CANADA'S VENTURE CAPITAL & PRIVATE EQUITY ASSOCIATION
ASSOCIATION CANADIENNE DU CAPITAL DE RISQUE ET D'INVESTISSEMENT

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VENTURE CAPITAL INVESTMENT in 2008 LOWEST RECORDED SINCE 1996

TORONTO: Deal activity in the Canadian venture capital (VC) market slowed significantly in 2008, to reach its lowest level in 12 years. Across the country,, $1.3 billion was invested, a drop of 36% from the $2.1 billion invested in 2007, according to the industry's statistical report released today by Canada's Venture Capital & Private Equity Association (CVCA) and research partner Thomson Reuters.

There were also comparatively fewer Canadian companies financed in 2008, though the year-over-year decline was not as sharp as the decrease in dollars invested. A total of 371 firms secured VC financing in 2008, which was 10% fewer than the 412 firms that were financed in 2007.

Market activity was especially slow between October and December with $302 million in investments, which was down 43% from the $526 million invested in the fourth quarter of 2007.

The data for 2008 reflect an investor shift away from large transactions. Company financings averaged $3.6 million compared with an average of $5.0 million in 2007. This contributed to a widening gap in Canada-United States deal capitalizations, with Canadian companies capturing on average just 38% of the VC dollars invested in companies south of the border.

"These statistics demonstrate the declining availability of capital in the venture capital industry, which has real repercussions for Canada's ability to drive innovation and to develop the knowledge-based economy we need to compete effectively on the global stage," said Gregory Smith, President of the CVCA and President of Macquarie Capital Funds Canada Ltd. "The availability of VC dollars has been eroding for years, a trend that has been exacerbated by the sharp economic downturn. We are failing to capitalize on the potential of our entrepreneurs and small growth companies, which have traditionally been vital drivers of jobs and prosperity for Canadians."

The CVCA has developed a four-point commercialization support program that would help the government to effectively address the primary systemic obstacles to increasing VC investment. The recommendations include: improving the Scientific Research and Experimental Development (SR&ED) tax credit program; setting up a third-party managed fund of funds to invest in promising Canadian companies; enabling greater use of government procurement/offsets to encourage domestic and foreign investment; and creating a tax incentive for Canadian companies to invest in Canadian VC funds.

Trends in the US VC Market

A pronounced downturn in VC market activity was visible across North America and on a global basis in 2008. Like Canada, annual disbursements in the United States fell for the first time since 2003 but at a more moderate rate, with US$28.3 billion invested in 3182 companies, which was 8% less than the US$30.9 billion invested in 2007.

Canadian VC Trends by Investor Type

A key variable in the Canadian market slowdown was greatly reduced cross-border activity. American VC funds and other foreign investors invested a mere $371 million to deals in Canada in 2008, or 56% below the $845 million they contributed to deals in 2007, and the lowest amount in five years.

Consequently, American and other foreign investors accounted for only 28% of all disbursements in Canada last year. This stands in sharp contrast with their 41% share in 2007, and helps explain the much smaller deal sizes, given the importance of cross-border cash sources to VC syndicates.

The activity of domestic investors was also sub-par on a year-over-year basis, though not to the same degree as foreign investors. Taken as a whole, Canadian VC funds invested $954 million in 2008, which is down 22% from the $1.2 billion they accounted for one year ago.

Canadian private-independent funds proved to be among the more active investor groups, deploying $330 million, which is only 8% shy of their $360 million in 2007. As a result, private funds held a one-quarter share of all disbursements this time around.

Not far behind them were LSVCC and other retail funds, accounting for $310 million invested and a relative share of 23% in 2008. However, in real terms, retail fund activity fell 24% from the year before, when $406 million was invested.

Canadian VC Trends by Region

The overall decline in Canadian deal activity was experienced in virtually all regions of the country. Ontario VC activity involved $570 million invested in 119 companies, down 40% from $950 million in 2007. The province also saw some erosion in its national share, taking 43% of all disbursements in 2008 versus 46% one year ago.

The year-over-year drop in Québec-based activity was equally sharp, with $349 million invested in 141 companies in 2008, down by 46% from the $642 million invested previously. As a consequence, Québec garnered 26% of total activity in Canada, which is at odds with its 2007 share of 31%.

In British Columbia, a total of $259 million was invested in 51 companies last year, or 18% below the $316 million of 2007. However, because of the more considerable plunge in dollars invested in Ontario and Québec, British Columbia's relative VC share rose to 19% in 2008.

Canadian VC Trends by Sector

The slower market context in Canada impacted trends in all major technology and non-technology sectors, though clean-tech fared better than most. While IT continued to account for close to half of all disbursements in 2008, real activity fell 39%, with 174 companies taking $644 million, as compared to $1.1 billion one year ago.

Software led among IT sectors, consuming $172 million, though this was down 32% from 2007. Telecom firms followed with $143 million, down an even greater 44%. Internet-related activity absorbed the largest drop, obtaining $118 million in 2008 versus $413 million the year before. However, electronics firms achieved year-over-year gains with $121 million invested, which was more than triple its previous level.

Activity in biopharmaceuticals and other life sciences sectors was also reduced in 2008, with $359 million invested in 78 companies, or 43% less than the $632 million of one year ago. The relative share assumed by life sciences activity was also eroded, standing at 27% this time around as compared to 31% during 2007.

2008 levels of clean-tech activity, reflecting 31 companies financed with $187 million, more closely approximated trends in 2007, when $198 million was invested. This gave energy and environmental technology sectors an unprecedented 14% of all disbursements, up from 10% the year before, as well as the more typical 4% average of prior years.

Non-technology sectors saw $101 million invested in 75 companies last year, down 41% from the $170 million of 2007. On balance, traditional activity obtained a sub-par 8% of total VC activity.

Trends in Canadian VC Fund-Raising

New commitments of capital going to Canadian VC funds also fell in 2008, as they have in almost every year since 2001. However, the year-over-year decline was slight, with $1.2 billion in new resources raised in total, or only 2% below the level in 2007. The results of VC fund-raising activity in Canada in both years were nonetheless the lowest on record since the mid-1990s. Private-independent funds attracted the largest volume of new commitments this time around, or $672 million, which is actually up an appreciable 45% from the $464 million netted the year before. Consequently, fresh partnership capital comprised 56% of the total in Canada last year, as compared to its previous 38% share.

This trend was offset by a 30% decrease in new resources brought into the market by LSVCC and other retail funds. In 2008, retail fund-raising activity obtained a total of $532 million compared with the $755 million it accounted for one year ago.

Trends in US VC Fund-Raising

Like Canada, VC fund-raising activity in the United States was reduced in 2008, though this was the first such decline on a per annum basis since 2002. New commitments south of the border totaled US$27.9 billion, down 21% from US$35.5 billion the year before.

CVCA

The CVCA - Canada's Venture Capital & Private Equity Association, was founded in 1974 and is the association that represents Canada's venture capital and private equity industry. Its over 1600 members are firms and organizations which manage the majority of Canada's pools of capital designated to be committed to venture capital and private equity investments. The CVCA fosters professional development, networking, communication, research and education within the venture capital and private equity sector and represents the industry in public policy matters.

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To arrange an interview with Gregory Smith, President of the CVCA and President of Macquarie Capital Funds Canada Ltd., contact Iris Roesler, 416 607-5166.

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