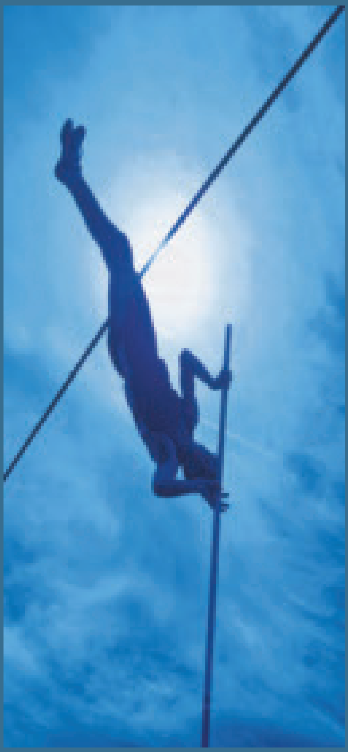
2006

Northern 3 VCT PLC

Annual Report and Accounts 30 September 2006

Northern Venture Managers Limited



Contents

Northern 3 VCT PLC is a Venture Capital Trust (VCT) managed by Northern Venture Managers. It invests mainly in unquoted venture capital holdings and aims to provide high long-term tax-free returns to shareholders through a combination of dividend yield and capital growth.

Financial Summary

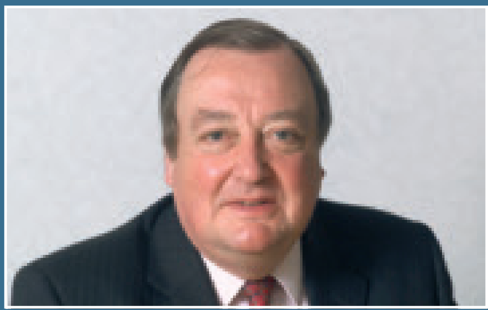
Year ended 30 September	2006	2005 As re-stated
Net assets	**£29,281,000**	£30,136,000
Net asset value per share	**95.2p**	95.8p
Investment income	**£1,372,000**	£1,232,000
Return on ordinary activities before tax		
Revenue	**£1,025,000**	£894,000
Capital	**(£3,000)**	£45,000
Total	**£1,022,000**	£939,000
Return per share		
Revenue	**2.4p**	2.4p
Capital	**0.5p**	0.7p
Total	**2.9p**	3.1p
Dividend per share declared in respect of the year		
Revenue	**2.0p**	2.0p
Capital	**2.0p**	0.4p
Total	**4.0p**	2.4p
Cumulative return to shareholders since launch		
Net asset value per share	**95.2p**	95.8p
Dividends paid per share*	**10.9p**	7.2p
Net asset value plus dividends paid per share	**106.1p**	103.0p
Share price at end of year	**83.0p**	87.0p

* Excluding proposed dividend not yet paid

KEY DATES

Results announced	**17 November 2006**
Shares quoted ex dividend	**13 December 2006**
Second interim dividend paid (to shareholders on register on 15 December 2006)	**19 January 2007**
Annual general meeting	**4 April 2007 (11.30am, City of London Club, London)**

Chairman's Statement



John Hustler

I am pleased to report that the company has been able to declare an increased dividend of 4.0p per share in respect of the year ended 30 September 2006. The increase in the company's size as a result of the share issues in the preceding year has allowed us to take a larger share of the unquoted investment opportunities developed by our managers, and has led to a welcome reduction in the total expense ratio. Your board views the future with confidence.

Financial results

There have been some changes in the way in which the company's annual financial statements are presented, as a result of new UK accounting standards. Last year's Profit and Loss Account, Statement of Total Recognised Gains and Losses and Note of Historical Cost Profits and Losses have been replaced by an Income Statement which includes all recognised gains and losses and, I believe, gives a better overall picture of the results for the year. Quoted investments are now valued at bid rather than mid-market price and proposed dividends are no longer included in the year-end balance sheet. The comparative figures for the year ended 30 September 2005 have been re-stated accordingly.

The net asset value (NAV) per share at 30 September 2006 was 95.2p, a slight reduction from the re-stated figure of 95.8p as at 30 September 2005. The NAV is stated after dividends of 3.7p per share which were charged to reserves during the year. The revenue return after tax was 2.4p, unchanged from the previous year. The directors have declared a second interim dividend rather than a final dividend, for reasons explained below; the second interim dividend will be 2.0p per share, of which 1.0p represents revenue and 1.0p a distribution of capital gains. This makes a total of 4.0p for the year (2.0p revenue and 2.0p capital), compared with 2.4p (2.0p revenue and 0.4p capital) last year. The second interim dividend will be paid on 19 January 2007 to shareholders on the register on 15 December 2006.

Investment portfolio

The Business Review on pages 6 to 11 gives details of developments in the investment portfolio during the year. Eight new venture capital investments were completed during the year at a total cost of £2.8 million. The rate of new investment was lower than expected, reflecting competitive market conditions following the large inflow of cash into the VCT sector generally over the past two years. Our managers have maintained an appropriate quality threshold in assessing new investments and have strengthened their investment team in order to increase the flow of opportunities. I am pleased to report that entering the new financial year we currently have two proposed new investments each of £1 million at an advanced stage of due diligence, with an encouraging list of further work in progress. Your directors and managers are conscious of the need to maintain a strong flow of new investments in order to satisfy the VCT qualifying conditions.

During the year successful exits were achieved from the investments in Omnico Plastics and AFI Aerial Platforms, generating capital profits for distribution to shareholders. As I reported at the interim stage, we also suffered the write-off of our investment in SMS Agencies which went into administration following a period of poor trading results.

Shareholder issues

The company has continued to buy back shares in the market for cancellation at a 10% discount to net asset value. During the year to 30 September 2006 a total of 857,930 shares, representing approximately 2.7% of the issued ordinary capital at the beginning of the year, were re-purchased at a cost of £745,000 – an average of 86.8p per share.

The introduction of 40% income tax relief on new VCT investment in the 2004/05 tax year appears to have resulted in a reduction in the secondary market demand for VCT shares. We believe that in the longer term it is important that an active market in

VCT shares should be encouraged, and with a view to improving the way in which the benefits of VCT investment are communicated to the investing public we have recently (together with approximately 70 other VCTs) joined the Association of Investment Companies.

The dividend investment scheme introduced two years ago has continued to operate, enabling shareholders to re-invest their dividend in new ordinary shares with the benefit of VCT tax reliefs at the current rates. A number of VCTs have announced the suspension of dividend schemes in response to VCT rule changes in the Finance Act 2006, but your board believes that the scheme remains viable under the new legislation and intends to continue it. Shareholders interested in joining the scheme should contact the company secretary for further information.

VCT qualifying status

Your board, advised by PricewaterhouseCoopers LLP, has continued to monitor closely the company's progress towards meeting the qualifying investment requirements laid down in the VCT legislation, and we are satisfied that the company's VCT qualifying status has been maintained.

Under the VCT rules the proceeds of the share issues in our financial year ended 30 September 2005 are required to be at least 70% invested in qualifying holdings by 30 September 2007, the date on which the company's third financial year end following the issue falls. This means that in practice the company will have had only 2½ years to achieve the required investment level. In order to increase the time available to as near three years as possible, it is the directors' intention to extend the company's financial year ending 30 September 2007 by changing the accounting year end to 31 March, so that the next audited accounts will be drawn up for the 18 months ending 31 March 2008. Unaudited interim accounts will be published for the six months ending 31 March 2007 and the 12 months ending 30 September 2007. In order to comply with the Companies Act rules relating to the timing and frequency of annual general meetings, it is proposed that the 2007 annual general meeting will be held in April 2007 and the 2008 meeting in June 2008. So as to avoid a delay in receipt by shareholders, the dividend scheduled to be paid in January 2007 will take the form of a second interim dividend for the year ended 30 September 2006, which does not require the approval of shareholders in general meeting, and there will be no final dividend. It is intended that dividends for future periods will continue to be paid half-yearly in January and July.

Management performance incentive

Last year I reported that the directors had decided, after consultation with the boards of the other funds managed by Northern Venture Managers, to introduce a new performance incentive scheme under which NVM's investment executives co-invest alongside the funds in new venture capital investments. The scheme came into effect in April 2006 and we will keep its operation under regular review. We also took the opportunity to reduce NVM's annual management fee from 2.5% to 2.0% of net assets, but with a mechanism for an additional performance-related fee of up to 1.0% depending on the margin by which annual targets set by the board are exceeded. The minimum target for the year under review was a total return equivalent to 3.5% of opening net asset value per share; only 3.2% was achieved and accordingly no performance fee is payable. The target for the year ending 30 September 2007 is a total return of 4.5%.

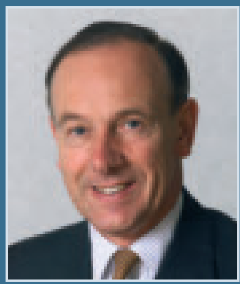
Future prospects

The priority for our managers in the next 18 months is to achieve an increase in the rate of new investment whilst maintaining a satisfactory quality standard. The number of new opportunities currently under review is encouraging. At the same time the portfolio of existing investments is becoming increasingly mature and this should present opportunities for the realisation of gains for distribution by way of dividend, so enhancing the tax-free dividend yield which your directors believe should in the medium term help to improve the market liquidity of the company's shares.

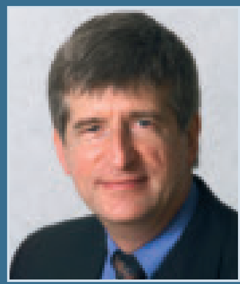
John Hustler
Chairman

Directors

John Hustler FCA MSI CF (Chairman), aged 60, was for ten years a corporate finance partner at KPMG, where he was head of venture capital; he formed Hustler Venture Partners Limited, a specialist adviser to small firms, in 1993. He is a non-executive director of Northern Venture Trust PLC, Hygea VCT plc and a number of other companies.

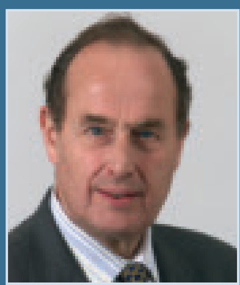


James Ferguson BA, aged 59, was chairman and managing director of Stewart Ivory Limited from 1989 until 2000. He is chairman of Value & Income Trust plc, The Monks Investment Trust PLC and The Scottish Oriental Smaller Companies Trust plc, a non-executive director of Lloyds TSB Scotland plc, Edinburgh US Tracker Trust plc and Independent Investment Trust plc and a former deputy chairman of the Association of Investment Companies.



Chris Fleetwood BA FCA, aged 55, held a number of positions in manufacturing businesses and was group chief executive of Whessoe plc from 1988 until 2000. He is now managing partner of io solutions, e-business strategy advisers. He is chairman of the North East Regional Portal 2001 Limited and a non-executive director of Chieftain Group plc and a number of other companies.

