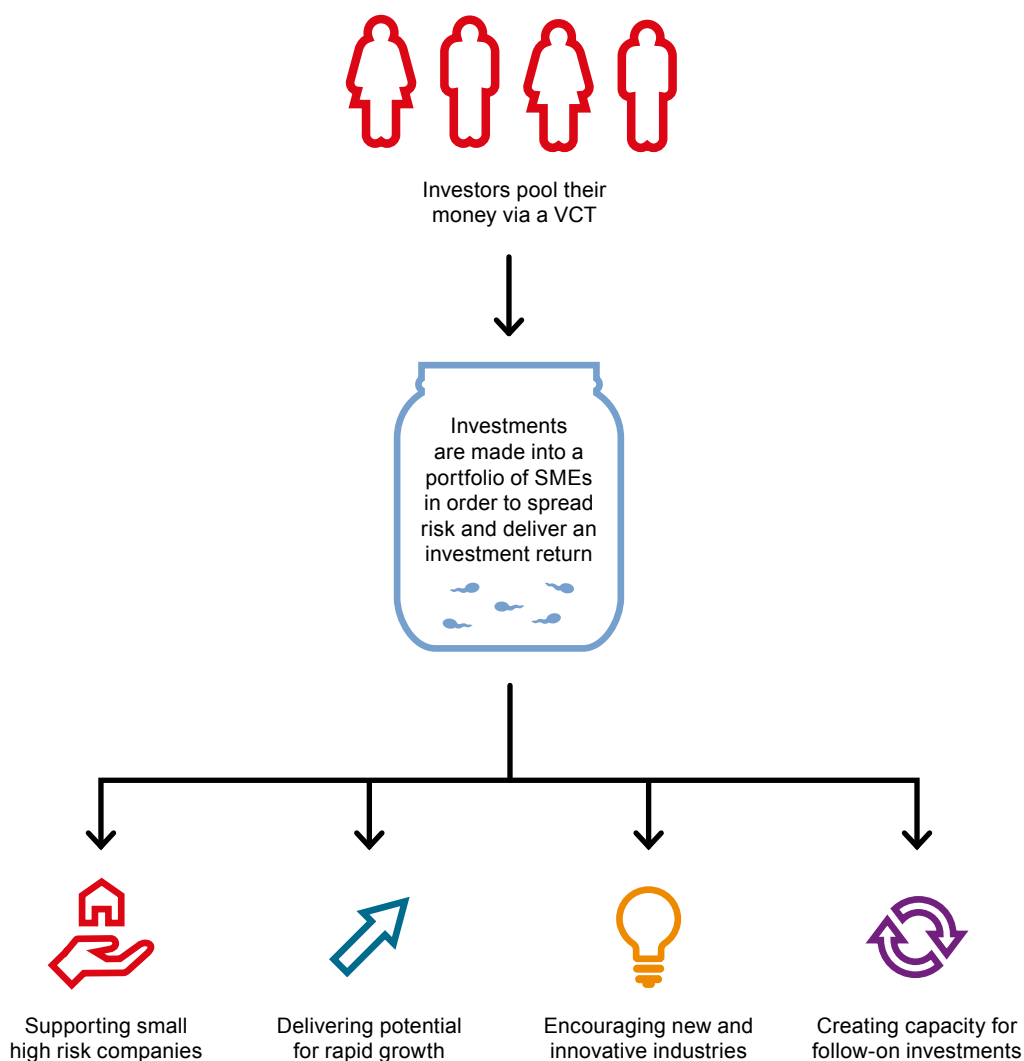
### Location of portfolio companies



## 4 A unique source of capital

VCTs provide money and expertise to transform small businesses. They pool the funds of retail investors who, in the absence of tax incentives to mitigate the risks, would be unlikely to dedicate their savings to this important, but often investment starved, part of the UK economy.

66% of companies supported by VCTs also benefit from a representative of the fund joining their board to provide expert insight and mentoring. This added dimension to VCT investment makes an important contribution to helping smaller businesses achieve growth.





Segura Systems helps retailers monitor the activities of their primary suppliers and any sub-contractors. This stops suppliers working with unapproved businesses without the knowledge of the retailer. It helps users eliminate harmful practices, such as the use of child labour, in their supply chain.

