

# INGENIOUS MUSIC VCT 2 PLC

ANNUAL REPORT & ACCOUNTS  
For the period ending  
31 December 2006



WE ARE **INGENIOUS**

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**THE COMPANY AND ITS ADVISERS**

<b>Directors</b>	Patrick McKenna (Chairman) Roger Ames Lionel Martin* Peter Reichardt*
<b>Company Secretary</b>	Susan Ford
<b>Registered Office</b>	15 Golden Square London W1F 9JG
<b>Company Number</b>	5564790
<b>Investment Manager &amp; Administrator</b>	Ingenious Ventures Limited 15 Golden Square London W1F 9JG
<b>Auditors</b>	Grant Thornton UK LLP Grant Thornton House Melton Street Euston Square London NW1 2EP
<b>Taxation Advisers</b>	PricewaterhouseCoopers LLP (PwC) 1 Embankment Place London WC2N 6RH
<b>Registrar</b>	Capita Registrars The Registry 34 Beckenham Road Beckenham Kent BR3 4TU
<b>Brokers</b>	KBC Peel Hunt Ltd 111 Old Broad Street London EC2N 1PH
<b>Solicitors</b>	Mayer Brown Rowe & Maw LLP 11 Pilgrim Street London EC4V 6RW

\* Independent director

## CHAIRMAN'S STATEMENT

I am delighted to present the Company's first annual report and accounts covering the period from the Company's incorporation on 15 September 2005 to 31 December 2006 (the **Reporting Period**).

### Overview of Activities

The Reporting Period has been an active one for the Company with the speed of investment increasing as the year has progressed. Following the Company's first investment in multi-platinum band, *Travis* in July 2006, it has proceeded to complete a further three qualifying investments, committing close to 10% of its available funds earmarked for qualifying investment purposes in the first eight months after fundraising closed.

The deals completed have contributed to creating a strong roster of diverse acts across the musical genres. The Company has committed over £1.3 million to support the debut albums of up-and-coming bands *Passenger* and *Apartment* and solo-artist and songwriter, *Indiana Gregg*. The investments were made alongside some of the most experienced players in the business including Gr8 Pop (*Indiana Gregg*), Kuba Music Limited (*Apartment*), and IE Music Limited (*Passenger*), which is headed up by Tim Clark and David Enthoven, the renowned managers of *Robbie Williams*.

The Manager continues to actively source and review new investment propositions as well as develop long-term relationships with both the Majors and leading independent record labels and artist managers.

### Board Announcements

I am pleased to announce that Peter Reichardt and Lionel Martin have been appointed to the Board as non-executive directors following the resignation of Peter Shawyer and Peter Stanton Clark, who have both accepted positions within the Ingenious group of companies.

Peter Reichardt has over 30 years' experience in the music publishing industry and more recently was the UK chairman and chief executive officer of EMI Music Publishing UK. Lionel Martin is a chartered accountant at Martin Green Ravden LLP, an accountancy and business consultancy firm, specialising in the media, entertainment and sports industries.

### Results

The Reporting Period has been dominated by fundraising and new investments, with over £2 million invested and committed to qualifying investments. The Company made a loss on ordinary activities of £174,000 in the period to 31 December 2006, which was expected, due to the Company incurring one-off start up costs as well as making investments which have not had time to mature. Accordingly, the Board do not recommend the payment of a dividend. The Company's net asset value, however, remained relatively constant during the period at £25.2 million or 95.2 pence per share.

**Outlook**

The outlook for the next financial year remains positive, with demand for the Company's investment capital expected to be driven by sustained activity from both the independent sector and the Majors.

I would like to take this opportunity to thank all shareholders for their continued support of the Company and I look forward to meeting those of you that are able to attend the AGM, which is scheduled for Wednesday 14 March 2007.

A handwritten signature in black ink, appearing to read 'P. McKenna'.

**Patrick McKenna**

Chairman

9 February 2007

### MANAGER'S REVIEW

#### Investment Objective

The investment objective of the Company is to provide shareholders with an attractive return from investments in a portfolio of music companies that will be engaged in the creation, development and exploitation of IP rights.

There has been strong deal flow throughout the Reporting Period and we expect this to continue into the next financial year, with sustained activity in the independent sector. We continue to see a large number of investment opportunities and have thus far focused our efforts on identifying projects that we believe support the development of both exciting acts and established artists, with the potential to deliver superior returns for our investors.

#### Investments 2006

After closing the first qualifying investment in *Travis* in July 2006, the Company has continued to actively source and review investment propositions and has since closed a further three deals, co-investing with its sister fund Ingenious Music VCT plc.

#### INDIANA GREGG

The Company closed its second qualifying investment on 6 November 2006, by investing £417,000 in the joint venture company, Thorpe Trading Ltd, set up in conjunction with GR8 Pop Limited, to provide funding for the support of all recording costs and ancillary expenditure including video, tour support and marketing expenditure required to launch Indiana Gregg's first solo album.

##### *About Indiana Gregg*

Indiana Gregg, who has already won numerous song writing awards, will be launching her first solo album with GR8 Pop Limited, led by Ian Morrow, who has previously worked with *Seal*, *Wet Wet Wet*, *Lisa Stansfield* and *Nightcrawlers* and Graham Marr, a 25-year veteran from Warner Music. Indiana will be collaborating with several highly respected music industry figures on her new album including Grammy award nominee Paul Wright, who has worked with *George Michael*, *Tina Turner* and *David Bowie*.

#### PASSENGER

On 14 November 2006 the Company closed its third qualifying investment in up-and-coming band, *Passenger*, (formerly known as *Mike Rosenberg Band*) committing to an investment of £660,725 from the Company to support the band's debut album to form a joint venture company, Genius Music Limited, in conjunction with IE Music.

IE Music is run by Tim Clark and David Enthoven, the esteemed managers of *Robbie Williams*, the UK's most successful solo artist whose albums have sold more than 32 million copies worldwide to date. Enthoven previously managed and named *T. Rex*, while also taking on amongst others, *Brian Eno* and *Roxy Music*. He did this with EG Records, the company he co-founded. Clark, as managing director of Island Records, oversaw the careers of *Bob Marley*, *Cat Stevens*, *Steve Winwood*, *Jethro Tull* and *Mott the Hoople*, amongst others.

##### *About Passenger*

Based in Brighton, the band is a creative partnership between lead vocalist 21-year old Mike Rosenberg and BAFTA nominated composer Andrew Phillips. The deal follows a year of successful touring for the band that made their debut festival appearance at O2 Wireless and who have gone on to perform at sell-out shows across Brighton as well as performing at Glastonbury, In The City and various London gigs.

## APARTMENT

The Company closed its fourth qualifying investment in its second up-and-coming band, *Apartment*, again on the 14 November 2006. The investment sees a financial commitment of £227,647 from the Company to form a joint venture company, Funwood Music Limited, alongside independent record label Kuba Music Limited, to back the launch of the Apartment's debut album.

Kuba Music was founded and is run by Jack Steven, who has launched and developed a number of successful artists and bands including the *Eurythmics* before moving to Sony Records and later working with The Ministry of Sound.

### *About Apartment*

*Apartment* has already released singles on the 'Fierce Panda' label, all of which have received critical acclaim from Radio 1 and XFM. The band has built up a strong live reputation and has previously supported *The Killers*, *The Bravery* and *The Editors* on tours.

## Outlook

The UK music industry is unique among European nations, and second only to the US, in terms of having nurtured and developed a rich recorded music heritage; making it a unique cultural asset.

The diverse ways in which music can now be consumed is adding to the ever increasing success of the music industry. The digital market and rising DVD sales have together contributed to another strong year for the UK music industry. Digital spend is now indicating as much as 10% in revenues for Majors as well as independents<sup>1</sup>.

The UK continues to maintain a commanding position in online sales, accounting for the largest number of digital downloads across Europe. A boom in sales of new British artists led to UK consumers buying a record 27.9 million albums in the first three months of 2006 with album sales up by 1.5% to give the best ever first quarter total sales of all artists on the global market, of which British artists claimed eight of the top 10 sellers, with seven debut acts.

According to industry figures, British acts continued to dominate the European album market in 2006. British acts scooped 19 of the year's 36 IFPI Platinum Awards for selling one million copies<sup>2</sup>. The British Phonographic Institute has stated that the results underlined the current boom in new British music, with 6 of the 19 UK Platinum awards being 2006 releases. In the first half of 2006, CD sales still accounted for nearly three quarters of all retail music sales, out-earning digital sales better than six to one. Retailers such as Target, Best Buy and particularly Wal-Mart have accounted for a steadily increasing share of CD sales<sup>3</sup>.

