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# Baronsmead VCT 3 plc

## 2004

Annual report & accounts  
for the year ended  
31 December 2004



# Investment Objective

Baronsmead VCT 3 is a tax efficient listed company which aims to achieve long-term capital growth and generate tax free dividends for private investors.

## Investment Policy

To establish a diverse portfolio comprising:

- Larger unquoted companies, typically as lead investor and alongside institutional investors, which do not offer the same tax benefits to their shareholders as a VCT.
- Technology-enabled companies.

## Shareholder Policies

Since launch in 2001, the Board of Directors has sought to communicate regularly and openly with Shareholders. Dialogue has been achieved principally through questionnaires, workshops and General Meetings. By understanding Shareholders' priorities, the Board has been able to initiate a number of policies, which provide greater choice for Shareholders and address their expressed objectives. The website, [www.baronsmeadvct3.co.uk](http://www.baronsmeadvct3.co.uk), contains both annual and interim statutory reports as well as other generic VCT publications.

### Shareholder choice

This is achieved by offering Shareholders the ability to:

- increase their shareholding through top-up offers
- reinvest their dividends, enabling those whose personal investment objective is capital growth to achieve this in a tax efficient manner
- sell their shares through the operation of a buy-back policy

### Buy-back policy

Purchases of shares will be made within guidelines established from time to time by the Board. This power will be exercised only if in the opinion of the Board a repurchase would be in the interests of shareholders as a whole. Historically the repurchase price has represented an approximate 10 per cent discount to Net Asset Value per share.

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### Dividend policy

Since launch the average annual tax-free dividends paid to Shareholders has been 3.5p per share (equivalent to a pre-tax return of 5.2p per share for a higher rate taxpayer). The Board wishes to sustain this level of average dividends if possible, but this depends primarily on the level of realisations achieved and it cannot be guaranteed. There will be variations in the amount of dividends paid year on year.

### Dividend reinvestment

The Directors offer to Shareholders the opportunity to reinvest their dividends by subscribing for new shares in the Company. The Dividend Reinvestment Scheme enables Shareholders to increase their shareholding without incurring dealing costs, issue costs or stamp duty. These shares should qualify for the VCT tax reliefs that are applicable to subscriptions for new shares and form part of each Shareholder's current annual limit of £200,000 for investing in VCTs.

# Financial Highlights

NAV per ordinary share increased by 13.0 per cent before deduction of dividends; giving a net change of 8.3 per cent after deduction of dividends

NAV per ordinary share after deduction of dividends was 105.26p

Revenue and capital dividends total 4.50p per ordinary share for the year

## Baronsmead VCT 3 NAV and NAV Total Return since launch against the FTSE All-Share Index Total Return

## Performance Summary

	<b>31 December 2004</b>	31 December 2003	% change
<b>Ordinary Share – capital values</b>			
Net asset value	<b>105.26p</b>	97.15p	8.3
Share price	<b>92.50p</b>	90.00p	2.8
Discount	<b>(12.1)%</b>	(7.4)%	
Net asset value total return since launch (note 1)	<b>27.5%</b>	12.7%	
Total assets less current liabilities	<b>£35.1m</b>	£33.0m	
(note 1) Net asset value total return assuming gross dividends re-invested.			
	<b>Year to 31 December 2004</b>	Year to 31 December 2003	
<b>Dividends</b>			
Revenue dividends per Ordinary Share	<b>1.20p</b>	2.20p	
Capital dividend per Ordinary Share	<b>3.30p</b>	2.00p	

# Four Year Record

At 31 December	Shareholders' funds £'000	Net asset value per share p	Net asset value total return* p	Share price p	Discount (note 1) %	Revenue dividend per Ordinary share p	Capital dividend per Ordinary share p
2001	31,069	93.85	101.21	88.00	(6.2)	2.30	–
2002	32,050	94.85	105.35	85.50	(9.9)	2.80	–
2003	32,994	97.15	112.66	90.00	(7.4)	2.20	2.00
2004	35,116	105.26	127.52	92.50	(12.1)	1.20	3.30

\*Source: F&C Asset Management plc.

Note 1 – (Discount)/premium is the difference between Baronsmead VCT 3's quoted price and its underlying net asset value.

## Cash Returned to Shareholders

The Board is also aware that shareholders are concerned that the original capital subscribed into Baronsmead VCT 3 has been maintained. The table below shows the cash returned to shareholders, including their income tax reclaimed on subscription.

Year subscribed	Subscription price p	Income tax reclaim p	Net cash invested p	Cumulative dividends paid p	Net annual yield* %	Gross annual yield† %
2001	100	20.0	80.0	13.8	4.4	6.5

Note 1 – The cash returns could be higher for those shareholders who were able to defer a capital gain on subscription and the net sum invested may be less.

\*Net annual yield represents the cumulative dividends paid expressed as a percentage of the net cash invested.

†The gross equivalent yield if the dividends had been subject to higher rate (40% income tax).

## Secondary market in the shares of Baronsmead VCT 3

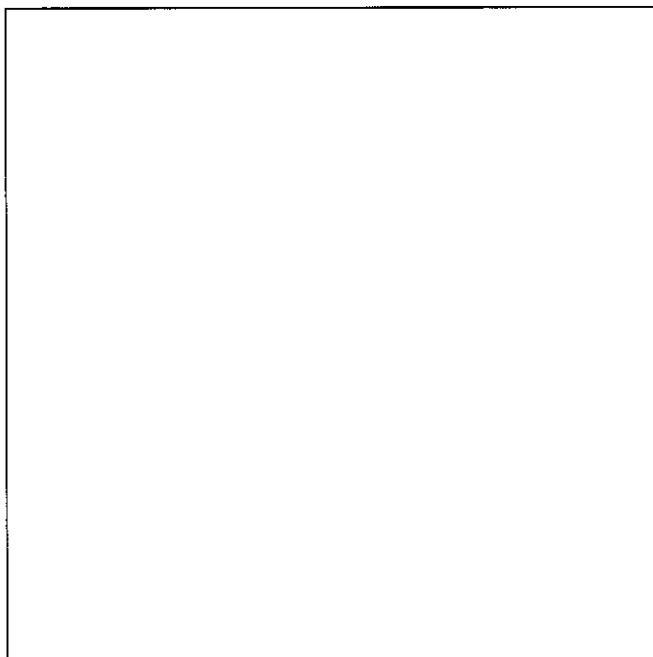
Shares can be bought and sold via a stockbroker, just like shares in any other listed company. Qualifying purchasers are individuals over the age of 18 and are UK resident for tax purposes. They can receive VCT dividends (including capital distributions of realised gains on investments) that are not subject to income tax. Capital gains arising on disposal of VCT shares are tax-free.

As shares in Baronsmead VCT 3 have been historically priced at 10 per cent below their net asset value, the 4.5p dividend being paid for 2004 equates to an approximate yield of 4.9 per cent based on the share price of 92.5p at 31 December 2004. The gross equivalent yield for a higher rate taxpayer would be 7.2 per cent.

There is no minimum time for which shares need to be held and they can be sold in the normal way.

# Chairman's Statement

We have met our twin objectives of creating capital growth and paying attractive tax free dividends in 2004. NAV value per share has advanced again based on the good underlying trading and asset growth across the portfolio.



**Mark Cannon Brookes**

Chairman

## Results

In the year to 31 December 2004, NAV per share increased by 13.0 per cent from 97.15p to 109.76p per share before providing for the full year dividends of 4.5p per share. These dividends comprise 3.3p per share from net realised capital profit and 1.2p per share from net revenue. The NAV per share at the year end was 105.3p per share.

The increase in the FTSE All-Share Index (total return) was 12.8 per cent over the comparable period to 31 December 2004.

The total return for Baronsmead VCT 3 of 27.5 per cent, net of all costs, since launch combines growth in NAV per share and reinvested dividends per share of 13.8p. This performance places your Company ahead of most other 'generalist' VCTs, which have a similar strategy investing across a range of unquoted and AiM companies. The FTSE All-Share Index (total return) over the comparable period since launch is down 10 per cent and so the performance of your Company remains substantially ahead of this index. The positive differential increases further if the benefits from the available VCT tax reliefs are also taken into account.

## The Portfolio

In the year under review, £7.3m was invested. Seventeen new investments were made with five unquoted and twelve AiM-traded companies resulting in a 47 strong portfolio as at 31 December 2004. Two investments were fully realised and details of these and other partial realisations are described within the Manager's review.

At times shareholders wish to know more about the performance of individual companies but it is not always possible to share detailed progress, either good or bad, as making confidential information public could potentially harm the commercial prospects of individual companies. This could influence the value of underlying investments to the possible detriment of overall shareholder value. As a result our policy is to publish publicly available information either recorded at Companies House or via the website of individual investees. Page 8 lists all investments within the portfolio.

The overall health of investee companies is monitored quarterly by noting the direction of travel of operating profits/other non-financial measures across the portfolio. Some 90 per cent of these companies are reporting steady or better profits and progress.

Although the Manager uses similar investment disciplines to select unquoted and AiM investments, the geared nature of the former increases the individual company risk as their balance sheets have higher levels of debt. Successful trading typically makes the return for shareholders that much higher whereas problematic trading will have the opposite effect should their business plans not be met. The Manager's review addresses this issue with specific reference to the existing portfolio companies.

## Meeting Shareholders Needs

The level of qualifying investment across the total portfolio at 31 December 2004 is approximately 72 per cent invested. The Board is mindful of the next phase of investment opportunities over the coming three years in order to build wider diversity across a larger number of investments and the business cycle. As previously announced, the Board is planning a C share fund raising later in 2005. Shareholder approval for this C share issue is being sought at the EGM to be held later after the AGM on the 23 March 2005. This will have the advantage of economies of scale but also will attract a wider base of new shareholders.

# Chairman's Statement

In the meantime, existing shareholders may wish to take advantage of the current 40 per cent income tax relief on subscription for both the current tax year ending 5 April 2005 and also the next tax year 2005/06 by availing themselves of the top up offer on publication of the fourth annual report.

To ensure that subscribers have at least three years to hold the new shares so as to retain the 40 per cent income tax relief, shareholders are being asked at the AGM to extend the life of the Company from 2008 to 2013. This longer horizon is consistent with the view of more than 80 per cent of shareholders, who in response as to how long they wished to hold their shares, stated that they did not intend to sell in the foreseeable future.

Existing shareholders were issued with 331,991 shares via a 'top up' offer in early 2004 and 551,623 new shares were issued under the dividend reinvestment scheme during 2004. 1.49m shares were bought back and cancelled within the last year at approximately a 10 per cent discount to NAV per share at around the level anticipated from the shareholder survey in autumn 2003.

As first stated in March 2004, the Board proposed an annual dividend policy and this has been increased to 4.5p per share. This cannot be guaranteed as it depends on the level of realised capital profits from the realisation of portfolio companies and economic circumstances beyond our control.

For the first time, the summary financial information on pages 1 and 2 of this report sets out the benefits of the VCT tax reliefs for shareholders in terms of average annual net yield for both standard rate and higher rate tax payers. The historic averages of 4.4 per cent and 6.5 per cent respectively illustrate that VCTs can be an important part of a retirement planning portfolio as VCTs are heritable and relatively flexible when compared to pensions.

## Corporate Governance

The Board operates within the Combined Code for fully listed companies and reviews quarterly the direction and control of the Company with the Investment Managers.

The Manager continues to evolve its strategy to improve the way in which unquoted transactions are found, managed and sold. It has also made good progress in the application of private equity disciplines when subscribing into AiM-traded companies applying its sector knowledge and exerting influence as normally one of the larger institutional shareholders.

