

Spark VCT - More Information

The Spark VCT is a venture capital trust which was formed by the merger in 2005 of the three former Quester VCTs (1, 2 and 3) which focused on investment in technology companies.

UKSA supported the merger of the Quester VCTs, indeed we had encouraged it, so as to reduce administrative expenses. When the merger was undertaken a new incentive scheme was introduced based on dividends paid to shareholders with a clear focus on achieving realisations from the portfolio to enable dividends to be paid, which had been lacking of late.

However, it was certainly not made clear at the time to shareholders that dividends would be paid even though the company did not have profits to cover those dividends. Although a number of successful disposals were made, the underlying portfolio continued to underperform resulting in continuing losses overall. This meant that the dividends paid to shareholders actually represented a return of shareholders capital rather than profits. In other words, the company was simply returning your own money to you. For example, in the last full financial year, the net asset value declined to 33.2p even after taking account of the dividend of 4.2p in that year.

After the merger, the former Quester fund management operation was acquired by Spark with changes of personnel thereafter and the company was renamed Spark VCT in June 2005.

The shareholders who turned up for the AGM last year (of which there were about 20) seemed to be concerned with a number of issues, but the two main ones were:

1. That the directors had chosen to recommend the payment of a dividend of 2.8p even though the company had made a loss in the last year. This had the result of crystallising the payment of the managers performance incentive bonus of £1,040,000 which would not otherwise have been payable – and that is not a trivial sum when the net assets of the company were only £37.7m at the year end. Note that we understand that this payment was in practice paid on to the former owners of the Quester fund management company, and neither Spark Venture Management nor their staff benefited from it. The Chairman of the Spark VCT has denied that there was any agreement with the former fund managers' owners regarding these payments.

2. That a new incentive scheme was being proposed at an EGM in a few weeks time which had a fairly low hurdle rate (5%) and was being rebased on the recent net asset value. This was of course the second time that the management incentive scheme was effectively rebased because it was also reset at the time of the merger.

As has happened in other VCTs, it would appear that when it becomes clear that the management incentive scheme is not going to generate significant bonus fees for the manager going forward, a "restructuring" of some kind takes place so as to restore some incentives. In practice this means that failure to achieve the expected performance over many years does not result in the investors saving on fees payable to the manager as one might have anticipated.

Historic Performance

The performance of your original investment in the Quester VCTs (taken from the last half yearly report) is as follows. This shows the total return - the capital valued at the company's valuation, and adding on dividends received. Your original investment was of course at 100p per share if you subscribed when the shares were first issued.

| Company | Total return (pence) |
|---------------|----------------------|
| Quester 1 VCT | 82.4 |
| Quester 2 VCT | 67.7 |
| Quester 3 VCT | 42.6 |

Those figures assume that the net asset value as reported by the company is 28.7p, but in reality if you tried to sell your shares in the market, you would achieve nothing like that figure. The bid price at the time of writing (i.e. what you might sell your shares for) is only 10p. The mid price is 18p with a spread of 10p-26p which shows how difficult it might be to sell the shares and how illiquid the market is. Shareholders would obviously realise very substantial losses over their initial investment cost if they sold now.

Note that the original Quester VCT (Quester 1) was launched in April 1996 and independent consultants Allenbridge report that since then it has achieved an average return of minus 3.0% per year. Quester 2 and Quester 3 investors will have suffered an even worse performance.

Why Has Performance Been So Bad?

I undertook a detailed review of the Quester 3 portfolio before the merger took place, and it was clear that investment choice was a major problem. Large sums (often over £1million) had been invested in early stage companies with unproven technology or unproven business models. Many never managed to establish themselves as viable businesses and either went bust or failed to attract further funding.

Although investment policy has subsequently changed, performance overall has not. Recent investments such as that in Skinkers still raise a lot of questions, which space here limits comment on.

But the board of directors is ultimately responsible and does not seem to have ever taken vigorous steps to tackle some of the issues facing this company. The slow response to the complaints of shareholders and demands for board changes is symptomatic of the lack of vigorous action demonstrated by the board in response to the challenges they have faced.