

## QUÉBEC'S VENTURE CAPITAL MARKET IN 2008: AN OVERVIEW

Levels of venture capital (VC) activity declined on an international basis in 2008. This included the Québec market, where deal activity slowed 46% last year, with \$349 million invested in total, compared to \$642 million invested in 2007. The number of Québec companies financed with VC, totaling 141, was also reduced 26%.

Québec based trends were in line with those of the overall Canadian market, which saw \$1.3 billion invested in 2008, down 36% from 2007. This was the first year-over-year drop in Canada since 2003, and among the lowest annual results since the mid-1990s. The same pattern was reflected in the American market, where US\$28.3 billion was invested, down 8%.

On balance, Québec accounted for 26% of all disbursements across the country in 2008, as compared to its 31% share one year ago. Québec continued to reflect the largest proportion of VC-backed firms, or 38% of the Canada-wide number.

A major factor influencing trends in Québec (and across Canada) was the smaller market presence of American VC and other foreign investors. Foreign activity dropped 62% last year, with \$78 million invested, or the lowest level in five years. This contributed to lower deal sizes as well, which averaged \$2.5 million in Québec, as compared to \$3.4 million in 2007.

The activity of domestic VC investors in Québec was also sub-par, with \$272 million invested in 2008, down 38% from the year before. Québec labour-sponsored and other retail funds led this time around, investing \$111 million, or 32% of total activity, followed by private-independent funds, which accounted for \$83 million invested, or a 24% share.

Slower market conditions in Québec impacted trends throughout technology and traditional sectors. Activity preferred IT companies in 2008, with these attracting 45% of all disbursements, or \$157 million, though this also reflected a decline of 25% from one year ago. Life sciences activity took 32% of total activity, or \$112 million, though this was less than half of the 2007 total.

VC fund-raising activity in the Canadian market netted \$1.2 billion in new resources last year, which was a moderate 2% below the level in 2007. Private funds attracted most new resources, or \$673 million. The largest share of new commitments made across Canada, or 46%, flowed to Québec focused VC fund managers.

### NOTICE OF DATA CHANGES

*In their mandates for investing risk capital in Québec small businesses, labour-sponsored and other retail funds have been undertaking a diverse range of private equity activity. Thomson Reuters is working closely with fund managers to ensure that the full range of this activity is captured and advises that related data changes may impact annual and quarterly reports on venture capital activity in Québec.*

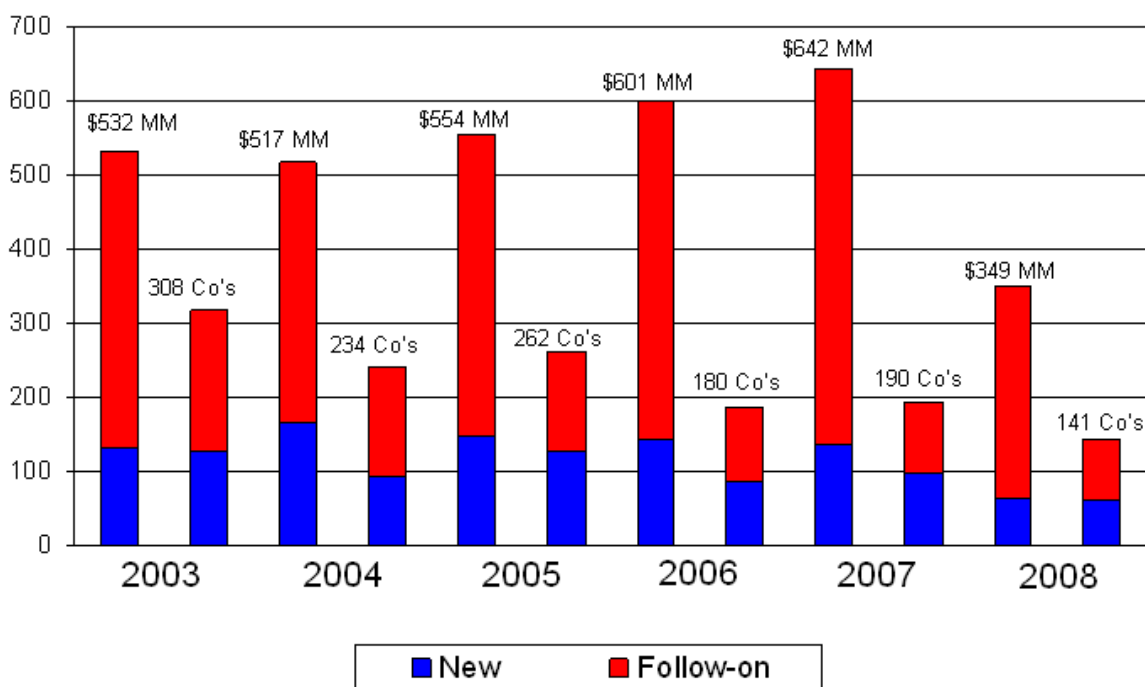
## 2008 GLOBAL VC SLOWDOWN FELT IN QUÉBEC

