



**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

July 22, 2013

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

With \$9.3 billion in net assets as at May 31, 2013, and over 615,000 unionized (56%) and non-unionized (44%) shareholders representing approximately 15% of Québec's labour force, the Fonds has become a key player and major institution in Québec's economic development.

The Fonds is an investment fund created in response to economic concerns by provincial legislation passed unanimously by the National Assembly in 1983. Leader of the federal Conservative party at the time, 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.

The Fonds is present in 25 economic sectors and invests at all stages of business development.

The Fonds currently supports 2,395 companies across Québec (over 70% of its partner companies are based in rural regions). The majority are SMEs and 80% of them have fewer than 100 employees. The added value of these companies equals approximately 8% of Québec's overall GDP in the industrial sectors targeted by the Fonds.

The Fonds invests in all the private equity asset classes. Between 2002 and 2012, the Fonds has authorized almost \$6 billion in direct high risk unsecured investments for mostly small and mid-sized businesses. Of this amount, \$3.9 billion was allocated to development capital and \$2.1 billion to venture capital (directly and also through private VC funds), making the Fonds one of Canada's largest direct and indirect venture capital investors.

The Fonds model

It is important to understand that 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.

To ensure sound management, the constituting act of the Fonds provides that a portion of its investments must be sufficiently liquid in order to meet its redemption obligations toward its shareholders as well as disburse the investments it has committed to companies and private funds.

The vast majority of the investments committed but not yet disbursed are to private VC funds that we have been supporting many years in Québec and elsewhere in Canada. The total of such investments are valued over \$600 million. Factoring this amount to such investments in direct investments, the Fonds will be disbursing approximately \$838 million in the medium term.

Regarding redemptions to our shareholders, we anticipate between \$750 and \$850 million per annum in the medium term. Including implicit redemptions (shareholders who have already redeemed some of their shares and who can therefore fully withdraw their savings on demand) and potential redemptions (shareholders of legal retirement age who can therefore also fully cash out on demand), the Fonds needs to have sufficient liquidity to redeem approximately \$1.4 billion in shares at any time.

Since we offer patient capital to companies, which by definition means non-liquid investments, the Fonds must ensure 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. As such, the Fonds must maintain a liquid portfolio of approximately \$3 billion at all times.

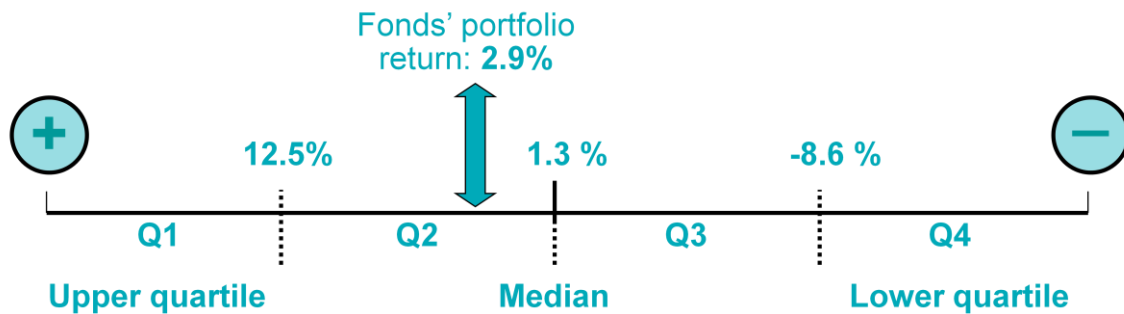
The remainder of our assets are invested in unsecured risk capital, as required by our mission stated in our constitutive act.

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 instated 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%¹ 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.



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)"

As well, contrary to what our critics claim, (our main critics of the LSVCC model are Doug Cumming, Jeffrey MacIntosh and Tariq Faney), Marcel Côté of SECOR/KPMG, Bryan Campbell of Concordia University and Benoît Perron of the University of Montréal demonstrate and refute the analysis made by the three critics in a well documented paper in 2013. We attached the paper prepared by Côté and al.

The Fonds' management expense ratio of about 1.4% compares quite favourably to that of the private equity industry (around 2% not including carried interest, which can drive expenses up to 6%) or of balanced mutual funds (2.6% on average in Canada).

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

Since the budget announcement on March 21st, 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,² 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.

1 At November 30, 2012

2 "Finding the Key: Canadian Institutional Investors and Private Equity," Industry Canada, June 2004.

In keeping with its unique mission, the Fonds, which manages the retirement savings of more than 615,000 Quebecers, allocates more than 66% of its funds to this asset class, 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.

To gain an accurate understanding of the Fonds' venture capital efforts, one must not just look at a portfolio's investments at a given point but rather over a period of time.

As such, during the 10-year period from 2002 to 2012,³ the Fonds committed \$6 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 (\$1.05 billion) or indirectly into Québec - and Canadian-based VC private funds (\$1.06 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.

The \$1.06 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 Duruflé⁴, 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. In addition to helping Quebecers save for their retirement, the labour sponsored funds in Québec are doing eight times more than the Venture Capital Action Plan will try to achieve (with an expected 2.5:1 leverage ratio).