## Outlook

UK economic conditions are more settled than previously and provide a better environment in which the Manager can select and then manage both unquoted and AiM investments through to eventual sale. Worldwide growth should continue at least close to the long term trend given the absence of unforeseen shocks.

The last year has seen sizeable growth in the portfolio and the task now is to sustain investment performance. The Board's role will be to continue to monitor such developments in order that we can sustain our twin investment objectives of achieving capital growth and paying attractive tax free dividends.

I look forward to welcoming as many shareholders as possible at the AGM on 23 March 2005 at 11.00 a.m. at the Offices of F&C Asset Management, Exchange House, Primrose Street, London EC2A 2NY. Please note this change of address which is adjacent to Liverpool Street Station in the City of London. The Investment Manager, David Thorp, will lead a presentation on portfolio issues and the current prospects. The Managing Director of Occam has accepted the invitation to comment on this company and its progress. The presentations will be followed by a buffet lunch with the intention of finishing by 12.30 p.m. prior to a shareholders workshop.

### Mark Cannon Brookes

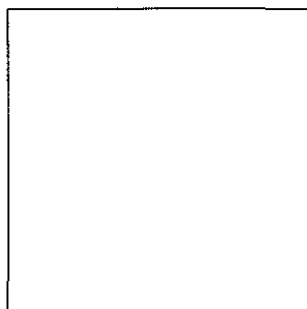
Chairman

9 February 2005



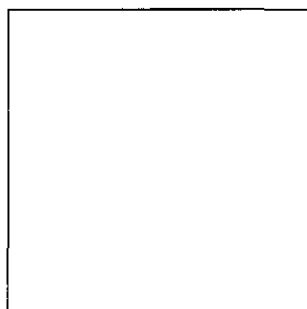
# Manager's Review

The high level of investment has increased the portfolio to 47 companies, the majority of which are trading strongly.



**David Thorp**  
Investment Manager

For example within the portfolio the strongest advances in valuation have come from the investments in Americana, The Art Group and AssA while conversely provisions have been made for Spaform and Hawksmere. The £510,000 loan stock in Americana was repaid in December 2004 and the value of the shareholding has increased from £0.84m to £2.08m over the last six months as profits have grown. The sale of BodyCare for 0.46 times cost (including interest received) illustrates that loan stock can play an important part increasing the sale proceeds.



**Rhonda Nicoll**  
Company Secretary

In terms of active portfolio management, an investment executive from the Manager normally joins the board of unquoted companies as a non-executive director. They can deploy their experience in helping the investee meet or exceed its plans as well as play their part in remedying problems when they arise. The investment in AssA demonstrates this as it has increased in value as trading has improved following some board changes.

In selecting new AiM-traded opportunities, the Manager applies a similar analytical /private equity approach to the extent that this is possible given the information and timescale available for making the investment. Co-investment by the four Baronsmead VCTs can often result in the combined investment being amongst the largest institutional shareholdings, which enables the Manager to sustain a regular and informed dialogue over the progress of these companies.

## New Investment

The target of increasing the portfolio to over 40 companies during 2004 was achieved mainly due to the larger number of AiM subscriptions. £7.3m was invested across seventeen new investments of which five were unquoted companies and twelve AiM-traded businesses.

£2.52m was realised from the part sale of two AiM shareholdings and the complete sale of investments in two unquoted companies plus the Americana redemption. Previously it had been announced that kidsunlimited had exchanged contracts in July 2004 to merge with a larger business within the child nursery sector. The board of 'kids' withdrew from the proposed transaction in November 2004 when it became clear that further delays and uncertainties were likely due to complex tax clearances. This business continues to expand its network of child day care centres and increase operating profits.

## Portfolio Performance and Realisations

The nature of creating greater shareholder value within unquoted and AiM-traded companies differs in that the investment into AiM investees is a straightforward subscription of shares whereas the structure of an unquoted transaction typically involves a substantial element of debt in the initial financing package.

Financial gearing via the use of loan stock is used in pursuit of higher potential returns but there are increased risks as well. These can be mitigated by the closer involvement of the Manager.

Diversity is evident by the number of investments in different years and a variety of activities within the five chosen sectors. The proportion of unquoted and AiM investments is almost level

<b>Realisations/Flotation in year to 31 December 2004</b>		First investment date	Cost £'000	Proceeds £'000	Multiple return
Huveaux	Market sale	March 2003	18	45	2.50
neuTec Pharma	Market sale	February 2002	239	544	2.28
Brownsword	Trade sale	December 2002	676	1,149	1.85*
Vectura	Flotation	April 2001	1,041	1,371†	1.32
Americana	Loan repayment	August 2003	510	510	1.00*
BodyCare	Secondary buyout	November 2001	1,000	273	0.46*

\*includes interest received  
†share price at 31/12/2004

# Manager's Review

following a period of more unquoted realisations than from AiM and the flotation of Vectura.

The technology section of the portfolio currently encompasses 16 investees, split into 7 within the bioscience/healthcare sector and 9 with an IT service/software activity. To date partial profit has been realised in neuTec which specialises in products to remedy MRSA 'hospital bugs'. Vectura shares can be sold on AiM now that Baronsmead VCT 3 is out of its restricted sale period following the AiM flotation in July 2004.

## Investor Relations

Computershare was appointed registrars in July 2004 and to date their capacity to handle relatively complex systems has aided more effective shareholder communication.

The web site for Baronsmead VCT 3 is now easier to access via [www.baronsmeadvct3.co.uk](http://www.baronsmeadvct3.co.uk) and contains a number of reports including not only the statutory reports and fact sheets but also the presentations at the annual general meeting and shareholder workshop. It also contains published generic information to aid financial planning for shareholders including the fourth edition of the guide 'A closer look at VCTs', a dividend reinvestment scheme document that explains how the 40 per cent income tax relief on subscription makes this scheme more advantageous (at least until April 2006) and finally a magazine 'VCT Forum informed choices'.

Michael Probin leaves ISIS Equity Partners to live with his family in the Falkland Islands at the beginning of March 2005. His skills will be retained for some project work/technical advice over the two or three years that he may be away from the UK.

For the last five years he has made a significant contribution to the development of investor relations not only across the four Baronsmead VCTs but also in helping to set standards for the whole VCT sector. We send him our best wishes and thank him for being a knowledgeable and accessible point of contact for shareholders and their advisers.

## Outlook

The priority remains to select unquoted and AiM-traded opportunities within our chosen sectors and continue to expand the portfolio towards 60 companies. The portfolio is well-diversified and the intention is to grow and then realise these investments when possible so as to meet the twin objectives of capital growth and sustain the dividend policy.

### David Thorp

Investment Manager

ISIS Equity Partners

9 February 2005

Company	Location	Sector	Activity	Investment cost £'000
<b>New unquoted investments</b>				
Country Artists	Stratford on Avon	Consumer	Giftware products	448
Domantis	Cambridge	Healthcare	Drug discovery	356
Occam	Bath	Business services	Integrated data services	420
SLR	Aylesbury	Business services	Environmental consultancy	494
Spaform	Portsmouth	Consumer	Portable spa baths	867
<b>Follow-on investments</b>				
AssA	Tyne & Wear	Business services	Work place training	139
Ardana	Cambridge	Healthcare	Drug discovery	170
Language Line	London	Business services	Interpretation services	22
Vectura	Chippenham	Healthcare	Drug delivery	100
Xention Discovery	Cambridge	Healthcare	Drug discovery	19
<b>AiM-traded investments</b>				
Adventis	London	Media	Advertising agency	281
Begbies Traynor	Manchester	Business services	Insolvency specialists	525
Business Direct	Rugby	Business services	Secure remote lockers	522
Interactive Prospect Targeting	London	Business services	On line marketing	253
Jelf Group	Yate	Business services	Corporate financial services	393
MKM	Chester	Business services	Sales promotion	284
Polaron	Walford	IT support services	Electronic equipment	296
Prologic	Berkhamsted	IT support services	Fashion software	310
Quadnetics	Nottingham	Business services	CCTV security systems	296
Sanderson	Coventry	IT support services	Software systems	387
Scott Tod	Powys	Business services	ATM operators	421
WIN	High Wycombe	IT support services	Text messaging services	263
<b>Total investments in the year</b>				<b>£7,266</b>

# Portfolio Analysis

## Portfolio by Sector . . .

Company Investments (excluding fixed interest portfolio)

**Sector Analysis as at 31 December 2004**

## . . . and by Asset Classification

Total Assets less Current Liabilities

**Market Analysis as at 31 December 2004**

## . . . and by Development Stage

**by Value as at 31 December 2004**

## . . . and by Time Investments Held

# Investment Portfolio

Company	Nature of Business	Cost £'000	Valuation £'000	% of Total Assets less Current Liabilities	% of Equity held by Baronsmead VCT 3 plc	% of Equity held by Other Funds*
<b>Unquoted</b>						
Americana	Consumer	57	2,076	5.9	3.2	33.1
The Art Group	Media	1,281	1,830	5.2	7.0	18.0
AssA	Business services	1,113	1,614	4.6	13.1	33.9
Martin Audio	Business services	786	1,540	4.4	13.0	33.6
RLA Media	Media	681	1,347	3.8	8.7	21.3
kidsunlimited	Business services	481	1,112	3.2	4.1	46.9
Fretwell Downing	IT support services	685	811	2.3	5.8	18.8
Language Line	Business services	660	660	1.9	6.0	61.9
Ardana	Healthcare	619	619	1.7	1.4	1.1
SLR Holding	Business services	494	494	1.4	2.6	22.6
Country Artists	Consumer	448	448	1.3	5.3	54.7
Occam	Business services	420	420	1.2	4.1	35.9
Domantis	Healthcare	356	356	1.0	1.0	1.2
Hawksmere	Business services	766	345	1.0	10.4	34.6
Oxxon Pharmaccines	Healthcare	250	250	0.7	0.8	0.8
Xention Discovery	Healthcare	131	131	0.4	2.7	–
Spaform	Consumer	867	0	0	13.5	36.5
<b>Total unquoted</b>		<b>10,095</b>	<b>14,053</b>	<b>40.0</b>		
<b>AIM</b>						
Vectura	Healthcare	1,041	1,371	3.9	2.0	6.8
Huveaux	Media	559	1,230	3.5	2.0	3.7
Zoo Digital	IT support services	584	736	2.1	2.0	3.5
The Real Good Food Company	Consumer	540	734	2.1	2.8	7.7
Begbies Traynor	Business services	525	688	2.0	2.0	5.6
Murgitroyd Group	Business services	500	687	1.9	5.0	5.0
Air Music & Media Group	Media	575	604	1.7	2.3	3.8
IDOX	IT support services	600	593	1.7	2.9	4.4
Medal Entertainment & Media	Media	371	528	1.5	4.1	6.2
Colliers CRE	Business services	470	525	1.5	1.2	2.5
Sanderson Group	IT support services	387	464	1.3	1.9	5.5
Business Direct	Business services	522	459	1.3	3.9	7.2
Jelf Group	Business services	393	444	1.3	3.6	10.2
Scott Tod	Business services	421	385	1.1	2.3	6.0
Interactive Prospect Targeting	Business services	253	329	0.9	1.1	3.2
Stagecoach Theatre Arts	Consumer	419	327	0.9	4.6	4.6
Quadnetics	Business services	296	324	0.9	1.0	2.3
Prologic	IT support services	310	321	0.9	4.1	10.9
Adventis	Media	281	320	0.9	3.0	7.8
Polaron	IT support services	296	307	0.9	1.4	3.4
WIN	IT support services	263	278	0.8	1.4	3.9
neuTec Pharma	Healthcare	79	246	0.7	0.2	0.2
MKM	Business services	284	245	0.7	4.9	12.6
Cardpoint	Business services	92	200	0.6	0.3	0.7
VI Group	IT support services	300	199	0.6	3.7	10.5
Micap	Healthcare	325	174	0.5	2.0	3.9
Universe Group	IT support services	158	136	0.4	1.1	2.8
Blooms of Bressingham	Consumer	320	126	0.4	1.1	1.1
Xpertise	Business services	296	81	0.2	2.6	4.4
Capcon Holdings	Business services	137	62	0.2	1.7	3.4
<b>Total AIM</b>		<b>11,597</b>	<b>13,123</b>	<b>37.4</b>		
<b>Fixed Interest</b>						
UK Treasury 4.5% 07/03/07		4,941	5,005	14.3		
Money Market OEIC		2,042	2,043	5.8		
<b>Total fixed interest</b>		<b>6,983</b>	<b>7,048</b>	<b>20.1</b>		
<b>Total investments</b>		<b>28,675</b>	<b>34,224</b>	<b>97.5</b>		
<b>Net current assets</b>		<b>–</b>	<b>892</b>	<b>2.5</b>		
<b>Total assets less current liabilities</b>		<b>–</b>	<b>35,116</b>	<b>100.0</b>		

A provision of £1,288,000 has been made against unquoted investments as at 31 December 2004 (31 December 2003 – £649,000).

