The Fonds de solidarité FTQ:
Part of the solution for the Venture Capital industry in Canada

Key role in structuring the VC industry

Successful model for quality job creation and prosperity

Important saving role

Reasonable shareholder return

Submitted to the Finance Committee

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The Fonds de solidarité FTQ (« Fonds ») at a glance

The Fonds is an investment fund created by provincial legislation passed unanimously by the National Assembly in 1983, in response to economic concerns. Then Prime Minister, Brian Mulroney quickly supported the institution and the federal government provided a 20% tax credit to its shareholders.

The Fonds' mission revolves around the following four elements:

- Invest in companies with an economic impact in Québec and provide them with services that will assist their development and create, maintain and protect jobs;
- Make workers aware of the need to save for retirement;
- Encourage programs to educate workers on economic matters;
- Stimulate the Québec economy through strategic investments.

With $11.2 in net assets as of November 30, 2015, and over 610,000 unionized (55%) and non-unionized (45%) shareholders representing approximately 14% of Québec's labour force, the Fonds is a key player in Québec's economic development. It is present in 25 economic sectors and invests at all stages of business development.

The Fonds currently supports 2,571 companies across Québec (over 70% based outside major urban centers). The majority are SMEs and 80% of them have fewer than 100 employees. The added value of these companies equals approximately 4.5% of Québec's overall private GDP.

The Fonds invests in all the private equity asset classes. Between 2006 and 2015, the Fonds has authorized almost $5.9 billion in direct unsecured investments for mostly small and mid-sized businesses. Of this amount, $3.8 billion was allocated to development capital and $2.1 billion to venture capital (directly and through private VC funds), making the Fonds one of Canada's largest venture capital investors.

The Fonds model

The Fonds has a business cycle of an approximate duration of 10 years. This is, on average, the length of time our shareholders own their shares as well as the length of time we hold our investments in private funds. Since the time horizon of our investments in Québec SMEs averages just under 7 years, we can conclude that during this 10-year cycle, our investments in Québec SMEs are 1.5 times the amount collected from our shareholders, making the federal tax credit efficiency ratio especially high.

Since the Fonds offers patient capital to companies, which by definition means non-liquid investments, its constituting act provides that a portion of its assets contain sufficiently liquid investments to meet its redemption obligations to shareholders as well as its capital commitments to private venture capital funds. The remainder of our assets are invested in unsecured risk capital.

The vast majority of the investments committed but not yet disbursed are to private VC funds, both in Québec and elsewhere in Canada (over $760 million). Factoring this amount to such investments in direct investments, the Fonds will be disbursing approximately $1.0 billion in the medium term[1].

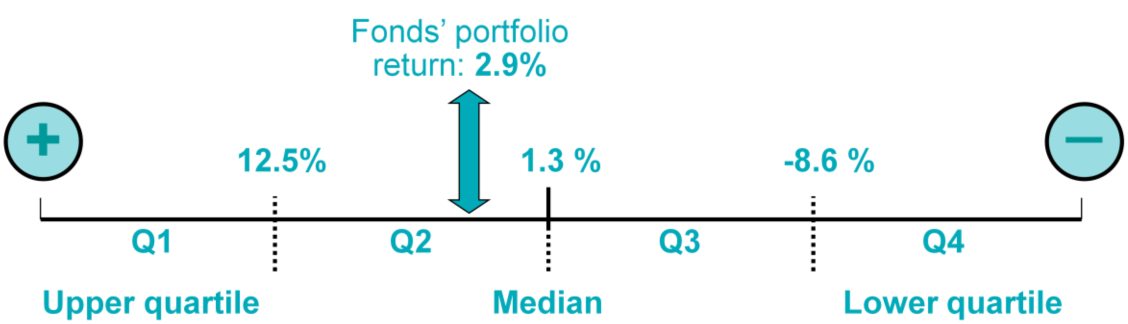
Regarding redemptions to our shareholders, we anticipate between $725 and $825 million per annum in the medium term. When taking into consideration possible upcoming redemptions, the Fonds needs to have sufficient liquidity to redeem up to $2.2 billion in shares at any time.

