Industry Canada Industrie Canada

Canada

Q1 2012

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VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

This publication provides current information about the venture capital industry in Canada. The series will track trends in investment activity, report on topical research and look at key technology clusters where investment is taking place.

INTRODUCTION

This issue covers venture capital (VC) investment and fundraising activity in Canada during the first quarter of 2012. It also describes recent federal and provincial government budget announcements in support of VC.

VC ACTIVITY OVERVIEW

Investment and fundraising

Strong fundraising performance by private independent VC funds during Q1 2012

Canadian VC investment slowed during Q1 2012, falling below $300 million for the first time in a single quarter since Q4 2010. Total investments by VC funds into Canadian companies were worth $263 million between January and March 2012, 34 percent less than the $398 million invested over the same period during 2011 (Table 1). Disbursement levels were also down 38 percent on a quarter-over-quarter basis compared to the $423 million that was invested into companies over Q4 2011 (Figure 1). This was most notable in Quebec, where investments reached historic lows (Figure 5).

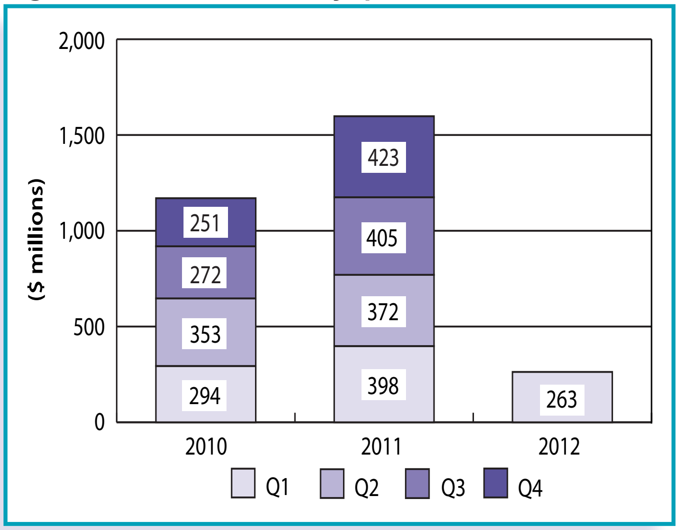
In comparison, Canadian VC fundraising experienced one of its strongest quarters in recent memory posting substantial year-over-year growth with $742 million in new capital committed to funds during Q1 2012 (Table 1). This is more than double the $306 million committed to fundraising at the same time in 2011. Private independent funds led fundraising during the quarter having brought a total of $554 million of new supply into the Canadian market, which exceeds amounts raised by them during the whole of 2010 and 2011. Retail funds captured an additional $181 million between January and March.

Table 1: VC investment and fundraising, Q1 2011 and Q1 2012

	Q1 2011	Q1 2012	Percent Change
	($ millions)		
Investment	398	263	-34
Fundraising	306	742	142

Source: Thomson Reuters Canada 2012.

Figure 1: VC Investment by quarter, 2010 to 2012



Source: Thomson Reuters Canada 2012.