The Company believes it is well positioned to take advantage of the new market developments and to capitalise on the full range of intellectual property rights that attach to an artist.

**Contact**

If you have any questions on this review or would like to speak to a member of the management team please do not hesitate to call us on 020 7319 4000.

**Ingenious Ventures Limited**

9 February 2007

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<sup>1</sup> References in this Part to “IFPI” are to IFPI’s report entitled “*Recording Industry World Sales 2005*” and press releases issued by IFPI. IFPI represents the recording industry worldwide with over 1,450 members in 75 countries and affiliated industry associations in 48 countries.

<sup>2</sup> Source of information in this section is the IFPI website.

<sup>3</sup> Source of information in this section is the BPI website.

**BOARD OF DIRECTORS****Patrick McKenna (Chairman) (50)**

Patrick founded Ingenious Media plc in 1998 and was the chief executive until 2002 when he became chairman. Prior to Ingenious, Patrick was chairman and chief executive of The Really Useful Group. Patrick started his career in the accountancy profession and was appointed partner and head of the media group at Deloitte & Touche in 1985. Patrick holds non-executive positions on the boards of a number of companies in Ingenious Ventures LP's investment portfolio and is the chairman of The Young Vic.

Patrick is actively engaged with the evaluation and selection of media projects proposed for funding by the investment vehicles operated by the Ingenious Group.

**Roger Ames (57)**

Roger began his career in the music industry with EMI UK in 1975. In 1979, he joined PolyGram UK in the A&R department of the Phonogram label and, in 1983, moved to PolyGram's re-launched London Records as general manager, subsequently becoming managing director. In 1993, he was appointed chairman and CEO of PolyGram UK. Roger was named executive vice president of PolyGram and president of the PolyGram Music Group in 1996 and was appointed chairman and CEO of Warner Music Group in August 1999. Four months later he was appointed president of Warner Music International. Roger returned to the UK following the sale of the Warner Music division to private investors.

**Lionel Martin (56)**

Lionel is a chartered accountant and director at Martin Green Ravden LLP an accounting and business consultancy firm, which specialises in the media, entertainment and sports industries. Lionel founded the leading accountancy firm in 1980 advising on all areas of business and taxation for artists and corporates in the music and theatre industries. Clients have included Tears For Fears, the Sex Pistols, G4, The Thomson Twins, Emmanuel Petit and Thierry Henry among many others.

**Peter Reichardt (57)**

Peter has over 30 years of experience in the music publishing business. Most recently, Peter was the UK chairman and chief executive officer of EMI Music Publishing UK, leaving in May 2005 after 16 years with EMI.

Peter started his music career as a 'plugger' with Elektra Records in 1973 before joining Warner Bros Music in 1976, progressing to managing director and then taking the same position when Warner merged with Chappell Music. He joined EMI Music Publishing in 1989, leading it to a Queen's Award for Export six years later.

## DIRECTORS' REPORT

The Directors submit their report and the audited financial statements for the first reporting period, being from 15 September 2005 to 31 December 2006.

### 1. Principal Activity, VCT & Investment Company Status

The principal activity of the Company is to invest in value-added creation, development and exploitation of music-related intellectual property rights. A review of the Company's business during the year and an indication of likely future developments are contained in the Chairman's Statement, Manager's Review and the Business Review.

The Directors have managed the affairs of the Company with the intention of maintaining its status as an approved VCT for the purposes of section 842AA of the ICTA. The Company was not at any time up to the date of this report a "close company" within the meaning of section 414 of the ICTA. The Company is an investment company as defined in section 266 of the Companies Act.

### 2. Directors and Directors' Interests

The Directors and their respective biographies are set out on page 7. Patrick McKenna and Roger Ames both served throughout the period. Peter Shawyer and Peter Clark were appointed to the Board on 14 November 2005 and resigned with effect from 8 June 2006, and were replaced by Lionel Martin and Peter Reichardt with effect from that date.

As at 31 December 2006, the interests of the Directors in the issued ordinary share capital of the Company were as follows:

Name	Number of Shares on appointment	Number of Shares as at 31 December 2006	% of issued ordinary share capital
Patrick McKenna*	1	100,121	0.38
Roger Ames	1	1	0.00
Lionel Martin	Nil	Nil	Nil
Peter Reichardt	Nil	Nil	Nil
Total	2	100,122	0.38

\* Includes 100,120 Shares held by Patrick McKenna's wife, Margaret McKenna

Except for one subscriber share acquired by each of Patrick McKenna and Roger Ames on 15 September 2005, the Directors and, where relevant, their spouses subscribed for the above interests during the period of Offer and on the terms set out in the Prospectus. There have been no changes to the above interests between 31 December 2006 and the date of this report. All interests are beneficial.

### 3. Major Interests in Shares

As at the date of this report, the Company was not aware of any beneficial interests exceeding 3 per cent of the issued ordinary share capital.

#### **4. VCT Status Monitoring**

The Company has appointed PwC to advise it on compliance with relevant VCT legislation. PwC advises on each proposed investment as required and regularly reviews the Company's investment portfolio. PwC works closely with Ingenious Ventures in monitoring the Company's VCT status but reports directly to the Board.

#### **5. Re-Appointment of Auditors**

A resolution to re-appoint Grant Thornton as auditors to the Company will be put to the Shareholders at the AGM (see resolution 9 of the Notice).

#### **6. Indemnities**

Pursuant to the Articles, and to the extent permitted by the Companies Act, every Director or other officer and auditor of the Company is entitled to be indemnified out of the assets of the Company against all liabilities which he may incur in the execution of his office.

In certain circumstances, Directors or other officers and auditors of the Company are also entitled to be indemnified out of the assets of the Company against liabilities incurred by them in defending proceedings brought against them.

The above indemnities have been in force throughout the period under review and will continue to remain in force.

#### **7. Policy and Practice on the Payment of Creditors**

The Company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, to ensure that suppliers are made aware of the terms of payment and to abide by the terms thereof. Trade creditor days of the Company as at 31 December 2006, calculated in accordance with the requirements of the Companies Act, were 53 days. This represents the ratio, expressed in days, between the amounts invoiced to the Company in the period by its suppliers and the amounts due, at the year end, to trade creditors falling due for payment within one year.

#### **8. The AGM**

The notice convening the AGM can be found on page 35. Additional information relating to the AGM and the resolutions to be considered by shareholders can be found on pages 37-38.

#### **9. Business Review**

The Directors have included their business review on pages 11 to 12.

#### **10. Directors' Responsibility**

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare financial statements in accordance with United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). The financial statements are required by law to 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 these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;

## INGENIOUS MUSIC VCT 2

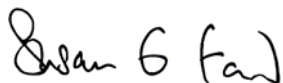
- make judgments and estimates that are reasonable and prudent;
- state whether applicable United Kingdom accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper accounting records that 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. 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 who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each Director has taken all the steps that they ought to have taken as a Director to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

After due and careful consideration, the Directors believe that the Company has adequate resources for the foreseeable future and that it is appropriate to apply the going concern basis in the preparation of the Company's financial statements.

By order of the Board



**Susan Ford**  
Company Secretary  
9 February 2007

## BUSINESS REVIEW

The purpose of this review is to provide shareholders with a summary setting out the business objectives of the Company, the Board's strategy to achieve those objectives, the risks faced, the regulatory environment and the key performance indicators (KPIs) used to measure performance.

### 1. Strategy for Achieving Objectives

Ingenious Music VCT 2 plc is a tax efficient company listed on The London Stock Exchange.

The investment policy of the Company is to invest in a portfolio of music companies that will be engaged in the value-added creation, development and exploitation of music-related intellectual property rights.

The investment objective is to achieve a combination of a high degree of downside protection in an otherwise potentially high risk proposition and long-term capital growth, maximising distributions in order to take advantage of tax-free dividends.

The Board has delegated day-to-day investment management and administration of the Company to Ingenious Ventures under the terms of a management deed and an administration agreement.

The Manager's review on pages 4 to 6 provides a review of the investment portfolio and the market outlook.

