Industry Canada Industrie Canada

Canada

Q4 2012

VENTURE CAPITAL MONITOR

A QUARTERLY UPDATE ON THE CANADIAN VENTURE CAPITAL INDUSTRY

www.ic.gc.ca/vcmonitor

This publication by the Small Business Branch 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 year-end issue of the Venture Capital Monitor covers venture capital (VC) activity from January 2012 to December 2012.

VC Activity Overview

Investment and fundraising

Substantial increase in annual fundraising levels

Canadian VC investment activity remained at a steady state in 2012, almost matching the dollar value invested in 2011 while demonstrating marginal growth in the number of innovative company financings. Just under $1.47 billion was invested into the market over the year, a small 3 percent decline from the $1.51 billion invested during 2011 (Table 1, Figure 1). Similarly, 458 firms secured venture capital financing during 2012, an increase of 1 from 457 firms during 2011. Year-end results were supported by a total of $321 million invested in Q4 2012, though this activity was down 15 percent on a year-over-year basis.

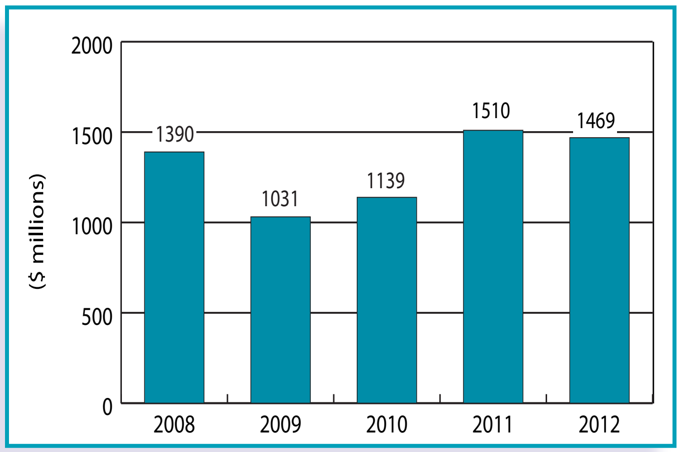
While investment levels remained relatively stable over the year, fundraising activity increased substantially in 2012. New capital commitments to VC funds reached its highest level in a decade, the result of several significant private independent fund closings early in 2012. Nearly $1.8 billion in new supply was committed to 33 domestic VC funds throughout the year, up 73 percent from $1.0 billion committed to 28 funds in 2011. This total was the highest in terms of total dollars committed since 2002 when $2.5 billion was committed.

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

	FY 2011	FY 2012	Percent Change
	($ millions)		
Investment	1510	1469	-3%
Fundraising	1031	1784	73%

Source: Thomson Reuters Canada 2013.

Figure 1: VC Investment by year, 2008–12



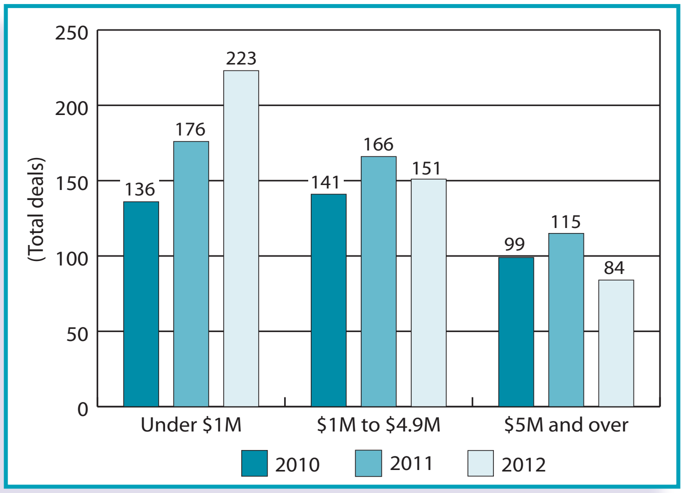
Source: Thomson Reuters Canada 2013.

Deal size

Average deal sizes remained virtually unchanged in 2012

In 2012, 458 firms secured financing, which was nearly the exact same amount as 2011 (Figure 2). This is the highest level of total deals completed since 2005 when 598 firms received VC financing. Average deal size changed marginally from $3.7 million in 2012 compared to $3.8 million in 2011.

Figure 2: Distribution of VC investment by deal size, 2010–12



Source: Thomson Reuters Canada 2013.