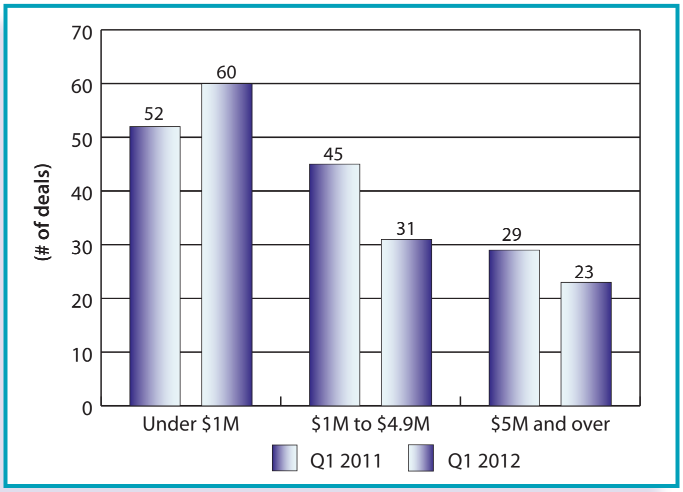
Deal size

Q1 2012 deal sizes down compared to Q1 2011

Total financing fell by $135 million (12 fewer deals) in Q1 2012 compared to Q1 2011. This decline in financing was largely the result of smaller deal sizes because amounts invested per firm during the quarter averaged approximately $2.3 million, down from $3.2 million in Q1 2011. Since the recession, Canadian VC deal sizes have typically averaged below $3 million as investors increasingly complete deals in the under $1 million range.

Noticeably, Q1 2012 saw very few deals completed in the $5 million and over range (Figure 2). This was the fewest large-size deals completed in a single quarter over the past decade. As a result, VC-backed firms in Canada garnered only 31 percent of the dollars going to firms located in the United States in first quarter.

Figure 2: Distribution of VC investment by deal size, Q1 2011 and Q1 2012



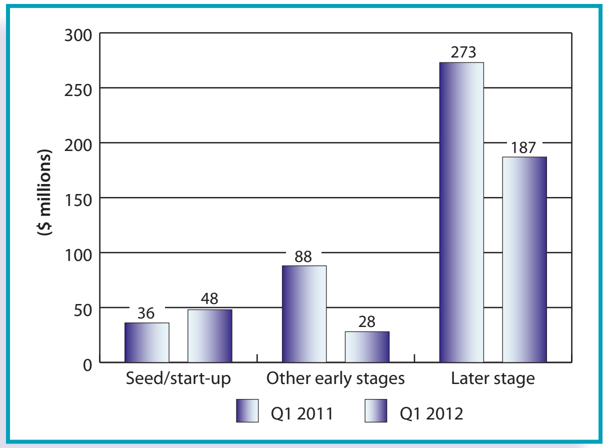
Source: Thomson Reuters Canada 2012.

Stage of development

More investment in seed/start-up companies compared to falling investment in companies at other stages

Investments in seed/start-up companies improved during Q1 2012 as $48 million was dedicated to 33 companies compared to $36 million in 28 companies over the same period in 2011 (Figure 3). Early stage investments into life sciences companies were particularly prevalent as about half of the $93 million attracted by the sector was invested into very young companies. Year-over-year financings fell at the other two measured stages of financing as companies in other early stages of development ($28 million invested into 15 companies) and later stage companies ($187 million invested into 66 companies) each posted notably lower activity.

Figure 3: VC investment by stage of development, Q1 2011 and Q1 2012



Source: Thomson Reuters Canada 2012.

New versus follow-on investments

Follow on investments remain constant as new investments drop

Of the total 114 deals completed in Q1 2012, 41 deals were new investments into companies and 73 were follow-on investments into portfolio companies (Table 2). New deals in Q1 2012 were worth $48 million, approximately one third the amount invested in new deals completed during Q1 2011. The decline in the number of new investments during Q1 2012 was most pronounced in later-stage deals, which helps to account for the decline in overall investment experienced over the quarter (Table 2).

Table 2: Number of companies that received new and follow-on investment, Q1 2011 to Q1 2012

Investment		Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012
New	Seed/start-up	17	12	25	20	18
	Other early stages	3	3	4	4	5
	Later stage	34	40	40	36	18
	All	**54**	**55**	**69**	**60**	**41**
Follow-on	Seed/start-up	11	15	15	16	15
	Other early stages	22	20	14	12	10
	Later stage	39	49	52	66	48
	All	**72**	**84**	**81**	**94**	**73**

Source: Thomson Reuters Canada 2012.