Tim Levett MBA, aged 57, is the investment director of Northern Venture Managers Limited. He is a non-executive director of several unquoted companies.



Barry Sealey CBE MA, aged 70, was managing director of Christian Salvesen plc from 1981 to 1990. He is now an active business angel investor and is a non-executive director of a number of companies.

Advisers

Secretary and Registered Office
Christopher Mellor FCA MSI
Northumberland House
Princess Square
Newcastle upon Tyne NE1 8ER
Telephone: 0191 244 6000
Fax: 0191 244 6001
E-mail: n3vct@nvm.co.uk

Registered Number
4280530

Investment Manager
Northern Venture Managers Limited
Northumberland House
Princess Square
Newcastle upon Tyne NE1 8ER

Fixed-interest Investment Advisers
Sarasin Chiswell
Juxon House
100 St Paul's Churchyard
London EC4M 8BU

Independent Auditors
KPMG Audit Plc
Saltire Court
20 Castle Terrace
Edinburgh EH1 2EG

Taxation Advisers
PricewaterhouseCoopers LLP
1 Embankment Place
London WC2N 6RH

Solicitors
Dickinson Dees
St Ann's Wharf
112 Quayside
Newcastle upon Tyne NE99 1SB

SJ Berwin LLP
10 Queen Street Place
London EC4R 1BE

Stockbrokers
Brewin Dolphin Securities Ltd
Commercial Union House
39 Pilgrim Street
Newcastle upon Tyne NE1 6RQ

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

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

Business Review

This review has been prepared by the directors in accordance with the requirements of Section 234ZZB of the Companies Act 1985, and forms part of the directors' report to shareholders. The company's independent auditors are required by law to report on whether the information given in the directors' report (including the business review) is consistent with the financial statements. The auditors' opinion is included in their report on page 27.

Objectives and investment strategy

The company's objective is to provide high long-term tax-free returns to investors through a combination of dividend yield and capital growth, by investing in a portfolio mainly comprising holdings in unquoted UK companies.

The company obtained provisional approval as a Venture Capital Trust when launched. Since then it has satisfied the requirements for full approval as a Venture Capital Trust by HM Revenue & Customs for the purposes of Section 842AA of the Income and Corporation Taxes Act 1988. In order to maintain its approved status the company is required to comply with certain legislative requirements, and in particular to ensure that not less than 70% of its investments comprise VCT qualifying holdings as defined in the legislation, of which at least 30% must take the form of eligible ordinary shares. The company's investments are managed with a view to ensuring that these conditions are observed at all times.

Investments are structured primarily with a view to capital growth but where appropriate income-yielding instruments are used, typically in the form of preference shares or loan stock redeemable over a five to seven year period.

Investment management

Northern Venture Managers Limited (NVM) has acted as the company's investment manager since inception. NVM has an experienced team of venture capital executives based in its offices in Newcastle upon Tyne, Edinburgh and Reading and currently has approximately £180 million under management in five venture capital funds. Northern 3 VCT is entitled to participate, pro rata to its net assets, in all investment opportunities generated by NVM.

The board's management engagement committee reviews the terms of NVM's appointment as investment manager on a regular basis. With effect from 1 October 2005 it was agreed that NVM's management fee would be reduced from 2.5% to 2.0% per annum of net assets, but with provision for an additional fee to be earned subject to exceeding an annual performance target set by the board. In addition, a new performance incentive scheme was introduced during the year under which NVM investment executives are required to co-invest in the ordinary shares of those companies in which Northern 3 VCT and other funds managed by NVM invest.

Overview of the year

During the year under review Northern 3 VCT achieved a total return to ordinary shareholders, before dividends, of 3.1p per share, equivalent to 3.2% of the opening net asset value per share (as re-stated) of 95.8p. The movement in total net assets and net asset value per share is summarised in the table at the top of page 7.

Investment activity was at a lower level than in the previous year. The flow of new opportunities remained strong, but competitive pressures reflecting the high level of VCT fund-raising over the past two years meant that the price of new deals often reached unacceptable levels. The net cash outflow relating to the portfolio was £1.7 million, comprising new investments of £2.9 million less disposal proceeds of £1.2 million.

After taking account of other cash flows, the company's total bank balances decreased over the year by £2.0 million to £3.6 million. In addition the company holds readily realisable listed fixed-interest investments totalling £13.2 million.

	£000	Pence per share
Net asset value at 30 September 2005 (re-stated)	**30,136**	**95.8**
Net revenue (investment income less revenue expenses and tax)	760	2.4
Capital surplus/(deficit) arising on investments:		
Realised losses on disposals	(106)	(0.3)
Unrealised revaluation movements	605	1.9
Management expenses allocated to capital account (net of tax relief)	(342)	(1.1)
Proceeds of issue of new shares (net of expenses)	126	—
Shares re-purchased for cancellation	(745)	0.2
Total return for the year before dividends	**298**	**3.1**
Net asset value at 30 September 2006 before dividends recognised	**30,434**	**98.9**
Dividends recognised in the financial statements for the year	(1,153)	(3.7)
Net asset value at 30 September 2006	**29,281**	**95.2**

Income and revenue return

Investment income attributable to ordinary shareholders totalled £1.37 million, an increase of 11.4% over the preceding year. There was no change in the revenue return per share which remained at 2.4p.

Dividends

The directors have declared dividends of 4.0p per share in respect of the year, comprising 2.0p revenue dividend and a 2.0p capital distribution.

Investment portfolio

During the year ended 30 September 2006, eight new holdings were added to the venture capital portfolio at a cost of £2.8 million, and additional investments totalling £0.1 million were made in existing portfolio companies. The portfolio at 30 September 2006 comprised 39 holdings with an aggregate value of £12.0 million. A summary of the portfolio is given on page 12, with information on the fifteen largest investments on pages 13 to 16.

Portfolio cash flow over the past five years is summarised in the following table:

Year ended	New investment £000	Disposal proceeds £000	Net outflow £000
30 September 2002	1,279	—	1,279
30 September 2003	1,978	368	1,610
30 September 2004	2,207	1,028	1,179
30 September 2005	4,733	288	4,445
30 September 2006	2,867	1,183	1,684
Total	**13,064**	**2,867**	**10,197**

New investments

The new investments completed during the year were:

- Inspicio (£100,000) – AIM-quoted provider of inspection and testing services, London
- Intercytex Group (£250,000) – AIM-quoted drug development company specialising in human cell therapy, Cambridge

Business Review

- **Adept Telecom** (£235,000) – AIM-quoted provider of telecommunications services, Tunbridge Wells
- **Wear Inns** (£282,000) – owner of managed public houses, Newcastle upon Tyne
- **Twenty** (£198,000) – AIM-quoted marketing services group, Northampton
- **Nightingales Holdings** (£992,000) – mail order retailer of women's clothing, Craven Arms
- **Touchstone Asset Management** (£593,000) – provider of property management services, Bath
- **Hat Pin** (£149,000) – AIM-quoted provider of executive search and recruitment services, London

Investment realisations

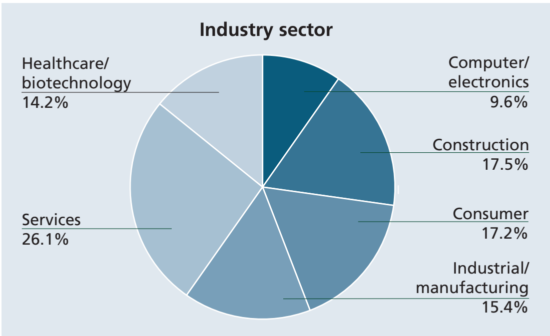
Details of investment sales during the year are given in Note 10 on page 35. The most significant disposals (original cost or sales proceeds in excess of £0.2 million) in the year are summarised in the following table:

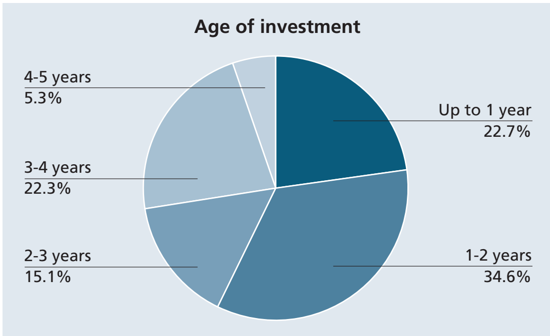
Company	Date of original investment	Original cost £000	Sale proceeds £000	Realised surplus/ (deficit) £000
AFI Aerial Platforms	2004	162	435	273
Omnico Plastics	2004	333	666	333
SMS Agencies	2004	500	—	(500)

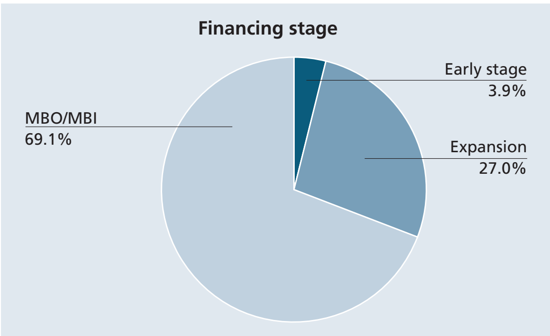
The investment in **AFI Aerial Platforms** was sold for cash to a venture capital investor as part of a deal involving a merger with another access equipment business. **Omnico Plastics** was sold for cash to SIG plc. As reported at the interim stage, **SMS Agencies** went into receivership in February 2006 following a period of poor trading.

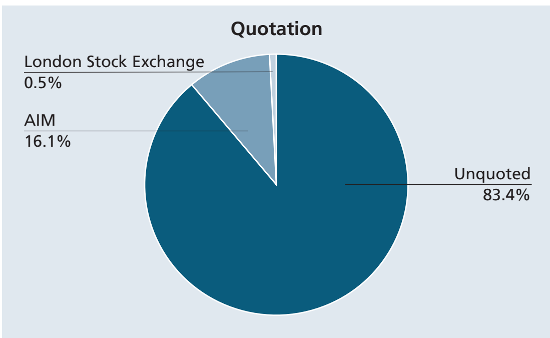
Portfolio composition

The following pie charts show the composition of the investment portfolio at 30 September 2006 according to industry sector, age, financing stage and whether quoted or unquoted. The portfolio is well diversified and we have continued to invest primarily in manufacturing and service businesses which meet our key criteria of good value, growth potential, strong management and ability to generate cash.









The unquoted portfolio has generally made good progress, with particularly strong performance from John Laing Partnership which is now the largest investment by value. Amongst the AIM-quoted holdings Computer Software Group had an excellent year, with the shares doubling in value, but the benefit of this was offset by price falls elsewhere.

Valuation policy

Unquoted investments are valued in accordance with the accounting policy set out on page 31, which takes account of the British Venture Capital Association's guidelines for the valuation of venture capital portfolios. Provision against cost is made where an investment is under-performing significantly, and no investment is revalued upwards within 12 months of its acquisition.

