Industry Canada Industrie Canada

Q1 2011

www.sme-fdi.gc.ca/vcmonitor

VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

Canadian high growth innovative small and medium-sized enterprises (SMEs) that commercialize research depend to a large extent on the venture capital (VC) industry for funding. Therefore, a strong VC industry is important for the growth of this segment of SMEs. The goal of this series is to provide current information about the VC industry in Canada. To this end, the series will track trends in investment activity, report on topical VC-related research and look at key technology clusters where VC investment is taking place.

INTRODUCTION

This issue discusses venture capital (VC) investment and fundraising activity in Canada during the first quarter of 2011. It also describes recent federal activity in support of VC. Finally, it includes an article on how the federal government's Centres of Excellence for Commercialization and Research program has helped create 22 internationally recognized centres that help new innovative start-ups access valuable resources, expertise and financing.

VC ACTIVITY OVERVIEW

Summary of investment and fundraising

Stable year-over-year investment

VC investment in Canada reached $315 million in Q1 2011 (111 deals), the highest level of new investments since Q2 2010, but virtually unchanged from the $311 million (111 deals) invested during the same period in 2010. Increased VC investment during Q1 2011 is largely the result of greater participation by government investors who invested approximately $61 million in Q1 2011 compared to $16 million in Q1 2010.

VC fundraising continued to lag in Q1 2011 as only $217 million of new capital was raised, down 44 percent from the $386 million raised in Q1 2010.

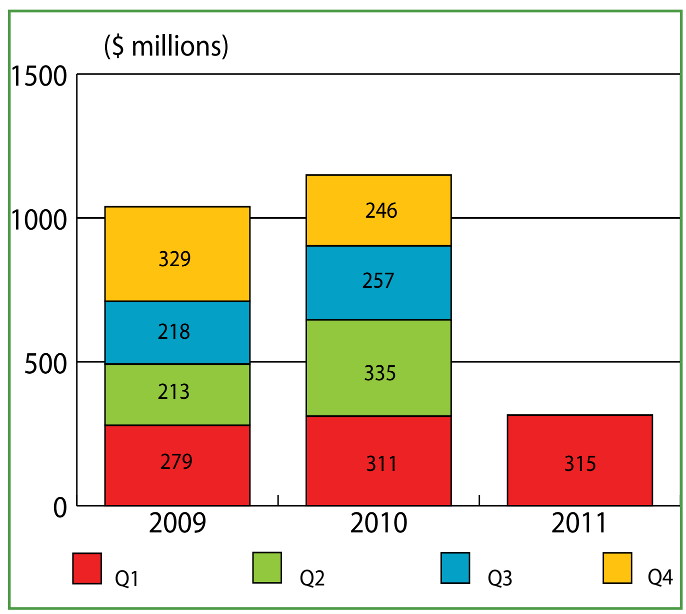
The majority of the new capital supply in Q1 2011 was absorbed by private VC funds ($117 million), 38 percent less than the amount attracted during the same period the year before.

Table 1: VC investment and fundraising, Q1 2010 and Q1 2011

	Q1 2010	Q1 2011	% Change
	($ millions)		
Investment	311	315	1
Fundraising	386	217	-44

Source: Thomson Reuters Canada 2011.

Figure 1: VC Investment by quarter, 2009 to 2011



Source: Thomson Reuters Canada 2011.

