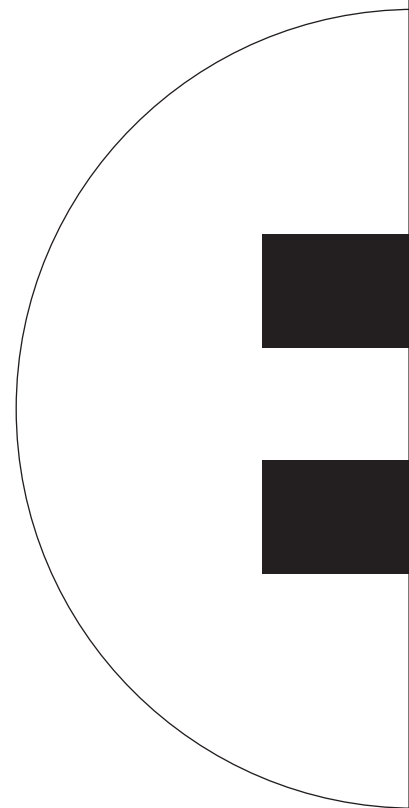


# Electra Kingsway VCT 2 Plc

## Report & Accounts

30 September 2005

**2005**



## **Objective**

The Company's objective is to maximise tax free income to shareholders from dividends and capital distributions. This will be achieved by investing in a portfolio of qualifying investments and in funds managed by Electra Partners.

## **Investment Strategy**

The Company will seek to invest in a diversified portfolio of unquoted and AIM listed companies. Unquoted investments will typically be in companies that intend to float on a market within a two year period or those that have a well developed growth and cash generation strategy. Investments in start-up companies where levels of risk are unacceptably high, in particular the technology sector, will generally be avoided.



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For all shareholder enquiries please contact:

**Shareholder Helpline +44 (0)20 7233 5902**

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References in this Report to Electra Kingsway VCT 2 Plc have been abbreviated to 'the Company' or 'the Fund'. References to Electra Partners Group Limited and its subsidiaries, including the Investment Manager, Electra Quoted Management Limited, have been abbreviated to Electra Partners.

# Annual Review Financial Highlights

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Period ended 30 September	<b>2005</b>
<b>Net assets</b>	£33.2m
<b>Net asset value per ordinary share</b>	97.2p
<hr/>	
<b>Dividend per ordinary share</b>	
Revenue	–
<hr/>	
<b>Cumulative return to shareholders since launch</b>	
Dividends per share	–
Net asset value plus dividends per share	97.2p
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# Annual Review Chairman's Statement

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This is my first annual report as your Chairman, and I welcome you as investors in the Company. The year 2005 was significant for the VCT industry, as the introduction of 40% income tax relief for VCT investors led to more than £500m being raised for new funds. Your Company – launched in October 2004 and closed for subscriptions on 30 June 2005 – raised £34.2m, which was the third-largest amount raised by a new fund in the year.

## Results

It is early days in the life of your Company, but I am pleased to report that the net asset value (NAV) per ordinary share at 30 September 2005 has risen from the initial price of 94.5p to 97.2p. The increase was mainly due to the good performance of the Fund's investments in Electra Investment Trust and Electra Active Management. At the year end, some 65% of the Fund was in liquid assets, 11% in qualifying investments and 24% in non-qualifying funds. Over time the Investment Manager will use the liquid funds to make qualifying investments.

## Dividend Policy

Although it is still too early for the Board to propose a dividend, our aim will be to distribute surplus income and capital profits, in the form of tax free dividends. Since the flow of dividends is dictated by the rate of disposals, it can often be hard to predict, but the Board aims to maintain a consistent and sustainable dividend policy.

## Co-investment with other Electra Kingsway VCTs

Investors may be aware that the Investment Manager already has a Fund (Electra Kingsway VCT Plc, raised in 2002) and launched a third Fund (Electra Kingsway VCT 3 Plc) in October 2005. Both have similar investment objectives to your Company. The Board believes the combination of these three funds will produce more opportunities to invest in larger unquoted transactions, thereby improving the quality of the deals available to your Company.

Accordingly, the Board has approved a co-investment policy that formalises relations among the three funds; details are on page 5.

## HM Revenue and Customs

In November 2005 HM Revenue and Customs issued a statement to the VCT industry about breaches of the VCT rules.

In light of this statement, the Board has reviewed with its Advisers and the Investment Manager the internal procedures and monitoring arrangements employed to ensure the Company complies with the rules. It is satisfied the Company has not breached any rules and has arrangements in place to ensure that breaches do not occur in future.

## Authority to Purchase Shares for Cancellation

Under the general authority granted by shareholders, the Directors have discretion to buy shares for cancellation at prices below the prevailing NAV per share, and will consider doing so (whenever the Company is free to deal) at a discount of 10%. I can now report that the Company bought and cancelled 14,546 ordinary shares during the period, at a cost of £12,437. This authority will expire at the Annual General Meeting to be held on Monday 13 March 2006, when shareholders will be asked to renew it.

## Shareholder Communications

The Company will communicate regularly with its shareholders through financial reports and newsletters. The Investment Manager's website [www.electraquoted.com](http://www.electraquoted.com) contains copies of all recent shareholder communications.

## Portfolio Prospects

Early indications are encouraging: the net asset value per ordinary share has moved up from its initial level, eight qualifying investments have been completed, and dealflow looks healthy. The economic environment remains benign, although consumer-sensitive sectors are struggling.

Rupert Pennant-Rea, Chairman

26 January 2006

# Annual Review Investment Manager

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The Fund's investments are managed by Electra Quoted Management, which is a subsidiary of Electra Partners. Electra Quoted Management was established in 1981 and is authorised and regulated by the Financial Services Authority. Electra Partners is the Manager of Electra Investment Trust (net assets of approximately £512m as at 30 September 2005), and the Manager or Adviser of other specialist funds.

Electra Partners has considerable expertise and a strong track record in private equity investments and has a well developed deal flow, including unquoted company proposals that originate from its own contacts and network, pre-float finance opportunities and broker led AIM flotations.

The Investment Manager has established an Investment Committee with Hugh Mumford as Chairman. The Investment Committee meets as required to consider and review investment proposals.



# Annual Review Co-investment Arrangements

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## **Co-investment Arrangements with other Electra Kingsway VCTs**

The Directors welcome the fact that the Investment Manager has three VCT funds (“Electra Kingsway VCTs”) it can use for co-investment. This allows the Company to spread its investment risk and gain access to larger investments than it could do on its own. Where a co-investment opportunity arises between the Company and either or both of the other two funds, the Company will invest in an agreed and consistent proportion on the same terms and in the same securities as the Electra Kingsway VCTs with which it co-invests. Costs associated with any such investment will be borne by each fund pro-rata to its investment.

In more detail, the Company’s Board has adopted a set of guidelines on its co-investment arrangements with the Electra Kingsway VCTs and the Investment Manager as follows:-

- Other than as set out below, investments will be allocated between the Company and the Electra Kingsway VCTs on a pro-rata basis by reference to each fund’s available cash resources.
- Where an opportunity arises for a second or subsequent round of investment in a company in which the Company or one of the Electra Kingsway VCTs has invested at an earlier stage, the fund holding the existing investment will have a preferential right to take up any pro-rata entitlement it may have in the new financing round. The amount it invests on this basis will not be taken into account in determining its co-investment share thereafter.
- The Company will make an investment in which one or more of the Electra Kingsway VCTs have existing investments only when the Board considers that to be in the best interests of the Company.
- Any potential conflict of interest in a proposed investment by one or more of the Electra Kingsway VCTs will be referred by the Investment Manager to the Board of the Company and the other relevant Boards.
- In the event of a possible conflict of interest between the Investment Manager and the Company, the matter will be decided by those directors who are independent of the Investment Manager.

The Board of the Company acknowledges that the Investment Manager may occasionally recommend an allocation of investments on a different basis from the one described above. For example, an exception may be made to ensure that one or more of the Electra Kingsway VCTs maintain their status as an HMRC approved VCT, or in the interests of balancing their portfolios. A different basis may also be necessary to meet the requirements of potential investee companies.

# Annual Review Principles of Valuation

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## **Qualifying Investments Valuation Methodology**

The Directors have adopted a valuation policy drawn substantially from the latest International Private Equity and Venture Capital guidelines in respect of unquoted investments.

Under these guidelines all investments are valued at fair value at the reporting date, except in situations where fair value cannot be measured reliably. In such situations the investments are reported at the carrying value at the previous reporting date, unless there is evidence that the investment has since then been impaired.

