Quester VCT 3 PLC

ANNUAL REPORT 2005

Quester VCT 3 plc is a venture capital trust established under the provisions introduced by the Finance Act 1995.

The Company's objective is to provide shareholders with an attractive income and capital return by investing in a broadly spread portfolio consisting largely of unquoted investments with strong growth prospects and also including quoted equities and fixed interest securities.

Dividends paid by Quester VCT 3 plc, as an approved venture capital trust, are tax free to eligible shareholders. This applies to dividends derived both from income and from capital profits. This substantially enhances the effective returns to eligible subscribers for shares or purchasers of shares on the London Stock Exchange.

Eligible shareholders are reminded that a sale of their shareholding in Quester VCT 3 plc may give rise to a loss of any capital gains tax deferral granted at the time of their original subscription.

FINANCIAL HIGHLIGHTS

AS AT 28 FEBRUARY

Per ordinary share (pence)	**2005**	2004	2003
Capital values			
Net asset value	**43.6**	43.9	50.8
Share price	**38.5**	41.0	62.5
Return and dividends			
Dividend	**–**	–	–
Cumulative dividend	**1.9**	1.9	1.9
Total return*	**45.5**	45.8	52.7

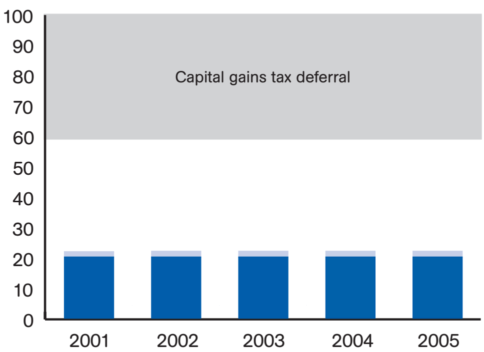
*Net asset value plus cumulative dividend

COMPOSITION OF THE FUND BY VALUE

	%
Venture capital investments (quoted 19.7%, unquoted 37.4%)	57.1
Listed equity investments*	33.2
Cash and other net current assets*	9.7
	100.0

*Retained as a reserve for potential future venture capital investment

CUMULATIVE CASH RETURN

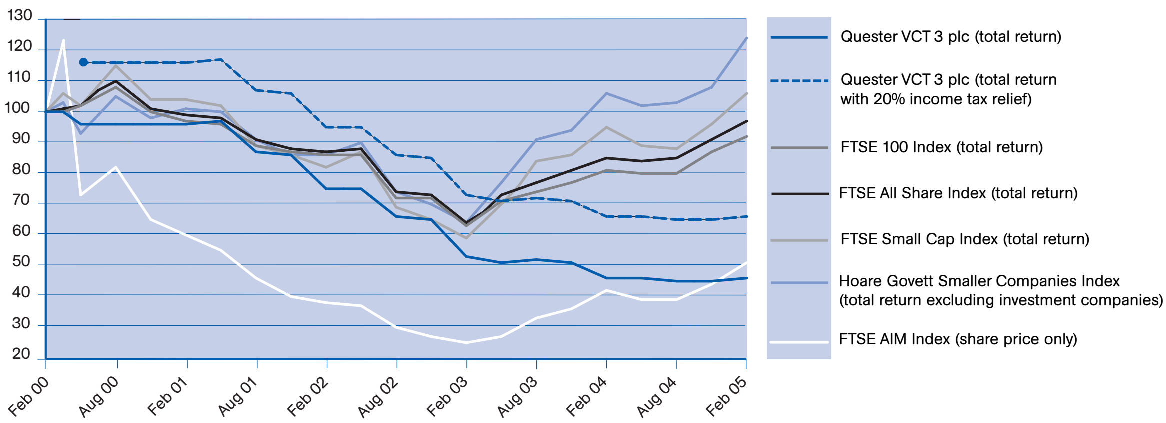


This diagram shows the progress made towards repayment of an original investor's initial investment, based on:

- the initial 100 pence investment price (February 2000)
- the initial 20 per cent income tax relief available to all eligible shareholders
- the cumulative dividends returned to eligible shareholders
- the amount of capital gains tax deferred for some eligible shareholders

COMPARATIVE PERFORMANCE

The comparative performance of Quester VCT 3 plc is shown on the graph, in comparison with a range of other indices. (Figures have been rebased to 100 at February 2000, when the Company was launched.)



CONTENTS

Page

CHAIRMAN'S STATEMENT

OVERVIEW

During the year to 28 February 2005, there was a small reduction in the Company's net asset value per share, from 43.9p to 43.6p, a fall of 0.3p or 0.6%. The corresponding net asset value of the Company fell from £20.8million to £20.3million. The change in net asset value is summarised as follows:

	£'000	Pence per share
Net asset value at 29 February 2004	20,778	43.9
Income	280	0.6
Other expenses including investment management fee	(780)	(1.7)
Realised net loss on investments	(1,169)	(2.4)
Net unrealised profit on revaluation of investments	1,619	3.4
Write-down of debtors	(122)	(0.2)
Share buy-backs*	(298)	–
Net asset value at 28 February 2005	20,308	43.6

*the impact of the share buy-backs on net asset value was to increase it by 0.02p per share

The statement of total return for the year shows a loss of £172,000, equivalent to 0.3p per share. This comprises a gain of £72,000 on the capital accounts, offset by a loss of £244,000 on the revenue account. Against this background, the Directors do not recommend a final dividend.

PROGRESS OF THE COMPANY'S INVESTMENTS

At the year end, the venture capital portfolio was valued at £11.6million compared with £11.7million at the start of the period. During the year, efforts were principally focused on the existing portfolio and follow-on investments totalling £917,000 were made. The only new investment was in Allergy Therapeutics, where £125,000 was subscribed at the time of the company's flotation on AIM.

The quoted investments held in the venture capital portfolio gave rise to an unrealised net gain of £693,000 on revaluation, to which the principal contributor was Loudeye Corporation. This company, which acquired On Demand Distribution in a share-for-share exchange during the year, is quoted on NASDAQ. At the year-end the holding was valued at £2.4million compared with a cost of £1.7million for the original investment. Other changes to this portfolio were disposals with a carrying value of £79,000 (giving rise to a gain of £23,000); write-offs totalling £1.5million; and net unrealised profits recognised during the year, amounting to £477,000. In addition, full provision was made against an earn-out entitlement which is held in debtors and which was previously valued at £122,000.

The listed equity portfolio, which is focused on shares in the FTSE All Share index, performed well during the period rising from £6.2million at the start of the year to close at a value of £6.7million at 28 February 2005. This was despite having sold equities with a value of £1million, so that the funds could be used for venture capital investment. Further details of investment performance are provided in the Investment Manager's report commencing on page 5.

CHAIRMAN'S STATEMENT (CONTINUED)

CHANGE OF CORPORATE BROKER AND MARKET MAKERS

In July 2004 the Company changed its corporate brokers to Noble & Company Limited. Following this change, Winterflood Securities Limited became market makers in the Company's shares.

PROPOSED MERGER, DIVIDEND AND OUTLOOK

As shareholders will be aware, the Board of Quester VCT 3 recently announced that it was in talks with the boards of Quester VCT plc and Quester VCT 2 plc regarding a possible merger of the three funds. Following these discussions, your Board has concluded that such a merger would be in the best interests of the Company and its shareholders and the other VCT Boards have reached similar conclusions.

Your Directors believe that the merger offers a number of benefits, including a reduction in running costs and a more broadly spread investment portfolio. I will be writing to shareholders to provide full details of the proposals.

If, for any reason, the merger does not proceed, the Company will continue to manage the existing portfolio so as to enhance its value and to look for exit opportunities that may permit other distributions to shareholders in due course.

David Quysner
Chairman

12 May 2005

INVESTMENT MANAGER'S REPORT

OVERVIEW

There was considerable activity in the venture capital portfolio in the year to 28 February 2005. The net result amounted to a £923,000 net realised and unrealised loss for this portfolio, a key component of the 0.6% reduction in net asset value per share. This is disappointing in the short term, reflecting performance behind plan by some portfolio companies, and particularly so against a background of gains on the quoted markets as the graphs on page 1 show. However, the exit transactions outlined below, are indicative of improved conditions for smaller companies, which has been encouraging and there has also been positive underlying progress made by a number of the other investments in the portfolio.