\*Other funds managed by the same Investment Managers, ISIS Equity Partners plc.

# Ten Largest Investments

by Current Value at 31 December 2004

## Americana Holdings Limited *Manchester*

<b>First Investment:</b>	July 2003	Year ended 30 June	<b>2004</b>	2002
<b>Cost:</b>	£57,000		<b>(18 months)</b>	
<b>Valuation:</b>	£2,076,000		<b>£ million</b>	£ million
<b>Valuation Basis:</b>	Discounted price earnings			
		Sales	<b>32.2</b>	25.3
<i>Americana is a fashion clothing business aimed at the youth market wholesaling and retailing under the brand names 'Bench' and 'Hooch'. In August 2003, £6.4m was raised to support a management buy-out.</i>		Profit before tax	<b>6.1</b>	4.9
		Retained profit	<b>4.1</b>	3.4
		Net assets	<b>5.2</b>	5.4

## The Art Group Limited *London*

<b>First Investment:</b>	October 2003	Year ended 31 December	<b>2003</b>	2002
<b>Cost:</b>	£1,281,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,830,000			
<b>Valuation Basis:</b>	Discounted price earnings			
		Sales	<b>18.3</b>	16.7
<i>The Art Group is a market leading publisher of art content on cards, posters and canvas prints sold to retailers in over 50 countries such as IKEA and Habitat. It raised £4.5m to support a management buy-out.</i>		Profit before tax	<b>2.0</b>	1.6
		Retained profit	<b>1.3</b>	1.1
		Net assets	<b>1.4</b>	2.5

## AssA Training and Learnings Limited *Tyne & Wear*

<b>First Investment:</b>	September 2003	Year ended 31 July	<b>2004</b>	2003
<b>Cost:</b>	£1,113,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,614,000			
<b>Valuation Basis:</b>	Discounted price earnings			
		Sales	<b>13.6</b>	7.2
<i>AssA Training and Learnings is a training developer and provider specialising in the marketing and delivery of public sector funded vocational training to the automotive and manufacture sectors. It raised £3m to support a management buy-out.</i>		Loss before tax	<b>(7.2)</b>	(10.8)
		Retained loss	<b>(7.8)</b>	(10.8)
		Net liabilities	<b>(6.9)</b>	(6.4)

## Martin Audio Limited *High Wycombe*

<b>First Investment:</b>	August 2003	Year ended 30 June	<b>2004</b>	2003
<b>Cost:</b>	£786,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,540,000			
<b>Valuation Basis:</b>	Discounted price earnings			
		Sales	<b>11.4</b>	9.5
<i>Martin Audio designs, assembles and markets high performance speaker systems for use in the concert and public entertainment markets, in the UK and overseas. It raised £3m of capital to support a management buy-out.</i>		Profit before tax	<b>1.1</b>	1.0
		Retained loss	<b>(0.8)</b>	–
		Net assets	<b>0.9</b>	1.3

## Vectura Limited *Chippenham*

<b>First Investment:</b>	April 2001	Year ended 31 March	<b>2004</b>	2003
<b>Cost:</b>	£1,041,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,371,000			
<b>Valuation Basis:</b>	Middle market price			
		Sales	<b>2.9</b>	3.5
<i>Vectura is a small, but rapidly growing drug formulation and drug delivery company. The role of drug delivery is to encapsulate a drug into an appropriate system that is acceptable for human use. The Company raised three rounds of capital between April 2001 and November 2002. Vectura floated on AiM in July 2004.</i>		Loss before tax	<b>(9.0)</b>	(6.9)
		Retained loss	<b>(8.1)</b>	(5.5)
		Net assets	<b>6.4</b>	14.4

# Ten Largest Investments

## RLA Media Limited *Bournemouth*

First Investment:	December 2002	Year ended 31 May	2004	2003*
<b>Cost:</b>	£681,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,347,000	Sales	<b>10.6</b>	4.5
<b>Valuation Basis:</b>	Discounted price earnings	Profit before tax	<b>1.7</b>	0.4
		Retained profit	<b>0.6</b>	0.1
		Net assets	<b>3.5</b>	2.9

*RLA is a regional marketing services agency, predominantly servicing national and multinational brands selling through local outlets. £2.4m was raised in December 2002 to fund a replacement capital deal.*

\*for the period from 19 November 2002 to 31 May 2003

## Huveaux Plc *London*

First Investment:	March 2003	Year ended 31 December	2003	2002
<b>Cost:</b>	£559,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,230,000	Sales	<b>1.5</b>	1.1
<b>Valuation Basis:</b>	Middle market price	Profit before tax	<b>1.2</b>	0.4
		Retained profit	<b>0.3</b>	0.3
		Net assets	<b>21.6</b>	6.1

*Huveaux is a publishing and media group with a strategy to expand into the government and educational sectors. The company joined AiM in December 2001. The Group raised £7.6m to purchase Lonsdale Publishing and support the Group's buy and build strategy.*

## kidsunlimited Limited *Wilmslow*

First Investment:	August 2003	Year ended 30 April	2004	2003
<b>Cost:</b>	£481,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£1,112,000	Sales	<b>16.8</b>	13.8
<b>Valuation Basis:</b>	Discounted price earnings	Loss before tax	<b>(1.3)</b>	(1.3)
		Retained loss	<b>(1.3)</b>	(1.3)
		Net liabilities	<b>(3.6)</b>	(2.3)

*kidsunlimited is a major UK provider of day care facilities for children under five years old. The company operates a combination of owned nurseries and those located within the workplace. It raised £4.95m to fund expansion and a share reorganisation.*

## Fretwell Downing Limited *Sheffield*

First Investment:	April 2002	Year ended 31 May	2004	2003
<b>Cost:</b>	£685,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£811,000	Sales	<b>4.6</b>	4.7
<b>Valuation Basis:</b>	Discounted revenue multiple	Profit/(loss) before tax	<b>0.1</b>	(1.7)
		Retained loss	<b>–</b>	(1.5)
		Net assets	<b>1.8</b>	1.5

*Fretwell Downing provides software solutions to public, research and corporate libraries across the UK, the USA and Australia. In April 2002, £3.2m of institutional equity money was raised.*

## Zoo Digital Group plc *Sheffield*

First Investment:	November 2003	Year ended 31 December	2003	2002
<b>Cost:</b>	£584,000		<b>£ million</b>	£ million
<b>Valuation:</b>	£736,000	Sales	<b>5.1</b>	1.9
<b>Valuation Basis:</b>	Middle market price	Loss before tax	<b>(1.5)</b>	(2.3)
		Retained loss	<b>(1.5)</b>	(2.2)
		Net assets	<b>9.2</b>	3.7

*Zoo Digital is a digital media developer and solutions provider, particularly for interactive DVD software. It joined AiM in 2001 and raised £5.7m of institutional equity in November 2003.*

# Tax Benefits for Shareholders

## Tax benefits for individuals

*The following is a summary of the main tax benefits available to individuals who subscribe for or purchase shares in a VCT. Investors are recommended to take professional advice as to how these might apply to their own circumstances.*

Venture Capital Trusts are fully listed companies whose shares are traded on the London Stock Exchange. VCTs invest in small unquoted companies, which includes companies whose shares are traded on AiM, that carry on qualifying trading activities mainly in the UK.

To obtain VCT tax reliefs, a VCT investor must be an individual 'qualifying individual' over the age of 18 with UK taxable income who is UK resident for tax purposes. An eligible investor can invest up to £200,000 per annum in VCT shares. This annual limit includes subscriptions for new VCT shares and investments in existing shares and includes shares issued through a VCT dividend reinvestment scheme.

No tax is payable by a VCT on any income (other than interest) that arises within the VCT and any gains it makes on the disposal of its investments are free of tax. Furthermore, provided the VCT has sufficient realised capital reserves, these gains can be distributed tax-free to shareholders.

## Tax reliefs on subscription for new VCT shares

*The following tax reliefs are available on subscription for new shares provided no more than £200,000 is invested in VCT shares in any one tax year.*

1. Initial Income Tax relief increased from 20% to 40% from 6 April 2004.

This initial income tax relief will be withdrawn if the investor does not hold the shares for a minimum period of five years for VCT shares issued before 5 April 2000 and three years for shares issued thereafter ('the holding period').

2. VCT dividends (including capital distributions of realised gains on investments) are not subject to income tax.
3. Capital gains on disposal of VCT shares are tax free, whenever the disposal occurs.

## Sources of new VCT shares

- Offers for subscription
- Dividend reinvestment scheme for the existing shareholders of a VCT

## Consequences of selling shares that were new VCT shares when acquired

- Provided the VCT shares have been held for the holding period, no initial income tax relief is withdrawn. If the VCT shares are sold within the holding period, initial income tax relief is withdrawn.
- No CGT payable on any profit made on the VCT shares (no allowable loss for losses made on disposal).
- If a gain was deferred at the time of the subscription to the VCT (prior to 6 April 2004), it comes back into charge as a gain in the year of disposal.

- For part disposals, the part of the gain deferred, which relates to the part of the holding sold, becomes chargeable to tax as a gain in the tax year of disposal. If the gain deferred was less than the amount subscribed, the part of the shareholding on which no gain was deferred, is treated as having been disposed of first.

## Tax reliefs on VCT shares purchased through the market (listed VCT shares)

1. VCT dividends (including capital distributions of realised gains on investments) are not subject to income tax.
2. Tax-free capital gains on disposal of VCT shares, whenever the disposal occurs.

These tax reliefs are available regardless of the length of time the shares are held. Individuals who are most likely to buy existing VCT shares are those who:

- Anticipate an increase in the NAV per share and the share price
- Require tax-free income
- Need an additional and/or flexible scheme for pension planning
- Want venture capital exposure within a self administered pension scheme.

## Source of listed VCT shares

The shares in an existing VCT can be bought and sold via a stockbroker, just like shares in any other listed company. Prior to the relevant anniversary of the issue of shares, there may be a limited supply of shares, as the original subscribers, in order to retain initial income tax relief, may not wish to dispose of their shares during the holding period.