As at 30 September 2006 the number of investments falling into each valuation category was as follows:

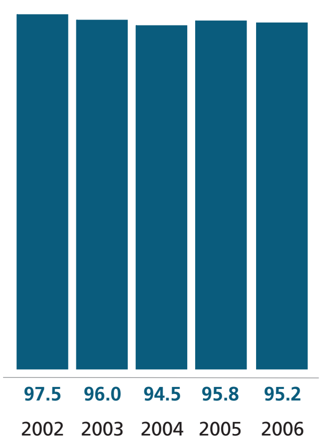
Category	Number of investments	Valuation £000	% of portfolio by value
Quoted investments at bid price			
Listed on London Stock Exchange	1	58	0.5
Quoted on Alternative Investment Market	12	1,939	16.1
Unquoted investments at directors' valuation			
Original cost	12	4,823	40.2
Original cost less provision	6	1,032	8.6
Earnings multiple	7	3,610	30.1
Net asset value	1	547	4.5
Total	**39**	**12,009**	**100.0**

Key performance indicators

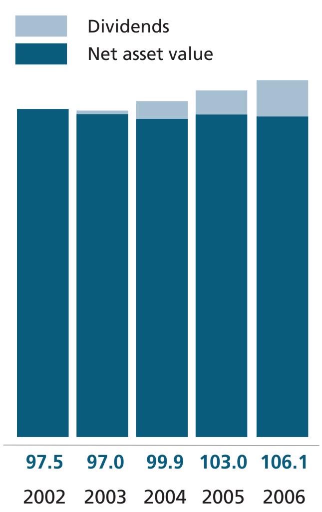
The directors regard the following as the key indicators pertaining to the company's performance:

Net asset value and total return to shareholders: the following charts show the movement in net asset value and total return (net asset value plus cumulative dividends) per ordinary share over the past five years:

Net asset value per share



Net asset value plus cumulative dividends paid per share

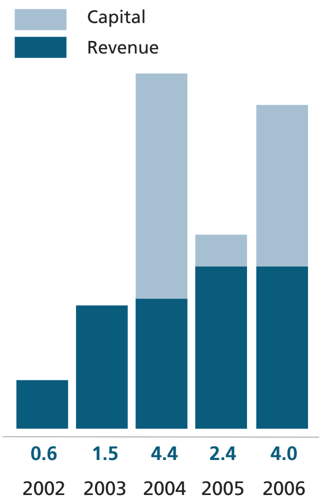


Years ended 30 September; figures in pence per share; net asset values for years to 30 September 2005 have been re-stated.

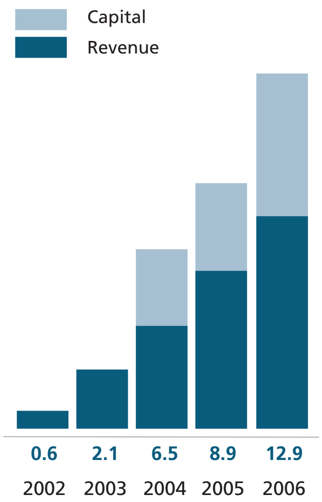
Business Review

Dividend distributions: the following charts show the ordinary dividends (revenue and capital) declared in respect of each of the past five financial years and on a cumulative basis since inception:

Dividend per share

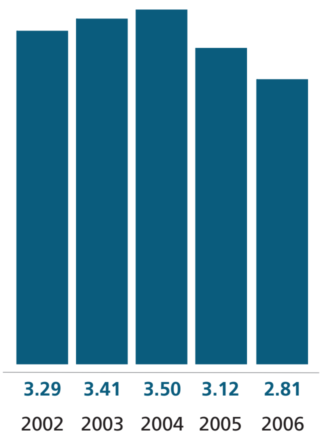


Cumulative dividends per share



Total expense ratio: the following chart shows total annual running expenses (including investment management fees charged to capital reserve) as a percentage of the average net assets attributable to ordinary shareholders for each of the past five years:

Total expense ratio



Maintenance of VCT qualifying status: the directors believe that the company has at all times since inception complied with the VCT qualifying conditions laid down by HM Revenue & Customs.

Risk management

The board carries out a regular review of the risk environment in which the company operates. The main areas of risk identified by the board are as follows:

Investment risk: the majority of the company's investments are in small and medium-sized unquoted companies which are VCT qualifying holdings, and which by their nature entail a higher level of risk and lower liquidity than investments in large quoted companies. The directors aim to limit the risk attaching to the portfolio as a whole by careful selection and timely realisation of investments, and by maintaining a wide spread of holdings in terms of financing stage, industry sector and geographical location. The board reviews the investment portfolio with the investment managers on a regular basis.

Financial risk: as most of the company's investments involve a medium- to long-term commitment and are relatively illiquid, the directors consider that it is inappropriate to finance the company's activities through borrowing except on an occasional short-term basis. Accordingly they seek to maintain a proportion of the company's assets in cash or cash equivalents in order to be in a position to take advantage of new unquoted investment opportunities. The company has very little exposure to foreign currency risk and does not enter into derivative transactions.

Internal control risk: the board regularly reviews the system of internal controls, both financial and non-financial, operated by the company and the manager. These include controls designed to ensure that the company's assets are safeguarded and that proper accounting records are maintained.

VCT qualifying status risk: the company is required at all times to observe the conditions laid down in the Income and Corporation Taxes Act 1988 for the maintenance of approved VCT status. The loss of such approval could lead to the company losing its exemption from corporation tax on capital gains, to investors being liable to pay income tax on dividends received from the company and, in certain circumstances, to investors being required to repay the initial income tax relief on their investment. The manager keeps the company's VCT qualifying status under continual review and reports to the board on a quarterly basis. The board has also retained PricewaterhouseCoopers LLP to undertake an independent VCT status monitoring role.

Future prospects

The priority for the next 18 months is to achieve an increase in the rate of new investment, without compromising on quality and value standards, so as to ensure that the VCT qualifying requirements continue to be met. Our managers report that deal flow is currently strong. The venture capital portfolio is still relatively immature but should be capable of generating good returns as the holdings develop.

By order of the Board

C D Mellor
Secretary

17 November 2006

Investment Portfolio

as at 30 September 2006

	Cost £000	Valuation £000	% of net assets by value
Fifteen largest venture capital investments (see pages 13 to 16)			
John Laing Partnership	305	1,014	3.5
Nightingales Holdings	992	992	3.4
IG Doors	500	683	2.3
Pivotal Laboratories Holdings	679	679	2.3
Envirotec	455	658	2.2
Touchstone Asset Management	593	593	2.0
Longhirst Group	480	547	1.9
Crantock Bakery	442	442	1.5
Abermed Group	375	375	1.3
Arleigh International	210	346	1.2
Arrow Industrial Group	245	344	1.2
KCS Global Holdings	338	338	1.2
Direct Valeting	427	320	1.1
Cello Group*	251	319	1.1
Ithaca Holdings	307	307	1.0
	6,599	**7,957**	**27.2**
Other venture capital investments			
LEDA Holdings	385	289	1.0
S&P Coil Products	240	285	1.0
Wear Inns	282	282	1.0
LiquidLogic	165	281	0.9
Computer Software Group*	135	271	0.9
DxS	263	263	0.9
Warmseal Windows (Newcastle)	339	254	0.9
RBF Industries	251	251	0.8
Adept Telecom*	235	236	0.8
e-know.net	225	225	0.8
Intercytex Group*	250	187	0.6
Andor Technology*	201	183	0.6
Hat Pin*	149	151	0.5
Twenty*	198	148	0.5
GB Industries	591	148	0.5
PM Group*	108	133	0.5
Inspicio*	100	130	0.4
Daniolabs	75	75	0.3
Oxonica*	45	70	0.2
Fountains*	84	67	0.2
Alizyme**	15	58	0.2
Spectrum Interactive*	163	44	0.2
Survey Inspection Systems	85	21	0.1
GSM-Central	78	—	—
Total venture capital investments	**11,261**	**12,009**	**41.0**
Total listed fixed-interest investments	13,348	13,229	45.2
Total fixed asset investments	**24,609**	**25,238**	**86.2**
Net current assets		4,043	13.8
Net assets		**29,281**	**100.0**

* Quoted on Alternative Investment Market

** Listed on London Stock Exchange

Fifteen Largest Venture Capital Investments

JOHN LAING PARTNERSHIP LIMITED

Cost	**£305,000**
Valuation	**£1,014,000**
Basis of valuation	Earnings multiple
Equity held	5.2%
Business/location	Housebuilder, Elstree
History	Management buy-out from John Laing plc, September 2003, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends £12,000, loan stock interest £17,000

Audited financial information:

Year ended 31 December	**2005 £m**	2004* £m
Sales	**57.9**	64.8
Profit before tax	**1.0**	0.1
Retained profit	**0.7**	0.1
Net assets	**1.5**	0.8

* 16 months ended 31 December

NIGHTINGALES HOLDINGS LIMITED

Cost	**£992,000**
Valuation	**£992,000**
Basis of valuation	Cost
Equity held	9.5%
Business/location	Mail order retailer of women's clothing, Craven Arms
History	Management buy-in/buy-out from private ownership, April 2006, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends nil, loan stock interest £32,000

Audited financial information:

First audited accounts will be for the period to 31 August 2006

IG DOORS LIMITED

Cost	**£500,000**
Valuation	**£683,000**
Basis of valuation	Earnings multiple
Equity held	5.0%
Business/location	Manufacture of steel and GRP composite doors, Cwmbran
History	Management buy-out from Expamet International, November 2003, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends £3,000, loan stock interest £81,000

Audited financial information:

Year ended 31 December	**2005 £m**	2004* £m
Sales	**18.0**	19.0
Profit/(loss) before tax	**0.6**	(0.5)
Retained profit/(loss)	**0.5**	(0.4)
Net assets	**0.5**	0.3

* 14 months ended 31 December

PIVOTAL LABORATORIES HOLDINGS LIMITED

Cost	**£679,000**
Valuation	**£679,000**
Basis of valuation	Cost
Equity held	8.7%
Business/location	Laboratory analysis service for clinical trials,York
History	Management buy-out from private ownership, August 2005, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends nil, loan stock interest £25,000

Audited financial information:

Period ended 31 October	**2005* £m**
Sales	**0.9**
Profit before tax	**0.1**
Retained profit	**—**
Net assets	**0.8**

* 2 months ended 31 October

Fifteen Largest Venture Capital Investments

ENVIROTEC LIMITED

Cost	**£455,000**
Valuation	**£658,000**
Basis of valuation	Earnings multiple
Equity held	4.9%
Business/location	Manufacture of hot air curtains and air handling equipment, High Wycombe
History	Management buy-out from institutional investor, January 2005, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends £4,000, loan stock interest £37,000