The decision to maintain a notional overweighting of FTSE companies held as a reserve for investment in the venture capital portfolio in FTSE companies paid off with a 29.3% total return being achieved.

PROGRESS OF THE VENTURE CAPITAL PORTFOLIO

During the year to 28 February 2005, a total of £917,000 has been invested in eight of the portfolio companies, as shown below:

Company	Industry sector	£'000
Anadigm Limited	Semiconductors	134
Antenova Limited	Communications	380
Anthropics Technology Limited	Communications	70
Avidex Limited	Healthcare & life sciences	78
Opsys Management Limited	Electronics	7
On Demand Distribution Limited	Internet	72
Reqio Limited	Software	51
TeraView Limited	Healthcare & life sciences	125
		917

In addition, a new investment was made in Allergy Therapeutics plc (£125,000), an established £18million turnover company with a range of allergy vaccines currently in the market and a programme for development of novel vaccines offering the potential for achievement of significant market expansion. This investment was made at the time of Allergy Therapeutics' capital raising on AIM. At 28 February 2005, it was showing an unrealised gain of £46,000.

PORTFOLIO NEWS

Transactions in four companies in the portfolio indicate a much improved climate for "exits", namely trade sales or listing on public markets of the unquoted investments and for raising additional capital for unquoted companies. We expect to continue to achieve further exits, provided these favourable conditions are maintained. This is a key area of focus for the Quester investment team, as we seek to deliver exit values ahead of the values of the investments in the accounts.

On Demand Distribution Limited ("OD2"), which had successfully developed as the largest digital music service provider in Europe, was acquired in July 2004 by the NASDAQ-quoted company Loudeye Corporation ("Loudeye"). The combination of the two businesses created the biggest business-to-business digital media provider in the world offering the largest digital music catalogue in the industry. The consideration was in the form of an initial receipt of Loudeye shares together with deferred consideration, receivable in cash or shares over the following 18 months, and an

INVESTMENT MANAGER'S REPORT (CONTINUED)

entitlement to an earnout depending upon the future performance of the combined entity. Subsequently, this arrangement has been renegotiated by the former OD2 shareholders resulting in an acceleration of the payment of the deferred consideration and the part crystallisation of the earnout. The valuation of the Loudeye holding as included in these accounts reflects this new arrangement and is also discounted to take account of both an orderly market agreement and warranty cover. It gives rise to an unrealised gain of £735,000.

Quester VCT 3 has been able to sell 26% of its holding of Loudeye shares subsequent to 28 February 2005 realising some of this gain. The sale proceeds represent 40.5% of the total original cost of this investment. The ultimate return to Quester VCT 3 will depend upon movements in both Loudeye's share price and in the movements of the dollar against sterling. The share price has been very volatile.

The shares of **Imagesound plc**, a leading UK supplier of in-store music, radio and TV services, were admitted to trading on AIM in August 2004 following a transaction involving a reverse takeover by the original Imagesound company of an AIM-traded shell and the acquisition of two smaller complementary businesses. Although market conditions have resulted in a reduction of £168,000, at 28 February 2005, in the carrying value of Quester VCT 3's investment (after discounting the share price of Imagesound plc by 10% to reflect the terms of a lock-up), the transaction created a business with a broader spread with a stronger platform for future growth.

The valuation of **Opsys Management Limited** (formerly Opsys Limited) is derived from the share price of **Cambridge Display Technology, Inc.** ("CDT") which acquired Opsys Limited in 2003. CDT achieved a NASDAQ listing in December 2004. Although its share price has been weak in the short term since listing (resulting in a mark-down in value of the residual investment value of Opsys Management Limited), ultimately there is the potential for shares in this world leading displays technology company to recover.

Antenova Limited completed an important £6.5million financing in December 2004 and continues to make positive progress. It has now signed a memorandum of understanding with Galtronics, a market leader in antenna design and manufacturing, to speed up the entrance of Antenova's high dielectric antenna technology into the handset and laptop/adapter market, and has more recently announced the winning of its first major supply agreement with a "top 5" OEM cellular handset manufacturer and a partnership agreement with Siemens for the design and supply of internal antennas for a new product range to be released by Siemens in 2005.

VALUATION CHANGES APPLIED TO VENTURE CAPITAL INVESTMENTS

The year's valuation process has been overseen by a wider range of outside parties as a result of the proposed merger.

Holdings in companies whose shares are either listed or traded on AIM are valued on the basis of mid-market price on 28 February 2005, less a discount, if appropriate, to reflect any lock-up or orderly market arrangements. During the year, these investments showed a net appreciation in value of £693,000. This was largely driven by gains in the investments in Loudeye (£735,000), Vernalis (£74,000) and Allergy Therapeutics (£46,000), offset by unrealised losses in Imagesound (£168,000).

Following BVCA guidelines, provisions were made against four investments; Anadigm Limited (£140,000), Arithmatica Limited (£1,009,000), The Casella Group Limited (£48,000) and Opsys Management Limited (£216,000). Whilst there is the potential for some of these valuations to recover, some of these downwards revaluations are considered permanent and, as such, these elements have been treated as realised. The earnout entitlement held in connection with the sale of CDC Solutions Limited in 2003 has been valued at £nil, a reduction of £122,000. It is still possible that some value will be derived from this entitlement based on 2005 and 2006 performance, but based on 2004 performance, it has been appropriate to reduce its carrying value.

SECTOR ANALYSIS OF THE VENTURE CAPITAL PORTFOLIO

The portfolio of Quester VCT 3 is balanced by sector and is well spread. A summary of the sectors covered by the portfolio at 28 February 2005 is provided in the table below:

Industry sector	Percentage of portfolio at valuation %	Valuation £'000	Number of investments
Healthcare & life sciences	28.8	3,339	6
Internet	28.8	3,336	3
Industrial products & services	16.2	1,880	2
Communications	9.3	1,075	2
Media	7.2	832	1
Semiconductors	4.8	561	2
Software	4.3	501	3
Electronics	0.6	72	1
	100.0	11,596	20

RESERVES FOR FOLLOW-ON INVESTMENT

The overall reserves requirement to support the existing venture capital portfolio has reduced during the year. This has freed up additional liquid resources for investment in new venture capital opportunities and the new investment in Allergy Therapeutics reflects this change of emphasis and the opportunity to make new investments. A further small investment has been made since the year end and there are others in the pipeline.

LISTED EQUITY AND FIXED INTEREST PORTFOLIO

At the period end, the value of the listed equity portfolio, comprising 31 investments, was £6.7million on a cost of £5.9million. During the year to 28 February 2005 it generated a strong total return of 29.3% reflecting realised and unrealised gains of £1.3million and a dividend yield of £262,000. Cash proceeds totalling £1million were withdrawn from the portfolio during the year.

OUTLOOK

The proposed merger process involving Quester VCT 3, which is designed to produce operating efficiency and reduced costs, offers a fundamental change to the shape and spread of the current venture capital portfolio. If market conditions for exits remain favourable, there is potential for the increased level of exit activity, as achieved last year in Quester VCT 3's portfolio, to be maintained by the merged company across a larger portfolio. Our objective is to continue to focus on this exit process in order to deliver cash for dividend payments and continued re-investment in new venture capital opportunities.

