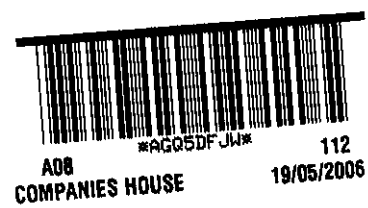


SIGNED ACCOUNTS

2006

Northern 2 VCT PLC

Annual Report and Accounts 31 January 2006



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Northern 2 VCT PLC is a Venture Capital Trust (VCT) managed by Northern Venture Managers. The trust was launched in 1999 through a public offer which raised £22 million; a further £22 million was raised in a second public offer in 2001. The trust invests mainly in unquoted venture capital holdings and aims to provide high long-term returns to shareholders through a combination of dividend yield and capital growth.

KEY DATES

Results announced	9 March 2006
Shares quoted ex dividend	22 March 2006
Annual general meeting	18 May 2006 (10.30am, Vermont Hotel, Newcastle upon Tyne)
Final dividend paid (to shareholders on register on 24 March 2006)	2 June 2006

Financial Summary

Year ended 31 January	2006	2005 As re-stated
Net assets*	£38,675,000	£40,272,000
Net asset value per share*	90.4p	91.0p
Investment income	£2,226,000	£2,074,000
Return on ordinary activities before tax		
Revenue	£1,736,000	£1,558,000
Capital	£(984,000)	£(729,000)
Total	£752,000	£829,000
Return per share		
Revenue	2.9p	2.5p
Capital	(1.4)p	(0.9)p
Total	1.5p	1.6p
Dividend per share		
Revenue	2.5p	2.5p
Capital	3.0p	6.3p
Total	5.5p	8.8p
Cumulative return to shareholders since launch		
Dividends per share**	27.9p	22.4p
Net asset value plus dividends per share	113.8p	111.9p
Share price at end of year	80.0p	80.0p

* Before deducting proposed final dividend

** Including proposed final dividend

Chairman's Statement

The past year has brought some successes and some disappointments. The reported net asset value per share fell slightly from last year's figure of 91.0p (re-stated from 89.7p as a result of changes in accounting policy) to 90.4p at 31 January 2006. Income generation from the investment portfolio was strong but the level of realised gains from investment sales was less than in the preceding year.

The performance chart in the directors' remuneration report on page 21 shows that over five years the company's net asset value and share price have continued to out-perform the FTSE All-Share index on a total return basis.

Presentation of results

The year under review has brought further changes in the way in which we present our financial statements, in response to the harmonisation of UK accounting practice with international standards. Full details of the changes and their implications are given in the notes to the financial statements. The most prominent consequence is that the year-end net asset value is now stated before deducting the proposed final dividend for the year. I will leave it to shareholders to form their own view as to whether the new regime is more informative than the old.

Investment portfolio

During the year eight new venture capital investments were completed and the portfolio at 31 January 2006 comprised 54 holdings with a total value of almost £30 million. Exit activity was down on the previous year's high level, though satisfactory realisations were achieved by Omnico Plastics and Crabtree of

Gateshead. Oxonica was successfully floated on the Alternative Investment Market. The overall performance of the portfolio was however adversely affected by the failure of VPTA and SMS Agencies.

Developments in the portfolio are discussed in more detail in the Investment Manager's Review. NVM has added considerable new resource to its investment team over the past 18 months and we expect to see this reflected in future results.

Revenue and dividends

Through a combination of increased investment income and lower running expenses, the revenue surplus before tax for the year increased by 11% to £1,736,000. As a result the revenue return per share rose from 2.5p to 2.9p. The revenue dividend has been maintained at 2.5p for the fifth year in succession. By realising gains from the venture capital portfolio we have also been able to declare capital dividends totalling 3.0p per share (last year 6.3p). The total dividend of 5.5p per share for the year comprises an interim dividend of 1.0p per share which was paid in December 2005 and a proposed final dividend of 4.5p per share which will, if approved by shareholders at the annual general meeting, be paid on 2 June 2006.

The tax-free total dividend of 5.5p is equivalent to a 9.2% gross yield to a higher-rate taxpayer subscribing for shares at 100p, and 11.5% if the 20% income tax relief on subscriptions obtained by subscribers in 1999 is taken into account. The cumulative total of dividends declared by the company over seven years is 27.9p per share, which is an average of just under 4.0p per year.

Continuation vote and proposed share issue

In February 2006 shareholders received a circular from the company containing information about two resolutions to be considered at an extraordinary general meeting on 9 March 2006. The first resolution was to amend the Articles of Association so that the next shareholder vote on continuation of the company will take place in 2011 rather than at the annual general meeting in May 2006, thus in effect extending the life of the company for a further

Chairman's Statement

five years. The second resolution was to authorise the directors to allot up to 11,000,000 new ordinary shares, in order that we can launch a "top-up" issue of ordinary shares which will be open for subscription in the 2005/06 tax year. As stated in the circular, the present tax reliefs on investment in VCTs are due to continue only until 5 April 2006 and the Chancellor of the Exchequer has not yet announced what, if any, changes will apply thereafter, so your directors felt it was important to be in a position to raise additional funds in the current tax year. It would clearly be inappropriate to proceed with this without certainty as to the future continuation of the company.

I am pleased to report that at the extraordinary general meeting both resolutions were passed by a wide margin; a prospectus setting out details of the share issue will be published in the near future and copies will be sent to all shareholders. If the share issue is fully subscribed the company's net assets will increase to approximately £48 million.

Management arrangements

The February 2006 shareholder circular also contained details of new management fee and performance incentive arrangements entered into between the company and NVM. Following a thorough review of the existing arrangements, your board decided to establish a co-investment scheme under which NVM executives are required to invest personally in the ordinary shares of companies, including those quoted on AIM, in which Northern 2 VCT invests. We believe this will benefit shareholders by enhancing NVM's ability to recruit and retain high-calibre investment executives in a competitive market environment. At the same time we took the opportunity to reduce the fixed element of NVM's annual management fee from 2.5% to 2.0% of net assets, whilst introducing a new performance-related element linked to future net asset growth and dividend generation.

Share buy-backs and market liquidity

During the year the company bought back for cancellation 1,583,148 shares, equivalent to approximately 3.6% of the issued capital at the start of the year, at an average price of 79p per share. A resolution will as usual be proposed at the annual general meeting to renew the board's authority to make market purchases of shares. The secondary market for VCT shares has remained depressed over the past year and it will be interesting to see what effect the Chancellor's forthcoming announcement on future tax reliefs has on the relative attractions of new and second-hand VCT shares.

VCT qualifying status

The company has continued to retain PricewaterhouseCoopers LLP as advisers on VCT taxation matters, and has throughout the year met the qualifying conditions laid down by HM Revenue & Customs for approval as a VCT.

The future

The future of the VCT sector is subject to some uncertainty as we await the Chancellor's Budget announcement on 22 March. VCTs have made a substantial contribution to business enterprise in the UK over the past decade and I hope that any changes to the VCT regulations will be gradual and judicious.

Our company is now well established, and the forthcoming share issue should ensure that liquid resources are sufficient for our investment requirements for the foreseeable future. As we begin the next five year cycle in our corporate life, we remain focussed on producing a strong dividend flow and asset growth for shareholders.

Dr Matt Ridley
Chairman

Directors

Dr Matt Ridley (Chairman), aged 48, is an author and businessman and was formerly science editor and American editor of The Economist. He is chairman of Northern Rock plc and a non-executive director of Northern Investors Company PLC.

Alastair Conn FCA, aged 50, is managing director of Northern Venture Managers Limited. He qualified as a chartered accountant with Price Waterhouse and was a co-founder of Northern Venture Managers in 1988. He is a non-executive director of Northern AIM VCT PLC.

Michael Denny MSI, aged 62, is the chairman of Northern Venture Managers Limited and was previously North-East region director of the National Enterprise Board. He is a non-executive director of Northern Investors Company PLC, Northern Venture Trust PLC and Deep-Sea Leisure PLC and is a past chairman of the British Venture Capital Association.

Christopher Fletcher CA, aged 54, is managing director of Baillie Gifford's life and retail operations. He previously spent ten years as a corporate finance partner in the Edinburgh office of KPMG, where he advised on a wide variety of business transactions.

Professor Sir Frederick Holliday CBE FRSE, aged 70, is chairman of Northumbrian Water Group plc and Northern Venture Trust PLC. He was formerly chairman of Brewin Dolphin Holdings plc and The Go-Ahead Group plc. He is a marine scientist and was vice-chancellor of the University of Durham from 1980 to 1990.

Frank Neale MBA, aged 55, is a partner in IRRfc, a private equity portfolio management business. He is a past vice-chairman of the British Venture Capital Association and is a director of a number of venture capital backed companies.

Advisers

Secretary and Registered Office

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Registered Number

3695071

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Edinburgh EH1 2EG

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SJ Berwin LLP
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Stockbroker

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Newcastle upon Tyne NE1 6RQ

Bankers

Barclays Bank PLC
71 Grey Street
Newcastle upon Tyne NE99 1JP

Registrars

Lloyds TSB Registrars
The Causeway
Worthing BN99 6DA
Shareholder helpline: 0870 601 5366

Investment Manager's Review

The investment process

Northern Venture Managers (NVM) currently receives over 40 new investment enquiries each month through its offices in Newcastle upon Tyne, Edinburgh and Reading. Many of these are eliminated in the initial screening process, but if the initial impression is positive then NVM will make a proposal to the enquirer setting out some broad terms and conditions for an investment. If the proposal is accepted, NVM carries out a detailed "due diligence" investigation into key aspects of the business, using specialist external advisers supported by NVM executives as appropriate. Once due diligence is complete, a comprehensive report is presented to the NVM board for discussion and decision; if the investment is approved, legal completion usually follows closely thereafter. The whole process typically takes between eight and ten weeks.

Northern 2 VCT is entitled to be offered participation in every investment proposal developed by NVM, and in the majority of cases the company co-invests alongside other funds managed by NVM.

Post-investment monitoring

On completion of a new investment one of NVM's executives takes responsibility for the ongoing

relationship with the investee company, often by taking a board position as a non-executive director. When appropriate, for instance where a particular area of expertise is called for, an external non-executive director will be brought in. The director will play a key role and must be able to contribute to the strategic development of the business, usually over a period of several years, so that the long-term objectives of all the shareholders can be met.

NVM monitors the progress of each investment carefully through well-established monthly reporting procedures, and NVM's monitoring reports are in turn reviewed on a regular basis by the board of Northern 2 VCT.

Overview of the year

Over the year to 31 January 2006 Northern 2 VCT achieved a total return to shareholders of 1.9p per share, equivalent to 2.1% of the opening net asset value (net of proposed dividends) of 89.5p. The movement in net asset value during the year is summarised in the table below.

Investment activity

During the year eight new holdings were added to the venture capital portfolio at a cost of £3.9 million, and existing investments received follow-on funding totalling £0.4 million.