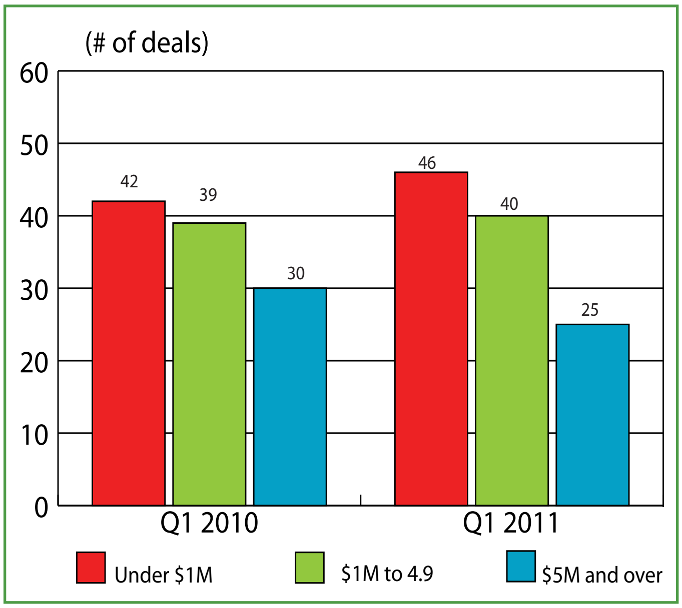
Canada

Deal size

Q1 2011 deal sizes equal to Q1 2010 deal sizes

During Q1 2011, 111 firms received VC financing. This was identical to the amount of financings during the same period in 2010 (Figure 2). While an improvement on 2009 figures, VC financings continue to fall short of pre-recession levels. Deal sizes for Q1 2011 averaged $2.8 million, consistent with the average deal sizes over the past two years. Despite a continued trend toward smaller deal sizes over the past few years, several very large deals (greater than $15 million) between January and March kept average deal sizes at $2.8 million.

Figure 2: Distribution of VC investment by deal size, Q1 2010 and Q2 2011



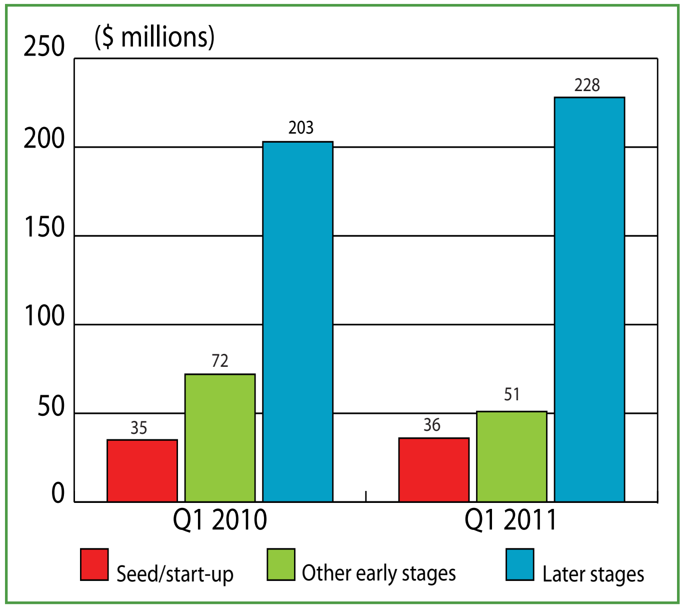
Source: Thomson Reuters Canada 2011.

Stage of development

Decrease in seed/start-up investment, but increase in large later-stage investments

Q1 2011 investments were increasingly concentrated in later-stage deals (73 percent of all value) both in terms of deals (63 percent) and value (73 percent) compared to Q1 2010. The combined value of financing in all early stages in Q1 2011 was $87 million, an 18 percent decline relative to Q1 2010 (Figure 3). This decline is attributable to fewer investments in other early-stage investments as seed and start-up financings remained relatively unchanged year-over-year.

Figure 3: VC investment by stage of development, Q1 2010 and Q1 2011



Source: Thomson Reuters Canada 2011.

New versus follow-on investments

New investments drop in the early-stages but increase in the later stages

For the second quarter in a row there were 48 first-time VC deals in Q1 2011, seven more than the same period in 2010. New deals in Q1 2011 were worth $98 million, which indicates that while there were more first-time VC deals in Q1 2011 they were of lower value than the new deals in Q1 2010 ($107 million). The majority of new financings during Q1 2011 were later-stage investments. Despite this, new seed and start-up investments were the highest they have been in a single quarter since 2009. Year-over-year follow-on investments fell marginally with 63 firms receiving follow-on financing in Q1 2011 (Table 2).

