VENTURE INVESTING

Interest, equity prospects offer an enticing play

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So you believe in the economic recovery but you're still a little gun-shy about taking on more risk. You wish there was a safer way to bet that asset values are heading up, especially in the small-capitalization arena.

Here's an idea: Instead of wagering directly on venture stocks, why not lend them money and earn interest with a little equity upside?

That's the business of **GC-Global Capital**. The company provides bridge or short-term loans to startups. In return, it earns healthy interest rates – typically 1 per cent a month – and some form of equity kicker, usually shares.

As you might expect, GC-Global did not emerge from the mother of all credit crunches unscathed. The stock, which was once quoted at $1.40, is now bid closer to 40 cents. The company, like any lender, was hit with stiff writedowns. And profits, which in good times are especially driven by gains on investments – i.e. shares in companies it lends to – disappeared.

Not only is the stock down but it's trading for roughly half of the company's stated book value, or net worth.

The investment thesis is pretty straightforward: Markets have recovered, especially big stocks. Smaller ones haven't, or not as much. If recovery is upon us, they will. When they do, more importantly to GC-Global's business, they'll be able to raise some money.

Why is that important? Two reasons: First, bridge loans to companies that generate little or no revenue are repaid when the company raises equity money in the stock market. The better the markets, the better the loans. Second, the value of a small, developing company's stock is based, in part, on its ability to raise more. It might have the most attractive project in the world but without the money to develop it, it might as well have nothing. Since GC-Global earns bonus shares when it makes loans, its income is more likely to go up in a healthy market.

So if you believe small caps (and small private, because GC-Global also lends to real estate developers and the like) are poised to recover, and you like the business model, what are you getting for the price of a share?

To start with, as mentioned, you're getting roughly twice as much value than you paid. GC-Global has $19.2-million worth of assets and hardly any liabilities (see table). The market cap is less than half that, meaning you could buy the entire thing, liquidate it and double your money.

That's the theory at least. In practice, you have to be confident that what the company lists on its balance sheet is worth what it says it's worth. I can't answer that fully. I can say that I had three meetings with the CEO and CFO, and I think they truly believe the book value is real. Their actions conform to that belief, too.

A good part of the company's assets are publicly traded and therefore marked to market. There are illiquid assets on the balance sheet too, including some U.S. real estate. These are, by law, valued by third parties for audit purposes. Some have been marked down. If, as the headlines suggest, property prices are stable, the carrying values are likely in the ball park.

The biggest comfort, though, comes from the fact that management owns 30 per cent of the stock. As CEO Jason Ewart told me, "Every time we make a loan, 30 cents on the dollar is our money. We care." Management paid for its stock (i.e. it wasn't a gift of cheap founders' shares) and they paid more than where it's trading now.

A related point is that the company pays a dividend. The yield is about 6 per cent based on this year's dividend, which was reduced from last year. Dividends are about a third of earnings. Companies that are worried about their balance sheets don't usually pay dividends.

In short, this is a bet on recovery. It's riskier than blue chips (although when you look at the volatility of big bank stocks, maybe not much more). But it's less risky than the more speculative investments GC-Global lends to.

If you believe in the start of a new bull market and want to take the risks that lead to bigger rewards, it looks interesting.

By the numbers

The balance sheet of GC Global Capital

Item	Stated value
Cash	$317,747
Short-term investments	$900,404
Accounts receivable and sundry assets	$783,393
Prepaid expenses	$14,080
Interest, dividends receivable	$416,236
Bridge loans, notes receivable and letters of credit	$9,080,324
Convertible debentures	$1,000,000
Portfolio investments	$2,548,629
Investment properties	$2,847,506
Property and equipment	$47,508
Future income taxes	$1,245,700
Total assets	$19,201,527
Liabilities	$634,956
Equity Market value	**$18,566,571**

Source: company reports