The fair value of an asset is defined as the amount for which that asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

- a) For unquoted investments including OFEX (a UK market focussed on small and medium companies) investments, fair value is commonly determined by utilising one or a combination of the following methodologies:
  - earnings multiple
  - price of recent investment
  - net assets
  - industry valuation benchmarks
- b) For quoted investments, fair value is determined by taking the mid market price, which is the recognised convention of AIM upon which the Fund's quoted portfolio companies will be most commonly listed. A marketability discount will be applied where:
  - there is a risk that the holding may not be sold immediately
  - there is a formal restriction on trading in the relevant securities.

The marketability discount will normally be up to 25% in such cases and a description will be provided on the assumptions for this rate, and any other which is adopted, according to the circumstances of each individual investment.

- c) For unquoted companies, investments held for less than one year will be valued at cost, in the absence of any reason to institute an impairment or any reason to uplift the investment.

## **Non-qualifying Investments Valuation Methodology**

The valuation policy for non-qualifying investments is set out in the Statement of Accounting Policies on page 26.



# Annual Review Investment Manager's Review

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## Investment Overview

At the period end, the portfolio comprised investments in six qualifying companies and two equity funds managed by Electra Partners. In addition, two further qualifying investments were completed after the period end. The current level of deal flow remains encouraging and the Fund is on track to meet its 70% qualification target at the end of year three. Of the eight investments made to date only one is AIM listed. This is because we perceive there to be better value in the unquoted market where we are able to do more due diligence and have better control over investments. Generally, we look at a lot of AIM companies but we have often not been able to get comfortable with the quality of information or the pricing. Another major issue for AIM companies is the lack of liquidity in the after-market, which can lead to significant price movements mainly downwards with very little volume. Therefore, when investing in AIM companies, we have tended to favour companies that have already been listed for some time and where the valuations have fallen to more reasonable levels.

The investment policy is primarily focused on profitable unquoted companies where it is possible to add value through leveraged financing structures and through corporate initiatives such as bolt-on acquisitions. The preferred transaction is a management buy-out, where the Investment Manager is working alongside the existing management to create value. To this end, the Fund will co-invest where appropriate with the two other Electra Kingsway VCTs, which will allow the Fund to gain exposure to larger transactions which tend to be less risky. The majority of unquoted investments will typically be a mix of ordinary shares and loan stock, which provides the potential for a running yield on the investment as well as downside protection.

## New Investments in the Period

### Gyro

The company is a specialist brand and marketing agency with a strong business-to-business focus. It has a blue chip client list with customers such as Oracle, Sun Microsystems and Sony. The company raised £2.5m to fund the buy-out of one of the two founder partners. The buy-out was part of a wider transaction which allowed a distribution of equity to other members of the management team. The Fund invested £375,000 alongside Electra Kingsway VCT for a combined equity stake of 6.8%.

### Keycom

A follow-on investment alongside Electra Kingsway VCT of £200,000. The company provides broadband and telephone services to students living in halls of residence. The company has long term contracts with a number of universities for both wireless and cabled services. The opportunities for growth include new universities, public sector accommodation, new services and off-campus students.

### Sanastro

The company is a business-to-business publisher specialising in the financial services market with two leading titles, Leasing Life and Motor Finance. In November 2004 the company raised £6.75m to acquire the Lafferty Group, a larger company that publishes 11 titles such as The Accountant, Retail Banker, and Bank Marketing International. The acquisition provides a number of synergies and a platform from which the company can continue to develop both organically and by further acquisitions. The Fund invested £600,000 alongside Electra Kingsway VCT for a combined equity stake of 20.3%.

### Amber Taverns

Amber is a company set up in conjunction with Honeycombe Leisure, an AIM listed pub company. The management team at Honeycombe will seek to build up a portfolio of freehold pubs based in the north west of England. The key is to acquire underperforming pubs, refurbish them and install better operating management. The Fund invested £750,000 alongside Electra Kingsway VCT for a combined equity stake of 33.0%.

### Find Portal

The company owns and operates the UK's leading internet financial services directory website, [www.find.co.uk](http://www.find.co.uk), which has the most complete A to Z listing of any UK directory website. The company was founded in 1996 and has demonstrated a successful record of profits growth. The key has been the rapid growth of online advertising and the attractiveness of the internet for marketing financial products. The Fund invested £1m alongside Electra Kingsway VCT for a combined equity holding of 28.2%.

### Ma Hubbards

The company is similar to Amber Taverns in that it was set up in conjunction with Honeycombe Leisure. The main difference is that the company's business is to acquire freehold pub sites and convert them into a value food offer. The business is based in the north Midlands. The Fund invested £750,000 alongside Electra Kingsway VCT for a combined 50.0% of the equity.

## Purchases Completed Since Period End

### Hill Station

The company is a manufacturer of premium ice cream and floated on the AIM market in 2004. As a stand alone entity the company was sub-scale; therefore it entered into negotiations to acquire two significantly larger ice cream manufacturers with the intention of merging the three companies into one manufacturing site. The deal should enable significant cost savings and synergies and create a company with a combined turnover of £18m. The Fund invested £758,085 alongside Electra Kingsway VCT for a combined equity stake of 16.0%.

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### **Conquest Business Media**

The company specialises in Business-to-Business Publishing. Its core magazines are The Manufacturer, The Manufacturer US and British Industry. The business was founded in 1996 and is located in Norwich. The Fund invested £750,000 alongside Electra Kingsway VCT for a 43.4% combined equity stake in the company.

### **Non qualifying investments**

Electra Investment Trust, which specialises in private equity investments, reported a net asset value uplift comfortably outperforming the FTSE All-Share Index. The Trust has a very good ten year track record and provides a good vehicle to gain exposure to larger private equity investments. The value of the Fund's holding rose by 26.1% in the period. Electra Active Management is an open ended investment company that specialises in smaller company value investing where a corporate catalyst has been identified which may lead to a valuation uplift. The Fund's investment in Electra Active Management rose by 6.7% in the period.

### **Outlook**

The Fund has got off to a good start and the rate of investment is in line with projections. Current deal flow is encouraging and we look forward to providing investors with further information in the next newsletter. The economic environment still offers a good investment backdrop, although most of the consumer related sectors are looking more difficult.

# Annual Review Portfolio Summary

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	Cost at 30 September 2005 £	Valuation at 30 September 2005 £	% of Portfolio by Value %
<b>Qualifying Investments:</b>			
Find Portal	1,000,000	1,000,000	8.45
Amber Taverns	750,000	750,000	6.33
Ma Hubbards	750,000	750,000	6.33
Sanastro	600,000	600,000	5.07
Gyro	375,000	375,000	3.17
Keycom	200,000	200,000	1.69
	3,675,000	3,675,000	31.04
<b>Non-qualifying Investments:</b>			
Electra Active Management	4,000,000	4,268,135	36.05
Electra Investment Trust	3,089,841	3,895,500	32.91
	7,089,841	8,163,635	68.96
	10,764,841	11,838,635	100.00
Cash		21,630,414	
<b>Total</b>		<b>33,469,049</b>	

## Annual Review Qualifying Investments\*

<b>Find Portal</b>		Year ended May	2005
Cost	£1,000,000		£m
Valuation	£1,000,000	Sales	4.0
Basis of valuation	Cost	Profit before tax	1.1
Equity held	14.1%	Retained profit	1.0
Business	An internet financial directory	Net assets	1.2

<b>Amber Taverns</b>		Year ended April	2005
Cost	£750,000		£m
Valuation	£750,000	Sales	n/a
Basis of valuation	Cost	Profit before tax	n/a
Equity held	16.5%	Retained profit	n/a
Business	Acquisition of a portfolio of managed pubs in NE England	Net assets	n/a

<b>Ma Hubbards</b>		Year ended April	2005
Cost	£750,000		£m
Valuation	£750,000	Sales	n/a
Basis of valuation	Cost	Profit before tax	n/a
Equity held	25.0%	Retained profit	n/a
Business	Development of a portfolio of family-style pubs in NE England	Net assets	n/a

<b>Sanastro</b>		Year ended November	2005
Cost	£600,000		£m
Valuation	£600,000	Sales	n/a
Basis of valuation	Cost	Profit before tax	n/a
Equity held	7.6%	Retained profit	n/a
Business	A publisher of financial newsletters	Net assets	n/a

\* Information on the above investments is extracted from their latest audited accounts.

## Annual Review Qualifying Investments \*

<b>Gyro</b>		Year ended October	2004
Cost	£375,000		£m
Valuation	£375,000	Sales	9.0
Basis of valuation	Cost	Profit before tax	0.7
Equity held	3.4%	Retained profit	0.5
Business	International creative agency based in London	Net assets	0.02

<b>Keycom</b>		Year ended September	2004
Cost	£200,000		£m
Valuation	£200,000	Sales	1.9
Basis of valuation	Cost	Profit before tax	(1.3)
Equity held	4.2%	Retained profit	(1.1)
Business	Provision of broadband and telephone services to students living in Halls of Residence	Net assets	(1.5)

\* Information on the above investments is extracted from their latest audited accounts.

