



Q3 2007

# VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

The Canadian venture capital (VC) industry is a key contributor to the growth of innovative firms that commercialize research. For this reason, the health of this industry is an ongoing concern. The goal of this series is to provide current information about this key enabling industry. 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 reports on trends in venture capital (VC) activity in Canada during Q3 2007. As part of a new feature series, it showcases programs offered by the Ottawa Centre for Research and Innovation (OCRI) to help entrepreneurs transform ideas into opportunities for investors. The “In Focus” article highlights the life sciences cluster in Montréal and discusses recent restructuring of the VC industry in Quebec.

## VC ACTIVITY OVERVIEW

### Investment and fundraising trends

Venture capital investment in Q3 2007 reached \$512M (141 deals), a 17-percent increase over Q2 2007 and a 47-percent increase over Q3 2006. This increase was largely due to three very large deals in Q3 2007 worth a total of \$156M. Investment during the first nine months of 2007 reached \$1561M (359 deals), up 30 percent from the \$1201M (392 deals) reached during the first nine months of 2006.

VC fundraising in Q3 2007 totalled \$113M, dropping 58 percent from \$272M in Q2 2007. This decline was driven by private independent funds that raised only \$7M during the quarter. VC fundraising

during the first nine months of 2007 reached \$852M, down 37 percent from the \$1350M committed during the first nine months of 2006.

**Table 1**  
VC investment and fundraising during the first nine months of 2006 and 2007

	2006	2007	% Change
	(first nine months)	(first nine months)	
(\$ millions)			
Investments	1201	1561	30
Fundraising	1350	852	-37

Source: Thomson Financial Canada 2007.

### Large increase in average deal size due mostly to deals involving foreign investors

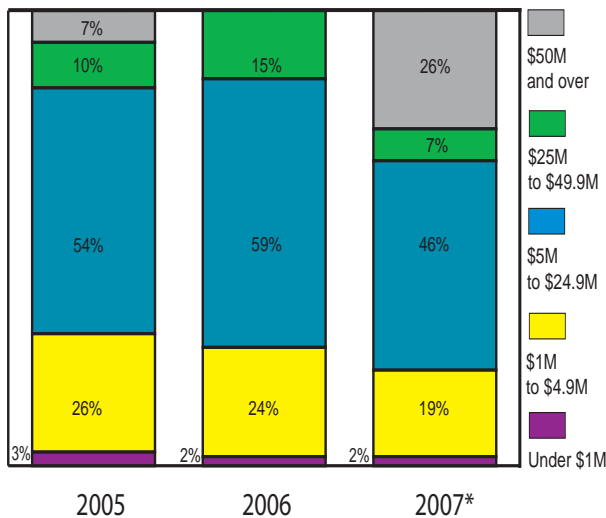
The average deal size in Q3 2007 was \$3.6M, up 33 percent from \$2.7M in Q3 2006. However, if the very small number of deals worth over \$25M are excluded, the average deal size in Q3 2007 drops to \$2.6M. The average deal size during the first nine months of 2007 was \$4.3M, up 16 percent over the \$3.7M observed during the entire year of 2006. The increase in the average deal size since 2005 has largely been driven by investments by foreign investors. During this period, there has been a slight increase in the average size of investments by domestic investors.

### Total investment boosted by a very small number of very large deals

Investment during the first nine months of 2007 was concentrated more in very large deals than in previous years (Figure 1). Four deals worth a total of \$400M account for 26 percent of total investment during this period.

During the period January 2005 to September 2007, all of the 22 deals worth \$25M or more included foreign investors and the six deals worth more than \$55M involved only foreign investors.