As for the Fonds' governance structure, it has been strengthened and modernized over the years. A majority of its independent directors are members of investment committees as well as the Audit Committee, the Valuation Committee and the Financial Assets Management Committee. A strong compliance process has been instaured and the Fonds is also inspected yearly by the Autorité des marchés financiers. Financial statements are audited twice yearly by two large external audit firms.

Reasonable shareholder returns

There are misconceptions about the Fonds' return that need to be dispelled.

When measured against the category most reflective of its activities (All Venture Capital and Private Equity), the unsecured risk capital portfolio's net return of 2.9%[2] (data non available from CVCA) places it in the second quartile (returns were calculated over a 10 year period similar to the lifespan of a limited partnership structure for a private fund). Considering the Fonds has a very specific mission highly concentrated in one region – Québec – this return is reasonable when compared to its peers. Today, the Fonds' IRR is 5.4%[3].



SOURCES: Fonds de solidarité FTQ and Canada's Venture Capital & Private Equity Association, Jun 18, 2013 -"Canadian Venture Capital & Private Equity Industry Performance Data – **Private Independent Funds (net returns)**"

[1] As of November 30, 2015
[2] As of November 30, 2012
[3] At November 30, 2015

The Fonds' management expense ratio of about 1.4% compares quite favourably to that of the private equity industry (around 2% <u>not</u> including carried interest, which can drive expenses up to 6%)[4] or of balanced mutual funds (2.4% on average in Canada).

The statement made in 2013 that the Fonds invests only 11% of its assets in venture capital did not reflect the Fonds' actual contribution to this high-risk asset class

At that time, some critics have stated that only 11% of the Fonds' assets are invested in venture capital. Before showing how this figure does not reflect the Fonds' actual contribution to this high-risk asset class, it bears mentioning that according to Aon Hewitt, Canada's pension funds allocate 7% of their assets on average to private equity. According to older data,[5] this figure is even lower, i.e. 3% of their assets. Incidentally, pension funds invest in private equity all over the world, not only in Canadian funds.

In keeping with its unique mission, the Fonds allocates approximately 2/3 of its funds to unsecured private equity investments, a much higher proportion than pension funds. With the right asset class allocation, the Fonds is able to both comply with its mission to invest in VC and risk capital and provide a reasonable return to its shareholders.

During the 10-year period from 2006 to 2015,[6] the Fonds committed $5.9 billion to unsecured risk capital investments. Of this amount, $2.1 billion (35%, and not 11%) was channeled directly as VC into private companies in Québec ($1.1 billion) or indirectly into Québec - and Canadian-based VC private funds ($1.0 billion).

Of note, the Fonds has invested in four of the twenty funds designated in the Startup Visa Canada program launched by the federal government in January 2013.

The $1.0 billion invested by the Fonds in private VC funds have helped structure Québec's venture capital industry and have helped them raise additional amounts. According to a study by Gilles Duruflé[7], for every dollar invested by the labour sponsored funds located in Québec, Canadian-based private funds were able to raise another five dollars on average, for a total of six dollars, costing the federal and provincial governments 30 cents, for a leverage effect of 20 to 1. Québec labour sponsored funds are therefore doing eight times more than the Venture Capital Action Plan will try to achieve (with an expected 2.5:1 leverage ratio).

[4] "We have met the enemy... And he is us" Lessons from twenty years of the Kauffman Foundation's investments in venture capital funds and the triumph of hope over experience. Ewing Marion Kauffman Foundation, May 2012.
[5] "Finding the Key: Canadian Institutional Investors and Private Equity," Industry Canada, June 2004.
[6] Data as of May 31, 2015
[7] « Direct and Indirect Venture Capital Investment of Québec's Retail Funds", Gilles Duruflé, April 2013

The effects of the phase-out

Maintaining the tax credit will result in the following: by allowing to raise $9 billion over 10 years, the Fonds will invest more than $6 billion in unsecured risk capital investments in Québec, of which close to $1 billion would be in private funds in Québec and elsewhere in Canada; approximately $8.0 billion will also be returned to shareholders eligible for retirement.