# Company Information Contact Details

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## **Electra Kingsway VCT 2 Plc**

### **Board of Directors**

Rupert Pennant-Rea (Chairman)  
Michael Broke  
David Donnelly  
Nicholas Ross  
David Sebire

### **Investment Manager and Administrator**

Electra Quoted Management Limited  
Paternoster House  
65 St Paul's Churchyard  
London EC4M 8AB  
Telephone +44 (0)20 7214 4200  
[www.electraquoted.com](http://www.electraquoted.com)

### **Secretary and Registered Office**

Philip Dyke  
Paternoster House  
65 St Paul's Churchyard  
London EC4M 8AB  
Telephone +44 (0)20 7214 4200

### **Company Number**

5210737

### **Registered Independent Auditors**

PricewaterhouseCoopers LLP  
Chartered Accountants  
Southwark Towers  
32 London Bridge Street  
London  
SE1 9SY

### **Investor Enquiries and Fixed Income Investment Advisor**

Downing Corporate Finance Limited  
69 Eccleston Square  
London  
SW1V 1PJ  
Telephone +44 (0)20 7233 5902  
[www.downing.co.uk](http://www.downing.co.uk)

### **Registrar and Transfer Office**

Capita Registrars  
Northern House  
Woodsome Park  
Fenay Bridge  
Huddersfield  
HD8 0LA  
Telephone +44 (0)8701 623131  
[www.capitaregistrars.com](http://www.capitaregistrars.com)

Any change of address of a shareholder or other relevant amendment to shareholder details should be communicated to the Company's Registrar, Capita Registrars.

## Company Information Board of Directors

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**Rupert Pennant-Rea, Chairman**

Aged 58, was appointed a Director on 7 September 2004.

He is a former Deputy Governor of the Bank of England and Editor of The Economist. He is currently Chairman of Henderson Plc and a Director of British American Tobacco and a number of other companies. He is Chairman of the Nomination Committee.

**\* Michael Broke**

Aged 69, was appointed a Director on 7 September 2004.

He is currently executive Chairman of Stockley Park Consortium. He was until recently a non-executive Director of Chelsfield, having joined the Board in October 1987 as Managing Director. He was Chief Executive of Stockley from January 1984 to June 1987 and prior to that a Director of J Rothschild & Co. Previous directorships have included Stalwart Group (Chairman) (now known as GE Life Group), Aspen Healthcare Holdings (Chairman) and Ashbourne Group.

**\* David Donnelly**

Aged 57, was appointed a Director on 7 September 2004.

He is CEO of FF&P Private Equity. Previously he was Chairman of Gordon House Asset Management, whose team joined Fleming Family & Partners in 2004. Previous directorships have included Highland Participants plc, an oil and gas exploration company (Chairman and Chief Executive), and R&W Hawthorn Leslie & Co (Executive Director), a publicly quoted shipbuilding and repair company. He was formerly a member of the London Stock Exchange. He is Chairman of the Remuneration Committee.

**Nicholas Ross**

Aged 43, was appointed a Director on 7 September 2004.

Nick joined Electra Partners in 1993 after several years in investment analysis and fund management. He has been responsible for the launch of Electra Active Management and the three Electra Kingsway VCT funds. He is a Director of Electra Quoted Management, Electra Active Management and all three Electra Kingsway VCT funds. He also sits on a number of investee company boards.

**\* David Sebire**

Aged 62, was appointed a Director on 7 September 2004.

He is a Chartered Accountant with extensive industrial and corporate finance experience. Until 1999 he was Chairman of Bridport and of PTS Group. He is non-executive Chairman of Aerobox and Clearspeed Technology and a number of private companies. He has been nominated the Senior Independent Director under the Combined Code on Corporate Governance and is additionally Chairman of the Audit Committee.

All Directors are also Directors of Electra Kingsway VCT Plc

\* Member of the Audit, Remuneration and Nomination Committees

# Accounts Report of the Directors

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## To the Members of Electra Kingsway VCT 2 Plc

The Directors present the audited Accounts of the Company for the period from incorporation to 30 September 2005 and their Report on its affairs.

## Business and Principal Activities

The principal activity of the Company during the period under review was investment in a diversified portfolio of unquoted and AIM listed companies. The Directors anticipate this activity will continue in the foreseeable future.

## Investment Company Status

Throughout the period under review the Company was an investment company as defined under Section 266 of the Companies Act 1985.

## VCT Status

HM Revenue and Customs has agreed to grant the Company provisional approval under Section 842AA ICTA as a VCT, effective from the first day on which shares were issued pursuant to the Offer as defined in the Prospectus dated 6 October 2004 ("the Prospectus"). The Board directs the affairs of the Company to enable it to seek approval as a VCT.

## Share Capital

The Company was incorporated on 20 August 2004 under the name De Facto 1151 Limited. The Company was re-registered as a public limited company on 5 October 2004 with the name Electra Kingsway VCT 2 Plc.

The company was incorporated with an authorised share capital of £1,000 divided into 1,000 ordinary shares of £1 each, two of which were issued nil paid to the subscribers to the Memorandum of Association of the Company.

By written resolutions passed on 23 September 2004:

- (i) it was resolved that each of the two issued ordinary shares and each of the 998 unissued ordinary shares of £1 each in the Company be sub-divided into 100 ordinary shares of 1p each giving a total of 100,000 ordinary shares of 1p each; and
- (ii) it was resolved to increase the authorised share capital of the Company to £600,000 by the creation of 54,900,000 ordinary shares of 1p each and 50,000 non-voting redeemable preference shares of £1 each in the capital of the Company.

On 24 September 2004, the Investment Manager was allotted 50,000 redeemable preference shares of £1 each against its irrevocable undertaking to pay £1 in cash for each such share as set out in the Prospectus.

On 4 April 2005, the Investment Manager's 50,000 redeemable preference shares of £1 each in the capital of the Company were redeemed by the Company and each redeemable preference share of £1 was thereafter sub-divided and redesignated as 100 ordinary shares of 1p each in the authorised but unissued share capital of the Company.

Accordingly, the current authorised share capital of the Company is £600,000 divided into 60,000,000 ordinary shares of 1p each.

Between 25 November 2004 and 30 September 2005 a total of 34,199,256 ordinary shares of 1p each were issued at price of £1 per share.

On 30 September 2005 the Company purchased a total of 14,546 of its ordinary 1p shares at a price of 85.5p per share for cancellation – the total consideration payable being £12,437. The Company does not hold any shares in Treasury.

As at 30 September 2005, a total of 34,184,910 ordinary shares of 1p each of the Company were in issue.

## Authority to Make Market Purchases of Shares

A Special Resolution will be proposed at the Annual General Meeting to be held on 13 March 2006 to renew, for one year, the Board's authority to buy up to 3,418,491 of the Company's ordinary shares, or such lesser number of shares as is equal to 10% of the total number of ordinary shares in issue as at the date of the passing of the resolution, subject to the constraints set out in the Special Resolution. Should any shares be purchased under this authority, it is the intention of the Board that such shares be cancelled.

## Results and Dividend

Revenue returns attributable to shareholders amounted to £147,234. The Directors do not recommend the payment of a final dividend in respect of the period ended 30 September 2005.

## Post Balance Sheet Events

The Fund has made the following investments since the period end:

November 2005	Hill Station	£758,085
November 2005	Conquest Business Media	£750,000



## Directors

The current Directors of the Company are listed on page 13. The Directors of the Company upon incorporation were Travers Smith Secretaries Limited and Travers Smith Limited who resigned as Directors on 7 September 2004 following the appointment of Mr RL Pennant-Rea, Mr MHA Broke, Mr DJ Donnelly, Mr NRW Ross and Mr DJ Sebire on the same date. No other person was a Director of the Company during any part of the period under review. All the current Directors will retire at the Annual General Meeting and, being eligible, offer themselves for re-election. Short biographical details of all the Directors are provided on page 13.

## Directors' Interests

The beneficial interests of the Directors in the ordinary shares of the Company are shown below. Save as disclosed, no Director had any notifiable interest in the securities of the Company. There have been no changes in the interests of any of the Directors in the ordinary shares of the Company between 1 October 2005 and 26 January 2006. No options over shares in the capital of the Company have been granted to the Directors.

	30 September 2005 Shares	* 20 August 2004 Shares
RL Pennant-Rea	102,500	–
MHA Broke	61,500	–
DJ Donnelly	–	–
NRW Ross **	103,100	100
DJ Sebire	–	–

\* Or date of appointment

\*\* NRW Ross also has an interest in £5,250 of the 4% loan notes.

