

Annual Report
for the year ended
31 December 2004



BRITISH
SMALLER
TECHNOLOGY
COMPANIES
VCT

2 plc

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British Smaller Technology Companies VCT 2 plc

Advised by YFM Private Equity Limited, British Smaller Technology Companies VCT 2 plc provides venture capital funding of up to £1m, to VCT qualifying companies, which are seen as having a:

- talented management team
- strong intellectual property
- significant potential market
- real commitment to growth

Financial Summary

| | 2004 £000 | 2003 £000 |
|---|-------------------|--------------|
| Profit (loss) before and after taxation | £1,080,000 | £(909,000) |
| Total recognised gains (losses) | £980,000 | £(554,000) |
| Dividend per share | 5.0p | – |
| Net asset value per share | 92.1p | 84.6p |

Financial Calendar

- | | | | |
|--------------------------|---------------|-------------------------|--------------|
| • Results Announced | 18 March 2005 | • Dividend Record Date | 1 April 2005 |
| • Annual General Meeting | 27 May 2005 | • Dividend Payment Date | 3 June 2005 |

Chairman's Statement

I am pleased to report that the second half of 2004 has shown a continuation of the progress seen in the first part of the year. Increased confidence in the technology sector has shown through with an increasing number of trade buyers and a strong stock market appetite for innovative companies, and has provided a healthy environment for the growing businesses within your Company's portfolio.

The improved market conditions and business confidence have been reflected in the performance of your Company over the past year. Net asset value, before dividend distribution, has risen 14.8% over the year as a whole.

As the portfolio starts to mature and capital growth on some of the earlier investments begins to be realised, we continue to look for suitable investment opportunities. In doing so, we need to retain sufficient liquidity to support the anticipated growth of our existing investments and to meet our ongoing operating requirements, whilst implementing an attractive dividend policy for the benefit of shareholders.

Operations

A total of £1.88 million was invested in ten businesses over the year. Three of these investments were in new companies to the portfolio. I commented on the investment in DxS Limited in my interim statement. This business continues to perform satisfactorily. The other two new investments were in Cozart plc and Allergy Therapeutics plc on their admission to AIM.

Cozart was well known to your Board, having been an existing investment of the other two VCTs in the British Smaller Companies stable. The company is a developer of hand-held drug testing devices. Since flotation the company's share price has consistently traded above the initial admission price of 30 pence per share.

Allergy Therapeutics is a speciality pharmaceutical company focused upon the treatment and prevention of allergies. The investment was made in October 2004 when the company raised a net £15 million through a placing on AIM at 73 pence per share. The company's share price has continued to rise since our year end.

In addition, the disposal of Sirius Pharmaceuticals Limited, which also received a small, further investment before the sale, has led

to your Company acquiring a stake in Arakis Limited, the purchaser of Sirius.

Toward the end of the year, the Board decided to realise the gain on your Company's holding in Amino Technologies plc. The total realised gain since the first investment in September 2001 was £1.46 million.

Financial results

I reported in my interim statement that the Board had decided to revoke investment company status in order to enable realised capital profits to be distributed in the form of tax free dividends. This formality was completed on 12 November 2004.

Following the revocation of investment company status, we are now required to present a profit and loss account in Companies Act format. However, for prior year comparative purposes, we have included a Statement of Total Return on page 14 prepared under the previously applied investment trust SORP guidelines. The financial result for the year under review was a profit of £1.08 million compared to a loss for the prior year, as restated, of £0.91 million.

The Company is now in a position to distribute realised gains. Your Board is recommending a dividend payment of 5 pence per share which, if approved, will be paid on 3 June 2005 to shareholders on the Register at 1 April 2005.

Warrants

A notice will shortly be sent to shareholders and warrant holders alerting them to the dates on which Warrants can be exercised in the current year. This is the last year in which Warrants can be exercised, after which time they will lapse.

"These improved market conditions and business confidence have been reflected in the performance of your Company over the past year."

“The current portfolio is beginning to mature and show some encouraging signs of growth potential.”

Dividend Reinvestment Scheme and Extraordinary General Meeting

Following feedback from shareholders, your Board is recommending a Dividend Reinvestment Scheme that will enable shareholders to elect to receive additional shares by reinvesting their cash dividends. Dividend reinvestment enables shareholders to increase their total holding in the Company without incurring dealing costs, issue costs or stamp duty. Subject to individual circumstances, these shares should qualify for the VCT tax reliefs that are applicable to subscriptions for new shares in venture capital trusts.

An Extraordinary General Meeting to authorise such a scheme will be convened to follow immediately after the Annual General Meeting. If authorised, this scheme will enable shareholders to re-invest the dividend just declared to take advantage of the 40% tax relief available on VCT subscriptions. Formal notification of the Extraordinary General Meeting accompanies this Annual Report.

Shareholder Relations

Your Board is continually looking at ways to improve shareholder liquidity. In furtherance of this strategy, I am pleased to tell you that the Board appointed Teather & Greenwood to act as broker to the Company. The firm is widely experienced in the investment company market and has a particular focus on the VCT sector, acting for a number of venture capital trusts. Teather & Greenwood are assisting the Board and our Investment Adviser, YFM Private Equity Limited, in refining its overall shareholder strategy. Initial benefits have already been seen by shareholders through a reduction in the discount of the Company's quoted share price to its net asset value. Over the last six months this has reduced from a 55% discount to around 12% at the current time.

Outlook

Following a gradual improvement in business confidence over the past couple of years, the trend has continued into the early part of 2005. Overall market conditions remain favourable, although the economic outlook for the medium term is more fragile than we would like. Nevertheless, we expect asset prices to remain attractive and your Company is well placed, with adequate liquid resources, to take advantage of this environment.

The current portfolio is beginning to mature and show some encouraging signs of growth potential. Following your Board's, strategy of targeting later stage innovative companies to get a better portfolio balance, I am pleased that the new investments made during the year are performing well.

I expect 2005 to continue to present opportunities for businesses within our portfolio. With over £3.8 million of liquid funds at the end of the year, your Company has sufficient resources to support the current portfolio through to maturity and to make selective new investments as opportunities arise.



Sir Andrew Hugh Smith
Chairman
12 April 2005

Investment Adviser's Review

Investment Portfolio

This section describes the business of the active companies in the portfolio. The website addresses of the companies are included to enable shareholders to obtain more details of the investee companies should they wish to do so. The Company's voting rights in an investee company are the same as the percentage of equity held for each investment set out below. In some instances a different valuation method has been adopted to that used in prior years as the directors believe it better reflects the fair value of the investment.

Broadreach Networks

Broadreach Networks Limited

| | |
|---------------------|--|
| Cost | £550,000 |
| Valuation | £550,000 |
| Dates of investment | February 2003, October 2003 and June 2004 |
| Equity held | 8.36% |
| Valuation basis | Valuation at last reporting date and recent investment |
| Location | London |

For the year ended 31 October 2003 audited pre-tax losses were £1.13m on turnover of £0.32m (2002: £0.16m and £0.13m respectively). At 31 October 2003 the aggregate net liabilities of Broadreach Networks Limited were £1.09m (2002: £nil).

Telecoms

Broadreach is a public access broadband provider, with both fixed access and wireless hot spots within its portfolio. A spin-out from Arthur D Little, the international management consultancy firm, Broadreach has also received funding from British Telecom, Virgin Group and Intel Capital.

The company has raised further funding from its shareholders to accelerate the growth of its network. A new subsidiary has also been created to address the significant on-train Wi-Fi opportunity that the company has been working on.

www.broadreachnet.com



Cozart plc

| | |
|--------------------|------------------|
| Cost | £394,000 |
| Valuation | £512,200 |
| Date of investment | July 2004 |
| Equity held | 1.46% |
| Valuation basis | Quoted bid price |
| Location | Abingdon |

The Financial Statements of Cozart plc are not yet available. The results of Cozart Bioscience Limited, its wholly owned subsidiary, are detailed below. For the year ended 31 May 2004 audited pre-tax profits were £0.11m on turnover of £4.04m (2003: £0.99m loss and £2.55m respectively). At 31 May 2004 net assets were £0.88m (2003: £0.70m).

Healthcare

Cozart is a pioneering medical diagnostics company which specialises in developing drug abuse detection devices. The company's products range from laboratory based test kits to on-site testing systems including The Cozart Rapiscan™.

Cozart apply scientific expertise and experience to deliver practical solutions with real user benefits and offer comprehensive after sales support. This approach has enabled the company to become the leading supplier of drugs of abuse tests to the forensic science community since its admission to AIM last year.

www.cozart.co.uk

Investment Adviser's Review

Allergy Therapeutics plc



| | |
|--------------------|------------------|
| Cost | £350,000 |
| Valuation | £431,507 |
| Date of investment | October 2004 |
| Equity held | 0.76% |
| Valuation basis | Quoted bid price |
| Location | Worthing |

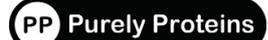
Audited financial statements are not yet available.

Healthcare

Allergy Therapeutics, an AIM-quoted company, specialises in the treatment and prevention of allergies. It has an existing sales base of approximately £19m per annum, with MHRA (the Medicines and Healthcare Products Regulatory Agency) approved manufacturing capability and an established sales and marketing infrastructure in several major European markets. In addition, the Company has a number of novel compounds which have already undergone initial clinical evaluation supported by documented clinical evidence of efficacy and safety.

www.allergytherapeutics.com

Purely Proteins Limited



| | |
|---------------------|-------------------------------------|
| Cost | £400,000 |
| Valuation | £400,000 |
| Dates of investment | November 2003 and September 2004 |
| Equity held | 22.86% |
| Valuation basis | Price of recent investment |
| Location | Cambridge |

For the period ended 30 September 2003 audited pre-tax losses were £0.02m on turnover of £0.04m and net liabilities were £0.02m.

Software

Purely Proteins purify high value proteins and develop affinity ligands for the extraction of proteins from complex media. It has signed a major contract with a Japanese pharmaceutical company to develop extraction technology for one of its therapeutic protein targets and began to make sales of purified proteins to companies for use in their development programmes.

During 2004 Purely Proteins raised additional capital with a new investor joining the syndicate.

www.purelyproteins.com

Vibration Technology Limited



| | |
|---------------------|---|
| Cost | £370,336 |
| Valuation | £370,336 |
| Dates of investment | March 2002, May 2003 and June 2004 |
| Equity held | 3.40% |
| Valuation basis | Revision of impairment at last reporting date and recent investment |
| Location | Glasgow |

For the year ended 31 December 2003 audited pre-tax losses were £1.13m on a turnover of £nil (2002: £1.81m and £nil respectively). At 31 December 2003 net assets were £1.04m (2002: £0.29m).

Industrial Automation

Vibration Technology (Vibtech) is a developer of a land and transition zone seismic acquisition system, which uses a patented cellular radio network to telemeter seismic data from any number of sensors to a central recording unit in real-time.

During the year, Vibtech completed a further £1.8m fund raising and successfully built and sold systems in China and Australia with a total value of \$3m. The senior team has been strengthened and, following successful demonstration of the technology to the US market, the company is actively pursuing sales prospects across the globe.

www.vibtech.co.uk

Investment Adviser's Review



Infinite Data Storage Limited

| | |
|---------------------|---|
| Cost | £375,009 |
| Valuation | £334,612 |
| Dates of investment | March 2002, November 2003, June 2004 and October 2004 |
| Equity held | 1.18% |
| Valuation basis | Revision of impairment at last reporting date and recent investment |
| Location | Dunfermline |

For the year ended 31 December 2003 audited pre-tax losses were £2.17m on turnover of £0.08m (2002: £1.85m and £0.17m). At 31 December 2003 net assets were £0.72m (2002: £1.65m).

Software

Infinite Data Storage is a leading player in personal data storage technologies, developing, licensing and supplying its products to leading global peripheral device and consumer product companies. It specialises in the creation of products and technology designed to fit into ordinary people's lives.

During the year, the company has raised further funding, has secured commercial agreements for its technologies and has now licensed and commenced production for Sony, IBM and Belkin.

www.infinitedatastorage.com



ExpressOn Biosystems Limited

| | |
|---------------------|--|
| Cost | £450,000 |
| Valuation | £265,441 |
| Dates of investment | October 2002, July 2003, December 2003 and June 2004 |
| Equity held | 22.40% |
| Valuation basis | Impairment to valuation at last reporting date and recent investment |
| Location | Edinburgh |

For the year ended 30 September 2003 audited pre-tax losses were £0.51m on turnover of £0.07m (2002: £0.21m and £0.07m respectively). At 30 September 2003 the aggregate net liabilities were £0.04m (2002: £0.20m).

Healthcare

ExpressOn has developed array technology for RNA interference and anti-sense RNA mapping of molecules.

During 2004, the company has launched its commercial product and expanded its product range to include a range of vectors for RNA delivery into cells. Whilst initial sales have been limited, there are encouraging signs of sales traction beginning to grow.

www.expresson.co.uk



Silistix Limited

| | |
|---------------------|---|
| Cost | £241,182 |
| Valuation | £241,182 |
| Dates of investment | December 2003 and October 2004 |
| Equity held | 10.96% |
| Valuation basis | Valuation at last reporting date and recent investment |
| Location | Manchester |

Audited financial statements for the first period of trading are not yet available.