Audited financial information:

Year ended 28 February	**2006 £m**	2005* £m
Sales	**6.0**	0.7
Profit before tax	**0.8**	0.1
Retained profit	**0.4**	—
Net assets	**1.3**	0.9

* 2 months ended 28 February

TOUCHSTONE ASSET MANAGEMENT LIMITED

Cost	**£593,000**
Valuation	**£593,000**
Basis of valuation	Cost
Equity held	5.3%
Business/location	Provider of property management services, Bath
History	Development capital investment, June 2006, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends nil, loan stock interest £10,000

Audited financial information:

First audited accounts will be for the period to 31 March 2007

LONGHIRST GROUP LIMITED

Cost	**£480,000**
Valuation	**£547,000**
Basis of valuation	Net asset value
Equity held	5.4%
Business/location	Provision of training and conference facilities, Morpeth
History	Management buy-out from public sector ownership, December 2002, led by NVM
Other NVM funds investing	Northern Investors Company, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends £4,000, loan stock interest £21,000

Audited financial information:

Year ended 31 March	**2006 £m**	2005 £m
Sales	**16.3**	16.8
(Loss)/profit before tax	**(1.6)**	0.4
Retained (loss)/profit	**(1.2)**	0.3
Net assets	**4.0**	2.1

CRANTOCK BAKERY LIMITED

Cost	**£442,000**
Valuation	**£442,000**
Basis of valuation	Cost
Equity held	6.2%
Business/location	Manufacture of premium hand-made Cornish pasties, Newquay
History	Management buy-out/buy-in from private ownership, October 2002, led by NVM
Other NVM funds investing	Northern Investors Company, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends nil, loan stock interest £19,000

Audited financial information:

Year ended 30 September	**2005 £m**	2004 £m
Sales	**6.5**	5.6
Profit before tax	**0.9**	—
Retained profit/(loss)	**0.4**	(0.1)
Net assets	**1.2**	0.8

Fifteen Largest Venture Capital Investments

ABERMED GROUP LIMITED

Cost	**£375,000**
Valuation	**£375,000**
Basis of valuation	Cost
Equity held	6.2%
Business/location	Provider of medical and occupational health services, Aberdeen
History	Management buy-out from private ownership, May 2005, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends nil, loan stock interest £29,000

Audited financial information:

Year ended 31 March	**2006 £m**
Sales	**5.0**
Profit before tax	**0.6**
Retained profit	**0.3**
Net assets	**0.6**

ARLEIGH INTERNATIONAL LIMITED

Cost	**£210,000**
Valuation	**£346,000**
Basis of valuation	Earnings multiple
Equity held	5.8%
Business/location	Supplier of spares and consumables for caravans and leisure boats, Nuneaton
History	Management buy-out from Firstserve Group, October 2004, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends £2,000, loan stock interest £19,000

Audited financial information:

Period ended 31 December	**2005* £m**
Sales	**6.3**
Profit before tax	**0.4**
Retained profit	**0.3**
Net assets	**0.6**

* 16 months ended 31 December

ARROW INDUSTRIAL GROUP LIMITED

Cost	**£245,000**
Valuation	**£344,000**
Basis of valuation	Earnings multiple
Equity held	5.6%
Business/location	Manufacture of industrial doors and curtains, Hull
History	Management buy-in from private ownership, October 2002, led by NVM
Other NVM funds investing	Northern Investors Company, Northern 2 VCT
Income in year	Dividends £5,000, loan stock interest £13,000

Audited financial information:

Year ended 30 September	**2005 £m**	2004 £m
Sales	**4.7**	4.6
Profit before tax	**0.4**	0.4
Retained profit	**0.2**	0.2
Net assets	**1.4**	1.2

KCS GLOBAL HOLDINGS LIMITED

Cost	**£338,000**
Valuation	**£338,000**
Basis of valuation	Cost
Equity held	4.7%
Business/location	Developer of human resources and payroll software and outsourcing services, Purley
History	Management buy-in/buy-out from RBDC, May 2005, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT, Northern AIM VCT
Income in year	Dividends nil, loan stock interest £6,000

Audited financial information:

Period ended 30 September	**2005* £m**
Sales	**1.6**
Loss before tax	**(0.6)**
Retained loss	**(0.6)**
Net assets	**0.4**

* 5 months ended 30 September

Fifteen Largest Venture Capital Investments

DIRECT VALETING LIMITED

Cost	**£427,000**
Valuation	**£320,000**
Basis of valuation	Cost less provision
Equity held	7.0%
Business/location	Car valeting contractor, Newcastle-under-Lyme
History	Management buy-out from private ownership, November 2004, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends £28,000, loan stock interest £21,000

Audited financial information:

Year ended 31 July	2005 £m
Sales	7.7
Profit before tax	0.2
Retained loss	(0.1)
Net assets	2.0

CELLO GROUP PLC

Cost	**£251,000**
Valuation	**£319,000**
Basis of valuation	Bid price (Alternative Investment Market)
Equity held	0.8%
Business/location	AIM-quoted marketing and communication services provider, London
History	The company floated on AIM in November 2004
Other NVM funds investing	Northern 2 VCT, Northern AIM VCT
Income in year	Nil

Audited financial information:

Year ended 31 December	2005 £m	2004* £m
Sales	52.1	9.4
Profit before tax	4.2	1.3
Retained profit	2.9	0.9
Net assets	45.5	33.5

* 8 months ended 31 December

ITHACA HOLDINGS LIMITED

Cost	**£307,000**
Valuation	**£307,000**
Basis of valuation	Cost
Equity held	4.8%
Business/location	Integrated business-to-business media and exhibitions company, London
History	Management buy-out from Penton Inc, April 2005, led by NVM
Other NVM funds investing	Northern Investors Company, Northern Venture Trust, Northern 2 VCT
Income in year	Dividends nil, loan stock interest £21,000

Audited financial information:

Year ended 31 December	2005 £m
Sales	6.0
Profit before tax	0.5
Retained profit	0.4
Net assets	0.3

The directors present their report and the audited financial statements for the year ended 30 September 2006.

Activities and status

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

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

The directors are required by the Articles of Association to propose an ordinary resolution that the company should continue as a venture capital trust for a further five year period at the tenth annual general meeting of the company and at each fifth subsequent annual general meeting of the company.

Business review

The directors are required by Section 234ZZB of the Companies Act 1985 to include a business review in their report to shareholders. The business review is set out on pages 6 to 11 and is included in the directors' report by reference.

Results and dividend

The return on ordinary activities after tax for the year of £917,000 has been transferred to reserves.

The final dividend of 1.7p per share in respect of the year ended 30 September 2005 and an interim dividend of 2.0p per share in respect of the year ended 30 September 2006 were paid during the year at a cost of £1,153,000 and have been charged to reserves.

The proposed second interim dividend of 2.0p per share in respect of the year ended 30 September 2006 will be paid on 19 January 2007 to shareholders on the register on 15 December 2006.

Provision of information to auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Directors

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

	30 September 2006	1 October 2005
J R Hustler (Chairman)	25,100	25,100
J G D Ferguson	102,800	102,800
C J Fleetwood	15,300	15,300
T R Levett	106,500	106,500
B E Sealey	46,100	46,100

All of the directors' share interests shown above were held beneficially. There have been no changes in the directors' share interests between 30 September 2006 and the date of this report.

Brief biographical notes on the directors are given on page 4. Mr J G D Ferguson and Mr T R Levett retire from the board by rotation in accordance with the Articles of Association and offer themselves for re-election.

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

Directors' and officers' liability insurance

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

Creditor payment policy

The company's payment policy for the forthcoming financial year is to agree terms of payment before business is transacted and to settle accounts in accordance with those terms. There were no amounts owing to trade creditors at 30 September 2006.

Directors' Report

Management

Northern Venture Managers Limited (NVM) has acted as investment adviser and manager to the company since incorporation. The principal terms of the company's management agreement with NVM are set out in Note 4 to the financial statements. Mr T R Levett is an executive director of NVM and a shareholder in its ultimate parent company, NVM Group Limited.

A performance incentive scheme was established during the year, whereby investment executives employed by NVM are required to invest personally (and on the same terms as Northern 3 VCT and other funds managed by NVM) in the ordinary share capital of investee companies in which the funds invest. The co-investing executives are required to subscribe as follows:

- where the investment comprises a mixture of ordinary shares and loans or redeemable preference shares, 5% of the aggregate amounts invested in ordinary shares at the same time by the funds; or
- where the investment is structured entirely as ordinary shares (including investments quoted on AIM), 1% of the aggregate amount invested at the same time by the funds; or
- where a further investment is made in an existing portfolio company, 1% of the entire investment "strip" (ie ordinary shares and any other investment instruments) invested at the same time by the funds.

All investments in unquoted companies made by executives under the scheme will be realised at the same time as, and on the same terms as, the corresponding investments made by the funds. Investments quoted on AIM may be realised after not less than 12 months or, if earlier, when the funds' corresponding investments have been realised.

Fixed assets

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

Share capital

During the year the company purchased for cancellation 857,930 of its own shares, representing 2.7% of the called-up share capital of the company, for a consideration of £745,000. 152,263 new ordinary shares of 5p were issued for a cash consideration of £145,000 through the company's dividend investment scheme.

Substantial shareholdings

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

Annual general meeting – special business

Renewal of directors' authority to allot shares

Resolution 8 in the notice of meeting on pages 41 and 42, which will be proposed as an ordinary resolution, is to renew the general authority granted to the directors at the annual general meeting held on 18 January 2006 to allot equity shares in the company. This resolution, if passed, gives the directors authority to allot shares up to a maximum nominal value of £962,184 (representing 62.5% of the issued share capital of the company at the date of the notice convening the annual general meeting).

This authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in June 2008) or, if earlier, 15 months from the date of the passing of the resolution, except insofar as commitments to allot shares have been entered into before that date. The directors have no present intention of exercising the authority granted by Resolution 8 except in connection with the issue of ordinary shares pursuant to the dividend investment scheme.

Disapplication of pre-emption rights

Resolution 9, which will be proposed as a special resolution, supplements the directors' authority to allot shares in the company given to them by Resolution 8. The resolution, if passed, is to substitute any power previously conferred upon the directors (save to the extent relied upon prior to the passing of Resolution 9) and authorises the directors to allot equity shares for cash otherwise than pro rata to existing shareholders and pursuant to the authority granted to the directors by Resolution 8 up to a total nominal value of £153,781 (representing 10% of the company's issued share capital at the date of the notice convening the annual general meeting).

The authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in June 2008) or, if earlier, 15 months from the date of the passing of the resolution.

