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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 year-end issue discusses Canada's venture capital (VC) activity during 2008, a year characterized by declining VC investments across nearly all regions, sectors and types of investors. The feature article highlights the findings of Canada's Venture Capital & Private Equity Association (CVCA) study of the economic impact of VC investment. The "In Focus" article discusses Manitoba's VC industry and diverse technology sectors.

VC ACTIVITY OVERVIEW

Investment and fundraising

Venture capital investments declined substantially in 2008 to $1.32B (Table 1), dropping 36 percent compared with the 2007 level and 22 percent compared with the 2006 level.

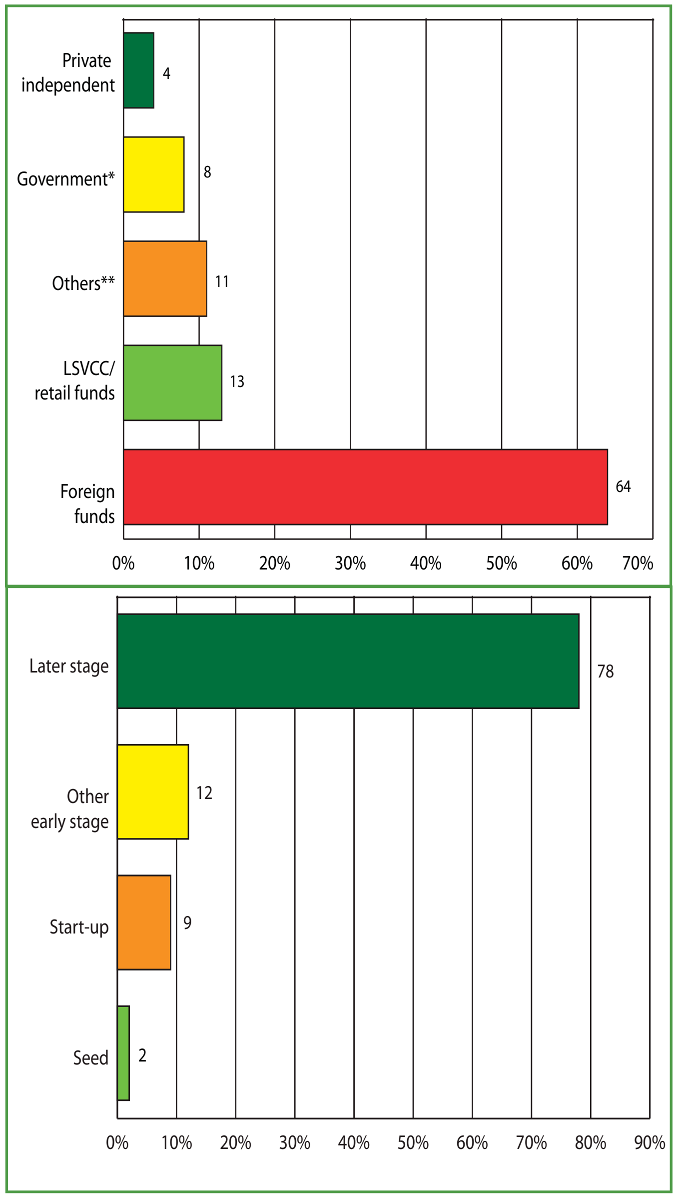
A steep decline in foreign investment is one of the major reasons for this year-over-year decline in VC investment (Figure 1).

Table 1
VC investment and fundraising in Canada, 2005–2008

	2005	2006	2007	2008
	($ millions)			
Investment	1713	1708	2066	1325
Fundraising	2220	1630	1231	1204

Source: Thomson Reuters Canada 2009.

Figure 1
Decline in VC investment from 2007 to 2008



* Federal and provincial governments.
** Includes institutional and corporate funds as well as undisclosed investors.
Source: Computed by Industry Canada based on Thomson Reuters Canada 2009.

Canada

Fundraising in 2008 remained flat, at $1.20B, compared with 2007. However, the distribution of fundraising between labour sponsored venture capital corporation (LSVCC)/retail funds and private independent funds has undergone a dramatic change, with private independent funds now raising more capital.