Software

Silistix is a start-up spin-out from the University of Manchester which is looking to develop a novel integrated circuit software toolset. During the year, the business made satisfactory technical progress and secured a second tranche of funding from this Company alongside monies from other investors and other funds under YFM Private Equity's Management.

Investment Adviser's Review

Immunobiology Limited



| | |
|---------------------|-------------------------------------|
| Cost | £200,000 |
| Valuation | £200,000 |
| Dates of investment | June 2003 and December 2003 |
| Equity held | 13.34% |
| Valuation basis | Valuation at last reporting date |
| Location | Cambridge |

For the year ended 31 May 2004 audited pre-tax losses were £0.26m on turnover of £0.28m (2003: £0.19m loss and £0.03m respectively). At 31 May 2004 net assets were £0.53m (2003: £0.16m).

Healthcare

Immunobiology is developing high efficacy vaccines for infectious diseases based on Heat Shock Protein Complexes.

Its initial product for Tuberculosis has now been licensed, although the final contract still awaits signing. Its influenza programme continues to show encouraging results, but has not yet reached the clinic.

www.immunobiology.co.uk

ART Technology Group Inc.



| | |
|--------------------|---------------------------------|
| Cost | £275,000 |
| Valuation | £160,776 |
| Date of investment | April 2003 |
| Equity held | 0.36% |
| Valuation basis | Discount to quoted bid price |
| Location | Cambridge, USA |

For the year ended 31 December 2003 audited pre-tax profits were \$3.92m on turnover of \$72.49m (2002: \$29.49m loss and \$101.49m respectively). At 31 December 2003 assets were \$67.36m (2002: \$104.84m).

Software

Primus Knowledge Solutions Inc, the NASDAQ listed company that acquired this Company's shareholding in Amacis Holdings Limited was itself acquired by ART Technology Group Inc (NASDAQ: ARTG) in a deal which closed on 1 November 2004.

ART Technology Group Inc. delivers software solutions to help consumer-facing organisations create an interactive experience for their customers and partners via the Internet and other channels. The sector that the business operates in is generally seen as being one of the potential growth areas in software as online consumer sales continue to grow at a significant rate.

The Company has had some significant contract wins since the acquisition and is looking for cross selling opportunities that should arise from the combined customer base.

www.atg.com

Investment Adviser's Review



DxS Limited

| | |
|--------------------|----------------------------|
| Cost | £131,250 |
| Valuation | £131,250 |
| Date of investment | April 2004 |
| Equity held | 4.15% |
| Valuation basis | Price of recent investment |
| Location | Manchester |

Audited financial statements are not yet available.

Healthcare

DxS owns the intellectual property for Scorpians™, a technology for identifying variations in an individual's DNA. During the year, progress was made in increasing the licensee base for the technology.

The market at large continues to develop as the large pharmaceutical companies and the associated regulatory bodies investigate and evaluate the requirement and application for such technology in the prescribing of the current and future generation of drugs.

www.dxsgenotyping.com



Oxonica Limited

| | |
|---------------------|---|
| Cost | £224,838 |
| Valuation | £118,000 |
| Dates of investment | May 2002 and December 2002 |
| Equity held | 1.23% |
| Valuation basis | Revision of impairment at last reporting date |
| Location | Kidlington |

For the year ended 31 December 2003 audited pre-tax losses were £2.71m on turnover of £0.21m (31 December 2002: £2.12m and £0.12m respectively). At 31 December 2004 consolidated net liabilities were £2.54m (2002: net assets of £0.07m).

Chemical

Oxonica operates in the new area of nanotechnology, which involves creating atomic scale products or particles. It currently has 15 filed patents and is continuing field trials for products in areas such as catalysis, medical diagnostics, healthcare and personal care.

Following successful trials, the company has secured commercial contracts for the fuel additives and sunscreen applications of its technology, which should see revenues growing in the forthcoming year.

www.oxonica.com



Cambridge Cognition Limited

| | |
|--------------------|----------------------------------|
| Cost | £240,000 |
| Valuation | £60,098 |
| Date of investment | May 2002 |
| Equity held | 6.27% |
| Valuation basis | Valuation at last reporting date |
| Location | Cambridge |

For the period ended 31 December 2003 audited pre-tax losses were £0.89m on turnover of £1.13m (2002: £0.81m and £0.61m respectively). At 31 December 2003 the aggregate net assets were £0.91m (2002: £0.72m).

Software

Cambridge Cognition is a cognitive test development company specialising in computerised psychological testing of the progress of mental conditions, especially Alzheimer's, schizophrenia and Attention Deficit Hyperactivity Disorder (ADHD). It supplies licenses and software to pharmaceutical, academic and medical customers across the globe.

During the year the company sold its manufacturing activities at a profit and is now solely focused on software development and sales.

www.camcog.com

Investment Adviser's Review

Arakis Limited



| | |
|--------------------|-----------------|
| Cost | £13,922 |
| Valuation | £nil |
| Date of investment | March 2004 |
| Equity held | 0.03% |
| Valuation basis | Full impairment |
| Location | Essex |

For the year ended 31 December 2003 audited pre-tax losses were £7.12m on turnover of £nil (2002: £3.79m loss and £nil respectively). At 31 December 2003 net assets were £8.22m (2002: £8.35m).

Healthcare

Arakis is a speciality pharmaceutical company, with a focus on inflammatory diseases and oncology adjunctive therapy. Its research capability specialises in cytokine and receptor mediated mechanisms of disease. Arakis identifies, develops and commercialises product opportunities based upon new clinical uses for known drugs, or known drug templates. Arakis currently has four clinical and one pre-clinical advanced development projects.

www.arakis.com

Tamesis Limited



| | |
|--------------------|-----------------|
| Cost | £150,000 |
| Valuation | £nil |
| Date of investment | July 2001 |
| Equity held | 1.66% |
| Valuation basis | Full impairment |
| Location | London |

Tamesis has taken advantage of the small company exemption available under the Companies Act 1985, and has not filed full audited financial statements at Companies House. At 31 December 2003 net assets were £0.29m (2002: £0.32m).

Software

Tamesis is a developer of real-time trading software for investment banks. This provides its clients with a capability that can change the way in which they view their own risk position and, therefore, significantly enhance the way in which they handle their investment business.

The company has had some success during the year, extending contracts and developing a simplified version of the trading software.

www.tamesis.com

Investment Adviser's Review

Introduction

In his closing remarks in the Interim Report, the Chairman commented that the performance of the portfolio in the first half of the year gave some grounds for optimism. We are pleased to confirm that this trend, coupled with a revival of the IPO market, continued into the second half, creating an attractive environment for investment in technology-based businesses.

During the year, the Company's investment strategy remained targeted at syndicated investments in businesses with market-ready products and services which are beginning to show signs of early market adoption. The funding environment has progressively eased during the year as potential syndicate partners returned to the market. With rising interest rates, the cautious sentiment remained evident in the investing community and, although there was keen competition for the better proposals, entry valuations were not forced up to unsustainable levels. This caution was also evident in the re-investment market, which has represented a key area for the portfolio during the year. It is inevitable that young, growing companies require an element of follow-on funding to realise their full potential and your Investment Adviser has continued to work closely with the existing portfolio companies to ensure strong management and sufficient funding to pursue sound strategic objectives.

As at 31 December 2004, cash and other resources totalled just over £3.8 million before taking account of the dividend payment of 5 pence per share. The anticipated funding which may be required by existing portfolio companies is held under continual review to ensure the Company reserves adequate funds to support those businesses that merit it.

Portfolio Overview

Progress in 2004

During the year, investments totalling just over £881,000 were made in three new companies with follow-on funding provided in support of seven existing portfolio companies totalling nearly £1 million. This takes the total investment to date to £4 million.

The new investments were made in DxS Limited, and in the flotations of Cozart plc and Allergy Therapeutics plc, all of which operate in the healthcare sector.

New investments in the year

| | £ |
|--------------------------|----------------|
| DxS Limited | 131,250 |
| Cozart plc | 400,000 |
| Allergy Therapeutics plc | 350,000 |
| Total | 881,250 |

Follow-on investments in the year

| | |
|--|----------------|
| Broadreach Networks Limited | 300,000 |
| ExpressOn Biosystems Limited | 150,000 |
| Infinite Data Storage Limited | 75,010 |
| Sirus Pharmaceuticals Limited | 20,000 |
| Vibration Technology Limited | 120,340 |
| Purely Proteins Limited | 200,000 |
| Silistix Limited | 120,591 |
| Arakis Limited (received as consideration for disposal of Sirus) | 13,922 |
| Total | 999,863 |

Investment Adviser's Review

In accordance with the policy set out in the original Prospectus, the Company has directed its investments into early stage companies with both a strong intellectual property that helps them gain a market advantage and products that, although market ready, have not yet achieved widespread market acceptance. The intention is that the new funding will help them develop rapidly to commercial viability. As the chart below illustrates, the proportion of current investments with either early or mass market adoption of their products has increased from 58% to 63% of the portfolio.



Early in the second half of the year, Amino Technologies plc completed a successful fund raising via an institutional placing on AIM. The company raised £7 million in an Issue that was heavily oversubscribed. Amino's revenue for the six months to June was £7.4 million compared with £1 million for the prior full year – an indication of the type of growth that can be achieved by a technology company once its products become widely accepted. The share price responded positively to this good news and the Company decided to realise its investment in Amino in November 2004, which gave a cash return of £1,875,000 on an original investment of £415,000, providing cash for the Company to both pursue its investment objectives and commence dividend payments.

In July, an investment was made into Cozart plc on its admission to AIM. Cozart was a company which was well known to your Investment Adviser through existing investments from British Smaller Technology Companies VCT plc and British Smaller Companies VCT plc, when it was a development company with embryonic technology. It floated just as its products were beginning to show market adoption with its drug testing technology being increasingly used by Police Forces throughout the UK. The shares moved to an immediate premium and a small parcel of shares was sold within two months at a 90% profit.

While the availability of new funding for technology businesses improved in 2004 compared with the previous year, valuations in additional funding rounds, particularly when new investors join, can put pressure on valuations, especially where the new rounds contain specific liquidation preferences which favour participating investors. For these reasons, it is important that residual funds are managed so as to ensure that the Company can participate in follow-on funding rounds when support is justified.

Investment Adviser's Review

Valuation Movements

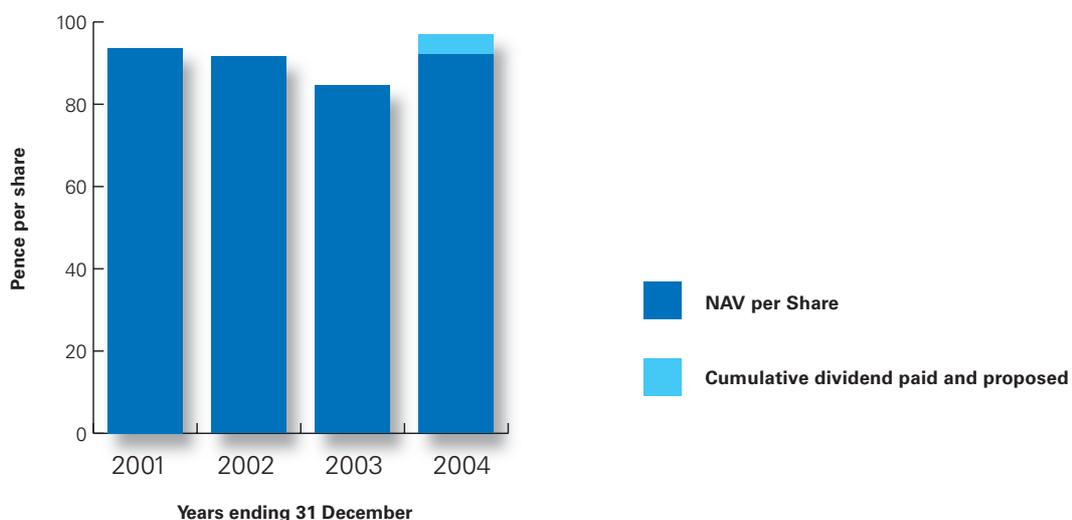
In the current year the net asset value of the Company is showing a 14.8% increase. The Company has continued to value unquoted investments in accordance with the BVCA Valuation guidelines, which are set out in some detail on pages 16 and 17.

Publicly quoted investments are valued at bid price together with a discount where this is required or considered appropriate. Such a case is the current investment in ART Technology Group Inc. The Company's original investment in Amacis Holdings Limited was transferred, on acquisition, to Primus Knowledge Solutions Inc, which, in turn, has been acquired by ART Technology Group Inc, another NASDAQ quoted software company. While this series of acquisitions is an endorsement of the original Amacis software, your Investment Adviser is unable to exercise the same level of control on behalf of a very small shareholder in the larger and distant entity. In addition, technology stocks on NASDAQ can be subject to volatility for no apparent reason and, ultimately, share transactions have to be translated into Sterling from what is, currently, a weak Dollar environment. In these circumstances it is considered appropriate to apply a discount to the bid price valuation.