Segura is already working with high-street names, such as Debenhams and Reiss, and over 2,000 factories across the globe. Octopus VCTs invested in December 2015 to help Segura further develop its products.

## IN THE STYLE



Founded by its chief executive in his bedroom in 2013, In The Style is an online fashion retailer. Its expansion has been boosted by celebrity collaborations, including E4's Binky Felstead, MTV's Charlotte Crosby and ITVBe's Billie Faiers.

It has 1.4 million social media followers, with its reach extended via its celebrity links.

Livingbridge VCTs invested in May 2017, helping the business grow its management team and warehouse operations and enter markets in America and Australia.

## 5 Impact of VCT investment

Over the lifetime of the VCT scheme thousands of smaller companies have received VCT finance. This report identified 512 UK smaller companies currently benefiting from £1.4 billion of VCT investment.

Their capital requirements varied widely. The smallest amount received was £50,000.

57% of smaller companies supported by VCTs received total investment between £2 million and £10 million, a level of funding not well-served by traditional investors. These amounts of money tend to be out of the reach of the business's own resources but are too small for conventional private equity funds, which prefer larger deals.

The **average**  
**amount** of VCT  
funds received by  
a small business  
was **£3.2 million**

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74% of businesses  
received **less**  
**than £5 million**

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30% of businesses  
received **less**  
**than £2 million**

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Established in 2011, Sipsynergy provides cloud-based communication services to SMEs. It creates products for IT and telecoms resellers and managed service providers. It enables efficient and cost effective service provision, including voice telephony and video conferencing.

YFM VCTs invested in 2016. These funds will help significantly accelerate the growth of Sipsynergy's customer base and increase revenues through recruitment into sales support and product development. The business employs 29 staff in Ware and Southampton, up from 15 on investment.



Velocity, founded in 2007, creates engineered kits of raw materials for composite aircraft parts. These kits help its customers reduce waste and increase efficiency in their own manufacturing processes.

It employs 97 staff in two facilities in Lancashire and Hampshire.

Artemis, Hargreave Hale, Octopus and Amati invested when Velocity launched its shares on AIM in May 2017. These funds will help it meet its strategic growth targets and replicate its business model internationally.



Perpetuum's products use the vibration created by moving trains to monitor the condition of trains and railway tracks. Operators receive real-time information enabling the optimisation of safety and maintenance programme.

Perpetuum was founded in 2004 as a spin-off from the University of Southampton. It recently won contracts in the UK and is seeking to expand internationally. Albion VCTs invested in 2006. Reflecting the challenges of building an innovative business, Perpetuum has yet to make a profit.



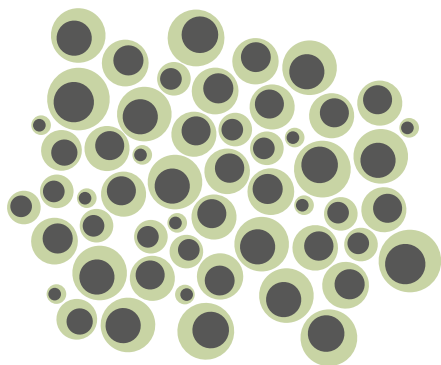
Weedingtech designs and manufactures herbicide-free weed control systems. Its core product kills weeds and moss using close to boiling water, encapsulated in environmentally friendly organic foam. It responds to environmental and health concerns raised by certain chemicals (such as glyphosate). Weedingtech's products are sold in Continental Europe, North America and the UK.

In December 2016, Calculus VCTs invested to boost Weedingtech's sales, manufacturing and product development capabilities.

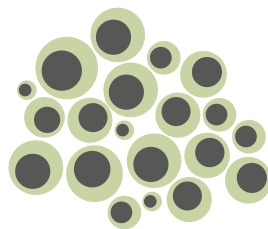
## Patient and permanent capital

VCTs take high-commitment investment positions. They invest for the long term and make follow-on investments as investee businesses evolve and their financing needs change.

### Duration of investment



**54%**  
of all companies held  
for longer than 5 years



**20%**  
of all companies held  
for longer than 10 years



**6%**  
of all companies held  
for longer than 15 years

### Elateral

Elateral, founded in 1995, produces digital marketing software in Farnham, Surrey. It enables brand owners, including AT&T, Cisco, Coca-Cola, Nestle, P&G, Morgan Stanley and Toyota, to produce relevant marketing content faster, cheaper and more accurately.