Deal size

The number of large deals dropped significantly in 2008 compared with 2007. Only 25 percent of deals were larger than $5M in 2008 compared with 31 percent in 2007. As well, the 10 largest deals in 2008 accounted for 20 percent of total investment compared with 30 percent in 2007. This led to a drop in the average deal size to $3.6M in 2008 compared with $5.0M in 2007.

Across every stage of development, the average deal size of LSVCC/retail funds and private independent funds is still consistently lower than that of foreign funds (Table 2).

Stage of development

As in previous years, the share of late-stage deals continues to dominate other stages of development, though it declined compared with 2007 in both investment amount and number of deals (Table 3). Foreign funds still play an important role in late-stage investments, with over 30 percent of total investment at this stage originating from foreign investors.

New and follow-on investments

Follow-on deals continue to be the focus of VC investors in Canada, with $982M invested in follow-on deals and $343M in new investments (Table 4). Follow-on deals were skewed toward late-stage companies, with 58 percent of total follow-on investments. New investment in early-stage companies stood at $138M in 65 deals, well below the 2007 level.

Table 2
Average deal size ($ millions) by stage of development and type of investor, 2007 and 2008

	LSVCC/Retail Funds		Private Independent Funds		Foreign Funds	
	2007	2008	2007	2008	2007	2008
Seed	1.0	0.9	1.8	1.5	N/A	9.0
Start-up	1.2	0.8	2.0	1.5	4.9	3.1
Other early stage	1.5	1.6	2.4	2.6	11.2	6.2
Later stage	1.6	1.6	2.4	2.3	12.6	5.1

Source: Thomson Reuters Canada 2009.

Table 3
VC investment and number of deals by stage of development, 2003–2008

	2003–2006	2007	2008	2003–2006	2007	2008
	Amount ($ millions)			Number of Deals		
Seed/ start-up	1089 (16%)	267 (13%)	192 (15%)	501 (22%)	94 (21%)	92 (22%)
Other early stage	2278 (34%)	446 (22%)	360 (27%)	770 (33%)	102 (22%)	93 (23%)
Later stage	3360 (50%)	1352 (65%)	772 (58%)	1044 (45%)	261 (57%)	228 (55%)

Source: Thomson Reuters Canada 2009.

Table 4
Distribution of new and follow-on investments, 2003–2008

		2003–2006	2007	2008	2003–2006	2007	2008
		Amount ($ millions)			Number of Deals		
New	Early stage	59% 1002	54% 205	40% 138	61% 532	49% 83	46% 65
	Later stage	41% 691	46% 176	60% 206	39% 334	51% 87	54% 76
Follow-on	Early stage	47% 2367	30% 509	42% 415	51% 739	39% 113	44% 120
	Later stage	53% 2670	70% 1176	58% 567	49% 710	61% 174	56% 152

Source: Thomson Reuters Canada 2009.

Type of investor

The value of foreign fund investments declined sharply during 2008 (Table 5). There were fewer very large deals backed by foreign investors in 2008 compared with 2007. Although foreign VC funds invested less money in Canadian companies in 2008, they financed approximately the same number of companies compared with the previous year. Investment by LSVCC/retail funds also dropped, falling 24 percent compared with 2007, while total investment by private independent funds dropped less dramatically (8 percent). Total investment by private independent funds exceeded that of LSVCC/retail funds for the first time since 1996.

Table 5
Distribution of VC investment by investor type, 2007 and 2008

	2007	2008	% Change
	Amount ($ millions)		
LSVCC/ retail funds	406	310	-24
Private independent funds	360	330	-8
Foreign funds	845	371	-56

Source: Thomson Reuters Canada 2009.

Fundraising

Fundraising remained flat in 2008 with $1.2B raised, a 2-percent decrease compared with 2007. However, unlike previous years, private independent funds became the largest fundraisers, raising $672M, an increase of 45 percent from the $464M raised in 2007 (Table 6).

LSVCC/retail funds raised $532M, down 30 percent from the $755M raised in 2007.

Table 6
Distribution of VC fundraising by investor type, 2007 and 2008

	2007	2008	% Change
	Amount ($ millions)		
LSVCC/ retail funds	755	532	-30
Private independent funds	464	672	45

Source: Thomson Reuters Canada 2009.

