

Management Report of Fund Performance



COVINGTON FUND II INC.

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This semi-annual management report of fund performance contains financial highlights but does not contain the complete semi-annual financial statements of Covington Fund II Inc. (the "Fund"). You can obtain a copy of the semi-annual financial statements at your request, and at no cost, by calling 1-866-244-4714, by writing to us at Covington Capital Corporation, 36 Distillery Lane, Suite 440, Toronto, Ontario M5A 3C4, by visiting our website at www.covingtonfunds.com or on SEDAR at www.sedar.com.

Shareholders may also contact us using one of these methods to request a copy of the Fund's proxy voting policies and procedures or proxy voting disclosure record.

FORWARD LOOKING STATEMENTS

This report may contain forward-looking statements about the Fund, its future performance, strategies or prospects, and possible future Fund actions. The words "anticipate", "could", "should", "may", "expect", "believe", "plan", "intends", "estimate", "forecast", "objective", "would"; and similar expressions are intended to identify forward-looking statements.

Forward-looking statements involve inherent risks and uncertainties, both about the Fund and general economic factors. It is not possible to guarantee that future performance, liquidity, predictions, forecasts, projections or other forward-looking statements will be achieved. Factors such as economic, political and market factors in Canada, the United States and internationally, interest and foreign exchange rates, global equity markets, business competition, technological changes, changes in laws and regulations, judicial or regulatory judgments, legal proceedings or catastrophic events could cause actual events or results to differ materially from those expressed or implied in any forward-looking statement made by the Fund. Please consider these and other pertinent factors before making any investment decisions and do not place undue reliance on forward-looking statements. All opinions contained in forward-looking statements are subject to change without notice.

INVESTMENT OBJECTIVES AND STRATEGIES

The investment objective of the Fund is to realize long-term capital appreciation on part of the investment portfolio, and current yield and early return of capital on the remainder of the investment portfolio. The strategy to accomplish this is by investing in two different types of situations. The first is in companies which the Fund anticipates will have significant growth potential in early stage or expanding markets. The second is in more established steady growth companies which the Fund anticipates will provide current yield and early return of capital to the Fund. The Fund combines the tax benefits of a Labour Sponsored Venture Capital Corporation ("LSVCC") and a Labour Sponsored Investment Fund ("LSIF") while giving investors access to the venture capital market.

The Fund is now in its eighteenth year of operations. The Fund has neither sold new subscriptions nor undertaken new investments in the past several years. The Fund's focus is on optimizing the value of the investment holdings as the Manager seeks out opportunities to sell the remaining portfolio investments to create liquidity to honour redemptions. Since the merger with the VenGrowth Funds in 2011, approximately 60% of the outstanding shares of the Fund have been redeemed for cash.

CLASS A SHARES

[in \$000's of Canadian dollars except for per share amounts, number of shares and percentages]

RISKS AND UNCERTAINTIES

The Fund is and always has been suitable for investors with a long-term investment focus and higher risk tolerance than conventional investment funds as discussed in the Fund's Annual Information Form.

Liquidity risk – Liquidity remains the largest risk factor facing the Fund. As at February 28, 2018, the Fund's investment portfolio consisted of 18 companies of which 1 is publicly traded and 17 are privately held. Due to minimal cash reserves, the majority of the Fund's total assets are held within private companies. The private illiquid nature and the follow-on funding required to support these companies continues to place liquidity pressures on the Fund. Exit opportunities for private companies within the portfolio are not certain and these investments cannot be readily converted to cash on an as needed basis. The exit strategy for venture backed companies is typically through mergers and acquisitions ("M&A") whereby strategic buyers may seek to augment their portfolios by purchasing smaller, private companies or, private companies may seek to grow themselves by accessing the public equity markets through an initial public offering ("IPO"). Uncertain M&A and IPO activity contributes to additional liquidity strain on the Fund.

The tax credit program for purchases of LSIFs has been phased out by the Ontario government. Additionally, the Federal government announced the phase-out of the LSVCC program after 2016 but reversed this stance in March 2016. The elimination of the program provincially along with market pressures has, in recent years, restricted the ability of all investment funds operating in this sector to raise significant amounts of capital. The Fund is closed to new subscriptions; as such, the Fund is dependent upon internal growth and portfolio exits in order to meet its investment objectives and provide liquidity to its shareholders via redemptions.