	£000	Pence per share
Net asset value at 31 January 2005 after dividends for the year	39,609	89.5
Net revenue (investment income less revenue expenses and tax)	1,281	2.9
Capital surplus arising on investments:		
Realised losses on disposals	(388)	(0.9)
Unrealised revaluation movements	265	0.6
Management expenses allocated to capital account (net of tax relief)	(509)	(1.1)
Shares issued (net of expenses)	97	—
Shares re-purchased for cancellation	(1,251)	0.4
Net asset value at 31 January 2006 before dividends	39,104	91.4
Dividends paid and proposed in respect of the year	(2,354)	(5.5)
Net asset value at 31 January 2006 after dividends	36,750	85.9

Investment Manager's Review

The new investments completed during the year were:

- **e-know.net** (£435,000) - application service provider, Telford
- **Daniolabs** (£145,000) - development of therapeutics for neurological and ophthalmological diseases, Cambridge
- **Spectrum Interactive** (£310,000) - AiM-quoted operator of payphones and public access internet terminals, Hemel Hempstead
- **Ithaca Holdings** (£594,000) - integrated business-to-business media and exhibitions company, London
- **Abermed Group** (£725,000) - provider of medical and occupational health services, Aberdeen
- **KCS Global Holdings** (£702,000) - developer of human resources and payroll software and outsourcing services, Purley
- **Pivotal Laboratories Holdings** (£857,000) - provider of laboratory analysis services for clinical trials, York

- **Inspicio** (£100,000) - AiM-quoted provider of testing, inspection and performance continuity services, London

Additional investments were made in **Computer Software Group** (£265,000) and **IRIS Technology** (£133,000).

After a quiet second half of the year the rate of new investment activity appears to be picking up again, with one new deal completed since the year end and two others in the later stages of due diligence.

Investment realisations

Realisations in the venture capital portfolio during the year are summarised in the table below.

Crabtree of Gateshead was sold to its management team in September 2005 through a bank-financed secondary buy-out, with NVM's funds making a complete exit. **Omnico Plastics** was acquired for cash by SIG plc in November 2005. The investment in **PrismTech**, which had been fully provided against in 2003 to reflect disappointing progress, was eventually sold for cash to a new management buy-out vehicle in March 2005. NVM's funds did not

Company	Year of original investment	Original cost £000	Sale proceeds £000	Realised gain/(loss) £000
Unquoted				
CQC - loan stock redemption	1999	150	150	—
Crabtree of Gateshead	2003	468	771	303
Keith Prowse - deferred sale consideration	2002	—	67	67
Omnico Plastics	2004	846	1,671	825
PrismTech	2000	743	121	(622)
Quadstone	2000	250	—	(250)
VPTA	1999	781	—	(781)
Widney - loan stock redemption	1999	233	233	—
Other		55	59	4
Quoted				
Alizyme	2000	54	121	67
BBI Holdings	2000	144	430	286
BioFocus	2000	159	62	(97)
Total		3,883	3,685	(198)

Investment Manager's Review

invest in the new company but have a small holding of warrants to subscribe for ordinary shares in the future. Quadstone, which had also been fully provided against, was acquired by a trade buyer on terms which did not attribute any value to the investment. VPTA (formerly Tolwood) was placed in administration in October 2005 shortly after the emergence of significant discrepancies between the company's real performance and that which had been reported to the investors. Investigations into the circumstances are still in progress but the bulk of the investment has been written off.

Portfolio review

The venture capital portfolio at 31 January 2006 comprised 54 holdings with an aggregate value of £29.8 million. A summary of the holdings at 31 January 2006 is given on page 10, with information on the fifteen largest investments on pages 11 to 14.

The pie charts at the foot of pages 8 and 9 show the composition of the investment portfolio at 31 January 2006 according to age, industry sector, financing stage and whether quoted or unquoted. The portfolio is well diversified and it remains our objective to invest primarily in businesses which meet our key criteria of good value, strong management and ability to generate cash.

In the unquoted portfolio there have been mixed results this year, with some companies failing to progress in line with expectations. This has resulted in reductions in valuation for Aiza, DMN, Stainton Metal Company and West's Engineering Design.

SMS Agencies, a recruitment business in which we invested in 2004, fell behind plan almost from the outset and has been unable to agree continuing facilities with its bankers, resulting in the appointment of administrators in February 2006. Full provision has been made against the investment at 31 January 2006 although it is possible that a partial recovery will be achieved. Improved performance has resulted in valuation uplifts for Interlube Systems, Alaric Systems, Crantock Bakery, John Laing Partnership, IG Doors, Warmseal Windows (Newcastle), AFI Aerial Platforms and Arleigh International. We are currently in active discussions with a view to sale or flotation of several companies.

The quoted investments in the portfolio have generally performed satisfactorily, with particularly strong share price rises during the year from Vectura Group (up 45%) and Colliers CRE (up 32%). The investment in BBI Holdings, which floated on AiM in 2004, was sold in full. Oxonica floated on AiM in July 2005 and has made good progress, although along with the other venture capital investors we have agreed not to sell our holding before July 2006.

Valuation policy

Unquoted investments are valued in accordance with the accounting policy set out on page 29, which takes account of the British Venture Capital Association's guidelines for the valuation of venture capital portfolios. Provision against cost is made where an investment is under-performing significantly, and no investment is revalued upwards within 12 months of its acquisition.

Investment Manager's Review

As at 31 January 2006 the number of investments falling into each valuation category was as follows:

Category	Number of investments	Valuation £000	% of portfolio by value
Quoted investments at bid price			
Listed on London Stock Exchange	1	396	1.3
Quoted on Alternative Investment Market	13	4,152	13.9
Unquoted investments at directors' valuation			
Original cost	15	10,024	33.7
Original cost less provision	10	1,319	4.4
Third party transaction	3	2,226	7.5
Earnings multiple	12	11,690	39.2
Total	54	29,807	100.0

Listed fixed-interest portfolio

Chiswell Associates Limited, part of the Sarasin Chiswell group, have continued to manage the company's portfolio of listed fixed-interest investments. The funds held in the portfolio reduced by approximately £1 million during the year to accommodate liquidity requirements.

VCT qualifying status

The company has continued to comply with HM Revenue & Customs' conditions for VCT approval. The principal requirements are that at least 70% of the company's investments should comprise VCT-qualifying holdings and that at least 30% of the qualifying holdings should be in ordinary shares. Both conditions were satisfied throughout the year. The directors keep the company's VCT status under careful review with the assistance of PricewaterhouseCoopers LLP, who have been retained to report regularly to the board on VCT compliance.

Outlook

The UK economy appears to have emerged from a period of falling growth rates in 2004 and early 2005, although recent increases in energy and raw materials prices are a cause for concern. NVM has continued to build up its executive team through new recruitment and internal development and this is reflected in our well-established position in our target market of UK unquoted investments in the range up to £5 million; we were one of three firms short-listed by *unquote* magazine for its 2005 Small Buy-out House of the Year award. The challenge for the year ahead is to keep up a healthy rate of new investment whilst maintaining quality standards and continuing to work actively with the existing portfolio.

Alastair Conn

Managing Director,
Northern Venture Managers Limited

Investment Portfolio

as at 31 January 2006

	Cost £000	Valuation £000	% of net assets by value
Fifteen largest venture capital investments (see pages 11 to 14)			
DMN	1,145	1,600	4.1
Crantock Bakery	1,107	1,491	3.9
Longhirst Group	1,440	1,484	3.8
Computer Software Group**	666	1,337	3.5
IG Doors	1,000	1,316	3.4
Stainton Metal Company	1,002	1,118	2.9
Arrow Industrial Group	735	1,099	2.8
Warmseal Windows (Newcastle)	818	1,082	2.8
Envirotec	975	975	2.5
John Laing Partnership	507	925	2.4
Alaric Systems	921	921	2.4
Direct Valeting	915	915	2.4
Pivotal Laboratories Holdings	857	857	2.2
LEDA Holdings	825	825	2.1
IRIS Technology	797	797	2.1
	13,710	16,742	43.3
Other venture capital investments			
Interlube Systems	500	782	2.1
Abermed Group	725	725	1.9
Arleigh International	435	722	1.9
KCS Global Holdings	702	702	1.8
TFB Group	700	700	1.8
RBF Industries	650	650	1.7
S&P Coil Products	620	620	1.6
Liquidlogic	564	607	1.6
Ithaca Holdings	594	594	1.6
DxS	604	582	1.5
GB Industries	1,097	548	1.4
AFI Aerial Platforms	248	510	1.3
Colliers CRE**	310	506	1.3
Barony Universal Products	146	438	1.1
Vectura Group**	234	435	1.1
e-know.net	435	435	1.1
PM Group**	172	435	1.1
Alizyme*	165	396	1.0
Cello Group**	251	284	0.7
Andor Technology**	201	245	0.6
Oxonica**	145	241	0.6
John Fredericks Plastics	907	227	0.6
Spectrum Interactive**	310	217	0.6
Widney**	90	169	0.4
CQC	163	163	0.4
VPTA	160	160	0.4
Daniolabs	145	145	0.4
Arrow Therapeutics	289	145	0.4
Fountains**	166	143	0.4
West's Engineering Design	480	120	0.3
Inspicio**	100	117	0.3
Survey Inspection Systems	195	98	0.3
Aiza	374	93	0.2
Lorantis Holdings	350	88	0.2
Bank Restaurant Group**	250	22	0.1
Warthog**	199	1	—
OnMedica Group	300	—	—
GSM-Central	192	—	—
SMS Agencies	1,000	—	—
Total venture capital investments	28,878	29,807	77.1
Listed fixed-interest investments			
Tesco 6% 2006	1,499	1,514	3.9
AIG SunAmerica 4 ³ / ₈ % 2008	1,226	1,237	3.2
Pacific Life Funding 6 ¹ / ₈ % 2006	1,099	1,106	2.9
Wells Fargo & Co 4 ³ / ₄ % 2010	997	998	2.6
Metropolitan Life Global Fund 5 ¹ / ₄ % 2008	651	658	1.7
West LB Finance 8 ¹ / ₈ % 2007	509	516	1.3
Total listed fixed-interest investments	5,981	6,029	15.6
Total fixed asset investments	34,859	35,836	92.7
Net current assets		2,839	7.3
Net assets		38,675	100.0

* Listed on London Stock Exchange

** Quoted on Alternative Investment Market

Fifteen Largest Venture Capital Investments

DMN LIMITED

Cost	£1,145,000	Audited financial information:		
Valuation	£1,600,000			
Basis of valuation	Earnings multiple	Year ended 31 December	2004 £m	2003 £m
Equity held	12.0%			
Business/location	Infrastructure installation for mobile telephone operators, Shrivenham	Sales	15.4	20.3
History	Management buy-out from private ownership, September 2001, led by NVM	Profit before tax	0.8	3.8
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern AIM VCT	Retained profit	0.5	2.4
Income in year	Dividends nil, loan stock interest £77,000	Net assets	4.9	4.3

CRANTOCK BAKERY LIMITED

Cost	£1,107,000	Audited financial information:		
Valuation	£1,491,000			
Basis of valuation	Earnings multiple	Year ended 30 September	2004 £m	2003 £m
Equity held	15.4%			
Business/location	Manufacture of premium hand-made Cornish pasties, Newquay	Sales	5.6	4.7
History	Management buy-in from private ownership, October 2002, led by NVM	Profit before tax	—	0.2
Other NVM funds investing	Northern Investors Company, Northern AIM VCT, Northern 3 VCT	Retained (loss)/profit	(0.1)	0.1
Income in year	Dividends nil, loan stock interest £121,000	Net assets	0.8	0.9

LONGHIRST GROUP LIMITED

Cost	£1,440,000	Audited financial information:		
Valuation	£1,484,000			
Basis of valuation	Latest funding round	Year ended 31 March	2005 £m	2004 £m
Equity held	17.6%			
Business/location	Provision of training and conference facilities, Morpeth	Sales	16.8	8.7
History	Management buy-out from public sector ownership, December 2002, led by NVM	Profit before tax	0.5	0.3
Other NVM funds investing	Northern Investors Company, Northern AIM VCT, Northern 3 VCT	Retained profit	0.1	0.2
Income in year	Dividends £68,000, loan stock interest £54,000	Net assets	3.1	1.5