Quester Capital Management Limited
Manager

12 May 2005

FUND SUMMARY

AS AT 28 FEBRUARY 2005	Industry sector	Original Cost £'000	Valuation £'000	Equity % held	% of fund by value
Quoted venture capital investments					
Allergy Therapeutics plc	Healthcare & life sciences	125	171	0.3%	0.8%
Imagesound plc	Media	1,000	832	6.2%	4.1%
Loudeye Corp.	Internet	1,691	2,426	2.8%	12.0%
The Innovation Group plc	Software	496	25	–	0.1%
Vernalis Group Plc	Healthcare & life sciences	965	546	0.5%	2.7%
Total quoted venture capital investments		**4,277**	**4,000**		**19.7%**
Unquoted venture capital investments					
Anadigm Limited	Semiconductors	1,278	223	2.8%	1.1%
Antenova Limited	Communications	1,254	1,005	5.4%	5.0%
Anthropics Technology Limited	Communications	1,070	70	7.0%	0.3%
Arithmatica Limited	Semiconductors	1,347	338	12.5%	1.7%
Artisan Software Tools Limited	Software	1,104	354	6.8%	1.7%
Avidex Limited	Healthcare & life sciences	464	464	1.2%	2.3%
Casella Group Limited, The	Industrial products & services	804	430	2.3%	2.1%
Community Internet Europe Limited	Internet	1,015	254	7.0%	1.3%
Cyclacel Group plc	Healthcare & life sciences	800	800	1.1%	3.9%
Elateral Holdings Limited	Software	1,873	122	12.9%	0.6%
Footfall Limited	Industrial products & services	1,450	1,450	8.5%	7.1%
Lorantis Holdings Limited	Healthcare & life sciences	1,000	625	1.6%	3.1%
Opsys Management Limited*	Electronics	1,038	72	–	0.4%
Sift Group Limited	Internet	875	656	4.5%	3.2%
TeraView Limited	Healthcare & life sciences	625	733	4.9%	3.6%
Total unquoted venture capital investments		**15,997**	**7,596**		**37.4%**
Total venture capital investments		**20,274**	**11,596**		**57.1%**
Listed equity investments		**5,912**	**6,749**		**33.2%**
Total investments		**26,186**	**18,345**		**90.3%**
Cash and other net current assets		**1,963**	**1,963**		**9.7%**
Net assets		**28,149**	**20,308**		**100.0%**

*Formerly Opsys Limited

TEN LARGEST VENTURE CAPITAL INVESTMENTS

LOUDEYE CORP.

www.loudeye.com

Initial investment:	November 2000
Cost:	£1,691,000
Valuation:	£2,426,000
Equity held:	2.8%
Valuation basis:	Mid-market price
Co-investing Quester Funds*: VCT 2, VCT 4 & QVP	

Latest published accounts:	**31.12.2004**	**31.12.2003**
Turnover:	$16,821,000	$11,948,000
Loss before tax:	($16,397,000)	($19,174,000)
Retained losses:	($209,284,000)	($192,887,000)
Net assets:	$66,450,000	$17,033,000

A NASDAQ-traded company specialising in business-to-business digital media solutions that facilitate the distribution and promotion of digital media content to media & entertainment, retail and enterprise clients. Loudeye acquired OD2, the largest digital music provider in Europe, in June 2004. The combined entity created the world's largest business-to-business digital media company with more than 200 client organisations across 20 countries.

FOOTFALL LIMITED

www.footfall.com

Initial investment:	April 2000
Cost:	£1,450,000
Valuation:	£1,450,000
Equity held:	8.5%
Valuation basis:	Cost
Co-investing Quester Funds*: VCT 2, VCT 4 & VCT 5	

Latest published accounts:	**31.03.2004**	**31.03.2003**
Turnover:	£4,003,000	£1,954,000
Profit/(loss) before tax:	£410,000	(£1,742,000)
Retained losses:	(£6,273,000)	(£7,033,000)
Net assets:	£3,210,000	£2,450,000

Footfall specialises in the provision of pedestrian counting information services to retailers and shopping centre owners. It also publishes the widely used "Footfall Index". Its expertise is to measure and collect data on pedestrian movements and to transform this into meaningful business intelligence. The company enjoys long-term contracts with clients, giving it a high level of recurring revenue. Trading results continue to show positive progress.

ANTENOVA LIMITED

www.antenova.com

Initial investment:	April 2001
Cost:	£1,254,000
Valuation:	£1,005,000
Equity held:	5.4%
Valuation basis:	Pricing of last round
Co-investing Quester Funds*: VCT 4, VCT 5 & QVP	

Latest published accounts:	**31.12.2004**	**31.12.2003**
Turnover:	£716,000	£198,000
Loss before tax:	(£2,380,000)	(£2,951,000)
Retained losses:	(£9,219,000)	(£7,079,000)
Net assets:	£6,846,000	£1,440,000

An early stage company focused on the development and marketing of next-generation antenna technology for wireless networks based on innovative antenna design using ceramic materials. Progress has continued to be positive: since 31 December 2003 the company has recorded its first sales revenues. It has entered into a partnership with Galtronics, a market leader in antenna design and manufacturing, and more recently has been accepted onto the antenna reference list for Intel. It has also signed a laptop antenna contract with Siemens and has contracts with two Tier 1 handset manufacturers amongst others.

* Isis: Isis College Fund Limited partnerships; VCT 1: Quester VCT plc; VCT 2: Quester VCT 2 plc; VCT 4: Quester VCT 4 plc; VCT 5: Quester VCT 5 plc; QVP: Quester Venture Partnership.

TEN LARGEST VENTURE CAPITAL INVESTMENTS (CONTINUED)

IMAGESOUND PLC

www.imagesound.co.uk

Initial investment:	July 2000	Latest published accounts:	**31.12.2004**	**31.10.2003**
Cost:	£1,000,000	Turnover:	£3,231,000	–
Valuation:	£832,000	Loss before tax:	(£565,000)	(£30,000)
Equity held:	6.2%	Retained losses:	(£1,151,000)	(£585,000)
Valuation basis:	Mid-market price	Net assets:	£10,314,000	£1,327,000
Co-investing Quester Funds*: VCT 2			(14 months)	

An AIM-traded company utilising the latest technology to source, manage and distribute profiled music, targeted messaging and high impact audio-visual content to over 10,000 of the UK's leading retail and leisure outlets. Imagesound listed on AIM in August 2004.

CYCLACEL GROUP PLC

www.cyclacel.com

Initial investment:	May 2001	Latest published accounts:	**31.12.2003**	**31.03.2003**
Cost:	£800,000	Turnover:	£5,000	£808,000
Valuation:	£800,000	Loss before tax:	(£8,700,000)	(£12,471,000)
Equity held:	1.1%	Retained losses:	(£39,912,000)	(£32,115,000)
Valuation basis:	Cost	Net assets:	£21,168,000	£12,643,000
Co-investing Quester Funds*: VCT 4 & VCT 5			(nine months)	

A drug discovery company engaged in the design and development of novel therapeutics for cancer and other diseases involving abnormal cell proliferation. Its most advanced research and development programme has completed Phase 1 trials in Europe. The company has entered into corporate alliances with AstraZeneca, CV Therapeutics, Lorus Sankyo and a "top five" pharmaceutical major, all in the oncology field. An IPO on the London Stock Exchange and NASDAQ, originally intended for 2004, has been postponed until general market conditions improve.

TERAVIEW LIMITED

www.teraview.co.uk

Initial investment:	April 2001	Latest published accounts:	**30.04.2004**	**30.04.2003**
Cost:	£625,000	Turnover:	†	†
Valuation:	£733,000	Profit before tax:	†	†
Equity held:	4.9%	Retained losses:	(£5,195,000)	(£3,561,000)
Valuation basis:	Pricing of last round	Net assets/(liabilities):	£1,427,000	(£1,531,000)
Co-investing Quester Funds*: VCT 4				

A Cambridge based company spun out of Toshiba Research Europe in April 2001 to exploit Terahertz imaging technology in the fields of security, pharmaceuticals and medical imaging. Sales for the year 2004 were ahead of the previous year. Additional sales and business development resource is being recruited. The company continues to make progress with two significant contracts in the security and imaging sectors.

* Isis: Isis College Fund Limited partnerships; VCT 1: Quester VCT plc; VCT 2: Quester VCT 2 plc; VCT 4: Quester VCT 4 plc; VCT 5: Quester VCT 5 plc; QVP: Quester Venture Partnership.

† Only abbreviated accounts available, information therefore unavailable.

SIFT GROUP LIMITED

www.sift.co.uk

Initial investment:	October 2000
Cost:	£875,000
Valuation:	£656,000
Equity held:	4.5%
Valuation basis:	Cost less provision
Co-investing Quester Funds*: VCT 1, VCT 2 & VCT 4	

Latest published accounts:	31.12.2004	31.12.2003
Turnover:	£4,022,000	£3,972,000
Profit/(loss) before tax:	£208,000	£196,000
Retained losses:	(£7,911,000)	(£8,119,000)
Net assets:	£477,000	£269,000

An innovative company specialising in developing 'virtual communities' over the internet. Sift develops community portals and knowledge management applications, offering clients a modular technology platform, supported by a best practice programme, site management and consultancy services. In 2004 the company generated revenues of £4million and further significant growth is expected as enterprises look to outsource their online community management requirements.