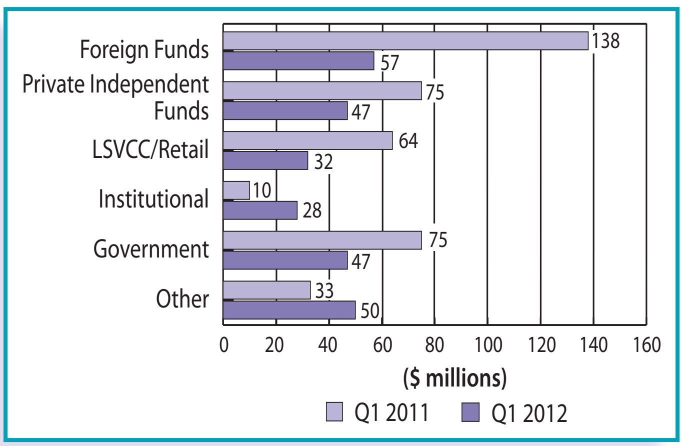
Year-over-year follow-on investments remained relatively constant with 73 deals completed (worth $215 million) during Q1 2012 compared to 72 during the same quarter the previous year. Most follow-on activity took place at the later-stages of development as these companies attracted a total of $164 million or 62 percent of all VC dollars invested during the quarter.

Type of investor

Decrease in year-over-year investment by labour-sponsored venture capital corporations, foreign funds, private independent funds and government

Declining VC investment activity in Q1 2012 is the result of decreased investment from typical VC funds such as foreign, private independent and Labour-Sponsored Venture Capital Corporations (LSVCC)/retail investors. LSVCC and retail fund investors contributed only half the amount of capital in Q1 2012 ($32 million) compared to Q1 2011 ($64 million), private independent funds contributions fell from $75 million in Q1 2011 to $47 million in Q1 2012 and most notably foreign sources invested $57 million, their lowest single quarter since Q2 2003 (Figure 4).

Figure 4: Distribution of VC investment by type of investor, Q1 2011 and Q1 2012



Source: Thomson Reuters Canada 2012.

Government sources of capital remained highly active during the quarter contributing about $47 million to Canadian companies. As a result, government sources were responsible for close to 18 percent of VC investments during the quarter, which is above the typical per quarter average. This was the highest single quarter amount since the same period last year when government sources contributed a single quarter record $75 million to Canadian companies.

Other investors, such as corporate funds and institutional investors, were more active during the quarter than over the same period last year. Most notably, OMERS Ventures, the VC arm of the Ontario Municipal Employees Retirement Savings pension fund, made a large investment worth $20-million into Vancouver's HootSuite Media, Inc. in March.

Fundraising

Strong fundraising performance by private independent funds during the quarter

As noted earlier, Canadian VC fundraising showed particular year-over-year growth in the first quarter of 2012 registering the strongest single quarter performance in nearly a decade. A total of $742 million was committed to Canadian funds over the quarter, more than doubling the $306 million committed to funds at the same time in 2011. Capital raised during the quarter represents nearly three quarters of total fundraising during 2011, auguring well for Canadian fundraising during 2012.