In the unquoted portfolio, while three companies have been valued upwards to reflect improving performance, a decision has been taken to make provisions against three of the other investments. The provisions reflect either under-performance when compared to expectations at the time of the investment, or movements in valuations arising from fundraising during the year. The remaining portfolio is valued at cost.

Performance History

The chart below illustrates the performance of the Company by measuring the total return (net asset value and cumulative dividends proposed) over time. The initial movement in shareholder value reflects the normal trend of unquoted venture capital funds where provisions for under performance are usually recognised before any valuation increases due to sustained business growth can be taken into account. With some companies within the portfolio now maturing as expected at the time of initial investment, this performance has been reflected in an encouraging upward trend in shareholder value and enabled the first payment of a dividend by the Company of 5 pence per share. We anticipate that this upward trend will continue over the coming year.



Conclusion and Outlook

The year under review has continued to show encouraging progress in the investment portfolio, which is reflected in the rising net asset value of the Company. The strength of the net asset value has been particularly supported by the exit from Amino Technologies plc at a healthy profit and the strong performance of Cozart plc following flotation. Other companies are continuing to make solid progress in fulfilling their development plans and, in several cases, the current year could see accelerating market penetration.

The Company has retained sufficient cash to participate in further funding rounds as required and to make selective new investments in businesses that have market ready products. The main emphasis for the coming year is to work closely with existing portfolio companies to help them achieve the results which we expected at the time of investment.

David Hall
YFM Private Equity Limited
12 April 2005

Unaudited Statement of Total Return

For the year ended 31 December 2004

| | Notes | Revenue £000 | 2004 Capital £000 | Total £000 | Revenue £000 | 2003 Capital £000 | Total £000 |
|--|-------|-----------------|-------------------------|---------------|-----------------|-------------------------|---------------|
| Net gains (losses) on investments | | – | 1,278 | 1,278 | – | (466) | (466) |
| Income | 2 | 77 | – | 77 | 256 | – | 256 |
| Investment advisory fee | 3 | (158) | (39) | (197) | (131) | (56) | (187) |
| Other expenses | 3 | (178) | – | (178) | (157) | – | (157) |
| Net return on ordinary activities before taxation | | (259) | 1,239 | 980 | (32) | (522) | (554) |
| Tax on ordinary activities | 4 | – | – | – | – | – | – |
| Net return on ordinary activities after taxation | | (259) | 1,239 | 980 | (32) | (522) | (554) |
| Dividends | 5 | (392) | – | (392) | – | – | – |
| Transfer (from) to reserves | | (651) | 1,239 | 588 | (32) | (522) | (554) |
| Return per Ordinary share | | | | | | | |
| Basic and diluted | | (3.31)p | 15.82p | 12.51p | (0.41)p | (6.68)p | (7.09)p |

The Statement of Total Return and the following notes are unaudited and do not form part of the financial statements.

In order to enable the Company to make capital distributions, the Company has revoked its investment company status and is accordingly unable to take advantage of the accounting exemptions that status permits. The results of the Company set out on page 32 have been prepared in accordance with the requirements of Schedule 4 of The Companies Act 1985, which requires that all realised gains and losses, including those arising from the disposal of investments, are included in the results of the year. When the Company re-values its investments, any unrealised gains or losses below historical costs are taken straight to the profit and loss account.

The results presented in the Statement of Total Return have been included to assist investors in comparing the results of the Company with other investment companies or Venture Capital Trusts. Although the basis of presentation of the Statement of Total Return and the profit and loss account on page 32 are different, the total gains recognised this year, together with the net assets attributable to each phase, remain the same, irrespective of the basis of preparation.

The element of the investment advisory fee that does not relate to the administrative services is allocated between capital and revenue in accordance with the estimated long-term split of returns in the form of capital gains and income respectively. 40% of the investment management fee relating to investment services has, therefore, been allocated 75% to capital reserve and 25% to revenue account.

Tax relief is allocated to the capital account using a marginal rate basis.

Any tax relief obtained in respect of management fees allocated to capital is reflected in the capital account and a corresponding amount is charged against revenue. The tax relief is the amount by which corporation tax payable is reduced as a result of these capital expenses.

Notes to the Unaudited Statement of Total Return

The following statement is unaudited and does not form part of the financial statements.

Set out below is a comparison of how the returns are recorded in the Statement of Total Return and the statutory accounts for the year ended 31 December 2004.

| | Notes | 2004 | | 2003 | |
|--|-------|---------------------------------|---|---------------------------------|---|
| | | Statement of Total Return | Statutory Profit and Loss Account | Statement of Total Return | Statutory Profit and Loss Account |
| | | £000 | £000 | £000 | £000 |
| Net return on ordinary activities after taxation | | 588 | - | (554) | - |
| Retained profit (deficit) for the year | | - | 688 | - | (909) |
| Net unrealised (losses) gains for the year | 7 | - | (100) | - | 355 |
| Total | | 588 | 588 | (554) | (554) |
| Revenue return after dividends | | (651) | - | (32) | - |
| Retained profit (deficit) for the year | | - | 688 | - | (909) |
| Investment advisory fee allocated to capital | 3 | - | 39 | - | 56 |
| Impairment of investments in the year | 7 | - | 20 | - | 750 |
| Net unrealised (gains) losses on disposal | 7 | - | (1,398) | - | 71 |
| Total | | (651) | (651) | (32) | (32) |
| Capital return after dividends | | 1,239 | - | (522) | - |
| Investment advisory fee allocated to capital | 3 | - | (39) | - | (56) |
| Net realised gains (losses) on disposal | 7 | - | 1,398 | - | (71) |
| Net unrealised (losses) gains for the year | 7 | - | (100) | - | 355 |
| Impairment of investments in the year | | - | (20) | - | (750) |
| Total | | 1,239 | 1,239 | (522) | (522) |

Reference to revenue and capital in the notes to the financial statements reflects the basis on which taxation is calculated and the treatment applied in determining the amounts available for revenue dividend distribution.

The basic revenue return per Ordinary share is based on net loss from ordinary activities after tax of £259,000 (2003: £32,000) and 7,830,000 (2003: 7,812,000) shares being the weighted average number of shares in issue during the year.

The basic capital return per Ordinary share is based on a net capital return from ordinary activities of £1,239,000 (2003: £522,000 net loss) and 7,830,000 (2003: 7,812,000) shares being the weighted average number of shares in issue during the year.

Valuation of Venture Capital Investments

In valuing venture capital investments, the directors follow the criteria set out below. These procedures comply with the British Venture Capital Association Valuation Guidelines.

The Valuation Guidelines set out a range of methodologies that should be followed to enable investments to be stated in the balance sheet at their fair value on the reporting date, except in situations where fair value cannot be reliably measured. Fair value is defined as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

In estimating fair value for an investment, the methodology applied should be appropriate in light of the nature, facts and circumstances of the investment and its materiality in the context of the total investment portfolio and should use reasonable assumptions and estimates. Methodologies should be applied consistently from period to period, except where a change would result in a better estimate of fair value.

Unquoted Investments

Methodologies are classified as to primary and secondary. Wherever possible, one of the primary methodologies will be used to determine fair value.

Primary methodologies

- **Price of recent investment.** This represents the cost of the investment or the price at which a significant amount of new investment has been made by an independent third party, but is only considered relevant for a limited period following the date of the relevant transaction. A period of one year is used in practice. During this period, the value of the investment is assessed for changes or events that would imply impairment to the fair value. In addition, the methodology also represents certain situations where although the one year period has expired, an alternative methodology is not followed because an additional investment has been made by the Company at the same price as the previous investment and an alternative methodology would not result in a better estimate of fair value. The whole investment is also assessed for impairment.
- **Earnings multiple.** A multiple that is appropriate and reasonable, given the risk profile and earnings growth prospects of the underlying company, is applied to the maintainable earnings of that company. Appropriate adjustments are made to reflect points of difference between the investee company and any comparators that have been used to determine the appropriate multiple. A marketability discount in the range of 10% to 30% is then applied to reflect the return market participants demand to compensate them for the risk they may not be able to sell an asset immediately.
- **Net assets.** The value of the business is derived by using appropriate measures to value the assets and liabilities of the investee company to which a marketability discount is then applied.

Secondary methodologies

- **Discounted cash flows of the underlying business.** The present value of the underlying business is derived by using reasonable assumptions and estimations of expected future cash flows and the terminal value, and discounting by applying the appropriate risk-adjusted rate that quantifies the risk inherent in the company.
- **Discounted cash flows from the investment.** Under this method, the discounted cash flow concept is applied to the expected cash flows from the investment itself rather than the underlying business as a whole.
- **Industry valuation benchmarks.**

Valuation of Venture Capital Investments

Where an independent third party valuation exists, this will be used as the basis to derive the gross attributable enterprise value of the company. In other cases, the most suitable methodology, as set out above, is used to determine this value. This value is then apportioned appropriately to reflect the respective amounts accruing to each financial instrument holder in the event of a sale at that level at the reporting date.

In situations where fair value cannot be reliably measured, the investment is reported at the carrying value at the previous reporting date, unless there is evidence that the investment has since been impaired. In such case the carrying value is reduced to reflect the estimated extent of impairment. In estimating the extent of impairment the directors will consider, amongst other things, the performance and prospects of the underlying business compared to the expectations on which the investment was based, the changes in the environment in which the business operates and deteriorations in general market conditions.

Quoted Investments

Quoted investments are valued at market price but reduced by a marketability discount where:

- i. there is a risk that the holding may not be sold immediately; or
- ii. there is a formal restriction on trading in the relevant securities.

Where a bid price is available, this is used to determine fair value. Otherwise, mid-market price is used.

The marketability discount will be determined by reference to the size of the holding in relation to normal trading volumes in that security and the extent of any particular trading restrictions. Discounts will typically range from 0% to 25%.

Application of Valuation Methodologies

Wherever possible, the fixed asset investments within the portfolio have been valued using a primary methodology to determine fair value. Where this primary methodology is not appropriate, a suitable secondary methodology has been applied, for example, where the date since the last investment is greater than 12 months, where the company is loss making and, therefore, an earnings multiple cannot be applied, and where the net assets of the company do not represent its underlying fair value.

Directors

Sir Andrew Colin Hugh Smith, Chairman (73)

Following a career at the Bar and in industry, became a partner of Capel Cure Myers in 1970, senior partner in 1979 and left the firm in 1988 to become chairman of the London Stock Exchange. He retired from the Exchange in 1994. He is currently chairman of British Smaller Companies VCT plc and British Smaller Technology Companies VCT plc.

Philip Simon Cammerman (62)

Has over 20 years of industrial experience in engineering and hi-tech industries and has worked in both the USA and the UK. He has spent the last 18 years in the venture capital industry and is chairman of YFM Private Equity Limited. He has been responsible for a wide range of venture capital deals in a variety of industries including hi-tech, software, computer maintenance, engineering, printing, safety equipment, design and textiles. He is a non-executive director of British Smaller Companies VCT plc and British Smaller Technology Companies VCT plc.

Richard Last (47)

Qualified as a chartered accountant with Coopers & Lybrand and is chief executive of Lynx plc, a computer software, systems and services group. He is chairman and non-executive director of Xpertise Group plc, an AIM-quoted IT training group and is a non-executive director of Patsystems plc, British Smaller Companies VCT plc and British Smaller Technology Companies VCT plc. He was appointed a non-executive director of Tamesis Limited following our investment in this company.

Stephen John Noar (57)

A dentist by profession, was the founder chairman and former chief executive of Denplan Limited until its successful trade sale in 1993 following its growth from start up to a turnover in excess of £70m. He was the New Business and Dental director of PPP Limited (prior to the company's acquisition by Guardian Royal Exchange) responsible for developing dental and other services. In 1994 he was winner of the Financial Times Venturer of the Year award. He is a non-executive director of British Smaller Technology Companies VCT plc. He was appointed a non-executive director of Purely Proteins Limited following our investment in this company.

Robert Martin Pettigrew (60)

A founding director of The Generics Group of companies, has extensive experience in the commercial exploitation of new technologies. He has technical expertise in opto-electronics and fibre optics, optical component and system design, lasers and laser applications. He is a non-executive director of British Smaller Companies VCT plc and British Smaller Technology Companies VCT plc.

Secretary and Registered Office

James Ernest Peter Gervasio LL.B.
Saint Martins House
210-212 Chapeltown Road
Leeds
LS7 4HZ

Registered No: 4084003

For the Year to 31 December 2004

The directors present their report and audited accounts of British Smaller Technology Companies VCT 2 plc ("the Company") for the year ended 31 December 2004.

Principal Activity and Business Review

The Company operates as a venture capital trust and has been approved by the Inland Revenue as an authorised venture capital trust under Section 842AA of the Income and Corporation Taxes Act 1988. It is the directors' intention to continue to manage the Company's affairs in such a manner as to comply with Section 842AA of the Income and Corporation Taxes Act 1988.

