

LABOUR-SPONSORED VENTURE FUNDS DOWN BUT NOT OUT; ATTRACTIVE RETURNS

By David Pett

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Faced with ongoing criticism and a growing lack of government support, labour-sponsored venture capital corporations (LSVCCs) are fighting hard to keep people from turning away.

It has been an uphill and largely unsuccessful battle to date, but with relative performance improving and still attractive tax savings on offer, there is hope from the sector that heading into the busiest sales week of the year, investors will stop to take another look.

"Based on the outcome of some funds in the asset class, a broader perception has developed that labour funds don't work," says John Varghese, managing partner of VentureLink.

"However, from an investment perspective, there is definitely value here. With Bank of Canada rates at 1%, you can't get a better return right now on the front end."

One of the knocks against labour-sponsored funds has been directed squarely at their performance over the years.

But with equity markets in freefall, returns are looking attractive. Through January, the Retail Venture Capital Peer Index returned -14.01% over the past year and -4.57% over the past five years. Over the same periods, the S&P/TSX Composite returned -31.08% and +2.0%, respectively. On the TSX Venture, returns were -65.59% and -50.78%.

Mr. Varghese's VentureLink family of funds has done particularly well in comparison to other equity investments, with the Brighter Futures Fund netting a one-year return through January of close to 2.4%. "These returns are net of fees and before the tax credit so once you lay the credit on top, they really have outperformed," Mr. Varghese says.

Dismal equity markets mean many investors are focused on tax savings this RRSP season. Much of that is being driven by all the attention surrounding the new Tax Free Savings Accounts of TFSAs, but Mr. Varghese points out that labour-sponsored investments also provide substantial tax savings to investors, with federal and provincial tax credits still worth up to 30% on an investment of \$7,500.

Investors appear to have lost sight of the tax incentive associated with LSVCCs, especially in Ontario, where the province announced in 2005 it would eliminate the 15% provincial tax credit in 2012.

Since that decision, annual fundraising and the total capital available to invest in Ontario's retail venture capital space has fallen at an accelerated pace and fundraisings are now expected to drop below \$50-million this year, compared with more than \$700-million at the start of the decade.

As a result, many funds are facing serious liquidity problems and have been forced to suspend redemptions.

"It's like a drug in its last year before going generic. Labour-sponsored funds are now viewed as a product at the end of its lifecycle and nobody wants to be the last one in," Mr. Varghese says.

Although VentureLink is not facing a liquidity crunch due to its strong cash position, he says government support is needed for the asset class to continue, and points to Saskatchewan and Quebec as two provinces that remain committed to the idea.

Without strong retail venture capital, he believes there is not enough institutional venture capital to pick up the slack.

Critics of LSVCCs disagree and argue retail venture programs like this have been a terrible mistake.

Calling LSVCC performance dismal in a recent column in the Financial Post, Douglas Cumming of York University's Schulich School of Business said "their eventual demise will open the door for greater involvement on the part of private investors and investment firms south of the border."

He added that entrepreneurs have expressed confidence that they could access capital from sources other than LSVCCs including other venture-capital (VC) providers, banks, leasing firms, trade customers, working shareholders and angel investors.

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