### 2. Principal Risks, Risk Management and Regulatory Environment

The Board believes that the principal risks faced by the Company are:

- **Investment and strategic** – an investment in the recorded music sector is tied to a certain degree to the fortunes of that industry generally. In particular, there is a risk that the Company will not identify opportunities where the Artists' success is sufficient to earn royalties over and above minimum contractual income negotiated.
- **Loss of approval as a Venture Capital Trust** – the Company must comply with section 842AA of the ICTA which allows it to be exempted from capital gains tax on investment gains realised by shareholders. Any breach of these rules may lead to the Company losing its approval as a VCT, qualifying shareholders who have not held their shares for the designated holding period having to repay the income tax relief they obtained and future dividends paid by the Company becoming subject to tax. The Company would also lose its exemption from corporation tax on capital gains.
- **Regulatory** – the Company is required to comply with the Companies Act, the rules of the UK Listing Authority and United Kingdom Accounting Standards. Breach of any of these regulatory rules might lead to suspension of the Company's Stock Exchange listing, financial penalties or a qualified audit report.
- **Financial** – inadequate internal controls might lead to misappropriation of assets. Inappropriate accounting policies might lead to misreporting or breaches of regulations.
- **External inherent risks** – The Company's investments will be in unquoted companies which by their nature involve a higher degree of risk than investment in the main market due to the fact there is no liquid market and may, therefore, be difficult to realise. Furthermore, there may be further constraints imposed on realisations because of the requirement to satisfy certain conditions necessary for the Company to maintain its VCT status (such as the obligation to have at least 70 per cent. by value of its investments in qualifying holdings).

The Board seeks to mitigate the internal risks by setting clear policies, including establishing a funding structure which provides for minimum royalty payments equivalent to at least 70 per cent. of the investment, regular reviews of performance, monitoring progress and compliance. Details of the Company's internal controls are contained in the Corporate Governance set out on pages 16 to 19.

**3. Key Performance Indicators (KPIs)**

The primary key performance indicator on which the Board assesses the performance of the Manager in meeting the Company's objective is the change in Net Asset Value per share.

A review of the Company's performance during the period, the position of the Company at the year end and the outlook for the coming year is contained within the Chairman's Statement and Manager's Review on pages 2 to 6.

**4. Financial Risk Management**

Details of the Company's financial instruments and risk management policies and objectives are provided in note 16 to the financial statements.

**INVESTMENT PORTFOLIO**

<b>Independiente Music Ventures - Travis Limited*</b>	
Artist:	Travis
Date of investment:	Jul-06
Initial investment:	£1,000,000
Valuation:	£1,000,000
Valuation basis:	Fair value - Price of Recent Investment
Percentage of equity held:	24.95%
<b>Thorpe Trading Limited*</b>	
Artist:	Indiana Gregg
Date of investment:	Nov-06
Initial investment:	£417,000
Valuation:	£417,000
Valuation basis:	Fair value - Price of Recent Investment
Percentage of equity held:	24.95%
<b>Funwood Music Limited*</b>	
Artist:	Apartment
Date of investment:	Nov-06
Initial investment:	£227,647
Valuation:	£227,647
Valuation basis:	Fair value - Price of Recent Investment
Percentage of equity held:	24.95%
<b>Genius Music Limited*</b>	
Artist:	Passenger (formally known as Mike Rosenberg Band)
Date of investment:	Nov-06
Initial investment:	£660,725
Valuation:	£660,725
Valuation basis:	Fair value - Price of Recent Investment
Percentage of equity held:	24.95%

\* The company has recently been incorporated and had not yet filed audited accounts.

**DIRECTORS' REMUNERATION REPORT**

This report has been prepared by the Directors in accordance with the requirements of Schedule 7A to the Companies Act. A resolution to approve the report will be proposed at the AGM. The law requires the Company's auditors to audit certain information included in this report. Where disclosures have been audited, they are indicated as such. The auditors' opinion is included in their report on page 21.

**1. Directors' Remuneration Policy**

Pursuant to the Articles, the aggregate fees of the Directors are capped at £100,000 per annum. The fees payable to non-executive Directors reflect their expertise, responsibilities and time spent on Company matters. In determining the level of non-executive remuneration, market equivalents are considered in comparison to the overall activities and size of the Company. Subject to the Articles, the Directors intend to continue to operate this remuneration policy for the forthcoming financial year and thereafter.

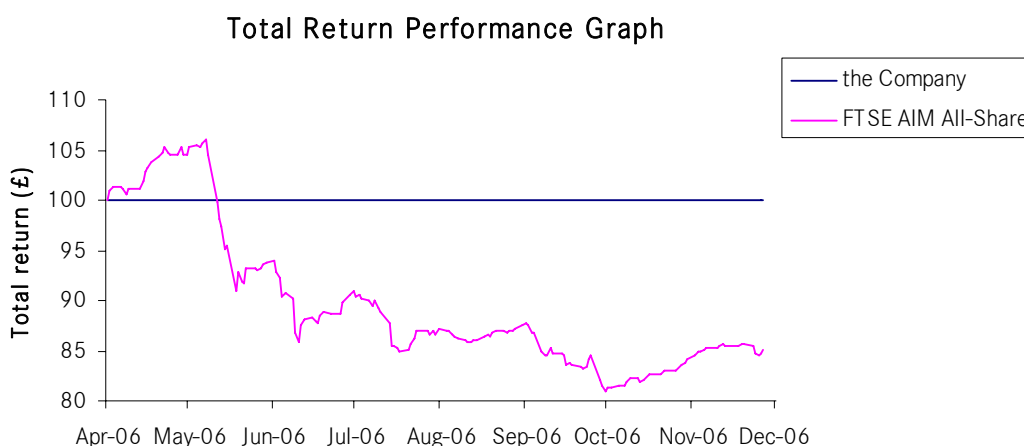
**2. Appointment Letters**

Each Director has executed an appointment letter which provides that he is to receive an annual fee equal to £15,000 per annum and to be reimbursed for any reasonable out-of-pocket expenses. These appointment letters state that a Director shall remain in office unless he: resigns as a director; is removed from his office by the Board or the members of the Company; or becomes prohibited by law from being a director.

The appointment letters do not provide for compensation upon early termination of appointment. There are no set minimum notice periods in the Directors' appointment letters but all Directors are subject to retirement by rotation. None of the Directors has a service contract.

**3. Performance**

The following line graph compares the total return on an investment of £100 in the ordinary shares of the Company, assuming any dividends are reinvested, with the total shareholder return on a notional investment of £100 made up of shares of the same kinds and number as those by reference to which the FTSE AIM All-Share Index is calculated. This index was chosen for comparison purposes as it is the most relevant to the Company's investment portfolio.



**4. Directors' Remuneration**

The following table shows a breakdown of the remuneration of individual Directors (exclusive of National Insurance Contributions):

	Period ended 31 December 2006
Director	Fees £'000
Patrick McKenna	16
Roger Ames	17
Peter Shawyer	8
Peter Clark	8
Lionel Martin	8
Peter Reichardt	8

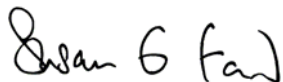
No expenses were paid to any Director in the period. The Company does not grant share options, long-term incentive schemes or retirement benefits to any Director. No contributions are made on behalf of the Directors to any pension scheme. No Director has received any bonuses, taxable expenses, compensation for loss of office or non-cash benefits for the period ended 31 December 2006. In respect of this period, the Company has purchased (and continues to maintain) liability insurance covering the Directors and officers of the Company.

This sub-paragraph 4 has been audited by Grant Thornton.

**5. Shareholder Approval**

This Directors' Remuneration Report will be put to the Shareholders for their approval at the AGM.

By order of the Board



**Susan Ford**  
Company Secretary  
9 February 2007

## CORPORATE GOVERNANCE REPORT

The Company is committed to maintaining the highest standards of corporate governance. The Directors seek to comply with the Combined Code to the extent that it is proportionate and relevant to: (i) the size and nature of the Company and its operations; and (ii) the Company's particular board and management structure as a VCT. On this basis, the Directors believe that, during the period under review, the Company has complied with the provisions of the 2006 Combined Code except as explained below.

### 1. Board Composition

The Board is comprised of four directors of which Lionel Martin and Peter Reichardt are considered to be independent. During part of the reporting period Peter Clark and Peter Shawyer were both non-executive directors and were considered to be independent during their time in office.

Patrick McKenna, the Company's Chairman, is the Chairman of Ingenious Ventures and Ingenious Music VCT (**VCT1**) and is not, therefore, considered to be independent. Roger Ames is a non-executive director of VCT1 and is also not considered to be independent.

However, the Board believes that these directorships of Patrick McKenna and Roger Ames allow for enhanced communication between the Company and the Manager as well as closer supervision of the Manager's performance and of the allocation of investments between the Company and VCT1. The Directors therefore believe that these directorships are advantageous to, and do not affect the well balanced nature of, the Board.