Albion VCTs first invested 18 years ago, in 1999, making it one of the longest-held current investments by a VCT. They have backed Elateral with eleven rounds of investment: a high commitment approach which has supported significant expansion of the business.

### NEXUS Vehicle Rental

Nexus connects car rental companies and customers using an online booking and rental management system. Today Nexus' customers can access 500,000 vehicles from 130 rental companies operating out of 2,000 locations. It offers choices ranging from cars to commercial vehicles, including ice cream vans and HGVs.

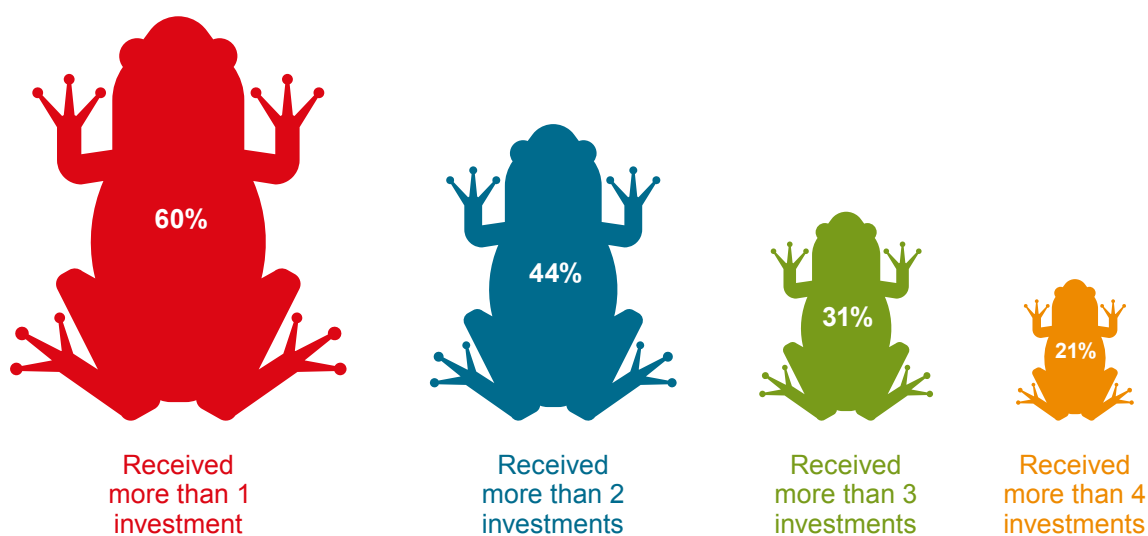
Livingbridge VCTs invested in Leeds-headquartered Nexus in 2008. When Livingbridge invested, Nexus' turnover was £6.9 million. When it sold its stake in 2015, turnover had grown fivefold to £45.5 million.



Providing follow-on finance is an important aspect of VCTs' investment approach. Once smaller businesses have utilised the first tranche of growth capital, many have been able to rely on continued support to move them to the next stage of their commercial development.

### Number of investments

Excluding any companies that have been held less than 3 years



## Sector focus

Some VCTs focus on specific commercial sectors. Others are generalists, investing in opportunities wherever they arise. One factor often critical in the decision to invest is an ambitious management team keen to make a real difference to the market they are operating in.

The mix of VCTs, with different expertise and investment focus, allows the sector to channel support to a diverse range of businesses.

Across the industry, the top sectors represented are:



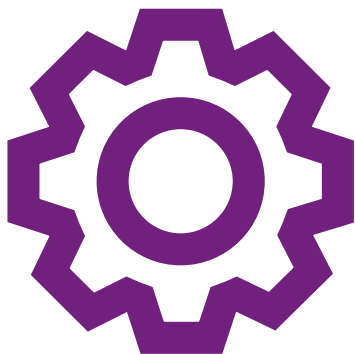
Digital, creative and  
information services



Business services



Information technology





Augmented reality (AR) superimposes computer generated images on the user's view of the real world. WaveOptics' AR products allow high-quality images to be projected onto lightweight lenses. Currently, this technology is used mainly by businesses in manufacturing and logistics. In the future, it is also expected to secure a significant consumer market.