These on-going liquidity pressures in conjunction with significant and increasing redemption requests received immediately upon the Fund re-opening for redemptions have caused the Fund to temporarily close for redemptions.

Valuation risk – The process of valuing venture investments for which no published market exists is subject to inherent uncertainties and the resulting values may differ from values which would have been ascribed had a ready market existed for those investments. This is valuation risk as described in the Fund's financial statements.

Portfolio risk – Approximately 95% of the Fund's venture holdings are in private companies. As the portfolio matures and exits occur, the portfolio concentration may change. For example, investments in the biotechnology sector are typically longer-term holds with varying levels of economic outcomes; as such, the weighting of biotech holdings within the portfolio as a whole may fluctuate over time. This is a concentration risk which may impact portfolio performance as different sectors experience market and economic fluctuations differently from one another. For example, at its peak, the biotechnology/health science sector has accounted for as much as 56% of the Fund's overall venture portfolio value but was represented by 25% of the companies within the portfolio. At period end, this sector represented 26% of the portfolio value held in 22% of the holdings. Volatility within the public markets could also place additional market risk within the venture portfolio.

RESULTS OF OPERATIONS

As at February 28, 2018, the total net assets attributable to holders of redeemable share of the Fund ("NAV") were \$85,600 as compared to \$92,310 as at August 31, 2016. The decrease is mainly due to operating expenses of \$2,281 and losses related to portfolio activity. As at February 28, 2018, the Fund held \$10,513 in cash to provide the Fund with liquidity to not only fund operations and support to existing companies within the portfolio but also future redemptions. The Fund's venture portfolio as at February 28, 2018 was at \$78,816 in value compared to \$91,442 in August 2017. The Fund completed 3 full exits during the period which, along with debt repayments generated proceeds of \$12,340 to provide liquidity for redemptions, follow-ons and operations.

The Fund completed \$4,081 in cash follow-on financings to support the venture portfolio. Interest, fee income and dividends for the period ended February 28, 2018 totalled \$80. Expenses for the six month period ended February 28, 2018 were \$2,281 and have declined by \$1,424 compared to the same period in 2017. Net asset based fees have declined consistently with the decline in average NAV over the period. Line items such as writedown of escrow receivable and other expense reflect adjustments related to non-recurring specific investee situations. In the current year, these expenses totalled \$18 whereas the same comparative in fiscal 2017 was \$505.

The MER of the Class A Shares, Series I was 5.03% and 5.04% for Class A Shares Series II.

CLASS A SHARES

[in \$000's of Canadian dollars except for per share amounts, number of shares and percentages]

RECENT DEVELOPMENTS

Temporary Suspension of Redemptions

On September 2, 2015, the fourth anniversary of the Merger, the redemption restriction expired on all Class A shares that have been issued and outstanding for eight years or more. On September 8, 2015 the Fund announced a temporary halt to redemptions of the Fund given the magnitude of redemption requests had the potential to eliminate the liquidity required to operate the Fund in an efficient manner. On January 18, 2016, the Fund re-opened to redemptions and was halted again after the cumulative redemptions for fiscal 2016 reached approximately 20% of the NAV as at the last day of fiscal 2015.

On October 24, 2016 the Fund was re-opened and subsequently closed to reflect the objective of the Fund meeting the annual redemption requirement of approximately 20% of the NAV as at the last day of fiscal 2016, as contemplated in the Fund's prospectus disclosure. The Fund is not required to redeem Class A Shares, in any financial year having an aggregate redemption price exceeding 20% of the NAV of the Fund as at the last day of the preceding fiscal year.

On March 9, 2018, The Fund announced that it will re-open to redemptions on May 7, 2018 to allow for the redemption of approximately \$10 Million by Class A Shareholders. The Fund will close to redemptions if and when the Fund receives redemptions requests meeting this amount. The \$10 Million in cash has been generated by Covington while it continues the process of selling portfolio holdings to meet the contemplated redemption requirement of 20%, or approximately \$18 Million of the NAV of the Fund as at the last day of fiscal 2017 as set out in both governing legislation and in the Fund's prospectus disclosure.

As the Fund progresses in generating liquidity, there are several portfolio companies that are well advanced in sale negotiations. Proceeds, depending upon the amounts and the timing of their receipt by the Fund, could allow for an additional re-opening of the Fund to complete further redemptions prior to the Fund's year end of August 31, 2018.