Biographical details of each of the Directors can be found on page 7.

### 2. Board Appointments

During the period there were two appointments to the Board following the resignations of Peter Shawyer and Peter Clark. The appointments of Lionel Martin and Peter Reichardt were approved by the Board as a whole, and both were identified through the Manager's extensive network of contacts in the music and media industry. As detailed in their respective biographies they have a wealth of relevant experience which they bring to the Board. Due to the specialised nature of the Company's investment policy, it was not felt necessary to engage the services of an external search consultancy firm or to advertise during the appointment process.

As the Company does not have any major shareholders there were no specific arrangements made by the Chairman to introduce the new non-executive directors to major shareholders.

Directors are not appointed for specified terms. The Board believes that, in the circumstances of the Company, the contribution of a non-executive director is enhanced by longer, continuous service. However, in accordance with the Combined Code, all of the Directors will retire from office and seek re-appointment at the AGM (this being the Company's first annual general meeting).

The Directors' terms of appointment may be inspected by shareholders at the Company's registered office during normal business hours and at the AGM.

To date, no formal performance evaluation of the Directors or the Board has been undertaken. Specific performance issues will be dealt with as and when they arise. No performance issues arose during the period under review and the Board considers that the individual performance of each of the Directors continues to be effective and to demonstrate their commitment to the role. The Board therefore recommends that the Directors be re-appointed and, accordingly, that shareholders vote in favour of resolutions 1 to 10 (inclusive) as set out in the Notice.

No senior independent director has been appointed due to the relatively small size of the Board. However, this will be reviewed during the next financial year and appropriate action taken if this is deemed appropriate.

### 3. Board Proceedings

The following table sets out the number of Board meetings held during the period and the number of meetings attended by each Director:

	Attended	Possible
Patrick McKenna	7	7
Roger Ames	7	7
Peter Shawyer	2	3
Peter Clark	2	3
Lionel Martin	3	3
Peter Reichardt	3	3

Peter Shawyer and Peter Clark did not attend the board meeting at which their resignations and the appointment of Lionel Martin and Peter Reichardt were considered.

The Manager provides the Board with appropriate information in a timely manner prior to all Board proceedings and at such other times as may be required by the Directors.

All of the Directors have access to the advice and services of Susan Ford, the Company Secretary, and the Manager's investment team. The Directors may also take independent professional advice at the Company's expense where necessary in the furtherance of their duties and responsibilities.

### 4. Board Responsibilities

The Board has delegated day-to-day investment management and administration of the Company to Ingenious Ventures under the terms of a management deed and an administration agreement. The Board retains overall responsibility for the Company's affairs, including the determination of its investment policy.

The Board believes that terms of this delegation are clearly defined and provide a healthy balance between: (i) maintaining supervision over the Manager's activities; and (ii) allowing the Manager to effectively source and implement appropriate qualifying investments in fulfilment of the Company's investment policy.

The Board, therefore, does not believe that it is necessary to adopt a specific schedule of reserved matters over and above the terms of the investment management and administration agreements which are currently in force.

### 5. Board Committees

The Directors have not appointed a nominations committee as they consider that this would be disproportionate to the size of the Board. Appointments of any new directors will be determined by the full Board.

The Board has not appointed an audit committee as it is currently considered appropriate to refer all audit matters to the full Board for review and approval. The need for an audit committee will be kept under review by the Board particularly as the size of the investment portfolio increases.

No remuneration committee has been appointed by the Board on the basis that the Company has no executive directors, employees or share incentive plans. No individual Director is involved in setting his own level of remuneration.

### **6. Relations with Shareholders and the AGM**

The Board places great importance on maintaining effective communication with Shareholders. The AGM, which will be held on 14 March 2007, will be an opportunity for shareholders to meet with both the Board and the Manager in order to discuss the Company's progress. Participation at the meeting is therefore encouraged.

### **7. Internal Controls**

The Board is responsible for supervising the Company's system of internal control operated by Ingenious Ventures and for reviewing its effectiveness. The Board, in conjunction with the Manager, has therefore established an ongoing process for identifying, evaluating and managing the significant risks faced by the Company. This process has been in place for the period under review and up to the date of approval of the Annual Report & Accounts and accords with the Turnbull Guidance.

The significant risks facing the Company, along with the internal controls operated by the Manager, have been reviewed by the Board. The particular focus of the review was on ensuring that the internal controls operated by the Manager continued to mitigate these significant risks in a manner which was satisfactory to the Board.

The Board will continue to conduct half-yearly reviews based on "by-exception" reports provided by the Manager.

In summary, the Company's system of internal controls involves the following key elements:

- the Manager prepares management accounts which provide the Board with a regular overview of the progress and performance of the Company and its investment portfolio;
- all investment decisions are approved by the Manager's investment team and communicated to the Board on a quarterly basis;
- the Manager monitors the qualifying status of each qualifying holding in conjunction with PwC who report to the Board twice annually on the Company's VCT status and advise on each investment proposal as appropriate; and
- the Manager continuously monitors the Company's progress and promptly informs the Board of any material developments as and when they occur.

The Board believes that the above procedures represent a sound system of internal control for the safeguarding of the shareholders' investment and the Company's assets.

It should be noted, however, that this system of internal control is designed to manage rather than eliminate the risk of failure to achieve the Company's business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

### **8. Internal Audit Function**

The Company does not have an internal audit function. The Board believes that such a function would be disproportionate to the size of the Company. However, this will be reviewed during the next financial year and appropriate action taken if this is deemed appropriate.

### **9. Going Concern**

Under the Revised Combined Code the directors are required to satisfy themselves that it is reasonable to presume the Company is a going concern.

After making enquiries, and on the strength of its balance sheet, the directors are of the opinion that the Company has adequate resources to continue its operational activities for the foreseeable future. The board is therefore of the opinion that the going concern basis should be adopted in the preparation of the financial statements.

**10. Auditor Independence**

The Board considers the scope and effectiveness of the Company's external auditors. The Company's auditors, Grant Thornton UK LLP also provide non-audit advice to the Company. These services relate to corporate tax compliance assistance and do not, in the Board's opinion, compromise the independence of Grant Thornton's audit team.

### **REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF INGENIOUS MUSIC VCT2 PLC**

We have audited the financial statements (the "financial statements") of Ingenious Music VCT 2 Plc for the period ended 31 December 2006 which comprise the income statement, reconciliation of movements in shareholders' funds, the balance sheet, the cash flow statement and notes 1 to 18. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

#### **Respective responsibilities of directors and auditors**

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) 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 International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred to the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the company's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Chairman's Statement, Manager's Review, the Directors' Report, Business Review, Investment Portfolio Schedule 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 International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

**Opinion**

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its loss for the period then ended;
- 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; and
- the information given in the Directors' Report is consistent with the financial statements.

*Grant Thornton UK LLP*

GRANT THORNTON UK LLP  
REGISTERED AUDITOR  
CHARTERED ACCOUNTANTS

London  
9 February 2007

**INCOME STATEMENT**

for the period 15 September 2005 to 31 December 2006

	Note	Revenue £'000	Capital £'000	Total £'000
Gain on disposal of investments		-	14	14
Increase in fair value of investments held		-	363	363
Investment income	2	278	152	430
Arrangement fees	3	(265)	-	(265)
Investment management fees	4	(245)	(245)	(490)
Other expenses	5	(182)	(44)	(226)
<b>Loss on ordinary activities before taxation</b>		(414)	240	(174)
Tax on ordinary activities	6	-	-	-
<b>Loss attributable to equity shareholders</b>		(414)	240	(174)
<b>Basic and diluted return per share (pence)</b>	7	(2.6)	1.5	(1.1)

The Company has no recognised gains and losses other than those disclosed above.

The accompanying notes are an integral part of these financial statements.

**RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS**

for the period 15 September 2005 to 31 December 2006

	£'000
Equity shareholders' funds at 15 September 2005	-
Capital subscribed	26,445
Issue costs	(1,058)
Loss for the period	(174)
<b>Equity shareholders' funds at 31 December 2006</b>	<b>25,213</b>

The accompanying notes are an integral part of these financial statements.