## Directors' Remuneration Report

An Ordinary Resolution to approve the Directors' Remuneration Report will be put to the Annual General Meeting.

## Contracts with Directors

No Director has a service contract with the Company.

As a result of his employment with Electra Partners, Mr NRW Ross is deemed to have an interest in the Management Contract to which the Company is a party.

## Substantial Shareholders

At 26 January 2006 the Directors had not been notified of any interests of 3% or more in the Company's issued share capital.

## Independent Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as Auditors to the Company will be proposed at the Annual General Meeting. A separate resolution will be proposed at the Annual General Meeting authorising the Directors to fix the remuneration of the Auditors.

## Creditor Payment Policy

The Company pays all its creditors within 30 days.

## Management Fees and Arrangements

Electra Quoted Management was appointed as Investment Manager under an agreement dated 6 October 2004. The agreement is for an initial period of four years and thereafter until terminated by not less than one year's notice. Fees are paid quarterly in arrears, as a percentage of net assets (less a rebate of fees suffered in investments in funds managed by Electra Partners), at the following annual rates:

Period ended 30 June 2005	1.5%
Year ended 30 June 2006	2.0%
Year ended 30 June 2007 and thereafter	2.5%

## Incentive Schemes

Certain employees of, and persons engaged in, the business of the Investment Manager, will be entitled to receive a performance fee based upon returns to shareholders. The incentives are designed to encourage significant dividend payments to shareholders and a NAV performance that would equate to a historic top decile industry ranking, before any performance fee payment is made. Therefore, if, by the end of a financial year, distributions of 30p per share have been declared and if the Performance Value, which is equal to the Net Asset Value plus distributions, at that date exceeds 130p per share, then the beneficiaries will be entitled to an incentive equal to 20% of the excess of such Performance Value over 100p per share. If, on a subsequent financial year end, the performance of the Company falls short of the performance of the Company on the previous financial year end, the beneficiaries will not be entitled to any incentive. If, on a subsequent financial year end, the performance of the Company exceeds the previous performance of the Company, the beneficiaries will be entitled to 20% of such excess. To give effect to this performance fee, Loan Notes have been issued by the Company to certain employees of, and persons engaged in, the business of the Investment Manager. No Loan Notes have been issued directly to the Investment Manager. Further details of the terms of the Loan Notes are set out in Note 10 of the Financial Statements.

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### **Going Concern**

The Directors believe that it is appropriate to continue to adopt the going concern basis in preparing the Accounts as the Company has adequate resources to continue in operational existence for the foreseeable future.

### **Annual General Meeting**

The Annual General Meeting of the Company will be held on Monday 13 March 2006.

By order of the Board of Directors  
PJ Dyke, Secretary, Paternoster House,  
65 St Paul's Churchyard, London EC4M 8AB

26 January 2006

The Directors confirm that during the period under review the Company has complied with Section 1 of the Combined Code on Corporate Governance ("the Code") issued by the Financial Reporting Council in July 2003.

## Directors' Attendance at Meetings

	Board	Audit Committee	Remuneration Committee
<b>Number of Meetings</b>	<b>6</b>	<b>1</b>	<b>1</b>
Rupert Pennant-Rea	5	n/a	n/a
Michael Broke	4	1	1
David Donnelly	5	1	1
Nicholas Ross	6	n/a	n/a
David Sebire	5	1	1

## The Board of Directors

The Board, which meets regularly, comprised of five Directors at 30 September 2005 all of whom were non-executive. All of the Directors who held office at 30 September 2005, apart from Mr NRW Ross, have been considered by the Board to be independent from the Investment Manager. The Board has nominated Mr DJ Sebire as the Senior Independent Director.

All of the Directors of the Company are also Directors of Electra Kingsway VCT Plc which was launched in 2001 and which is also managed by Electra Partners. The Board has particularly considered the question of the independence of each Director in the light of the Code's provisions on that subject.

The Board believes that each of the Company's Directors, apart from Mr NRW Ross, continues to be wholly independent under the Code notwithstanding their cross-directorships detailed above. Independence is a state of mind and the character and judgement which accompany this are distinct from and in the Board's opinion are not compromised by having cross directorships with other Directors.

The Board has agreed a schedule of matters reserved for its specific approval, which includes a regular review of the Company's Management Agreement with Electra Partners, together with the monitoring of the performance thereunder. The Management Agreement sets out the matters over which Electra Partners has authority in accordance with the policies and directions of the Board. The Board Meetings consider as appropriate such matters as overall strategy, investment performance, share price performance, share price discount and communication with shareholders. The

Board considers that it meets sufficiently regularly to discharge its duties effectively. The number of meetings of the Board and the Audit and Remuneration Committees are shown in the table above.

The Board receives information that it considers to be sufficient and appropriate to enable it to discharge its duties. Each Director receives board papers several days in advance of each scheduled Board meeting and is able to consider in detail the Company's performance and any issues to be discussed at the relevant meeting.

The Directors believe that the Board has the balance, skills and experience which enable it to provide effective strategic leadership and proper governance of the Company. Information about the Directors, including their relevant experience can be found on page 13.

## Performance Appraisal

The Board carried out a formal appraisal process of its own and of its Committees' operation and performance during the period under review. This was implemented by means of questionnaires circulated to the Directors, the results of which were then summarised and reviewed by the Board. Issues covered included board composition, meeting arrangements and communication. The process was considered by the Board to be constructive in identifying areas for improving the functioning and performance of the Board and of its Committees. The Board concluded that its performance and that of its Committees was satisfactory.

The Chairman carried out a formal appraisal of each of the Directors during the period under review and the Board, under the leadership of the Senior Independent Director, similarly appraised the Chairman. Relevant matters considered included the attendance and participation at Board and Committee meetings, commitment to Board activities and the effectiveness of the contribution made by the relevant Director. As a result of this process, the Chairman has confirmed that the performance of each of the Directors being proposed for re-election continues to be effective and that each of them continues to show commitment to his role. The Senior Independent Director has also confirmed the continuing effectiveness and commitment of the Chairman.

## Re-election of Directors

In accordance with the Code's provisions or the Company's Articles, all Directors will submit themselves for re-election at the Company's first Annual General Meeting to be held in 2006. At subsequent Annual General Meetings one third of Directors will retire by rotation and seek re-election and Directors appointed by the Board will seek re-appointment at the Annual General Meeting following their appointment.

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### **Independent Professional Advice**

Individual Directors may seek independent professional advice in furtherance of their duties at the Company's expense within certain parameters. All Directors have access to the advice and services of the Company Secretary. Any appointment or removal of the Company Secretary would be a matter of consideration by the entire Board.

### **The Audit Committee**

The Board has an Audit Committee established in compliance with the Code. It comprises all the Directors, other than the Chairman of the Board and Mr NRW Ross, with Mr DJ Sebire as Chairman of the Committee. The Board has taken note of the suggestion that at least one member of the Committee should have recent and relevant financial experience and is satisfied that the Committee is properly constituted in this respect. Its authority and duties are clearly defined in its written terms of reference which are available on request.

### **The Committee's Responsibilities Include:**

- monitoring and reviewing the integrity of the financial statements, the internal financial controls and the independence, objectivity and effectiveness of the external auditors;
- making recommendations to the Board in relation to the appointment of the external auditors and approving the remuneration and terms of their engagement;
- developing and implementing the Company's policy on the provision of non-audit services by the external auditors;
- reviewing the arrangements in place within Electra Partners whereby their staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters insofar as they may affect the Company;
- considering annually whether there is a need for the Company to have its own internal audit function.

The Committee has reviewed the provision of non-audit services provided by the external auditors and believes them to be cost effective and not an impediment to the external auditors' objectivity and independence. The non-audit services include the provision of a monitoring service to ensure the Company complies with VCT legislation. It has been agreed that all non-audit work to be carried out by the external auditors, must be approved by the Audit Committee and that any special projects must be approved in advance.

### **Internal Audit**

Following the review carried out by the Audit Committee as to whether there is a need for the Company to have its own internal audit function, the Board has considered and continues to believe that the internal control systems in place within Electra Partners and the work carried out by the Company's external auditors provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the Company, is therefore considered unnecessary.

### **The Remuneration Committee**

The Remuneration Committee was comprised during the period under review of all the Directors of the Company other than the Chairman of the Board, who resigned from the Committee shortly after the start of the period under review, and Mr NRW Ross. The Committee has written terms of reference which are available on request. Full details of its role are set out in the Directors' Remuneration Report.

### **The Nomination Committee**

The Nomination Committee meets on an ad hoc basis to consider suitable candidates for appointment as Director. It comprises all the Directors apart from Mr NRW Ross with Mr RL Pennant-Rea as Chairman. It was not necessary to hold any meeting of the Committee during the course of this period. The Committee has written terms of reference which are available on request. The Committee is responsible for identifying and nominating, for the approval of the Board, candidates to fill board vacancies to maintain a balanced Board.