Regional distribution

The decline in VC investments was felt across nearly all provinces, with Quebec dropping 45 percent, Ontario 40 percent and British Columbia 17 percent (Table 7). Quebec's share in the national total dropped from 31 percent in 2007 to 26 percent in 2008, while Ontario's share dropped from 46 percent to 43 percent. Despite a drop in total investment, British Columbia's share in the national total increased from 15 percent in 2007 to 20 percent in 2008. In contrast to trends in the rest of the country in 2008, investment in both Alberta and New Brunswick increased by more than 60 percent compared with 2007.

Table 7
VC investments and number of deals by province, 2007 and 2008

	Amount ($ millions) 2007		Amount ($ millions) 2008		Number of Deals 2007		Number of Deals 2008	
British Columbia	316	15%	259	20%	59	13%	56	14%
Alberta	47	2%	77	6%	15	3%	29	7%
Saskatchewan	59	3%	21	2%	7	2%	8	2%
Manitoba	18	1%	4	0%	9	2%	3	1%
Ontario	950	46%	570	43%	143	31%	138	33%
Quebec	642	31%	349	26%	206	45%	154	37%
New Brunswick	16	1%	26	2%	7	2%	11	3%
Nova Scotia	18	1%	17	1%	11	2%	13	3%
Prince Edward Island								
Newfoundland and Labrador			2	0%			1	0%
Territories								

Source: Thomson Reuters Canada 2009.

Sector distribution

All major sectors of activity were negatively affected by the decline in VC investment in 2008 (Table 8). Despite a 39-percent decline in the information technology sector between 2007 and 2008, the sector still accounts for almost half of VC investment in Canada. Investment in the life sciences sector dropped by 43 percent and only represented 27 percent of total VC investment in 2008, down from 31 percent in 2007. Investment in energy and environmental technologies dropped by only 5 percent during the same period. Investment in "other" technologies increased, mainly because of two large deals totalling nearly $20M.

GOVERNMENT ACTIVITIES

In Q4 2008, the Business Development Bank of Canada (BDC) made VC investments in 14 companies (Table 9). The BDC committed $16.7M and its co-investors committed an additional $90.7M.

Export Development Canada participated in a US$15M venture capital deal in an Ottawa-based telecommunications company.

The Government of Ontario announced in January 2009 that eight promising high-tech firms will each receive up to $500 000 from Ontario's Investment Accelerator Fund. The Investment Accelerator Fund is an early-stage seed fund managed by the Ontario Centres of Excellence.

Table 8
VC investments by sector of activity, 2007 and 2008

	2007	2008	2007	2008
	Amount ($ millions)		Number of Deals	
Life sciences	31% 634	27% 359	18% 83	21% 86
Information technology	51% 1059	49% 644	47% 216	48% 198
Energy and environmental technologies	10% 198	14% 187	8% 36	8% 35
Other technologies	0% 6	3% 34	1% 6	4% 15
Traditional	8% 170	8% 101	25% 116	19% 79

Source: Thomson Reuters Canada 2009.

Table 9
BDC deals in Q4 2008

	BDC	Co-investors	Total	Number of Deals
	($ millions)			
Start-up	2.7	4.7	7.4	2
Other early stage	5.3	22.6	27.9	4
Later stage	8.7	63.4	72.1	8
Total	16.7	90.7	107.4	14

Source: Business Development Bank of Canada, 2009.

ECONOMIC IMPACT OF VC-BACKED FIRMS IN CANADA

A recent study on the economic impact of VC was conducted and funded by Canada's Venture Capital & Private Equity Association (CVCA), with additional funding provided by the Government of Canada, Business Development Bank of Canada, and governments of British Columbia, Alberta, Ontario and Quebec.

The study, entitled *Why Venture Capital is Essential to the Canadian Economy: The Impact of Venture Capital on the Canadian Economy*,[1] reports that surveyed companies in Canada that received VC at some time during the period from 1996 to 2003 posted average annual revenue growth rates of 32 percent from 2003 to 2007 and average annual employment growth rates of 17 percent. The study also segments these data by region and in three broad industry sectors. The results are based on an analysis of responses from companies that were backed by six of Canada's largest VC portfolios, as well as an analysis of 15 of Canada's largest companies that received VC prior to 1996.