Table 2: Number of companies that received new and follow-on investment, Q1 2010 to Q1 2011

Investment		Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011
New	Seed/ start-up	12	12	5	5	14
	Other early stages	6	7	4	9	2
	Later stage	23	28	32	34	32
	All	**41**	**47**	**41**	**48**	**48**
Follow-on	Seed/ start-up	12	11	9	14	9
	Other early stages	21	24	28	12	18
	Later stage	37	40	30	41	36
	All	**70**	**75**	**67**	**67**	**63**

Source: Thomson Reuters Canada 2011.

Type of investor

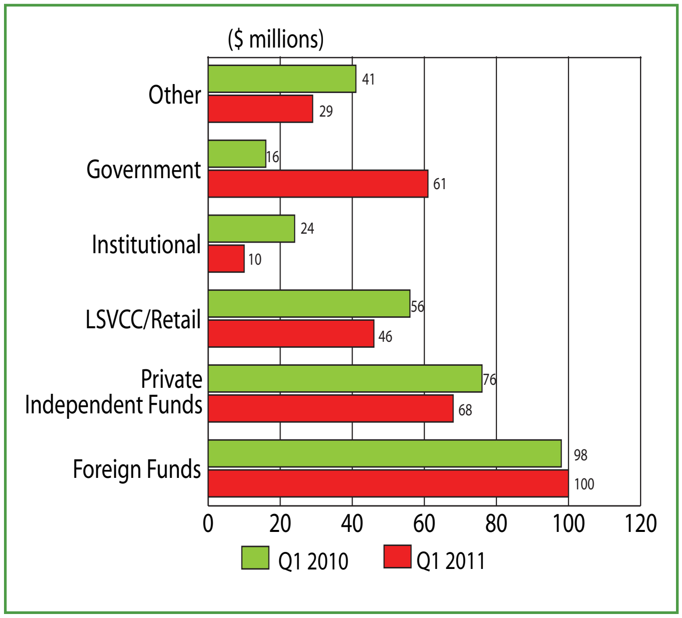
Increase among government and foreign investors

Increased VC investment activity in Q1 2011 is the result of increased foreign and government VC investment (Figure 4). Year-over-year Labour Sponsored Venture Capital Corporations (LSVCC) and retail fund investment fell 18 percent and investment from private independent funds fell from $76 million in Q1 2010 to $68 million in Q1 2011.

Direct government VC investment reached its highest single quarter level since 2002 at $61 million. The BDC Venture Capital Group was most active among government investors, but significant deals were also made by EDC Equity Fund, the Ontario Emerging Technologies Fund, GO Capital Fund and the Tandem Expansion Fund.

The amount invested by foreign funds in Q1 2011 continued to recover since 2008, as Canadian companies attracted approximately $100 million in foreign financing (Figure 4). As a result, cross-border activity accounted for almost one-third of total VC dollars invested in Q1 2011, which approximates the traditional market share.

Figure 4: Distribution of VC investment by type of investor, Q1 2010 and Q1 2011



Source: Thomson Reuters Canada 2011.

Fundraising

Canadian VC fundraising continues to lag

Canadian VC fundraising activity continued its lagging performance in Q1 2011 as only $217 million in new funding was allocated to VCs. This was 44 percent below the $386 million committed in Q1 2010 and was the fourth consecutive quarter of fundraising below $300 million. Lower fundraising in the first quarter affected both private-independent and retail funds, which were down 38 percent and 51 percent respectively compared to Q1 2010.