The profit and loss account for the year is set out on page 32.

A review of the Company's operations is given in the Chairman's statement on pages 2 to 3 and the Investment Adviser's Review on pages 4 to 13. In the context of the economic factors and market conditions prevailing during the year, the directors consider the result for the year and the financial position at the end of the year to be satisfactory.

On 12 November 2004, the Board determined it was appropriate to revoke the Company's investment company status by giving notice in the prescribed form of the Registrar of Companies.

A consequence of the revocation of investment company status is that the Company is now required to prepare accounts in accordance with the requirements of Schedule 4 of the Companies Act 1985 and not in accordance with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies' as was previously the case. The main effect of this change is that the Company presents a profit and loss account instead of a statement of total return. For shareholders' information, a statement of total return for the year ended 31 December 2004, and a comparison to the statutory accounts profit and loss format, is included on pages 14 and 15.

Results and Dividends

The profit on ordinary activities after taxation for the year amounted to £1,080,000 (2003: £909,000 loss).

The directors are recommending the payment of a final dividend of 5.0p per Ordinary Share (2003: nil) to shareholders on the Register at 1 April 2005. A resolution to this effect will be put before shareholders at the Annual General Meeting on 27 May 2005.

After recognition of the recommended dividend the net asset value per Ordinary share at 31 December 2004 was 92.1p (2003: 84.6p). The transfer to reserves is given in note 13.

Share Capital and Exercise of Warrants

On 14 May 2004, following the exercise of 10,073 Warrants, the Company issued 10,073 Ordinary shares of 10p each at a price of 100p per share.

All unexercised Warrants under the original Warrant Deed dated 28 November 2000 have now lapsed.

Under the Warrant Deed dated 23 November 2001, relating to the issue of up to 2,000,000 New Warrants to subscribe for Ordinary shares of 10p each in the Company, exercisable at 100p per share, New Warrantheolders could exercise the right to subscribe in 2004 and may exercise the right to subscribe in 2005. In this regard, letters will be issued to New Warrantheolders.

Directors' Report

Purchase of Own Shares

Following shareholder approval at the Annual General Meeting held on 6 May 2004, the Company's authority to purchase its own Ordinary shares in the market was extended until 14 May 2006. No purchases have been made during the year.

On 22 March 2005 the Company purchased for cancellation under existing authority granted by the shareholders, 150,000 Ordinary shares of 10p each in the market, representing 1.91% of the issued, called-up and fully paid share capital at that date, at a price of 81.0p per share.

Creditor Payment Policy

The Company's payment policy is to agree terms of payment before business is transacted and to settle accounts in accordance with those terms (further details are given in note 11).

Directors and their Interests

The directors of the Company at 31 December 2004, their interests and contracts of significance are set out in the Directors' Remuneration Report on pages 27 to 29.

Fixed Assets

Movements on investments held as fixed assets are shown in notes 7 and 8.

Substantial Shareholdings

The directors are not aware of any substantial shareholdings representing 3% or more of the Company's issued share capital at the date of this report.

Annual General Meeting

Shareholders will find the Notice of the Annual General Meeting on page 49 of these financial statements.

Independent Auditors

A resolution to reappoint PricewaterhouseCoopers LLP will be put to the shareholders at the Annual General Meeting.

VCT Status Monitoring

The Company has retained PricewaterhouseCoopers LLP to advise it on compliance with the legislative requirements for Venture Capital Trusts. PricewaterhouseCoopers LLP reviews new investment opportunities as appropriate and carries out regular reviews of the Company's investment portfolio under the instruction of the Investment Adviser to ensure legislative requirements are properly assessed.

Post Balance Sheet Events

There have been no significant events, including venture capital investments made, following the year end.

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company. 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 a going concern basis, unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for ensuring that proper accounting records are kept which disclose, with reasonable accuracy at any time, the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The financial statements are published at www.yfmprivateequity.co.uk, which is a website maintained by the Company's Investment Adviser. The work carried out by the auditors does not involve consideration of the maintenance and integrity of this website and, accordingly, the auditors accept no responsibility for any changes that have occurred to the financial statements since they were initially presented on the website. Visitors to the website need to be aware that legislation in the United Kingdom governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

Directors' Report

Statement of Corporate Governance

The Board is committed to the principle and application of sound Corporate Governance and confirms that the Company has taken appropriate steps, relevant to its size and operational complexity, to comply with, The FRC 2003 Combined Code published in July 2003, ("The Combined Code").

The Board has complied throughout the year, and up to the date of this report, with Section 1 of the Combined Code issued in July 2003, except for those provisions relating to the appointment of a recognised senior independent non-executive director, those relating to the establishment of an independent Remuneration or Nomination Committee, the Chairman acting as chairman of the Audit Committee, and the presumption concerning his independence (see below).

Role of the Board

A management agreement between the Company and YFM Private Equity Limited sets out the matters over which the Investment Adviser has authority. This includes management of the Company's assets and the provision of accounting, company secretarial, administration, and some marketing services. All other matters are reserved for the approval of the Board. A formal schedule of matters reserved to the Board for decision has been approved during the year. This includes determination and monitoring of the Company's investment objectives and policy and its future strategic direction, gearing policy, management of the capital structure, appointment and removal of third party service providers, review of key investment and financial data and the Company's corporate governance and risk control arrangements.

The Board meets at least five times during the year and additional meetings are arranged as necessary. Full and timely information is provided to the Board by the Investment Adviser to enable it to function effectively and to allow directors to discharge their responsibilities.

There is an agreed procedure for directors to take independent professional advice if necessary and at the Company's expense. This is in addition to the access that every director has to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that applicable rules and regulations are complied with and that Board procedures are followed. To the extent permitted by law, the Company indemnifies its directors and officers and has purchased insurance to cover its directors. Neither the insurance nor the indemnity provide cover where the director has acted fraudulently or dishonestly.

Board Composition

The Board consists of five non-executive directors, three of whom are regarded by the Board as independent and four of whom are regarded as independent of the Company's Investment Adviser, including the Chairman. The independence of the Chairman was assessed upon his appointment. Although the Combined Code presumes that the chairman of a company is deemed not to be an independent director, the remaining directors, having considered the nature of the role in this Company, and taking account of the Chairman's role within other venture capital trusts to which YFM Private Equity Limited is the Investment Adviser, are satisfied that Sir Andrew Hugh Smith continues to fulfill the criteria for independence as a non-executive director. The directors have a breadth of investment, business and financial skills and experience relevant to the Company's business and provide a balance of authority. Brief biographical details of each director are set out on page 18.

A review of Board composition and balance is included as part of the annual performance evaluation of the Board, details of which are given below.

There are no executive directors or officers of the Company. Given the structure of the Board and the fact that the Company's administration is conducted by YFM Private Equity Limited, the Board does not consider it necessary or appropriate to appoint a chief executive officer or a senior independent non-executive director. In addition, the directors consider that the role of a senior independent non-executive director is taken on by all of the directors. Shareholders are therefore able to approach any director with any queries they may have.

Directors' Report

Tenure

Directors are initially appointed until the following Annual General Meeting when, under the Company's Articles of Association, it is required that they be elected by shareholders. Thereafter, a director's appointment will run for an initial term of three years. Subject to the performance evaluation carried out each year, the Board will agree whether it is appropriate for the director to seek an additional term. The Board does not believe that length of service in itself necessarily disqualifies a director from seeking re-election but, when making a recommendation, the Board will take into account the ongoing requirements of the Combined Code, including the need to refresh the Board and its Committees. Any director who has served for a period of more than nine years will stand for annual re-election thereafter.

The terms and conditions of directors' appointments are set out in formal letters of appointment, copies of which are available for inspection on request at the Company's registered office and at the Annual General Meeting.

The directors recommend the re-election of Sir Andrew Hugh Smith and Mr Philip Cammerman whom retire by rotation at this year's AGM because of their commitment, experience and contribution to the Company.

Meetings and Committees

The Board delegates certain responsibilities and functions to committees. Directors who are not members of committees may attend at the invitation of the Chairman.

The table below details the number of Board and Audit Committee meetings attended by each director. During the year there were 8 formal Board meetings and 2 Audit Committee meetings. The directors met via telephone conferences on 16 other occasions.

| Director | Board meetings attended | Audit Committee meetings attended |
|-------------------------|-------------------------|-----------------------------------|
| Sir Andrew Hugh Smith | 8 | 2 |
| Philip Simon Cammerman | 7 | n/a |
| Richard Last | 8 | 2 |
| Stephen John Noar | 8 | 2 |
| Robert Martin Pettigrew | 7 | 2 |

Training and Appraisal

On appointment, the Investment Adviser and Company Secretary provide all directors with induction training. Thereafter, regular briefings are provided on changes in regulatory requirements that affect the Company and directors. Directors are encouraged to attend industry, and other, seminars covering issues and developments relevant to venture capital trusts.

The performance of the Board has been evaluated in respect of the current financial year. The Board, led by the Chairman, has conducted a performance evaluation to determine whether it and individual directors are functioning effectively. The factors taken into account were based on the relevant provisions of the Combined Code and included attendance and participation at Board and Committee meetings, commitment to Board activities and the effectiveness of the contribution. Particular attention is paid to those directors who are due for reappointment. The results of the overall evaluation process are communicated to the Board. Performance evaluation will be conducted on an annual basis.

The Chairman is being proposed for re-election at the forthcoming AGM. An independent director has appraised his performance, taking account of the views of the directors. He considered that the Chairman's performance continues to be effective and that he continues to demonstrate a commitment to the role. The directors therefore believe that Sir Andrew Hugh Smith should be re-elected to the Board. The Chairman has confirmed that the performance of the other director being proposed for re-election, Mr Philip Cammerman (see page 18), continues to be effective and that he continues to show commitment to the role.

Directors' Report

Nomination Committee and Remuneration Committee

Due to the size of the Board and the appointment and remuneration procedures currently in place, it is the directors' opinion that there is no role for an Independent Remuneration or Nomination Committee. The Directors' Remuneration Report may be found on pages 27 to 29. Any proposed appointment to the Board is a matter for the whole Board.

Audit Committee

The Audit Committee consists of the directors who are independent of the Investment Adviser, being Sir Andrew Hugh Smith, R Last, SJ Noar and R M Pettigrew, and meets at least twice each year. The directors consider that it is appropriate that the Chairman of the committee should be Sir Andrew Hugh Smith. The members of the Committee consider that they have the requisite skills and experience to fulfil the responsibilities of the Committee.

The Audit Committee reviews the actions and judgements of management in relation to the interim and annual financial statements and the Company's compliance with the Combined Code. It reviews the terms of the management agreement and examines the effectiveness of the Company's internal control systems, receives information from the Investment Adviser's compliance department and reviews the scope and results of the external audit, its cost effectiveness and the independence and objectivity of the external auditors. Representatives of the Company's auditors attend the Committee meeting at which the draft Annual Report and financial statements are considered. The directors' statement on the Company's system of internal control is set out below.

The Audit Committee considers the independence and objectivity of the auditors on an annual basis in light of the provision of any non-audit services provided to the Company in the year. The Audit Committee considers that given the low level of non-audit services provided in the year ended 31 December 2004, the independence and objectivity of the auditors has not been impaired or compromised.

The Audit Committee has written terms of reference which clearly define its responsibilities, copies of which are available for inspection on request at the Company's registered office and at the AGM.

Relations with Shareholders

The Board regularly monitors the shareholder profile of the Company. It aims to provide shareholders with a full understanding of the Company's activities and performance, and reports formally to shareholders twice a year by way of the Annual Report and the Interim Report. This is supplemented by the quarterly publication, through the London Stock Exchange, of the net asset value of the Company, and the daily publication of the Company's share price.

All shareholders have the opportunity, and are encouraged, to attend the Company's Annual General Meeting at which the directors and representatives of the Investment Adviser are available in person to meet with and answer shareholders' questions. During the year the Company's Investment Adviser held discussions with shareholders through regular VCT workshop presentations. These, typically, covered the performance of the Company, an update on the current portfolio (including presentations from investee businesses) and a review of general VCT industry developments. The directors are made fully aware of shareholders' views and the Chairman and directors make themselves available, as and when required, to address their queries. The directors may be contacted through the Company Secretary whose details are shown on page 18.

The Company's Annual Report is published in time to give shareholders at least 20 working days' notice of the Annual General Meeting. Shareholders wishing to raise questions in advance of the meeting are encouraged to write to the Company Secretary at the address shown on page 18. Separate resolutions are proposed for each separate issue. Proxy votes will be counted and the results announced at the Annual General Meeting for and against for each resolution.