**Figure 1**  
VC investment by deal size

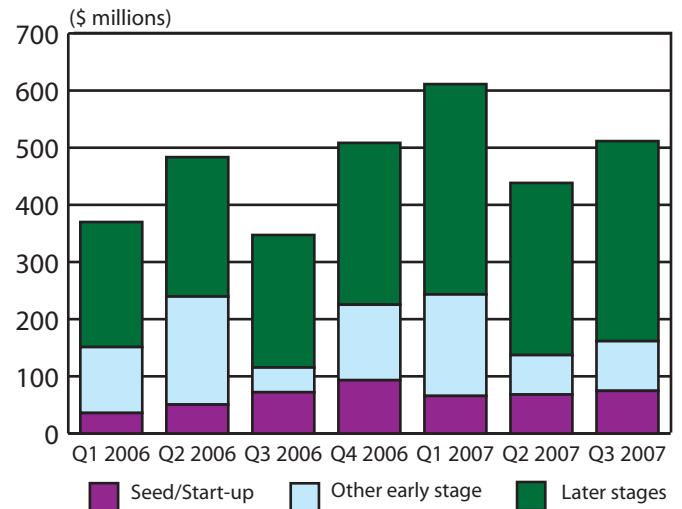


Source: Thomson Financial Canada 2007.  
\*First nine months.

### Increase in share of later-stage investments driven by very large deals

Investment in later-stage companies accounted for 68 percent of VC investment in Q3 2007 (79 deals) and 65 percent of total investment during the first nine months of 2007 (205 deals). These proportions are greater than any observed in an entire year since 1996. This trend has been driven by six very large investments (worth a total of \$403M) that were placed in later-stage companies in 2007. As a result, the increase in overall investment during 2007 has not increased the capital available to seed and start-up companies (Figure 2).

**Figure 2**  
VC investment by stage of development

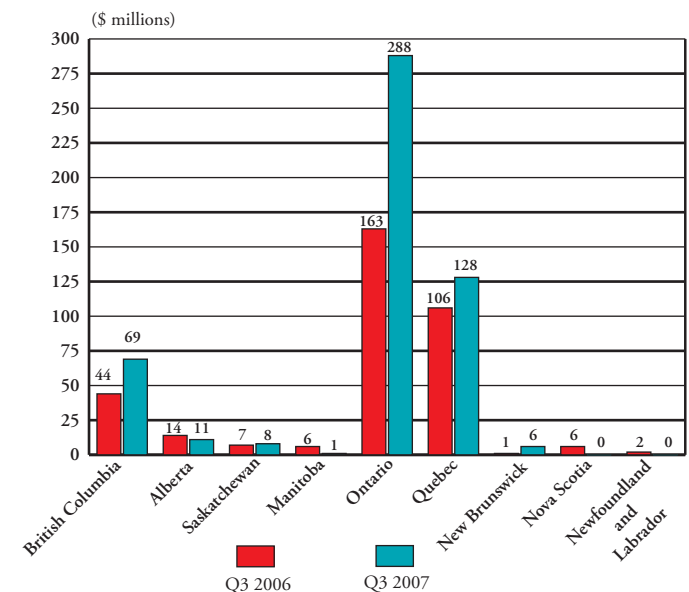


Source: Thomson Financial Canada 2007.

### Increase in Ontario VC investment

Ontario had a strong third quarter, attracting \$288M in VC investment (49 deals), up 77 percent from \$163M in Q3 2006 (Figure 3). For the most part, this was due to two very large deals totalling \$130M. Relative to Q3 2006, investment in Quebec rose 20 percent to \$128M (56 deals) and investment in British Columbia rose 57 percent to \$69M (19 deals) in Q3 2007.

**Figure 3**  
Regional distribution of VC investments, Q3 2006 and Q3 2007



Source: Thomson Financial Canada 2007.