The amount of deals completed in the under $1 million range increased substantially over the year going from 176 firms in 2011 to 223 firms in 2012. Smaller deal sizes are a continuation of a trend that has become more pronounced in recent years. Total deal sizes under $1 million represented nearly half of all deals completed in 2012 compared to 39 percent in 2011 and 36 percent in 2010. Despite this, overall deal sizes benefited from several major financings completed during the year including the: $80 million financing of Kitchener's Desire2Learn Inc.; $50 million financing of Calgary's Engineered Power Inc.; $35 million financing of Vancouver's D-Wave Systems Inc.; and $35 million financing of Montréal's Thrasos Innovation Inc.

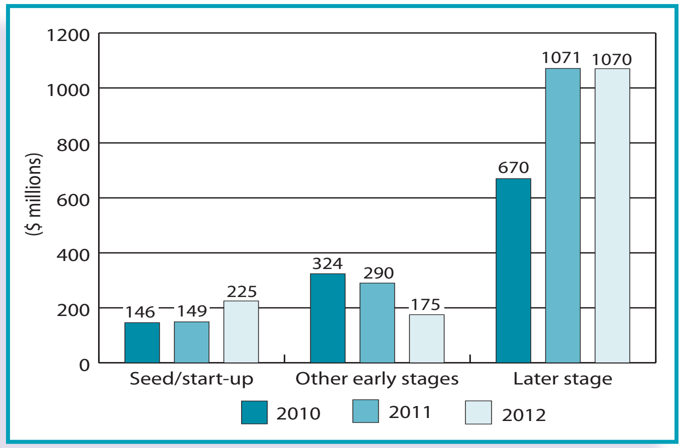
Stage of development

Significant increase in seed and start-up deals completed in 2012

Investments continued to be highly concentrated in later-stage deals during 2012 attracting approximately 73 percent of all investment dollars an increase from 71 percent in 2011. The total $1.07 billion invested into later-stage deals in 2012 was virtually unchanged from the 2011 (Figure 3). The 248 total deals completed throughout the year were later stage deals, representing about 55 percent of all deals completed.

Notably, 2012 saw a substantial increase in deals completed at the seed and start-up stages (Figure 3). Altogether 141 firms at the seed and start-up stages brought in about $225 million, a 66 percent increase over the $149 million invested during 2011. However, despite a substantial increase in investments at the seed and start-up stages, other early stage investments fell from $290 million in 2011 to $175 million over 2012.

Figure 3: VC investment by stage of development, 2010–12



Source: Thomson Reuters Canada 2013.

New versus follow-on investments

Year-over-year increase in new deals completed

There were 210 new VC deals recorded in 2012, 28 more than during 2011 and the highest figure experienced since 2005. These new deals were worth approximately $539 million, a 53 percent year-over-year increase compared to the $353 invested into new deals in 2011. New deals at the seed and start-up stages of development experienced notable growth with 33 more new deals completed at these stages than during 2011. The 104 new deals completed at the seed and start-up stages are the highest annual figure on record since 2002 and nearly triple the historic low experienced in 2010.

Completed follow-on deals experienced a drop from 275 in 2011 to 248 in 2012. Follow-on deals at the other early stages saw a decrease from 60 in 2011 to 39 in 2012 (Table 2).

Table 2: Number of companies that received new and follow-on investment, 2010–12

Investment		Total		
		2010	2011	2012
New	Seed/start-up	35	71	104
	Other early stages	24	15	30
	Later stage	90	96	76
	All	**149**	**182**	**210**
Follow-on	Seed/start-up	40	43	37
	Other early stages	69	60	39
	Later stage	118	172	172
	All	**227**	**275**	**248**
Total	**All**	**376**	**457**	**458**

Source: Thomson Reuters Canada 2013.