Purchase of ordinary shares by the company

Resolution 10, which will be proposed as a special resolution, will, if passed, authorise the company to purchase in the market up to 3,075,631 ordinary shares (equivalent to 10% of the issued ordinary share capital) at a minimum price of 5p per share and a maximum price per share of not more than the lower of (i) net asset value per share and (ii) the higher of 105% of the average market value for the ordinary shares in the company for the five business days prior to the date on which the ordinary shares are purchased and the price stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation 2003. Unless previously renewed, varied or revoked, the authority will be effective until the conclusion of the next annual general meeting of the company (expected to be held in June 2008) or, if earlier, 15 months from the date of the passing of the resolution.

Purchases of ordinary shares will be made only within the guidelines established and to be reviewed from time to time by the directors, and where it is considered that such purchases would be to the advantage of the company and its shareholders as a whole. It is the directors' intention that purchases will be made in the market for cash only at prices below the prevailing net asset value per share, thereby enhancing the net asset value per share for the company's remaining shareholders. Purchases will be financed from the company's own cash resources or, if appropriate, from short term borrowings.

Under the Listing Rules, the maximum price which can be paid by the company is the higher of 105% of the average market value of the ordinary shares in the company for the five business days prior to the date on which the ordinary shares were purchased and the price stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation 2003. The purchase of shares will involve a stamp duty cost to the company of approximately 0.5% of the purchase price. Shares which are purchased will be cancelled (and the number of the company's shares in issue will be reduced accordingly).

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

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

Reduction of share premium account

Resolution 11, which will be proposed as a special resolution, is to seek shareholders' approval to reduce the share premium account of the company by £15,000,000. Upon reduction of the share premium account, a distributable reserve will be created which can be used by the board for the payment of dividends and market purchases of the company's shares.

Once shareholders have approved the reduction of the company's share premium account, it will be necessary for the company to petition the High Court to seek its confirmation of the reduction. It is expected that the Court order confirming the reduction of the share premium account will be made in the first half of 2007. The reduction of the share premium account will take effect only when an office copy of the Court order is duly registered with the Registrar of Companies.

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

Independent auditors

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

By order of the Board

C D Mellor

Secretary 17 November 2006

Directors' Remuneration Report

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

The company's independent auditors, KPMG Audit Plc, are required to give their opinion on certain information included in this report, as indicated below. Their report on these and other matters is set out on page 27.

Board of directors

The board currently comprises five directors, all of whom are non-executive. The board does not have a separate remuneration committee, as the company has no employees or executive directors. The board has established a nomination committee, chaired by Mr J R Hustler and comprising all the directors, which considers the selection and appointment of directors and makes recommendations to the board as to the level of directors' fees. The board has not retained external advisors in relation to remuneration matters but has access to information about directors' fees paid by other companies of a similar size and type.

Remuneration policy

The board considers that directors' fees should reflect the time commitment required and the high level of responsibility borne by directors, and should be broadly comparable to those paid by similar companies. It is not considered appropriate that directors' remuneration should be performance-related, and none of the directors is eligible for bonuses, pension benefits, share options, long-term incentive schemes or other benefits in respect of their services as non-executive directors of the company. Mr T R Levett is entitled to participate in performance incentive arrangements established for the benefit of certain executives of Northern Venture Managers, as described in the Directors' Report on page 18.

Directors' fees were reviewed by the nomination committee during its meeting in September 2006, when it was recommended that fees should be increased to £17,500 (previously £15,000) per annum for the chairman and £13,000 (previously £12,500) for other directors for the year ending 30 September 2007. The Articles of Association place an overall limit (currently £100,000 per annum) on directors' remuneration.

Directors' fees (audited information)

The following fees were paid to individual directors in respect of the years ended 30 September 2006 and 2005:

	Year ended 30 September 2006 £	Year ended 30 September 2005 £
J R Hustler (Chairman)	15,000	13,500
J G D Ferguson	12,500	10,750
C J Fleetwood	12,500	10,750
T R Levett	—	—
B E Sealey	12,500	10,750

Mr T R Levett waived his entitlement to directors' fees in respect of both periods. Mr B E Sealey's fees were paid to Morago Limited in consideration for his services.

Terms of appointment

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

Company performance

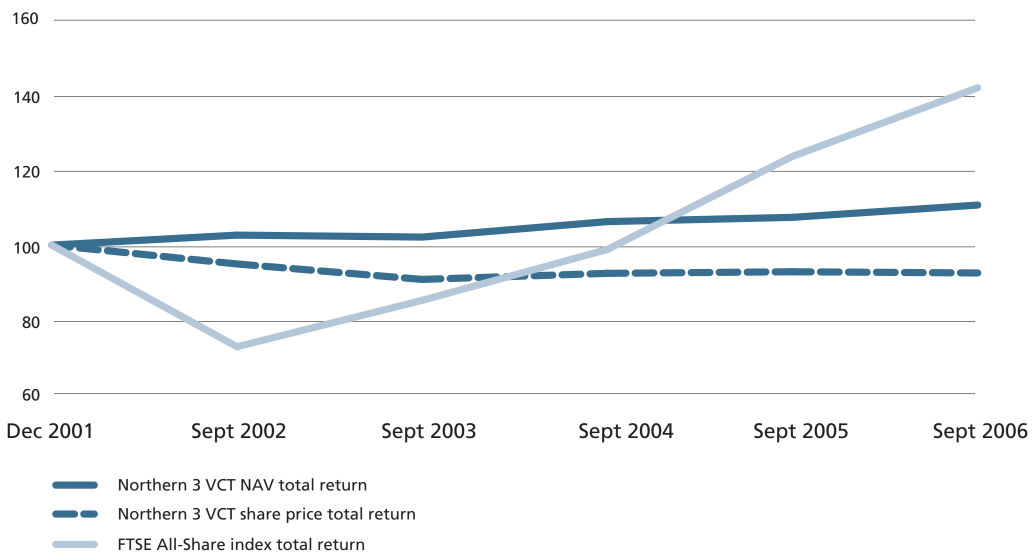
The graph below compares the total return (assuming all dividends are re-invested) to ordinary shareholders in the company over the period from 31 December 2001 to 30 September 2006 with the total return from a notional investment in the FTSE All-Share index over the same period. This index is considered to be the most appropriate broad equity market index for comparative purposes.

By order of the Board

C D Mellor
Secretary 17 November 2006

Return to shareholders in Northern 3 VCT PLC

Period to 30 September 2006 (December 2001 = 100)



Corporate Governance

The company is committed to maintaining high standards in corporate governance. The directors consider that the company has throughout the year under review complied in all material respects with the provisions of the revised Combined Code on corporate governance issued by the Financial Reporting Council in July 2003.

Board of directors

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

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

The board has established a formal process, led by the chairman, for the annual evaluation of the performance of the board, its principal committees and individual directors. The performance of the chairman is evaluated by a meeting of the other board members under the leadership of Mr C J Fleetwood. The directors are made aware on appointment that their performance will be subject to regular evaluation.

The company secretary, Mr C D Mellor, is responsible for advising the board, through the chairman, on all governance matters. All of the directors have access to the advice and services of the company secretary, who has administrative responsibility for the meetings of the board and its committees. Directors may also take independent professional advice at the company's expense where necessary in the performance of their duties. As all of the directors are non-executive, it is not considered appropriate to identify a member of the board as the senior non-executive director of the company.

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

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

Independence of directors

The board regularly reviews the independence of its members and is satisfied that (with the exception of Mr T R Levett who is a director and employee of NVM, the company's investment manager) the company's directors are independent in character and judgement and there are no relationships or circumstances which could affect their objectivity. Mr J R Hustler is also a non-executive director of Northern Venture Trust PLC, another venture capital trust managed by NVM, but after careful consideration the board has concluded that his independence is not affected by this relationship.

Board committees

The board has appointed three standing committees to make recommendations to the board in specific areas:

Audit Committee

During the year the audit committee comprised:
Mr C J Fleetwood (Chairman)
Mr J G D Ferguson
Mr B E Sealey

Under its terms of reference, the audit committee monitors the integrity of the company's financial statements and any formal announcements relating to the company's performance. It also reviews the investment manager's arrangements for enabling employees to raise matters of possible impropriety in confidence, with suitable subsequent follow-up action. The committee is responsible for monitoring the effectiveness of the external audit process and making recommendations to the board in relation to the appointment, re-appointment and remuneration of the external auditors. It is also responsible for ensuring that an appropriate relationship between the company and the external auditors is maintained, including reviewing non-audit services and fees. The committee reviews its terms of reference and its effectiveness annually and recommends to the board any changes required as a result of the review. The terms of reference are available on request from the company secretary.

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

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

During the year ended 30 September 2006 the audit committee discharged its responsibilities by:

- reviewing and approving the external auditors' terms of engagement and remuneration;
- reviewing the external auditors' plan for the audit of the company's financial statements, including identification of key risks and confirmation of auditor independence;
- reviewing NVM's statement of internal controls operated in relation to the company's business and assessing the effectiveness of those controls in minimising the impact of key risks;
- reviewing periodic reports on the effectiveness of NVM's compliance procedures;
- reviewing the appropriateness of the company's accounting policies;
- reviewing the company's draft annual financial statements and interim results statement prior to board approval; and
- reviewing the external auditors' detailed reports to the committee on the annual financial statements.

Nomination Committee

During the year the nomination committee comprised:
Mr J R Hustler (Chairman)
Mr J G D Ferguson
Mr C J Fleetwood
Mr T R Levett
Mr B E Sealey

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

The board does not have a separate remuneration committee, as the company has no employees or executive directors. Detailed information relating to the remuneration of directors is given in the Directors' Remuneration Report on pages 20 and 21.

Corporate Governance

Management Engagement Committee

During the year the management engagement committee comprised:
Mr J R Hustler (Chairman)
Mr J G D Ferguson
Mr C J Fleetwood
Mr B E Sealey

The management engagement committee undertakes a periodic review of the performance of the investment manager, NVM, and of the terms of the management agreement including the level of fees payable and the length of the notice period. The principal terms of the agreement are set out in Note 4 to the financial statements on page 33.

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

Attendance at board and committee meetings

The table at the foot of the page sets out the number of formal board and committee meetings held during the year ended 30 September 2006 and the number attended by each director compared with the maximum possible attendance.

Investor relations

In fulfilment of the chairman's obligations under the Combined Code, the chairman gives feedback to the board on issues raised with him by shareholders.

The board recognises the value of maintaining regular communications with shareholders. Formal reports are sent to shareholders at the interim and year-end stages, and an opportunity is given to shareholders at the annual general meeting to question the board and the investment manager on matters relating to the company's operation and performance. Proxy voting figures for each resolution are announced at the annual general meeting.

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

Internal control

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

	Board	Audit Committee	Nomination Committee	Management Engagement Committee
Number of meetings held	**5**	**3**	**1**	**1**
Attendance (actual/possible):				
J R Hustler (Chairman)	5/5	n/a	1/1	1/1
J G D Ferguson	5/5	3/3	1/1	1/1
C J Fleetwood	5/5	3/3	1/1	1/1
T R Levett	5/5	n/a	1/1	n/a
B E Sealey	4/5	2/3	1/1	1/1

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

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

Risk management

Risk management is discussed in the Business Review on page 11.