## Investment from foreign sources continues to climb

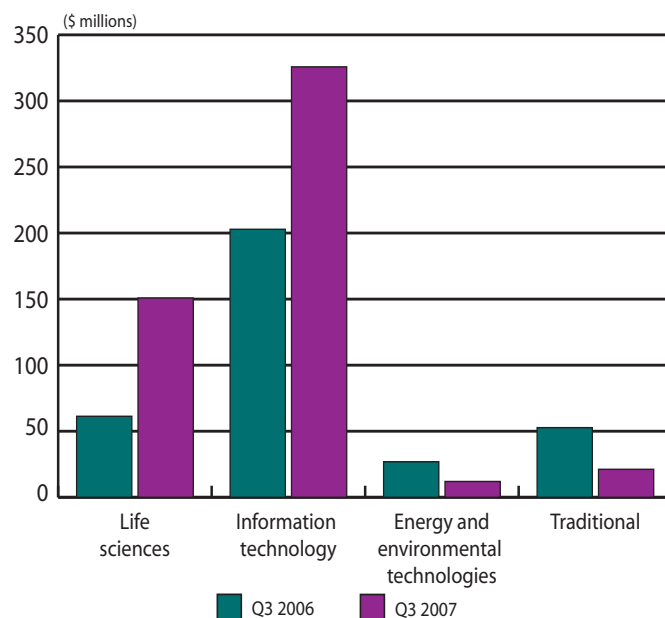
The amount invested by foreign sources reached \$213M in Q3 2007 (25 deals), more than doubling the \$92M invested in Q3 2006 (15 deals) and accounting for 42 percent of total VC investment. In the first nine months of 2007, the total invested by foreign sources reached \$640M (55 deals), surpassing the \$526M (70 deals) invested during the entire year of 2006. Notably, seed and start-up deals accounted for only 4 percent of foreign investment during the first nine months of 2007 (five deals), much lower than the average of 13 percent from 2002 to 2006.

## Large increase in life sciences investment

Investment in the life sciences sector in Q3 2007 jumped to \$151M (30 deals), increasing 148 percent from \$61M (25 deals) in Q3 2006 (Figure 4). Even if two very large biopharmaceutical deals worth a total of \$51M are excluded, investment in the life sciences sector still increased by 64 percent compared with Q3 2006. Investment in the information technology (IT) sector also experienced a dramatic increase, rising to \$326M (72 deals), up 61 percent from \$203M (61 deals) in Q3 2006. If one deal in the communications sector worth \$105M is excluded, the IT sector experienced more modest 9-percent growth.

Investment in energy and environmental technologies declined to \$11.97M in Q3 2007 (seven deals), dropping 56 percent from \$26.90M (five deals) in Q3 2006. Investment in traditional sectors also declined, dropping 60 percent to \$21.18M (30 deals) in Q3 2007 from \$52.71M (33 deals) in Q3 2006.

**Figure 4**  
Investment by sector, Q3 2006 and Q3 2007



Source: Thomson Financial Canada 2007.

## VC-related government activities

In Q3 2007, the Business Development Bank of Canada (BDC) committed to 23 deals worth a total of \$268M, including co-investors (Table 2).<sup>1</sup> All but one of the deals were made in syndication with other investors. BDC's commitments included a total of \$8.6M to two start-up companies that had not previously received VC.

**Table 2**  
BDC deals by stage of development, Q3 2007

	Number of deals	Financing (\$ millions)	
		BDC's share	Total deal value
Seed	1	1	3
Start-up	8	21	107
Development	9	15	106
Expansion (first-stage)	5	7	53
<b>Total</b>	<b>23</b>	<b>43</b>	<b>268</b>

Source: Business Development Bank of Canada 2007.

<sup>1</sup> These data are provided by the Business Development Bank of Canada and are based on commitments. They differ from Thomson Financial data, which are based on disbursements.

Farm Credit Canada's FCC Ventures invested \$3.6M in three VC deals in Q3 2007. Two of those deals were made in syndication with Avrio Ventures. Avrio Ventures is a VC fund for industrial life sciences companies and was launched in 2006 with a \$50M investment from Farm Credit Canada.

Export Development Canada (EDC) announced in August 2007 that it had committed \$7.5 million to a fund managed by the private equity firm Avigo, located in India. The fund will invest in companies operating in India that have the potential to strategically match the expertise of Canadian exporters.

Provincial government agencies participated in seven venture capital deals in Q3 2007, according to Thomson Financial's data. Alberta's AVAC Fund Ltd. was among the most active, acting as the sole investor in three seed-stage deals worth a total of \$4.4M. It invested in two agriculture biotechnology companies and one wireless technology company.

The Ontario Ministry of Innovation announced in November the launch of the Ontario Venture Capital Fund. This \$165M fund of funds will be managed by an experienced third-party fund manager. Ontario has committed \$90M, BDC \$15M and the balance will be contributed by leading Canadian institutional investors, including OMERS Administration Corporation, RBC Capital Partners and Manulife Financial.