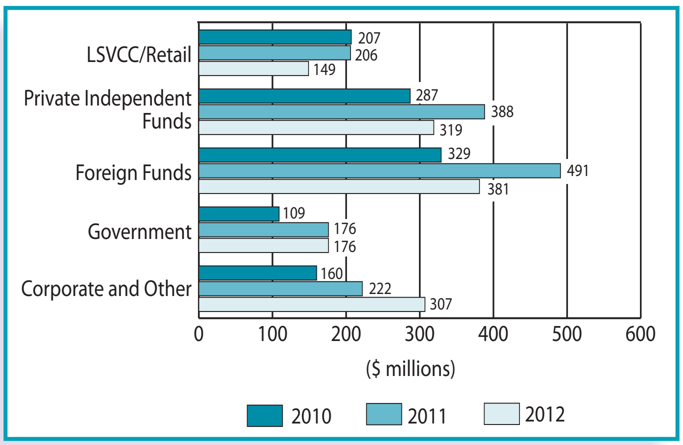
Type of investor

Domestic funds lead financing during 2012

Domestic funds played an essential role in Canadian market trends in 2012. Altogether, domestic VC invested a total of $1.1 billion during 2012, a 7 percent increase over 2011. While private independent funds were the most active investors during the year with $319 million deployed, corporate and other investors experienced the most substantial increase in investment levels. Altogether corporate and other investors invested 38 percent more than during 2011, with much of this activity driven by OMERS Ventures.

Retail/Labour sponsored venture capital corporations (LSVCC) continued to trend downward for the sixth straight year, as only $149 million in VC was invested by these funds during 2012. This is the lowest annual amount invested by LSVCC's on record. Government investors remained unchanged year-over-year once again investing $176 million into Canadian companies. In contrast, American and other foreign VC funds were less active in Canada in 2012, bringing $381 million to deals, which is 22 percent less than the $491 million they brought to deals the year before (Figure 4). Consequently, foreign funds contributed 26 percent of total dollars invested in the Canadian market last year, which is off from the 32 percent share these funds held in 2011.

Figure 4: Distribution of VC investment by type of investor, 2010–12



Source: Thomson Reuters Canada 2013.

Fundraising

Highest single fundraising year experienced in more than a decade

While investment levels remained relatively stable over 2012, Canadian fundraising experienced its most active year in more than a decade. By the end of 2012 just less than $1.8 billion in new supply had been committed to 33 domestic VC funds, up 73 percent from the $1.0 billion committed to 28 funds in 2011. Fundraising into private independent funds was largely backed by large government investors such as the Business Development Bank of Canada (BDC) and other government supported fund-of-funds such as the Ontario Venture Capital Fund.

Fundraising was lead by private independent funds, of which 23 funds brought in close to $1.2 billion of new supply into the Canadian VC market, or about 70 percent of all dollars raised. Retail/LSVCC funds also saw growth in new commitments last year having raised $414 million over the year, up more than 3 percent from the $402 million raised over 2011. As in past years, the vast majority of LSVCC fundraising activity (about 73 percent) was centred in Quebec.

Regional distribution

Ontario firms lead the way in terms of VC dollars captured

In terms of value, Ontario firms paced the Canadian VC market in 2012 having attracted $603 million, a notable increase over the $564 million attracted by the province during 2011. Growth in the Ontario market was largely driven by increased investments into ICT companies, which attracted about $456 million or 76 percent of Ontario's VC dollars. Quebec and British Columbia each experienced small declines in the value of VC invested with $409 million and $222 million invested into the provinces respectively (Figure 5). Saskatchewan experienced a sharp increase in investment levels over the year, attracting $73 million over 15 deals compared to only $13 million the previous year (Table 3).

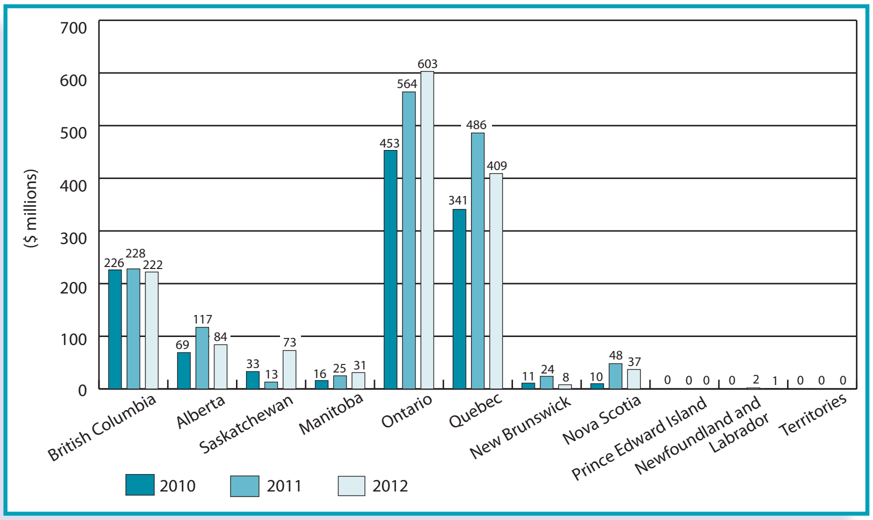
Table 3: Number of companies receiving VC by province, 2011 and 2012