COMPUTER SOFTWARE GROUP PLC

Cost	£666,000	Audited financial information:		
Valuation	£1,337,000			
Basis of valuation	Bid price (AiM)	Year ended 28 February	2005 £m	2004 £m
Equity held	2.9%			
Business/location	Computer software for ticketing and accounting applications, London	Sales	14.1	6.3
History	Holding acquired through share-for-share offer for Chorus Application Software Limited, May 2003	Profit/(loss) before tax	0.9	(0.3)
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern AIM VCT, Northern 3 VCT	Retained profit	1.3	0.1
Income in year	Nil	Net assets	17.6	6.3

Fifteen Largest Venture Capital Investments

IG DOORS LIMITED

Cost	£1,000,000	Audited financial information:	
Valuation	£1,316,000		
Basis of valuation	Earnings multiple	Period ended 31 December	2004*
Equity held	10.0%		£m
Business/location	Manufacture of steel and GRP composite doors, Cwmbran	Sales	19.0
History	Management buy-out from Expamet International, November 2003, led by NVM	Loss before tax	(0.5)
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern AIM VCT, Northern 3 VCT	Retained loss	(0.4)
Income in year	Dividends nil, loan stock interest £129,000	Net assets	0.3
		*14 months ended 31 December	

STAINTON METAL COMPANY LIMITED

Cost	£1,002,000	Audited financial information:		
Valuation	£1,118,000			
Basis of valuation	Earnings multiple	Year ended 30 September	2004	2003
Equity held	14.2%		£m	£m
Business/location	Manufacture of metal lamp posts and lighting columns, Stockton-on-Tees	Sales	12.6	12.8
History	Management buy-out from Canadian corporation, October 2001, led by NVM	Profit before tax	1.3	1.1
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern AIM VCT	Retained profit	0.6	0.3
Income in year	Dividends nil, loan stock interest £74,000	Net assets	2.3	1.7

ARROW INDUSTRIAL GROUP LIMITED

Cost	£735,000	Audited financial information:		
Valuation	£1,099,000			
Basis of valuation	Earnings multiple	Year ended 30 September	2004	2003
Equity held	16.8%		£m	£m
Business/location	Manufacture of industrial doors and curtains, Hull	Sales	4.6	3.6
History	Management buy-in from private ownership, October 2002, led by NVM	Profit before tax	0.4	0.1
Other NVM funds investing	Northern Investors Company, Northern 3 VCT	Retained profit	0.2	—
Income in year	Dividends nil, loan stock interest £52,000	Net assets	1.2	1.0

WARMSEAL WINDOWS (NEWCASTLE) LIMITED

Cost	£818,000	Audited financial information:		
Valuation	£1,082,000			
Basis of valuation	Earnings multiple	Year ended 30 June	2005	2004*
Equity held	14.8%		£m	£m
Business/location	Manufacturer and supplier of PVCu windows, doors and conservatories, Newcastle upon Tyne	Sales	11.2	4.7
History	Management buy-out from private ownership, December 2003, led by NVM	Profit/(loss) before tax	0.2	(0.1)
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT	Retained profit/(loss)	0.1	(0.1)
Income in year	Dividends nil, loan stock interest £80,000	Net assets	0.4	0.3
		*6 months ended 30 June		

Fifteen Largest Venture Capital Investments

ENVIROTEC LIMITED

Cost	£975,000	Audited financial information:	
Valuation	£975,000		
Basis of valuation	Cost	Period ended 28 February	2005*
Equity held	10.5%		£m
Business/location	Manufacture of hot air curtains and air handling equipment, High Wycombe	Sales	0.7
History	Management buy-out from institutional investor, January 2005, led by NVM	Profit before tax	0.1
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT	Retained profit	—
Income in year	Dividends nil, loan stock interest £84,000	Net assets	0.9
		*2 months ended 28 February	

JOHN LAING PARTNERSHIP LIMITED

Cost	£507,000	Audited financial information:	
Valuation	£925,000		
Basis of valuation	Earnings multiple	Period ended 31 December	2004*
Equity held	8.2%		£m
Business/location	Housebuilder, Elstree	Sales	64.8
History	Management buy-out from John Laing plc, September 2003, led by NVM	Profit before tax	0.1
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT, Northern AIM VCT	Retained profit	0.1
Income in year	Dividends nil, loan stock interest £28,000	Net assets	0.8
		*16 months ended 31 December	

ALARIC SYSTEMS LIMITED

Cost	£921,000	Audited financial information:		
Valuation	£921,000			
Basis of valuation	Cost	Year ended 31 March	2005	2004
Equity held	7.9%		£m	£m
Business/location	Developer of electronic payment protection software, London	Sales	2.8	2.2
History	Development capital financing in November 2000, led by NVM	Loss before tax	(0.6)	(0.8)
Other NVM funds investing	Northern Investors Company, Northern Venture Trust	Retained loss	(0.5)	(0.5)
Income in year	Dividends nil, loan stock interest £2,000	Net (liabilities)/assets	(0.3)	0.2

DIRECT VALETING LIMITED

Cost	£915,000	Audited financial information:	
Valuation	£915,000		
Basis of valuation	Cost	First audited accounts will be for the period to 31 July 2005	
Equity held	15.0%		
Business/location	Outsourced car valeting, Newcastle-under-Lyme		
History	Management buy-out from private ownership, November 2004, led by NVM		
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT		
Income in year	Dividends £52,000, loan stock interest £41,000		

Fifteen Largest Venture Capital Investments

PIVOTAL LABORATORIES HOLDINGS LIMITED

Cost	£857,000	Audited financial information:
Valuation	£857,000	
Basis of valuation	Cost	First audited accounts will be for the period to
Equity held	11.0%	31 October 2005
Business/location	Laboratory analysis service for clinical trials, York	
History	Management buy-out from private ownership, August 2005, led by NVM	
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT, Northern AIM VCT	
Income in year	Dividends nil, loan stock interest £16,000	

LEDA HOLDINGS LIMITED

Cost	£825,000	Audited financial information:	
Valuation	£825,000		
Basis of valuation	Cost	Year ended 31 March	2005
Equity held	15.0%		£m
Business/location	Provider of temporary staff to construction, industrial and engineering sectors, Leeds	Sales	18.1
History		Profit before tax	0.6
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 3 VCT	Retained profit	0.4
Income in year	Dividends £6,000, loan stock interest £71,000	Net assets	0.2

IRIS TECHNOLOGY LIMITED

Cost	£797,000	Audited financial information:		
Valuation	£797,000			
Basis of valuation	Cost	Year ended 31 January	2005	2004
Equity held	13.7%		£m	£m
Business/location	Remote telemetry data transmission systems, Lancaster	Sales	0.2	0.2
History	Development capital financing in February 2002, led by NVM	Loss before tax	(0.6)	(0.6)
Other NVM funds investing	Northern Investors Company, Northern Venture Trust	Retained loss	(0.5)	(0.6)
Income in year	Nil	Net liabilities	(1.1)	(0.6)

Shareholder Information

The Company

Northern 2 VCT PLC is a Venture Capital Trust (VCT) launched in January 1999 through an offer for subscription which raised £22 million. In January 2001 a second public offer raised a further £22 million. The trust invests mainly in unquoted venture capital holdings, with its remaining assets invested in a portfolio of listed fixed-interest investments and bank deposits.

Northern 2 VCT PLC is managed by Northern Venture Managers Limited (NVM), an independent specialist firm of venture capital managers based in Newcastle upon Tyne, Edinburgh and Reading. NVM also acts as manager of four other listed investment companies, Northern Investors Company PLC, Northern Venture Trust PLC, Northern AIM VCT PLC and Northern 3 VCT PLC, and has a total of over £160 million under management.

Venture Capital Trusts

Venture Capital Trusts (VCTs) were introduced by the Chancellor of the Exchequer in the November 1994 Budget, the relevant legislation being contained in the Finance Act 1995. VCTs are intended to provide a means whereby private individuals can invest in small unquoted trading companies in the UK, with an incentive in the form of a range of tax benefits. With effect from 6 April 2004, the benefits to eligible investors include:

- income tax relief at up to 40% on new subscriptions of up to £200,000 per tax year, provided the shares are held for at least three years;
- exemption from income tax on dividends paid by VCTs (such dividends may include the VCT's capital gains as well as its income); and
- exemption from capital gains tax on disposals of shares in VCTs.

Prior to 6 April 2004, subscribers for shares in VCTs were entitled to income tax relief at 20% rather than 40% and could also obtain capital gains deferral relief. Capital gains deferred by pre-6 April 2004 subscriptions are not affected by the subsequent changes in tax relief.

In order to maintain its approval by HM Revenue & Customs as a VCT, Northern 2 VCT PLC must comply with certain requirements on a continuing

basis; in particular, within three years from the date of provisional approval at least 70% of the company's investments must comprise "qualifying holdings", of which at least 30% must be in eligible ordinary shares. Where a VCT's original share issue is subsequently followed by further issues, the investments made using the proceeds of the further issues may be disregarded for the purpose of the 70% and 30% tests in all financial years ending no later than three years after the relevant share issue. A "qualifying holding" consists of up to £1 million invested in any one year in new shares or securities in an unquoted company (including companies quoted on AiM) which is carrying on a qualifying trade and whose gross assets do not exceed £15 million at the time of investment. The definition of "qualifying trade" excludes certain activities such as property investment and development, financial services and asset leasing.

Financial calendar

The company's financial calendar for the year ending 31 January 2007 is as follows:

September 2006	Interim report for six months to 31 July 2006 published
December 2006	Interim dividend paid
April 2007	Final dividend and preliminary results for year to 31 January 2007 announced; annual report and financial statements published
May 2007	Annual general meeting
June 2007	Final dividend paid

Share price

The company's share price is carried daily in the Financial Times, the Daily Telegraph, the Newcastle Journal and The Herald. The company's FT-SE Actuaries classification is "Investment Companies".

Share price information can also be obtained via the NVM website at www.nvm.co.uk.

Dividend investment scheme

The company operates a dividend investment scheme, giving shareholders the option of reinvesting their dividends in new shares in the company with the benefit of the VCT tax reliefs available at the time of re-investment. Information about the scheme can be obtained from the Company Secretary (see page 5 for contact details).

Directors' Report

The directors present their report and the audited financial statements for the year ended 31 January 2006.

Activities and status

The principal activity of the company during the year was the making of long-term equity and loan investments, mainly in unquoted companies. The company was an investment company as defined in Section 266 of the Companies Act 1985 until 1 April 2004 when investment company status was revoked in order to permit the distribution of capital profits.

The company has been approved as a venture capital trust by HM Revenue & Customs and has been listed on the London Stock Exchange since April 1999. The Chairman's statement on pages 2 and 3 includes a review of developments during the year and of future prospects.

The directors have managed the affairs of the company with the intention of maintaining its status as an approved venture capital trust for the purposes of Section 842AA of the Income and Corporation Taxes Act 1988. The directors consider that the company was not at any time up to the date of this report a close company within the meaning of Section 414 of that Act.

The directors are required by the Articles of Association, as amended at the extraordinary general meeting on 9 March 2006, to propose an ordinary resolution at the company's annual general meeting in 2011 that the company should continue to operate as a venture capital trust and, if passed, at each fifth subsequent annual general meeting thereafter. If any such resolution is not passed, the directors shall within four months convene an extraordinary general meeting to consider proposals for the reorganisation or winding-up of the company.

Results and dividend

The return on ordinary activities after tax for the year of £649,000 has been transferred to reserves.

The final dividend of 1.5p per share in respect of the year ended 31 January 2005 and an interim dividend of 1.0p per share in respect of the year ended 31 January 2006 were paid during the year at a cost of £1,092,000 and have been charged to reserves.