In response to a weakening economy, levels of venture capital (VC) activity declined on an international basis in 2008. This was also the case in the Québec market, where the pace of deal activity slowed 46% last year, with \$349 million invested in total, compared to \$642 million invested in 2007.

There were also fewer Québec firms receiving VC in 2008, though the decrease in these numbers was not as great as dollars invested. Companies financed totaled 141, or 26% fewer than the 190 companies financed the year before.

Québec trends were in line with those of the Canadian market as whole, in which \$1.3 billion was invested last year, down 36% from the \$2.1 billion of 2007. This was the first year-over-year drop in the overall domestic market since 2003, and among the lowest annual results since the mid-1990s. Activity was also significantly reduced in Ontario, where \$570 million was invested, off by 40%.

### New vs. Follow-On Activity; Québec



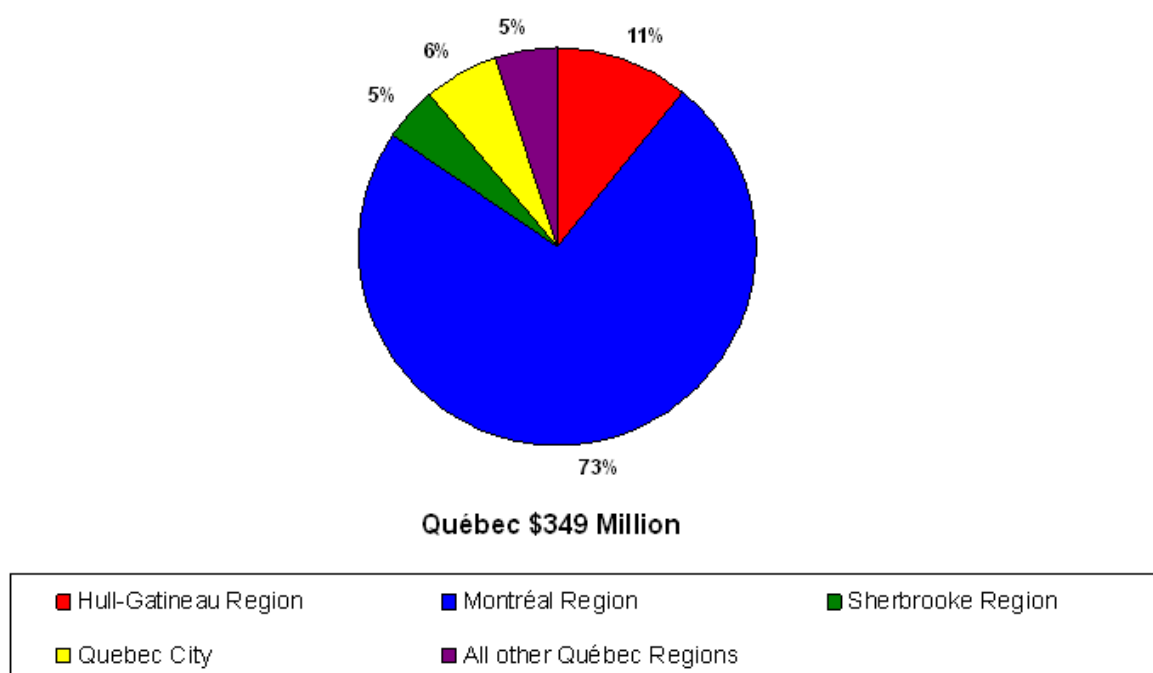
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Throughout the Canadian VC market, activity was particularly low-key in the final three months of 2008. A total of \$302 million was invested coast to coast, down 43% from Q4 2007. During the same period, Ontario and Québec saw \$99 million and \$86 million invested respectively, down a respective 54% and 56%.