Letters of appointment, which specify the terms of appointment, are issued to new Directors.

### **Induction and Training**

New Directors are provided with an induction programme which is tailored to the particular circumstances of the appointee and which includes being briefed fully about the Company by the Chairman and senior executives of Electra Partners. Following appointment, Directors continue to receive other relevant training and advice as necessary to enable them to discharge their duties.

### **The Company's Relationship with its Shareholders**

The Company places great importance on communication with the Company's shareholders. In addition to the Annual and Interim Reports shareholders will be sent regular newsletters from the Investment Manager.

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At the Annual General Meeting all shareholders are welcome to attend and have the opportunity to put questions to the Board.

The notice of the Annual General Meeting and related papers are sent to shareholders at least 20 working days before the meeting. A separate resolution is proposed on each substantially separate issue including the annual report and accounts. All proxy votes are counted and, except where a poll is called, the Chairman indicates the level of proxies lodged for each resolution and the balance for and against the resolution after it has been dealt with on a show of hands.

The Chairman and the Senior Independent Director can always be contacted either through the Company Secretary or care of the Company's registered office at Paternoster House, 65 St Paul's Churchyard, London EC4M 8AB.

### Internal Control

The Code requires the Directors to review the effectiveness of the Company's system of internal control and report to shareholders that they have done so. The Code extended the earlier reporting requirements and now includes financial, operational and compliance controls and risk management.

The Board confirms that it has an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process has been in place throughout the period and has continued since the period end. It is reviewed at regular intervals by the Board and accords with the guidance set out in 'Internal Control: Guidance for Directors on the Combined Code'.

The Board is responsible for the Company's system of internal control and it has reviewed its effectiveness for the period ended 30 September 2005. The system of internal control is designed to manage rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Since investment management, custody of assets and all administrative services are provided or arranged for the Company by Electra Partners, the Company's system of internal control mainly comprises the monitoring of services provided by Electra Partners, including the operating controls established by them, to ensure they meet the Company's business objectives. The key elements designed to provide effective internal control for the Company are as follows:

- Financial Reporting – Regular and comprehensive review by the Board of key investment and financial data including management accounts, revenue projections, analyses of transactions and performance comparisons.
- Investment Strategy – Agreement by the Board of the Company's investment strategy and authorisation and monitoring of all large investments.

- Management Agreements – The Board regularly monitors the performance of Electra Partners to ensure that the Company's assets and affairs are managed in accordance with the guidelines determined by the Board.
- Investment Performance – The investment transactions and performance of the Company's assets and affairs are managed in accordance with the guidelines determined by the Board.
- Management Systems – Electra Partners' system of internal control includes clear lines of responsibility, delegated authority, control procedures and systems. Electra Partners' compliance department monitors compliance with the Financial Services Authority rules.

The Board keeps under review the effectiveness of the Company's system of internal control by monitoring the operation of the key controls of Electra Partners as follows:

- The Board reviews the terms of the management agreement and receives regular reports from Electra Partners' executives.
- The Board reviews the certificates provided by Electra Partners on a six monthly basis, verifying compliance with documented controls.

### Voting Policy

The Company's investee companies are principally a mixture of listed and unlisted companies in which the Company is a significant shareholder and the Company is usually a party to all issues requiring shareholder approval. The Company has given discretionary voting power to Electra Partners to vote on its behalf.

Electra Partners' voting policy as agent for the Company has adopted and applies the Statement of Principles drawn up by the Institutional Shareholders Committee when it considers these in its reasonable judgement to best serve the financial interests of the Company's shareholders. Electra Partners' voting policy has been reviewed and endorsed by the Board.

## Accounts Statement of Directors' Responsibilities

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Company law requires the Directors to prepare accounts for each financial period which give a true and fair view of the state of affairs of the Company as at the end of that period and of the net revenue and gains of the Company for that period. In preparing those accounts the Directors are required to:

- select appropriate accounting policies and then apply them consistently on the basis of judgements and estimates that are reasonable and prudent;
- state whether applicable Accounting Standards have been followed, subject to any material departures disclosed and explained in the Accounts;
- prepare the Accounts on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for ensuring that proper accounting records are kept which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the Accounts comply with the Companies Act 1985. They are also responsible for taking such steps as are reasonably open to them for safeguarding the assets of the Company and for the prevention and detection of fraud and other irregularities. The Directors confirm that they have complied with these requirements.

After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the Accounts.

# Accounts Directors' Remuneration Report

The Directors submit this report in accordance with the requirements of Schedule 7A of the Companies Act 1985. An Ordinary Resolution for the approval of this report will be put to members at the forthcoming Annual General Meeting. The law requires the Company's Auditors to audit certain of the disclosures provided. Where disclosures have been audited they are indicated as such.

## Remuneration Committee

The Remuneration Committee was comprised during the period under review of all the Directors of the Company other than the Chairman of the Board, who resigned shortly after the start of the period under review, and Mr NRW Ross. Mr DJ Donnelly was Chairman of the Remuneration Committee throughout the period.

The Remuneration Committee reviewed the level of Directors' fees during the period under review and agreed that no changes should be made to the level of these fees. The current annual fee rates are £20,000 for the Chairman and £15,000 for each of the other Directors apart from Mr NRW Ross who receives no remuneration from the Company. The Committee has not been provided with advice or services by any person in respect of Directors' remuneration during the period.

## Policy on Directors' Remuneration

In accordance with the Articles of Association of the Company, the aggregate remuneration of the Directors may not exceed £100,000 per annum or such higher amount as may from time to time be determined by an Ordinary Resolution of the Company. Subject to this overall limit, the Remuneration Committee's policy is that remuneration of non-executive Directors should be sufficient to attract and retain the Directors needed to oversee the Company and to reflect the specific circumstances of the Company, the duties and responsibilities of the Directors and the value and amount of time committed to the Company's affairs. It is intended that this policy will continue for the year ended 30 September 2006 and subsequent years. Non-executive Directors are not eligible to receive bonuses, pension benefits, share options and other benefits.

## Directors' Service Contracts

None of the Directors has a service contract with the Company. No arrangements have been entered into between the Company and the Directors to entitle any of the Directors to compensation for loss of office.

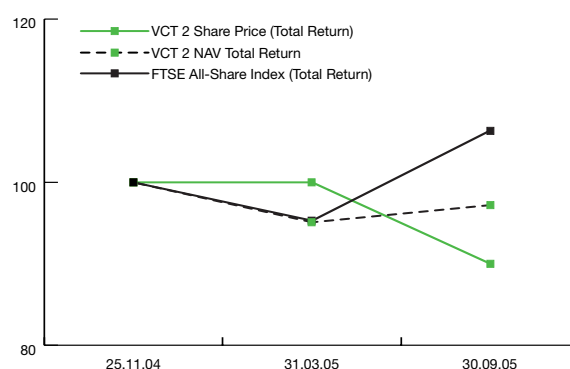
## Performance Graph

The graph below shows the Company's performance being measured in terms of its Total Shareholder Return and its Net Asset Value per share since the date on which shares were first issued being 25 November 2004 against the Total Shareholder Return of the FTSE All-Share Index.

The graph has incorporated the change in net asset value per share because changes in net asset value per share relative to the FTSE All-Share Index are an important indicator of the performance of the Company's assets.

The Directors consider that since the Company invests in a broad range of commercial sectors the FTSE All-Share Index is the most appropriate index against which to compare the Company's performance.

## Electra Kingsway VCT 2 Share Price Total Return v Electra Kingsway VCT 2 Net Asset Value v FTSE All-Share Index (Total Return)



## Directors' Remuneration for the Period (audited)

The Directors who served during the period received the following emoluments in the form of fees:

	For the period from 20 August 2004 to 30 Sept 2005 £
RL Pennant-Rea (Chairman & highest paid Director)	20,000
MHA Broke	15,000
DJ Donnelly	15,000
DJ Sebire	15,000
NRW Ross	–
<b>Total</b>	<b>65,000</b>

As an executive of Electra Partners, NRW Ross has an interest in the Management Contract. £50,000 of his remuneration is estimated to be in respect of the duties he undertakes for the Company.

By order of the Board of Directors  
PJ Dyke, Secretary, Paternoster House,  
65 St Paul's Churchyard, London EC4M 8AB  
26 January 2006

# Accounts Independent Auditors' Report

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## To the Members of Electra Kingsway VCT 2 Plc

We have audited the Financial Statements which comprise the Statement of Total Return, the Balance Sheet, the Cash Flow Statement, the Statement of Accounting Policies and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' Remuneration Report ("the auditable part").