**BALANCE SHEET**

As at 31 December 2006

	<b>Note</b>	<b>£'000</b>
<b>Fixed assets</b>		
Qualifying investments	8	2,305
<b>Current assets</b>		
Debtors	10	7
Non-Qualifying investments	11	22,936
Cash at bank and in hand		264
<b>Creditors: amounts falling due within one year</b>		
	12	(299)
<b>Net current assets</b>		22,908
<b>Net assets</b>		<b>25,213</b>
<b>Capital and reserves</b>		
Called-up share capital	13	265
Share premium account	14	25,122
Capital reserves		
realised	14	(123)
unrealised	14	363
Revenue reserve	14	(414)
<b>Equity shareholders' funds</b>		<b>25,213</b>
<b>Net asset value (pence per share)</b>		<b>95.2</b>

The financial statements on pages 22 to 34 were approved by the Board of Directors on 9 February 2007.

Signed on behalf of the Board of Directors:



Patrick McKenna  
Chairman

## INGENIOUS MUSIC VCT 2

### CASH FLOW STATEMENT

for the period 15 September 2005 to 31 December 2006

	<b>£'000</b>
<b>Net cash outflow from operating activities</b>	(259)
<b>Capital expenditure and financial investment</b>	
Purchase of qualifying investments	(2,305)
Purchase of non-qualifying investments	(24,129)
Disposal of non-qualifying investments	1,570
<b>Net cash outflow from capital expenditure and financial investment</b>	(24,864)
<b>Financing</b>	
Issue of redeemable preference shares	50
Repurchase of redeemable preference shares	(50)
Issue of ordinary shares	26,445
Expenses of the issue of ordinary shares	(1,058)
<b>Net cash inflow from financing</b>	25,387
<b>Increase in cash</b>	264
<b>Reconciliation of Loss Before Taxation to Net Cash Flow from Operating Activities</b>	
	<b>£'000</b>
Loss on ordinary activities before taxation	(174)
Gain on disposal of investments	(14)
Increase in fair value of investments held	(363)
Increase in receivables	(7)
Increase in payables	299
<b>Net cash outflow from operating activities</b>	(259)
<b>Reconciliation of Net Cash Flow to Movement in Net Funds</b>	
	<b>£'000</b>
Opening cash balances	-
Net cash inflow	264
<b>Closing cash balances</b>	264

The accompanying notes are an integral part of these financial statements.

**NOTES TO THE FINANCIAL STATEMENTS**

for the period 15 September 2005 to 31 December 2006

**1. Accounting policies****(a) Basis of Accounting**

The financial statements for the period ended 31 December 2006 have been prepared in accordance with the UK Generally Accepted Accounting Practice, and with the Statement of Recommended Practice (the SORP) entitled "Financial Statements of Investment Trust Companies" which was issued in January 2003 and revised in December 2005.

**(b) Valuation of Investments***Qualifying Investments*

Unquoted investments including equity and loan investments are stated at fair value in accordance with the International Private Equity and Venture Capital Guidelines and Financial Reporting Standard 26 "Financial Instruments Measurement" (**FRS 26**). They are designated at fair value through profit and loss in accordance with FRS 26.

The guidelines set out six permissible valuation methodologies, of these the two methodologies most applicable to the VCT investments are:

1 - Price of recent investment. Where the investment being valued was made recently, its cost will generally provide a good indication of value. It is generally considered that this would only apply for a limited period, in practice a period of up to a year is often applied as the long stop date for such a valuation.

2 - Discounted cash flows/earnings of the underlying business, calculating the net present value of expected future cashflows of the investee companies. In relation to the VCT investments, anticipating future cashflows in excess of the guaranteed amounts would clearly require highly subjective judgements to be made in the early stage of each investment (i.e. pre-release) and therefore would not be an appropriate methodology to apply in the early stage of the investment.

The adopted approach fair values the investments at the "price of recent investment" (i.e. cost) in their first year of investment. Subsequently, the portfolio of investments is fair valued on the discounted cash flow/earnings basis using the latest available information following the release of the artists' records/albums.

*Non-Qualifying Investments*

The Company's investments in interest bearing money market open ended investment companies (OEIC's) are valued at mark-to-market. They have been designated as fair value through profit and loss for the purposes of FRS26.

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

**(c) Investment Income**

Interest income is included using the effective interest method.

**(d) Expenses**

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

- expenses which are incidental to the acquisition or disposal of an investment are charged to capital in the income statement as incurred; and
- expenses are split and presented partly as capital items where a connection with the maintenance or enhancement of the value of the investments held can be demonstrated.

**(e) 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 a right to pay less, tax in the 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.

**2. Investment Income**

	15 September 2005 to 31 December 2006 £'000
Bank deposit interest	278
Reinvested interest from OEIC's	152
	<hr/> 430

**3. Arrangement Fees**

	15 September 2005 to 31 December 2006 £'000
Arrangement fees	<hr/> 265

All direct and indirect expenses and costs arising out of the Offer were incurred by the Promoter and a fee of 5% of the gross proceeds of the Offer was paid in consideration of the service provided. The Directors believe that 80% of these fees relate directly to the raising of capital and have classified this proportion as issue costs. In accordance with FRS 26, the issue costs have been deducted from the share premium account.

The remaining 20% reflected above has been taken to revenue.

**4. Investment Management Fee**

	15 September 2005 to 31 December 2006		
	Revenue £'000	Capital £'000	Total £'000
Investment management fee	209	209	418
Irrecoverable VAT	36	36	72
	245	245	490

For the purposes of the revenue and capital columns in the income statement, the management fee has been allocated 50% to revenue and 50% to capital, which represents the proportion of the fee attributable to the management of the investments of the Company.

**5. Other Expenses**

	15 September 2005 to 31 December 2006		
	Revenue £'000	Capital £'000	Total £'000
Directors' remuneration	65	-	65
Social security costs	8	-	8
Auditors' remuneration	16	-	16
Legal & professional fees	2	44	46
Other administration expenses	91	-	91
	182	44	226

All figures include irrecoverable VAT, where applicable. The company is not registered for VAT. Auditors' remuneration relates to audit services only. Further details on the Directors' fee disclosures are given in the Directors' Remuneration Report.

**6. Tax Charge on Ordinary Activities**

	15 September 2005 to 31 December 2006		
	Revenue £'000	Capital £'000	Total £'000
Loss on ordinary activities before tax	(414)	240	(174)
Loss on ordinary activities by tax rate (30%)	(124)	72	(52)
Adjustments:			
Non taxable gains on investments	-	(103)	(103)
Disallowed expenses	-	13	13
Dividends not taxable	-	(10)	(10)
Unutilised losses for the current period	124	28	152
	-	-	-

## INGENIOUS MUSIC VCT 2

Capital returns are not included in the above as the Company is a VCT and its capital gains are not taxable.

At 31 December 2006 the Company had surplus management expenses of £506,000 which have not been recognised as a deferred tax asset. This is due to the fact that the Company has only been investing for a short period of time, and future taxable income can not be predicted with reasonable certainty. Due to the Company's status as a VCT, and the intention to continue meeting the conditions required to obtain approval in the foreseeable future the Company does not provide deferred tax on any capital gains or losses which arise on the revaluation of investments.

### 7. Basic and Diluted Return per Share

	15 September 2005 to 31 December 2006		
	Revenue	Capital	Total
£'000			
(Loss)/Profit on ordinary activities after taxation	(414)	240	(174)
Weighted average shares in issue (number)	15,922,602	15,922,602	15,922,602
Loss attributable per share (pence)	(2.6)	1.5	(1.1)

There are no dilutive potential ordinary shares, including convertible instruments, options or contingent share agreements in issue for the Company. The basic return per share is therefore the same as the diluted return per share.

### 8. Fixed Asset Investments

	2006 £'000
Unquoted investments	2,305
Equity shares	692
Unsecured loan notes	1,613
	2,305
	Qualifying Investments £'000
Opening valuation	-
Purchases at cost	2,305
<b>Closing valuation and book cost at 31 December 2006</b>	<b>2,305</b>

## 9. Significant Interests

The Company has interests of greater than 20% of the nominal value of the allotted shares of the following UK incorporated investee company as at 31 December 2006:

	% class and share type	% voting rights
Independiente Music Ventures – Travis Limited	24.95% A Ordinary	24.95%
Thorpe Trading Limited	24.95% A Ordinary	24.95%
Genius Music Limited	24.95% A Ordinary	24.95%
Funwood Music Limited	24.95% A Ordinary	24.95%

The investments made by the Company are part of its portfolio of investments. As a VCT, the Company value those investments at fair value in accordance with FRS 9 and FRS 26.

