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Jovian's disclosure questioned

Barry Critchley May 9, 2012 – 9:08 PM ET

When a company makes a boatload from selling two key divisions but hasn't generated consistent earnings or share price gains, how should management be compensated?

That's the situation at Jovian Capital Corp., which in its third quarter of 2011 sold MGI Financial and its Horizons ETF business for $119-million generating a $77-million pre-tax gain. Jovian has made a $12.2-million preliminary provision for its senior management profit plan. News of that plan came in mid-February and Jovian indicated "the preliminary provision will be reassessed at March 31, 2012," the end of its fourth quarter. In the years ended March 2011 and March 2010, no payments were made.

The Ravensource Fund, a Jovian shareholder, argues the amounts are too large. "In the face of a history of significant operating losses, Jovian's payout to its senior management under the plan appears to have been triggered by a one-time capital gain on the sale of assets. In other words the payout is, in effect, based on a return of capital rather than a return on capital," said Scott Reid, president of Stornoway Portfolio Management, the fund's manager.

As a shareholder, Ravensource will benefit from those asset sales: On Friday it's slated to receive a $4-a-share special distribution. That payment is a return of capital.

Another unnamed institutional shareholder said, "We don't like the compensation scheme because it has never been disclosed. In my mind it's without precedent for a publicly traded company to hold back net income for management without informing shareholders ahead of time."

Reid went public with his complaints after being "unsatisfied" with discussions his company had with management and after writing to directors requesting the board "immediately provide full public disclosure of all material provisions of the plan and seriously reconsider the amounts which were proposed to be paid thereunder." Reid said the board has taken his concerns "under advisement."

Reid has prepared a 16-page document highlighting his objections to the payout that amounts to more than 20% of Jovian's adjusted EBITDA, more than 10% of its market cap and almost 10% of its book value. He argues the proposed payment is even more excessive given Jovian has suffered a string of significant operating losses, a share price that has fallen in the years it has been public and that "the source of the earnings used to justify the proposed payout is an extraordinary gain on an asset sale." Over the five years ended March 2011, Jovian made cumulative losses of $35.7-million.

But when payments are made, they are skewed toward management. By toting up the cumulative net income generated by Jovian and adding back the bonuses paid to management, Reid determined Jovian has generated $25.5-million, of which $15.4-million was paid to management. The balance of $10.1-million (or 39.7%) flowed to the shareholders. Shareholders haven't received any dividends over that period.

Reid is also critical of the lack of disclosure about the workings of the profit plan. "Jovian is not a hedge fund. With a hedge fund, compensation is disclosed and contractual, the manager gets paid for delivering results, is normally subject to a [so-called] high-water mark, with performance fees kicking in after investors have received a preferred return. And performance fees are capped at 20%.

Jovian's chief executive Philip Armstrong couldn't be reached for comment by press time.

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