## Respective Responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the Financial Statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities. The Directors are also responsible for the Directors' Remuneration Report.

Our responsibility is to audit the financial statements and the auditable part of the Directors' Remuneration Report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This Report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this Report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the Directors' Remuneration Report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Report of the Directors' is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Report of the Directors', the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Investment Manager's review, the Corporate Governance statement and the other items included in the contents section.

We review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code issued in 2003 specified for our review by the Listing Rules of the Financial Services

Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Company's Corporate Governance procedures or its risk and control procedures.

## Basis of Audit Opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Financial Statements and the auditable part of the Directors' Remuneration Report. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Financial Statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Financial Statements and the auditable part of the Directors' Remuneration Report are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Financial Statements.

## Opinion

In our opinion:

- the Financial Statements give a true and fair view of the state of affairs of the Company at 30 September 2005 and of its total return and cash flows for the period then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the Directors' Remuneration Report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
London  
26 January 2006

## Notes:

- a The maintenance and integrity of the Electra Quoted Management website is the responsibility of the Investment Manager; the work carried out by the Auditors does not involve consideration of these matters and, accordingly, the Auditors accept no responsibility for the information presented on the website.
- b Legislation in the United Kingdom governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.



# Accounts Statement of Total Return

Incorporating the Revenue Account of the Company for the period ended 30 September 2005

	Notes	For the period 20 August 2004 to 30 September 2005		
		Revenue £	Capital £	Total £
Unrealised gains on investments		–	1,073,794	1,073,794
Income	1	557,765	–	557,765
		557,765	1,073,794	1,631,559
Investment management fees	2	(99,517)	(298,551)	(398,068)
Other expenses	3	(311,014)	–	(311,014)
<b>Return on Ordinary Activities before Taxation</b>		147,234	775,243	922,477
Tax on ordinary activities	5	–	–	–
<b>Return on Ordinary Activities after Taxation</b>		147,234	775,243	922,477
<b>Return to Shareholders per Ordinary Share</b>	6	0.80p	4.21p	5.01p

The amounts dealt with in the Statement of Total Return are all derived from continuing activities.

No operations were acquired or discontinued in the period.

The notes on pages 27 to 34 form part of these financial statements.

# Accounts Reconciliation of Total Shareholders' Funds

	For the period 20 August 2004 to 30 September 2005 £
Total Return	922,477
Share issue expenses charged to Share Premium account	(1,880,960)
Ordinary shares issued	34,199,456
Repurchase of ordinary shares	(12,437)
<b>Movements in Total Shareholders' Funds</b>	<b>33,228,536</b>
Total Shareholders' Funds at start of period	–
<b>Total Shareholders' Funds</b>	<b>33,228,536</b>

# Accounts Balance Sheet

As at 30 September 2005

	Notes	£	As at 30 September 2005 £
<b>Fixed Assets</b>			
Investments	7		11,838,635
<b>Current Assets</b>			
Debtors and prepayments	8	79,910	
Cash at bank	16	21,630,414	
			21,710,324
<b>Current Liabilities</b>			
Creditors: amounts falling due within one year			
Other creditors	9	299,173	
			299,173
<b>Net Current Assets</b>			21,411,151
Total assets less current liabilities			33,249,786
Creditors: amounts falling due after more than one year	10		21,250
<b>Net Assets</b>			33,228,536
<b>Capital and Reserves</b>			
Called-up share capital	12		341,849
Share premium	13		31,976,502
Capital redemption reserve	13		145
Realised capital reserve	13		(298,551)
Unrealised capital reserve	13		1,073,794
Revenue reserve	13		134,797
<b>Total Equity Shareholders' Funds</b>			33,228,536
<b>Net Asset Value per Ordinary Share</b>	14		97.20p

As at 30 September 2005

Number of Ordinary Shares in issue at end of period	34,184,910
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The information on pages 26 to 34 forms part of these Financial Statements.

The Financial Statements on pages 23 to 34 were approved by the Board of Directors on 26 January 2006 and were signed on its behalf by:

R Pennant-Rea, Chairman.

# Accounts Cash Flow Statement

	Notes	£	For the period 20 August 2004 30 September 2005 £
<b>Operating Activities</b>			
Investment income received		413,242	
Bank deposit interest received		64,613	
Investment management fees paid		(228,000)	
Other cash payments		(194,346)	
<b>Net Cash Inflow from Operating Activities</b>	15		55,509
<b>Investing Activities</b>			
Acquisition of investments	7	(10,764,841)	
<b>Net Cash Outflow from Investing Activities</b>			(10,764,841)
<b>Cash Outflow before Financing and Management of Liquid Resources</b>			(10,709,332)
<b>Financing</b>			
Issue of ordinary shares		34,199,456	
Expenses of the issue of ordinary shares		(1,880,960)	
Issue of loan notes		21,250	
<b>Net Cash Inflow from Financing</b>			32,339,746
<b>Increase in Cash for the Period</b>	16		21,630,414

# Accounts Statement of Accounting Policies

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A summary of the principal accounting policies, all of which have been applied consistently throughout the current period, is set out below:

## a) Basis of accounting

The accounts have been prepared under the historical cost convention, modified to include the revaluation of investments, and in accordance with applicable accounting standards in the United Kingdom and with the Statement of Recommended Practice (2003), 'Financial Statements of Investment Trust Companies'.

## b) Valuation of investments

Listed investments and investments traded on AIM are stated at closing mid-market prices. Where quoted investments are subject to restrictions, an appropriate discount to the latest market price is applied with regard to the International Private Equity and Venture Capital ("IPEVC") valuation guidelines.

Unquoted investments and investments traded on OFEX are stated at Directors' valuation.

In valuing unlisted investments, the Directors follow a number of general principles in accordance with the latest IPEVC guidelines which are set out on page 6.

Realised gains or losses on the disposal of investments are taken to the realised capital reserve. Unrealised gains or losses on the revaluation of investments are taken to the unrealised capital reserve.

## c) Income

Dividends receivable from equity investments are brought into account on the ex-dividend date.

Fixed returns on non-equity investments and on debt securities are recognised on a time apportionment basis, which reflects the effective yield.

Interest receivable on cash deposits is accounted for on an accruals basis.

## d) Expenses

All expenses are accounted for on an accruals basis and are charged through the revenue account, except as follows:

- expenses which are incidental to the acquisition of an investment are included in the cost of investment;
- expenses which are incidental to the disposal of an investment are deducted from the disposal proceeds of the investment;

- expenses incurred as a result of an issue of shares are allocated against the share premium account; and
- expenses relating to investment management and incentive fees, which are dealt with below.

## e) Investment management and incentive fees

The investment management fees for the Investment Manager's services are charged 25% to the revenue account and 75% to the capital account. This is in line with the Board's long-term projections of returns from the investment portfolio of the Company. The incentive fee on realisations in the period is charged to the realised capital reserve and the incentive fee provision in respect of unrealised value growth in the portfolio is charged to the unrealised capital reserve.

## f) Capital reserves

Gains and losses on the realisation of investments are accounted for in the realised capital reserve. Increases and decreases in the valuation of investments held at the period end are accounted for in the unrealised capital reserve.

## g) Taxation

The charge for taxation is based on the net revenue for the period. Deferred tax is provided on all timing differences that have originated but not reversed by the balance sheet date. Deferred tax assets are only recognised to the extent that they are recoverable.

The tax effects of different items in the Statement of Total Return are allocated between capital and revenue on the same basis as the particular item to which they relate using the Company's effective rate of tax for the accounting period.

# Accounts Notes to the Accounts

## 1 Income

	For the period 20 August 2004 to 30 September 2005 £
Franked investment income	493,152
Interest from bank deposits	64,613
	<b>557,765</b>

## 2 Investment Manager's Fees

	Revenue 2005 £	Capital 2005 £	Total 2005 £
Electra Quoted Management	99,517	298,551	398,068

The Management Fee includes irrecoverable VAT of £59,286.

Electra Quoted Management also received an administration fee of £56,082, net of VAT, which increases each year in line with RPI. The administration fee is included in the administration expenses of £311,014 in Note 3.