The proposed final dividend of 4.5p per share for the year ended 31 January 2006 will, if approved by shareholders, be paid on 2 June 2006 to shareholders on the register on 24 March 2006.

Directors

The directors of the company during the year and their interests in the issued ordinary shares of 5p of the company were as follows:

	31 January 2006	1 February 2005
M W Ridley (Chairman)	210,686	207,891
A M Conn	110,928	107,891
E M P Denny	25,000	25,000
C G A Fletcher	40,504	40,504
Sir Frederick Holliday	10,100	10,100
F L G Neale	55,464	53,945

All of the directors' share interests shown above were held beneficially. There have been no changes in the directors' share interests between 31 January 2006 and the date of this report.

Brief biographical notes on the directors are given on page 4. Mr C G A Fletcher and Mr F L G Neale retire from the board by rotation in accordance with the Articles of Association and offer themselves for re-election.

Directors' Report

None of the directors has a contract of service with the company and, except as mentioned below under the heading "Management", no contract or arrangement subsisted during or at the end of the year in which any director was materially interested and which was significant in relation to the company's business.

Directors' and officers' liability insurance

The company has, as permitted by Section 310(3) of the Companies Act 1985, maintained insurance cover on behalf of the directors and secretary indemnifying them against certain liabilities which may be incurred by them in relation to the company.

Creditor payment policy

The company's payment policy for the forthcoming financial year is to agree terms of payment before business is transacted and to settle accounts in accordance with those terms. There were no amounts owing to trade creditors at 31 January 2006.

Management

Northern Venture Managers Limited (NVM) has acted as investment adviser and manager to the company since April 1999. The principal terms of the company's management agreement with NVM are set out in Note 4 to the financial statements. Mr A M Conn and Mr E M P Denny are executive directors of NVM and shareholders in its ultimate parent company, NVM Group Limited.

As mentioned in the Chairman's Statement, the management performance share option scheme has been terminated and has been replaced by a co-investment scheme under which investment executives employed by NVM will be required to invest personally (and on the same terms as Northern 2 VCT and other funds managed by NVM) in the ordinary share capital of investee companies in which the company invests. The co-investing executives will be required to subscribe as follows:

- where the investment comprises a mixture of ordinary shares and loans or redeemable preference shares, 5% of the aggregate amounts

invested in ordinary shares at the same time by the company; or

- where the investment is structured entirely as ordinary shares (including investments quoted on AiM), 1% of the aggregate amount invested at the same time by the company; or
- where a further investment is made in an existing portfolio company, 1% of the entire investment "strip" (ie ordinary shares and any other investment instruments) invested at the same time by the company.

All investments in unquoted companies made by executives under the scheme will be realised at the same time as, and on the same terms as, the corresponding investments made by the company.

Share capital

During the year the company purchased for cancellation 1,583,148 of its own shares, representing 3.6% of the called-up share capital of the company, for a consideration of £1,251,000. 126,210 new ordinary shares of 5p were issued for a cash consideration of £112,000 through the company's dividend investment scheme.

Fixed assets

Movements in fixed asset investments during the year are set out in Note 9 to the financial statements.

Substantial shareholdings

So far as the directors are aware, there were no individual shareholdings representing 3% or more of the company's issued share capital at the date of this report.

Annual general meeting - special business

Renewal of directors' authority to allot shares

Resolution 9 in the notice of meeting on pages 41 and 42, which will be proposed as an ordinary resolution, is to renew the general authority granted to the directors at the annual general meeting held on 19 May 2005. This resolution, if passed, gives the directors authority to allot shares up to a

Directors' Report

maximum nominal value of £860,633 (representing 40.2% of the issued share capital of the company at the date of the notice convening the annual general meeting). This authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in May 2007) or, if earlier, 15 months from the date of the passing of the resolution.

Disapplication of pre-emption rights

Resolution 10, which will be proposed as a special resolution, supplements the directors' authority to allot shares in the company given to them by Resolution 9. The resolution, if passed, substitutes any power previously conferred upon the directors (save to the extent relied upon prior to the passing of Resolution 10) and authorises the directors to allot equity shares for cash otherwise than pro rata to existing shareholders and pursuant to the authority granted to the directors at the extraordinary general meeting held on 9 March 2006 up to a total nominal value of the lower of £763,936 (representing the aggregate of (i) the nominal value of 10% of the company's issued share capital at the date of the notice convening the annual general meeting and (ii) the nominal value of 11,000,000 equity shares to be allotted pursuant to the authority granted to the directors at the extraordinary general meeting held on 9 March 2006) and the then existing unissued share capital of the company as if Section 89(1) of the Companies Act 1985 did not apply.

The authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in May 2007) or, if earlier, 15 months from the date of the passing of the resolution.

Purchase of ordinary shares by the company

Resolution 11, which will be proposed as a special resolution, will, if passed, authorise the company to purchase in the market up to 4,278,732 ordinary shares, equivalent to 10% of the issued share capital, at a minimum price of 5p per share and a maximum price per share of not more than the

higher of 105% of the average market value for the ordinary shares of the company for the five business days prior to the date on which the ordinary shares are purchased and that stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation. Unless previously renewed, varied or revoked, the authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in May 2007) or, if earlier, 15 months from the date of the passing of the resolution.

It is the directors' intention that purchases will be made in the market for cash only at prices below the prevailing net asset value per share, thereby enhancing the net asset value per share for the company's remaining shareholders. Purchases will be financed from the company's own cash resources or, if appropriate, from short-term borrowings.

Under the Listing Rules, the maximum price which can be paid by the company is the higher of 105% of the average market value of the ordinary shares of the company for the five business days prior to the date on which the ordinary shares are purchased and that stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation. The purchase of shares will involve a stamp duty cost to the company of approximately 0.5% of the purchase price. Shares which are purchased will be cancelled (and the number of the company's shares in issue will be reduced accordingly), subject to the restrictions set out in Resolution 10 or its equivalent in force at the time.

In accordance with the Listing Rules, no purchases will be made by the company during the two month period immediately preceding the preliminary announcement of the company's year end results or the publication of the half-yearly results, or, if shorter, the period from the end of the relevant financial period up to and including the announcement or publication of the relevant results.

There are no existing ordinary shares covered by options or warrants at the date of publication of this document.

Directors' Report

Reduction of share premium account

Resolution 12, which will be proposed as a special resolution, seeks shareholders' approval to reduce the share premium account of the company by £15,000,000. Upon reduction of the share premium account, a distributable reserve will be created which can be used by the board for the payment of dividends and market purchases of the company's shares.

Once shareholders have approved the reduction of the company's share premium account, it will be necessary for the company to petition the High Court to seek its confirmation of the reduction. It is expected that the Court order confirming the reduction of the share premium account will be made in the first half of 2006. The reduction of the share premium account will take effect only when an office copy of the Court order is duly registered with the Registrar of Companies.

In circumstances where a reduction of the share premium account involves any repayment to shareholders, the High Court may require protection for creditors of the company whose debts remain outstanding at the effective date unless such creditors consent otherwise. Appropriate arrangements will be made with the approval of the High Court for the protection of any other creditors of the company.

Independent auditors

KPMG Audit Plc have indicated their willingness to continue as auditors of the company and resolutions to re-appoint them and to authorise the directors to fix their remuneration will be proposed at the annual general meeting.

By order of the Board

C D MELLOR
Secretary



9 March 2006

Directors' Remuneration Report

This report has been prepared by the directors in accordance with the requirements of Schedule 7A to the Companies Act 1985. A resolution to approve the report will be proposed at the annual general meeting.

The company's independent auditors, KPMG Audit Plc, are required to give their opinion on certain information included in this report, as indicated below. Their report on these and other matters is set out on page 40.

Board of directors

The board currently comprises six directors, all of whom are non-executive. The board does not have a separate remuneration committee, as the company has no employees or executive directors. The board has established a nomination committee, comprising Dr M W Ridley (Chairman), Mr E M P Denny, Mr C G A Fletcher, Professor Sir Frederick Holliday and Mr F L G Neale, which considers the selection and appointment of directors and makes recommendations to the board as to the level of directors' fees. The board has not retained external advisers in relation to remuneration matters but has access to information about directors' fees paid by other companies of a similar size and type.

Remuneration policy

The board considers that directors' fees should reflect the time commitment required and the high level of responsibility borne by directors, and should be broadly comparable to those paid by similar companies. It is not considered appropriate that directors' remuneration should be performance-related, and none of the directors is eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits in respect of their services as non-executive directors of the company. Mr A M Conn and Mr E M P Denny are entitled to participate in performance incentive arrangements established for the benefit of certain executives of Northern Venture Managers, as described in the *Directors' Report* on page 17.

Directors' fees were reviewed by the nomination committee during its meeting in January 2006, when it was recommended that fees should remain at £15,000 per annum for the chairman and should be increased to £12,500 (previously £12,000) for other directors for the year ending 31 January 2007. The Articles of Association place an overall limit (currently £100,000 per annum) on directors' remuneration.

Directors' fees (audited information)

The following fees were paid to individual directors in respect of the years ended 31 January 2006 and 2005:

	Year ended 31 January 2006 £	Year ended 31 January 2005 £
M W Ridley (Chairman)	15,000	13,500
A M Conn	—	—
E M P Denny	12,000	11,000
C G A Fletcher	12,000	11,000
Sir Frederick Holliday	12,000	11,000
F L G Neale	12,000	11,000

Mr A M Conn waived his entitlement to directors' fees in respect of both years. Mr C G A Fletcher's fees were paid to Baillie Gifford & Co in consideration for his services.

Terms of appointment

The Articles of Association provide that directors shall retire and be subject to re-election at the first annual general meeting after their appointment and at least every three years thereafter. None of the directors has a service contract with the company. On being appointed or re-elected, directors receive a letter from the company setting out the terms of their appointment and their specific duties and responsibilities. A director's appointment may be terminated on three months' notice being given by the company and in certain other circumstances.

Directors' Remuneration Report

Company performance

The graph below compares the total return (assuming all dividends are re-invested) to ordinary shareholders in the company over the five years ended 31 January 2006 with the total return from a notional investment in the FTSE All-Share index over the same period. This index is considered to be the most appropriate broad equity market index for comparative purposes.

By order of the Board

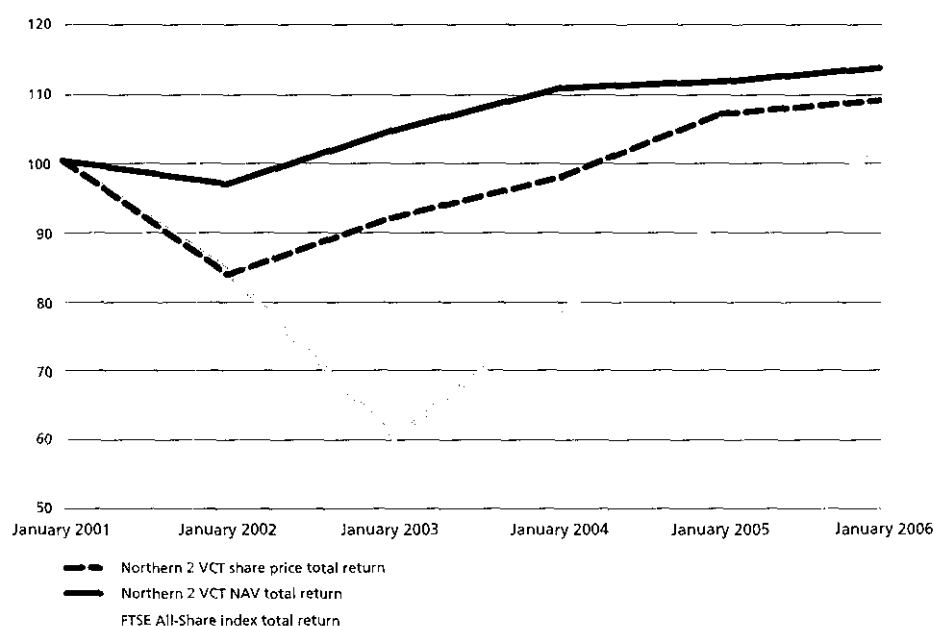
C D MELLOR

Secretary

9 March 2006

Return to shareholders in Northern 2 VCT PLC

Five years to 31 January 2006 (January 2001 = 100)



Corporate Governance

Throughout the year to 31 January 2006 the company complied in all material respects with the provisions of the revised Combined Code on corporate governance issued by the Financial Reporting Council in July 2003. The company is committed to maintaining high standards in corporate governance.