Directors' responsibilities

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

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

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

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

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements for the year ended 30 September 2006 comply with the requirements set out above and that suitable accounting policies, consistently applied and supported by reasonable and prudent judgement, have been used in their preparation. The directors are also responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

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

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

Going concern

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

Shareholder Information

The Company

Northern 3 VCT PLC is a Venture Capital Trust (VCT) launched in September 2001. It has raised a total of £32.2 million through its public share offers. The trust invests mainly in unquoted venture capital holdings, with its remaining assets invested in a portfolio of listed fixed-interest investments and bank deposits.

Northern 3 VCT PLC is managed by Northern Venture Managers Limited (NVM), an independent specialist firm of venture capital managers based in Newcastle upon Tyne, Edinburgh and Reading. NVM also acts as manager of four other listed investment companies, Northern Investors Company PLC, Northern Venture Trust PLC, Northern 2 VCT PLC and Northern AIM VCT PLC, and has a total of over £180 million under management.

Venture Capital Trusts

Venture Capital Trusts (VCTs) were introduced by the Chancellor of the Exchequer in the November 1994 Budget, the relevant legislation being contained in the Finance Act 1995. VCTs are intended to provide a means whereby private individuals can invest in small unquoted trading companies in the UK, with an incentive in the form of a range of tax benefits. With effect from 6 April 2006, the benefits to eligible investors include:

- income tax relief at up to 30% on new subscriptions of up to £200,000 per tax year, provided the shares are held for at least five years;
- exemption from income tax on dividends paid by VCTs (such dividends may include the VCT's capital gains as well as its income); and
- exemption from capital gains tax on disposals of shares in VCTs.

Subscribers for shares in VCTs between 6 April 2004 and 5 April 2006 were entitled to income tax relief at 40% rather than 30% and the shares had to be held for at least three years rather than five years. Prior to 6 April 2004, subscribers for shares in VCTs were entitled to income tax relief at 20% and could also obtain capital gains deferral relief. Capital gains deferred by pre-6 April 2004 subscriptions are not affected by the subsequent changes in tax reliefs.

Northern 3 VCT PLC obtained provisional approval as a Venture Capital Trust when launched. Since then it has satisfied the requirements for full approval as a Venture Capital Trust by HM Revenue & Customs for the purposes of Section 842AA of the Income and Corporation Taxes Act 1988. In order to maintain its approval the company must comply with certain requirements on a continuing basis; in particular, at least 70% of the proceeds of each new share issue must within three years be invested in “qualifying holdings”, of which at least 30% must be in eligible ordinary shares. A “qualifying holding” consists of up to £1 million invested in any one year in new shares or securities in an unquoted company (including companies quoted on AIM) which is carrying on a qualifying trade and whose gross assets do not exceed £15 million at the time of investment. The definition of “qualifying trade” excludes certain activities such as property investment and development, financial services and asset leasing. The gross assets limit has been reduced to £7 million for investments made using funds subscribed after 5 April 2006.

Share price

The company’s share price is carried daily in the Financial Times, the Daily Telegraph, the Newcastle Journal and The Herald. The company’s FTSE Actuaries classification is “Investment Companies”.

A range of shareholder information is provided on the internet by the company’s registrars, Lloyds TSB Registrars at www.shareview.co.uk, including details of shareholdings, indicative share prices and information on recent dividends (see page 5 for contact details for Lloyds TSB Registrars).

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

Dividend investment scheme

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

To the members of NORTHERN 3 VCT PLC

We have audited the financial statements of Northern 3 VCT PLC for the year ended 30 September 2006 which comprise the Income Statement, the Balance Sheet, the Reconciliation of Movements in Shareholders' Funds, the Cash Flow Statement, and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of directors and auditors

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

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

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

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

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 30 September 2006 and of its total return for the year then ended;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG AUDIT Plc
Chartered Accountants
Registered Auditor
Edinburgh 17 November 2006

Income Statement

for the year ended 30 September 2006

	Notes	Year ended 30 September 2006 Revenue £000	Capital £000	Total £000	Year ended 30 September 2005 As re-stated Revenue £000	Capital £000	Total £000
(Loss)/gain on disposal of investments	9	—	(106)	(106)	—	29	29
Unrealised adjustments to fair value of investments	9	—	605	605	—	491	491
		—	499	499	—	520	520
Income	3	1,372	—	1,372	1,232	—	1,232
Investment management fee	4	(167)	(502)	(669)	(158)	(475)	(633)
Other expenses	5	(180)	—	(180)	(180)	—	(180)
Return on ordinary activities before tax		1,025	(3)	1,022	894	45	939
Tax on return on ordinary activities	6	(265)	160	(105)	(233)	152	(81)
Return on ordinary activities after tax		760	157	917	661	197	858
Return per share	8	2.4p	0.5p	2.9p	2.4p	0.7p	3.1p

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

Reconciliation of Movements in Shareholders' Funds

for the year ended 30 September 2006

	Notes	Year ended 30 September 2006 £000	Year ended 30 September 2005 As re-stated £000
Equity shareholders' funds at 1 October 2005			
As previously reported		29,610	20,802
Prior year adjustment	2	526	865
As re-stated		30,136	21,667
Return on ordinary activities after tax		917	858
Dividends recognised in the year	7	(1,153)	(1,098)
Net proceeds of share issues		126	9,208
Shares purchased for cancellation		(745)	(499)
Equity shareholders' funds at 30 September 2006		29,281	30,136

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

Balance Sheet

as at 30 September 2006

	Notes	30 September 2006 £000	30 September 2005 As re-stated £000
Fixed assets			
Investments	9	25,238	24,042
Current assets			
Debtors	13	600	617
Cash at bank		3,606	5,631
		4,206	6,248
Creditors (amounts falling due within one year)	14	(163)	(154)
Net current assets		4,043	6,094
Net assets		29,281	30,136
Capital and reserves			
Called-up equity share capital	15	1,538	1,573
Share premium	16	22,759	22,641
Capital redemption reserve	16	77	34
Capital reserve – realised	16	3,703	5,031
Capital reserve – unrealised	16	629	324
Revenue reserve	16	575	533
Total equity shareholders' funds		29,281	30,136
Net asset value per share	17	95.2p	95.8p

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

The financial statements on pages 28 to 40 were approved by the directors on 17 November 2006 and are signed on their behalf by:

J R Hustler
Director

C J Fleetwood
Director

Cash Flow Statement

for the year ended 30 September 2006

	Year ended 30 September 2006 £000	Year ended 30 September 2006 £000	Year ended 30 September 2005 As re-stated £000	Year ended 30 September 2005 As re-stated £000
Net cash inflow from operating activities		525		204
Taxation				
Corporation tax paid		(81)		(24)
Financial investment				
Purchase of investments	(9,740)		(17,372)	
Sale/repayment of investments	9,043		6,028	
Net cash outflow from financial investment		(697)		(11,344)
Equity dividends paid		(1,153)		(1,098)
Net cash outflow before financing		(1,406)		(12,262)
Financing				
Issue of ordinary shares	145		9,698	
Share issue expenses	(19)		(490)	
Purchase of ordinary shares for cancellation	(745)		(499)	
Net cash (outflow)/inflow from financing		(619)		8,709
Decrease in cash at bank		(2,025)		(3,553)

Reconciliation of return before tax to net cash flow from operating activities

	2006 £000	2005 £000
Return on ordinary activities before tax	1,022	939
Loss/(gain) on disposal of investments	106	(29)
Unrealised adjustments to fair value of investments	(605)	(491)
Decrease/(increase) in debtors	17	(222)
(Decrease)/increase in creditors	(15)	7
Net cash inflow from operating activities	525	204

Analysis of movement in net funds

	1 October 2005 £000	Cash flows £000	30 September 2006 £000
Cash at bank	5,631	(2,025)	3,606

1 Accounting policies

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

a Basis of accounting

The financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial instruments, and in accordance with UK Generally Accepted Accounting Practice (UK GAAP). The adoption of new UK Financial Reporting Standards which became mandatory for the year ended 30 September 2006 has resulted in a number of changes in accounting policy, the effect of which is set out in Note 2. Where presentational guidance set out in the Statement of Recommended Practice (SORP) "Financial Statements of Investment Trust Companies", revised in December 2005, is consistent with the requirements of UK GAAP, the directors have sought to prepare the financial statements on a consistent basis compliant with the recommendations of the SORP.

b Investments

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

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

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

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

c Income

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

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

d Expenses

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

- expenses which are incidental to the acquisition or disposal of an investment are charged to capital return as incurred; and

1 Accounting policies continued

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

e Taxation

UK corporation tax payable is provided on taxable profits at the current rate. The tax charge for the year is allocated between revenue return and capital return on the "marginal basis" as recommended in the SORP.

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

f Dividends payable

Dividends payable are recognised as distributions in the financial statements when the company's liability to make payment has been established. This represents a change in accounting policy, the effect of which is set out in Note 2.

2 Changes in accounting policies

The company is required to comply with a number of new UK Financial Reporting Standards (FRS), which now represent UK Generally Accepted Accounting Practice (UK GAAP), in presenting its financial statements for the year ended 30 September 2006. These Standards have been introduced as part of the process of aligning UK accounting principles with International Accounting Standards. The revised accounting policies differ from those used in preparing the annual financial statements for the year ended 30 September 2005 in the following respects:

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

The comparative figures for the year ended 30 September 2005 have been re-stated accordingly.

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

	30 September 2005		1 October 2004	
	Net assets £000	Net asset value per share p	Net assets £000	Net asset value per share p
As reported under previous UK GAAP	29,610	94.1	20,802	93.4
Less: adjustment in valuation of quoted investments to bid price	(9)	—	(3)	—
Add: proposed dividends not accounted for until declared and paid	535	1.7	868	3.9
As reported under revised UK GAAP	30,136	95.8	21,667	97.3

3 Income	Year ended 30 September 2006 £000	Year ended 30 September 2005 £000
Franked investment income		
Unquoted companies	97	59
Quoted companies	9	5
Interest receivable		
Bank deposits	84	242
Treasury bills	—	6
Loans to unquoted companies	455	361
Listed fixed-interest investments	727	557
Sundry income	—	2
	1,372	1,232

4 Investment management fee	Year ended 30 September 2006 Revenue £000	Capital £000	Total £000	Year ended 30 September 2005 Revenue £000	Capital £000	Total £000
Investment management fee	142	427	569	135	404	539
Irrecoverable VAT thereon	25	75	100	23	71	94
	167	502	669	158	475	633

Northern Venture Managers Limited (NVM) provides investment management and secretarial services to the company under an agreement dated 24 September 2001. The agreement ran for an initial period of three years with effect from 19 October 2001 and may now be terminated at any time by not less than twelve months' notice being given by either party.