Octopus VCTs invested in WaveOptics in December 2015. This helps the company in its efforts to enter new business and consumer markets.



Creo Medical is a 'knowledge intensive' company that was founded in 2003 to develop microwave and radiowave technologies to improve patient outcomes in surgical endoscopy. The miniaturised devices are used in minimally invasive surgery, which is often associated with the investigation and resection of cancers. Creo employs 37 staff, including 8 PhD scientists. It has secured 70 patents, with another 180 patents pending.

The Hargreave Hale VCTs invested in Creo Medical when it listed on AIM in December 2016.



Channel Mum was founded in 2015 by Siobhan Freegard, the creator of Netmums. In two years they have built the leading parenting community on social media using video vloggers.

NVM's VCT investment helped Channel Mum grow its team, create a network of video vloggers and attract an impressive list of corporate clients. The prospects for the company to build on its early success by continuing to invest in relevant content and strengthen the video vlogger network is exciting.



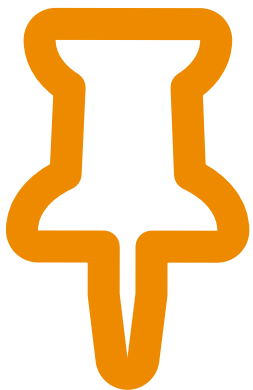
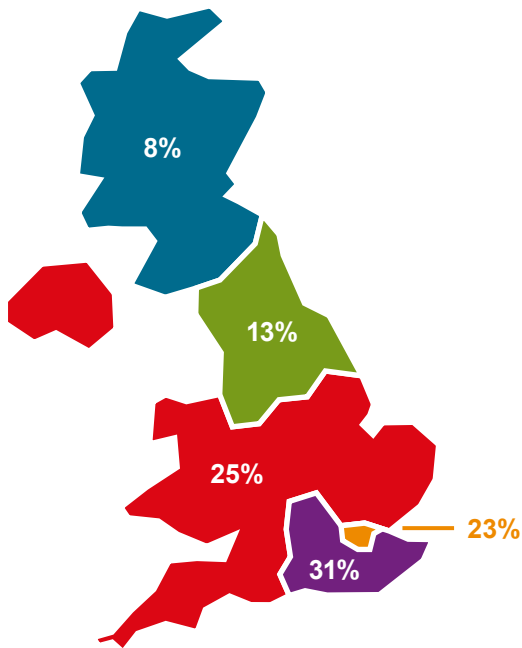
Origin Broadband provides a range of telecommunications services to thousands of homes and businesses across the UK. The company operates a large national network in addition to providing services through blue-chip wholesale partners.

The Calculus VCT invested in Origin in December 2016, enabling the company to hire staff, accelerate sales efforts and rapidly develop its market presence. In the six months since the investment Origin has grown its customer base at an annualised rate of over 1,000%.

## Working across the UK

The geographical reach of VCTs is facilitated by fund managers operating from various regional centres. It is also supported by the informal networks that have been developed by the sector since the scheme's inception in 1995.

### Distribution of investments (by value)



The logo for FreeAgent, featuring the word 'FreeAgent' in a blue and green sans-serif font.

Based in Edinburgh, FreeAgent provides online accounting software for micro-businesses. It targets users with little financial knowledge and makes company administration straightforward.

After raising early capital from angel investors and crowdfunding, and despite securing annual revenue increases of 30-40%, FreeAgent required further capital to achieve profitability. It raised these funds via AIM. In November 2016 Amati VCTs acted as cornerstone investors to the float. Without their involvement, it is doubtful that FreeAgent could have taken this critical step.



Founded in 2011 and based near Manchester, Matillion provides cloud-based data integration software to help companies collect, store, analyse and share information. Its services help clients reduce their data costs and increase efficiency. Matillion opened its first international office in New York in 2016.

YFM VCTs invested in 2016, to support Matillion's international expansion and accelerate its product development. YFM also helped recruit a highly experienced non-executive chairman to add commercial experience to the business.

## Enabling growth

Achieving growth is the fundamental ambition of VCTs.

In the current VCT portfolio, every £1 million of investment has been accompanied by an average increase of £2.2 million in turnover.

Where funds have had longer to work, growth has been greater.