Province	2011	2012	Percent Change
British Columbia	52	56	8
Alberta	23	18	-22
Saskatchewan	8	15	88
Manitoba	5	4	-20
Ontario	132	161	22
Quebec	217	166	-24
New Brunswick	9	11	22
Nova Scotia	8	25	17
Prince Edward Island	0	0	n/a
Newfoundland and Labrador	0	0	n/a
Territories	0	0	n/a

Source: Thomson Reuters Canada 2013.

While Ontario lead the country in terms of value of deals completed, Quebec continued to lead the country in terms of financings completed with 166 deals completed,

Figure 5: Regional distribution of VC investment in Canada, 2010–12



Source: Thomson Reuters Canada 2013.

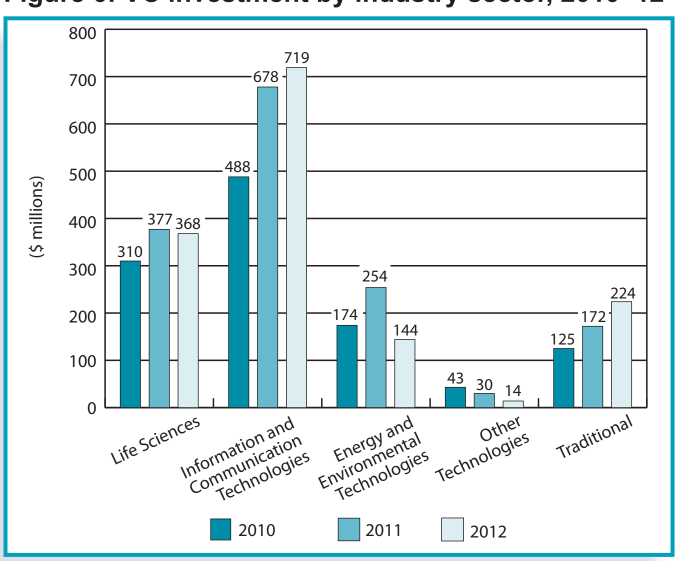
a 24 percent shortfall of the total amount of deals completed in the province over the previous year. Average deal sizes in Ontario substantially outsized those across the country and were largely buoyed by several very large deals, including an $80 million financing into Kitchener's Desire2Learn Inc.

Sector distribution

Software and Internet-focused firms continued their upward trend during 2012

Canadian VC was driven by information technology (IT) companies in 2012. A total of $719 million went to 214 companies or just below half of all VC invested over the year (Figure 6). Software and Internet-focused firms continued their upward trend as firms in the two sectors attracted $345 million and $179 million respectively. This represented the single strongest year in terms of investment received by software companies in more than a decade.

Figure 6: VC investment by industry sector, 2010–12



Source: Thomson Reuters Canada 2013.

Life sciences firms saw a very small decline in total financing received over the year as $368 million was invested into the sector over 2012 compared to $377 million during the previous year. Ontario and Quebec life sciences firms were the main recipients of this capital, having attracted $118 million and $114 million respectively. British Columbia saw a decline in terms of total life sciences VC received falling from $83 million in 2011 to just $42 million in 2012.

The energy and environmental technologies sector experienced a sharp decline in investment levels over 2012. Throughout the year these firms attracted only $144 million, nearly $110 million less than the $254 million received during 2011. This decline was most pronounced in Quebec, where investments into the sector fell from $102 million in 2011 to just $19 million in 2012.

Government Activities

Business Development Bank of Canada Activities

During Q4 2012, the Business Development Bank of Canada (BDC) made VC commitments totalling $16.6 million into 32 companies (Table 4). These financings were leveraged to a total of $65.7 million including contributions by co-investors.

Table 4: VC activities of the Business Development Bank of Canada, Q4 2012

	BDC	Co-investors	Total	Number of deals
	($ millions)			
Seed/start-up	6.3	3.1	9.4	22
Development	6.0	22.1	28.1	7
Later stage	4.3	23.9	28.2	3
Total	**16.6**	**49.1**	**65.7**	**32**

Source: Business Development Bank of Canada 2013.