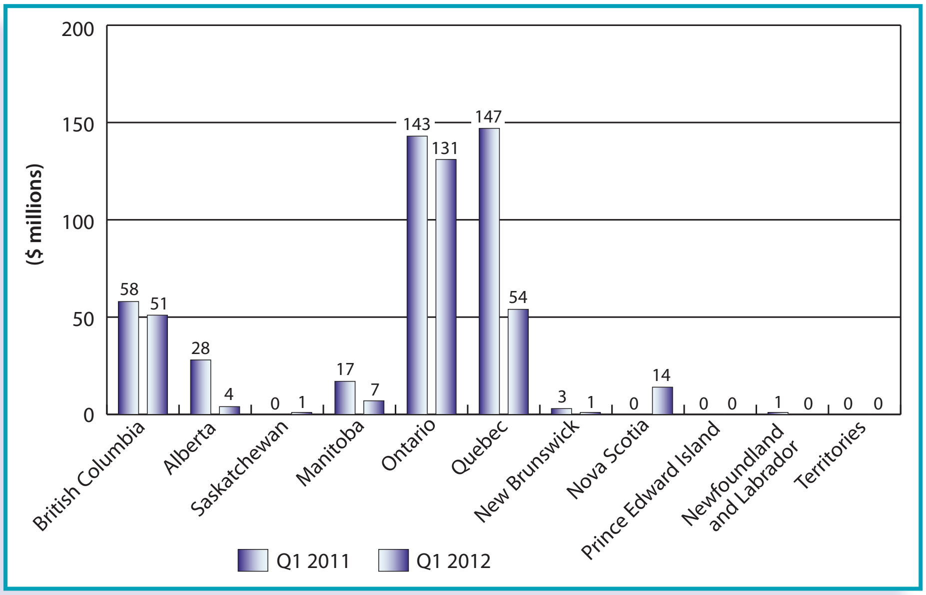
While LSVCCs captured $181 million of the new supply the majority of new capital was raised by private independent funds, which raised $554 million in new capital supply. This includes the $150 million final close of Blackberry Partners Fund II, the $101 million first close of Lumira Capital II Fund, $100 million first close of SAIL Venture Partners Canadian Cleantech Fund (a partnership between SAIL Venture Partners and Stifel Financial Corp.), and the $85 million first close of Cycle Capital Fund III LP. The rest of fundraising is rounded up by a series of early-stage VC funds including the Merck Lumira Biosciences Fund, the MaRS Cleantech Fund LP and Extreme Startups Accelerator Fund. The $554 million raised by private independent funds during Q1 2012 exceeds the total annual fundraising efforts of 2010 and 2011.

Regional distribution

Quebec experiences lowest single quarter investment levels on record

Reflecting lower total levels during the quarter, VC investment values were down across much of Canada. Investments were particularly low in Quebec where companies attracted $54 million, or 63 percent less than the $147 million invested during Q1 2011 (Figure 5). This was the worst single quarter performance on record for investments in Quebec. Quebec-based firms attracted one-fifth of total dollars invested in Q1 2012, which is at some distance from the 33 percent share it has averaged in recent years.

Figure 5: Regional distribution of VC investment in Canada, Q1 2011 and Q1 2012



Source: Thomson Reuters Canada 2012.

About half of all Canadian VC dollars were placed into Ontario companies with $131 million invested into 43 companies (Table 3). Despite this, VC investments in the province were down 9 percent from the $143 million invested in the province during Q1 2011. British Columbia attracted $51 million over the period, or 19 percent of all disbursements, down 13 percent from the $58 million invested the year before. In Alberta, $4 million was invested in this period, down from $28 million invested in Q1 2011. Atlantic Canada-based activity showed year-over-year growth as $15 million was invested in Q1 2012 or more than triple the $4 million invested during Q1 2011.

Table 3: Number of companies receiving VC by province, Q1 2011 and Q1 2012

Province	Q1 2011	Q1 2012	Percent Change
British Columbia	14	15	7
Alberta	4	3	-25
Saskatchewan	2	1	-50
Manitoba	2	1	n/a
Ontario	39	43	10
Quebec	62	40	-35
New Brunswick	2	3	50
Nova Scotia	0	7	n/a
Prince Edward Island	0	0	n/a
Newfoundland & Labrador	1	1	n/a
Territories	0	0	n/a