## 10. Debtors

	31 December 2006
	£'000
Prepayments and accrued income	7

## 11. Current Asset Investment

	31 December 2006
	£'000
Funds held in listed money market instruments	22,936

	Non-Qualifying Investments
	£'000
Opening valuation	-
Purchases at cost	24,129
Disposal proceeds	(1,570)
Realised gains on disposal	14
Unrealised change in value of investment	363
<b>Closing valuation and book cost at 31 December 2006</b>	<b>22,936</b>

In order to safeguard the capital available for investment in Qualifying Investments and balance this with the need to provide good returns to investors, available funds from the net proceeds are invested in appropriate securities (money market securities and cash funds) until required for Qualifying Investment purposes.

Included within the total amount for Non-Qualifying Investments, £3.1m has been invested in the Ingenious Enhanced Cash Fund managed by Ingenious Asset Management.

**12. Creditors: Amounts Falling Due Within One Year**

	31 December 2006
	£'000
Trade creditors	257
Accruals and deferred income	42
	<u>299</u>

**13. Called-Up Share Capital**

	31 December 2006
	£'000
Authorised	400
40,000,000 ordinary shares 1p each	<u>400</u>
Allotted, called-up and fully paid	
26,475,381 ordinary shares 1p each	<u>265</u>

26,475,379 shares were issued and allotted in accordance with the terms of the Prospectus. The two subscriber shares created upon incorporation were issued at par. Share issue costs amounting to £1,058,000 have been set off against share premium.

The entire issued ordinary share capital of the Company has been admitted to the official list maintained by the Financial Services Authority and to trading on the London Stock Exchange.

<b>Date of issue and allotment</b>	Number of shares allotted	Aggregate nominal value allotted £'000	Aggregate consideration received net of issue costs £'000
15 September 2005	2	-	-
9 February 2006	5,603,620	56	5,351
29 March 2006	6,551,268	66	6,289
3 April 2006	7,414,679	74	7,118
4 April 2006	705,790	7	657
5 April 2006	6,221,538	62	5,972
13 December 2006	(21,516)	-	-
	<u>26,475,381</u>	<u>265</u>	<u>25,387</u>

On 23 September 2005, the Company issued and allotted 50,000 redeemable preference shares of £1 each to the Manager (paid-up as at one quarter of their nominal value) in order to enable the Company to obtain a certificate under section 117 of the Companies Act. On 16 May 2006, these redeemable preference shares were redeemed at par by the Company. Pursuant to article 2.4(d) of the Articles, each redeemable preference share has since been re-designated as, and subdivided into, 100 ordinary shares of 1p each in the authorised but unissued share capital of the Company. The redeemable preference shares carried the right to receive a fixed cumulative preferential dividend from the revenue profits of the Company which are

available for distribution and which the Directors determine to distribute by way of dividend in priority to any dividend payable on the ordinary shares, however as there were no revenue profits during the period prior to redemption no dividends were paid.

On 13 December 2006, 21,516 unpaid ordinary shares with an issue price of 100p were forfeited.

#### 14. Reserves

	Share premium £'000	Capital realised £'000	Capital unrealised £'000	Revenue reserve £'000	Total reserves £'000
<b>At 15 September 2005</b>	-	-	-	-	-
Issue of equity	26,180	-	-	-	26,180
Gain on disposal of investments	-	14	-	-	14
Increase in fair value of investments held	-	-	363	-	363
Investment income	-	152	-	278	430
Arrangement fees	(1,058)	-	-	(265)	(1,323)
Investment management fees	-	(245)	-	(245)	(490)
Other expenses	-	(44)	-	(182)	(226)
<b>At 31 December 2006</b>	25,122	(123)	363	(414)	24,948

#### 15. Net Asset Value Per Share

31 December 2006

Net assets attributable to shareholders (£'000)	25,213
Shares in issue (number)	26,475,381
Net asset value per share (pence)	95.2

#### 16. Financial Instruments and Risk Management

The Company's financial instruments comprise equity and floating rate debt investments in unquoted companies, cash balances and listed money market instruments. The Company holds financial assets in accordance with its investment policy.

Fixed asset investments (see note 8) are valued at fair value. For quoted securities, this is bid price. In respect of unquoted investments, these are fair valued by the Directors in accordance with the International Private Equity and Venture Capital Valuation Guidelines. The fair value of all other financial assets and liabilities is represented by their carrying value on the Balance Sheet.

The Company's investing activities expose it to various types of risk that are associated with the financial instruments and markets in which it invests. The most important types of financial risk to which the Company is exposed are:

- Market risk;
- Interest rate risk;
- Credit risk; and
- Liquidity risk

The nature and extent of the financial instruments outstanding at the balance sheet date and the risk management policies employed by the Company are discussed below:

### **a) Market risk**

Market risk embodies the potential for both losses and gains and includes interest rate risk and price risk.

The Company's strategy on the management of investment risk is driven by the Company's investment objective. Investments in unquoted companies, by their nature, involve a higher degree of risk than investments in larger "blue chip" companies.

The risk of loss in value is managed through careful selection in accordance with a formalised investment decision process, with each investment proposal evaluated by the investment committee as part of the due diligence stage. The risk is also managed through continuous monitoring of the performance of investments and changes in their risk profile.

### **b) Interest rate risk**

Some of the Company's financial assets are interest bearing, all of which are at floating rates. As a result, the Company is subject to exposure to interest rate risk due to fluctuations in the prevailing levels of market interest rate.

When the Company retains cash balances, the majority of cash is held within an interest bearing money market open ended investment company (OEIC). The benchmark rate which determines the interest payments received on interest bearing cash balances and debt investments in unquoted companies is the bank base rate which was 5 per cent as at 31 December 2006.

### **c) Credit risk**

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the company.

Whilst the Company is exposed to credit risk due to its unsecured loan note instruments, this risk is mitigated by the Company requiring that minimum royalty arrangements are in place prior to the investment as set out in the Company's investment policy. In addition, and in accordance with the Company's monitoring procedure, the Manager, in conjunction with Ingenious Consulting, closely monitors progress (including financial expenditure) against the investee companies' agreed business plans.

### **d) Liquidity risk**

The Company's financial instruments include equity and debt investments in unquoted companies, which are not traded in an organised public market and which generally may be illiquid. As a result, the Company may not be able to liquidate quickly some of its investment in these instruments at an amount close to fair value.

The Company maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements at all times.

## 17. Contingencies, Guarantees and Financial Commitments

There is currently interest income accruing on the unsecured loan note instruments at a rate of 6 per cent, being 1 per cent over the bank base rate which was 5 per cent as at 31 December 2006, totalling £25,666. The repayment of this interest is contingent on future profits being derived by the investee companies, which currently can not be determined with any certainty, therefore the Directors have not provided for it in the financial statements.

The Company has entered into a shareholder agreement with Independiente Music Ventures – Travis Limited, whereby the Company has committed to acquire a further 499 A Ordinary shares for a total subscription price of £150,000 and to enter into a further unsecured loan note instrument for the principle sum of £350,000. This commitment will be made no earlier than July 2007 and no later than August 2007. The agreement also contains an option, whereby Independiente Limited (being the company engaged to provide certain services in connection with the recording, marketing and distribution of the album) may exercise this option for further funding. The funding will be for a further £500,000, allocated as £150,000 equity and £350,000 unsecured loan note instrument.

## 18. Related Party Transactions

The Company has appointed Ingenious Media Investments Limited, a company in which Patrick McKenna is a director, to be their promoter. Ingenious Media Investments Limited is a wholly owned subsidiary of Ingenious plc which is controlled by Patrick McKenna.

The Company has appointed Ingenious Ventures, a company in which Patrick McKenna is a director, to provide investment management and administrative services. Ingenious Ventures is a wholly owned subsidiary of Ingenious plc which is controlled by Patrick McKenna.

During the period the Company has carried out a number of transactions with the above-mentioned related parties in the normal course of the business and on an arm's length basis:

<b>Entity</b>	<b>Expenditure paid £'000</b>	<b>Amounts due £'000</b>
Ingenious Ventures Limited		
- Investment management fee	490	200
- Administration fee	37	10
 Ingenious Media Investments		
- Arrangement fee	1,323	-

Ingenious Consulting Limited, a company in which Patrick McKenna is a director, has entered into consultancy agreements with each of the investee companies to provide management services. For the provision of such services, consulting fees totalling £396,960 (inc VAT) have been invoiced, and of this amount £153,735 remains outstanding as at 31 December 2006.

MGR LLP and MGR Audit Limited, a company in which Lionel Martin is a director, have provided professional services throughout the period to Independiente Limited who hold 49.9% of the equity in Independiente Music Ventures – Travis Limited (investee company). For the provision of such services, £51,113 (inc VAT) in total has been invoiced, nothing remains outstanding as at 31 December 2006.