LORANTIS HOLDINGS LIMITED

www.lorantis.co.uk

Initial investment:	April 2001
Cost:	£1,000,000
Valuation:	£625,000
Equity held:	1.6%
Valuation basis:	Pricing of last round
Co-investing Quester Funds*: VCT 4, VCT 5 & QVP	

Latest published accounts:	31.12.2004	31.12.2003
Turnover:	–	–
Loss before tax:	(£6,072,609)	(£5,643,000)
Retained losses:	(£19,351,126)	(£13,908,000)
Net assets:	£25,497,434	£30,928,000

A drug discovery company focused on the development of novel immunotherapeutics, targeting indications such as asthma, allergic reactions, autoimmune diseases and transplant rejection. This is an early stage biotechnology company based on high quality science. As yet, however, the company has no products in clinical trials and carries inherent science and funding risks. These are balanced by the high quality of the scientific team and the attractive long-term investment potential.

VERNALIS GROUP PLC

www.vernalis.com

Initial investment:	July 2000
Cost:	£965,000
Valuation:	£546,000
Equity held:	0.5%
Valuation basis:	Mid-market price
Co-investing Quester Funds*: VCT 2	

Latest published accounts:	31.12.2004	31.12.2003
Turnover:	£15,195,000	£8,631,000
Loss before tax:	(£30,967,000)	(£36,864,000)
Retained losses:	(£485,220,000)	(£456,011,000)
Net assets:	£12,875,000	£33,789,000

A UK-based biotechnology company with a marketed product, Frovatriptan, and a development pipeline focused on CNS disease and oncology. Frovatriptan is approved in the United States and Europe as an acute oral treatment for migraine headache. Vernalis is currently conducting further trials to develop Frovatriptan and five other products are in clinical development. Positive long-term growth opportunities exist through the progression of the product portfolio and further participation in consolidation of the biotechnology sector.

* Isis: Isis College Fund Limited partnerships; VCT 1: Quester VCT plc; VCT 2: Quester VCT 2 plc; VCT 4: Quester VCT 4 plc; VCT 5: Quester VCT 5 plc; QVP: Quester Venture Partnership.

TEN LARGEST VENTURE CAPITAL INVESTMENTS (CONTINUED)

AVIDEX LIMITED

www. avidex.com

Initial investment:	December 2000
Cost:	£464,000
Valuation:	£464,000
Equity held:	1.2%
Valuation basis:	Cost
Co-investing Quester Funds*: Isis, VCT 4, VCT 5 & QVP	

Latest published accounts:	31.3.2004	31.3.2003
Turnover:	†	†
Profit before tax:	†	†
Retained losses:	(£18,580,000)	(£12,513,000)
Net assets:	£4,555,000	£10,623,000

A drug discovery company focused on the development of therapeitics based around its proprietary T-cell receptor technology. The company was formed in 1999 as a spinout from the University of Oxford's Institute of Molecular Medicine. Scientific progress has been most encouraging. As yet, however, the company has no products in clinical trials and carries inherent science and funding risks. These are balanced by the high quality of the scientific team and the attractive long-term investment potential.

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† Only abbreviated accounts available, information therefore unavailable.

DIRECTORS

David Quysner (58), non-executive Chairman, worked for 3i Group plc from 1969 until 1982. He then joined Abingworth Management Limited, a venture capital fund management company, becoming its Managing Director in 1994 and its Chairman in 2002. He has been involved in a wide range of venture capital investment activity in the UK, Continental Europe and the USA and is a past Chairman of the British Venture Capital Association. He is chairman of the Audit Committee.

Mike Brooke (63) has been closely involved in the successful creation and development of a substantial number of businesses, largely in the computer and communications related industries. Several of these companies have been subsequently acquired by large corporations while others have attained quotations on the London Stock Exchange. He is currently a director of Interquad Group Limited, Prelude Investment Trust Plc, Maxima Holdings plc, Evolved Group Limited, Imprimatur Capital Limited and Kinetic Solutions Limited. He is a member of the Audit Committee.

George Hayter (66), after initially working as an avionics designer and control engineer, developed his career in IT Systems, managing British Airways' real time systems development for eight years. In 14 years at the London Stock Exchange he then led the revolution in information and trading systems, culminating in the transition to off-floor trading at the "Big Bang", and rising to be managing director of Trading Markets. He is currently the Chairman of E*TRADE Group Inc. and a non-executive director of Surfcontrol plc. In a varied consulting practice he has provided guidance to a wide range of commercial organisations including many securities markets in emerging and well established economies. He is a member of the Audit Committee.

As part of the proposed merger process, Andrew Holmes and John Spooner resigned as directors of the Company on 31 January 2005 to assist the independent evaluation of the merger proposals by the Board.

All the directors are non-executive. David Quysner, Mike Brooke and George Hayter are independent of the Manager. George Hayter will offer himself for re-election at an annual general meeting to be convened by the Company in due course if the proposed merger of the Company is not implemented.

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 28 February 2005.

ACTIVITIES AND STATUS

The principal activity of the Company during the year was the making of equity investments, mainly in unquoted companies. As at 28 February 2005, the Company was an investment company as defined in Section 266 of the Companies Act 1985 and has been granted provisional approval by the Inland Revenue as a venture capital trust in accordance with Section 842AA of the Income and Corporation Taxes Act 1988. In the opinion of the directors, the Company has conducted its affairs so as to enable it to continue to maintain such approval. The Company was not at any time up to the date of this report a close company within the meaning of Section 414 of that Act.

The Company's ordinary shares of 1p each have been listed on the Official List of the UK Listing Authority since 16 February 2000.

An ordinary resolution is required to be proposed at the Company's tenth annual general meeting, to be held in 2010, to the effect that the Company should continue as a venture capital trust. This resolution will continue to be proposed, if applicable, at five yearly intervals thereafter.

The Company has no subsidiaries.

REVIEW OF THE BUSINESS

The Chairman's Statement and Investment Manager's Report commencing on pages 3 and 5 respectively include a review of developments during the year and of future prospects.

RESULTS AND DIVIDENDS

A revenue loss of £244,000 has arisen during the year ended 28 February 2005 taking the deficit on the revenue reserve to £645,000. The Board does not recommend the payment of a dividend in respect of the year.

As at 28 February 2005, the Company had accumulated unrealised capital losses of £255,000 and retained a positive balance on the realised capital reserve of £595,000 following a transfer of £9.5million from the Special Reserve (see note 12).

The mid-market price of the Company's shares as at the close of business on 28 February 2005 was 38.5p per share. The mid-market price ranged from 28.5p to 42.5p during the year. Whilst the Company's net asset value ranged from 41.5p to 44.5p during the same period.

CORPORATE GOVERNANCE

A report on corporate governance is set out on pages 28 to 29. The directors' remuneration report is presented on page 30.

PURCHASE AND CANCELLATION OF SHARES

During the year 753,374 ordinary shares of 1p each representing 1.6% of the issued share capital were bought in by the Company for cancellation at a total cost of £298,000. The impact on the net asset value was to increase it by 0.02p per share.

DIRECTORS

The directors of the Company who held office during the year and their interests in the ordinary shares of 1p each of the Company as at 28 February 2005 and as at the date of this report were as follows:

	2005	2004
DW Quysner (Chairman)	**100,000**	100,000
MJ Brooke	**30,000**	30,000
GA Hayter	**30,000**	30,000
APG Holmes (resigned 31 January 2005)	**100,000**	100,000
JA Spooner (resigned 31 January 2005)	**100,000**	100,000

The interests in the ordinary shares of the Company held by APG Holmes and JA Spooner, as disclosed in the table above, include interests held by connected parties.

All of the directors' share interests shown above were held beneficially. No options over the share capital of the Company have been granted to the directors. There have been no changes in the holdings of the directors since the year end.

APG Holmes and JA Spooner are directors and shareholders of Querist Limited (the ultimate parent company of Quester Capital Management Limited ("QCML"), the Manager). They are also executive directors of QCML and Quester Services Limited. Quester Services Limited, an indirect subsidiary undertaking of Querist Limited and an employee benefit trust, may become entitled to be granted options to subscribe for shares under the Subscription Share Option Agreement referred to in note 11 to the financial statements.

Save for the Subscription Share Option Agreement referred to above and the Management Agreement referred to below, no contracts were subsisting during or at the end of the year in which any director was materially interested. Disclosures required by the Financial Reporting Standard (FRS) 8, 'Related Party Disclosures' are set out in note 17 of the financial statements.