Internal Control

Under an agreement dated 28 November 2000, the executive functions of the Company have been subcontracted to YFM Private Equity Limited. The Board receives operational and financial reports on the current state of the business and on appropriate strategic, financial, operational and compliance issues. These matters include, but are not limited to:

- A clearly defined investment strategy for YFM Private Equity Limited, the Investment Adviser to the Company. All decisions concerning the acquisition or disposal of investments are taken by the Board after due consideration of the recommendations made by the Investment Adviser.
- Regular reviews of the Company's investments, liquid assets and liabilities, revenue and expenditure.
- Regular reviews of compliance with the venture capital trust regulations to retain status.
- The Audit Committee reviews the internal control procedures adopted by the Investment Adviser and the Board approves annual budgets prepared by the Investment Adviser.
- The Board receives copies of the management accounts on a regular basis showing comparisons with budget. These include a report by the Investment Adviser with a review of performance. Additional information is supplied on request.

The Board confirms that procedures to implement the guidance *Internal Control: Guidance for directors on the Combined Code* ("the Turnbull Report") were in place throughout the year ended 31 December 2004 and up to the date of this report.

The Board acknowledges that it is responsible for the Company's system of internal control and for reviewing its effectiveness. Such a system 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 Board arranges its meeting agenda so that risk management and internal control is considered on a regular basis and a full risk and control assessment takes place no less frequently than twice a year. There is an on-going process for identifying, evaluating and managing the significant risks faced by the Company. This process has been in place for longer than the year under review and up to the date of approval of the Annual Report. The process is formally reviewed bi-annually by the Board. However, due to the size and nature of the Company, the Board has concluded that it is not necessary at this stage to set up an internal audit function. This decision will be kept under review. The directors are satisfied that the systems of risk management that are in place are sufficient to comply with the terms of the Turnbull Report.

The directors have reviewed the effectiveness of the Company's systems of internal control for the year to the date of this report. The directors are of the opinion that the Company's systems of internal financial, and other, controls are appropriate to the nature of its business activities and methods of operation given the size of the Company.

Corporate Governance and Voting Policy

The Company delegates responsibility for monitoring its investments to YFM Private Equity Limited whose policy, which has been noted by the Board, is as follows:

YFM Private Equity Limited is committed to introducing corporate governance standards into the companies in which its clients invest. With this in mind, the Company's investment agreements contain contractual terms specifying the required frequency of management Board meetings and of annual shareholders' meetings, and for representation at such meetings through YFM Private Equity Limited. In addition, provision is made for the preparation of regular and timely management information to facilitate the monitoring of investee company performance in accordance with best practice in the private equity sector.

Directors' Report

Going Concern

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

Investment policy

The Investment Adviser, YFM Private Equity Limited, is responsible for the sourcing and screening of initial enquiries, carrying out suitable due diligence investigations and making submissions to the Board regarding potential investments. Once approved, further due diligence is carried out as necessary and Inland Revenue clearance is obtained for approval as a qualifying VCT investment.

The Board regularly monitors the performance of the portfolio and the investment targets set by the relevant VCT legislation. Reports are received from YFM Private Equity Limited as to the trading and financial position of each investee company and members of the investment team regularly attend Board meetings. Monitoring reports are also received at each Board meeting on compliance with VCT investment targets so that the Board can ensure that the status of the Company is maintained and take corrective action where appropriate.

Prior to the investment of funds in suitable qualifying companies, the liquid assets of the Company are invested in a portfolio of Government stocks or other similar fixed interest securities. Reporting to YFM Private Equity Limited, the portfolio is managed by Brewin Dolphin Securities Limited on a discretionary basis. The Board receives regular reports on the make-up and market valuation of this portfolio. Government stocks are classified as current assets due to their use as temporary holdings whilst venture capital opportunities arise.

Financial Assets

Investments made in suitable qualifying holdings will predominantly comprise Ordinary shares with, in some instances, either fixed rate coupon Preference shares or debenture loans. Each investment is valued in accordance with the British Venture Capital Association guidelines, a summary of which is set out on pages 16 and 17 of this report. Investments in fixed interest Government securities are valued at their market value as at the balance sheet date. To this end, the directors consider that the carrying value of the investment portfolio at 31 December 2004 equates to its fair value.

The Company invests in financial assets to comply with the VCT legislation and provide capital growth for shareholders that can eventually be distributed by way of dividends. Unquoted venture capital investments normally take a number of years to mature and are, by nature, illiquid. Therefore, realised capital gains on these investments are a medium-to-long term aim.

Due to the structure of certain investments, Preference share redemptions and loan stock repayments may become due during the term of the investment. These are usually at fixed dates, although in some instances the investee company will have the option of repaying earlier. In some instances the redemption may carry a premium repayment.

Investments in Government stocks are held solely for the purpose of liquidity whilst waiting for suitable qualifying investment opportunities to arise. Therefore, trading in these stocks is determined mainly by the demand for venture capital funds.

Details of financial assets held at 31 December 2004 can be found in the Investment Adviser's Review and notes 7, 8 and 9 to these Financial Statements.

By order of the board

J E P Gervasio
Company Secretary
12 April 2005

Directors' Remuneration Report

The Board does not have a separate Remuneration Committee due to the size of the Board and the remuneration procedures currently in place. In the directors' opinion, and under the Listing Rules, there is no requirement for an independent Remuneration Committee. All fees continue to be paid to the directors in accordance with the statements in the Company's Listing Particulars.

Directors and their Interests

The directors of the Company at 31 December 2004 and their beneficial interests in the share capital of the Company (including those of immediate family members) were as follows:

| | Number of Ordinary shares at 31 December 2004 | Number of Warrants at 31 December 2004 | Number of Ordinary shares at 31 December 2003 | Number of Warrants at 31 December 2003 |
|-----------------------|--|---|---|--|
| Sir Andrew Hugh Smith | 25,000 | – | 25,000 | 5,000 |
| P S Cammerman | 10,000 | – | 10,000 | 2,000 |
| R Last | 10,000 | – | 10,000 | 2,000 |
| S J Noar | 10,000 | – | 10,000 | 2,000 |
| R M Pettigrew | 27,225 | – | 27,225 | 5,445 |

None of the directors have subscribed for, or purchased additional shares since the year end.

None of the directors held any option to acquire additional shares at the end of the year.

None of the directors exercised any Warrants during the year. Unexercised Warrants previously held by the directors have now lapsed.

Brief biographical notes on the directors are given on page 17. In accordance with the Company's Listing Particulars, no director has a contract of service with the Company that entitles him to any benefit other than the remuneration disclosed below and, save as described under "Administration" below, no contract subsisted during or at the end of the year in which any director was materially interested and which was significant in relation to the Company's business. The Company does not generally offer compensation for loss of office when a director leaves office.

The Company had no employees in either year.

Administration

YFM Private Equity Limited has acted as Investment Adviser and performed administrative and secretarial duties for the Company since 28 November 2000. The principal terms of the agreement are set out in note 3 to the financial statements. YFM Private Equity Limited is authorised by the Financial Services Authority. Mr Cammerman is a director of YFM Private Equity Limited and has a beneficial shareholding in its ultimate parent company, Yorkshire Enterprise Group (Holdings) Limited.

Under the Subscription Rights Agreement dated 28 November 2000, YFM Private Equity Limited and Generics Asset Management Limited have a performance-related incentive, structured so as to entitle them to an amount (satisfied by the issue of Ordinary shares) equivalent to 20% of the amount by which the cumulative cash dividends paid as at the last business day in December in any year plus the average of the middle market quotation per Ordinary share exceeds 120p per Ordinary share on that same day multiplied by the number of Ordinary shares in issue and the shares under option (if any). The subscription rights are exercisable in the ratio 50:50 between YFM Private Equity Limited and Generics Asset Management Limited. No shares have been issued in either year under this agreement. By a Deed of Assignment dated 19 December 2004, the benefit of the YFM Private Equity Limited subscription right was assigned to YFM Private Equity Limited Trust, an employee benefit trust formed for the benefit of certain employees of YFM Private Equity Limited and associated companies. Mr Cammerman is one of the beneficiaries of that Trust.

Directors' Remuneration Report

Basic Remuneration

Total directors' remuneration for the year amounted to £27,625 (2003: £33,250) of which £27,625 (2003: £33,250) was paid to four individuals for services as directors (2003: four). There were no payments to third parties in respect of directors' services (2003: £nil).

The total fees paid in respect of individual directors were as follows:

| | Year ended 31 December 2004 £ | Year ended 31 December 2003 £ |
|-------------------------|--|--|
| Sir Andrew Hugh Smith | 12,000 | 12,000 |
| J R Ashcroft (deceased) | – | 6,250 |
| P S Cammerman | – | – |
| R Last | 7,500 | 7,500 |
| S J Noar | 7,500 | 7,500 |
| R M Pettigrew | 625 | – |

There are no executive directors (2003: Nil). Mr Cammerman, who is a director of the Company's Investment Adviser, received no fees for his services as a director of the Company. None of Mr Cammerman's remuneration from YFM Private Equity Limited is considered to relate to his role with the Company.

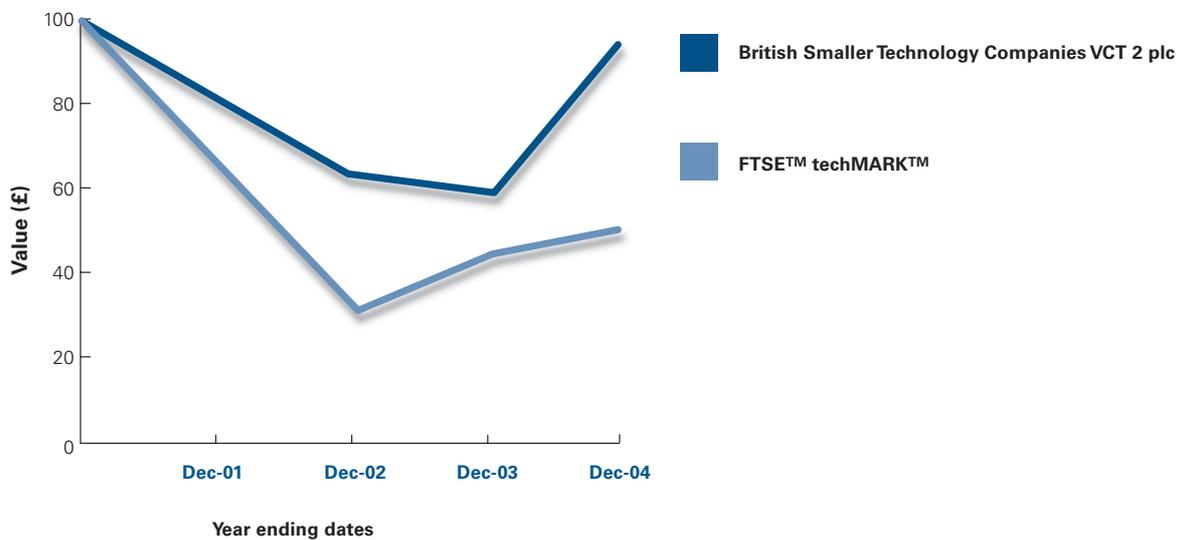
It is the Company's policy not to provide any performance related emoluments, benefits in kind, any other emoluments or pension contributions to any director. No director is entitled to shares under any share option or long term incentive schemes.

The 'Basic Remuneration' section is the only section of the Directors' Remuneration Report subject to audit. All of the remaining sections are not subject to audit.

Directors' Remuneration Report

Performance Graph

The graph below shows a comparison between the Company's total shareholder return compared with the companies in the FTSE™ techMARK™ All-Share Index for the period from the first allotment of shares to 31 December 2004. The graph looks at the value, by the end of 2004, of £100 invested in the Company's shares with the value of £100 invested in the FTSE™ techMARK™ All-Share Index. The directors consider this to be the most appropriate published index on which to report on comparative performance given the technology focus of the Company's investment criteria, whilst recognising that the Company's investments are invariably in relatively early stage unquoted companies.



Signed on behalf of The Board

Sir Andrew Hugh Smith
Director
12 April 2005

Independent Auditors' Report

To the Members of British Smaller Technology Companies VCT 2 plc

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the cash flow statement, the statement of total recognised gains and losses and the related notes. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Directors' Remuneration Report ("the auditable part").

Respective Responsibilities of Directors and Auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities. The directors are also responsible for preparing the Directors' Remuneration Report.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the directors' remuneration report have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the 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 is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Chairman's Statement, the Investment Adviser's Review, the directors' report including the corporate governance statement, the unaudited part of the Directors' Remuneration Report and the other items included in the Contents section.

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

Basis of Audit Opinion

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

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

Independent Auditors' Report

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the Company's affairs at 31 December 2004 and of its profit and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- those parts of the directors' remuneration report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors

Leeds

12 April 2005

Profit and Loss Account

For the year ended 31 December 2004

| | Notes | 2004 £000 | Restated 2003 £000 |
|---|-------|---------------|--------------------------|
| Income | 2 | 77 | 256 |
| Administrative expenses: | | | |
| Investment advisory fee | 3 | (197) | (187) |
| Other expenses | 3 | (178) | (157) |
| | | (375) | (344) |
| Profit (loss) on realisation of investments | 7 | 1,398 | (71) |
| Impairment of investments | 7 | (20) | (750) |
| Profit (loss) on ordinary activities before taxation | | 1,080 | (909) |
| Taxation | 4 | - | - |
| Profit (loss) on ordinary activities after taxation | | 1,080 | (909) |
| Dividends | 5 | (392) | - |
| Retained profit (deficit) for the year | 13,14 | 688 | (909) |
| Basic and diluted earnings (loss) per Ordinary share | 6 | 13.79p | (11.64)p |

Notes

All activity has arisen from continuing operations.