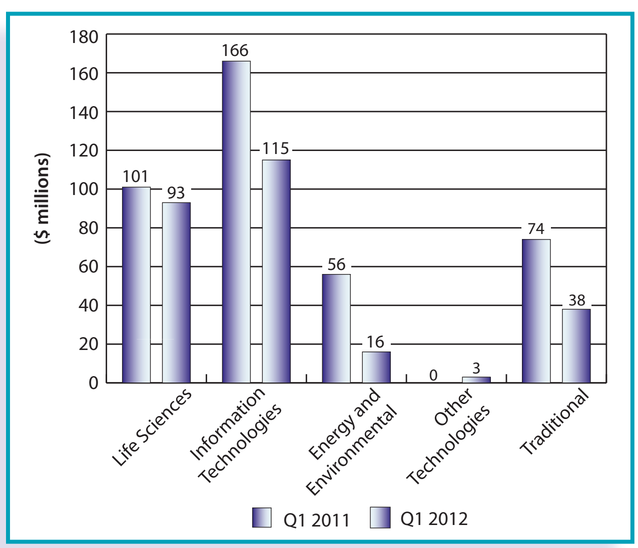
Source: Thomson Reuters Canada 2012.

Sector distribution

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

During Q1 2012, information and communication technology (ICT) firms continued to attract the most financing ($115 million or 44 percent of all financing) (Figure 6). This represents a 31 percent decrease compared to total ICT VC investment during Q1 2011. The majority of ICT investments were placed into Ontario companies, which attracted 57 percent ($65 million) of Canada's ICT VC investments. Notably, 87 percent of total ICT dollars were invested into Internet and software companies compared to only 39 percent over the same period last year.

Figure 6: VC investment by industry sector, Q1 2011 and Q1 2012



Source: Thomson Reuters Canada 2012.

Life sciences and energy/environmental firms attracted less financing during Q1 2012 than during Q1 2011. Declining investment into energy and environmental firms was particularly noticeable as these firms attracted only $16 million over the quarter, a decline of about 72 percent compared to the same period last year.

GOVERNMENT ACTIVITIES

Business Development Bank of Canada Activities

During Q1 2012, the Business Development Bank of Canada (BDC) made VC commitments totalling $19.8 million into 17 companies (Table 4). These financings were leveraged to a total of $59.4 million including contributions by co-investors.

Table 4: VC activities of the Business Development Bank of Canada, Q1 2012

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed/start-up	5.1	8.4	13.5	8
Development	10.4	20.5	30.9	8
Later stage	4.3	10.7	15.0	1
Total	**19.8**	**39.6**	**59.4**	**17**

Source: Business Development Bank of Canada.

Additionally, the BDC invested a total of $23 million into private independent funds. Funds were matched by co-investors for a total of $200 million.

Federal Government Budget 2012

Budget 2012 has committed the federal government to making $400 million available to help increase private sector investments in early-stage risk capital and to support the creation of large-scale venture capital funds led by the private sector. This will increase the amount of funding available for growth-oriented innovative firms while focusing resources on those that are likeliest to become global leaders. In the coming months, the Government of Canada will consider how to structure its support in order to encourage private sector investments and management of seed and large-scale venture capital funds.

In addition, Budget 2012 confirms the previous commitment to make available an additional $100 million to support the venture capital activities of the Business Development Bank of Canada.

Province of Quebec Budget 2012

Quebec's 2012–13 Budget commits the Government of Quebec to completing the conversion of its Innovatech initiative, which provides financing and support for Quebec technology companies, into a public/private partnership operated through Desjardins—Innovatech. In addition, the Government of Quebec will inject $80 million along with $100 million from partners for a total of $180 million to be invested into Quebec companies. Funds will be used to:

- Help implement a new technology accelerator in the city of Québec, to support the development of the best technology businesses in that region;
- Create the Quebec technology fund to support the best businesses that have gone through the technology accelerator;
- Create a co-investment fund in association with the Anges Quebec network, to support innovative businesses in the early commercialization phase; and
- Establish a specialized technology venture capital fund in partnership with and CM-CIC Capital Finance, an European venture capital fund. This partnership will benefit Quebec technology businesses while opening doors for them in Europe.

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).

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Cat. No. Iu186-2/2012-1E-PDF
ISSN 1911-9267
61007

Aussi offert en français sous le titre *Le Moniteur du capital de risque — Premier trimestre de 2012.*