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VENGROWTH FIGHT HEADS TO COURT

Sheila Avari / November 30, 2010

Covington Fund's bid for VenGrowth was center-stage at the firm's AGM last week, commanding 73% of the "yes" vote. But David Levi, president of competing bidder, GrowthWorks, says he isn't giving up.

"It's not over yet, by a long shot," says Levi, who urged shareholders to vote "no" on the Covington deal. "There was an odd voting process and we don't know how many proxies were actually validated at the meeting. The rights of the shareholders were not met."

A fairness hearing will be set in December where a judge will decide whether the proxies were counted fairly and address other protocol issues related to Covington's information circular, which was issued in October and outlined the terms of their original offer.

In October, Covington Fund II proposed the Fund would acquire five VenGrowth retail venture capital funds and the New Generation Biotech Equity Fund in exchange for Covington Fund II Class A shares. The transaction would result in one of Canada's largest and most highly diversified retail venture capital funds. The net asset value of Covington Fund II is $65 million, and if the deal goes through, the combined fund would be $425 million, holding approximately 55 venture investments in its portfolio.

GrowthWorks responded in November, sweetening the deal for shareholders with higher penalty-free share redemptions, lower performance incentives, $5 million toward manager termination costs and lower redemption penalties.

The VenGrowth bid has sparked labour-sponsored fund industry insiders and advisors to speak up.

"We were not in favour of the Covington deal, and were advising clients to vote against the proposal," says Andrew McGoey, CFP and Wealth Advisor at ScotiaMcLeod in Toronto. "The initial details outlined by Growthworks did present a better offer to unit holders as a liquidity option, which was the main concern of many of our Vengrowth clients."

Advisors are concerned, too, says Levi, adding that hundreds of advisors contacted GrowthWorks saying they'll vote against the Covington offer, a major reason why he is seeking the recount.

Financial advisors like Paul West says he feels VenGrowth is handing the company off to Covington as a pure business transaction, without considering interests of individual unit holders. West, a CFP with Worldsource Financial in Etobicoke, Ont., has 150 clients invested in LSIFs and says they are already feeling the hit with poor performance in their funds, without having to endure more costs that will come with the Covington bid. Covington did subsequently announce it will match GrowthWorks with $5 million toward associated termination costs.

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Consolidation over the past few years has left only a handful of serious LSIFs. “With the continued tax-credit phase out in Ontario, there will continue to be less capital flowing into these funds for managers to work with,” says Andrew McGoey, CFP and wealth advisor at ScotiaMcLeod in Toronto. “In light of the past three years there will likely be increasing numbers of investors divesting from the asset class. I see this as a major challenge for the industry, managing cash out-flows, while trying to maximize returns for unit holders with less and less new money flowing in.”

McGoey suggests larger fund companies may merge funds internally (as the industry saw with Venturelink earlier this year) or LSIF companies may diversify their business lines (as Growthworks did with its purchase of Mavrix Funds and Vengrowth tried with Criterion several years ago).

Sensing the trend and challenges in the LSIF industry, West essentially stopped recommending LSIFs to his clients in 2003. An agreeable strategy, says McGoey. “We are continuing to move clients out of their LSIF positions as they mature to invest in securities which provide better liquidity.”

For most Canadians, tax-advantaged investment options are thin, though advisors should still emphasize maximizing annual RRSP contributions and opening a tax-free savings account for additional saving.

Higher-net worth investors could consider Limited Partnerships, a tax-advantaged investment option with a much shorter holding period and a richer tax-deduction, McGoey suggests.

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