## FEATURE SERIES: CREATING QUALITY DEMAND FOR RISK CAPITAL IN CANADA

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Canada has a diversified research and development community. Although this community is rife with great ideas and innovative approaches, the key to economic prosperity for Canada lies in efficiently transforming these innovations into commercialized products and services for domestic and international marketplaces. This process requires matching ideas and innovations with market opportunities, entrepreneurs, technologists and, finally, appropriate

risk capital investors. This series of articles will showcase organizations and programs that facilitate the creation of quality demand opportunities for risk capital investors, such as Calgary's Wireless City,<sup>2</sup> referenced in the Q2 2007 issue of *Venture Capital Monitor*. This issue features the Ottawa Centre for Research and Innovation (OCRI),<sup>3</sup> an organization that helps entrepreneurs transform ideas into opportunities for investors.

### *Snapshot: Ottawa Centre for Research and Innovation*

OCRI's investment and commercialization (I/C) group helps start-ups, entrepreneurs and investors build successful global businesses, focusing on companies that are primarily technology-based and operate in high-growth industries across the life science, clean technology, and information and communications technology sectors. Services of the investment and commercialization team are offered in four main areas.

### *Business Advisory Services*

Business advisors work with companies to undertake a business assessment and work with management to determine how they can best utilize OCRI's services, which include:

- business plan reviews,
- advice on investment pitch presentations and assistance in crafting messages for the investment community,
- access to *Business Insights* market intelligence reports and other reports as needed to make informed business decisions, and
- referrals to funding agencies such as the Industrial Research Assistance Program (IRAP) and Investment Accelerator Fund (IAF), to other OCRI programs and services, and to targeted investors.

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<sup>2</sup> [www.wirelesscity.ca](http://www.wirelesscity.ca)

<sup>3</sup> [www.ocri.ca](http://www.ocri.ca)

## *Mentorship Program*

Through experienced business mentors, OCRI provides strategic advice to companies on a case-by-case basis to solve a defined business problem. Mentors are found within and outside the Ottawa region, capitalizing on the vast networks that OCRI has available, including its partnership in the Business Mentorship and Entrepreneurship Program (BMEP), a program of the Ministry of Research and Innovation and administered by MaRS.<sup>4</sup>

## *Market Intelligence*

OCRI has established partnerships with a variety of leading market intelligence service providers to provide companies and investors with timely information to make knowledgeable business decisions.

## *Investor Readiness*

The I/C group works with investors locally, nationally and internationally to identify opportunities and make connections for investment. It also works with local angel networks, VC firms and others to help increase the depth of capital in the market. It is actively engaged in organizing networking and professional development activities for angels in conjunction with the National Angel Organization as well as promoting opportunities for investors to network with some of Ottawa's emerging companies.

OCRI's Investment and Commercialization Group Statistics from January to November 2007	
Total number of companies receiving services from the investment and commercialization group	61
Total number of companies receiving mentorship services	10
Total value of mentorship services provided	\$100 000
Total number of companies from mentorship program that received angel financing	4
Total number of companies accessing market intelligence services	14
Total value of market intelligence services	\$67 500
Total number of companies referred to the Ontario Centres of Excellence Market Readiness Fund	17
Total number of companies referred to IRAP	3
Total number of spinoff companies referred to I/C group from National Research Council Canada (NRC)	6
Total number of spinoff companies referred to I/C group from universities	2

## **"IN FOCUS" — MONTRÉAL AREA**

### *Montréal's life sciences cluster*

Montréal is known for its life sciences cluster. It is the home of world-class university research centres, including the Centre Interuniversitaire de Recherche en Toxicologie (CIRTOX), created by the Université de Montréal in 1989, and the McGill AIDS Centre, which had a hand in the discovery of 3TC, a leading AIDS treatment. The federal National Research Council's Biotechnology Research Institute, the largest Canadian research facility devoted to biotechnology,<sup>5</sup> is also located in Montréal.

Companies in Montréal captured over a third of total VC investment in the life sciences sector in Canada over the last five years. Life sciences accounted for about two fifths of VC investment in Montréal during that period, with IT attracting another two fifths.

<sup>4</sup> MaRS is an innovation centre located in Toronto that is supported by governments, the private sector, universities and hospitals.

<sup>5</sup> National Research Council Canada, 2007.