Board of directors

The company has a board of six non-executive directors, the majority of whom are considered to be independent of the company's investment manager, Northern Venture Managers Limited (NVM). The board meets regularly on a quarterly basis, and on other occasions as required, to review investment performance and monitor compliance with the investment policy laid down by the board. The board has a formal schedule of matters specifically reserved for its decision. A brief biographical summary of each director is given on page 4.

The chairman (Dr M W Ridley) leads the board in the determination of its strategy and in the achievement of its objectives. The chairman is responsible for organising the business of the board, ensuring its effectiveness and setting its agenda, and has no involvement in the day to day business of the company. *He facilitates the effective contribution of the directors and ensures that they receive accurate, timely and clear information and that they communicate effectively with shareholders.*

The board has established a formal process, led by the chairman, for the annual evaluation of the performance of the board, its principal committees and individual directors. The directors are made aware on appointment that their performance will be subject to regular evaluation. The performance of the chairman was evaluated by other directors under the leadership of Professor Sir Frederick Holliday.

The company secretary, Mr C D Mellor, is *responsible for advising the board through the chairman on all governance matters.* All of the directors have access to the advice and services of the company secretary, who has administrative responsibility for the meetings of the board and its committees. Directors may also take independent professional advice at the company's expense where necessary in the performance of their duties. Professor Sir Frederick Holliday is the senior non-executive director of the company.

The company's Articles of Association and the schedule of matters reserved to the board for decision provide that the appointment and removal of the company secretary is a matter for the full board.

The company's Articles of Association require that one third of the directors should retire by rotation *each year and seek re-election at the annual general meeting*, and that directors newly appointed by the board should seek re-appointment at the next annual general meeting. The board complies with the requirement of the Combined Code that all directors are required to submit themselves for re-election at least every three years.

Independence of directors

The board regularly reviews the independence of its members and is satisfied that (with the exception of Mr A M Conn and Mr E M P Denny who are directors and employees of NVM, the company's investment manager) the company's directors are independent in character and judgement and there are no relationships or circumstances which could affect their objectivity. Dr M W Ridley is also a non-executive director of Northern Investors Company PLC and Professor Sir Frederick Holliday is also non-executive chairman of Northern Venture Trust PLC. These companies are also managed by NVM, but after careful consideration the board has concluded that the directors' independence is not affected by these relationships.

Audit Committee

During the year the audit committee comprised:

Mr C G A Fletcher (Chairman)
Professor Sir Frederick Holliday
Mr F L G Neale

All of the members of the committee are independent non-executive directors.

Under its terms of reference, the audit committee *monitors the integrity of the company's financial statements and any formal announcements relating to the company's performance.* It also reviews the investment manager's arrangements for enabling employees to raise matters of possible impropriety in confidence, with suitable subsequent follow-up action. The committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the board in relation to the appointment, re-appointment and remuneration

of the external auditors. It is also responsible for ensuring that an appropriate relationship between the company and the external auditors is maintained, including reviewing non-audit services and fees. The committee reviews its terms of reference and its effectiveness annually and recommends to the board any changes required as a result of the review. The terms of reference are available on request from the company secretary.

The board considers that the members of the audit committee have collectively the skills and experience required to discharge their duties effectively, and that the chairman of the committee meets the requirements of the revised Combined Code as to recent and relevant financial experience.

The company does not have an independent internal audit function as it is not deemed appropriate given the size of the company and the nature of the company's business. However, the committee considers annually whether there is a need for such a function and if so would recommend this to the board.

During the year ended 31 January 2006 the audit committee discharged its responsibilities by:

- Reviewing the company's draft annual financial statements and interim results statement, including a detailed review of the valuation of investments, prior to board approval;
- Reviewing the external auditors' detailed report to the committee on the financial statements;
- Reviewing the appropriateness of the company's accounting policies;
- Reviewing and approving the audit fee;
- Reviewing the external auditors' plan for the audit of the company's financial statements, which included key risks, confirmation of auditor independence and the proposed audit fee, and approving the terms of engagement for the audit;
- Reviewing NVM's statement of internal controls operated in relation to the company's business and assessing the effectiveness of those controls *in minimising the impact of key risks*;
- Reviewing periodic reports on the effectiveness of NVM's compliance procedures; and
- Reviewing the annual budgets and quarterly financial reports in relation to the company's own business.

Nomination Committee

During the year the nomination committee comprised:

Dr M W Ridley (Chairman)
Mr E M P Denny
Mr C G A Fletcher
Professor Sir Frederick Holliday
Mr F L G Neale

The nomination committee considers the selection and appointment of directors and makes annual recommendations to the board as to the level of directors' fees. The committee monitors the balance of skills, knowledge and experience offered by board members, and satisfies itself that they are able to devote sufficient time to carry out their role efficiently and effectively. When recommending new appointments to the board the committee draws on its members' extensive business experience and range of contacts to identify suitable candidates; the use of formal advertisements and external consultants is not considered cost-effective given the company's size. New directors are provided with briefing material relating to the company, its investment managers and the venture capital industry as well as to their own legal responsibilities as directors. The committee has written terms of reference which are reviewed annually and are available on request from the company secretary.

The board does not have a separate remuneration committee, as the company has no employees or executive directors. Detailed information relating to the remuneration of directors is given in the Directors' Remuneration Report on page 20.

Management Engagement Committee

During the year the management engagement committee comprised:

Dr M W Ridley (Chairman)
Mr C G A Fletcher
Professor Sir Frederick Holliday
Mr F L G Neale

The management engagement committee undertakes a periodic review of the performance of the investment manager, NVM, and of the terms of the management agreement including the level of fees payable and the length of the notice period. The principal terms of the agreement are set out in Note 4 to the financial statements on page 31.

Corporate Governance

Following the latest review by the committee, the board concluded that the continuing appointment of NVM was in the interests of the company and its shareholders as a whole. NVM has demonstrated its commitment to and expertise in venture capital investment over an extended period, as a result of which the company has established a strong long-term performance record. NVM has also performed its company secretarial and accounting duties efficiently and effectively.

Attendance at board and committee meetings

The table at the foot of page 24 sets out the number of formal board and committee meetings held during the year ended 31 January 2006 and the number attended by each director compared with the maximum possible attendance.

Investor relations

In fulfilment of the chairman's obligations under the Combined Code, the chairman gives feedback to the board on issues raised with him by shareholders. The board recognises the value of maintaining regular communications with shareholders. Formal reports are sent to shareholders at the interim and year-end stages, and an opportunity is given to shareholders at the annual general meeting to question the board and the investment manager on matters relating to the company's operation and performance. Proxy voting figures for each resolution are announced at the annual general meeting.

Further information can also be obtained via the NVM website at www.nvm.co.uk.

Internal control

The directors have overall responsibility for ensuring that there are in place systems of internal control, both financial and non-financial, and for reviewing their

effectiveness. The purpose of the internal financial controls is to ensure that proper accounting records are maintained, the company's assets are safeguarded and the financial information used within the business and for publication is accurate and reliable; such a system can provide only reasonable and not absolute assurance against material misstatement or loss. The board regularly reviews financial results and investment performance with the investment manager. Responsibility for accounting, secretarial services and physical custody of documents of title relating to venture capital investments has been contractually delegated to NVM under the management agreement. NVM has established its own system of internal controls in relation to these matters, details of which have been reviewed by the audit committee.

Non-financial internal controls include the systems of operational and compliance controls maintained by the investment manager in relation to the company's business as well as the management of key risks as referred to in the section headed "Risk management" below.

The directors confirm that by means of the procedures set out above, and in accordance with "Internal Controls: Guidance for Directors on the Combined Code", published by the Institute of Chartered Accountants in England and Wales, they have established a continuing process for identifying, evaluating and managing the significant potential risks faced by the company and have reviewed the effectiveness of the internal control systems. This process has been in place throughout and subsequent to the accounting period under review.

Risk management

The company's objective is to maximise tax-free income and capital returns to shareholders by investing in a portfolio of quoted and unquoted

	Board	Audit Committee	Nomination Committee	Management Engagement Committee
Number of meetings held	5	3	1	1
Attendance (actual/possible):				
M W Ridley (Chairman)	5/5	n/a	1/1	1/1
A M Conn	5/5	n/a	n/a	n/a
E M P Denny	4/5	n/a	0/1	n/a
C G A Fletcher	5/5	3/3	1/1	1/1
Sir Frederick Holliday	5/5	3/3	1/1	1/1
F L G Neale	5/5	3/3	1/1	1/1

smaller UK companies. Such investments in equities and loans by their nature entail a higher degree of risk than investments in large quoted companies, as well as a lower degree of liquidity. The company's investments are also exposed to market price fluctuations. NVM seeks to manage these risks by careful selection and timely realisation of investments and by maintaining a spread of investments in terms of financing stage, industry sector and geographical location. The board reviews the company's investments on a regular basis.

The company has little exposure to cashflow risk and the managers aim to ensure that an appropriate proportion of the company's assets is held in cash or readily realisable securities, so as to meet any funding commitments which may arise. The company has little exposure to interest rate risk or (save as noted above) credit risk and no direct exposure to foreign currency risk.

The company has not undertaken any borrowings nor entered into any derivative transactions and does not expect to do so in the foreseeable future.

Directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements, in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards.

The financial statements are required by law to give a true and fair view of the state of affairs of the company at the end of the financial period and of the return of the company for that period.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in

the financial statements; and

- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements for the year ended 31 January 2006 comply with the requirements set out above and that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement, have been used in their preparation.

The directors are also responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The company's financial statements are published on the NVM website, www.nvm.co.uk. The maintenance and integrity of this website is the responsibility of NVM and not of the company. The work carried out by KPMG Audit Plc as independent auditors of the company does not involve consideration of the maintenance and integrity of the website and accordingly they accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website should be aware that legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in their jurisdiction.

Going concern

After making enquiries, the directors believe that it is appropriate to continue to apply the going concern basis in preparing the financial statements.

Income Statement

for the year ended 31 January 2006

	Notes	Year ended 31 January 2006			Year ended 31 January 2005 As re-stated		
		Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
(Loss)/gain on disposal of investments held at fair value	9	—	(388)	(388)	—	1,164	1,164
Unrealised adjustments to fair value of investments	9	—	265	265	—	(950)	(950)
Income	3	2,226	—	2,226	2,074	—	2,074
Investment management fee	4	(287)	(861)	(1,148)	(315)	(943)	(1,258)
Other expenses	5	(203)	—	(203)	(201)	—	(201)
Return on ordinary activities before tax		1,736	(984)	752	1,558	(729)	829
Tax on return on ordinary activities	6	(455)	352	(103)	(422)	301	(121)
Return on ordinary activities after tax		1,281	(632)	649	1,136	(428)	708
Return per share	8	2.9p	(1.4)p	1.5p	2.5p	(0.9)p	1.6p

- The total column of this statement is the profit and loss account of the company. The supplementary revenue return and capital return columns have been prepared under guidance published by the Association of Investment Trust Companies.
- There are no recognised gains or losses other than those disclosed in the income statement.
- All items in the above statement derive from continuing operations.
- The accompanying notes are an integral part of this statement.

