

Some things you may not have known about the Crocus Fund

By BERNIE BELLAN

(The writer is Business Manager and co-Publisher of The Jewish Post & News. He has also written about the Crocus Fund for The Jewish Post & News each year from 1994-2000.)

From its inception in 1993 the Crocus Fund grew rapidly to become a cornerstone of the investment market in Manitoba.

Until recently Crocus had achieved an enviable record of success on several counts. Year after year Crocus was able to meet its sales targets as Manitobans invested ever increasing amounts in the Fund. At the same time Crocus was able to trumpet a consistent record of growth in the value of shares held by investors. Finally, Crocus was proud of having contributed to the growth of Manitoba companies that were, for the most part, socially responsible as well as financially successful.

Yet, in the past two years Crocus's fortunes have begin to fare less well. Some major investments have either soured or are likely to sour in the near future. In one particular case, that of Westsun International, huge amounts of capital appear to have been poured into a company whose prospects are, at best, highly uncertain.

At the same time, the value of share prices in Crocus has continued to slide. No longer does the thrust of Crocus's advertising trumpet the excellent returns that the Fund had brought to its investors. Now, the only theme that is much heard or seen is "Buy Crocus for the tax credits".

As well, there are questions surrounding Crocus's contribution to Winnipeg's downtown revitalization, specifically the role Crocus has taken in the True North project.

As a result of some of the concerns about the direction that I believed Crocus had taken, I posed a series of questions in the form of an e-mail dated February 3, to Sherman Kreiner, who is President and CEO of the Crocus Fund. To date, Mr. Kreiner has not responded to those questions himself, although I did speak with Bob Jones, who is Director of Marketing for the Crocus Fund. Mr. Jones did respond to some of the questions that were posed.

In addition, in researching this article, I spoke with five different financial advisors in Winnipeg, all of whom are very well known. Each of them asked that their comments remain off the record. As a matter of fact, when I suggested to one particular advisor that there seems to be a deafening silence when it comes to publicly voicing criticism of the Crocus Fund from within Manitoba's financial community, his rather succinct response was: "Don't shit where you eat."

In other words, the Crocus Fund has made a lot of money for individuals within the financial community - many of whom were initially very sceptical about the Crocus Fund. While many of those same individuals indicated that they had very serious reservations about certain aspects of the Crocus Fund, the general consensus was that Crocus can still serve as a useful component of many typical portfolios. However, when I specifically referred to certain particularly worrisome investment decisions that Crocus has made within the recent past, some of these same advisors conceded that they might have to be more careful in recommending Crocus to their clients in the future.

I also contacted two well-known individuals, one of whom sits on Crocus's Board of Directors, while the other sits on the Board of Investment Advisors. Both these individuals expressed concerns about Crocus's investment in Westsun International, although they both wished to remain off the record.

One individual who was willing to be quoted for this article was Rob Hilliard, who is the President of the Manitoba Federation of Labour, also a member of Crocus's Board of Directors. My colleague, Martin Zeilig, spoke with Mr. Hilliard.

In order to get a sense of the situation in which the Crocus Fund now finds itself, it is important to know something about the history of the Fund and about labour sponsored investment funds in general.

The first LSIF was created in Quebec, in 1983 - the Fédération des travailleurs et travailleuses du Québec. The inspiration for creating a venture capital fund sponsored by the labour movement came as a result of the recession of 1981-83. Quebec labour leaders were searching for a means by which capital pools could be generated that would be used either to create or retain jobs in that province by companies that would behave in a socially responsible manner.

In 1988 the Federal government introduced changes to the Income Tax Act, allowing for the creation of LSIF's in all other provinces. The most important aspect of the changes was the introduction of tax credits for anyone contributing to an LSIF

In 1988 the Manitoba Federation of Labour approached Sherman Kreiner, who was, at the time, a Philadelphia lawyer who had been successful in creating worker-owned co-operatives in that city, to help design the rules that would govern what would become the Crocus Fund.