Regional distribution

Increase in VC investment in British Columbia and Ontario

During Q1 2011 total number of financings increased in each of the provinces of British Columbia (BC), Ontario and Quebec, compared to the same period in 2010 (Table 3). Despite this, average deal size in Quebec fell almost 30 percent, causing lower overall investment in the province during Q1 2011. Ontario attracted the most VC investment during the quarter (42 percent of Canadian VC), buoyed by large information and communication technology (ICT) investments, and had its strongest quarter since Q4 2009 (Figure 5). BC demonstrated the greatest year-over-year growth with 25 percent more investment in Q1 2011 over Q1 2010. This was mostly based on two large energy sector deals completed in March.

Table 3: Number of companies receiving VC by province, Q1 2010 and Q1 2011

	Q1 2010	Q1 2011	% Change
British Columbia	12	19	58
Alberta	6	4	-33
Saskatchewan	3	2	-33
Manitoba	2	2	n/a
Ontario	33	37	12
Quebec	43	50	16
New Brunswick	3	2	-33
Nova Scotia	2	0	-100
Prince Edward Island	0	0	n/a
Newfoundland & Labrador	0	2	n/a
Territories	0	0	n/a

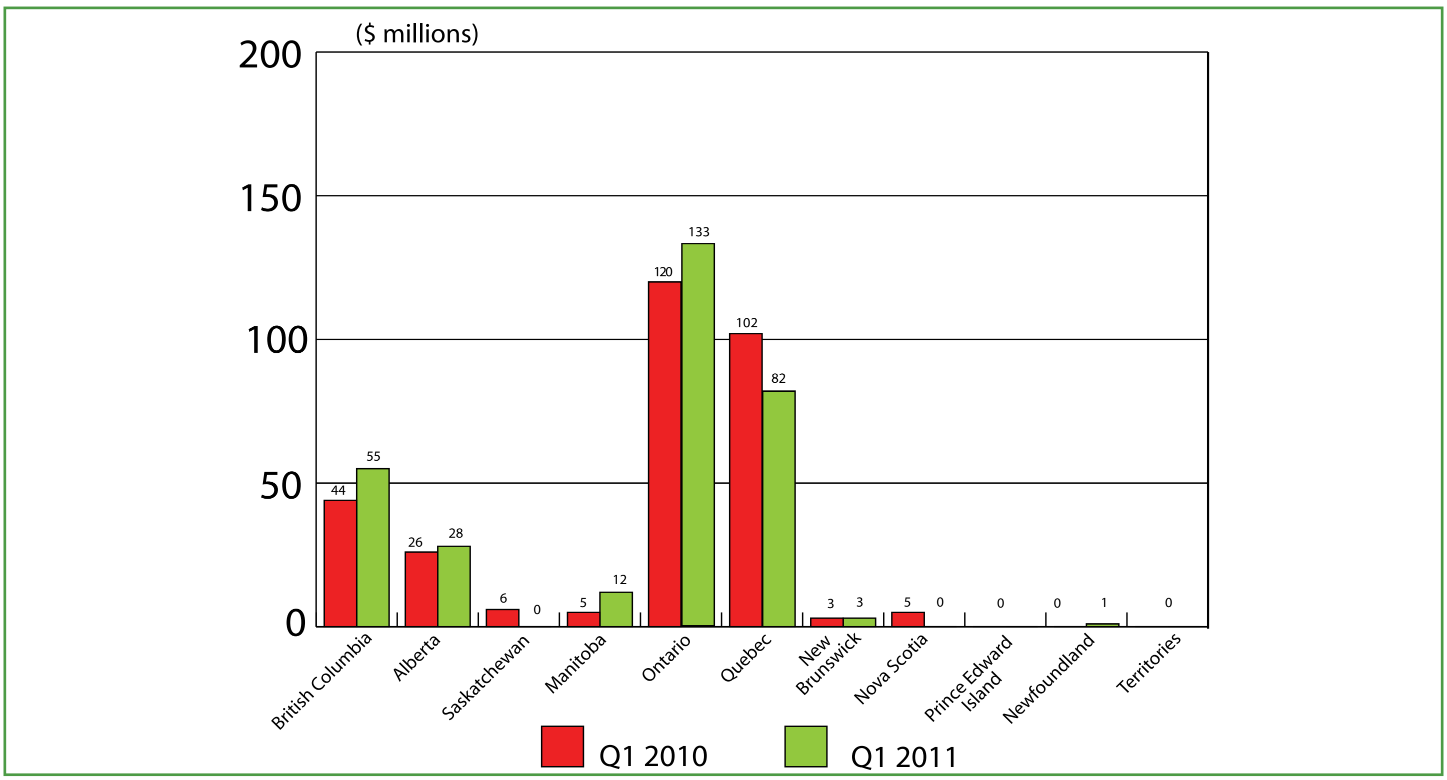
Source: Thomson Reuters Canada 2011.