### Management Fees and Arrangements

Electra Quoted Management was appointed as Investment Manager under an agreement dated 6 October 2004. The agreement is for an initial period of five years and thereafter until terminated by not less than one year's notice to expire at any time after the initial period. Fees are paid quarterly in arrears, as a percentage of net assets (less a rebate of fees suffered in investments in funds managed by Electra Partners), at the following annual rates:

Period ended 30 June 2005	1.5%
Year ended 30 June 2006	2.0%
Year ended 30 June 2007 and thereafter	2.5%

### Incentive Schemes

Certain employees of, and persons engaged in, the business of the Investment Manager, will be entitled to receive a performance fee based upon returns to shareholders. The incentives are designed to encourage significant dividend payments to shareholders and a NAV performance that would equate to a historic top decile industry ranking, before any performance fee payment is made. Therefore, if by the end of a financial year, distributions of 30p per share have been declared and if the Performance Value, which is equal to the Net Asset Value plus distributions, at that date exceeds 130p per share, then the beneficiaries will be entitled to an incentive equal to 20% of the excess of such Performance Value over 100p per share. If, on a subsequent financial year end, the performance of the Company falls short of the performance of the Company on the previous financial year end, the beneficiaries will not be entitled to any incentive. If, on a subsequent financial year end, the performance of the Company exceeds the previous performance of the Company, the beneficiaries will be entitled to 20% of such excess. To give effect of this performance fee, Loan Notes have been issued by the Company to certain employees of, and persons engaged in, the business of the Investment Manager. No Loan Notes have been issued directly to the Investment Manager. Further details of the terms of the Loan Notes are set out in Note 10 of the Financial Statements.

At 30 September 2005 there was no amount due under the Incentive Schemes.

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### 3 Other Expenses

	For the period 20 August 2004 30 September 2005
	£
Directors' remuneration (including Employer's NIC)	68,429
IFA trail commission	83,280
Auditors' fees – audit	21,150
– non-audit	16,156
Administration expenses	121,999
	<hr/> 311,014 <hr/>

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### 4 Directors' Remuneration

Details of Directors' remuneration are shown in the table in the Directors' Remuneration Report on page 21.

The Company has no employees or employee costs.

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### 5 Taxation on Ordinary Activities

	For the period 20 August 2004 to 30 September 2005
	£
<b>Analysis of charge in the year</b>	
Current tax:	
UK corporation tax at 19%	–
Total Current Tax	–
<b>Factors affecting tax charge for the year</b>	
Revenue return on ordinary activities before tax	147,234
Revenue return at corporate tax rate	27,974
Effects of:	
Dividend income	(43,797)
Expenses not deductible for tax purposes	15,823
	<hr/> – <hr/>

In light of the Company's status as a venture capital trust and the Directors' intention to continue to meet the conditions necessary to obtain such approval in the foreseeable future, the Company has not provided for deferred tax on any capital gains and losses arising on the revaluation or disposal of investments.

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## 6 Return per Ordinary Share

The revenue return per ordinary share is based on the net revenue from ordinary activities after taxation of £147,234 and on 18,430,338 ordinary shares, being the weighted average number of ordinary shares in issue during the period.

The capital return per ordinary share is based on net capital gains of £775,243 and on 18,430,338 ordinary shares, being the weighted average number of ordinary shares in issue during the period.

There is no difference between the diluted Return per Ordinary Share and the basic Return per Ordinary Share shown above.

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## 7 Investments

	Qualifying Investments		Non-qualifying Investments		
	Traded on OFEX	Unlisted	Open-ended Investment Company	Closed-ended Investment Company	Total
	£	£	£	£	£
Purchases at cost	200,000	3,475,000	4,000,000	3,089,841	10,764,841
Unrealised gains in period	–	–	268,135	805,659	1,073,794
<b>Valuation at 30 September 2005</b>	<b>200,000</b>	<b>3,475,000</b>	<b>4,268,135</b>	<b>3,895,500</b>	<b>11,838,635</b>
Cost at 30 September 2005	200,000	3,475,000	4,000,000	3,089,841	10,764,841
Unrealised gains at 30 September 2005	–	–	268,135	805,659	1,073,794
<b>Valuation at 30 September 2005</b>	<b>200,000</b>	<b>3,475,000</b>	<b>4,268,135</b>	<b>3,895,500</b>	<b>11,838,635</b>

Further details of investments are provided in the Portfolio Summary on page 9 of these accounts.

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## 8 Debtors

	2005 £
Amounts due within one year:	
Accrued income	79,910
	79,910

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## 9 Creditors: amounts falling due within one year

	2005 £
Other creditors	116,670
Due to Electra Quoted Management Ltd	170,066
Outstanding settlements	12,437
	<hr/> 299,173

## 10 Creditors: amounts falling due after more than one year

	2005 £
Unsecured 4% Loan Notes	21,250
	<hr/> 21,250

The Loan Notes are redeemable at par in certain circumstances. They carry a 4% coupon paid on 30 September each year and also the right to additional payments under the terms of the incentive schemes set out in Note 2 to the financial statements.

## 11 Significant Interests

At 30 September 2005 the Company held significant investments, amounting to 3% or more of the equity capital in the following companies:

	Equity Investment (Ordinary Shares) £	Investment Loan Stock and Preference Shares £	Total Investment £	Percentage of Investee Company's Total Equity %
Sanastro	600,000	–	600,000	7.6
Gyro	112,500	262,500	375,000	3.4
Amber Taverns	225,000	525,000	750,000	16.5
Find Portal	100,394	899,606	1,000,000	14.1
Ma Hubbards	225,000	525,000	750,000	25.0
Keycom	200,000	–	200,000	4.2

It is considered that, as permitted by FRS 9 "Associates and Joint Ventures", the above investments are held as part of an investment portfolio and that, accordingly, their value to the Company lies in their marketable value as part of its portfolio. In view of this, it is not considered that the above represent investments in associated undertakings. The above companies are incorporated in the United Kingdom.



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## 12 Called Up Share Capital

	Number	2005 £
<b>Authorised:</b>		
Ordinary shares of 1p each: 60,000,000	60,000,000	600,000
	60,000,000	600,000
<b>Issued:</b>		
Ordinary shares of 1p each issued during the period	34,199,456	341,994
Ordinary shares of 1p each repurchased during the period	(14,546)	(145)
At 30 September 2005	34,184,190	341,849

The company was incorporated with an authorised share capital of £1,000 divided into 1,000 ordinary shares of £1 each, two of which were issued nil paid to the subscribers to the Memorandum of Association of the Company.

By written resolutions passed on 23 September 2004:

- (i) it was resolved that each of the two issued ordinary shares and each of the 998 unissued ordinary shares of £1 each in the Company be sub-divided into 100 ordinary shares of 1p each giving a total of 100,000 ordinary shares of 1p each; and
- (ii) it was resolved to increase the authorised share capital of the Company to £600,000 by the creation of 54,900,000 ordinary shares of 1p each and 50,000 non-voting redeemable preference shares of £1 each in the capital of the Company.

On 24 September 2004, the Investment Manager was allotted 50,000 redeemable preference shares of £1 each against its irrevocable undertaking to pay £1 in cash for each such share as set out in the Prospectus. On 4 April 2005 the Investment Manager's 50,000 redeemable preference shares of £1 each in the capital of the Company were redeemed by the Company and each redeemable preference share of £1 was thereafter sub-divided and redesignated as 100 ordinary shares of 1p each in the authorised but unissued share capital of the Company.

Accordingly, the current authorised share capital of the Company is £600,000 divided into 60,000,000 ordinary shares of 1p each.

Between 25 November 2004 and 30 September 2005 a total of 34,199,256 ordinary shares of 1p each were issued at a price of £1 per share.

On 30 September 2005 the Company purchased a total of 14,546 of its ordinary 1p shares at a price of 85.5p per share for cancellation – the total consideration payable being £12,437.

As at 30 September 2005 a total of 34,184,910 ordinary shares of 1p each of the Company were in issue.

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## 13 Reserves

	Share Premium Account £	Capital Redemption Reserve £	Realised Capital Reserve £	Unrealised Capital Reserve £	Revenue Reserve £
Premium on issues of shares during the period	33,857,462	–	–	–	–
Expenses of share issues	(1,880,960)	–	–	–	–
Shares repurchased in year	–	145	–	–	(12,437)
Investment management fee	–	–	(298,551)	–	–
Increase in unrealised appreciation	–	–	–	1,073,794	–
Retained net revenue for the year	–	–	–	–	147,234
At 30 September 2005	31,976,502	145	(298,551)	1,073,794	134,797

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## 14 Net Asset Value per Ordinary Share

Net asset value per ordinary share is based on net assets at 30 September 2005, and on 34,184,910 ordinary shares, being the number of ordinary shares in issue on that date.

There is no difference between the diluted NAV per Ordinary Share and the basic NAV per Ordinary Share shown above.

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## 15 Reconciliation of Net Revenue Before Taxation to Net Cash Inflow from Operating Activities

	For the period 20 August 2004 30 September 2005 £
Net revenue before taxation	147,234
Investment management fees charged to capital	(298,551)
Increase in debtors	(79,910)
Increase in creditors and accruals	286,736
Net cash inflow from operating activities	55,509

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## 16 Analysis of Changes in Cash

	For the period 20 August 2004 30 September 2005 £
At beginning of the period	–
Net cash inflow	21,630,414
At 30 September	21,630,414

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## 17 Financial Instruments

The Company's financial instruments comprise:

- Equity and non-equity shares, units in an open-ended investment company and shares in a closed-ended investment company that are held in accordance with the Company's investment objective.
- Cash, liquid resources and short-term debtors and creditors that arise directly from the Company's operations.