Reconciliation of Movements in Shareholders' Funds

for the year ended 31 January 2006

Notes	31 January 2006		31 January 2005 As re-stated	
	£000		£000	
Equity shareholders' funds at 1 February 2005				
As previously reported		39,693		43,233
Prior year adjustment	2	579		1,289
As re-stated		40,272		44,522
Return on ordinary activities after tax		649		708
Dividends recognised in the year	7	(1,092)		(4,564)
Net proceeds of share issues		97		305
Shares purchased for cancellation		(1,251)		(699)
Equity shareholders' funds at 31 January 2006		38,675		40,272

- The accompanying notes are an integral part of this statement.

Balance Sheet

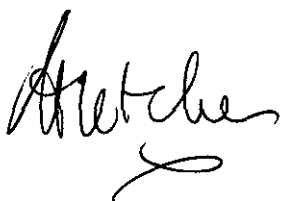
as at 31 January 2006

	Notes	31 January 2006 £000	31 January 2005 As re-stated £000
Fixed assets			
Investments designated at fair value through profit and loss	9	35,836	36,295
Current assets			
Debtors	13	409	420
Cash at bank		2,664	3,795
		3,073	4,215
Creditors (amounts falling due within one year)	14	(234)	(238)
Net current assets		2,839	3,977
Net assets		38,675	40,272
Capital and reserves			
Called-up equity share capital	15	2,139	2,212
Share premium	16	34,141	34,050
Capital redemption reserve	16	142	63
Capital reserve - realised	16	351	2,263
Capital reserve - unrealised	16	977	948
Revenue reserve	16	925	736
Total equity shareholders' funds		38,675	40,272
Net asset value per share	17	90.4p	91.0p

■ The accompanying notes are an integral part of this statement.

The financial statements on pages 26 to 39 were approved by the directors on 9 March 2006 and are signed on their behalf by:

C G A Fletcher
Director



Cash Flow Statement

for the year ended 31 January 2006

	Year ended 31 January 2006		Year ended 31 January 2005 As re-stated	
	£000	£000	£000	£000
Net cash inflow from operating activities		972		539
Taxation				
Corporation tax paid		(115)		(88)
Financial investment				
Purchase of investments	(6,293)		(10,341)	
Sale/repayment of investments	6,551		9,142	
Net cash inflow/(outflow) from financial investment		258		(1,199)
Equity dividends paid		(1,092)		(4,563)
Net cash inflow/(outflow) before financing		23		(5,311)
Financing				
Issue of ordinary shares	112		305	
Share issue expenses	(15)		—	
Purchase of ordinary shares for cancellation	(1,251)		(699)	
Net cash outflow from financing		(1,154)		(394)
Decrease in cash at bank		(1,131)		(5,705)
Reconciliation of return before tax to net cash flow from operating activities				
Return on ordinary activities before tax		752		829
Loss/(gain) on disposal of investments held at fair value		388		(1,164)
Unrealised adjustments to fair value of investments		(265)		950
Decrease/(increase) in debtors		89		(70)
Increase/(decrease) in creditors		8		(6)
Net cash inflow from operating activities		972		539
Analysis of movement in net funds				
	1 February 2005 £000	Cash flows £000		31 January 2006 £000
Cash at bank	3,795	(1,131)		2,664

Notes to the Financial Statements

for the year ended 31 January 2006

1 Accounting policies

A summary of the principal accounting policies, all of which have been consistently applied throughout the year, is set out below. Except as described in Note 2, these policies are consistent with the prior year.

a Basis of accounting

The financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial instruments, and in accordance with UK Generally Accepted Accounting Practice (UK GAAP). The adoption of new UK Financial Reporting Standards which became mandatory for the year ended 31 January 2006 has resulted in a number of changes in accounting policy, the effect of which is set out in Note 2. Where presentational guidance set out in the Statement of Recommended Practice (SORP) "Financial Statements of Investment Trust Companies", revised in December 2005, is consistent with the requirements of UK GAAP, the directors have sought to prepare the financial statements on a consistent basis compliant with the recommendations of the SORP.

b Investments

Quoted investments are stated at bid price. This represents a change in accounting policy, the effect of which is set out in Note 2.

The company's investments have been designated by the directors as fair value through profit and loss for the purposes of Financial Reporting Standard 26 "Financial Instruments: Measurement" and are carried at fair value as determined by the directors. In the case of investments quoted on a recognised stock exchange, fair value is established by reference to the closing bid price on the relevant date. In the case of unquoted investments, fair value is established by using measurements of value such as price of recent investment, earnings multiple and net assets; where no reliable fair value can be estimated using such techniques, unquoted investments are carried at cost subject to provision for impairment where necessary.

Gains and losses arising from changes in fair value of investments are recognised as part of the capital return within the income statement and allocated to the realised or unrealised capital reserve as appropriate. Transaction costs attributable to the acquisition or disposal of investments are charged to capital return within the income statement.

Those venture capital investments that may be termed associated undertakings are carried at fair value as determined by the directors in accordance with the company's normal policy and are not equity accounted as required by the Companies Act 1985. The directors consider that, as these investments are held as part of the company's portfolio with a view to the ultimate realisation of capital gains, equity accounting would not give a true and fair view of the company's interests in these investments. Quantification of the effect of this departure is not practicable. Carrying investments at fair value is specifically permitted under Financial Reporting Standard 9 "Associates and Joint Ventures", where venture capital entities hold investments as part of a portfolio.

c Income

Investment income includes income tax withheld at source. Dividend income is shown net of any related tax credit.

Dividends receivable on quoted equity shares are brought into account on the ex-dividend date. Dividends receivable on unquoted equity shares are brought into account when the company's right to receive payment is established and there is no reasonable doubt that payment will be received. Fixed returns on non-equity shares and debt securities are recognised on a time apportionment basis so as to reflect the effective interest rate, provided there is no reasonable doubt that payment will be received in due course.

d Expenses

All expenses are accounted for on an accruals basis. Expenses are charged to revenue return within the income statement except that:

- expenses which are incidental to the acquisition or disposal of an investment are charged to capital return as incurred; and
- expenses are split and presented partly as capital items where a connection with the maintenance or enhancement of the value of the investments held can be demonstrated, and accordingly the investment management fee has been allocated 25% to revenue return and 75% to capital return, in order to reflect the directors' expected long-term view of the nature of the investment returns of the company.

Notes to the Financial Statements

for the year ended 31 January 2006

1 Accounting policies continued

e Taxation

Corporation tax payable is provided on taxable profits at the current rate. The tax charge for the year is allocated between revenue return and capital return on the "marginal basis" as recommended in the SORP. Under this basis, the benefit of tax relief on allowable expenses is allocated to revenue return unless allowable expenses exceed taxable income in which case the benefit of the relief on the excess is credited to capital return.

Provision is made for deferred taxation on all timing differences calculated at the current rate of tax relevant to the benefit or liability.

f Dividends payable

Dividends payable are recognised as distributions in the financial statements when the company's liability to make payment has been established.

2 Changes in accounting policies

The company is required to comply with a number of new UK Financial Reporting Standards (FRS), which now represent UK Generally Accepted Accounting Practice (UK GAAP), in presenting its financial statements for the year ended 31 January 2006. These Standards have been introduced as part of the process of aligning UK accounting principles with International Accounting Standards. The revised accounting policies differ from those used in preparing the annual financial statements for the year ended 31 January 2005 in the following respects:

- the company's investments have been designated as fair value through profit and loss and accordingly the unrealised gain or loss resulting from the revaluation of investments held at fair value is now recognised in the income statement, as required by FRS 26 "Financial Instruments: Measurement";
- quoted investments are valued at bid price rather than mid-market price, as required by FRS 26 "Financial instruments: Measurement"; and
- dividends to shareholders are accounted for in the period in which the company is liable to pay them, rather than in the period in respect of which they are declared, as required by FRS 21 "Events after the Balance Sheet Date". Dividends payable are treated as a charge on reserves and accounted for through the reconciliation of movements in shareholders' funds rather than in the profit and loss account as previously.

The comparative figures for the year ended 31 January 2005 have been re-stated accordingly.

The effect of the above changes on the reported net assets and net asset value per share of the company is as follows:

	31 January 2006		31 January 2005		31 January 2004	
	Net assets	Net asset value per share	Net assets	Net asset value per share	Net assets	Net asset value per share
	£000	p	£000	p	£000	p
As reported under previous UK GAAP	36,819	86.1	39,693	89.7	43,233	96.5
Less: adjustment in valuation of quoted investments to bid price	(69)	(0.2)	(84)	(0.2)	(58)	(0.1)
Add: proposed dividends not accounted for until declared and paid	1,925	4.5	663	1.5	1,347	3.0
As reported under revised UK GAAP	38,675	90.4	40,272	91.0	44,522	99.4

Notes to the Financial Statements

for the year ended 31 January 2006

	Year ended 31 January 2006 £000	Year ended 31 January 2005 £000
3 Income		
Franked investment income		
Unquoted companies	173	150
Quoted companies	47	17
Interest receivable		
Government stocks and bonds	377	487
Bank deposits	64	61
Loans to unquoted companies	1,558	1,359
Sundry income	7	—
	<u>2,226</u>	<u>2,074</u>

	Year ended 31 January 2006			Year ended 31 January 2005		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
4 Investment management fee						
Investment management fee	244	733	977	268	803	1,071
Irrecoverable VAT thereon	43	128	171	47	140	187
	<u>287</u>	<u>861</u>	<u>1,148</u>	<u>315</u>	<u>943</u>	<u>1,258</u>

Northern Venture Managers Limited (NVM) provides investment management and secretarial services to the company under a management agreement which ran for an initial period of five years with effect from 20 December 1999 and may be terminated at any time thereafter by not less than twelve months' notice given by either party.

Until 31 January 2006 NVM received a management fee, payable quarterly in advance, at the rate of 2.5% of gross assets less current liabilities calculated at half-yearly intervals as at 31 July and 31 January. With effect from 1 February 2006 the basic rate of management fee has been reduced from 2.5% to 2.0%, with a performance-related element of up to a further 1.0% capable of being earned if the total return (net asset value growth plus dividends paid) in a financial year exceeds 14% of opening net assets, reducing on a sliding scale to nil if total return is less than 3.5%. NVM is responsible for paying the fees of Sarasin Chiswell in respect of the management of the listed fixed-interest portfolio.

NVM also provides administrative and secretarial services to the company for a fee of £40,000 per annum (linked to the movement in RPI), which is included in other expenses (see Note 5).

	Year ended 31 January 2006 £000	Year ended 31 January 2005 £000
5 Other expenses		
Administrative and secretarial services	40	39
Directors' remuneration	63	57
Auditors' remuneration - audit services	11	9
Legal and professional expenses	18	18
Irrecoverable VAT	18	18
Other expenses	53	60
	<u>203</u>	<u>201</u>

Information on directors' remuneration is given in the directors' remuneration report on page 20.