The fair value of the Fund's portfolio will continue to be determined every week and there are no anticipated changes to the value of its private investments as a result of this decision. The challenge remains to optimize exit values for the private investments while trying to meet redemption requests of shareholders. It is not in the best interest of the Fund nor the portfolio companies to accelerate exits to the detriment of obtaining a fair value on those exits in the current marketplace.

RELATED PARTY TRANSACTIONS

The Manager and Sponsor are deemed to be related parties to the Fund. Please refer to the section entitled "Fees and Expenses" which outlines the fees paid to these related parties or Note 7 in the Fund's 2018 interim financial statements.

CLASS A SHARES

[in \$000's of Canadian dollars except for per share amounts, number of shares and percentages]

FINANCIAL HIGHLIGHTS

The following tables show selected key financial information about the Fund and are intended to help you understand the Fund's financial performance.

FUND'S NET ASSETS ATTRIBUTABLE TO HOLDERS OF REDEEMABLE UNITS

SERIES I	Period ended February 28, 2018	Year ended August 31, 2017	Year ended August 31, 2016	Year ended August 31, 2015	Year ended August 31, 2014	Year ended August 31, 2013 ⁽³⁾
Net assets attributable to holders of redeemable units, beginning of period ⁽¹⁾ ⁽²⁾	\$ 5.58	\$ 6.83	\$ 8.16	\$ 8.98	\$ 8.58	\$ 7.48
Increase (decrease) from operations:						
Total revenue	-	0.07	1.22	0.08	0.02	0.07
Total expenses	(0.14)	(0.44)	(0.39)	(0.46)	(0.63)	(0.80)
Realized gain (loss) on investments	(0.05)	0.27	(1.46)	0.89	1.13	0.22
Unrealized gain (loss) on investments	(0.21)	(1.11)	(0.77)	(1.35)	(0.22)	1.61
Total increase (decrease) from operations ⁽²⁾	(0.39)	(1.21)	(1.40)	(0.84)	0.30	1.10
Net assets attributable to holders of redeemable units, end of period ⁽¹⁾ ⁽²⁾	\$ 5.19	\$ 5.58	\$ 6.83	\$ 8.16	\$ 8.98	\$ 8.61
SERIES II						
Net assets attributable to holders of redeemable units, beginning of period ⁽¹⁾ ⁽²⁾	\$ 5.31	\$ 6.50	\$ 7.78	\$ 8.59	\$ 8.28	\$ 7.32
Increase (decrease) from operations:						
Total revenue	-	0.07	1.19	0.07	0.02	0.07
Total expenses	(0.13)	(0.43)	(0.39)	(0.48)	(0.66)	(0.88)
Realized gain (loss) on investments	(0.04)	0.25	(1.44)	0.85	1.15	0.21
Unrealized gain (loss) on investments	(0.20)	(1.04)	(0.69)	(1.21)	(0.18)	1.64
Total increase (decrease) from operations ⁽²⁾	(0.37)	(1.15)	(1.33)	(0.77)	0.33	1.04
Net assets attributable to holders of redeemable units, end of period ⁽¹⁾ ⁽²⁾	\$ 4.93	\$ 5.31	\$ 6.50	\$ 7.78	\$ 8.59	\$ 8.32

(1) This information is derived from the Fund's audited annual financial statements and the most recent semi-annual financial statements. The net assets attributable to holders of redeemable units per unit presented in the financial statements may differ from the net asset value per unit calculated for fund pricing purposes.

(2) Net assets attributable to holders of redeemable units are based on the actual number of shares outstanding as at the stated dates. The increase/(decrease) from operations is based on the weighted average number of shares outstanding over the fiscal period.

(3) Historical figures are based on Canadian GAAP.

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RATIOS AND SUPPLEMENTAL DATA