Until 30 September 2005 NVM's management fee was at a fixed rate of 2.5% per annum of net assets, calculated half-yearly as at 31 March and 30 September and payable quarterly in advance. With effect from 1 October 2005 the management fee comprises a fixed element of 2.0% plus a performance-related fee which is payable if the company's total return per share (net asset value growth plus dividends paid) in a financial year exceeds the annual target set by the board. The performance fee accrues on a sliding scale, from nil where total return is less than or equal to target up to a maximum of 1.0% where total return is equal to or greater than 200% of target. The target for the year ended 30 September 2006 was a total return equivalent to 3.5% of opening net asset value per share, but no performance fee was earned. The target for the year ending 30 September 2007 is a total return equivalent to 4.5% of opening net asset value per share. NVM's management fees are subject to VAT.

The total running costs of the company, excluding performance-related management fees and any irrecoverable VAT thereon, are capped at 3.5% of its net assets and NVM has agreed that any excess will be refunded by way of a reduction in its fees. NVM bears the cost of Sarasin Chiswell's fees for managing the listed fixed-interest portfolio.

NVM also provides administrative and secretarial services to the company for an annual fee equivalent to 0.25% of net assets, subject to an RPI-linked cap (£38,000 for the year ended 30 September 2006). This fee, which is subject to VAT, is included in other expenses (Note 5).

5 Other expenses	Year ended 30 September 2006 £000	Year ended 30 September 2005 £000
Administrative and secretarial services	38	38
Directors' remuneration	52	46
Auditors' remuneration – audit services	11	8
Irrecoverable VAT	15	16
Other expenses	64	72
	180	180

Information on directors' remuneration is given in the directors' remuneration report on pages 20 and 21.

6 Tax on return on ordinary activities	Year ended 30 September 2006 Revenue £000	Capital £000	Total £000	Year ended 30 September 2005 Revenue £000	Capital £000	Total £000
(a) Analysis of return for the year						
UK corporation tax payable/(recoverable) on the return for the year	265	(160)	105	233	(152)	81
(b) Tax reconciliation						
Return on ordinary activities before tax	1,025	(3)	1,022	894	45	939
Return on ordinary activities multiplied by the standard rate of UK corporation tax of 30% (2005 30%)	308	(1)	307	268	14	282
Effect of:						
UK dividends not subject to tax	(32)	—	(32)	(19)	—	(19)
Capital returns not subject to tax	—	32	32	—	(9)	(9)
Unrealised adjustments to fair value	—	(182)	(182)	—	(148)	(148)
Marginal relief	(11)	(9)	(20)	(16)	(9)	(25)
Current tax charge/(credit) for the year	265	(160)	105	233	(152)	81

(c) Factors which may affect future tax charges

The directors are not aware of any matters which may affect the tax charges in future periods. There is no provided or unprovided deferred tax as at 30 September 2006.

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

7 Dividends	Year ended 30 September 2006 Revenue £000	Capital £000	Total £000	Year ended 30 September 2005 Revenue £000	Capital £000	Total £000
(a) Recognised as distributions in the financial statements for the year						
Previous year's final dividend	409	126	535	245	623	868
Current year's first interim dividend	309	309	618	230	—	230
	718	435	1,153	475	623	1,098
(b) Paid and proposed in respect of the year						
Interim paid – 2.0p (2005 0.7p) per share	309	309	618	230	—	230
Second interim proposed – 2.0p (2005 Nil) per share	308	308	616	—	—	—
Final proposed – Nil (2005 1.7p) per share	—	—	—	409	126	535
	617	617	1,234	639	126	765

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

The proposed second interim dividend of 2.0p per share for the year ended 30 September 2006 has not been recognised as a liability in these financial statements.

8 Return per share

The calculation of the return per share is based on the return on ordinary activities after tax for the year of £917,000 (2005 £858,000) and on 31,170,737 (2005 27,500,452) shares, being the weighted average number of shares in issue during the year.

9 Fixed asset investments

		30 September 2006 £000	30 September 2005 As re-stated £000
Venture capital investments	– unquoted	10,012	8,433
	– quoted	1,997	1,301
Listed fixed-interest investments		13,229	14,308
		25,238	24,042

Movements in investments during the year are summarised as follows:

	Venture capital - unquoted £000	Venture capital - quoted £000	Listed fixed-interest £000	Total £000
Book cost at 1 October 2005	8,391	1,004	14,323	23,718
Unrealised appreciation at 1 October 2005				
– as previously reported	42	306	(15)	333
– prior year adjustment (Note 2)	—	(9)	—	(9)
– as re-stated	42	297	(15)	324
Valuation at 1 October 2005 (as re-stated)	8,433	1,301	14,308	24,042
Movements in the year:				
Purchases at cost	1,931	936	6,873	9,740
Disposals – proceeds	(1,148)	(35)	(7,860)	(9,043)
– net realised gains/(losses)	8	10	(124)	(106)
Movement in unrealised appreciation	788	(215)	32	605
Valuation at 30 September 2006	10,012	1,997	13,229	25,238
Comprising:				
Book cost at 30 September 2006	9,328	1,933	13,348	24,609
Unrealised appreciation at 30 September 2006	684	64	(119)	629
	10,012	1,997	13,229	25,238

At 30 September 2006 there were commitments totalling £2,612,000 (30 September 2005 £Nil) in respect of investments approved by the manager but not yet completed.

10 Investment disposals

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

	Original cost £000	Carrying value prior to disposal £000	Disposal proceeds £000	Realised gain/(loss) against carrying value £000
AFI Aerial Platforms	162	257	435	178
Alizyme*	7	25	35	10
Keith Prowse (deferred consideration)	—	—	47	47
Omnico Plastics	333	633	666	33
SMS Agencies	500	250	—	(250)
	1,002	1,165	1,183	18

* Part disposal

Notes to the Financial Statements

for the year ended 30 September 2006

11 Unquoted investments

The cost and carrying value of material investments in unquoted companies held at 30 September 2006 are shown below. For this purpose, any unquoted investment included in the table of the fifteen largest venture capital investments on pages 13 to 16, or in the corresponding table in the previous year's annual report, is regarded as material.

	30 September 2006		30 September 2005	
	Total cost £000	Carrying value £000	Total cost £000	Carrying value £000
John Laing Partnership Limited				
Ordinary shares	21	730	16	16
Irredeemable preference shares	44	44	44	44
Loan stock	240	240	240	240
	305	1,014	300	300
Nightingales Holdings Limited				
Ordinary shares	142	142	—	—
Loan stock	850	850	—	—
	992	992	—	—
IG Doors Limited				
Ordinary shares	50	233	50	50
Loan stock	450	450	450	450
	500	683	500	500
Pivotal Laboratories Holdings Limited				
Ordinary shares	68	68	68	68
Loan stock	611	611	611	611
	679	679	679	679
Envirotec Limited				
Ordinary shares	105	308	105	105
Loan stock	350	350	350	350
	455	658	455	455
Touchstone Asset Management Limited				
Ordinary shares	122	122	—	—
Loan stock	471	471	—	—
	593	593	—	—
Longhirst Group Limited				
Ordinary shares	150	217	150	165
Redeemable preference shares	150	150	150	150
Loan stock	180	180	180	180
	480	547	480	495
Crantock Bakery Limited				
Ordinary shares	90	90	90	166
Loan stock	352	352	352	352
	442	442	442	518

11 **Unquoted investments** continued	30 September 2006 Total cost £000	30 September 2006 Carrying value £000	30 September 2005 Total cost £000	30 September 2005 Carrying value £000
Abermed Group Limited				
Ordinary shares	38	38	38	38
Loan stock	337	337	337	337
	375	375	375	375
Arleigh International Limited				
Ordinary shares	21	157	21	21
Loan stock	189	189	189	189
	210	346	210	210
Arrow Industrial Group Limited				
Ordinary shares	35	134	35	156
Loan stock	210	210	210	210
	245	344	245	366
KCS Global Holdings Limited				
Ordinary shares	78	78	78	78
Loan stock	260	260	260	260
	338	338	338	338
Direct Valeting Limited				
Ordinary shares	43	—	43	43
Redeemable preference shares	210	146	210	210
Loan stock	174	174	174	174
	427	320	427	427
Ithaca Holdings Limited				
Ordinary shares	31	31	31	31
Loan stock	276	276	276	276
	307	307	307	307
LEDA Holdings Limited				
Ordinary shares	53	—	53	53
Loan stock	332	289	332	332
	385	289	385	385
Warmseal Windows (Newcastle) Limited				
Ordinary shares	34	—	34	91
Loan stock	305	254	305	305
	339	254	339	396
Omnico Plastics Limited				
Ordinary shares	—	—	33	333
Loan stock	—	—	300	300
	—	—	333	633

Additional information relating to material investments in unquoted companies is given on pages 13 to 16.

Notes to the Financial Statements

for the year ended 30 September 2006

12 Significant interests

There are no shareholdings in companies where the company's holding at 30 September 2006 represents (1) more than 20% of the allotted equity share capital of any class, (2) more than 20% of the total allotted share capital or (3) more than 20% of the assets of the company itself.

13 Debtors

	30 September 2006 £000	30 September 2005 £000
Prepayments and accrued income	600	617

14 Creditors (amounts falling due within one year)

	30 September 2006 £000	30 September 2005 As re-stated £000
Accruals and deferred income	58	73
Corporation tax payable	105	81
	163	154

15 Called-up equity share capital

	30 September 2006 £000	30 September 2005 £000
Authorised:		
50,000,000 (2005 50,000,000) ordinary shares of 5p	2,500	2,500
Allotted and fully paid:		
30,756,312 (2005 31,461,979) ordinary shares of 5p	1,538	1,573

During the year the company issued 152,263 ordinary shares of 5p for cash at an average premium of 89.7p per share in connection with the dividend investment scheme. 857,930 shares were repurchased for cancellation at a cost of £745,000.

16 Reserves

	Share premium £000	Capital redemption reserve £000	Capital reserve - realised £000	Capital reserve - unrealised £000	Revenue reserve £000
At 1 October 2005					
– as previously reported	22,641	34	4,905	333	124
– prior year adjustment (Note 2)	—	—	126	(9)	409
– as re-stated	22,641	34	5,031	324	533
Premium on issue of ordinary shares	137	—	—	—	—
Share issue expenses	(19)	—	—	—	—
Shares purchased for cancellation	—	43	(745)	—	—
Loss on disposal of investments	—	—	(106)	—	—
Previously recognised gains now realised	—	—	300	(300)	—
Unrealised adjustments to fair value of investments	—	—	—	605	—
Management fee capitalised net of associated tax	—	—	(342)	—	—
Revenue return on ordinary activities after tax	—	—	—	—	760
Dividends recognised in the year	—	—	(435)	—	(718)
At 30 September 2006	22,759	77	3,703	629	575

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

17 Net asset value per share

The calculation of net asset value per share as at 30 September 2006 is based on net assets of £29,281,000 (2005 £30,136,000) divided by the 30,756,312 (2005 31,461,979) ordinary shares in issue at that date.