Sector distribution

Increase in life sciences and energy/ environmental technologies; small decline in ICT

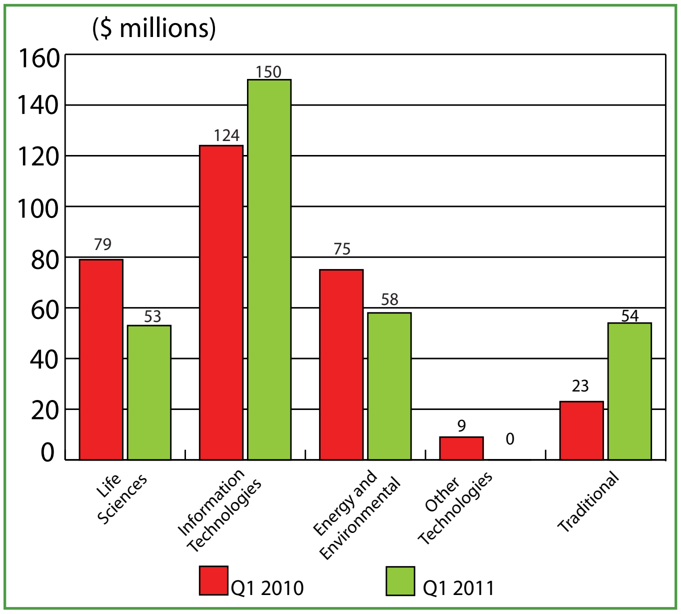
During Q1 2011, ICT firms continued to attract the most financing ($150 million or 48 percent of all financing) (Figure 6).This represents a 21 percent increase compared to total ICT VC investment during Q1 2010. Life sciences and energy and environmental firms attracted less financing during Q1 2011 than during Q1 2010 while investment into firms in traditional sectors more than doubled in Q1 2011 over Q1 2010.

Figure 5: Regional distribution of VC investment in Canada 2010



Source: Thomson Reuters Canada 2011.

Figure 6: VC investment by industry sector, Q1 2010 and Q1 2011



Source: Thomson Reuters Canada 2011.

GOVERNMENT ACTIVITIES

Business Development Bank of Canada Activities

During Q1 2011, the Business Development Bank of Canada (BDC) made VC commitments totalling $34.8 million into 17 companies. These financings were worth a total of $222.9 million including contributions by co-investors. Additionally, the BDC invested a total of $25 million into two Canadian private independent funds. These funds were matched by co-investors for a total of $145 million.

Table 4: VC activities of the Business Development Bank of Canada, Q1 2011

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed/ start-up	8.0	19.4	27.4	6
Development	19.2	81.1	100.3	7
Later stage	7.6	87.6	95.2	4
Total	**34.8**	**188.1**	**222.9**	**17**

Source: Business Development Bank of Canada.

As part of its 2011 Budget released in March, the Government of Quebec announced funding for the creation of a $30 million *Capital Anges Québec* side-car fund. The Government of Quebec will contribute $20 million to the fund and the rest will be raised by private sector angels. The Anges Québec network, the largest network of angel investors in Quebec, will manage the fund. The fund will be active for 12 years with a mandate to invest alongside eligible angels into Quebec-based start-up firms operating in the information technology and industrial technology sectors.