Without important inflows, the Fonds would have no choice but to stop supporting the venture capital industry, and in so doing (taking the last years as a basis to analyse the next 10 years) deprive private funds of close to $1 billion, which translates into $5 billion of private fund investments when factoring in the leverage effect[8].

Since the 2013 budget announcement many business owners, communities and associations have been very supportive of the Fonds' presence because it is in their collective best interests as well as the economy as a whole. A large consensus has developed about the necessity to maintain both federal and provincial tax credits offered to more than 600,000 shareholders, mostly middle class individuals.

An important savings role

Labour funds also play an important role in helping improve the savings habits of Quebecers and Canadians. In the last five years, the Fonds has collected $650 to $850 million yearly from Québec workers. The Fonds also encourages non-savers to change their saving habit. In fact, 202,000 Quebecers had never contributed to an RRSP before becoming Fonds shareholders. 80% of those new shareholders then contributed to other RRSP which is an additional proof that the Fonds benefit the entire economy, including other financial institutions offering RRSP.

Last but not least, the Fonds has encouraged many SMEs to offer ways that make it easier to contribute to an RRSP. Group RRSPs (offered by 1,596 companies), combined with payroll deduction (6,500 participating companies), help increase the number of workers saving for retirement and encourage larger contributions.

The Fonds is clearly a powerful and efficient institution channelling retirement savings to Canada's SME and VC sectors.

[8] « Direct and Indirect Venture Capital Investment of Québec's Retail Funds", Gilles Duruflé, April 2013

Government objectives and Fonds' role in the economy

The current government's objectives emphasize jobs, growth, prosperity, innovation and productivity. The Fonds' mission and investments are precisely driven toward those objectives:

Jobs

- One of the four Fonds' objectives included in its Act
- Approximately 560,000 jobs created since inception
- Better paid jobs[9]

Growth

- Investments in the form of non guaranteed subordinated financial instruments in more than 2,500 business, mainly SME
- When compared to their peers in Canada, our portfolio businesses export on average three times more[10] and invest four times more in R&D[11]

Innovation

- One of the largest supplier of venture capital in Canada[12]

Productivity

- Value added per supported job by Fonds' partner companies is higher than GDP per job in Québec[13]

Prosperity

- The Fonds in Canada is encouraging prosperity[14] through better financed businesses and better shareholders' saving behaviour

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[9] According to « Analysis of the Economic Impact of the Fonds de solidarité des travailleurs du Québec's investments » KPMG, 2016, p. 35 (referred to as "KPMG 2016")
[10] According to « Portraits des investissements du Fonds de solidarité des travailleurs du Québec et analyse de leurs impacts économiques », Secor, 2005, p.22 (referred to as « Secor 2005 »)
[11] Secor 2005, p. 38
[12] According to 2012 data provided by Thomson Reuters, Fonds is the largest contributor of VC by number of deals in Canada
[13] KPMG 2016, p. 38
[14] See Secor 2010 and Secor 2005

- The Fonds supports working class individuals in encouraging savings (53% of employees earn less than $60,000)
- The tax credit is an effective way to minimize the government's direct intervention into the economy by utilizing the leverage effect, and the use of private expertise

Regional Development

- Close to 70% of the Fonds' investments are in regions (outside the Montréal and Québec city area) and 80% in companies that have less than 100 employees.

Conclusion

Over the years, the Fonds has been a profitable retirement savings vehicle that even low income earners can afford thanks to its payroll deduction plan. It has also become invaluable to businesses, offering them a source of otherwise inaccessible capital and lastly, to the provincial and federal governments, which quickly recoup the cost of the tax credits[15] (in 6.0 and 7.0 years respectively) and can maximize the leverage on the investments they make in the economy and venture capital industry.

The Fonds is ready to continue its contribution to the VC industry through direct and indirect investments. To achieve this, it is important to ensure the Fonds' ability to continue attracting significant amounts of savings from its shareholders.

[15] See KPMG 2016