APG Holmes and JA Spooner resigned as directors on 31 January 2005.

MANAGEMENT

QCML is the Investment Manager to the Company. The principal terms of the Company's management agreement with QCML are set out in note 3 of the financial statements.

CREDITOR PAYMENT POLICY

The Company's payment policy for the forthcoming year is to ensure settlement of suppliers' invoices in accordance with their standard terms. As at 28 February 2005 there were 76 days' billing from the suppliers of services outstanding (2004: 35 days).

SUBSTANTIAL SHAREHOLDINGS

As at 28 February 2005 and at the date of this report, the Company was not aware of any beneficial interest exceeding 3% of any class of the issued share capital.

DIRECTORS' REPORT (CONTINUED)

GOING CONCERN

The directors confirm that they are satisfied that the Company has adequate resources to continue in business for the foreseeable future. For this reason they believe that the Company continues to be a going concern and that it is appropriate to continue to apply the going concern basis in preparing the financial statements.

MERGER

A proposal is being put to shareholders for a merger with Quester VCT plc and Quester VCT 2 plc. If the merger is not implemented, the Company will convene an annual general meeting to transact its ordinary and special business.

AUDITOR

KPMG Audit Plc is willing to continue in office. If an AGM is convened by the Company, a resolution to reappoint KPMG Audit Plc and to authorise the directors to fix its remuneration will be proposed at that meeting.

By order of the Board

RJ Drover
Secretary

12 May 2005

STATEMENT OF TOTAL RETURN (INCORPORATING THE REVENUE ACCOUNT)

FOR THE YEAR ENDED 28 FEBRUARY 2005

	Notes	2005 Revenue £'000	2005 Capital £'000	2005 Total £'000	2004 Revenue £'000	2004 Capital £'000	2004 Total £'000
Profit/(loss) on investments	8(c)	–	450	450	–	(2,711)	(2,711)
Write-down of debtors	9	–	(122)	(122)	–	–	–
Income	2	280	–	280	356	–	356
Investment management fee	3	(256)	(256)	(512)	(303)	(303)	(606)
Other expenses	4	(268)	–	(268)	(353)	–	(353)
Return on ordinary activities before tax		(244)	72	(172)	(300)	(3,014)	(3,314)
Tax on ordinary activities	6	–	–	–	–	–	–
Return on ordinary activities after tax		(244)	72	(172)	(300)	(3,014)	(3,314)
Dividend proposed		–	–	–	–	–	–
Transfer (from)/to reserves		(244)	72	(172)	(300)	(3,014)	(3,314)
Loss per share	7	(0.5)p	0.2p	(0.3)p	(0.6)p	(6.3)p	(6.9)p

The revenue column of this statement is the profit and loss account of the Company.

All revenue and capital items in the above statement derive from continuing operations.

The Company has only one class of business and derives its income from investments made in shares and securities and from bank deposits.

The accompanying notes are an integral part of this statement.

BALANCE SHEET

AS AT 28 FEBRUARY 2005

	Notes	2005 £'000	2004 £'000
Fixed assets			
Investments	8(a)	**18,345**	17,849
Current assets			
Debtors	9	**486**	1,613
Cash at bank		**1,729**	1,439
		2,215	3,052
Creditors (amounts falling due within one year)	10	**(252)**	(123)
Net current assets		**1,963**	2,929
Net assets		**20,308**	20,778
Capital and reserves			
Called-up equity share capital	11	**466**	474
Share premium	12	**2**	2
Special reserve	12	**20,145**	29,955
Capital reserve – realised	12	**595**	287
– unrealised	12	**(255)**	(9,539)
Revenue reserve	12	**(645)**	(401)
Equity shareholders' funds		**20,308**	20,778
Net asset value per share	13	**43.6p**	43.9p

The financial statements on pages 17 to 27 were approved by the directors on 12 May 2005 and are signed on their behalf by:

David Quysner
Chairman

The accompanying notes are an integral part of this statement.

CASH FLOW STATEMENT

FOR THE YEAR ENDED 28 FEBRUARY 2005

	Notes	2005 £'000	2004 £'000
Cash inflow/(outflow) from operating activities	15	**634**	(2,061)
Financial investment			
Purchase of venture capital investments	8(b)	**(1,042)**	(2,374)
Purchase of listed equities and fixed interest investments	8(b)	**(903)**	(1,701)
Sale of venture capital investments	8(b)	**102**	2,126
Recoveries made in respect of investments previously written-off	8(c)	**227**	–
Sale/redemption of listed equities and fixed interest investments	8(b)	**1,570**	3,467
Total financial investment		**(46)**	1,518
Financing			
Buy-back of ordinary shares	11	**(298)**	(114)
Increase/(decrease) in cash for the year		**290**	(657)

Reconciliation of net cash flow to movement in net funds		
Increase/(decrease) in cash for the year	**290**	(657)
Net funds at the start of the year	**1,439**	2,096
Net funds at the end of the year	**1,729**	1,439

The accompanying notes are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

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

BASIS OF ACCOUNTING

These financial statements have been prepared under the historical cost convention, modified to include the revaluation of fixed asset investments, and in accordance with applicable accounting standards and with the Statement of Recommended Practice "Financial statements of investment trust companies".

INVESTMENTS

Unquoted investments are stated at directors' valuations. Such investments are valued in accordance with the British Venture Capital Association ("BVCA") guidelines, which state that investments should be reported at fair value at the reporting date except in situations where fair value cannot be reliably measured. Primary indicators of fair value are derived from earnings multiples, prices of recent investment or from net assets. Where fair value cannot be reliably measured, which is generally the case for early stage technology and life sciences businesses, the policy is to carry them at cost except where there is evidence that an investment has been impaired. Examples of events or changes that could indicate impairment include:

- the performance and/or prospects of the underlying business are significantly below the expectations on which the investment was based;
- a significant adverse change either in the investee company's business or in the technological, market, economic, legal or regulatory environment in which the business operates; or
- market conditions have deteriorated, which may be indicated by a fall in the share prices of quoted businesses operating in the same or related sectors.

Listed investments are stated at mid-market prices. However, where the Company is unable to sell its shares in a company on account of a lock-up, a discount is applied to the mid-market price. If the lock-up is for a period of six months or less from the reporting date then a discount of 10% is to be applied. If the lock-up is for a longer period than six months then a discount of 10% or more will be applied. Certain venture capital investments deemed to be associated undertakings are carried at cost or valuation in accordance with the Company's normal accounting policy and Financial Reporting Standard (FRS) 9.

GAINS AND LOSSES ON INVESTMENTS

Capital gains and losses on investments, whether realised or unrealised, are dealt with in the Capital Reserve.

INCOME

Dividends receivable on listed equity shares are brought into account on the ex-dividend date. Income receivable on unquoted equity and non-equity shares and loan notes is brought into account when the Company's right to receive payment is established and there is no reasonable doubt that payment will be received. Fixed returns on quoted debt securities are recognised on a time apportionment basis (including amortisation of any premium or discount to redemption) so as to reflect the effective yield, provided there is no reasonable doubt that payment will be received in due course.

EXPENSES

All expenses are accounted for on an accruals basis. Expenses are charged wholly to the revenue account, with the exception of:

- expenses incidental to the acquisition or disposal of an investment, which are included within the cost of the investment or deducted from the disposal proceeds as appropriate;
- the investment management fee, 50% of which has been charged to the realised capital reserve to reflect an element which is, in the directors' opinion, attributable to the maintenance or enhancement of the value of the Company's investments.
- any costs associated with the issue of shares are charged to the Share Premium account. Any costs associated with the buy-back of shares are charged to the Special Reserve.

TAXATION

Corporation tax is applied to profits chargeable to corporation tax, if any, at the applicable rate for the year.

The tax effect of different items of income/gain and expenditure/loss is allocated between capital and revenue on a marginal basis using the Company's effective rate of tax for the accounting period.

The Company has not provided for deferred tax on any capital gains/losses arising on the revaluation or disposal of investments as these items are not subject to tax whilst the Company retains its venture capital status. The Company intends to continue to meet the conditions required for it to continue its approved venture capital trust status for the foreseeable future.