Businesses receiving investment more than five years ago achieved average turnover growth of £3.9 million per £1 million invested.

Those who received funds over ten years ago have performed even more strongly; with an average increase of £8 million in turnover per £1 million invested.

The risky nature of VCT investment means that there is wide variability in performance.

The best performing 5% of investee businesses contributed 63% of the total turnover growth. These companies had been receiving support for, on average, nine years with an additional five rounds of follow-on funding.

The sectors achieving the greatest turnover growth were:



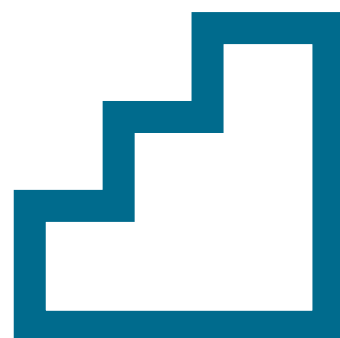
Retail



Business services



Health



## Creating jobs

Building an economy able to create and maintain good quality jobs is a key government priority. VCT investment sustains business growth and, in turn, job creation.

Businesses currently receiving VCT backing now employ 50,000 staff.

Since VCTs invested, these companies have created 27,000 jobs, an increase of 116%.

Each VCT-backed business employs, on average, 109 staff.

Sectors seeing the most jobs created were:



Retail



Business services



Information technology







ECSC, founded in 2000, provides cyber security services. It uses custom-built approaches to detect and protect clients against emerging threats.

The company was invested in by VCTs managed by Artemis and Unicorn when it floated its shares on AIM in December 2016. These funds helped it recruit specialist staff (with headcount up from 57 to 98) and grow its business. It opened facilities in Leeds in early 2017 with other sites in Australia and London opening in the summer.



camwatch  
PREVENTING CRIME 24/7

Maven VCTs first invested in Camwatch in 2007. Camwatch was developing security systems using light and heat sensitive cameras and motion sensor technology for construction sites and utilities. Its equipment can run on hydrogen fuel cells and is monitored centrally.

Maven funds helped Camwatch grow its turnover and increase its headcount from 50 to 82 employees. Camwatch was sold in 2014 to a trade buyer, VPS, which planned to roll out the business model into continental Europe.

**BIOSITE**<sup>®</sup>

Biosite's integrated biometric access control, workforce management, online induction and wireless fire alarm systems are designed specifically to address the complex health, safety and security needs of the construction industry, ensuring compliance, whilst improving productivity and reducing cost.

Investment by Mobeus VCTs in November 2016 helped Biosite expand its team and develop new products. Biosite has since increased its headcount from 50 to over 80 and is expected to secure its first international sales in 2017.

## Achieving exports

International growth is a goal of many ambitious smaller companies. Many VCT-backed businesses are striving to increase their international sales. Those that are successful can achieve striking results.

213 companies receiving VCT investment (41% of those surveyed) reported exports worth £1.4 billion. This represented nearly half (46%) of their total turnover.

The top 5% of VCT-backed businesses achieved exports of £596 million, just under 20% of their total sales.

Where VCT-backed companies are exporting, the average non-UK turnover is £6.8 million.

The sectors achieving the highest amount of foreign revenue were:



Digital, creative and information services



Business services



Information technology





Firefly Learning was founded by two GCSE students. Launched as a full-time venture in 2008, Firefly is now used by 500 schools in 35 countries, covering some 400,000 students.

Firefly's online tool is used by teachers, students and parents for homework, sharing resources and tracking progress.

In November 2016, the ProVen VCTs, managed by Beringea, invested to help Firefly expand its product range, enter new geographic markets and expand its offices in London, Brighton, Sydney and Singapore.

## secret Escapes

Secret Escapes is an online travel club and among the fastest growing holiday businesses in Europe. Members can purchase luxury holidays at significant discounts for a limited period. These deals are guaranteed to be better than can be found elsewhere.

Since Octopus VCTs invested in 2011, Secret Escapes has expanded into Germany, Poland, Sweden, Norway, Denmark, the Netherlands, Belgium, Switzerland, Austria, Spain, Italy, USA, France, Hungary, Slovakia, Czech Republic, Singapore, Hong Kong, Indonesia and Malaysia.