## Structural change in Montréal VC industry

The structure of the VC industry in Montréal, and in Quebec as a whole, has gone through important changes in recent years. Prior to 2004, direct venture capital investment in Quebec was dominated by public sector funds. However, starting in 2004, the Quebec government made major changes to its VC strategy. It began privatizing and re-orienting government funds to become less active in direct early-stage investment. It also launched FIER Partenaires, a “fund-of-funds” with a mandate to support the development of VC funds. Around the same time, the Caisse de dépôt et placement du Québec (CDP), the manager of the Quebec Pension Plan, announced a new VC strategy that was more focused on partnerships with private sector VC funds.<sup>6</sup>

Following these changes, Quebec now had three large funds — CDP, FIER Partenaires and Fonds de solidarité FTQ, Canada’s oldest and largest retail VC fund — all with mandates to work with private-sector VC funds. A coordinated effort among these three organizations, including investments totalling \$470M, has led to 13 funds being established in Montréal. CDP, FIER Partenaires and Fonds de solidarité FTQ have attracted Canadian VC firms such as Brightspark and J.A. Albright, and major U.S. firms, including Vantage Point and Rho Capital Partners.<sup>7</sup> This occurred largely because Quebec-based VC firms had formed relationships with these out-of-province firms from previous investments. This also made it possible to draw world-class VC fund managers to Quebec. Developing relationships with foreign VC funds is an important component of the new VC industry structure in Quebec as it contributes to the development of Canadian companies and VC firms and helps companies tap into international markets.

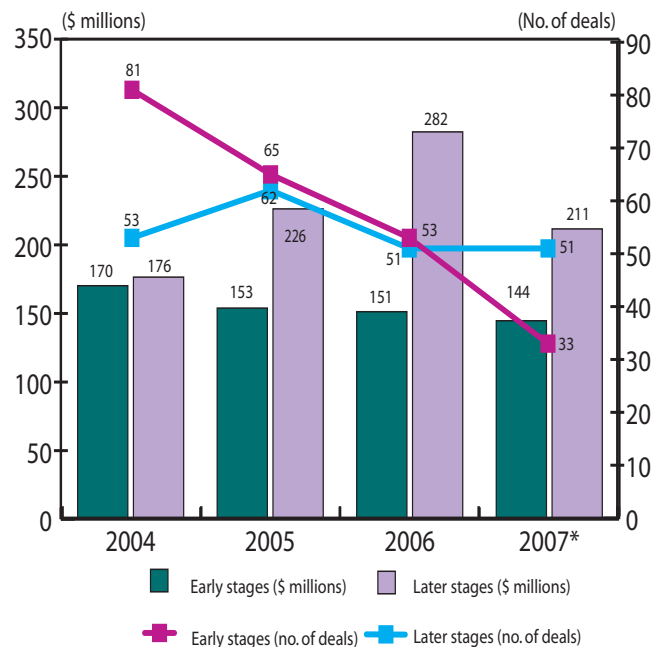
As expected, the share of foreign investment in Montréal has increased dramatically, according to Thomson Financial, rising from 23 percent in 2003 to 41 percent in the first nine months of 2007. At the same time, there has been a relative decline in direct investment from public sources (government, retail and institutional), which represented 46 percent of

VC investment in Montréal in 2003 and only 25 percent in 2007.

With foreign VC playing a more dominant role in Montréal in recent years, the amount invested in later-stage companies has increased 57 percent from 2004 to 2006. This has not been accompanied by a comparable increase in the number of late-stage deals, causing the average late-stage deal size to increase from \$1.76M in 2004 to \$3.6M in 2006. In contrast, early-stage investment experienced a decline during this period (Figure 5).

This shift towards lower-risk later-stage investments, which is being observed nationwide, has been somewhat offset in Quebec by the establishment of specialized early-stage funds such as ID Capital, GO Capital and iNovia.

**Figure 5**  
VC investment in Montréal by stage of development



Source: Thomson Financial Canada.

\*First nine months.

<sup>6</sup> Montréal InVivo, 2006. Page 3.

<sup>7</sup> Mazurkewich, 2007.

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## NOTES

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This publication is part of a series prepared by the Small Business Policy 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 Policy 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](http://www.sme-fdi.gc.ca).

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