The study also highlights the important role that VC has played in helping to build many of Canada's top companies. For example, over 50 percent of the companies on *The Globe and Mail*'s 2007 Top 1000 Publicly Traded Companies list in the information technology and telecommunications sector, as well as the biotechnology sector, have received VC funding in the past. As well, the study illustrates, through anecdotal evidence, how successful VC transactions:

(1) create wealth for the founders of VC-backed start-ups, which often reinvest a portion of those proceeds into other new start-ups,

(2) help grow the managerial talent pool in Canada for the next generation of start-ups, and

(3) create new serial entrepreneurs.

Furthermore, the study shows how VC-backed firms are highly research and development intensive and export oriented. The net effect is

[1] Report can be found at http://www.cvca.ca/files/Downloads/CVCA_2008_VC_Economic_Impact_Single.pdf.

that VC has played a role in developing Canada's knowledge-based economy.

Similar studies have been conducted for other nations, including the United States.[2] Although average growth rates vary from study to study, partially due to differences in methodologies and country-specific factors that affect performance, the studies share the general conclusion that VC-backed companies outperformed their non-venture-capital-backed counterparts in terms of job creation and revenue growth.

IN FOCUS: WINNIPEG

The City of Winnipeg has experienced solid economic growth in recent years that exceeded the Canadian average. This trend continues and the city is forecast to be ranked third among Canadian cities for economic growth in 2009 according to the Conference Board of Canada's Metropolitan Outlook, Winter 2009.

Promising technology sectors

The city's economy is driven by leading products and companies in a number of sectors, including medical devices, biotechnology, information technology, new media, aerospace, bus manufacturing, agri-business and consumer goods manufacturing.

These private sector companies are bolstered by the presence of world-class public research and technology institutions, many of which are located at Smartpark, a research and technology park on the University of Manitoba's Fort Garry campus. These include TRLabs Winnipeg, specializing in the domains of data networking and e-health; the Richardson Centre for Functional Foods and Nutraceuticals; the Composites Innovation Centre; and the Industrial Technology Centre, an economic development and technology commercialization centre that includes the Virtual Reality Research and Innovation Centre. Other important research institutes in Winnipeg include the NRC Institute for Biodiagnostics, the St. Boniface General Hospital Research Centre, and the soon-to-be-opened Siemens Institute for Advanced Medicine.

Venture capital investment in Winnipeg

The city's economic diversity is reflected in the companies that have been backed by VC. Of the 42 disclosed companies that have received VC investment since the end of the tech bubble in 2001, approximately half operated in traditional sectors and the rest were divided equally between the life sciences and information technology sectors.

Labour-sponsored investment funds are very active in Winnipeg, having participated in over three quarters of the city's VC deals since 2001. There has been a restructuring of labour-sponsored funds in Winnipeg involving well-established funds from other provinces. Recently, the labour-sponsored investment fund ENSIS, active in the province since 1998, merged with the GrowthWorks Canadian Fund. As well, Saskatchewan-based Golden Opportunities Fund recently announced that it will expand into Manitoba by beginning fundraising and investment activities in the province.

Private independent funds have also made several VC investments in the city, especially Western Life Sciences Venture Fund, based in Winnipeg, and MMV Financial, based in Toronto. Winnipeg is also home to two private equity firms specializing in buyouts: Richardson Capital Limited and Canterbury Park Management Inc.

A number of successful Winnipeg companies have grown through VC investment and remain headquartered in the city.

- A new media company that received over $7M in VC since 2006 has produced a number of television series and provided visual effects for major Hollywood films.
- A biopharmaceutical company developing diabetes treatments received nearly $3M in VC,

[2] *Venture Impact: The Economic Importance of Venture Capital Backed Companies to the U.S. Economy*. Fourth Edition. Global Insight. Copyright 2007 by the National Venture Capital Association.

leading to an initial public offering on the TSX in 2007 worth $5.5M for investors, and has since been ranked in OCRI's "Canada's Top 10" in the life sciences category.

- A company developing surgical imaging technology received financing from a local angel investor, a local limited partnership and a private equity firm based in Toronto. This led to an initial public offering in 2007 worth $40M for investors.

The presence of well-performing technology companies across a number of sectors means that there is a variety of strong investment opportunities in Winnipeg.

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Thomson Reuters Canada 2009.

NOTES

This publication is part of a series prepared by the Small Business and Tourism 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 and Tourism 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.

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