2 INCOME

	2005 £'000	2004 £'000
Dividend income		
Unquoted companies	–	1
Listed equity shares	**262**	232
Interest receivable		
Listed fixed interest securities	–	66
Bank deposits	**18**	22
Loans to unquoted companies	–	12
Other	–	23
	280	356

3 INVESTMENT MANAGEMENT FEE

Quester Capital Management Limited ("QCML") provides investment management services to the Company under an agreement dated 19 January 2000.

A charge of £512,000 (2004: £606,000) in respect of the management fee payable to QCML was paid during the year together with irrecoverable VAT of £80,000 (2004: £120,000). The basis for determining this fee, which is payable quarterly in advance, was modified during the year. Under this new basis the fee is levied quarterly at the rate of one quarter of 2.5% of the lower of the audited net asset value at the end of the preceding financial period or the closing net asset value at the end of each respective quarter. Previously, the fee was determined annually and was equal to 2.5% of the audited net asset value at the end of the preceding financial period.

The manager's appointment is for a fixed term which expires on the seventh anniversary of the commencement of the fund and shall continue until terminated by either party subject to a notice period. If such notice is given on or after the seventh anniversary of the commencement of the fund, the notice period shall be the longer of (i) twelve months and (ii) the period from the date on which notice is given to the tenth anniversary of the commencement of the fund.

QCML provides administrative and secretarial services to the Company for which it is entitled to a fee of £44,000 per annum (linked to the movement in the RPI), which is included in other expenses (note 4).

4 OTHER EXPENSES

	2005 £'000	2004 £'000
Administrative and secretarial services	**44**	43
Directors' remuneration (note 5)	**39**	39
Auditor's remuneration:		
Audit services	**18**	22
Non audit services	**10**	10
Insurance	**17**	16
Legal and professional expenses	**6**	24
UKLA, LSE and registrar's fees	**15**	17
Irrecoverable VAT	**107**	146
Other	**12**	36
	268	353

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

5 DIRECTORS' REMUNERATION

	2005 £'000	2004 £'000
Fees paid to directors	**15**	15
Amounts paid to third parties, excluding VAT, in consideration for the services of directors	**24**	24
	39	39

The total fees paid or payable in respect of individual directors for the period is detailed in the Directors' Remuneration Report set out on page 30.

6 TAX ON ORDINARY ACTIVITIES

	2005 Revenue £'000	2005 Capital £'000	2004 Revenue £'000	2004 Capital £'000
Corporation tax payable	–	–	–	–

Reconciliation of loss on ordinary activities to corporation tax payable

	2005 Revenue £'000	2005 Capital £'000	2004 Revenue £'000	2004 Capital £'000
(Loss)/profit on ordinary activities before tax	(244)	72	(300)	(3,014)
Tax on (loss)/profit on ordinary activities at standard UK corporation tax rate of 30% (2004: 30%)	(73)	22	(90)	(904)
Effects of:				
Non-taxable items	–	(98)	–	813
Unutilised expenses	73	76	90	91
Corporation tax payable	–	–	–	–

7 LOSS PER SHARE

The revenue loss per share of 0.5p (2004: 0.6p) is based on the net loss on ordinary activities after tax of £244,000 (2004: £300,000) and on 46,974,816 shares (2004: 47,558,116), being the weighted average number of shares in issue during the period of trading.

The capital profit per share of 0.2p (2004: 6.3p loss per share) is based on the net realised and unrealised capital gain for the period of £72,000 (2004: loss of £3,014,000) and on 46,974,816 shares (2004: 47,558,116), being the weighted average number of shares in issue during the period of trading.

8 INVESTMENTS

8(a) Summary of investments

	2005 £'000	2004 £'000
Venture capital investments	**11,596**	11,684
Listed equity investments	**6,749**	6,165
	18,345	17,849

Listed equity investments comprise equity investments in companies quoted on the London Stock Exchange.

8(b) Movements in investments

Movements in investments during the year are summarised as follows:

	Venture capital investments £'000	**Listed equity investments £'000**	**Total £'000**
Cost at 1 March 2004	20,979	6,409	27,388
Unrealised net losses	(9,295)	(244)	(9,539)
Valuation at 1 March 2004	11,684	6,165	17,849
Movements in the year:			
Purchases at cost	1,042	903	1,945
Disposals – proceeds	(102)	(1,570)	(1,672)
– realised net gains on disposals	23	109	132
Write-off of investments	(1,528)	–	(1,528)
Net unrealised profit on revaluation of investments	477	1,142	1,619
Valuation at 28 February 2005	**11,596**	**6,749**	**18,345**
Cost at 28 February 2005	12,688	5,912	18,600
Unrealised net (losses)/profits at 28 February 2005	(1,092)	837	(255)
	11,596	**6,749**	**18,345**

8(c) Profit/(loss) on investments

The overall profit on investments for the period shown in the Statement of Total Return on page 17 is analysed as follows:

	2005 £'000	2004 £'000
Realised net gains on disposals	**132**	657
Recoveries made in respect of investments previously written-off	**227**	–
Write-off of investments	**(1,528)**	(1,060)
Net unrealised profit/(loss) on investments	**1,619**	(2,308)
	450	(2,711)

The realised net gains on disposals represent the difference between proceeds received and the carrying values of those investments sold during the year.

The amounts reported under "write-off of investments" represent the proportion of the carrying value of certain investments that have, in the opinion of the directors, suffered a permanent diminution in value.

Both amounts are charged to the realised capital reserve (note 12).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

9 DEBTORS

	2005 £'000	2004 £'000
Prepayments and accrued income	**39**	7
Other debtors	**309**	1,102
Debtors: amounts falling due in over one year	**138**	504
	486	1,613

Other debtors and debtors falling due in over one year include loan notes and an earnout entitlement in connection with the sale of the investment in CDC Solutions Limited in December 2003. The loan notes receivable amount to £415,000 (2004: £415,000), with £277,000 falling due within one year (2004: £138,000) and the balance of £138,000 falling due in over one year (2004: £277,000). The earnout entitlement has been valued at £nil (2004: £122,000).

10 CREDITORS (AMOUNTS FALLING DUE WITHIN ONE YEAR)

	2005 £'000	2004 £'000
Trade creditors and accruals	**252**	123
	252	123

11 CALLED-UP EQUITY SHARE CAPITAL

	2005 £'000	2004 £'000
Authorised:		
60,000,000 ordinary shares of 1p	**600**	600
Allotted, issued and fully paid:		
46,607,993 ordinary shares of 1p (2004: 47,361,367)	**466**	474

The Company bought back for cancellation 753,374 (2004: 273,538) ordinary shares with a nominal value of £7,534 (2004: £2,735), representing 1.6% of the issued share capital, at a cost of £298,000 (2004: £114,000).

Under the terms of a Subscription Share Option Agreement dated 19 January 2000, Quester Services Limited and an employee benefit trust ("the Options Holders") will become entitled to subscribe for new ordinary shares at par provided aggregate gross dividends of at least 60p per share have been declared and paid and the net asset value per share plus the aggregate gross dividends paid on each share are at least 160p in 2005, increasing by 4p per year up to 188p in 2012. The number of new shares to be issued will be calculated according to a formula contained in the Agreement such that the benefit to the Option Holders will be equivalent to between 3% and 15% of the equity of the Company on a sliding scale depending on the performance of the Company in excess of the hurdle rate of return as described above.

In addition, the option arrangement provides that the Option Holders will together be entitled to subscribe, at nominal value, for a further 5% of the ordinary shares, if a higher performance target is met, bringing the total benefit to the Option Holders to 20% of the equity of the Company in aggregate. This higher target starts at 200p in 2005 and increases by 4p per year to 228p in 2012.

12 RESERVES

	Share premium £'000	Special reserve £'000	Capital reserve realised £'000	Capital reserve unrealised £'000	Revenue reserve £'000
At 1 March 2004	2	29,955	287	(9,539)	(401)
Share buy-ins	–	(290)	–	–	–
Net gain on realisation of investments	–	–	132	–	–
Recoveries made in respect of investments previously written off	–	–	227	–	–
Write-off of investments	–	–	(1,528)	–	–
Transfer from unrealised reserve	–	–	(7,665)	7,665	–
Net unrealised profit on revaluation of investments	–	–	–	1,619	–
Write-down of debtors	–	–	(122)	–	–
Transfer from special reserve	–	(9,520)	9,520	–	–
Net expenses charged to capital	–	–	(256)	–	–
Loss for the year	–	–	–	–	(244)
At 28 February 2005	2	20,145	595	(255)	(645)

The Special Reserve is a distributable reserve that was created following the cancellation of the share premium account in August 2001. This reserve allows the Company, amongst other things, to fund the buy-back of its ordinary shares as and when it is considered by the Board to be in the best interests of shareholders.