The funds invested in OEIC's, is managed by Ingenious Asset Management Limited, a company in which Patrick McKenna is a director. Ingenious Asset Management is a wholly owned subsidiary of Ingenious which is controlled by Patrick McKenna.

Patrick McKenna is a director of The Young Vic (a registered charity) which holds 0.2% of the equity in each of the investee companies.

## SHAREHOLDER INFORMATION

### 1. Share Price

All of the Shares have been admitted to trading on the LSE. The mid-price of the 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.

### 2. Share Trading

Shares can be bought and sold in the same way as any other quoted company on the LSE via a stockbroker. The primary market maker for the Shares is KBC Peel Hunt Ltd.

Selling your Shares may have tax consequences. You should contact your financial adviser if you are in any doubt as to such potential consequences.

### 3. Share Buy-Backs

The Company’s share buy-back policy for the next financial year is set out on page 35 but is subject to resolutions 7 and 8 set out in the Notice being adopted at the AGM.

The Company is unable to buy-back Shares directly from a Shareholder. Share buy-backs must therefore be conducted through a Shareholder’s stockbroker. The Manager is able to provide details of periods when the Company is prohibited from buying-back Shares from Shareholders under the Listing Rules.

### 4. Change of Shareholder Address

Communications with Shareholders are sent to the registered address held on the register of members. In the event of a change of address or any other relevant amendments, please notify the Company’s registrar, Capita Registrars, under the signature of the registered holder of the Shares in question.

### 5. Investor Relations Team

The Company and the Manager are committed to maintaining excellent investor relations. Therefore, if you have any questions about the Company’s progress please contact the Investor Relations Team below or your usual Ingenious contact.

Désirée Parker

Tel.: +44 (0) 207 319 4013

Fax: +44 (0) 207 319 4001

Email: [desiree.parker@ingeniousmedia.co.uk](mailto:desiree.parker@ingeniousmedia.co.uk)

Please note that neither the Investor Relations Team nor your usual Ingenious contact can provide you with any investment, tax, legal or other advice in relation to your Shares.

**NOTICE OF ANNUAL GENERAL MEETING**

**INGENIOUS MUSIC VCT 2 PLC**

*(Incorporated in England and Wales under the Companies Act 1985 with registered number 5564790)*

**NOTICE IS HEREBY GIVEN THAT** the first Annual General Meeting of Ingenious Music VCT 2 plc (the **Company**) will be held at 1.30 pm on Wednesday 14 March 2007 at 15 Golden Square, London W1F 9JG for the following purposes:

To consider and, if thought fit, pass resolutions 1 to 6 and 9 to 10 as ordinary resolutions and resolutions 7 and 8 as special resolutions.

**Annual Report and Accounts**

1. To receive and consider the Company's Annual Report and Accounts for the period ended 31 December 2006.

**Directors' Remuneration Report**

2. THAT the Directors' Remuneration Report for the period ended 31 December 2006 be and is hereby approved.

**Election of Directors**

3. THAT Patrick McKenna, who was appointed on incorporation of the Company, be elected as a non-executive director.
4. THAT Roger Ames, who was appointed by the Board on 23 September 2005, be elected as a non-executive director.
5. THAT Peter Reichardt, who was appointed by the Board on 8 June 2006, be elected as a non-executive director.
6. THAT Lionel Martin, who was appointed by the Board on 8 June 2006, be elected as a non-executive director.

**Reduction of Share Premium Account**

7. THAT, subject to the approval of the High Court of Justice, the Company be and is hereby generally and unconditionally authorised to reduce its share premium account by 50 per cent. of the amount standing to the credit of the share premium account.

**Share Buy-Backs**

8. THAT the Company be and is hereby generally and unconditionally authorised pursuant to section 166 of the Companies Act 1985 (the **Act**) to make one or more market purchases (as defined in section 163 of the Act) of ordinary shares of 1p each in the capital of the Company (the **Shares**) on such terms and in such manner as the Directors may determine provided that:
  - (a) such market purchases shall comply with UK Listing Authority and HM Inland Revenue & Customs requirements;
  - (b) the aggregate maximum number of Shares authorised to be purchased pursuant to this resolution shall not exceed 14.99 per cent. of the issued ordinary share capital of the Company;

- (c) the price paid shall not be less than 5p per Share, nor more than:
- (i) the net asset value per Share; or
  - (ii) 5 per cent. above the average of the middle market prices shown in the quotations for a Share in the Daily Official List of the London Stock Exchange for the five business days immediately preceding the date of purchase of the Share,
- the maximum and minimum prices being exclusive of expenses (including stamp duty); and
- (d) this authority, unless renewed or revoked prior to such time, shall expire on the earlier of 15 months from the passing of this resolution and the conclusion of the Company's next Annual General Meeting. The Company may, before the expiry of such authority, conclude contracts to purchase Shares which will or may be completed wholly or partly after the expiry of such authority and may make purchases of Shares in pursuance of any such contracts as if the authority hereby conferred had not expired.

### **Auditors**

9. THAT Grant Thornton UK LLP be and are hereby re-appointed as auditors to the Company, to hold office until the conclusion of the next general meeting at which accounts are laid.
10. THAT the Directors be and are hereby authorised to agree the remuneration of Grant Thornton UK LLP as auditors to the Company.

Dated: 9 February 2007

Registered Office:  
15 Golden Square  
London W1F 9JG

By order of the Board  
**Susan Ford**  
Company Secretary

### **NOTES**

- (a) Explanations relating to the above resolutions can be found overleaf.
- (b) Shareholders entitled to attend and vote at the above meeting are entitled to appoint one or more proxies to attend and, on a poll, to vote in their place. A proxy need not be a shareholder of the Company.**
- (c) To be valid, the Proxy Form must be completed in accordance with the instructions printed on it and must be deposited (together with the power of attorney or other authority (if any) under which it is signed or a notarially certified or office copy of such power or authority) by no later than 48 hours before the time appointed for holding the meeting with the Company's registrars, Capita Registrars, Proxy Processing Centre, Telford Road, Bicester OX26 4LD.
- (d) Completion of a Proxy Form will not prevent you from attending and voting at the meeting in person.
- (e) In accordance with Regulation 41 of the Uncertificated Securities Regulations 2001, the Company gives notice that only those shareholders entered on the relevant register of members (the "**Register**") for certificated or uncertificated shares of the Company (as the case may be) at 1.30 pm on 12 March 2007 (the "**Specified Time**") will be entitled to attend or vote at the AGM in respect of the number of shares registered in their name at the time. Changes to entries on the Register after the Specified Time will be disregarded in determining the rights of any person to attend or vote at the AGM. Should the AGM be adjourned to a time not more than 48 hours after the Specified Time, that time will also apply for the purpose of determining the entitlement of members to attend and vote (and for the purpose of determining the number of votes they may cast) at the adjourned AGM. Should the AGM be adjourned for a longer period, then to be so entitled, members must be entered on the Register at the time which is 48 hours before the time fixed for the adjourned AGM or, if the Company gives notice of the adjourned AGM, at the time specified in the notice.
- (f) In accordance with the requirements of the Companies Act 1985, the register of directors' interests will be available for inspection at the Annual General Meeting.
- (g) The terms and conditions of appointment of non-executive directors of the Company are available for inspection by any person at the Registered Office of the Company on each business day during normal business hours and will be available on the day of the AGM, at the place of the AGM, from at least 15 minutes prior to the AGM until its conclusion.

## **ADDITIONAL INFORMATION RELATING TO THE AGM**

In compliance with the Combined Code, a separate resolution on each substantially separate issue will be considered by the Shareholders at the AGM. All proxy votes will be counted and, except where a poll is called, the Chairman of the AGM will indicate the level of proxies lodged on each resolution, the balance for and against the resolution in question and the number of votes withheld after the resolution has been dealt with on a show of hands. The following resolutions will be considered by the Shareholders:

### *Resolution 1 – Annual Report & Accounts*

The Shareholders will be asked in this resolution to resolve to receive the Annual Report & Accounts for the period ended 31 December 2006.

### *Resolution 2 – Directors’ Remuneration Report*

In accordance with the Director’s Remuneration Report Regulations 2002, the Shareholders will be asked in this resolution to approve the Directors’ Remuneration Report to 31 December 2006 which can be found on pages 14 to 15.

### *Resolutions 3 to 6 – Election of Directors*

Pursuant to the Combined Code, all of the Directors will seek election at the AGM (this being the Company’s first annual general meeting). The Directors’ biographical details can be found on page 7.