## Consequences of disposing of shares which were existing shares when bought

- No CGT payable on profits made on VCT shares (no allowable loss for losses made on disposal)
- There is no required holding period for these shares but on a part disposal, shares acquired earliest (subscribed or purchased) will be treated as disposed of before later acquisitions.

## Estate Planning

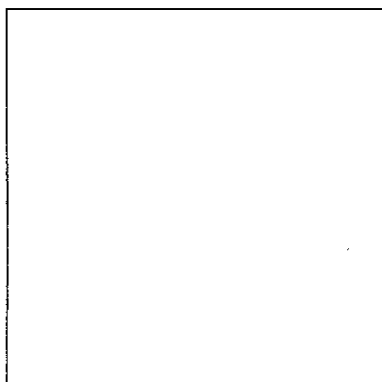
If an investor dies owning VCT shares they form part of their estate for inheritance tax purposes because they are quoted shares. If a qualifying individual inherits VCT shares, VCT reliefs are retained provided the value of the shares inherited and acquired in that tax year does not exceed the £200,000 limit.

On death, no CGT is payable on any gain that was deferred at the time of the investment or on any increase in the value of VCT shares themselves.

If death occurs within the holding period, the initial income tax relief is not withdrawn.

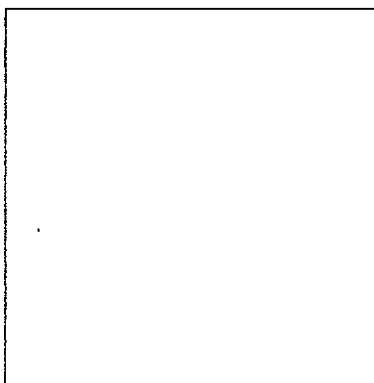
# Board of Directors

as at 31 December 2004



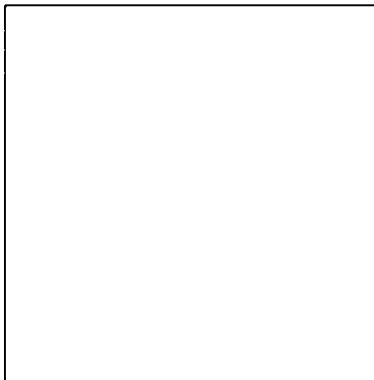
## Mark Cannon Brookes (Chairman)

(age 65) is a director of NCL Smith & Williamson. The NCL group has £6 billion of investments under management. He is chairman of CG Asset Management Limited and is also a director of ISIS UK Select Trust plc and a number of other companies, mostly overseas.



## Andrew Karney

(age 62) is deputy chairman and a shareholder of Language Line Limited in which Baronsmead VCT 3 is an investor. He is also a director of The Guardian Media Group plc, Guardian Newspapers Limited and a number of unquoted companies. Previously he was a director of Integrated Micro Products plc, a founder director of Cable London plc and an executive director of Logica plc.



## Gillian Nott

(age 59) was until March 1999 chief executive of ProShare (UK) Limited. She was, until recently, a director of the Financial Services Authority and is on the board of a number of listed and unlisted companies including Foreign and Colonial Pacific Investment Trust plc and Martin Currie Portfolio Investment Trust plc. Previously she worked for the BP Group where she managed their venture capital portfolio. She is also chairman of Baronsmead VCT plc and a director of Baronsmead VCT 2 plc.



## Robert Owen

(age 59) is a director of Baronsmead VCT 4 plc. Previously he was a senior manager at Coutts and Co, responsible for the overall running of the venture capital investment portfolio.

As a fully listed Company, Baronsmead VCT 3 is required to comply with the Combined Code relating to its Corporate Governance. This Code requires the Company to be headed by an effective Board of Directors who lead and control the Company's affairs.

The Directors of a VCT and investment managers are required under the listing and continuing obligations of the London Stock Exchange to have sufficient and satisfactory experience in the management of a portfolio of unquoted investments of the size and type in which the VCT proposes to invest.

# Report of the Directors

## Results and Dividends

The Directors submit the Fourth Report and Accounts of the Company for the year ended 31 December 2004.

	£'000
Unrealised gain on revaluation of investments	<b>4,173</b>
Loss on ordinary activities after taxation	<b>(59)</b>
Interim dividend of 1.8p per share paid on 12 August 2004	<b>(612)</b>
Final dividend for the year of 2.7p per ordinary share payable on 24 March 2005 to shareholders on the register on 18 February 2005	<b>(900)</b>
Transferred from profit and loss account	<b>(1,571)</b>
Retained gain during the year	<b>2,602</b>

## Principal Activity and Status

The Company is registered as a Public Limited Company under the Companies Act 1985. The Directors have managed and intend to continue to manage the Company's affairs in such a manner as to comply with Section 842AA of the Income and Corporation Taxes Act and the Company has received full approval as a Venture Capital Trust from the Inland Revenue for the year to 31 December 2003. A review of the Company's business during the year is contained in the Chairman's Statement and Manager's Review.

## Issue and Buy-Back of Shares

During the year the Company issued 883,614 Ordinary Shares and raised net proceeds of £860,000. The Company bought back for cancellation 1,485,000 Ordinary Shares (being 4.5 per cent of closing issued share capital) during the year, at a cost of £1,340,000 (2003: 85,000 shares at a cost of £74,000).

## Directors

Biographies of the Directors are shown on page 12.

Gillian Nott and Robert Owen whose biographies appear on page 12 both retire by rotation at the fourth Annual General Meeting of the Company and, being eligible, offer themselves for re-election.

The Board confirms that following performance evaluations, the performance of each of the Directors seeking re-election continues to be effective and demonstrates commitment to the role and believes that it is therefore in the best interest of shareholders that these Directors are re-elected.

The Directors who held office during the year, and their interests in the Ordinary Shares of the Company, were:

	31 December 2004 Ordinary 10p Shares	31 December 2003 Ordinary 10p Shares
Mark Cannon Brookes	<b>112,128</b>	<b>106,513</b>
Andrew Karney	<b>23,098</b>	<b>21,941</b>
Gillian Nott	<b>15,450</b>	<b>15,450</b>
Robert Owen	<b>10,709</b>	<b>10,709</b>

There have been no changes in the holdings of the Directors between 31 December 2004 and 9 February 2005.

No Director has a service contract with the Company.

## Corporate Governance

Arrangements to ensure the appropriate level of corporate governance have been put in place by the Board, which it believes are appropriate to a venture capital trust. During the year the Company took the necessary steps such that, except as disclosed below, it also complies with the provisions of the revised Combined Code on Corporate Governance issued by the Financial Reporting Council in July 2003, which is applicable for accounting years beginning on or after 1 November 2003 ('the revised Code').

Since all Directors are non executive, the Company is not required to comply with the provisions of the revised Code in respect of the Directors' remuneration, except in so far as they relate specifically to non-executive Directors.

The Board consists solely of non-executive Directors of which Mark Cannon Brookes is Chairman and Andrew Karney is Senior Independent Director. All Directors are considered by the Board to be independent of the Company's Manager. New Directors will receive an induction from the Manager on joining the Board, and all Directors receive other relevant training as necessary.

Mark Cannon Brookes is a Director of ISIS UK Select Trust plc, which is managed by F&C Asset Management plc. Gillian Nott is Chairman of Baronsmead VCT plc and is a Director of Baronsmead VCT 2 plc and F&C Pacific Investment Trust plc, which is managed by F&C Asset Management plc. Robert Owen is a Director of Baronsmead VCT 4 plc. The Board does not consider that a Director's tenure reduces his ability to act independently. The Board believes that, as a whole, it comprises an appropriate balance of skills, experience and tenure. It also believes that each Director is independent in character and judgement and that there are no relationships or circumstances which are likely to affect the judgement of any Director.

# Report of the Directors

The Company has no executive Directors or employees.

A management agreement between the Company and its Manager, ISIS Equity Partners plc, sets out the matters over which the Manager has authority and the limits above which Board approval must be sought. All other matters, including strategy, investment and dividend policies, gearing and corporate governance procedures, are reserved for the approval of the Board of Directors. The Board meets at least quarterly and receives full information on the Company's investment performance, assets, liabilities and other relevant information in advance of Board meetings. The Manager, in the absence of explicit instructions from the Board, is empowered to exercise discretion in the use of the Company's voting rights. All shareholdings are voted, where practicable, in accordance with the Manager's own corporate governance policy, which is to seek to maximise shareholder value by constructive use of votes at company meetings and by endeavouring to use its influence as an investor with a principled approach to corporate governance.

Throughout the year a number of committees have been in operation. The committees are the Audit Committee, the Management Engagement and Remuneration Committee and the Nomination Committee.

The Audit Committee, chaired by Mark Cannon Brookes, operates within clearly defined terms of reference and comprises all of the Directors. The duties of the Audit Committee include reviewing the Annual and Interim Accounts, the system of internal controls, the terms of appointment of the auditors together with their remuneration, and ensuring that auditor objectivity and independence is safeguarded in the provision of non audit services by the auditors. It also provides a forum through which the auditors may report to the Board of Directors and meets at least twice yearly. The Board has reviewed the revised Code's recommendation that the position of Audit Committee Chairman should not be held by the Chairman of the Board, but concluded that Mark Cannon Brookes as Chairman of the Board was suited to the role.

The Management Engagement and Remuneration Committee, chaired by Mark Cannon Brookes, comprises the full Board and reviews the appropriateness of the Manager's appointment together with the terms and conditions thereof on a regular basis.

The Nomination Committee, chaired by Mark Cannon Brookes, comprises the full Board and is convened for the purpose of considering the appointment of additional Directors as and when considered appropriate. In considering appointments to the Board, the Nomination Committee takes into account the ongoing requirements of the Company and the need to have a balance of skills and experience within the Board.

During the year the performance of the Board, committees and individual Directors was evaluated through an assessment process, led by the Chairman. The performance of the Chairman was evaluated by the other Directors under the leadership of the Senior Independent Director.

The following table sets out the number of Board and Committee meetings held for the period to 2 February 2005 and the number of meetings attended by each Director.

	Board of Directors*		Audit Committee		Management Engagement and Remuneration Committee		Nomination Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mark Cannon Brookes (Chairman)	4	4	2	2	1	1	1	1
Andrew Karney	4	4	2	2	1	1	1	1
Gillian Nott	4	3	2	2	1	1	1	1
Robert Owen	4	4	2	2	1	1	1	1

\* Incorporate valuation meetings.

Individual Directors may, at the expense of the Company, seek independent professional advice on any matter that concerns them in the furtherance of their duties. The Company maintains appropriate Directors' and Officers' liability insurance.

After making enquiries, and bearing in mind the nature of the Company's businesses and assets, the Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

## Internal Control

The Board is responsible for the Company's system of internal control and for reviewing its effectiveness. The Board has therefore established an ongoing process designed to meet the particular needs of the Company in managing the risks to which it is exposed, consistent with the guidance provided by the Turnbull Committee. The process is based principally on the Manager's existing risk-based approach to internal control whereby a test matrix is created that identifies the key functions carried out by the Manager and other service providers, the individual activities undertaken within those functions, the risks associated with each activity and the controls employed to minimise those risks. A residual risk rating is then applied. The test matrix is regularly updated and the Board is provided with regular reports highlighting all material changes to the risk ratings and confirming the action which has been, or is being, taken. A formal annual review of these procedures is carried out by the Audit Committee and includes consideration of FRAG 21 and similar reports issued by the Manager and other service providers.