## Jump starting innovation

Innovation helps ambitious businesses disrupt existing markets or create new ones.

193 companies held by VCTs (36% of those surveyed) reported research and development expenditure of £282 million during 2016.

Companies reporting research and development expenditure had an average spend of £1.46 million in 2016.

These companies received £549 million from VCTs since investment, funds which have been critical in helping them to develop new products and services.

Sectors backed by VCTs spending the most on R&D were:



Health



Information technology



Digital, creative and  
information services



Poq is a software-as-a-service platform that empowers retailers to quickly create effective, customised apps. It allows retailers to build stronger brands, sell more of their products, deepen customer loyalty and deliver relevant content, communications and rewards. Poq's clients include the UK's largest brands and retailers, such as Missguided, House of Fraser and Holland & Barrett.

The Proven VCTs, managed by Beringea, invested in July 2016. These funds are supporting the growth of Poq's team and investment in R&D.



Chromatography...every step of the way

Chromatography is a technique for separating and analysing chemical compounds.

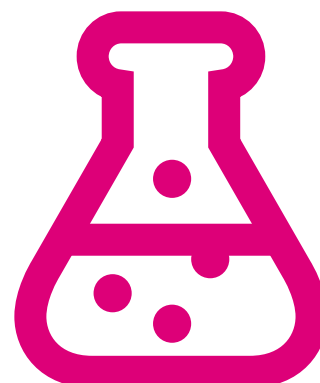
Crawford Scientific, based in Scotland, provides specialist chromatography products and services to the pharmaceutical, agrochemical, oil and gas and other industrial sectors. It helps companies undertake environmental analysis and quality control. Maven VCTs invested in 2014. Their backing has helped Crawford Scientific expand into new markets including China and the US. A representative from Maven now chairs the business.



Curo Compensation, based in Edinburgh and London, was established in 2009. It helps businesses manage their annual staff pay reviews (salary, bonus and other incentives).

Curo allows companies to control staff costs, plan changes and ensure proper governance of their remuneration practices.

Downing VCTs invested in 2013. Since then Curo has acquired high profile clients including Clifford Chance and Bupa as well as developing its presence in the United States.



## 6 Value for money intervention

Retail investors in VCTs receive tax incentives to compensate them for the additional risks of allocating their savings to smaller, more risky businesses.

VCTs justify this support by helping transform those businesses and securing higher turnover and employment. Over the longer term this boosts government revenues as investee companies achieve greater financial strength, and ultimately profitability, than would otherwise have been achieved. The outcome is greater payments of corporation, payroll and other taxes.

249 investee companies surveyed paid £245 million in tax in their most recent financial year. The total VCT investment amounted to £821 million. The initial tax relief supporting these investments was £246 million.

In one year, these businesses reported taxes equivalent to the amount of initial tax relief received.

Critically, the initial relief received by VCTs is a one-off. The benefits of enabling smaller businesses to prosper, and in turn to pay taxes back to the government, are accrued year after year.



## Rockar.

Rockar was established in 2012 and is developing a software platform to sell cars digitally.

The Rockar platform lets customers sell their existing car, choose finance options and select a new model without any sales staff involvement.

NVM and Maven VCTs invested in July 2016. These funds will help Rockar extend its partnerships with car manufacturers and further develop its innovative online platform.

## TAPAS REVOLUTION

Founded by celebrity chef Omar Allibhoy, Tapas Revolution is a UK restaurant chain offering Spanish tapas cuisine. Following the opening of a first venue in 2010, six more restaurants have since opened, with locations including London, Birmingham, Sheffield, Bath and Newcastle-upon-Tyne.

In January 2017 Mobeus VCTs invested to support the opening of additional venues. The ambition is for Tapas Revolution to become a prominent feature of the UK casual dining landscape.

## quantexa

outcomes delivered

Founded in 2016, Quantexa builds fraud detection systems. It is targeting clients in financial services, corporate and government markets.

Albion VCTs invested in March 2017. This will help Quantexa develop its software, which uses artificial intelligence and machine learning to gather intelligence related to clients' commercial relationships and compliance risks. It is also supporting Quantexa's international expansion, with offices planned for Brussels, Sydney and New York. An Albion representative joined the board to help deliver its business plan.