The Capital Reserve Realised is the reserve into which realised capital gains and losses arising from investments held are transferred. These include both gains and losses arising from the disposal of investments as well as the losses arising from permanent diminutions in value. In addition, 50% of the management fee is also charged to this reserve, reflecting an element which is, in the directors' opinion, attributable to the maintenance or enhancement of the value of the Company's investments. A transfer of £9,520,000 has been made from the Special Reserve to the Capital Reserve Realised. The purpose of this transfer is to offset all realised losses incurred on investments in the financial period ended on 28 February 2005.

The Capital Reserve Unrealised is the reserve into which unrealised gains and losses, which are not considered to be permanent, arising from the revaluation of investments are transferred.

13 NET ASSET VALUE PER SHARE

The calculation of net asset value per share as at 28 February 2005 of 43.6p (2004: 43.9p) is based on net assets of £20,308,000 (2004: £20,778,000) divided by the 46,607,993 ordinary shares (2004: 47,361,367) in issue at that date.

14 RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

	2005 £'000	2004 £'000
At 1 March 2004	**20,778**	24,206
Cost of share buy-backs	**(298)**	(114)
Total return on ordinary activities after tax	**(172)**	(3,314)
At 28 February 2005	**20,308**	20,778

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

15 RECONCILIATION OF OPERATING LOSS TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2005 £'000	2004 £'000
Loss on ordinary activities before taxation	**(244)**	(300)
Decrease/(increase) in debtors	**1,005**	(1,461)
Increase/(decrease) in creditors	**129**	(7)
Management fees charged to capital reserve	**(256)**	(303)
Amortisation of fixed interest investments	**–**	10
Cash inflow/(outflow) from operating activities	**634**	(2,061)

16 FINANCIAL INSTRUMENTS

Management of risk

As a venture capital trust, the Company's objective is to provide shareholders with an attractive income and capital return by investing approximately 85% of its funds in a broad spread of unquoted UK or AIM traded companies meeting the relevant criteria for venture capital trusts and approximately 15% in fixed interest securities or equities and convertible securities quoted on a recognised stock exchange, this allocation to be held as a reserve and available for second-round financing or investment in additional unquoted or AIM traded companies. The holding of these financial instruments to meet this objective results in certain risks.

The Company's financial instruments may comprise:

- Shares, securities and other financial commitments, including guarantees, in unquoted and quoted companies, which are held in accordance with the Company's investment objective; and
- Cash, liquid resources and short-term debtors and creditors arising from the Company's operations.

The main risks arising from the Company's financial instruments are liquidity risk, market price risk and interest rate risk.

Short term and long term debtors and creditors that meet the definition of a financial asset or liability under FRS 13 have been excluded from the numerical disclosures in this note.

Liquidity risk

The funds raised since incorporation are currently used to fund the Company's primary objective of investing in venture capital opportunities; approximately 79% of the funds raised since incorporation have now been utilised in this investment process. By their nature, unquoted investments may not be readily realisable. A portfolio of listed equities is held to offset the liquidity risk. As at the year end, the Company had no borrowings.

Market price risk

Market price risk arises mainly from uncertainty about future prices of financial instruments used in the Company's operations. It represents the potential loss the Company might suffer through holding market positions or unquoted investments in the face of price movements, mitigated by stock selection.

Interest rate risk

At the year end and throughout the year, the Company had no liabilities that were subject to interest rate risk (2004: £nil).

The interest rate risk profile of the Company's financial assets is shown below.

16 FINANCIAL INSTRUMENTS – CONTINUED

Interest rate risk profile of financial assets

The following analysis sets out the interest rate risk of the Company's financial assets.

	2005 £'000	2004 £'000
Floating rate	**515**	477
Fixed rate	**545**	801
Non-interest bearing	**19,014**	18,010
	20,074	19,288

Fixed rate financial asset weighted averages

	2005	2004
Fixed rate financial assets weighted average interest rate	**4.3%**	3.5%
Weighted average time for which rate is fixed (years)	**1.2**	4.4

Fair values of financial assets

All the financial assets of the Company are held at fair value as at 28 February 2005.

	Book value and fair value 2005 £'000	Book value and fair value 2004 £'000
Primary financial instruments:		
Quoted investments	**10,749**	6,667
Unquoted investments	**7,596**	11,182
Cash at bank	**1,729**	1,439

The fair values of the unquoted investments have been determined according to the methods detailed in the Company's Accounting Policies (note 1).

17 RELATED PARTY DISCLOSURES

Some of the directors and members of their close families have made investments in one company in which the Company has invested. These transactions were made at the same time and on the same terms and conditions as applicable to the Company.

	No. of directors	2005 £'000	No. of directors	2004 £'000
Anadigm Limited	**3**	**7**	3	8
CDC Solutions Limited (disposal)†	**4**	**9**	4	43
Elateral Holdings Limited (disposal)*	**–**	**–**	4	–
Opsys Limited*	**–**	**–**	1	1
Opsys Limited (disposal)*	**–**	**–**	1	1

†Receipt of deferred proceeds following the original disposal in December 2003.

*The holdings of certain directors in Elateral Holdings Limited, deriving from the early financing rounds of that company, had been diluted to such an extent by later financing rounds that they had effectively become worthless. The holdings were sold at nominal amounts in order to crystallise a loss for tax purposes. The transactions by one director in the shares of Opsys Limited were undertaken for similar reasons.

Quester Capital Management Limited, a company for which both APG Holmes and JA Spooner act as director, may, from time to time, be eligible to receive transaction fees and/or directors' fees from investee companies. During the year ended 28 February 2005, fees of £37,000 attributable to the investments of the Company were received pursuant to these arrangements (2004: £74,000).

CORPORATE GOVERNANCE

The Board considers that the Company has complied throughout the year with the provisions of Section 1 of the Combined Code on Corporate Governance and the related guidance and good practice suggestions published by the UK Listing Authority in July 2003 and incorporated into the listing rules as the Listing Rules (Combined Code(Amendment)) Instrument 2004.

THE BOARD

Following the resignations of APG Holmes and JA Spooner, the Board consists of three non-executive directors, who are all independent of the Company's investment manager.

The Board has a formal schedule of matters reserved to it and meets at least four times each year and on other occasions as required. The Board as a whole is responsible for the appointment of its own members and its professional advisors (neither a nominations nor a remunerations committee has been appointed as the directors consider the Board to be small). Other matters specifically reserved to the Board include banking arrangements, proposals for changes to the Articles, related party transactions and review of investments made. In addition, the Board carefully reviews the allocation of investments made by the Manager between the Company and its other managed funds, in accordance with established guidelines. The Board receives detailed management accounting information on a monthly basis. Any additional information is supplied on request. Due to the small size of the Board and the lack of complexity of the business, none of the directors has been nominated as a senior independent director.

The attendance of individual directors at the formal quarterly Board and bi-annual Audit Committee meetings held during the year was as follows:

	Scheduled Board meetings	Audit Committee meetings
DW Quysner (Chairman)	4/4	2/2
MJ Brooke	4/4	2/2
GA Hayter	4/4	2/2
APG Holmes (resigned 31 January 2005)	3/3	n/a
JA Spooner (resigned 31 January 2005)	3/3	n/a

In addition to the meetings referred to above, a number of further board, committee and individual meetings were held during the year to deal with matters arising in the ordinary course of the Company's business.

A formal process for evaluating the performance of the Board has been introduced in respect of the current financial year. Under this arrangement, the Board, led by the Chairman, has conducted a performance evaluation to determine whether it, its committees and individual directors are functioning effectively. A list of questions, based on the January 2003 Suggestions for Good Practice contained in the Higgs report, has been used to provide a framework for this evaluation process. Particular attention is paid to those directors who are due for reappointment. The results of the overall evaluation process are communicated to the Board and followed up with appropriate action, if necessary. The Chairman's own performance evaluation is performed by the other directors. A performance evaluation will be conducted annually.