# Report of the Directors

Such review procedures have been in place throughout the financial year and up to the date of approval of the Annual Report and the Board is satisfied with their effectiveness. By their nature these procedures can provide reasonable, but not absolute, assurance against material misstatement or loss. The Board monitors the investment performance of the Company in comparison to the benchmark index and to comparable venture capital trusts at each Board meeting. The Board also reviews the Company's activities since the last Board meeting to ensure that the Manager adhere to the agreed investment policy and approved investment guidelines and, if necessary, approve changes to such policy and guidelines.

The Board has reviewed the need for an internal audit function. The Board has decided that the systems and procedures employed by the Manager, including their internal audit function and the work carried out by the Company's external auditors, provide sufficient assurance that a sound system of internal control, which safeguards shareholders' investment and the Company's assets, is maintained. An internal audit function, specific to the Company, is therefore considered unnecessary.

## Relations with Shareholders

The Company welcomes the views of shareholders and places great importance on communication with its shareholders. The Chairman and other Directors are available to meet shareholders if required. The Annual General Meeting of the Company provides a forum both formal and informal, for shareholders to meet and discuss issues with the Directors and Manager of the Company. Details of the resolutions to be proposed at the Annual General Meeting on 23 March 2005 can be found in the Notice of Meeting on page 31.

## Management

ISIS Equity Partners plc ("the Manager") manages the AIM, unquoted investments and fixed interest investments for the Company. The Manager will also provide or procure the provision of secretarial, administrative and custodian services to the Company. The management agreement had an initial fixed term of three years which has now expired and may be terminated at any date by either party giving twelve months' notice of termination. Under the management agreement, the Manager received a fee of 2 per cent per annum of the net assets of the Company in the first three years and will receive 2.5 per cent per annum thereafter. In addition, the Manager receives an annual administration fee of £31,968 (adjusted for the movement in RPI) plus a variable administration fee equivalent to 0.125 per cent per annum on net assets over £5 million, subject to annual review. Annual running costs are capped at 3.5 per cent of the net assets of the Company (excluding any performance fee payable to the Manager and irrecoverable VAT), any excess being refunded by the Manager by way of an adjustment to its management fee.

It is the Board's opinion that the continuing appointment of ISIS Equity Partners plc on the terms agreed is in the best interests of shareholders as a whole.

## Performance Incentive

The Manager may become entitled to receive a performance fee from the Company calculated by reference to the increase (if any) in the net asset value of the Company, calculated on the assumption that any dividends paid by the Company are re-invested by way of subscription for further shares (the 'Total Return').

No performance fee will be paid unless and until the Total Return on net proceeds of the Offers exceeds 8 per cent per annum (simple) over the period from the issue of shares under the 2001/2002 Offers to the end of the relevant accounting period. To the extent that the Total Return to the end of an accounting period exceeds this threshold, a performance fee (plus VAT) will be paid to the Manager of 20 per cent of the excess. The first performance fee will not be paid to the Manager unless and until the Total Return on the net proceeds of the Offers exceeds 40 per cent. In addition, the amount of any performance fee due which is paid in respect of an accounting period shall not exceed 5 per cent of the net asset value of the Company at the end of the year.

In the event that the Company purchases shares or raises new capital, the threshold returns required in order for the Manager to earn a performance fee will be adjusted so that the Manager's entitlement is unaffected by the purchase of new capital raising.

## Co-investment Scheme

The Directors wish to ensure the Manager continues to have one of the best investment teams in the VCT/private equity market place. They have supported this objective by introducing a co-investment incentive scheme which they believe will help to attract, recruit, retain and incentivise the Manager's staff.

## ISIS Equity Partners plc – Arrangement Fees

During the year to 31 December 2004, ISIS Equity Partners plc received net income of £39,403 in connection with arrangement fees and after abort costs in investee companies.

## VCT Status Adviser

The Company has retained PricewaterhouseCoopers LLP (PwC) as the VCT Tax Status Advisers to the Company. PwC review new investment opportunities, as appropriate, and review regularly the investment portfolio of the Company. PwC work closely with the Manager but report directly to the Board.

# Report of the Directors

## Environment

The Company seeks to conduct its affairs responsibly and environmental factors are, where appropriate, taken into consideration with regard to investment decisions.

## Creditor Payment Policy

The Company's payment policy is to settle investment transactions in accordance with market practice and to ensure settlement of supplier invoices in accordance with stated terms.

The Company did not have any trade creditors at the year end.

## Auditors

PKF have expressed their willingness to continue in office as auditors and a resolution proposing their re-appointment will be submitted at the Annual General Meeting.

## Substantial Interests

At 9 February 2005 the Company was not aware of any beneficial interest exceeding 3 per cent of the issued Ordinary Share capital.

## Directors' Authority to Allot Shares and to Disapply Pre-emption Rights

The authorities proposed under Resolutions 7 and 8 are required so that the Directors may offer existing shareholders the opportunity to add to their investment or to offer to potential shareholders an opportunity to invest in the Company in a tax efficient manner without the Company having to incur substantial costs. Any consequent modest increase in the size of the Company will, in the opinion of the Directors, be in the interests of shareholders generally and will not dilute their existing interest. Any such issues would only be made at a price greater than the net asset value per share and therefore would increase the assets underlying each Ordinary Share. The issue proceeds would be available for investment in line with the Company's investment policy and may be used, in part, to purchase ordinary shares in the market.

Resolution No. 7 renews the Directors' authority to issue Ordinary Shares. This would enable the Directors, until 22 March 2010, to allot up to 25,020,760 Ordinary Shares (representing approximately 75 per cent of the Company's issued share capital as at 9 February 2005).

Resolution No. 8 renews and extends (see 'Dividend Reinvestment' below) the Directors' authority to allot equity securities for cash without pre-emption rights applying in certain circumstances. This resolution would authorise the Directors,

until the date falling 15 months after the date of the passing of the resolution or, if earlier, the conclusion of the next Annual General Meeting of the Company to issue Ordinary Shares for cash without pre-emption rights applying by way of offer to existing shareholders, under the Dividend Reinvestment Scheme, or otherwise up to a maximum of 10,008,300 Ordinary Shares (representing approximately 30 per cent of the Company's issued share capital as at 9 February 2005).

## Dividend Reinvestment

The Directors offer shareholders the opportunity to reinvest their dividends by subscribing for new Ordinary Shares in the Company.

The substantial tax reliefs detailed on page 11, should be available to qualifying investors reinvesting their dividends in these new Ordinary Shares. Such reliefs will not be available in any tax year where a shareholder has already subscribed £200,000 for venture capital trust shares. In the event of the Company being wound up within three years of such shares being issued (under dividend reinvestment or otherwise) then shareholders may be required to repay their initial income tax relief.

The extension of the Directors' authority to allot equity securities for cash without pre-emption rights applying referred to above (see 'Directors' Authority to Allot Shares and to Disapply Pre-emption Rights') will enable the Directors to allot Ordinary Shares when dividends are reinvested.

## Directors' Authority to Purchase Shares

The current authority of the Company to make purchases of up to approximately 14.99 per cent of its issued share capital expires at the end of the Annual General Meeting and resolution 9 seeks renewal of such authority until the Annual General Meeting in 2006 (or the expiry of 15 months, if earlier). The price paid for shares will not be less than the nominal value of 10p per share nor more than the maximum amount determined by the rules of the UK Listing Authority at the time of purchase (which currently set a maximum equal to 5 per cent above the average of the market values of those shares for the five business days before the shares are purchased). This power will be exercised only if, in the opinion of the Directors, a repurchase would be in the best interests of shareholders as a whole. The funding required to purchase Ordinary Shares would be met either from available cash resources, including borrowing facilities, or from selling investments in the portfolio. Any Ordinary Shares repurchased under this authority will either be cancelled or held in treasury for future re-sale in appropriate market conditions.

# Report of the Directors

The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 ('the Regulations') came into force on 1 December 2003. The Regulations allow companies (such as the Company) to hold shares acquired by way of market purchase as treasury shares, rather than having to cancel them. Up to 10 per cent of each class of a Company's shares may be held in this way. Such shares may be subsequently cancelled or sold for cash.

This would give the Company the ability to re-issue treasury shares quickly and cost efficiently, and would provide the Company with additional flexibility in the management of its capital base.

## Extension to the Life of the Company

A survey was carried out during September 2003 to which over 600 shareholders responded. Shareholders indicated both income tax relief and capital growth as their main long term objectives. Furthermore, approximately 80 per cent of shareholders have indicated that they expect to hold their shares in the Company for the foreseeable future.

The Board of Baronsmead VCT 3 offers shareholders the opportunity to top up their investment through offers for subscription and a Dividend Reinvestment Scheme, to obtain further income tax relief. This can only happen if these shares are held for three years, which requires the life of the Company to be extended. In addition, the longer life will enable newer investments the time to develop and potentially increase shareholder value. Resolution No. 10 seeks to amend the Company's articles of association to extend the life of the Company to the Annual General Meeting in 2013.

By Order of the Board,

**Rhonda Nicoll**

for F&C Asset Management plc

Secretary

80 George Street  
Edinburgh EH2 3BU

9 February 2005



# Directors' Remuneration Report

The Board has prepared this report, in accordance with the requirements of Schedule 7A to the Companies Act 1985. An ordinary resolution for the approval of this report will be put to the members at the forthcoming Annual General Meeting.

The law requires the Company's auditors to audit certain of the disclosures provided. Where disclosures have been audited, they are indicated as such. The auditors' opinion is included in their report on page 30.

## Directors' Fees

The Board consists solely of independent non-executive Directors and considers at least annually the level of the Board's fees, in accordance with the Combined Code on Corporate Governance. The Company Secretary provides information on comparative levels of Directors' fees to the Board in advance of each review.

The Remuneration Committee is Mark Cannon Brookes (Chairman), Andrew Karney, Gillian Nott and Robert Owen. As the Company has no executive Directors, the Committee meets, at least annually, to determine the remuneration and terms of appointment of the Investment Manager.

## Policy on Directors' Fees

The Board's policy is that the remuneration of non-executive Directors should reflect the experience of the Board as a whole, be fair and comparable to that of other relevant venture capital trusts that are similar in size and have similar investment objectives and structures. Furthermore the level of remuneration should be sufficient to attract and retain the Directors needed to properly oversee the Company and to reflect the specific circumstances of the Company, the duties and responsibilities of the Directors and the value and amount of time committed to the Company's affairs. It is intended that this policy will continue for the year ended 31 December 2005 and subsequent years.

The fees for the non-executive Directors are determined within the limits set out in the Company's Articles of Association. The present limit is £55,493 per annum and the approval of shareholders in a general meeting would be required to change this limit. Non-executive Directors are not eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits.

## Directors' service contracts

It is the Board's policy that Directors do not have service contracts, but new Directors are provided with a letter of appointment.

Director	Date of Original Appointment	Due date for Re-election
Mark Cannon Brookes	10 January 2001	AGM 2006
Andrew Karney	10 January 2001	AGM 2007
Gillian Nott	10 January 2001	AGM 2005
Robert Owen	10 January 2001	AGM 2005

The terms of Directors' appointment are for an initial period of three years and provide that a Director shall retire and be subject to re-election at the first annual general meeting after

their appointment. Directors are thereafter obliged to retire by rotation, and, if they wish, to offer themselves for re-election by shareholders, at least every three years after that. There is no notice period and no provision for compensation upon early termination of appointment.