IN FOCUS

Canada's Centres of Excellence for Commercialization and Research

Helping new firms bring great research to market

High potential technology start-ups experience significant challenges translating research excellence into commercial success. These start-ups will often lack access to the resources, financing, knowledge and experience required to turn new ideas into a succesful business. The Government of Canada's Centres of Excellence for Commercialization and Research (CECR) program is a novel approach to help technology firms address the commercial challenges in building a business.

Administered by the Networks Of Centres Of Excellence Secretariat, which is composed of the presidents of Canada's three granting agencies as well as the deputy ministers of both Industry Canada and Health Canada, the CECR program funds research centres operating in specific subsectors of Canada's four priority science and technology sectors. Unlike the Networks Of Centres Of Excellence program, which funds research, CECR grants support centre operation and non-research commercialization costs (e.g., intellectual property protection, market studies, business plan development, counselling and mentoring and technology evaluation).

Since 2009, the program has helped create 22 internationally recognized research commercialization centres across the country. These centres provide researchers with the tools and expertise they need to help them become entrepreneurs, grow their businesses, and attract future investment.

Dr. Mehran Anvari of the Centre for Surgical Invention and Innovation Centre in Hamilton Ontario explained that, “CECR fills an essential gap in translating research at the university level into something for everyday life. The program complements other research avenues. As a researcher, there are many avenues of funding available, but few avenues for commercialization. The CECR program helps to capitalize Canada’s investment.”

Each centre is highly discipline-oriented and managed independently. Eligibility criteria for candidates are determined by the centres, but the centres must be able to demonstrate benefit to Canada. Program funding attracts matching resources (talent, infrastructure and services) from academic and industrial partners and as a result, the centres experience considerable scale and have attracted significant investment for Canadian start-ups. This includes foreign direct investment and venture capital from individuals and organizations interested in growing new companies.

According to CEO, Julian White, the performance of Seregon Solutions Inc. was enhanced, and the company continues to be able to meet the ever-increasing global demand for mobile device applications because of the company’s boost in personnel. This boost was made possible by $200 000 of funding from the Centre for Commercialization of Research (CCR), a centre created by the CECR program.

“CCR provided funding to expand our executive team, including helping to bring in the company’s Chief Financial Officer. This was key to raising more external investment,” says White. “CCR also invested the money being used to take our product to market.”

Since 2007, the program has completed three competitions resulting in the creation of 22 centres. The results of the most recent round of competitions were announced in December, 2010 resulting in the creation of five new Networks of Centres of Excellence. For more information on the program and on the 22 centres, please visit: www.nce-rce.gc.ca.

NOTES

This publication is part of a series prepared by the Small Business Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses' access to financing. Current research is focused on high-growth firms, the aspects of both Canada's VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

The Small Business Branch is also responsible for the Small and Medium-Sized Enterprise Financing Data Initiative (SME FDI). The SME FDI is a comprehensive data-collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of and demand for financing by small and medium-sized businesses. Further information and statistical findings and reports are available at www.sme-fdi.gc.ca.

To be added to the distribution list for this quarterly publication or for questions related to its content, please contact Michael Scholz at 613-954-4369 or Michael.Scholz@ic.gc.ca.

COPYRIGHT

This publication is available upon request in accessible formats. Contact:

Multimedia Services Section
Communications and Marketing Branch
Industry Canada
Room 441F, East Tower
235 Queen Street
Ottawa ON K1A 0H5

Tel.: 613-947-5177
Fax: 613-954-6436
Email: multimedia.production@ic.gc.ca

This publication is also available electronically on the World Wide Web in HTML format at the following address: www.sme-fdi.gc.ca/vcmonitor.

ISSN 1911-9267
60901

Aussi offert en français sous le titre *Le Moniteur du capital de risque — Premier trimestre de 2011.*