SERIES I	Period ended February 28, 2018	Year ended August 31, 2017	Year ended August 31, 2016	Year ended August 31, 2015	Year ended August 31, 2014	Year ended August 31, 2013
Total net assets attributable to holders of redeemable units ⁽¹⁾	\$ 52,639	\$ 56,758	\$ 84,636	\$ 127,748	\$ 151,028	\$ 151,633
Number of shares outstanding	10,143,293	10,165,503	12,385,692	15,655,888	16,824,904	17,673,307
Management expense ratio ⁽²⁾	5.03%	6.87%	5.35%	5.33%	7.13%	10.10%
Management expense ratio before IPA ⁽²⁾	4.93%	6.41%	4.28%	4.69%	6.68%	4.77%
Portfolio turnover rate ⁽³⁾	4.50%	3.94%	39.54%	20.42%	18.88%	41.54%
Trading expense ratio ⁽⁴⁾	-	-	0.07%	0.08%	0.17%	-
Net assets attributable to holders of redeemable units per unit	\$ 5.19	\$ 5.58	\$ 6.83	\$ 8.16	\$ 8.98	\$ 8.58
SERIES II						
Total net assets attributable to holders of redeemable units ⁽¹⁾	\$ 32,961	\$ 35,552	\$ 56,194	\$ 86,840	\$ 109,562	\$ 123,972
Number of shares outstanding	6,682,531	6,699,307	8,645,176	11,166,508	12,747,483	14,966,676
Management expense ratio ⁽²⁾	5.04%	6.95%	5.56%	5.81%	7.79%	11.49%
Management expense ratio before IPA ⁽²⁾	4.93%	6.49%	4.49%	5.17%	7.31%	6.14%
Portfolio turnover rate ⁽³⁾	4.50%	3.94%	39.54%	20.42%	18.88%	41.54%
Trading expense ratio ⁽⁴⁾	-	-	0.08%	0.08%	0.17%	-
Net assets attributable to holders of redeemable units per unit	\$ 4.93	\$ 5.31	\$ 6.50	\$ 7.78	\$ 8.59	\$ 8.28

(1) This information is provided as at August 31 of the years shown, except the most recent which is February 28, 2018.

(2) Management expense ratio includes all fees, expenses, capital taxes, HST and the Manager's conditional IPA and is expressed as an annualized percentage of the average net assets administered during the period. Conditional IPA is the determination of the bonus that would be payable to the Manager if the Fund were to dispose of its venture investment at its carrying value as at the dates shown. The Manager is entitled to this bonus only upon realization of certain conditions as outlined in the Fund's prospectus and/or annual information form.

(3) The Fund's portfolio turnover rate indicates how active the Fund's portfolio advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the period. The higher a fund's portfolio turnover rate in a period, the greater the trading costs payable by the fund in the period, and the greater the chance of an investor receiving taxable capital gains in the period. There is not necessarily a relationship between a high turnover rate and the performance of a fund.

(4) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net assets during the period.

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MANAGEMENT FEES

Covington, as the Manager, is responsible for directing the business, operations and affairs of the Fund and for implementing the investment strategy, monitoring the Fund's investments and providing management assistance to portfolio companies. Because the portfolio companies of the Fund are generally small in size and at an earlier stage of development relative to conventional mutual funds, the Fund requires a greater level of management involvement in the analysis, monitoring support and development activities.

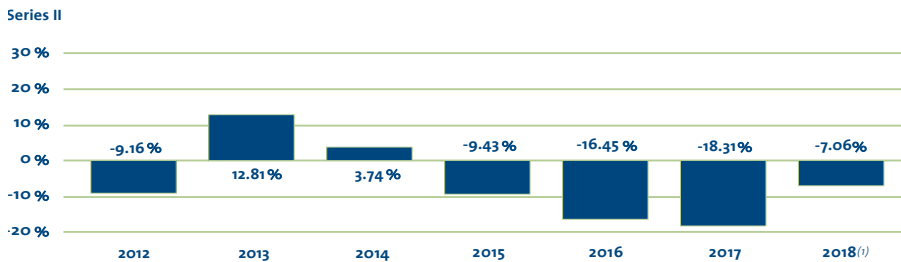
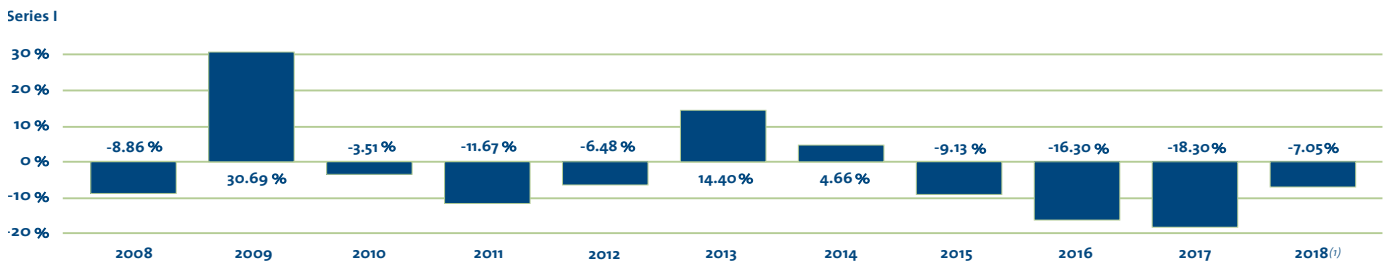
Covington uses its management fees to finance its operations as follows: approximately 98% for general administration over the affairs of the Fund including implementation of the Fund's investment strategy, portfolio management and financial monitoring, retaining and supervising service providers and managing its overall business affairs and 2% for the implementation of communications, sales, marketing, and distribution strategies. Over time, the allocation of management resources has increased for investment and portfolio management relative to sales, marketing, and distribution.