## Company performance

The Board is responsible for the Company's investment strategy and performance, although the management of the Company's investment portfolio is delegated to the Manager through the investment management agreement, as referred to in the 'Report of the Directors'. The graph below compares from 29 January 2001 (the date the Company commenced trading) to 31 December 2004, the percentage change over each period in the total return (assuming all dividends are reinvested) to ordinary shareholders compared to the percentage change over each period in total shareholder return on a notional investment made up of shares of the same kinds and number as those by reference to which the FTSE All-Share Index is calculated. This index was chosen for comparison purposes, as it represents a comparable broad equity market index against which investors can measure the relative performance of the fund. An explanation of the performance of the Company is given in the Chairman's statement and Manager's review.

## Share Price Total Return and FTSE All-Share Index Total Return Performance Graph

## Directors' emoluments for the year (audited)

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

	Fees 2004 £	Fees 2003 £
Mark Cannon Brookes	16,500	15,000
Andrew Karney	11,000	10,000
Gillian Nott	11,000	10,000
Robert Owen	11,000	10,000

On behalf of the Board,  
**Mark Cannon Brookes**  
Chairman  
9 February 2005



# Profit and Loss Account

for the year ended 31 December 2004

	Notes	2004 Revenue £'000	2004 Capital £'000	2004 Total £'000	2003 Revenue £'000	2003 Capital £'000	2003 Total £'000
Profit on realisation of investments	8	–	200	200	–	1,199	1,199
Income	2	987	–	987	1,472	–	1,472
Investment management fee	3	(248)	(745)	(993)	(193)	(581)	(774)
Other expenses	4	(253)	–	(253)	(241)	–	(241)
<b>Profit/(loss) on ordinary activities before taxation</b>		<b>486</b>	<b>(545)</b>	<b>(59)</b>	1,038	618	1,656
Tax on ordinary activities	5	(76)	76	–	(268)	185	(83)
<b>Profit/(loss) on ordinary activities after taxation</b>		<b>410</b>	<b>(469)</b>	<b>(59)</b>	770	803	1,573
Dividends paid/payable	6	(402)	(1,110)	(1,512)	(747)	(679)	(1,426)
Retained profit/(loss) transferred to/(from) reserves		8	(1,579)	(1,571)	23	124	147
<b>Return per ordinary 10p share</b>	7	<b>1.21p</b>	<b>(1.38)p</b>	<b>(0.17)p</b>	2.27p	2.37p	4.64p

# Statement of Total Recognised Gains and Losses

for the year ended 31 December 2004

	Notes	2004 Revenue £'000	2004 Capital £'000	2004 Total £'000	2003 Revenue £'000	2003 Capital £'000	2003 Total £'000
Profit/(loss) on ordinary activities after taxation		410	(469)	(59)	770	803	1,573
Unrealised gain on revaluation of investments	8	–	4,173	4,173	–	638	638
<b>Total recognised gain during the year</b>		<b>410</b>	<b>3,704</b>	<b>4,114</b>	770	1,441	2,211
Total recognised gain per ordinary share		<b>1.21p</b>	<b>10.92p</b>	<b>12.13p</b>	2.27p	4.25p	6.52p

# Note of Historical Cost Profits and Losses

for the year ended 31 December 2004

	2004 £'000	2003 £'000
(Loss)/profit on ordinary activities before taxation	(59)	1,656
Realisation of revaluation (losses)/profits of previous years	(319)	506
<b>Historical cost (loss)/profit on ordinary activities before taxation</b>	<b>(378)</b>	2,162
Historical cost (loss)/profit for the year retained after taxation and dividends	<b>(1,890)</b>	653

All items in the above statement derive from continuing operations.  
No operations were acquired or discontinued in the year.  
The accompanying notes are an integral part of this statement.

# Balance Sheet

as at 31 December 2004

	Notes	2004 £'000	2003 £'000
<b>Fixed assets</b>			
Investments	8	<b>34,224</b>	23,946
<b>Current assets</b>			
Debtors	9	<b>260</b>	123
Cash at bank and on deposit		<b>1,951</b>	10,908
		<b>2,211</b>	11,031
<b>Creditors</b> (amounts falling due within one year)	10	<b>(1,319)</b>	(1,983)
<b>Net current assets</b>		<b>892</b>	9,048
<b>Total assets less current liabilities</b>		<b>35,116</b>	32,994
<b>Capital and reserves</b>			
Called-up share capital	11	<b>3,335</b>	3,396
Share premium account	12	<b>1,786</b>	1,014
Capital redemption reserve	12	<b>175</b>	26
Revaluation reserve	12	<b>5,549</b>	1,057
Profit and loss account	12	<b>24,271</b>	27,501
<b>Equity shareholders' funds</b>	13, 14	<b>35,116</b>	32,994
<b>Net asset value per share</b>			
- Basic	13	<b>105.26p</b>	97.15p

The financial statements on pages 19 to 29 were approved by the Board of Directors on 9 February 2005 and were signed on its behalf by:



MARK CANNON BROOKES (Chairman)

The accompanying notes are an integral part of this balance sheet.

# Cash Flow Statement

for the year ended 31 December 2004

	Notes	2004 £'000	2003 £'000
<b>Operating activities</b>			
Investment income received		786	1,310
Deposit interest received		69	228
Other income		–	–
Investment management fees		(939)	(764)
Other cash payments		(224)	(270)
Net cash (outflow)/inflow from operating activities	16	(308)	504
<b>Taxation</b>			
Corporation tax paid		(83)	(215)
Taxation paid		(83)	(215)
<b>Capital expenditure and financial investment</b>			
Purchase of investments		(20,511)	(12,539)
Disposal of investments		14,158	19,190
Net cash (outflow)/inflow from capital expenditure and financial investment		(6,353)	6,651
<b>Dividends</b>			
Equity dividends paid		(1,733)	(778)
Net cash (outflow)/inflow before financing		(8,477)	6,162
<b>Financing</b>			
Issue of ordinary shares		875	243
Buy-back of ordinary shares		(1,340)	(74)
Expenses of the issue		(15)	(10)
Net cash (outflow)/inflow from financing		(480)	159
<b>(Decrease)/Increase in cash</b>		<b>(8,957)</b>	6,321
<b>Reconciliation of net cash flow to movement in net cash</b>			
(Decrease)/increase in cash in the year		(8,957)	6,321
Net cash at 31 December 2003		10,908	4,587
<b>Net cash at 31 December 2004</b>	15	<b>1,951</b>	10,908

The accompanying notes are an integral part of these statements

# Notes to the Accounts

## 1. Accounting policies

### (a) Basis of accounting

These financial statements have been prepared under the historical cost convention, modified to include the revaluation of fixed asset investments. These financial statements are presented in accordance with the Investment Trust Companies SORP (including the provision of additional information) except where departures are necessary to comply with Schedule 4 of the Companies Act 1985 as a result of the fact that the Company has relinquished its investment company status under the Act.

### (b) Valuation of investments

In respect of quoted investments the British Venture Capital Association (BVCA) have stated that VCTs should have regard to Generally Accepted Accounting Practice in the valuation of investments and accordingly these are valued at mid market price, in accordance with the Investment Trust Companies SORP. The Directors consider the need for discounts as appropriate.

Unquoted investments are valued by the Directors in accordance with the following rules, which are consistent with the British Venture Capital Association (BVCA) guidelines:

1. Following the issue of new BVCA guidelines, investments are to be held at cost for a limited period only and not necessarily for a full 12 month period as has been the case in the past. The Company values new investments on a price earnings basis when audited financial statements are available within the first 12 months of the investment being made.
2. Investments outwith the initial limited holding period are valued using a price earnings ratio (at a significant discount to an appropriate stock market prospective price earnings ratio) in the absence of overriding factors. Where such factors apply, alternative methods of valuation will include application of an arm's length third party valuation, a provision on cost, or a net asset basis.

### (c) Income

Interest income on loan stock and dividends of preference shares are accrued on a daily basis. Provision is made against this income when recovery is doubtful.

Dividends on quoted shares are recognised as income on the date that the related investments are marked ex-dividend and, where no dividend date is quoted, when the Company's right to receive payment is established.

Income from fixed interest securities and deposit interest are included on an accruals basis.

### (d) Expenses

All expenses are accounted for on an accruals basis.

### (e) Revenue/capital

The revenue column of the profit and loss account includes all income and expenses. The capital column accounts for the realised profit and loss on investments and the proportion of management fee charged to capital.

### (f) Issue costs

Issue costs are deducted from the share premium account in accordance with Financial Reporting Standard No. 4.

### (g) Deferred taxation

Deferred taxation is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or right to pay less, tax in future have occurred at the balance sheet date. This is subject to deferred tax assets only being recognised if it is considered more likely than not that there will be suitable profits from which the future reversal of the underlying timing differences can be deducted. Timing differences are differences arising between the Company's taxable profits and its results as stated in the financial statements which are capable of reversal in one or more subsequent periods.

# Notes to the Accounts

## 2. Income

	2004 £'000	2003 £'000
<b>Income from investments</b>		
UK franked	174	108
UK unfranked	744	1,136
	<b>918</b>	1,244
<b>Other income</b>		
Deposit interest	69	228
<b>Total income</b>	<b>987</b>	1,472
<b>Total income comprises:</b>		
Dividends	174	108
Interest	813	1,364
	<b>987</b>	1,472
<b>Income from investments:</b>		
Listed UK	332	871
Unlisted UK	586	373
	<b>918</b>	1,244

## 3. Investment management fee

	2004 £'000	2003 £'000
Investment management fee	993	774

For the purposes of the revenue and capital columns in the profit and loss account, the management fee has been allocated 25 per cent to revenue and 75 per cent to capital.

The management agreement may be terminated at any date by either party giving twelve months' notice of termination. F&C Asset Management plc receives a quarterly fee, payable in arrears, equal to 2.5 per cent of the value of the total assets less current liabilities of the Company. Further details of the management agreement and the management performance fee are contained in the Report of the Directors. F&C Asset Management plc also receives a quarterly secretarial fee, payable in arrears, comprising £31,968 (2003: £31,098) and a variable fee of 0.125 per cent per annum on net assets over £5 million adjusted for movements in the Retail Price Index.

## 4. Other expenses

	2004 £'000	2003 £'000
Directors' fees	50	45
Secretarial fees	80	69
Remuneration of the auditors and their associates:		
– audit	12	9
– other services to the Company	3	3
Other	108	115
	<b>253</b>	241

The Chairman receives £16,500 per annum (2003: £15,000). Each of the other Directors receives £11,000 per annum (2003: £10,000).

Charges for other services provided by the auditors in the year ended 31 December 2004 were in relation to tax compliance work. The Directors consider the auditors were best placed to provide this service. The Audit Committee reviews the nature and extent of non-audit services to ensure that independence is maintained.

# Notes to the Accounts

## 5a. Tax on ordinary activities

	2004 £'000	2003 £'000
UK corporation tax	–	83
	–	83

The profit and loss account shows the tax charge allocated between revenue and capital.

## 5b. Factors affecting tax charge for the year

The tax charge for the year is lower than the standard rate of corporation tax in the UK for an investment company (30 per cent). The differences are explained below:

	2004 £'000	2003 £'000
Corporation tax at standard rate of 30 per cent	(18)	497
Effect of:		
– non-taxable dividend income	(52)	(32)
– non taxable profits on investment realisations	(60)	(360)
– small companies rate relief	–	(22)
– losses carried forward	130	–
Tax charge for the year (5a)	–	83

## 6. Dividends

	2004 £'000	2003 £'000
Dividends on equity shares:		
– ordinary shares – interim revenue dividend 0.3p per share on 34,033,170 ordinary shares paid on 12 August 2004 (2003: 0.9p)	102	305
– ordinary shares – interim capital dividend 1.5p per share on 34,033,170 ordinary shares paid on 12 August 2004 (2003: nil)	510	–
– ordinary shares – final proposed 0.9p per share on 33,361,024 ordinary shares payable on 24 March 2005 (2003: 1.30p)	300	442
– ordinary shares – final proposed capital dividend 1.8p per share on 33,361,024 ordinary shares payable on 24 March 2005 (2003: 2.0p)	600	679
	1,512	1,426

The profit and loss account shows the apportionment of revenue and capital dividends.