In 1993 the Crocus Fund was created in Manitoba, under legislation brought forward by the Filmon government. According to the Crocus Fund's prospectus, the Fund sees its mandate as follows:

"The Fund strives to be the pre-eminent private sector economic development organization in Manitoba. To achieve this goal, it seeks to:

- provide competitive financial and non-financial rewards for its shareholders through investments in socially responsible Manitoba businesses that operate in accordance with ethical policies with respect to employment practices, workplace safety, environmental suitability and other matters;
- maintain continuity of local ownership of Manitoba businesses, bolster job growth, and model and foster social responsibility in Manitoba businesses;
- provide investment opportunities in the Manitoba economy for all Manitobans; and
- promote broad-based economic participation opportunities for Manitoba workers with a view to increasing productivity in Crocus investee companies and as a strategy that can make an important contribution to overall financial compensation for workers at all levels of such a business."

At the same time, the Prospectus duly warns potential investors of the risk factors involved in investing in the Crocus Fund: It says, in part: "An investment in Common Shares of the Fund is speculative and may not be a suitable investment for all investors."

Notwithstanding the warnings given to investors, over 30,000 Manitobans have actually invested in the Crocus Fund over the years. By any measure this is a tremendous indication of support for the Fund from Manitobans.

In fact while the Fund showed no growth in share value over its first two years of operation, as it set about the business of organizing itself and finding suitable companies in which to invest, it wasn't long before the Fund began to show very impressive results.

In 1994 the Crocus Fund raised just over \$6 million through the sale of shares to investors, but by 1996 the Fund had raised \$22 million in just one year through the sale of shares to over 5,000 investors.

Share values had also shown steady growth, starting from an initial price of \$10.00 and rising steadily to a peak of just over \$15.00 in 2000. Since then the share price has been in somewhat steady decline, with a current price of \$13.51 as of the date of writing.

Crocus's initial investments were relatively few in number. Its first investment was in 1994, when \$720,000 was invested in Infocorp Computer Solutions, a software developer.

In 1995, Crocus made six further investments, one of which was for \$2.5 million in Westsun International - a builder and leaser of lighting and audio equipment to the entertainment industry across North America.

Although the initial investment in Westsun did not stand out much from any other investment, over the years the investment in Westsun grew many times over. According to the Fund's Annual Statement, as of September 30, 2001, the investment in Westsun

International now stands at \$20,915,442, of which \$6,112,903 is in the form of equity, while \$14,802,539 is in the form of debt and convertible debt. Interestingly, the stake of Crocus's investment in Westsun grew by \$6,805,089 between 2000 and 2001.

In my e-mail to Sherman Kreiner I asked him about the investment in Westsun: "Rumour has it that the Fund has lost \$20 million on its Westsun investment. From your 2001 statement I see that there is an increase in Westsun's debt held by Crocus of some \$7 million, bringing Crocus's total investment to over \$20 million. Does this not mean that Crocus has more than 10% of its total capital invested in one company? Does this not constitute a violation of Crocus's mandate? Further, is Westsun still in operation? Are there any prospects that it might be sold?"

Neither Sherman Kreiner nor Bob Jones answered my questions about the Westsun Investment. Mr. Jones did suggest that the performance of the Fund overall should be taken into account:

"The Fund is of course always prepared to discuss the overall performance of the Fund as this is the true test of financial performance that is of interest to shareholders and one of the best indications available to financial advisors in making recommendations to their clients."

Jones went on to say, in response to my questions about the performance of the Fund, that "As is the case with all venture capital investing, performance of individual investments within a portfolio varies. As a general rule applied by many venture investors, 60% of companies perform as expected, 20% exceed expectations, and the remaining 20% under perform. At Crocus we believe that in the final analysis the performance of the entire portfolio of companies over a completed mandatory hold period is the only true indication of success for shareholders."

In fact, Westsun had been one of the stellar performers in the Crocus portfolio until quite recently. With offices in nine different cities, including its head office in Winnipeg, Westsun had expanded rapidly since its inception in 1978. Unfortunately, several events conspired to have an adverse effect on the company's fortunes, especially the failure of Livent, a theatrical company owned by Garth Drabinsky. Livent had been producing some of Toronto's and New York's major theatrical shows and Westsun had been actively engaged as providing light and sound support until Livent's sudden failure.

Although attempts at contacting spokespersons for Westsun proved fruitless, I did manage to speak with an employee at the Winnipeg warehouse for Westsun. I was told that Westsun has a skeleton staff in Winnipeg, and that the bulk of its operations are now located in New Jersey.

