

## THE GREAT LSIF MYTH

By MRM

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Myths have a habit of surviving long past their due date. If not disproven, myths can often become accepted as fact.

Was there a shooter on the grassy knoll? Do pets explode in a microwave? There is no such thing as global warming (just look at the weather yesterday). Will your sports car disintegrate if you drive 300 km/h and hit a retaining wall? If you are 8 years old and fire a pellet gun, you'll shoot your eye out. And so on....

As Darwinian forces have culled the Ontario Labour Sponsored Fund Industry over the past few years, there are but a few tall trees standing: GrowthWorks, ROI, VenGrowth and VentureLink are the four that come to mind that still have new material capital to deploy into new Ontario-based opportunities. Covington is also looking at new deals on the back of their great Platespin win.

There are a variety of reasons why these firms have survived the Ontario Government's penny-wise-but-pound-foolish 2005 decision to kill the LSIF industry (see prior post "Ontario politicians asked to address deteriorating VC climate" October 1-07). "Poor returns" was certainly one of the key alleged reasons behind Premier McGuinty's decision to kill the program, despite excellent results in B.C. and Quebec.

I love talking about returns, because so few people in positions of power can clearly articulate what a good return is.

Is investing \$30 million of taxpayers money into an engine plant a good investment if it will only save 75 jobs? Is a flat return in an LSIF fund over the past twelve months a "poor return"? What about a 5% positive return over the past three years, Mr. Premier? Is that a

"good return" or a "poor return" for retail investors?

Let's have a look at some relevant returns, shall we?:

### Sample LSIF returns:

GrowthWorks Canadian: 3 yrs: +2.85%, since inception: +0.01%  
 GrowthWorks Canadian Diversified I: +5.9%, since inception: +5.5%  
 ROI CDN Retirement Series A: 3yrs: +1.2%, since inception: +6.7%  
 ROI High Yield Series A: 3 yrs: +8.0%, since inception: +8.7%  
 VenGrowth III Diversified A: 3 yrs: -6.2%, since inception: -5.2%  
 VenGrowth Traditional Industries A: 3 yrs: -0.3%, since inception: +0.1  
 VentureLink Balanced: 1 yr: +13.4%, since inception: +7.4%  
 VentureLink Brighter Future I: 1 yr: + 34.6%, since inception: +15.3%  
 VentureLink Diversified Income I: 3 yrs: -0.3%, since inception: +1.0%

### Sample Household Name Financial Institution Returns:

Blackstone Group (BX:NYSE): -49.9% since June 29, 2007 (1st day of trading post IPO)  
 BMO (BMO:TSX, NYSE): 1 yr: -37.9%, 3 yrs: -25.8%  
 CIBC (CM:TSX, NYSE): 1 yr: -41.6%, 3 yrs: -27.0%  
 CIT Group (CIT:NYSE): 1 yr: -83.9%, 3 yrs: -78.7%  
 Citigroup (C:NYSE): 1 yr: -66.6%, 3 yrs: -63.9%  
 Fortress Inv. Group (FIG:NYSE): -61.9% since Feb 16, 2007 (1st day trading post IPO)  
 Goldman Sachs (GS:NYSE): 1 yr: -19.1%, 3yrs: +69%  
 JP Morgan (JPM:NYSE): 1 yr: -29.8%, 3 yrs: -19%  
 Lehman Brothers (LEH:NYSE): 1 yr: -71.9%, 3 yrs: -57.3%  
 Wells Fargo (WFC:NYSE): 1 yr: -31.4%, 3 yrs: -20.6%

So, according to publicly available information, a wide variety of labour-sponsored funds have performed better than all but one of the 10 global financial

institutions named above. And by “better”, I don’t mean that they’ve lost their investors less money. In fact, many LSIF investors are up over the one and three year investment horizons. QED.

Since the McGuinty Government pulled the plug three years ago, they can’t be blamed for not knowing that these investment teams would outperform the likes of BMO, CIBC, Citigroup, Lehman, Blackstone, et al. But, now that they have these facts, the rationale for killing the program just lost one of the alleged key drivers: poor investment returns.

And returns aren’t the only good news. LSIF funds are producing real companies: 5N Plus, Bridgewater, DataCom, Diamedica, DragonWave, Espial, IMRIS, RuggedCom, Sandvine and TeraGo all went public on the TSX between March and December 2007.

Moreover, Med-Eng Systems, Galleon Energy, Sandvine, Aspreva Pharmaceuticals and Lakeport Brewing have all been honoured by the Canadian Venture Capital and Private Equity Association over the past three years as either “Deal of the Year” or “Entrepreneur of the Year”. Each of these successful investments had LSIF backers.

Perhaps, with these new bits of pithy information, the Ontario Government will consider recrafting the LSIF program as the “Commercialization Fund Program” in their Fall economic statement. With so much money pouring into “R&D”, but with so little commercializable activity coming out the other end, now’s the time to focus the Queen’s Park minds.

Here are some ways to reform the LSIF program (change the name to “Commercialization Fund” to start):

- focus must be on commercializing companies in such sectors as information technology, biotech, cleantech, alternative energy;
- cap the investee company size at \$20MM of trailing revenue at the time of investment;

- limit the public basket to 10%;
- grandfather the existing large funds (AUM of, say, \$100MM and up) so as to preclude a bunch on new, and uneconomic, would-be managers;
- cap management and servicing fees at, say, 4%;
- encourage institutional sidecar funds;
- no pacing.

Firms such as ours might do even better if we had less competition, but that’s a small-minded approach. Ontario, and Canada, would be better off if the local venture capital community was given a chance to thrive. With five consecutive years of reduced VC investment, Ontario needs to take the plunge and keep the essence, if not the name, of the LSIF program. An incremental \$15 million/year via the MRI Fund is but a drop in the bucket (see prior post “MRI Fund rumors come true” June 11-08).

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(I own BMO, GS; VentureLink is a partner of our Funds II and III) .

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