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

Statement of Total Recognised Gains and Losses

| | Notes | 2004 £000 | 2003 £000 |
|---|-------|--------------|--------------|
| Profit (loss) for the financial year | 14 | 1,080 | (909) |
| Unrealised (losses) profits on valuation of investments | 14 | (100) | 355 |
| Total recognised gains (losses) for the year | | 980 | (554) |

Note of Historical Cost Profits and Losses

| | Notes | 2004 £000 | 2003 £000 |
|--|-------|--------------|--------------|
| Profit (loss) on ordinary activities before taxation | 14 | 1,080 | (909) |
| Realisation of investment profits of previous years | | 31 | 67 |
| Historical cost profit (loss) on ordinary activities before taxation | | 1,111 | (842) |
| Historical cost profit (loss) on ordinary activities after taxation and dividends | | 719 | (842) |

Balance Sheet

At 31 December 2004

| | Notes | 2004 £000 | Restated 2003 £000 |
|--|-------|--------------|--------------------------|
| Fixed Assets | | | |
| Investments | 7 | 3,775 | 2,535 |
| Current Assets | | | |
| Debtors | 10 | 112 | 26 |
| Investments | 7 | 1,280 | 1,026 |
| Cash | | 2,544 | 3,057 |
| | | 3,936 | 4,109 |
| Creditors: amounts payable within one year | 11 | (497) | (28) |
| Net Current Assets | | 3,439 | 4,081 |
| Total Net Assets | | 7,214 | 6,616 |
| Capital and Reserves | | | |
| Called-up share capital | 12 | 783 | 782 |
| Share premium account | 13 | 9 | – |
| Capital redemption reserve | 13 | 1 | 1 |
| Revaluation reserve | 13 | 223 | 354 |
| Warrant reserve | 13 | 3 | 4 |
| Special reserve | 13 | 5,364 | 6,592 |
| Other reserve | 13 | 2 | 1 |
| Profit and loss account | 13 | 829 | (1,118) |
| Equity shareholders' funds | 14 | 7,214 | 6,616 |
| Net asset value per Ordinary share | 15 | 92.1p | 84.6p |

Signed on behalf of the board

Sir Andrew Hugh Smith

Director

12 April 2005

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

Cash Flow Statement

For the year ended 31 December 2004

| | Notes | 2004 £000 | 2003 £000 |
|---|--------|----------------|--------------|
| Net cash outflow from operating activities | 16 | (307) | (1) |
| Investing activities | | | |
| Purchase of fixed asset investments | 7 | (1,881) | (1,606) |
| Proceeds from sale of fixed asset investments | 7 | 1,901 | – |
| Net cash inflow (outflow) from investing activities | | 20 | (1,606) |
| Net cash outflow before management of liquid resources and financing | | (287) | (1,607) |
| Management of liquid resources | | | |
| Purchase of fixed interest Government stocks | 7 | (1,257) | (1,980) |
| Proceeds from the sale of fixed interest Government stocks | 7 | 1,021 | 6,613 |
| Net cash (outflow) inflow from management of liquid resources | 17,18 | (236) | 4,633 |
| Financing | | | |
| Issue of Ordinary shares on exercise of warrants | 12 | 10 | 3 |
| Purchase of own shares and associated warrants | | - | (6) |
| Net cash inflow (outflow) from financing | | 10 | (3) |
| (Decrease) increase in cash in the year | 17, 18 | (513) | 3,023 |

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

Notes to the Financial Statements

For the year ended 31 December 2004

1. Principal Accounting Policies

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

Basis and Preparation of Accounting

The financial statements are prepared on a going concern basis under the historical cost convention, as modified by the revaluation of certain investments, and in accordance with the Companies Act 1985 and with applicable accounting standards in the United Kingdom.

In order to enable the Company to make capital distributions, the Company has revoked its investment company status and is unable to take advantage of the accounting exemptions that status permits. The results of the Company set out on page 32 have been prepared in accordance with the requirements of Schedule 4 of the Companies Act 1985.

The main consequence of this change is that the Company now prepares a profit and loss account instead of a statement of total return. In addition, any unrealised gains or losses above historical cost are credited/charged to the revaluation reserve, whilst any unrealised gains or losses below historical cost are taken immediately to the profit and loss account. When an investment is sold or written off, any balance already held on the revaluation reserve in respect of that investment is transferred to the profit and loss account as a movement on reserves. Previously all gains and losses, whether realised or unrealised, were recognised in the capital account for the period. Expenses, previously allocated between the revenue and capital account, are now charged 100% to the profit and loss account in the period in which they are incurred.

Reference to revenue and capital in the notes to these financial statements reflects the basis on which taxation is calculated and the treatment applied in determining the amounts available for revenue dividend distribution

Income

Dividend income on unquoted equity shares is recognised at the time when the right to the income is established. Fixed returns on non-equity shares are recognised on a time apportionment basis so as to reflect the effective yield, provided there is no reasonable doubt that payment will be received in due course. All other income is recognised on an accruals basis.

Expenses

Expenses are accounted for on an accruals basis and are charged 100% through the profit and loss account.

Investments

Investments in unquoted companies are treated as fixed assets and stated in the balance sheet at fair value in accordance with the British Venture Capital Association guidelines issued in June 2004 for the valuation of venture capital investments. Further details of the guidelines adopted by the Company can be found on pages 15 and 16 of this report.

Quoted investments are valued at market bid prices, or middle market prices where the bid price is not readily available, less a discount if appropriate. Venture capital investments in AIM quoted companies are treated as fixed assets. Quoted investments held as Government securities are treated as current assets due to their use as temporary holdings until venture capital investment opportunities arise and are held at current cost which equates to market value as at the balance sheet date.

Notes to the Financial Statements

1. Principal Accounting Policies (cont.)

Investments (cont.)

When the Company revalues its investments during the year, any unrealised gains or losses above historical costs are credited/charged to the revaluation reserve, whilst any unrealised gains or losses below historical cost are taken immediately to the profit and loss account. When an investment is sold or written off, any balance already held on the revaluation reserve in respect of that investment is transferred to the profit and loss account as a movement on reserves.

Although the Company holds more than 20% of the equity of certain companies, it is considered that the investments are held as part of an investment portfolio. Accordingly, and as permitted by FRS9 'Associates and Joint Ventures,' their value to the Company lies in their marketable value as part of that portfolio. It is not considered that any of the holdings represent investments in associated undertakings.

Foreign currencies

Transactions denominated in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction; monetary assets and liabilities at the balance sheet date are translated at the year end rate of exchange. Exchange differences thus arising are reported as part of the results for the year.

Warrants

When the Company issues Ordinary shares with Warrants attached, the Warrants are accounted for separately from the Ordinary shares as they are capable of being transferred, cancelled and redeemed independently of each other. The net proceeds attributed to the Warrants are shown as a reserve, the "Warrant reserve," which is included as part of shareholders funds.

Upon exercise of a Warrant, the amount previously recognised in respect of the Warrant is treated as part of the net proceeds of the shares issued. On exercise of the Warrant, this amount is transferred to a separate, non-distributable reserve within shareholders' funds.

If a Warrant lapses unexercised, the amount previously recognised in respect of the Warrant is a realised gain and is considered to be of a capital nature which is dealt with in the statement of total recognised gains and losses.

Where the Company repurchase and then cancel Warrants, the net cost is reflected in the capital column of the statement of total return. Any amount standing to the credit of a Warrant reserve in respect of Warrants repurchased and cancelled is released and set against the cost of repurchase in arriving at the net cost on repurchase and cancellation.

Taxation

Corporation tax payable is provided on taxable profits at the current rate.

Deferred tax 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 tax in the future, or a right to pay less tax in the future, have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted at the balance sheet date. Deferred tax is measured on a non-discounted basis.

Notes to the Financial Statements

2. Income

| | 2004 £000 | 2003 £000 |
|--------------------------------------|--------------|--------------|
| Fixed interest Government securities | 53 | 229 |
| Interest on bank deposits | 2 | 19 |
| Loan interest | 22 | 8 |
| | 77 | 256 |

3. Administrative Expenses

| | 2004 £000 | 2003 £000 |
|---|--------------|--------------|
| Investment advisory fee (including irrecoverable VAT) | 197 | 187 |
| Other expenses: | | |
| Administration fee (including irrecoverable VAT) | 44 | 42 |
| Directors' remuneration | 29 | 33 |
| Auditors' remuneration: | | |
| audit fees* | 20 | 12 |
| non-audit services | 9 | 9 |
| General expenses | 76 | 61 |
| | 178 | 157 |
| | 375 | 344 |

* Audit fees for the year ended 31 December 2004 include an amount of £3,000 relating to an under accrual in respect of the prior year.

During the year the Company obtained tax compliance services and VCT compliance monitoring services from the Company's auditors PricewaterhouseCoopers LLP, amounting to £2,500 (2003: £3,000) and £6,500 (2003: £6,000) respectively. Given the low level of non-audit services provided, the auditors' objectivity and independence is not considered to be compromised.

YFM Private Equity Limited provides investment advisory services to the Company under an agreement dated 28 November 2000. The agreement may be terminated by not less than twelve months' notice given by either party at any time after the fourth anniversary of the agreement. No notice has been given by either party.

YFM Private Equity Limited receives an investment advisory fee, payable quarterly in advance, at the rate of 3% on the first £5m of gross funds raised and 2½% of the remaining gross funds raised in excess of £5m, calculated at half-yearly intervals as at 30 June and 31 December. The investment advisory fee comprises an investment administration fee of £118,000 (2003: £112,000), including irrecoverable VAT, and an investment management fee of £79,000 (2003: £75,000).

Under this same agreement YFM Private Equity Limited also provides administrative and secretarial services to the Company for a fee of £35,000 per annum plus annual adjustments to reflect movements in the Retail Prices Index.

The total remuneration payable to YFM Private Equity Limited in the period (including VAT) was £241,000 (2003: £229,000). The details of directors' remuneration are set out in the Directors' Remuneration Report on pages 27 to 29.

Notes to the Financial Statements

4. Taxation on Ordinary Activities

| | 2004 £000 | 2003 Restated £000 |
|--|--------------|--------------------------|
| Corporation tax payable at 19% (2003: 19%) | – | – |
| Profit (loss) on ordinary activities before taxation | 1,080 | (909) |
| Profit (loss) on ordinary activities multiplied by standard small company rate of corporation tax in UK of 19% (2003: 19%) | 205 | (173) |
| Effect of: | | |
| Non taxable (profits) losses on investments (i) | (262) | 156 |
| Excess management expenses (ii) | 57 | 17 |
| Current tax charge for the year | – | – |

(i) Venture capital trusts are not subject to corporation tax on these items.

(ii) The Company has no deferred tax liability.

Deferred tax assets of £87,000 (2003: £30,000) in respect of unrelieved management expenses have not been recognised as management do not currently believe that it is more likely than not that sufficient taxable profits will be available against which assets can be recovered.

Due to the Company's status as a venture capital trust and the continued intention to meet with the conditions required to comply with Section 842AA of the Income and Corporation Taxes Act (1988), the Company has not provided for deferred tax on any capital gains and losses on the realisation or disposal of investments.

5. Dividends

| | 2004 £000 | 2003 £000 |
|---|--------------|--------------|
| Final proposed – 5.0p per share (2003: nil per share) | 392 | – |
| | 392 | – |

6. Earnings (Loss) per Ordinary Share

The earnings (loss) per Ordinary share is based on the profit from ordinary activities after tax of £1,080,000 (2003: £909,000 loss) and 7,830,000 (2003: 7,812,000) shares being the weighted average number of shares in issue during the year.

The only potentially dilutive shares are those shares which, subject to certain criteria being achieved in the future, may be issued by the Company to meet its obligations under the investment management agreement as set out in Note 3 together with the Warrants. No such shares have been issued or are currently expected to be issued. There are, therefore, considered to be no potentially dilutive shares in issue at 31 December 2004. Consequently, basic and diluted earnings per share are the same for the year ended 31 December 2004.

Under FRS 14 'Earnings per share' any potentially dilutive shares are deemed anti-dilutive in the event that a loss has been incurred. Consequently, the basic and diluted loss per share for the year ended 31 December 2003 are the same.