## 7. Ordinary Shares

The 0.17p loss per share (2003: 4.64p profit per share) is based on the net loss from ordinary activities after tax of £59,000 (2003: profit of £1,573,000) and on 33,920,111 (2003: 33,895,164) ordinary shares, being the weighted average number of ordinary shares in issue during the year.

The total recognised gains and losses per share is based on the total gains recognised for the year of £4,114,000 (2003: £2,211,000) and on 33,920,111 (2003: 33,895,164) shares, being the weighted average number of ordinary shares in issue during the year.

# Notes to the Accounts

## 8. Investments

	<b>2004</b>	2003		
	<b>£'000</b>	£'000		
Fixed interest securities	<b>7,048</b>	5,715		
Investments quoted on the Alternative Investment Market (AIM)	<b>13,123</b>	7,645		
Unquoted investments	<b>14,053</b>	10,586		
	<b>34,224</b>	23,946		
Equity shares	<b>21,591</b>	10,921		
Preference shares	<b>1,269</b>	1,905		
Fixed income securities	<b>11,364</b>	11,120		
	<b>34,224</b>	23,946		
	Fixed interest securities £'000	Quoted on AIM £'000	Unquoted £'000	Total £'000
Opening book cost	5,939	6,581	10,369	22,889
Opening unrealised (depreciation)/appreciation	(224)	1,064	217	1,057
	5,715	7,645	10,586	23,946
Movements in the year:				
Purchases at cost	12,797	4,332	2,934	20,063
Sales – proceeds	(11,520)	(604)	(2,034)	(14,158)
– realised (losses)/gains on sales	(9)	108	101	200
Transfer of listings	–	942	(942)	–
Transfer unrealised (losses)/gains realised during the year	(224)	238	(333)	(319)
Increase in unrealised appreciation	289	462	3,741	4,492
Closing valuation	<b>7,048</b>	<b>13,123</b>	<b>14,053</b>	<b>34,224</b>
Closing book cost	6,983	11,597	10,095	28,675
Closing unrealised appreciation	65	1,526	3,958	5,549
	<b>7,048</b>	<b>13,123</b>	<b>14,053</b>	<b>34,224</b>
	<b>2004</b>	2003		
	<b>£'000</b>	£'000		
Increase in unrealised appreciation	<b>4,173</b>	638		

# Notes to the Accounts

## 9. Debtors

	2004 £'000	2003 £'000
Prepayments and accrued income	260	123
	<b>260</b>	123

## 10. Creditors (amounts falling due within one year)

	2004 £'000	2003 £'000
Amounts due to brokers	92	540
Proposed dividend	900	1,121
Taxation	–	83
Management and secretarial fees due to the managers	287	215
Other creditors	40	24
	<b>1,319</b>	1,983

## 11. Called-up share capital

	2004 £'000
<b>Authorised:</b>	
80,000,000 ordinary shares of 10p each	<b>8,000</b>
<b>Allotted, called-up and fully-paid:</b>	
33,962,410 ordinary shares of 10p each at 31 December 2003	<b>3,396</b>
883,614 ordinary shares of 10p issued during the year	<b>88</b>
(1,485,000) ordinary shares of 10p repurchased and cancelled during the year	<b>(149)</b>
33,361,024 ordinary shares of 10p each at 31 December 2004	<b>3,335</b>

# Notes to the Accounts

## 12. Reserves

	Share premium account £'000	Capital redemption reserve £'000	Revaluation reserve £'000	Profit and loss account £'000
At 31 December 2003	1,014	26	1,057	27,501
Issue of shares	787	–	–	–
Repurchase and cancellation of shares	–	149	–	(1,340)
Expenses of share issue	(15)	–	–	–
Transfer of prior years' revaluation to profit and loss account	–	–	319	(319)
Net increase in value of investments	–	–	4,173	–
Retained loss for the year	–	–	–	(1,571)
	<b>1,786</b>	<b>175</b>	<b>5,549</b>	<b>24,271</b>

When the Company revalues its investments during the year, any gains or losses arising are credited/charged to the revaluation reserve unless any diminution in value is considered permanent, in which case it is charged to the profit and loss account. When an investment is sold any balance held on the revaluation reserve is transferred to the profit and loss account as a movement in reserves.

## 13. Net asset value per share

The net asset value per share and the net asset values attributable to the ordinary shares at the year end are calculated in accordance with their entitlements in the Articles of Association and were as follows:

	Net asset value per share attributable		Net asset value attributable	
	2004 pence	2003 pence	2004 £'000	2003 £'000
Ordinary shares (basic)	<b>105.26</b>	97.15	<b>35,116</b>	32,994

The movements during the year of the assets attributable to the ordinary shares were as follows:

	Ordinary Shares (basic) £'000
Total net assets attributable at beginning of the year	32,994
Capital subscribed	875
Expenses of issue	(15)
Share capital bought back	(1,340)
Unrealised gain on revaluation of investments	4,173
Loss for the year	(1,571)
	<b>35,116</b>

Basic net asset value per share is based on net assets at the year end, and on 33,361,024 (2003: 33,962,410) ordinary shares, being the number of shares in issue at the year end.

# Notes to the Accounts

## 14. Reconciliation of movements in shareholders' funds

	2004 £'000	2003 £'000
Opening shareholders' funds	32,994	32,050
(Decrease)/increase in share capital	(480)	159
Unrealised gain on revaluation of investments	4,173	638
(Losses)/gains for the year	(1,571)	147
Closing shareholders' funds	35,116	32,994

## 15. Analysis of changes in cash

	2004 £'000	2003 £'000
Beginning of year	10,908	4,587
Net cash (outflow)/inflow	(8,957)	6,321
As at 31 December 2004	1,951	10,908

## 16. Reconciliation of net revenue before taxation to net cash (outflow)/inflow from operating activities

	2004 £'000	2003 £'000
(Loss)/profit on ordinary activities before taxation	(59)	1,656
Profit on realisation of investments	(200)	(1,199)
(Increase)/decrease in debtors	(137)	66
Increase/(decrease) in creditors	88	(19)
Net cash (outflow)/inflow from operating activities	(308)	504

## 17. Contingencies, guarantees and financial commitments

There were no contingencies, guarantees and financial commitments of the Company as at 31 December 2004.

# Notes to the Accounts

## 18. Significant interests

There were no interests of 20 per cent or more of any class of share capital, in investee companies at 31 December 2004.

## 19. Financial instruments

The Company's financial instruments comprise equity and fixed interest investments, cash balances and liquid resources. The Company holds financial assets in accordance with its investment policy to invest in a diverse portfolio of established and profitable UK unquoted companies and companies raising new share capital on the Alternative Investment Market.

Fixed asset investments held (see note 8) are valued at middle market prices, cost or in accordance with the British Venture Capital Association guidelines and Generally Accepted Accounting Practice (see Note 1). The fair value of all other financial assets and liabilities is represented by their carrying value in the Balance Sheet. Short term debtors and creditors are excluded from disclosure as allowed by FRS 13.

## 20. Market price risk

The management of market price risk is part of the fund management process and is typical of equity investment. The portfolio is managed with an awareness of the effects of adverse price movements through detailed and continuing analysis with an objective of maximising overall returns to shareholders. Investments in unquoted stocks and AiM listed companies, by its nature, involves a higher degree of risk than investment in the main market. These investments may be more difficult to realise. Further information on the investment portfolio is set out on page 8.

## 21. Interest rate and liquidity risk

### Floating rate

When the Company retains cash balances the majority of cash is ordinarily held on interest bearing deposit accounts. The benchmark rate which determines the interest payments received on cash balances is the bank base rate.

### Fixed rate

	2004			2003		
	Total fixed rate portfolio £'000	Weighted average interest rate %	Weighted average time for which rate is fixed (days)	Total fixed rate portfolio £'000	Weighted average interest rate %	Weighted average time for which rate is fixed (days)
<b>Ordinary shares</b>						
<b>Fixed rate</b>						
Financial assets	5,005	4.5	796	5,715	7.7	1,121

# Directors' Responsibility Statement

## Statement of Directors' Responsibilities

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those 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 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 are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for ensuring that the Directors' Report, Directors' Remuneration Report and other information included in the Annual Report is prepared in accordance with company law in the United Kingdom. They are also responsible for ensuring that the Annual Report includes information required by the Listing Rules of the Financial Services Authority.

## Independent Auditors' Report

### Independent Auditors' Report to the Members of Baronsmead VCT 3 plc

We have audited the financial statements of Baronsmead VCT 3 plc for the year ended 31 December 2004 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses, the Note of Historical Cost Profits and Losses 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 auditors' 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 United Kingdom Accounting Standards are set out in the Statement of Directors' Responsibilities.

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 United Kingdom Auditing Standards.

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 or the Listing Rules regarding Directors' remuneration and transactions with the Company is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC 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 other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Financial Highlights, the Chairman's Statement, the Managers' Review, the Directors' Report and the unaudited part of the Directors' Remuneration Report. 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 United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the 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 of the state of the Company's affairs as at 31 December 2004 and of its loss 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.

PKF *PKF*  
Registered Auditors  
London  
9 February 2005

# Notice of Annual General Meeting

**Notice is hereby given that the Annual General Meeting of Baronsmead VCT 3 plc will be held at the offices of F&C Asset Management plc, Exchange House, Primrose Street, London EC2A 2NY, on 23 March 2005 at 11.00 am for the following purposes:**

To consider and, if thought fit, pass the following Resolutions:

## Ordinary Business

1. That the Report and Accounts for the year to 31 December 2004 be received.
2. To approve payment of a final dividend of 2.7 pence per Ordinary Share (comprising 0.9 pence revenue and 1.8 pence capital).
3. That Gillian Nott, who retires by rotation, be re-elected as a Director.
4. That Robert Owen, who retires by rotation, be re-elected as a Director.
5. That the Directors' Remuneration Report for the year to 31 December 2004 be approved.
6. That PKF, be re-appointed as Auditors and that the Directors be authorised to determine their remuneration.

## Special Business

### Ordinary Resolution

7. That:
  - (a) the Directors of the Company (the "Directors") be and are hereby generally and unconditionally authorised in accordance with section 80 of the Companies Act 1985 (the "Act") to exercise all the powers of the Company to allot relevant securities (as defined in that section) up to an aggregate nominal amount of £2,502,076 during the period commencing on the passing of this resolution and expiring on 22 March 2010 (unless previously revoked, varied or extended by the Company in general meeting), but so that this authority shall allow the Company to make before the expiry of this authority offers or agreements which would or might require relevant securities to be allotted after such expiry; and
  - (b) all previous authorities given to the Directors in accordance with section 80 of the Act be and they are hereby revoked, provided that such revocation shall not have retrospective effect.