The Articles of Association require that all directors be subject to re-election procedures by rotation at the Annual General Meeting. All directors, in accordance with the code, will submit themselves for re-election at least once every three years. If the merger does not become effective, the Company will convene an AGM at which George Hayter will offer himself for re-election. The Chairman has conducted a performance evaluation for this director, taking into account the views of all directors. He considers that his performance continues to be effective and that he continues to demonstrate commitment to the role. He therefore believes that George Hayter should be re-elected to the Board, if so proposed.

All directors have access to the advice and services of the Company Secretary and are able to take independent professional advice in furtherance of their duties, if necessary. Information regarding the terms of appointment of the non-executive directors is available on request.

THE AUDIT COMMITTEE

The Audit Committee consists of the three independent non-executive directors. Written terms of reference have been constituted for the Audit Committee and are available to shareholders on request. The Audit Committee meets at least twice a year to review the Company's financial controls, the interim financial statements, annual report and accounts and the terms of appointment of the external auditor together with its remuneration and independence. The Committee undertakes a periodic review of the terms of the management agreement with Quester Capital Management Limited ("QCML").

INTERNAL CONTROL

The Board is responsible for the Company's system of internal controls and for reviewing its effectiveness. It has adopted a risk-based approach to identifying the key internal controls, the performance of which has been monitored throughout the year and up to the date of the approval of this report via the production of quarterly exception reports, which are presented to the Board. These reports are prepared by QCML. The key risks and internal controls are re-appraised annually by the Company's directors. This process accords with the Internal Control Guidance for Directors on the Combined Code first published in September 1999 ('the Turnbull guidance'). It is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The need for an internal audit function has been considered by the Board and will be reconsidered annually. Due to the size of the business and lack of complexity, the directors consider that the establishment of an internal audit function is unnecessary.

Responsibility for accounting, secretarial services and custody of documents of title relating to investments has been contractually delegated to QCML under the management agreement. QCML, which is authorised and regulated by the Financial Services Authority, has established its own system of internal controls in relation to these matters, on which it has reported to the Board.

RELATIONS WITH SHAREHOLDERS

The Company does not have any major shareholders.

The Board is always pleased to respond to any queries made by shareholders.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare financial statements for each financial year which gives a true and fair view of the state of affairs of the Company at the end of the financial year and of the profit or loss for that year. 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 to 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, for the system of internal control and hence for taking steps for the prevention and detection of fraud and other irregularities. The Directors confirm that the applicable accounting standards have been followed in the financial statements, which accompany this report.

DIRECTORS' REMUNERATION REPORT

This report is prepared in accordance with Schedule 7A of the Companies Act 1985. The Company's auditor is required to report on certain information contained within this report (shown in the box below). The auditor's opinion is included within the auditor's report on page 31.

The Board as a whole considers directors' remuneration and, as such, a remuneration committee has not been established. The Board's policy is that the remuneration of non-executive directors should reflect time spent and the responsibilities borne by the directors on the Company's affairs and should be sufficient to enable candidates of high calibre to be recruited. The Company's Articles of Association limit fees payable to the directors to £100,000 in aggregate. Directors' fees payable during the year totalled £39,000, as set out below and in note 5.

The directors who served during the year received emoluments as detailed below:

	2005	2004
	£'000	£'000
DW Quysner (Chairman)	**15**	15
MJ Brooke	**12**	12
GA Hayter	**12**	12
APG Holmes (resigned 31 January 2005)	**–**	–
JA Spooner (resigned 31 January 2005)	**–**	–

This level of emoluments has remained unchanged since the appointment of the directors in January 2000. None of the directors received any other remuneration or benefit during the period except as disclosed in these accounts. APG Holmes and JA Spooner have waived their entitlement to directors' fees for all accounting periods ended on, or prior to, 28 February 2005.

Under the terms of a Subscription Share Option Agreement, APG Holmes, JA Spooner, their immediate families, including family trusts together known as "the Option Holders" would become entitled to subscribe for new ordinary shares at par provided that certain performance criteria are met. Further information on the terms of this option agreement is provided in note 11.

The share option arrangement is viewed as an appropriate incentive plan for those former directors, who are also directors of QCML, as it links their benefits to those of the shareholders of the Company. Except for this, no director's or former director's remuneration is performance related and directors are not eligible for bonuses, pension benefits, share options, long term incentive schemes or other benefits. It is considered appropriate that no other aspect of directors' remuneration should be performance related in light of the directors' non-executive status. It is the intention of the Board that the above remuneration policy will continue to apply in the forthcoming financial year and in subsequent years.

There is no notice period stipulated in the appointment letters of the Company with any of the directors. No compensation is payable to directors on leaving office. The graph on page 1 charts the total return (defined as the net asset value per share of the Company plus cumulative dividends paid) to ordinary shareholders since the date of incorporation compared to a range of other indices (since there is no clearly appropriate benchmark against which the performance of the Company should be measured, a range of other indices are shown including the FTSE Small Cap Index, the Hoare Govett Smaller Companies Index and the FTSE AIM Index which are considered to be the nearest available comparables).

The directors' remuneration report forms part of the annual report and accounts of the Company. These were approved by the Board of Directors on 12 May 2005 and signed on its behalf by DW Quysner.

If the merger does not become effective, the Company will convene an AGM at which an ordinary resolution for the approval of this report will be put to shareholders.

INDEPENDENT AUDITOR'S REPORT

We have audited the financial statements on pages 17 to 27. 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 are responsible for preparing the annual report and the directors' remuneration report. As described on page 29, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

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

We review whether the corporate governance statement on pages 28 to 29 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Company's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the 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 affairs of the Company as at 28 February 2005 and of the loss of the Company for the year then ended; and the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

12 May 2005

SHAREHOLDER INFORMATION

DIVIDENDS

No dividend is proposed in respect of the year ended 28 February 2005.

SHARE PRICE AND NET ASSET VALUE ANNOUNCEMENTS

The mid-market price of shares in Quester VCT 3 plc is reported daily in the Financial Times and appears under the heading “Investment Companies”. Estimates of the Company’s current net asset value are reported on certain days in the Financial Times. These estimates are not provided by Quester.

The Company generally announces changes in its net asset value on a monthly basis. However, no announcements will be made in respect of year end net asset values and subsequent month end net asset values until the audited results have been released. Half year net asset value announcements and subsequent month end net asset value announcements will generally not be made until the internal valuation process for the unquoted investments has been completed. No other announcements regarding changes in the net asset value will be made unless material and/or required under UK Listing Authority rules.

DIVIDEND REINVESTMENT SCHEME

A dividend reinvestment scheme has been created to allow shareholders to reinvest their dividends if they so wish. The details of the scheme are contained in the circular previously sent to shareholders. Shareholders who have not already done so may elect to join the scheme and should do so by notifying the Company’s registrars, Capita Registrars, in writing. Copies of the scheme’s terms and conditions may be obtained from the Company Secretary.

Shareholders are reminded that the election to reinvest dividends is an enduring declaration and so applies to all future dividends paid by the Company. In order to cancel this enduring declaration, a written instruction must be sent to the Company’s registrars, Capita Registrars.

INVESTOR RELATIONS

The Board is always pleased to respond to any queries made by shareholders.

Shareholders may now view details of their shareholdings via an online service available under the “Investor Relations” section of the Quester website, www.quester.co.uk.

MANAGEMENT AND ADMINISTRATION

REGISTERED OFFICE	29 Queen Anne's Gate London SW1H 9BU (Registered in England, No 3892235)
MANAGER	Quester Capital Management Limited 29 Queen Anne's Gate London SW1H 9BU Tel: 020 7222 5472 Fax: 020 7222 5250 Email: contact@quester.co.uk www.quester.co.uk Authorised and regulated by the Financial Services Authority
SECRETARY	RJ Drover
STOCKBROKER	Noble & Company Limited 120 Old Broad Street London EC2N 1AR
SOLICITORS	Travers Smith Braithwaite 10 Snow Hill London EC1A 2AL
AUDITOR	KPMG Audit Plc Chartered Accountants and Registered Auditor
VCT TAX ADVISER	KPMG LLP *both of:* 8 Salisbury Square London EC4Y 8BB
QUOTED AND FIXED INTEREST INVESTMENT ADVISER	OLIM Limited Pollen House 10/12 Cork Street London W1X 1PD
REGISTRARS	Capita Registrars The Registry 34 Beckenham Road Beckenham Kent BR3 4TU Tel: 0870 162 3100 Fax: 020 8639 2342
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