Notes to the Financial Statements

7. Investment Portfolio

Movements in investments during the year to 31 December 2004 are summarised as follows:

| | Unquoted Investments | Quoted Investments | Total Fixed Asset Investments | Fixed Income Securities | Total |
|---|-------------------------|-----------------------|--|-------------------------------|----------------|
| | £000 | £000 | £000 | £000 | £000 |
| Opening cost | 2,900 | 275 | 3,175 | 1,033 | 4,208 |
| Opening unrealised (loss) gain | (963) | 323 | (640) | (7) | (647) |
| Opening valuation | 1,937 | 598 | 2,535 | 1,026 | 3,561 |
| Flotation of unquoted companies (cost) | (415) | 415 | – | – | – |
| Flotation of unquoted companies (valuation) | (31) | 31 | – | – | – |
| Additions at cost | 1,131 | 750 | 1,881 | 1,257 | 3,138 |
| Disposal proceeds | (14) | (1,887) | (1,901) | (1,021) | (2,922) |
| Realised (losses) profits on disposal | (33) | 1,436 | 1,403 | (5) | 1,398 |
| Unrealised gain (loss) in the year | 95 | (238) | (143) | 23 | (120) |
| | 2,670 | 1,105 | 3,775 | 1,280 | 5,055 |
| Closing cost | 3,346 | 1,019 | 4,365 | 1,257 | 5,622 |
| Closing unrealised (loss) gain | (676) | 86 | (590) | 23 | (567) |
| Closing valuation | 2,670 | 1,105 | 3,775 | 1,280 | 5,055 |

Fixed income securities are UK Government stocks and are classified as current assets due to their use as temporary holdings until venture capital investment opportunities arise.

Total unrealised gains in the year of £120,000 (2003: losses of £395,000) consists of an unrealised loss of £100,000 (2003: £355,000) which is reflected in the revaluation reserve and an impairment charge of £20,000 (2003: £750,000) reflected in the profit and loss account.

Notes to the Financial Statements

8. Investments

The cost and carrying value of investments held at 31 December 2004, all of which are registered in England and Wales except where noted, are detailed as follows:

| | 2004 | | | 2003 | | |
|--|--------------|-------------------|-----|--------------|-------------------|-----|
| | Cost £000 | Valuation £000 | % | Cost £000 | Valuation £000 | % |
| Arakis Limited | | | | | | |
| Ordinary shares of £1 each | 14 | – | – | – | – | – |
| Broadreach Networks Limited | | | | | | |
| Ordinary shares of 1p each | 75 | 75 | | 25 | 25 | |
| Fixed rate secured loan stock | 475 | 475 | | 225 | 225 | |
| | 550 | 550 | 7.2 | 250 | 250 | 3.8 |
| Cambridge Cognition Limited | | | | | | |
| Ordinary shares of £1 each | 240 | 60 | 0.8 | 240 | 60 | 0.9 |
| DxS Limited | | | | | | |
| Ordinary shares of 10p each | 15 | 15 | | – | – | – |
| Floating rate unsecured loan stock | 116 | 116 | | – | – | – |
| | 131 | 131 | 1.7 | – | – | – |
| ExpressOn Biosystems Limited | | | | | | |
| (Registered in Scotland) | | | | | | |
| Ordinary shares of 0.25p each | 165 | – | | 150 | 78 | |
| Floating rate convertible unsecured loan stock | 285 | 265 | | 150 | 150 | |
| | 450 | 265 | 3.5 | 300 | 228 | 3.5 |
| Immunobiology Limited | | | | | | |
| Ordinary shares of 10p each | 200 | 200 | 2.6 | 200 | 200 | 3.0 |
| Infinite Data Storage Limited | | | | | | |
| (Registered in Scotland) | | | | | | |
| Ordinary shares of £1 each | 255 | 215 | | 180 | – | |
| Preferred Ordinary shares | 120 | 120 | | 120 | 76 | |
| | 375 | 335 | 4.4 | 300 | 76 | 1.2 |
| Oxonica Limited | | | | | | |
| Ordinary shares of 1p each | 107 | – | | 107 | – | |
| Variable rate convertible secured loan stock | 118 | 118 | | 118 | 67 | |
| | 225 | 118 | 1.6 | 225 | 67 | 1.0 |

Notes to the Financial Statements

8. Investments (cont.)

| | 2004 | | | 2003 | | |
|---|--------------|-------------------|-------------|--------------|-------------------|------|
| | Cost £000 | Valuation £000 | % | Cost £000 | Valuation £000 | % |
| Purely Proteins Limited | | | | | | |
| Ordinary shares of 1p each | 400 | 400 | 5.3 | 200 | 200 | 3.0 |
| Silistix Limited | | | | | | |
| Ordinary shares of 1p each | 241 | 241 | 3.2 | 121 | 121 | 1.8 |
| Sirus Pharmaceuticals Limited | | | | | | |
| Ordinary shares of 1p each | – | – | – | 25 | – | – |
| 0% Convertible unsecured loan stock | – | – | – | 225 | 27 | – |
| | – | – | – | 250 | 27 | 0.4 |
| Tamesis Limited | | | | | | |
| Ordinary shares of 0.04p each | 150 | – | – | 150 | 37 | 0.6 |
| Vibration Technology Limited | | | | | | |
| (Registered in Scotland) | | | | | | |
| Ordinary shares of 1p each | 370 | 370 | 4.9 | 249 | 225 | 3.4 |
| Total excluding quoted investments | 3,346 | 2,670 | 35.2 | 2,485 | 1,491 | 22.6 |
| Ordinary shares held in quoted companies | | | | | | |
| Allergy Therapeutics plc | | | | | | |
| Ordinary shares of £1 each | 350 | 432 | 5.7 | – | – | – |
| Amino Technologies plc (formally Amino Holdings Limited) | | | | | | |
| Ordinary shares of 1p each | – | – | – | 415 | 446 | 6.7 |
| Cozart plc | | | | | | |
| Ordinary shares of 1p each | 394 | 512 | 6.7 | – | – | – |
| The ART Technology Group Inc. | | | | | | |
| (formally Primus Knowledge Solutions Inc.) | | | | | | |
| (Registered in USA) | | | | | | |
| Common stock of \$0.01 each | 275 | 161 | 2.1 | 275 | 598 | 9.0 |
| Total venture capital investments | 4,365 | 3,775 | 49.7 | 3,175 | 2,535 | 38.3 |

Notes to the Financial Statements

8. Investments (cont.)

| | 2004 | | | 2003 | | |
|--|--------------|-------------------|--------------|--------------|-------------------|-------|
| | Cost £000 | Valuation £000 | % | Cost £000 | Valuation £000 | % |
| Government stocks | | | | | | |
| 6.5% Treasury stock 2004 | – | – | | 1,033 | 1,026 | |
| 5.0% Treasury stock 2008 | 1,033 | 1,055 | | – | – | |
| 4.5% Treasury stock 2007 | 224 | 225 | | – | – | |
| Total Government stocks | 1,257 | 1,280 | 16.8 | 1,033 | 1,026 | 15.5 |
| Total financial asset investments | 5,622 | 5,055 | 66.5 | 4,208 | 3,561 | 53.8 |
| Cash | | 2,544 | 33.5 | | 3,057 | 46.2 |
| Other net current assets | | 5 | 0.0 | | (2) | – |
| Equity shareholders' funds | | 7,604 | 100.0 | | 6,616 | 100.0 |

YFM Private Equity Limited also acts as Investment Adviser to certain other funds under its management, namely British Smaller Companies VCT plc, British Smaller Technology Companies VCT plc, the Baring English Growth Fund (North) Limited Partnership and the North West Business Investment Scheme Limited Partnership, that have invested in the companies within the current portfolio of this Company.

Details of these investments are summarised below. The amounts shown are the investments made at cost as at 31 December 2004 and exclude those companies which are in receivership or liquidation.

| | British Smaller Companies VCT plc £000 | British Smaller Technology Companies VCT plc £000 | Baring English Growth Fund (North) £000 | North West Business Investment Scheme £000 | TOTAL £000 |
|------------------------------|---|---|--|--|---------------|
| Arakis Limited | – | 12 | – | – | 12 |
| Cambridge Cognition Limited | 325 | – | – | – | 325 |
| Cozart plc | 500 | 500 | – | – | 1,000 |
| DxS Limited | – | – | – | 131 | 131 |
| Immunobiology Limited | – | 150 | – | – | 150 |
| Silistix Limited | – | – | – | 241 | 241 |
| Tamesis Limited | 350 | 350 | 325 | – | 1,025 |
| Vibration Technology Limited | – | 515 | – | – | 515 |

Notes to the Financial Statements

9. Financial Instruments

The Company has no derivative financial instruments and has no financial asset or liability for which hedge accounting has been used in either period.

The investments are valued in accordance with the British Venture Capital Association guidelines and, therefore, the directors consider all assets to be carried at a valuation which equates to fair value.

Investments are made in a combination of equity and fixed rate financial instruments so as to comply with venture capital trust legislation and provide potential high future capital growth.

Surplus funds are held in fixed rate Government stocks until suitable venture capital investment opportunities arise.

At 31 December 2004 and 31 December 2003, the financial assets, by value, excluding short term trade debtors and creditors, as permitted by FRS13, comprised:

| | 2004 | | 2003 | |
|------------------------------------|--------------|--------------|-------|-------|
| | £000 | % | £000 | % |
| Venture capital investments | | | | |
| Ordinary shares | 2,681 | 35.3 | 1,990 | 30.0 |
| Loan stock | 974 | 12.8 | 469 | 7.1 |
| Preferred Ordinary Shares | 120 | 1.6 | 76 | 1.2 |
| | 3,775 | 49.7 | 2,535 | 38.3 |
| Fixed interest Government stocks | 1,280 | 16.8 | 1,026 | 15.5 |
| Cash | 2,544 | 33.5 | 3,057 | 46.2 |
| | 7,599 | 100.0 | 6,618 | 100.0 |

Notes to the Financial Statements

9. Financial Instruments (cont.)

There were no fixed rate financial assets in venture capital investments held at 31 December 2004 (2003: nil%). For all financial assets, including investments in Government stocks, the weighted average interest rate on fixed rate assets was 4.66% (2003: 4.97%) with a weighted average period of 2 years, 9 months (2003: 11 months).

Ordinary share investments are excluded from the weighted average interest rate risk analysis in both years as there is no pre-defined maturity date on these investments.

The Company invests in financial assets to comply with the venture capital trust legislation and provide capital growth for shareholders that can eventually be distributed by way of dividends. Unquoted venture capital investments normally take a number of years to mature and are, by their nature, illiquid. Therefore, realised capital gains on these investments are a medium-to-long term aim.

Due to the structure of certain investments, loan stock repayments may become due during the term of the investment. These are usually at fixed dates, although in some instances the investee company has the option of repaying earlier.

Investments in Government stocks are held solely for the purpose of liquidity whilst waiting for suitable qualifying investment opportunities to arise. Therefore, trading in these stocks is determined mainly by the demand for venture capital funds.

There are no undrawn committed borrowing facilities at either year end.

Market price risk arises from uncertainty about the future prices of financial instruments held in accordance with the Company's investment objectives. It represents the potential loss that the Company might suffer through holding market positions in the face of market movements. The investments in equity and fixed interest stocks of unquoted companies the Company holds are thinly traded, and as such, the prices are more volatile than those of more widely backed securities. In addition, the ability of the Company to purchase or sell investments is also constrained by requirements set down for venture capital trusts.

All financial assets are predominately held in sterling. However, at 31 December 2004 the company had investments valued at £161,000 denominated in US dollars (2003: £598,000).

The Company's total return and balance sheet can be affected by foreign exchange movements due to the Company having assets denominated in currencies other than the Company's base currency (sterling).

The Board has identified three principal areas where foreign currency risk could impact the Company:

- Movements in rates affecting the value of investments
- Movements in rates affecting short-term timing differences
- Movements in rates affecting the income received

The Company has not hedged the sterling value of the investment priced in US dollars by the use of derivatives.

The Company might also be subject to short-term exposure from exchange rate movements, for example between the date when an investment is bought or sold and the date when settlement of the transaction occurs. Income denominated in foreign currencies is converted to sterling on receipt.

Notes to the Financial Statements

10. Debtors

| | 2004 | 2003 |
|--|------------|------|
| | £000 | £000 |
| Amounts receivable within one year: | | |
| Prepayments and accrued income | 112 | 26 |

11. Creditors

| | 2004 | 2003 |
|---|------------|------|
| | £000 | £000 |
| Amounts payable within one year: | | |
| Accrued expenses | 105 | 28 |
| Proposed dividend | 392 | - |
| | 497 | 28 |

Although the Company has no trade creditors, the average number of creditor payment days during the year was 24 (2003: 30).

12. Called-up Share Capital

| | 2004 | | 2003 | |
|---|--------------------|--|--------------------|--|
| | Authorised £000 | Allotted, Called-up and Fully paid £000 | Authorised £000 | Allotted, Called-up and Fully paid £000 |
| Ordinary shares of 10p | | | | |
| Authorised: 50,000,000 (2003: 50,000,000) | | | | |
| Issued: 7,833,466 (2003: 7,823,393) | 5,000 | 783 | 5,000 | 782 |

The movement in the year was as follows:

| | Date | No of Shares | Share Capital £000 | Share Premium* £000 |
|------------------------|--------|-----------------|-----------------------|------------------------|
| As at 1 January 2004 | | 7,823,393 | 782 | - |
| Warrant conversion | May 04 | 10,073 | 1 | 9 |
| As at 31 December 2004 | | 7,833,466 | 783 | 9 |

* net of amounts attributed to Warrants.