### *Resolution 7 – Reduction of Share Premium Account*

This resolution will allow the Company, subject to the approval of the High Court of Justice, to reduce its share premium account and to create a new special reserve which can be used to finance share buy-backs.

### *Resolution 8 – Share Buy-Backs*

Pursuant to the Company’s articles of association the Company is authorised to make market purchases of an amount up to (but not including) 15 per cent. of the issued ordinary share capital of the Company subject to (amongst other things) the price paid being neither:

- less than 5p per Share;
- more than the net asset value per Share; nor
- five per cent. above the average of the market value of the Shares for the five business days immediately preceding the date of purchase.

This authority will expire at the conclusion of the Company’s first AGM. Although the Company has not made any market purchases during the period under review, the Shareholders will be asked to consider this special resolution in order to extend the authority. Subject to this resolution and resolution 7 being passed, the Directors will continue to consider making market purchases of Shares during the next financial year.

Nevertheless, the Directors will only implement such purchases if they are satisfied, after careful consideration, that these are in the best interests of the Shareholders as a whole and would result in an increase in expected earnings per share. Account will also be taken of the overall financial implications for the Company. Any market purchases will therefore be conducted entirely at the Directors’ discretion. Market purchases will also be subject to the requirements of the Companies Act, the rules of the UK Listing Authority and the rules of HM Revenue & Customs.

Although the Directors’ intention is that Shareholders who wish to sell their Shares should be able to do so, Shareholders should be aware that this may not always be possible.

## **INGENIOUS** MUSIC VCT 2

The Directors intend to cancel any Shares purchased by the Company in the next financial period, so reducing the total number of shares in issue.

### *Resolutions 9 and 10 – Re-Appointment of Grant Thornton UK LLP and Audit Fees*

In these resolutions, the Shareholders will be asked to approve the re-appointment of Grant Thornton UK LLP as auditors to the Company and to authorise the Directors to agree their remuneration for audit services. Further background to these resolutions can be found in paragraph 5 of the Directors' Report.

**PROXY FORM**

**ANNUAL GENERAL MEETING 14 MARCH 2007**

Please print clearly in **BLACK INK** and in **BLOCK CAPITALS**. Please read the **NOTES** below before completing this Proxy Form.

		<b>Notes</b>
Name: (full)	<input type="text"/>	
Address: (full)	<input type="text"/>	
	<input type="text"/>	
Postcode:	<input type="text"/>	
I/we the abovementioned shareholder(s) of Ingenious Music VCT 2 plc, hereby appoint the Chairman of the Annual General Meeting <i>If you wish to appoint someone other than the Chairman of the Annual General Meeting as your proxy, then please cross-out the words the Chairman of the Annual General Meeting and insert the full name(s) of the person(s) that you wish to appoint as your proxy below (note that a proxy need not be a member of the Company, but must attend the meeting in person):</i>		
Name: (full)	<input type="text"/>	
Address: (full)	<input type="text"/>	
	<input type="text"/>	
Postcode:	<input type="text"/>	
as my/our proxy to vote in my/our name(s) and on my/our behalf at the Annual General Meeting of Ingenious Music VCT 2 plc to be held on 1:30 pm on 14 March 2007 at 15 Golden Square London W1F 9JG and at any adjournment thereof.		

	For	Against	Withheld	1
1. To receive and consider the Company's Annual Report and Accounts for the period ended 31 December 2006 ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
2. THAT the Directors' Remuneration Report for the period ended 31 December 2006 be and is hereby approved ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
3. THAT Patrick McKenna, who was appointed on incorporation, be elected as a non-executive director ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
4. THAT Roger Ames, who was appointed by the Board on 23 September 2005, be elected as a non-executive director ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
5. THAT Peter Reichardt, who was appointed by the Board on 8 June 2006, be elected as a non-executive director ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
6. THAT Lionel Martin, who was appointed by the Board on 8 June 2006, be elected as a non-executive director ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	

	For	Against	Withheld	1
7. THAT, subject to the approval of the High Court of Justice, the Company be and is hereby generally and unconditionally authorised to reduce its share premium account ( <i>special resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
8. To approve the Company's authority to make market purchases of Shares ( <i>special resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
9. THAT Grant Thornton UK LLP be and are hereby re-appointed as auditors as auditors to the Company ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	
10. THAT the Directors be and are hereby authorised to agree the remuneration of Grant Thornton UK LLP ( <i>ordinary resolution</i> )	<input type="text"/>	<input type="text"/>	<input type="text"/>	

Shareholder signature:	<input type="text"/>	<b>2</b>
Date:	<input type="text"/>	

**NOTES**

- Please indicate above how you wish your votes to be cast in respect of each resolution by placing an "X" (or entering the number of Shares which you are entitled to vote) in the appropriate box. If you sign this Form of Proxy and return it without an indication of as to how your proxy will vote on any particular matter, your proxy will exercise his or her discretion as to whether, and if so how, he/she votes and he/she may also vote on any other business (including any amendments to the resolutions) which may be properly conducted at the Annual General Meeting. A vote withheld is not a vote in law and will not be calculated in the calculation of proportion of votes for and against each resolution.  
**This Proxy Form will only be used in the event of a poll being directed or demanded.**
- In the case of joint holders, the signature of one holder will be accepted but the names of all joint holders should be given. In the case of a corporation, this proxy should be either given under the corporation's common seal or signed for and on its behalf by a duly authorised officer or attorney of the corporation.

**Upon completing this Proxy Form, please sign and return it to the Company's registrars, Capita Registrars, using the reply paid envelope enclosed with this Annual Report & Accounts. This Proxy Form must be received by Capita Registrars by no later than 48 hours before the time appointed for holding the meeting together with the power of attorney or other authority (if any) under which it is signed or a notarially certified or office copy of such power or authority. The completion and return of this Proxy Form will not, however, preclude (a) holder(s) of Shares from attending and voting at the meeting if he/she (they) so wish/wishes and is (are) so entitled.**

## DEFINITIONS

The following definitions apply throughout these Annual Report & Accounts unless the context otherwise requires:

### **A&R**

Artist and repertoire.

### **AGM**

The annual general meeting of the Company which is to be held on 14 March 2007 as convened by the Notice.

### **Annual Report & Accounts**

These annual report & accounts of the Company for the period ending 31 December 2006.

### **Articles**

The Company's articles of association.

### **Board**

The Company's board of directors from time to time.

### **BPI**

The British Phonographic Industry (the British record industry's trade association).

### **Combined Code**

Combined Code on Corporate Governance 2006.

### **Companies Act**

Companies Act 1985.

### **Company**

Ingenious Music VCT 2 plc

### **Directors**

Directors of the Company from time to time.

### **FRS**

Financial Reporting Standard.

### **Grant Thornton**

Grant Thornton UK LLP.

### **ICTA**

Income & Corporation Taxes Act 1988.

### **IFPI**

The International Federation of the Phonographic Industry (the representative of the record industry worldwide).

### **Indies**

Small to medium-sized companies comprising the independent music sector.

### **Ingenious or Ingenious Group**

Ingenious Media plc and its subsidiaries.

### **Ingenious Consulting**

Ingenious Media Consulting Limited.

### **Ingenious Investments**

Ingenious Media Investments Limited.

### **Ingenious Ventures**

Ingenious Ventures Limited.

### **Majors**

Sony BMG, EMI Music, Warner Music and Universal Music.

### **Manager**

Ingenious Ventures.

### **Notice**

The notice convening the AGM and which can be found on page 35.

### **Offer**

The Company's offer to the public to subscribe for up to 30 million Shares at an issue price of 100p per Share launched on 22 November 2005.

### **Prospectus**

The prospectus published by the Company on 22 November 2005 in connection with the Offer.

### **PwC**

PricewaterhouseCoopers LLP.

### **Qualifying Company**

An unquoted company carrying on a trade wholly or mainly in the United Kingdom which satisfies certain other conditions as defined in schedule 28B of the ICTA and which meets the criteria to be a qualifying holding for the purpose of that schedule.

### **Qualifying Investment**

An investment by a VCT in a Qualifying Company.

### **Shares**

Ordinary shares of 1p each in the share capital of the Company.

### **Shareholder**

Holders of Shares.

### **SORP**

Has the meaning given to it on page 25.

### **VCT**

A company approved by HM Revenue & Customs as a venture capital trust under section 842AA of the ICTA.

### **VCT 1**

Has the meaning given to it on page 16.

In these Annual Report & Accounts (and unless the context otherwise requires), a reference to a time of day is to the time of day in London and a reference to a page is to a page of these Annual Report & Accounts.