18 Financial instruments

The company's financial instruments comprise equity and fixed-interest investments, cash balances and liquid resources.

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

The company has no derivative financial instruments and has no financial asset or liability for which hedge accounting has been used. All financial assets are held in sterling, hence there is no foreign currency exchange rate exposure.

Fixed asset investments are valued at fair value. For quoted investments this is either bid price or the latest traded price. In respect of unquoted investments, these are fair valued by the directors in accordance with the British Venture Capital Association's guidelines. Where no reliable fair value can be estimated, unquoted investments are carried at cost subject to provision for impairment where necessary. The fair value of all other financial assets and liabilities is represented by their carrying value in the balance sheet.

Market risk, credit risk and liquidity risk are discussed in the Business Review on page 11.

Some of the company's financial assets are interest-bearing, some of which are at fixed rates and some at variable. As a result, the company is subject to exposure to fair value interest rate risk due to fluctuations in prevailing levels of market interest rates.

At 30 September 2006 the company's financial assets by value, excluding short-term trade debtors and creditors as permitted by Financial Reporting Standard 25 "Financial Instruments: Disclosure and Presentation", comprised:

	£000	%	Interest rate	Weighted average interest rate %	Weighted average period for which rate is fixed years
Venture capital investments:					
Ordinary shares	5,255	18.2	N/A	N/A	N/A
Preference shares	340	1.1	Fixed	9.4	2.6
Loan stock – fixed rate	1,752	6.1	Fixed	8.4	3.1
Loan stock – floating rate	4,662	16.2	Floating	7.8	N/A
	12,009	41.6			
Listed fixed-interest investments	13,229	45.9	Fixed	5.5	3.1
Total fixed asset investments	25,238	87.5			
Bank deposits – interest-bearing	106	0.4	Floating	4.5	N/A
Bank deposits – non interest-bearing	3,500	12.1	N/A	Nil	N/A
	28,844	100.0			

18 **Financial instruments** continued

The corresponding figures at 30 September 2005 (as re-stated) were as follows:

	£000	%	Interest rate	Weighted average interest rate %	Weighted average period for which rate is fixed years
Venture capital investments:					
Ordinary shares	3,579	12.1	N/A	N/A	N/A
Preference shares	481	1.6	Fixed	8.8	3.6
Loan stock – fixed rate	2,397	8.1	Fixed	8.7	4.4
Loan stock – floating rate	3,277	11.0	Floating	7.7	N/A
	9,734	32.8			
Listed fixed-interest investments	14,308	48.2	Fixed	4.4	3.3
Total fixed asset investments	24,042	81.0			
Bank deposits – interest-bearing	1,931	6.5	Floating	4.2	N/A
Bank deposits – non interest-bearing	3,700	12.5	N/A	Nil	N/A
	29,673	100.0			

Notice is hereby given that the fifth annual general meeting of Northern 3 VCT PLC will be held at the City of London Club, 19 Old Broad Street, London EC2N 1DS at 11.30am on Wednesday 4 April 2007 for the following purposes:

As ordinary business

1 To receive the financial statements for the year ended 30 September 2006 and the directors' and independent auditors' reports thereon.

2 To approve the directors' remuneration report in respect of the year ended 30 September 2006.

3 To re-elect as a director Mr J G D Ferguson who retires by rotation in accordance with the Articles of Association and offers himself for re-election.

4 To re-elect as a director Mr T R Levett who retires by rotation in accordance with the Articles of Association and offers himself for re-election.

5 To re-appoint KPMG Audit Plc as independent auditors of the company until the conclusion of the next annual general meeting of the company.

6 To authorise the directors to fix the independent auditors' remuneration.

7 To transact any other ordinary business of the company.

As special business

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

"That, in substitution for and to the exclusion of any power previously conferred upon the directors in this regard, the directors be generally and unconditionally authorised for the purpose of Section 80 of the Companies Act 1985 ("the Act") to exercise all the powers of the company to allot relevant securities (within the meaning of Section 80(2) of the Act) up to an aggregate nominal amount of £926,184, provided that:

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

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

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

"That, in substitution for and to the exclusion of any power previously conferred upon the directors in this regard (save to the extent relied upon prior to the passing of this resolution), the directors be and are empowered to allot equity securities (as defined in Section 94(2) of the Act) pursuant to the authority conferred by Resolution 8 in the notice convening the 2007 annual general meeting as if Section 89(1) of the Act did not apply to any such allotment provided that the power conferred by this resolution shall be limited to the allotment of equity securities up to an aggregate nominal value of £153,781 and this power shall expire on the conclusion of the next annual general meeting of the company after the passing of this resolution or, if earlier, on the expiry of 15 months from the date of the passing of this resolution save that the company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities in pursuance of such offer or agreement as if the power conferred hereby had not expired."

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

"That the company be and is hereby generally and unconditionally authorised in accordance

Notice of Annual General Meeting

with Section 166 of the Act to make one or more market purchases (within the meaning of Section 163(3) of the Act) on the London Stock Exchange of ordinary shares of 5p each in the capital of the company provided that:

(a) the maximum number of ordinary shares hereby authorised to be purchased is 3,075,631, representing approximately 10% of the company's issued ordinary share capital;

(b) the minimum price which may be paid for an ordinary share shall be 5p per share;

(c) the maximum price which may be paid for an ordinary share shall not be more than the lower of (i) net asset value per share and (ii) the higher of 105% of the average market value for the ordinary shares of the company for the five business days prior to the date on which the ordinary shares are purchased and the price stipulated by Article 5(1) of the Buy-back and Stabilisation Regulation 2003; and

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

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

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

By order of the Board

C D MELLOR
Secretary 17 November 2006

Northumberland House
Princess Square
Newcastle upon Tyne NE1 8ER

NOTES

1 A member entitled to attend and vote at this meeting is entitled to appoint one or more proxies to attend and, on a poll, to vote in his stead. A proxy need not be a member of the company. The appointment of a proxy does not preclude a member from attending and voting in person at the meeting should he subsequently decide to do so.

2 To be valid, a form of proxy together with, if applicable, the power of attorney or other authority under which it is signed, or a certified copy thereof, must be received by Lloyds TSB Registrars at The Causeway, Worthing BN99 6DA not later than 11.30am on Monday 2 April 2007.

3 The company, pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, specifies that only those shareholders registered in the register of members of the company as at 6.00pm on Tuesday 3 April 2007 shall be entitled to attend or vote (whether on a show of hands or on a poll) at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the register after 6.00pm on Tuesday 3 April 2007 (or after 6.00pm on the day before any adjourned meeting) shall be disregarded in determining the rights of any person to attend or vote at the meeting.

4 None of the directors has a contract of service with the company. The register of directors' interests will be available for inspection on the day of the above meeting, at the place of the meeting, from at least 15 minutes prior to the meeting until its conclusion.

Form of Proxy

NORTHERN 3 VCT PLC
Annual General Meeting – 4 April 2007

I/We ____

(block capitals please)

of ____

being a member of Northern 3 VCT PLC, hereby appoint (see note 1)

____

or failing him/her the chairman of the meeting to be my/our proxy and vote for me/us on my/our behalf at the fifth annual general meeting of the company to be held on 4 April 2007, notice of which was sent to shareholders with the annual report and accounts for the year ended 30 September 2006, and at any adjournment thereof. The proxy will vote as indicated below in respect of the resolutions set out in the notice of meeting:

Resolution number		For	Against	Vote withheld
1	To receive the financial statements for the year ended 30 September 2006	☐	☐	☐
2	To approve the directors' remuneration report in respect of the year ended 30 September 2006	☐	☐	☐
3	To re-elect Mr J G D Ferguson as a director	☐	☐	☐
4	To re-elect Mr T R Levett as a director	☐	☐	☐
5	To re-appoint KPMG Audit Plc as independent auditors	☐	☐	☐
6	To authorise the directors to fix the remuneration of the independent auditors	☐	☐	☐
8	To authorise the directors to allot shares pursuant to Section 80 of the Companies Act 1985	☐	☐	☐
9	To disapply Section 89 of the Companies Act 1985 in relation to certain allotments of equity securities	☐	☐	☐
10	To authorise the company to make market purchases of ordinary shares in accordance with Section 166 of the Companies Act 1985	☐	☐	☐
11	To reduce the sum registered to the share premium account	☐	☐	☐

Signed: ______________________________ Date: ______________________

NOTES

1 A member wishing to appoint a person other than the chairman of the meeting as proxy should insert the name and address of such person in the space provided.

2 Use of the form of proxy does not preclude a member from attending and voting in person.

3 Where the form of proxy is executed by an individual it must be signed by that individual or his or her attorney.

4 Where the form of proxy is executed by joint shareholders it may be signed by any of the members, but the vote of the member whose name stands first in the register of members of the company will be accepted to the exclusion of the votes of the other joint holders.

5 Where the form of proxy is executed by a corporation it must be either under its seal or under the hand of an officer or attorney duly authorised.

6 If the form of proxy is signed and returned without any indication as to how the proxy shall vote, the proxy will exercise his/her discretion as to whether and how he/she votes.

7 To be valid, the form of proxy together with, if applicable, the power of attorney or other authority under which it is signed, or a certified copy thereof, must be received by Lloyds TSB Registrars at The Causeway, Worthing BN99 6DA not later than 11.30am on Monday 2 April 2007.

8 Only those shareholders registered in the register of members of the company as at 6.00pm on Tuesday 3 April 2007 shall be entitled to attend or vote (whether on a show of hands or on a poll) at the meeting in respect of the number of shares registered in their name at the time. Changes to entries on the register of members after 6.00pm on Tuesday 3 April 2007 (or after 6.00pm on the day before any adjourned meeting) shall be disregarded in determining the rights of any person to attend or vote at the meeting.

9 The "vote withheld" option is provided to enable a member to abstain from voting on the resolution; however, it should be noted that a "vote withheld" is not a vote in law and will not be counted in the calculation of the proportion of the votes "for" and "against" the resolution.

Attendance indication

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

I intend to attend the annual general meeting at 11.30am on Wednesday 4 April 2007 at the City of London Club, 19 Old Broad Street, London EC2N 1DS ☐

Signed: ______________________________ Date: ______________________

Third fold and tuck in

First Fold

BUSINESS REPLY SERVICE
Licence No. SEA 10850

LLOYDS TSB REGISTRARS
THE CAUSEWAY
WORTHING
BN99 6ZR

Second fold

Northern 3 VCT PLC
Northumberland House
Princess Square
Newcastle upon Tyne NE1 8ER

Tel: 0191 244 6000
Fax: 0191 244 6001
E-mail: n3vct@nvm.co.uk