Yet, the investment in Westsun dwarfs the next largest investment, which is \$8,622,576 in SLMsoft.com. Inc. (which took over Infocorp Computer Solutions Inc. in 1998). According to the Crocus Fund's own prospectus, "The Crocus Act restricts the Fund from acquiring an Eligible Investment that would result in the total fair market value of the Fund's investments in any one Qualified Manitoba Business being more than 10% of the fair market value of its Investment Assets."

According to the Fund's own Annual Report, the total fair value of all its investments in Manitoba businesses was \$125,615,724, as of Sept. 30, 2001. Thus, the investment in Westsun International constitutes 16.65% of Crocus's total investment portfolio.

As previously indicated, I attempted to have two members of Crocus boards comment on the Westsun investment. One of these individuals was quite surprised at what I told him about the size of Crocus's investment in just one company, while the other admitted that members of the Board of Directors find the Westsun situation "worrisome".

Rob Hilliard, President of the Manitoba Federation of Labour, was willing to offer this comment on the investment in Westsun: "Westsun has been in serious trouble and it's a major investment (of Crocus). It's one that's given us our biggest headache. There are currently discussions happening about buyouts and a merger of Westsun with bankers, lenders and other potential buyers."

Westsun is not alone among investments that have not performed well in Crocus's portfolio. Last year the Fund took a \$7,126,651 write-off on its investment in Isoboard Enterprises, a strawboard manufacturer in Elie that has ceased operations. As well, the almost \$7 million invested in Winnport is definitely in peril. (Winnport is a cargo transport company that was originally created to take advantage of Winnipeg's central North American location in serving as a hub between Winnipeg and several Chinese centres, including Shenzhen and Nanjing. Unfortunately, the deals that Winnport had hoped would materialize between those two cities and Winnipeg have yet to materialize.)

There are other companies in which Crocus has invested that are also in financial difficulty. To be sure, the Crocus Fund is a venture capital fund and any would-be investor should be well apprised of the risk involved in putting money into a venture capital fund. However, the size of some of the investments that are either lost or likely to be lost certainly gives one pause for concern. Certainly the Crocus Fund must answer for the huge amount at risk with Westsun.

As Crocus has grown, it has taken a more active role in the community. It has taken a special interest in downtown revitalization, through such endeavours as co-sponsoring concerts at the Forks, its investment in CanWest Global ballpark, and its relocation to new headquarters in the former Big 4 Sales building at Main and Bannatyne.

Crocus is also a partner in the True North Entertainment Complex, as well as a major investor in the Manitoba Moose. In 1996 Crocus became a 25 percent partner in the Moose by means of a \$1,488,000 (US) contribution toward the purchase price. Since then Crocus's share in the Moose has grown substantially to the point where it now has a \$4,293,344 stake in the team. At the time that Crocus first invested in the Moose I had questioned Sherman Kreiner about the wisdom of investing in a professional hockey team. Mr. Kreiner's response at that time was that new franchises in the International Hockey League were being sold for \$10 million US; therefore the Moose would be worth at least \$10 million US, he said. Unfortunately, the International Hockey League folded this past year.

In November Martin Zeilig and I wrote an article for Lifestyles in which we examined the True North project. In that article we raised certain points that had not been paid much attention in other media. One of the questions raised in that article, as well as by several other commentators since then has been over who is going to be providing the additional financing for the new arena above and beyond that which has already been committed by representatives of both the public and private sectors.

In my e-mail to Sherman Kreiner I asked him the following question: "Some time ago you said that obtaining financing for True North would not be a problem. In fact, you used the phrase: "an embarrassment of riches" in describing the capital that lenders were eager to turn over to True North. Why has there not been any further announcement of the loan capital that True North assured the public was forthcoming?"

The question remains.

Finally, amidst the concerns that Crocus shareholders might now have about the operation of the Fund, based upon some of the questions that have been raised in this article, there is another, more general question that needs to be asked about institutions that are given a relatively free ride in the media: How is it that there has been nothing written or said about some of the very serious problems that the Crocus Fund is having with such a large proportion of its investment portfolio? Has the Crocus Fund become so important to the livelihoods of financial advisors who profit from selling its shares and to members of the media who benefit from Crocus's extremely generous advertising budget that its shortcomings have been tacitly ignored?

If so, perhaps the time is now appropriate to be paying much closer attention to an institution that has grown from nothing in just nine years to a powerful player in so many parts of Manitobans' lives.