## BEAUMONT HOUSE

Day Nursery & Pre-school

Pilgrim is building a nursery group in London and South-East England. It opened its first facility in May 2017 with another due to launch later this year. It intends to open seven further sites in the next five years. These will be custom-built facilities offering the highest standards of care.

Downing VCTs invested in October 2016 and these funds will be critical to achieving Pilgrim's plans for growth.

## 7 Methodology

### Sector attribution

Respondents self-identified the sector in which the investee company is active.

Some sectors have been combined for the purposes of this report.

'Information and communications technology and precision instruments' has been combined with 'Technology/IT' and re-labelled 'Information technology'.

'Biotech/pharma', 'Healthcare', 'Health and social care', 'Pharmaceuticals' and 'Research and development' have been combined and re-labelled 'Health'.

'Communications' has been included in 'Digital, creative and information services'.

### VCT investment today

Data includes information received on investments made since the rule change in November 2015 to May 2017.

### Impact of VCT investment

The sample included data for 512 companies. Of these, 455 reported total investments received to date.

### Enabling growth

Overall turnover growth analysis is based on 476 companies which provided turnover data at the date of investment and at end of 2016. These companies received £1.4 billion of VCT investment overall. The turnover at investment was £3 billion and £9.6 billion at the end of 2016.

The assessment of turnover growth for companies in receipt of VCT funds for less than five years covered 273 companies, with initial turnover of £2 billion and £2.7 billion at the end of 2016. Investment received was £830 million.

The assessment of turnover growth for companies in receipt of VCT funds for over five years covered 201 companies, with initial turnover of £1 billion and turnover of £6.8 billion at the end of 2016. Investment received was £575 million.

The assessment of turnover growth for companies in receipt of VCT funds for less than ten years covered 377 companies, with initial turnover of £2.2 billion and £5.3 billion at the end of 2016. Investment received was £1.3 billion.

The assessment of turnover growth for companies in receipt of VCT funds for over ten years covered 71 companies, with initial turnover of £265 million and turnover of £4.4 billion at the end of 2016. Investment received was £173 million.



## Creating jobs

The analysis of creation of jobs in VCT-backed businesses was based on returns from 466 companies. They saw the number of employees rise from 23,649 employees at investment to 51,192 at the end of 2016.

The assessment of job growth by companies receiving investment less than five years ago is based on returns from 273 companies. Jobs at investment were 14,686 and 19,077 at the end of 2016.

The assessment of job growth by companies receiving investment more than five years ago is based on returns from 192 companies. Jobs at investment were 8,757 and 31,869 at the end of 2016.

The assessment of job growth by companies receiving investment less than ten years ago is based on returns from 398 companies. Jobs at investment were 20,212 and 31,284 at the end of 2016.

The assessment of job growth by companies receiving investment more than ten years ago is based on returns from 67 companies. Jobs at investment were 3,231 and 19,362 at the end of 2016.

## Achieving exports

The analysis of exports by VCT-backed businesses was based on returns from 213 companies, with total export revenues of £1.5 million. Investment received was £654 million.

## Value for money intervention

The analysis of the amount of taxpayer support for VCTs assumes that the funds invested received a 30% tax relief.

It is the case that some of the funds received by SMEs may have been raised during periods when the 40% relief was provided (that is, between 2004 and 2006) or when the 20% relief was available (that is, pre-2004).

However, assuming a relief rate of 30% is reasonable. Over half of all funds raised by the VCT scheme were raised in the last 10 years, when the initial income tax relief was 30%. 25% of all VCT funds were raised when the initial tax relief of 20% was provided. Only 19% of funds raised by VCTs were supported by an initial income tax relief of 40%.



## 8 Acknowledgements

The AIC is grateful to the following managers for their contributions:

Albion Capital, Amati Global Investors, Artemis Investment Management, Beringea, Calculus Capital, Downing, Elderstreet Investments, Foresight Group, Hargreave Hale, Hazel Capital, Livingbridge, Maven Capital Partners, Mobeus Equity Partners, NVM Private Equity, Octopus Investments, Triple Point Investment Management, Unicorn Asset Management and YFM Private Equity.

Copies of the previous versions of the AIC's annual research into the impact of VCT investment can be found at the following link:

[www.theaic.co.uk/vct-research](http://www.theaic.co.uk/vct-research)







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