Notes to the Financial Statements

for the year ended 31 January 2006

6 Tax on return on ordinary activities	Year ended 31 January 2006			Year ended 31 January 2005 As re-stated		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
(a) Analysis of charge/(credit) for the year						
UK corporation tax payable/(recoverable) on the return for the year	455	(352)	103	422	(301)	121
(b) Tax reconciliation						
Return on ordinary activities before tax	1,736	(984)	752	1,558	(729)	829
Return on ordinary activities multiplied by the standard rate of UK corporation tax of 30% (2005 30%)	521	(295)	226	467	(219)	248
Effect of:						
UK dividends not subject to tax	(66)	—	(66)	(50)	—	(50)
Capital returns not subject to tax	—	116	116	—	(349)	(349)
Unrealised adjustments to fair value	—	(79)	(79)	—	285	285
Marginal relief	—	(13)	(13)	—	(18)	(18)
Adjustments to tax charge in respect of prior periods	—	(81)	(81)	5	—	5
Current tax charge/(credit) for the year	455	(352)	103	422	(301)	121

(c) Factors which may affect future tax charges

The directors are not aware of any matters which may affect the tax charges in future periods. There is no provided or unprovided deferred tax as at 31 January 2006.

Approved venture capital trusts are exempt from tax on capital gains within the company. Since the directors intend that the company will continue to conduct its affairs so as to maintain its approval as a venture capital trust, no deferred tax has been provided in respect of any capital gains or losses arising on the revaluation or disposal of investments.

7 Dividends	Year ended 31 January 2006			Year ended 31 January 2005 As re-stated		
	Revenue £000	Capital £000	Total £000	Revenue £000	Capital £000	Total £000
(a) Recognised as distributions in the financial statements for the year						
Previous year's final dividend	663	—	663	673	674	1,347
Current year's interim dividend	429	—	429	434	2,783	3,217
	1,092	—	1,092	1,107	3,457	4,564
(b) Paid and proposed in respect of the year						
Interim paid – 1.0p (2005 7.3p) per share	429	—	429	434	2,783	3,217
Final proposed – 4.5p (2005 1.5p) per share	642	1,283	1,925	663	—	663
	1,071	1,283	2,354	1,097	2,783	3,880

The revenue dividends paid and proposed in respect of the year form the basis for determining whether the company has complied with the requirements of Section 842AA of the Income and Corporation Taxes Act 1988 as to the distribution of investment income.

The proposed final dividend of 4.5p per share for the year ended 31 January 2006 is subject to approval by shareholders at the annual general meeting on 18 May 2006 and has not been recognised as a liability in these financial statements.

Notes to the Financial Statements

for the year ended 31 January 2006

8 Return per share

The calculation of return per share is based on the return on ordinary activities after tax for the year of £649,000 (2005 £708,000) and on 43,672,468 (2005 44,419,725) shares, being the weighted average number of shares in issue during the year.

	31 January 2006 £000	31 January 2005 As re-stated £000
9 Fixed asset investments		
Venture capital investments		
– unquoted	25,259	25,391
– quoted	4,548	3,939
Listed fixed-interest investments	6,029	6,965
	<u>35,836</u>	<u>36,295</u>

Movements in investments during the year are summarised as follows:

	Venture capital – unquoted £000	Venture capital – quoted £000	Listed fixed-interest £000	Total £000
Book cost at 1 February 2005	25,683	2,794	6,870	35,347
Unrealised appreciation at 1 February 2005				
– as previously reported	(292)	1,229	95	1,032
– prior year adjustment (Note 2)	—	(84)	—	(84)
– as re-stated	(292)	1,145	95	948
Valuation at 1 February 2005	<u>25,391</u>	<u>3,939</u>	<u>6,965</u>	<u>36,295</u>
Movements in the year:				
Purchases at cost	3,603	681	2,009	6,293
Disposals – proceeds	(3,072)	(613)	(2,944)	(6,629)
– net realised gains/(losses)	(559)	141	30	(388)
Transfers	(142)	142	—	—
Movement in unrealised appreciation	38	258	(31)	265
Valuation at 31 January 2006	<u>25,259</u>	<u>4,548</u>	<u>6,029</u>	<u>35,836</u>
Comprising:				
Book cost at 31 January 2006	25,619	3,259	5,981	34,859
Unrealised appreciation at 31 January 2006	(360)	1,289	48	977
	<u>25,259</u>	<u>4,548</u>	<u>6,029</u>	<u>35,836</u>

At 31 January 2006 there were commitments totalling £1,834,000 (31 January 2005 £881,000) in respect of investments approved by the manager but not yet completed.

Notes to the Financial Statements

for the year ended 31 January 2006

10 Investment disposals

Disposals of venture capital investments during the year were as follows:

	Original cost £000	Carrying value prior to disposal £000	Disposal proceeds £000	Realised gain/(loss) against carrying value £000
Alizyme*	54	120	121	1
BBI Holdings	144	291	430	139
BioFocus	159	61	62	1
CQC*	150	150	150	—
Crabtree of Gateshead	468	842	771	(71)
Keith Prowse	—	—	67	67
Omnico Plastics	846	1,450	1,671	221
PrismTech	743	120	121	1
Quadstone	250	—	—	—
VPTA*	781	781	—	(781)
Widney*	233	233	233	—
Other	55	55	59	4
	<u>3,883</u>	<u>4,103</u>	<u>3,685</u>	<u>(418)</u>

*Part disposal

11 Unquoted investments

The cost and carrying value of material investments in unquoted companies held at 31 January 2006 are shown below. For this purpose any investment included in the table of the fifteen largest venture capital investments on pages 11 to 14, or in the corresponding table in the previous year's annual report, is regarded as material.

	31 January 2006		31 January 2005	
	Total cost £000	Carrying value £000	Total cost £000	Carrying value £000
DMN Limited				
Ordinary shares	245	700	245	1,240
Convertible loan stock	900	900	900	900
	<u>1,145</u>	<u>1,600</u>	<u>1,145</u>	<u>2,140</u>
Crantock Bakery Limited				
Ordinary shares	225	609	225	225
Loan stock	882	882	882	882
	<u>1,107</u>	<u>1,491</u>	<u>1,107</u>	<u>1,107</u>
Longhirst Group Limited				
Ordinary shares	450	494	450	494
Preference shares	450	450	450	450
Loan stock	540	540	540	540
	<u>1,440</u>	<u>1,484</u>	<u>1,440</u>	<u>1,484</u>
IG Doors Limited				
Ordinary shares	100	416	100	100
Loan stock	900	900	900	900
	<u>1,000</u>	<u>1,316</u>	<u>1,000</u>	<u>1,000</u>

Notes to the Financial Statements

for the year ended 31 January 2006

11 Unquoted investments continued	31 January 2006		31 January 2005	
	Total cost £000	Carrying value £000	Total cost £000	Carrying value £000
Stainton Metal Company Limited				
Ordinary shares	110	226	110	933
Convertible loan stock	892	892	892	892
	<u>1,002</u>	<u>1,118</u>	<u>1,002</u>	<u>1,825</u>
Arrow Industrial Group Limited				
Ordinary shares	105	469	105	662
Loan stock	630	630	630	630
	<u>735</u>	<u>1,099</u>	<u>735</u>	<u>1,292</u>
Warmseal Windows (Newcastle) Limited				
Ordinary shares	82	346	82	82
Loan stock	736	736	736	736
	<u>818</u>	<u>1,082</u>	<u>818</u>	<u>818</u>
Envirotec Limited				
Ordinary shares	225	225	225	225
Loan stock	750	750	750	750
	<u>975</u>	<u>975</u>	<u>975</u>	<u>975</u>
John Laing Partnership Limited				
Ordinary shares	34	452	27	27
Preference shares	73	73	73	73
Loan stock	400	400	400	400
	<u>507</u>	<u>925</u>	<u>500</u>	<u>500</u>
Alaric Systems Limited				
Ordinary shares	889	889	889	659
Loan stock	32	32	32	32
	<u>921</u>	<u>921</u>	<u>921</u>	<u>691</u>
Direct Valeting Limited				
Ordinary shares	91	91	91	91
Preference shares	450	450	450	450
Loan stock	374	374	374	374
	<u>915</u>	<u>915</u>	<u>915</u>	<u>915</u>
Pivotal Laboratories Holdings Limited				
Ordinary shares	86	86	—	—
Loan stock	771	771	—	—
	<u>857</u>	<u>857</u>	<u>—</u>	<u>—</u>

Notes to the Financial Statements

for the year ended 31 January 2006

11 Unquoted investments continued	31 January 2006		31 January 2005	
	Total cost £000	Carrying value £000	Total cost £000	Carrying value £000
LEDA Holdings Limited				
Ordinary shares	112	112	112	112
Loan stock	713	713	713	713
	<u>825</u>	<u>825</u>	<u>825</u>	<u>825</u>
IRIS Technology Limited				
Ordinary shares	192	192	192	192
Loan stock	605	605	472	472
	<u>797</u>	<u>797</u>	<u>664</u>	<u>664</u>
RBF Industries Limited				
Ordinary shares	65	65	65	311
Loan stock	585	585	585	585
	<u>650</u>	<u>650</u>	<u>650</u>	<u>896</u>
VPTA Limited				
Ordinary shares	—	—	162	162
Preference shares	—	—	242	242
Loan stock	160	160	538	538
	<u>160</u>	<u>160</u>	<u>942</u>	<u>942</u>
SMS Agencies Limited				
Ordinary shares	100	—	100	100
Loan stock	900	—	900	900
	<u>1,000</u>	<u>—</u>	<u>1,000</u>	<u>1,000</u>
Omnico Plastics Limited				
Ordinary shares	—	—	85	689
Loan stock	—	—	761	761
	<u>—</u>	<u>—</u>	<u>846</u>	<u>1,450</u>
Crabtree of Gateshead Limited				
Ordinary shares	—	—	69	443
Loan stock	—	—	398	398
	<u>—</u>	<u>—</u>	<u>467</u>	<u>841</u>

Additional information relating to investments in unquoted companies is given on pages 11 to 14.

Notes to the Financial Statements

for the year ended 31 January 2006

12 Significant interests

Details of shareholdings in those companies where the company's holding at 31 January 2006 represents (1) more than 20% of the allotted equity share capital of any class, (2) more than 20% of the total allotted share capital or (3) more than 20% of the assets of the company itself, are given below. All of the companies named are incorporated in Great Britain.

Company	Class of shares (nominal value £1 unless stated)	Number held	Proportion of class held
Direct Valeting Limited	Ordinary (1p)	149,700	15.0%
	Preference	450,000	30.0%
DxS Limited	Ordinary (10p)	34,779	10.6%
	Preference	195,000	26.0%
Longhirst Group Limited	Ordinary (10p)	193,694	17.6%
	Preference	450,000	36.0%

13 Debtors

	31 January 2006 £000	31 January 2005 £000
Prepayments and accrued income	409	420

14 Creditors (amounts falling due within one year)

	31 January 2006 £000	31 January 2005 As re-stated £000
Accruals and deferred income	49	41
Corporation tax payable	185	197
	<u>234</u>	<u>238</u>

15 Called-up equity share capital

	31 January 2006 £000	31 January 2005 £000
Authorised:		
60,000,000 (2005 60,000,000) ordinary shares of 5p	3,000	3,000
Allotted and fully paid:		
42,787,325 (2005 44,244,263) ordinary shares of 5p	2,139	2,212

During the year the company issued 126,210 ordinary shares of 5p for cash at an average premium of 84.4p per share as part of the dividend investment scheme. 1,583,148 shares were repurchased for cancellation at a cost of £1,251,000.

The share option scheme established on 10 February 1999 has been terminated. No options have been or will be issued under the scheme.