It is not the Company's policy to trade in financial instruments or derivatives. The main risks arising from the Company's financial instruments are due to fluctuations in market prices and interest rates. The Board regularly reviews and agrees policies for managing each of these risks and they are summarised below:

### Key Risks

**Credit Risk:** Failure by counter-parties to deliver securities which the company has paid for, or pay for securities which the Company has delivered.

**Market Price Risk:** Market price risk arises from uncertainty about the future prices of financial instruments held in accordance with the Company's investment objectives. It represents the potential loss that the Company might suffer through holding market positions in the face of market movements.

The investments in equity and fixed interest stocks of unquoted and AIM listed companies the Company holds are thinly traded and as such the prices are more volatile than those of more widely traded securities. In addition, the ability of the Company to realise the investments at their carrying value may at times not be possible if there are no willing purchasers. The ability of the Company to purchase or sell investments is also constrained by the requirements set down for venture capital trusts.

**Interest Rate Risk:** The Company's equity and non-equity investments and net revenue may be affected by interest rate movements.

**Currency Risk:** All assets and liabilities are denominated in sterling and therefore there is no currency risk.

### Management of Risks

**Credit Risk:** All transactions are settled on the basis of delivery against payment.

**Market Price Risk:** The Board manages the market price risk inherent in the Company's portfolio by maintaining an appropriate spread of market risk, and by ensuring full and timely access to relevant information from the Investment Manager. The Investment Committee reviews the investment performance and financial results, as well as compliance with the Company's objectives. The Board seeks to ensure that an appropriate proportion of the Company's portfolio is invested in cash and readily realisable securities, which are sufficient to meet any funding commitments that may arise. The Company does not use derivative instruments to hedge against market risk.

**Interest Rate Risk:** The Company's assets include liquidity funds, the values of which are regularly reviewed by the Board, as referred to above. The Company does not use derivative instruments to hedge against interest rate risk.

The interest rate risk profile of the Company's financial assets (excluding short-term debtors and creditors) at 30 September 2005 was:

	Financial Assets on which no Interest Paid £	Variable Rate Financial Assets £	Total £	Weighted Average Interest Rates %	Average Period to Maturity Years
Equity shares	11,838,635	–	11,838,635	–	–
Cash	–	21,630,414	21,630,414	–	–
<b>Total</b>	<b>11,838,635</b>	<b>21,630,414</b>	<b>33,469,049</b>	<b>–</b>	<b>–</b>

The only financial liabilities are the unsecured loan notes of £21,250 which carry a 4% coupon.

## 18 Post Balance Sheet Events

The Fund has made the following investments since the period end:

November 2005	Hill Station	£758,085
November 2005	Conquest Business Media	£750,000

## 19 Geographical Analysis

The operations of the Company are wholly in the United Kingdom.

## 20 Contingencies, Guarantees and Financial Commitments

There were no contingencies, guarantees or financial commitments of the Company at 30 September 2005.

## 21 Transactions with the Manager

During the period ended 30 September 2005 the Company paid £293,897 to Electra Quoted Management, the Investment Manager. At 30 September 2005, the Company owed £170,066 to the Investment Manager. Details of the Investment Manager's fee arrangements are included in Note 2.

# Annual General Meeting Notice of Annual General Meeting

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Notice is hereby given that the first Annual General Meeting of Electra Kingsway VCT 2 Plc will be held on Monday 13 March 2006 at the later of 1.30pm or the conclusion of the Annual General Meeting of Electra Kingsway VCT Plc to be held at 1.00pm on the same day at Paternoster House, 65 St Paul's Churchyard, London EC4M 8AB for the purpose of considering and, if thought fit, passing the following Resolutions (of which, Resolutions 1 to 9 will be proposed as Ordinary Resolutions):

## Ordinary Business

- 1 To receive, consider and adopt the Reports of the Directors and Auditors and the Company's Accounts for the period from incorporation to 30 September 2005.
  - 2 To approve the Directors' Remuneration Report for the period from incorporation to 30 September 2005 which is set out in the Annual Report & Accounts of the Company for the period from incorporation to 30 September 2005.
  - 3 To re-elect Mr RL Pennant-Rea as a Director of the Company.
  - 4 To re-elect Mr MHA Broke as a Director of the Company.
  - 5 To re-elect Mr DJ Donnelly as a Director of the Company.
  - 6 To re-elect Mr NRW Ross as a Director of the Company.
  - 7 To re-elect Mr DJ Sebire as a Director of the Company.
  - 8 To re-appoint PricewaterhouseCoopers LLP as Auditors of the Company to hold office until the conclusion of the next general meeting at which accounts are laid before the Company.
  - 9 To authorise the Directors to fix the remuneration of the Auditors.
- iii) the maximum price, which may be paid for an ordinary share, shall be an amount equal to 105% of the average of the middle market quotations for an ordinary share taken from and calculated by reference to the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is purchased;
  - iv) any purchase of ordinary shares will be made in the market for cash at prices below the prevailing net asset value per ordinary share (as determined by the Directors); and
  - v) unless renewed, the authority hereby conferred shall expire on the earlier of 13 June 2007 or the conclusion of the Company's Annual General Meeting in 2007 save that the Company may, prior to such expiry, enter into a contract to purchase ordinary shares which will or may be completed or executed wholly or partly after such expiry.

By order of the Board of Directors

PJ Dyke, Secretary, Paternoster House,  
65 St Paul's Churchyard, London EC4M 8AB

26 January 2006

## Notes

## Special Business

As Special Business, to consider and, if thought fit, to pass the following Resolution which will be proposed as a Special Resolution:

## Special Resolution

- 10 THAT the Company be and is hereby generally and unconditionally authorised in accordance with Section 166 of the Companies Act 1985 (as amended and in force from time to time) (the "Act") to make market purchases (within the meaning of Section 163 (3) of the Act) of ordinary shares of 1 pence each, provided that:
    - i) the maximum number of ordinary shares of 1p each hereby authorised to be purchased is 3,418,491 or such lesser number of shares as is equal to 10% of the total number of ordinary shares in issue as at the date of the passing of this resolution;
    - ii) the minimum price which may be paid for an ordinary share shall be 1 pence;
- A Any member of the Company who is entitled to attend and vote at the Meeting is entitled to appoint one or more proxies to attend and, on a poll, vote on his behalf. Such proxy need not be a member of the Company.
  - B A Form of Proxy is provided. To be effective, the Form of Proxy and any power of attorney under which it is executed (or a duly certified copy of such power) must reach the Company's Registrars, Capita Registrars, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU, not less than 48 hours before the time of the Meeting or adjourned Meeting or (in the case of a poll taken otherwise than at or on the same day as the Meeting or adjourned Meeting) for the taking of the poll at which it is to be used. Completion and return of the Form of Proxy will not prevent a member from attending and voting at the Meeting.
  - C In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, only those holders of ordinary shares entered on the register of members of the Company as at 6.00pm on 11 March 2006 (the "Specified Time") shall be entitled to attend and vote at the Meeting in respect of the number of ordinary shares registered in their name at that time. Changes to entries on the register of members after 6.00pm on 11 March 2006 shall be disregarded in determining the rights of any person to attend and vote at the Meeting.

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- D If the Meeting is adjourned to a time not more than 48 hours after the Specified Time applicable to the original Meeting, that time will also apply for the purposes of determining the entitlement of members to attend and vote (and for the purposes of determining the number of votes they may cast) at the adjourned Meeting. If, however, the Meeting is adjourned for a longer period, then to be so entitled, members must be entered on the Company's register of members at a time which is not more than 48 hours before the time fixed for the adjourned Meeting or, if the Company gives notice of the adjourned Meeting, at the time specified in that notice.
- E The following documents will be available for inspection at the registered office of the Company during usual business hours on any weekday (Saturdays and public holidays excepted) from the date of this notice until the close of the Annual General Meeting, and will be available at the place of the Annual General Meeting for 15 minutes prior to and during the Meeting:
- the Register of Directors' Interests in the share capital of the Company maintained in accordance with Section 325 of the Companies Act 1985; and
  - the Articles of Association of the Company.
- F Short biographical details of Mr RL Pennant-Rea, Mr MHA Broke, Mr DJ Donnelly, Mr NRW Ross and Mr DJ Sebire are contained in the Report & Accounts for the period to 30 September 2005 on page 13.