Prime Minister Announces the Venture Capital Action Plan

The Government of Canada is pursuing a comprehensive action plan for deploying the $400 million announced in Budget 2012, over the next seven to ten years. On January 14, 2013, the Government of Canada announced the Venture Capital Action Plan, which will make available: $250 million to establish new, large private sector-led national funds of funds in partnership with institutional and corporate strategic investors; up to $100 million to recapitalize existing large private sector-led funds of funds; and an aggregate investment of up to $50 million in three to five existing high-performing venture capital funds in Canada.

In Focus: A perspective by the BDC on activity and trends in Canada's VC ecosystem

Investment + fundraising environment

Improvements in VC investment and fundraising, combined with the Government of Canada's Venture Capital Action Plan, are contributing to a more optimistic view over the mid- to long-term for the Canadian VC ecosystem.

VC investment has steered a steady course over the past year, suggesting a return to stability. With a general increase in VC investment activity, more Canadian firms are receiving venture funding. Private and institutional venture funds have led the growth in domestic VC activity, which is a promising sign. Larger deals are now getting done in Canada (e.g., Desire2Learn—$80 million) and exit markets have gained momentum, driven largely by strategic acquisitions/sales.

From an ecosystem perspective, perhaps the most important development has been the short-term easing of the VC fundraising logjam, with significant growth in VC fundraising activity in 2012. Nevertheless, the pool of capital remains limited with demand outstripping supply. While the limited available capital is flowing to the highest quality funds, fundraising remains difficult and time-consuming for first-time and experienced fund managers alike.

Market developments

Within the past 12 to 18 months, there appears to have been a "renaissance" in early stage tech entrepreneurial and start-up funding activity across Canada. This is being driven by a number of factors, including: the emergence of "lean start-up" methodologies; the impact of incubators (e.g., MaRS, Communitech, etc.) and accelerators (e.g., GrowLab Ventures, FounderFuel, Extreme Startups, HyperDrive, JOLT); more active seed and early stage investors (e.g., Version One Ventures, Real Ventures, iNovia Capital, Golden Venture Partners, and BDC VC); early stage funding programs in certain regions (e.g., FedDev Ontario); and active "re-investment" in entrepreneurial companies by angels and successful tech entrepreneurs. While this activity is encouraging, concerns remain as to the capacity of the ecosystem to provide continued funding to the highest-potential companies as they develop and require larger amounts of capital.

New funding models have emerged and are having a notable impact in the early stage ecosystem, including "micro VC" or "super angel" funds, as well as accelerators. Taking a hands-on approach, these models frequently provide a combination of seed capital and invaluable mentorship to talented entrepreneurs and bridge the gap to more traditional venture funding. However, their structures and activities often depart from the traditional VC investment model and, as such, they pose a challenge for many, if not most, institutional investors.

Strategic Initiatives and Investments' contribution to the ecosystem

To help rebuild and re-energize the VC ecosystem, BDC VC created a Strategic Initiatives and Investments (SII) team that makes investments to bridge the gap between early stage (angels, accelerators) and traditional VC. The team has been active with many of the new funding models discussed above, including accelerators and seed/early stage funds. Since the SII team's inception, demand for its support—both financial and non-financial—has been strong. SII has developed an innovative convertible note program that it employs with select accelerators (GrowLab Ventures, Vancouver; Extreme Startups, Toronto; FounderFuel, Montréal; Hyperdrive, Kitchener-Waterloo) and has invested $4.95 million in 33 companies ($1.95 million in 13 companies during the last quarter alone). SII has also committed $27.5 million to four early stage funds, most recently the Atlantic Canada Regional Venture Fund (Halifax) and Version One Ventures (Vancouver). In the last quarter, SII also invested in Execution Labs, a hybrid game incubator and go-to-market accelerator in Montréal, and provided financial support to the Notman House, a collaborative hub where Montréal entrepreneurs building high-tech companies can share knowledge, exchange ideas and build collaborative networks.

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.

To be added to the distribution list of online release of the Small Business Branch publications, please subscribe at: www.ic.gc.ca/SMEresearch/subscription.

For questions related to its content, please email: VCMonitor-MoniteurCR@ic.gc.ca.

Copyright

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

Multimedia Services Section
Communications and Marketing Branch
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.ic.gc.ca/vcmonitor.

ISSN 1911-9267

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