All Ordinary shares have Warrants attached on a 1 for 5 basis. Each Warrant entitles the warrant holder to subscribe in cash in whole or in part on 30 April in each of the years 2004 to 2005 for one Ordinary share at a price of 100p payable in full in cash on subscription. The Ordinary shares issued during the year resulted from the exercise of such Warrants.

Notes to the Financial Statements

13. Reserves

The movement in the year was as follows:

| | Share Premium Account £000 | Capital Redemption Reserve £000 | Capital Reserve Realised £000 | Capital Reserve Unrealised £000 | Revaluation Reserve £000 | Warrant Reserve £000 | Special Reserve £000 | Other Reserve £000 | Profit and Loss Account* £000 |
|--|-------------------------------------|--|--|--|--------------------------------|----------------------------|----------------------------|--------------------------|--|
| At 1 January 2004 as previously reported | – | 1 | (118) | (647) | – | 4 | 6,592 | 1 | 1 |
| Prior year adjustment | – | – | 118 | 647 | 354 | – | – | – | (1,119) |
| At 1 January 2004 as restated | – | 1 | – | – | 354 | 4 | 6,592 | 1 | (1,118) |
| Unrealised gain on revaluation of investment portfolio | – | – | – | – | (100) | – | – | – | – |
| Realisation of gains on valuation of investments in prior years | – | – | – | – | (31) | – | – | – | 31 |
| Transfer from special reserve to profit and loss account | – | – | – | – | – | – | (1,228) | – | 1,228 |
| Warrants exercised | 9 | – | – | – | – | (1) | – | 1 | – |
| Profit for the year | – | – | – | – | – | – | – | – | 688 |
| As at 31 December 2004 | 9 | 1 | – | – | 223 | 3 | 5,364 | 2 | 829 |

*Previously referred to as 'revenue reserve' in the prior year financial statements.

In prior years, as an investment company, accounts were prepared in accordance with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies'. As a result of the revocation of investment company status, the Company is required to prepare accounts in accordance with Schedule 4 of the Companies Act 1985 which has resulted in the statement of total return being restated as a profit and loss account and a number of reserves also being restated. The Companies Act 1985 requires that all realised gains and losses, including those arising from the disposal of investments, are included in the results for the year. When the Company revalues its investments, any unrealised gains or losses above historical cost are credited/charged to the Revaluation reserve, whilst any unrealised gains or losses below historical cost are taken straight to the profit and loss account.

A transfer has been made from the special reserve to the profit and loss account which equates to the accumulated realised capital losses of prior periods.

The special reserve is a distributable reserve.

The notes on page 15 reconcile the statement of total return to the profit and loss account for 2003 and 2004.

Notes to the Financial Statements

14. Reconciliation of Movements in Shareholders' Funds

| | 2004 £000 | Restated 2003 £000 |
|---|--------------|--------------------------|
| Beginning of the year | 6,616 | 7,173 |
| Profit (loss) on ordinary activities after taxation | 1,080 | (909) |
| Exercise of warrants | 10 | - |
| Dividends paid and payable | (392) | - |
| Net proceeds of share issue | - | (3) |
| Net unrealised movements in the year | (100) | 355 |
| As at 31 December | 7,214 | 6,616 |

15. Net Asset Value per Ordinary Share

The net asset value per Ordinary share is calculated on attributable assets of £7,214,000 (2003: £6,616,000 and 7,833,466 (2003: 7,823,393) shares in issue at the year end.

16. Reconciliation of Profit (Loss) on Ordinary Activities before Taxation to Net Cash Outflow from Operating Activities

| | 2004 £000 | Restated 2003 £000 |
|---|--------------|--------------------------|
| Profit (loss) on ordinary activities before taxation | 1,080 | (909) |
| (Increase) decrease in prepayments and accrued income | (86) | 90 |
| Increase (decrease) in accruals | 77 | (3) |
| (Profit) loss on realisation of investments in the year | (1,398) | 71 |
| Impairment of investments in the year | 20 | 750 |
| Net cash outflow from operating activities | (307) | (1) |

17. Reconciliation of Net Cash Flow to Movement in Net Funds

| | 2004 £000 | 2003 £000 |
|---|--------------|--------------|
| (Decrease) increase in cash in the period | (513) | 3,023 |
| Cash outflow (inflow) from increase in liquid resources | 236 | (4,633) |
| Changes in net funds resulting from cash flows | (277) | 1,610 |
| Other non-cash items: | | |
| Movement in value of current asset quoted investments | 18 | (78) |
| Net funds at beginning of year | 4,083 | 5,771 |
| Net funds at 31 December | 3,824 | 4,083 |

Notes to the Financial Statements

18. Analysis of Net Funds

| | 1 January 2004 £000 | Cash flow £000 | Other non cash changes £000 | 31 December 2004 £000 |
|-----------------------------------|---------------------------|----------------------|-----------------------------------|-----------------------------|
| Cash | 3,057 | (513) | – | 2,544 |
| Fixed interest quoted investments | 1,026 | 236 | 18 | 1,280 |
| | 4,083 | (277) | 18 | 3,824 |

19. Financial Commitments

There were no further investments (2003: £120,000) approved by the Board of Directors at 31 December 2004. Since the year end, further investments totalling £291,666 (2003: £60,000) have been approved by the Board.

20. Related Party Transactions

Mr Last, a director of the Company, is a non-executive director of Tamesis Limited. The appointment was made pursuant to the Subscription Rights agreement following the investment made in that company. During the year Mr Last received £5,000 (2003: £5,000) from Tamesis Limited in respect of his services.

Mr Noar, a director of the Company, is a non-executive director of Purely Proteins Limited. The appointment was made pursuant to an agreement following the investment made in that company. During the year Mr Noar received £16,000 (2003: £3,000) from Purely Proteins Limited in respect of his services.

Notice of the Annual General Meeting

No: 4084003

BRITISH SMALLER TECHNOLOGY COMPANIES VCT 2 plc

NOTICE IS HEREBY GIVEN that the ANNUAL GENERAL MEETING of the Company will be held at 23 Berkeley Square, London W1J 6HE on 27 May 2005 at 1.20pm for the following purposes:

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

As Ordinary Business

ORDINARY RESOLUTIONS

1. That the Annual Report and Accounts for the year ended 31 December 2004 be received.
2. That a final dividend for the year to 31 December 2004 of 5.0 pence per share be approved.
3. That the Directors' Remuneration Report be approved.
4. That Mr Philip S Cammerman who retires by rotation be re-elected as a Director.
5. That Sir Andrew Hugh Smith who retires by rotation be re-elected as a Director.
6. That PricewaterhouseCoopers LLP be re-appointed as auditors to the Company to hold office until the conclusion of the next general meeting at which accounts are laid before the Company and that the directors be authorised to determine their remuneration.

By order of the board

J E P Gervasio

Secretary

12 April 2005

Registered office:
Saint Martins House
210-212 Chapeltown Road
Leeds
LS7 4HZ

Notice of the Annual General Meeting

Notes:

- (1) A member of the Company entitled to attend and vote at the Meeting may appoint a proxy to attend and, on a poll, vote instead of him. A proxy need not be a member of the Company.
- (2) To be valid, a form of proxy must be lodged with the Company's registrars, Northern Registrars, Proxy Department, the Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU not later than 48 hours before the time of appointment for holding the Meeting. Completion of the proxy does not preclude a member from subsequently attending and voting at the Meeting in person if he so wishes.
- (3) In accordance with Regulation 41 of The Uncertified Securities Regulations 2001, only those members entered on the Company's register of members not later than 1.20pm on 25 May 2004, or if the Meeting is adjourned, shareholders entered on the Company's register of members not later than 48 hours before the time fixed for the adjourned Meeting, shall be entitled to attend and vote at the Meeting.
- (4) Completion and return of a form of proxy will not preclude a member of the Company from attending and voting in person at the Meeting if he wishes to do so.
- (5) Biographical details concerning the two Directors retiring by rotation and offering themselves for re-election can be found at page 18 of the Annual Report.

British Smaller Technology Companies VCT 2 plc

Form of Proxy

To be used at the Annual General Meeting of the Company
to be held at 23 Berkeley Square, London, W1J 6HE on 27 May 2005 at 1.20pm

I/We being a member/members of the above named Company entitled to attend and vote at the Annual General Meeting of the Company hereby appoint the Chairman of the Meeting or (see note a) of as my/our proxy to vote for me/us on my/our behalf at the Annual General Meeting of the Company to be held on 27 May 2005 at 1.20pm and at any adjournment thereof.

My/our proxy is to vote as indicated below.

ORDINARY RESOLUTIONS

| | FOR | AGAINST |
|---|--------------------------|--------------------------|
| 1. To receive the Annual Report and Accounts | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. To approve the Final Dividend | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. To approve the Directors' Remuneration Report | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. To re-elect as a Director Mr Philip S Cammerman | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. To re-elect as a Director Sir Andrew Hugh Smith | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. To re-appoint PricewaterhouseCoopers LLP as auditors | <input type="checkbox"/> | <input type="checkbox"/> |

Signature Dated 2005

NOTES

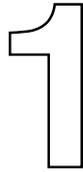
- (a) If you wish to appoint a proxy or proxies other than the Chairman of the Meeting please insert that person's name and address and delete (initialling the deletion) "the Chairman of the Meeting or." A proxy need not be a Member of the Company. You may attend and vote at the Meeting instead of any proxy appointed by you if you so wish.
- (b) Please indicate by inserting "x" in the appropriate box the way in which your proxy is to vote. If you do not do so, your proxy may vote or abstain as he thinks fit. Your proxy will have the authority to vote at his discretion on any amendment or other motion proposed at the Meeting, including any motion to adjourn the Meeting. This proxy will only be used in the event of a poll being directed or demanded.
- (c) This form of proxy must be signed by the appointor or his attorney duly authorised in writing or if the appointor is a corporation this proxy must be given under its Common Seal or be signed by an officer or attorney duly authorised in writing.
- (d) To be valid, this form of proxy duly completed and any power of attorney or other authority (if any) under which it is notarially certified, or office copy of such power or authority, must be deposited at the office of the Company's Registrars, Capita Registrars, Proxy Department, the Registry, 34 Beckenham Road, Beckenham, Kent, BR3 4TU not less than 48 hours before the time appointed for holding the above Meeting or (as the case may be) adjourned Meeting.
- (e) The resolutions are set out in full in the Notice of Annual General Meeting.



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Business Reply Service
Licence No MB122



**CAPITA REGISTRARS
PROXY DEPARTMENT
PO BOX 25
BECKENHAM
KENT
BR3 4TU**

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Financial Summary

| | Year ended 31 December 2004 | Year ended 31 December 2003 restated* | Year ended 31 December 2002 | Period ended 31 December 2001 |
|---|-----------------------------------|---|-----------------------------------|-------------------------------------|
| Income | £77,000 | £256,000 | £296,000 | £288,000 |
| Profit (loss) on ordinary activities before tax | £1,080,000 | £(909,000) | £5,000 | £35,000 |
| Profit (loss) on ordinary activities after tax | £1,080,000 | £(909,000) | £5,000 | £28,000 |
| Earnings (loss) per ordinary share | 13.79p | (11.64)p | 0.07p | 0.49p |
| Total recognised gain (loss) per ordinary share | 12.51p | (7.09)p | (2.41)p | (0.48)p |
| Dividend per share | 5.0p | – | – | – |
| Net assets | £7,214,000 | £6,616,000 | £7,173,000 | £6,441,000 |
| Net asset value per share | 92.1p | 84.6p | 91.6p | 93.7p |

* Restated for the effect of the revocation of investment company status (see Note 1)

The consequences of the revocation of investment company status have not been reflected in the disclosures for the years ended 31 December 2002, 2001 or 2000. The profit (loss) on ordinary activities before and after tax for those periods relate to the revenue return as calculated in accordance with the Statement of Recommended Practice 'Financial Statements of Investment Trust Companies'.

Advisers to the Company

- Investment Adviser and Custodian

YFM Private Equity Limited
Saint Martins House
210-212 Chapeltown Road
Leeds LS7 4HZ

- Registrars

Capita Registrars
Northern House
Woodsome Park
Fenay Bridge
Huddersfield HD8 0LA

- Solicitors

Keeble Hawson
Protection House
16-17 East Parade
Leeds LS1 2BR

- Stockbrokers

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

- Quoted Investments Adviser

Brewin Dolphin Securities Limited
34 Lisbon Street
Leeds LS1 4LX

- Independent Auditors

PricewaterhouseCoopers LLP
Benson House
33 Wellington Street
Leeds LS1 4JP

- VCT Status Adviser

PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

- Bankers

The Royal Bank of Scotland plc
27 Park Row
Leeds LS1 5QB



BRITISH
SMALLER
TECHNOLOGY
COMPANIES
VCT 2 plc

Saint Martins House
210 - 212 Chapeltown Road
Leeds LS7 4HZ