Notes to the Financial Statements

for the year ended 31 January 2006

16 Reserves	Share premium £000	Capital redemption reserve £000	Capital reserve - realised £000	Capital reserve - unrealised £000	Revenue reserve £000
At 1 February 2005					
– as previously reported	34,050	63	2,263	1,032	73
– prior year adjustment (Note 2)	—	—	—	(84)	663
– as re-stated	34,050	63	2,263	948	736
Premium on issue of ordinary shares	106	—	—	—	—
Share issue expenses	(15)	—	—	—	—
Shares purchased for cancellation	—	79	(1,251)	—	—
Loss on disposal of investments held at fair value	—	—	(388)	—	—
Unrealised adjustments to fair value of investments	—	—	—	265	—
Previously recognised gains now realised	—	—	236	(236)	—
Management fee capitalised net of associated tax	—	—	(509)	—	—
Revenue return on ordinary activities after tax	—	—	—	—	1,281
Dividends recognised in the year	—	—	—	—	(1,092)
At 31 January 2006	34,141	142	351	977	925

The realised capital reserve and the revenue reserve are distributable reserves.

17 Net asset value per share

The calculation of net asset value per share as at 31 January 2006 is based on net assets of £38,675,000 (2005 £40,272,000) divided by the 42,787,325 (2005 44,244,263) ordinary shares in issue at that date.

18 Financial instruments

The company has no derivative financial instruments and has no financial asset or liability for which hedge accounting has been used. All financial assets are held in sterling, hence there is no foreign currency exchange rate exposure. Fixed asset investments are valued at fair value as determined by the directors. There is little exposure to interest rate risk and the company does not have any financial liabilities other than short-term creditors. Market risk is discussed in the corporate governance statement on pages 24 and 25.

Investments are made in a combination of equity and loan instruments so as to enable the company to achieve its objective of providing high long-term returns to shareholders through a combination of dividend yield and capital growth. Surplus funds are held on bank deposit or in listed money market instruments.

Notes to the Financial Statements

for the year ended 31 January 2006

18 Financial instruments continued

At 31 January 2006 the company's financial assets by value, excluding short-term trade debtors and creditors as permitted by Financial Reporting Standard 25 "Financial Instruments: Disclosure and Presentation", comprised:

	£000	%	Interest rate	Weighted average interest rate	Weighted average period to maturity
Venture capital investments:					
Ordinary shares	13,401	34.8	N/A	N/A	N/A
Preference shares	1,560	4.1	Fixed	5.8%	3.3 years
Loan stock	14,846	38.6	Floating	7.9%	2.6 years
	29,807	77.5			
Listed fixed-interest investments	6,029	15.7	Fixed	5.6%	1.5 years
Total fixed asset investments	35,836	93.2			
Bank deposits	2,664	6.8	Floating	4.3%	N/A
	38,500	100.0			

Independent Auditors' Report

To the members of NORTHERN 2 VCT PLC

We have audited the financial statements of Northern 2 VCT PLC for the year ended 31 January 2006 which comprise the Income Statement, the Reconciliation of Movements in Shareholders' Funds, the Balance Sheet and the Cash Flow Statement and the related notes.

These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities on page 25.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report 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 other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code 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 form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 part of the Directors' Remuneration Report to be audited. 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.

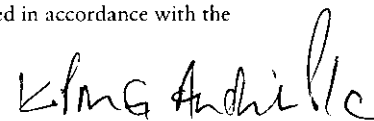
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from 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 and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 January 2006 and of its return for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Edinburgh



9 March 2006

Notice of Annual General Meeting

Notice is hereby given that the seventh annual general meeting of Northern 2 VCT PLC will be held at the Vermont Hotel, Castle Garth, Newcastle upon Tyne NE1 1RQ at 10.30am on Thursday 18 May 2006 for the following purposes:

As ordinary business

- 1 To receive the financial statements for the year ended 31 January 2006 and the directors' and independent auditors' reports thereon.
- 2 To declare a final dividend of 4.5p per share in respect of the year ended 31 January 2006.
- 3 To approve the directors' remuneration report in respect of the year ended 31 January 2006.
- 4 To re-elect as a director Mr C G A Fletcher who retires by rotation in accordance with the Articles of Association and offers himself for re-election.
- 5 To re-elect as a director Mr F L G Neale who retires by rotation in accordance with the Articles of Association and offers himself for re-election.
- 6 To re-appoint KPMG Audit Plc as independent auditors of the company until the conclusion of the next annual general meeting of the company.
- 7 To authorise the directors to fix the independent auditors' remuneration.
- 8 To transact any other ordinary business of the company.

As special business

- 9 To consider and, if thought fit, to pass the following resolution as an ordinary resolution:

"That, in substitution for and to the exclusion of any power previously conferred upon the directors in this regard, the directors be generally and unconditionally authorised for the purpose of Section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the Company to allot relevant securities (within the meaning of Section 80(2) of the Act) up to an aggregate nominal amount of £860,633, provided that:

(a) (except as provided in paragraph (b) below) this authority shall expire on the conclusion of the next annual general meeting of the Company after the passing of this resolution or, if earlier, 15 months from the date of the passing of this resolution, but may be previously revoked or varied by an ordinary resolution of the Company; and

(b) the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of such offer or agreement notwithstanding that the authority conferred by this resolution has expired."

- 10 To consider and, if thought fit, to pass the following resolution as a special resolution:

"That, in substitution for and to the exclusion of any power previously conferred upon the directors in this regard (save to the extent relied upon prior to the passing of this resolution), the directors be and are empowered to allot equity securities (as defined in Section 94(2) of the Act) pursuant to the authority conferred by Resolution 9 in the notice convening the 2006 Annual General Meeting as if Section 89(1) of the Act did not apply to any such allotment provided that the power conferred by this resolution shall be limited to the allotment of equity securities up to an aggregate nominal value of the lower of £763,936 and the then existing unissued share capital of the company, and this power shall expire on the conclusion of the next annual general meeting of the Company after the passing of this resolution or, if earlier, on the expiry of 15 months from the passing of this resolution save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired."

Notice of Annual General Meeting

11 To consider and, if thought fit, to pass the following resolution as a special resolution:

"That the company be and is hereby generally and unconditionally authorised in accordance with Section 166 of the Act to make one or more market purchases (within the meaning of Section 163(3) of the Act) on the London Stock Exchange of ordinary shares of 5p each in the capital of the Company provided that:

- (a) the maximum number of ordinary shares hereby authorised to be purchased is 4,278,732, representing approximately 10% of the company's issued ordinary share capital;
- (b) the minimum price which may be paid for an ordinary share shall be 5p per share;
- (c) the maximum price which may be paid for an ordinary share shall not be more than the lower of (i) net asset value per share and (ii) the higher of 105% of the average market value for the ordinary shares of the company for the five business days prior to the date on which the ordinary shares are purchased and that stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation; and

(d) unless previously renewed, varied or revoked, the authority hereby conferred shall expire on the conclusion of the next annual general meeting of the company or, if earlier, on the expiry of 15 months from the passing of this resolution save that the company may before such expiry enter into a contract to purchase ordinary shares which will or may be completed wholly or partly after such expiry."

12 To consider and, if thought fit, to pass the following resolution as a special resolution:

"That the sum registered to the share premium account of the Company be reduced by £15,000,000."

By order of the Board

C D MELLOR

Secretary

9 March 2006

Northumberland House
Princess Square
Newcastle upon Tyne NE1 8ER

NOTES

- 1 A member entitled to attend and vote at this meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote in his stead. A proxy need not be a member of the company. The appointment of a proxy does not preclude a member from attending and voting in person at the meeting should he subsequently decide to do so.
- 2 To be valid, a form of proxy together with, if applicable, the power of attorney or other authority under which it is signed, or a certified copy thereof, must be received by Lloyds TSB Registrars at The Causeway, Worthing BN99 6DA not later than 10.30am on Tuesday 16 May 2006.
- 3 The company, pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those shareholders registered in the register of members of the company as at 6.00pm on Wednesday 17 May 2006 shall be entitled to attend or vote (whether on a show of hands or on a poll) at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the register after 6.00pm on Wednesday 17 May 2006 (or after 6.00pm on the day before any adjourned meeting) shall be disregarded in determining the rights of any person to attend or vote at the meeting.
- 4 None of the directors has a contract of service with the company. The register of directors' interests will be available for inspection on the day of the above meeting, at the place of the meeting, from at least 15 minutes prior to the meeting until its conclusion.

Form of Proxy

NORTHERN 2 VCT PLC Annual General Meeting – 18 May 2006

I/We _____
(block capitals please)

of _____
being a member of Northern 2 VCT PLC, hereby appoint (see note 1)

_____ or failing him/her the Chairman of the meeting to be my/our proxy and vote for me/us on my/our behalf at the seventh annual general meeting of the company to be held on 18 May 2006, notice of which was sent to shareholders with the annual report and accounts for the year ended 31 January 2006, and at any adjournment thereof. The proxy will vote as indicated below in respect of the resolutions set out in the notice of meeting:

Resolution number	For	Against	Vote withheld
1 To receive the financial statements for the year ended 31 January 2006	☐	☐	☐
2 To declare a final dividend of 4.5p per share in respect of the year ended 31 January 2006	☐	☐	☐
3 To approve the directors' remuneration report in respect of the year ended 31 January 2006	☐	☐	☐
4 To re-elect Mr C G A Fletcher as a director	☐	☐	☐
5 To re-elect Mr F L G Neale as a director	☐	☐	☐
6 To re-appoint KPMG Audit Plc as independent auditors	☐	☐	☐
7 To authorise the directors to fix the remuneration of the independent auditors	☐	☐	☐
9 To authorise the directors to allot shares pursuant to Section 80 of the Companies Act 1985	☐	☐	☐
10 To disapply Section 89 of the Companies Act 1985 in relation to the allotment of equity securities	☐	☐	☐
11 To authorise the company to make market purchases of ordinary shares in accordance with Section 166 of the Companies Act 1985	☐	☐	☐
12 To reduce the sum registered to the share premium account	☐	☐	☐

Signed: _____ Date: _____ 2006

NOTES

- 1 A member wishing to appoint a person other than the Chairman of the meeting as proxy should insert the name and address of such person in the space provided.
- 2 Use of the form of proxy does not preclude a member from attending and voting in person.
- 3 Where the form of proxy is executed by an individual it must be signed by that individual or his or her attorney.
- 4 Where the form of proxy is executed by joint shareholders it may be signed by any of the members, but the vote of the member whose name stands first in the register of members of the company will be accepted to the exclusion of the votes of the other joint holders.
- 5 Where the form of proxy is executed by a corporation it must be either under its seal or under the hand of an officer or attorney duly authorised.
- 6 If the form of proxy is signed and returned without any indication as to how the proxy shall vote, the proxy will exercise his/her discretion as to whether and how he/she votes.
- 7 To be valid, the form of proxy, together with, if applicable, the power of attorney or other authority under which it is signed, or a certified copy thereof, must be received by Lloyds TSB Registrars at The Causeway, Worthing BN99 6DA not later than 10.30am on Tuesday 16 May 2006.
- 8 Only those shareholders registered in the register of members of the company as at 6.00pm on Wednesday 17 May 2006 shall be entitled to attend or vote (whether on a show of hands or on a poll) at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the register of members after 6.00pm on Wednesday 17 May 2006 (or after 6.00pm on the day before any adjourned meeting) shall be disregarded in determining the rights of any person to attend or vote at the meeting.
- 9 The "vote withheld" option is provided to enable a member to abstain from voting on the resolution; however, it should be noted that a "vote withheld" is not a vote in law and will not be counted in the calculation of the proportion of the votes "for" and "against" the resolution.

Attendance indication

Shareholders who intend to attend the annual general meeting are requested to place a tick in the box below in order to assist with administrative arrangements.

I intend to attend the annual general meeting at 10.30am on Thursday 18 May 2006
at the Vermont Hotel, Castle Garth, Newcastle upon Tyne NE1 1RQ ☐

Signed: _____ Date: _____ 2006

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First Fold

**LLOYDS TSB REGISTRARS
THE CAUSEWAY
WORTHING
BN99 6ZR**

Second fold