The effects of the phase-out

As explained earlier, the Fonds operates on an approximately 10-year business cycle. If the tax credit were maintained the following would result: it would allow us to raise \$9 billion over the next 10 years, it would allow us to invest almost \$6.5 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; and \$8.6 billion returned to shareholders eligible for retirement.

The elimination of the tax credit would weaken an extremely effective economic development tool for Québec.

³ Data at May 31, 2012

⁴ « Direct and Indirect Venture Capital Investment of Québec's Retail Funds », Gilles Duruflé, April 2013

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 effect⁵.

The proposed budget measure would therefore result in less investments in innovations, commercialisation, job creation, economic growth, regional development as well as less savings for retirement.

As a result, since the 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. We attach a full report of the support the Fonds – and Québec based labour sponsored funds – spontaneously received through open letters, letters to officials and press releases during the last two months. From the Conseil du patronat to the Montreal Metropolitan Board of Trade, from CVCA to several chambers of commerce in all regions of Québec, 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 who – through the Fonds – financially support an extensive network of businesses and private funds and who would certainly not invest in VC if the Fonds is no longer able to attract significant amounts of savings to accomplish its mission.

An important savings role

Labour funds also play an important role in helping improve the savings habits of Quebecers and Canadians, many of whom are not preparing adequately for retirement and who will not have enough money set aside to see them through this next stage of their lives. This is a cause for concern, particularly since in recent years Quebecers have been saving less and spending more.

Hundreds of thousands of Quebecers save with the Fonds. In the last five years, the Fonds has collected \$600 million to \$800 million yearly from Québec workers. The Fonds also encourages non-savers to change their saving habit. In fact, 205,000 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 1,411 companies), combined

⁵ « Direct and Indirect Venture Capital Investment of Québec's Retail Funds », Gilles Duruflé, April 2013

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.

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
- More than 500,000 jobs created since inception
- Better paid jobs⁶

Growth

- Investments in the form of non guaranteed subordinated financial instruments in more than 2,200 business, mainly SME
- When compared to their peers in Canada, our portfolio businesses export on average three times more⁷ and invest four times more in R&D⁸

Innovation

- One of the largest supplier of venture capital in Canada⁹

Productivity

- Value added per supported job by Fonds' partner companies is higher than GDP per job in Québec¹⁰

⁶ According to « Analysis of the Economic Impact of the Fonds de solidarité des travailleurs du Québec's investments » Secor., 2010, p. 33 (referred to as « Secor 2010 »)

⁷ 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 »)

⁸ Secor 2005, p. 23

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According to 2012 data provided by Thomson Reuters, Fonds is the largest contributor of VC by number of deals in Canada

¹⁰ Secor 2010, p. 33

Prosperity

- Results of both the Fonds' investment and savings roles lead to conclusion that the presence of the Fonds in Canada is creating prosperity¹¹ through better financed businesses and positively influencing shareholders' saving behaviour
- The Fonds support working class individuals in encouraging savings (72% of shareholders have income between \$25,000 and \$75,000)
- The tax credit offered by the federal government 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
- 212,000 individuals among all our shareholders contribute through payroll deductions in 6,600 companies which facilitate saving discipline

Regional Development

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

Conclusion

The outpouring of support from the business community and Canada's Venture Capital & Private Equity Association (CVCA) for maintaining the labour fund tax credit demonstrate just how aware business people and private fund managers are of the repercussions of the budget measure, not only for Québec's economic development, but also for the venture capital industry in general, which will be deprived of more than \$6 billion in the next 10 years.

Over the years, the Fonds has proven its value for Québec workers, to whom it offers 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 (Quebecers' savings) and lastly, to the provincial and federal governments, which quickly recoup the cost of the tax credits¹² (in 2.2 and 4.7 years respectively) and which maximize the leverage on the investments they make in the economy and venture capital industry.

The Fonds is ready to continue its partnership with the federal government. Its mission is clearly aligned with the government's economic objectives. The Fonds would be ready to continue its important contribution to the VC industry through commitments to invest

¹¹ See Secor 2010 and Secor 2005

¹² See Secor 2010, p. 41

directly and indirectly (private funds) in this important initiative of the government. To achieve this purpose it is of course important to ensure the Fonds' ability to continue attracting significant amounts of savings from its shareholders.

The following six documents referred to in this submission paper are annexed:

- Analysys of the Economic Impact of the Fonds de solidarité des travailleurs du Québec's Investments – SECOR – July 2010
- Portrait des investissements du Fonds de solidarité des travailleurs du Québec et analyse de leur impact économique – SECOR – Février 2005
- Analysis of Changes in Retirement Savings in Québec and the Impact of the Fonds de solidarité FTQ – SECOR – June 2010
- The Performance of Labour-Sponsored Venture Capital Funds: Reviewing the Evidence – Marcel Côté KPMG/Secor – July 2013
- Direct and Indirect Venture capital Investment of Québec's Retail Funds – Gilles Duruflé – April 23, 2013
- Press Articles and support for maintaining the Tax Credit for Labour Funds