### Special Resolutions

8. That subject to the passing of Resolution 7 set out in the notice of this meeting:
  - (a) the Directors of the Company (the "Directors") be and are hereby empowered, pursuant to section 95 of the Companies Act 1985 (the "Act"), to allot equity securities for cash pursuant to the authority given in accordance with section 80 of the Act by that resolution as if section 89(1) of the Act did not apply to any such allotment, provided that this power shall be limited to the allotment of equity securities in connection with:
    - (i) an offer of securities, open for acceptance for a period fixed by the Directors, to holders of Ordinary Shares of 10p each in the Company and such other equity securities of the Company as the Directors may determine on the register on a fixed record date in proportion (as nearly as may be) to their respective holdings of such securities or in accordance with the rights attached thereto (but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient to deal with fractional entitlements that would otherwise arise or with legal or practical problems under the laws of, or the requirements of any recognised regulatory body or any stock exchange in, any territory or otherwise howsoever);
    - (ii) the dividend reinvestment plan as more particularly described in the Report of the Directors;
    - (iii) (otherwise than pursuant to sub-paragraphs (i) and (ii) above) up to an aggregate nominal amount of £1,000,830; and shall expire on the date falling 15 months after the date of the passing of this resolution or, if earlier, at the conclusion of the next Annual General Meeting of the Company, except that the Company may, before such expiry, make offers or agreements which would or might require equity securities to be allotted after such expiry; and in this resolution 'allot' and allotment shall be construed in accordance with section 94 (3A) of the act.
  - (b) words and expressions defined in or for the purposes of Part IV of the Act shall bear the same meanings in this resolution.
9. That the Company is hereby generally and unconditionally authorised to make market purchases (within the meaning of section 163 of the Companies Act 1985) of Ordinary Shares of 10p each in the Company ("Ordinary Shares"), provided that:
  - (a) the maximum number of Ordinary Shares hereby authorised to be purchased shall be 5,000,810;
  - (b) the minimum price which may be paid for each Ordinary Share is 10p;
  - (c) the maximum price which may be paid for an Ordinary Share shall be equal to the maximum amount permitted to be paid in accordance with the rules of the UK Listing Authority in force as at the date of purchase;
  - (d) the authority hereby conferred shall expire at the conclusion of the Annual General Meeting of the Company in 2006 or, if earlier, on the expiry of 15 months from the passing of this resolution, unless such authority is renewed prior to such time; and
  - (e) the Company may make a contract to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be completed or executed wholly or partly after the expiration of such authority.
10. That the Articles of Association of the Company (the 'Articles') be and are hereby amended by replacing the first sentence in Article 161.1 with the following sentence:

"The Board shall procure that the annual general meeting of the Company in 2013 and every third annual general meeting thereafter an ordinary resolution will be proposed to the effect that the Company shall continue in being as a venture capital trust."

By Order of the Board

**Rhonda Nicoll**  
for F&C Asset Management plc  
Secretary  
80 George Street  
Edinburgh EH2 3BU  
9 February 2005



Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, the Company has specified that only those shareholders registered on the register of members of the Company as at 6.00 pm on 21 March 2005, or in the event that the meeting is adjourned, on the register of members 48 hours before the time of the meeting, shall be entitled to attend and vote at the meeting in respect of the number of ordinary shares registered in their name at that relevant time. Changes to entries on the register of members after 6.00 pm on 21 March 2005, or in the event that the meeting is adjourned to a later time, on the register of members 48 hours before the time of any adjourned meeting, shall be disregarded in determining the rights of any person to attend and vote at the meeting.

A member who is entitled to attend and vote at this meeting is entitled to appoint one or more proxies to attend and, on a poll, vote on his/her behalf. Such a proxy need not also be a member of the Company.

To be valid, a Proxy Card must be lodged with the Company's Registrar, Computershare Investor Services PLC, PO Box 1075, The Pavilions, Bridgwater Road, Bristol BS99 3ZZ at least 48 hours before the meeting. A Proxy Card for use by ordinary shareholders is enclosed with this Report. Completion of the Proxy Card will not prevent a shareholder from attending the meeting and voting in person.

No Director has a contract of service with the Company.

# Shareholder Information

## Dividends

Interim dividends are paid to shareholders in September. Final dividends are paid to shareholders in March. Shareholders who wish to have dividends paid directly into their bank account rather than by cheque to their registered address can complete a Mandate Form for this purpose. Mandates can be obtained by telephoning the Company's registrar on 0870 703 0137 or by writing to them at, Computershare Investor Services PLC, PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH.

## Dividend Reinvestment Scheme

The Company operates a dividend reinvestment scheme to enable shareholders to buy shares using their dividends. The shares issued via this scheme are new shares and attract VCT tax reliefs for eligible investors. Details can be obtained from the Company Secretary.

## Share Price

The Company's Ordinary Shares are listed on the London Stock Exchange. The mid-price of the Company's Ordinary Shares is given daily in the *Financial Times* in the Investment Companies section of the London Share Service. Share price information can also be obtained from many financial websites.

## Trading Shares

The Company's Ordinary Shares can be bought and sold in the same way as any other quoted company on the London Stock Exchange via a stockbroker. The market makers for Baronsmead VCT 3 plc are:

- Teather & Greenwood (020 7426 9000)
- UBS Warburg (020 7567 8000)
- Winterfloods (020 7621 0004)

Please call the Company Secretary if you or your adviser have any questions about this process.

## Financial Calendar

12 March 2005	Date by which applications to join the dividend reinvestment scheme must be received by the registrars
23 March 2005	Annual General Meeting – offices of F&C Asset Management plc
24 March 2005	Final dividend paid for the year to 31 December
4 April 2005	Offer for subscription to close – tax year 2004/2005
8 April 2005	Offer for subscription to close – tax year 2005/2006
August 2005	Announcement of interim results and posting of interim report
September 2005	Interim dividend paid
February 2006	Announcement of final results for year to 31 December 2005

## VCT Workshop

A workshop for shareholders and their advisors is being held on 23 March 2005 and will be held at the office of the Investment Managers following the Annual General Meeting, which commences at 11.00 am.

# Shareholder Information

## Ordinary Shares

There are 1,957 holders of Ordinary Shares. Their shareholdings are analysed as follows:

Size of shareholding	Number of shareholders	Percentage of total number of shareholders	Number of Ordinary Shares	Percentage of Ordinary Shares
Over 100,000	18	0.9	2,322,950	7.0
50,001–100,000	92	4.7	6,386,229	19.1
25,001–50,000	253	12.9	9,034,223	27.1
10,001–25,000	601	30.7	9,988,924	29.9
5,001–10,000	532	27.2	3,899,030	11.7
2,001–5,000	446	22.8	1,717,661	5.1
1–2,000	15	0.8	12,007	0.1
Total	1,957	100.0	33,361,024	100.0

## Notification of Change of Address

Communications with shareholders are mailed to the registered address held on the share register. In the event of a change of address or other amendment this should be notified to the Company's registrar, Computershare Investor Services PLC, under the signature of the registered holder.

## Enquiries

*Computershare Investor Services PLC contact details*

Shareholder Helpline: 0870 703 0317

e-mail: [web.queries @computershare.co.uk](mailto:web.queries@computershare.co.uk)

Internet: [www.computershare.com](http://www.computershare.com)

## *Investor Centre*

A free Internet based service provided by our registrars which enables shareholders to manage their share portfolio online. Once registered shareholders will be able to access the following information:

- view their share portfolio
- see the market price of their shares
- calculate the total market value of each shareholding as well as the overall share portfolio in a choice of currencies
- view transaction history and dividend payment history
- online update facility for Change of Address and Dividend Mandate Instructions

To join this service please visit: [www-uk.computershare.com/investor](http://www-uk.computershare.com/investor)

F&C Broker Support Helpline: 08457 99 22 99.

# Baronsmead VCT 3 plc

# PROXY

I/We \_\_\_\_\_  
 (BLOCK LETTERS PLEASE)

of \_\_\_\_\_  
 being a member of Baronsmead VCT 3 plc, hereby appoint the Chairman of the meeting, or\*

as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company, to be held on 23 March 2005, on the following Resolutions to be submitted to the meeting and at any adjournment thereof and at their discretion on any matter arising at such meeting.

Please indicate with an 'X' in the appropriate spaces how you wish your votes to be cast. Unless otherwise instructed, the proxy will vote as he thinks fit or abstain.

Ordinary Resolutions	For	Against	Vote Withheld
1. To receive the Report and Accounts for the year to 31 December 2004.			
2. To approve payment of a final dividend of 2.70 pence per Ordinary Share.			
3. To re-elect Gillian Nott as a Director.			
4. To re-elect Robert Owen as a Director.			
5. To approve the Directors' Remuneration Report for the year to 31 December 2004.			
6. To re-appoint PKF as Auditors, and to authorise the Directors to determine their remuneration.			
7. To renew the Directors' authority to allot Ordinary Shares.			
Special Resolutions			
8. To renew the Directors' authority to disapply statutory pre-emption rights.			
9. To renew the Directors' authority to buy-in shares.			
10. To amend Article 161.1 'Duration of the Company' of the Articles of Association.			

Signature \_\_\_\_\_

Dated this \_\_\_\_\_ day of \_\_\_\_\_ 2005

**Notes**

\*You may, if you wish, in the space provided insert the name(s) of the person(s) of your choice to attend and vote at the meeting on your behalf.

In the case of a corporation, the proxy must be either under its common seal or under the hand of an officer.

In order to have effect, the proxy must be deposited at the Company's Registrars, Computershare Investor Services PLC, PO Box 1075, The Pavilions, Bridgwater Road, Bristol BS99 3ZZ at least 48 hours before the time of the meeting or any adjournment thereof together where appropriate with the power of attorney under which it is signed or a notarially certified copy of such power.

In the case of a joint holding, a proxy need only be signed by one joint holder. If more than one such joint holder lodges a proxy only that of the holder first on the Register will be counted.

Any alterations made in this proxy should be initialled.

Completion of a proxy shall not prevent a shareholder from attending the Annual General Meeting and voting in person should you decide to do so.

SECOND FOLD

BUSINESS REPLY SERVICE  
Licence SWB 1002

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Computershare Investor Services PLC  
PO Box 1075  
The Pavilions  
Bridgwater Road  
Bristol BS99 3ZZ

FIRST FOLD

THIRD FOLD AND TUCK IN

# Corporate Information

## Directors

Mark Cannon Brookes (Chairman)  
Andrew Lumsdaine Karney  
Gillian Nott OBE  
Robert Richardson Owen

## Secretary

F&C Asset Management plc  
80 George Street  
Edinburgh EH2 3BU

## Registered Office and Investment Managers

ISIS Equity Partners plc  
Exchange House  
Primrose Street  
London EC2A 2NY

## VCT Status Adviser

PricewaterhouseCoopers LLP  
1 Embankment Place  
London WC2N 6RH

## Registrars and Transfer Office

Computershare Investor Services PLC  
PO Box 82  
The Pavilions  
Bridgwater Road  
Bristol BS99 7NH  
Tel: 0870 703 0137

## Brokers

Teather & Greenwood Limited  
Beaufort House  
15 St Botolph Street  
London EC3A 7QR

## Auditors

PKF  
*Farringdon Place*  
20 Farringdon Road  
London EC1M 3AP

## Solicitors

Norton Rose  
Kempson House  
Camomile Street  
London EC3A 7AN

## ISIS Equity Partners – Investment Managers

ISIS Equity Partners is a wholly owned subsidiary of F&C Asset Management plc. F&C Asset Management plc (F&C) is the new business created on 11 October 2004 following the merger of ISIS Asset Management plc and F&C Group Limited. The combined business has around £125 billion of funds under management and is a leading asset manager in both the UK and Europe. The merger created a well balanced and diversified asset management business. F&C is a company listed on the London Stock Exchange.