The Fund pays annual fees of 1.35% of the net asset value of the Fund for management services. The Fund's management expense ratio ("MER") consists of all of its operating expenses, including sales commissions, certain ongoing marketing costs of the Fund, audit and legal expenses, fees paid to any independent valuator, IPA (if any), and certain consultancy costs. The largest component of the MER are fees that are calculated as a percentage of the NAV of the Fund and these fees are the management fees, Vengrowth contract amount, the capital maintenance fees, the Co-Sponsor's fees and the Transfer Agent's fees. For a summary of these fees, please see Note 7 to the Fund's interim financial statements.

PAST PERFORMANCE

Year by Year Non-Cumulative Returns

The graph below indicates the Fund's annual performance for each of the years shown and how the Fund's performance has changed from year to year. It also shows, in percentage terms, how an investment made on the first day of each financial year should have increased or decreased by the last day of each financial year. The Fund's past performance is no guarantee of how it will perform in the future.



(1) For the six month period ended February 28, 2018.

COVINGTON FUND II INC.

CLASS A SHARES

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SUMMARY OF INVESTMENT PORTFOLIO

Below is a summary of the Fund's portfolio as at February 28, 2018. This is a summary only and may change due to ongoing portfolio activity in the Fund. See the Statement of Investment Portfolio in the financial statements for a complete listing. An update is available quarterly on Covington's website at www.covingtonfunds.com.

HOLDINGS ⁽¹⁾

	Debt at cost \$	Equity at cost \$	Total at cost \$
WireE Holdings International Inc.	28,315	8,811	37,126
Axela Inc.	24,149	-	24,149
Mist Mobility Integrated Systems Technology Inc.	16,225	2,250	18,475
Interface Biologics Inc.	-	17,473	17,473
PowerBand Global Inc.	7,540	8,446	15,986
Nakina Systems Inc.*	-	7,427	7,427
OTYC Holdings Inc.	-	6,820	6,820
Embotics Corporation	-	6,079	6,079
Clek Inc.	-	5,458	5,458
Fidelity PAC Metals Ltd.	286	2,060	2,346
Ivey CSBIF I Inc.	-	2,000	2,000
Ivey CSBIF II Inc.	-	2,000	2,000
Fusebill Inc.	-	1,615	1,615
Spartan Bioscience Inc.	-	231	231
bitHeads Inc.	98	-	98
Black Bull Resources Inc.†	-	6	6

* Investment made and tracked in US\$.

† Indicates a publicly traded security.

⁽¹⁾ Excluding cash and short-term investments.

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[in \$000's of Canadian dollars except for number of companies and percentages]

SUMMARY OF INVESTMENT PORTFOLIO - *Continued*

Stage of development	Number of companies	Cost of investments \$	% Total venture investments at cost %	Fair value of investments \$	% Total venture investments at fair value %
Start-Up/Early	5	78,279	53.1	48,856	62.0
Expansion	11	68,779	46.7	28,212	35.8
Later	2	231	0.2	1,748	2.2
	18	147,289	100.0	78,816	100.0
Industry class					
Biotechnology/Health Sciences	4	48,673	33.0	20,680	26.2
Financial Services	3	6,346	4.3	5,046	6.4
Technology	7	68,331	46.4	32,231	40.9
Manufacturing/Distribution	4	23,939	16.3	20,859	26.5
	18	147,289	100.0	78,816	100.0
Composition of net assets				Fair value of investments \$	% of Net asset value %
Cash and marketable securities				10,513	12.3
Venture investments, at fair value				78,816	92.1
Liabilities, net of other assets				(3,729)	(4.4)
Net assets attributable to holders of redeemable units				85,600	100.0

Fund Symbols

Covington Fund II Inc.

CIG912 - Closed

CIG 961 - Closed

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