On balance, Québec accounted for 26% of all disbursements across the country in 2008, as compared to its 31% share one year ago. Québec activity nonetheless continued to reflect the largest proportion of VC-backed firms, or 38% of the Canada-wide number.

The pronounced VC market downturn was also evident in the United States. Like Canada, 2008 disbursement levels in the United States represented the first such decline in five years, with US\$28.3 billion invested in total, or 8% less than the US\$30.9 billion of the year before.

### Dollars Invested by Québec Region; 2008



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A major factor influencing trends in Québec (and across Canada) last year was an especially sharp plunge in American VC and other foreign activity. This contributed to considerably lower deal sizes as well, with the amount invested per firm in Québec averaging \$2.5 million, down from \$3.4 million in 2007.

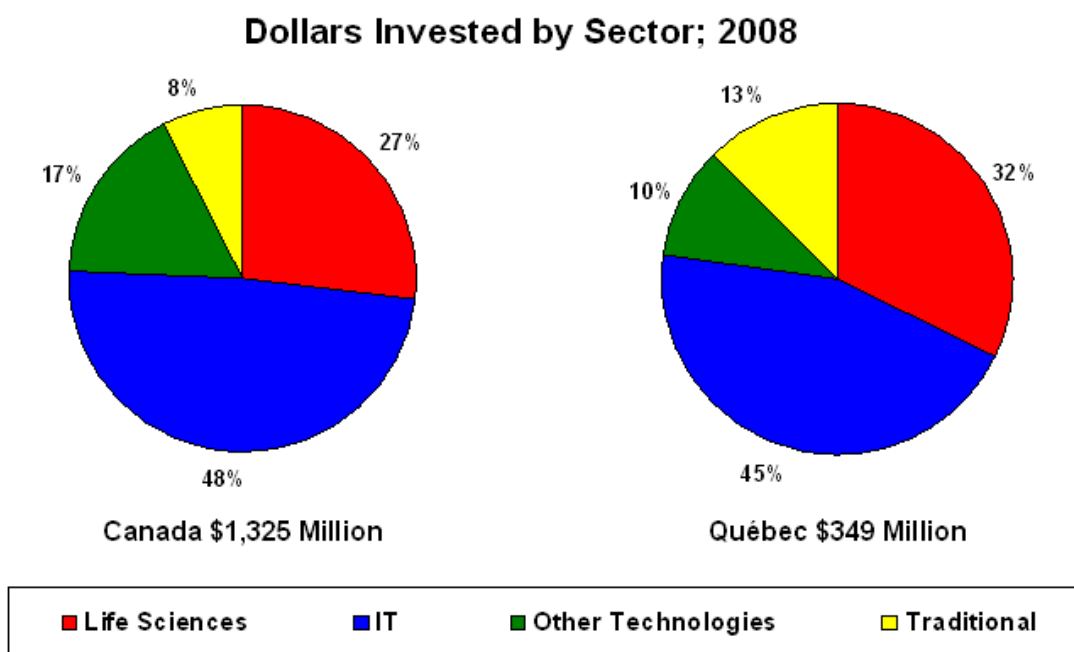
New deal activity also fell in Québec in 2008, as 61 companies seeking VC for first time captured \$64 million, or 53% below the \$136 million captured one year ago. Consequently, existing portfolio firms took 82% of all disbursements, though in real terms, follow-on activity was 44% less year-over-year.

Montréal based activity remained at the fore in 2008, garnering close to three-quarters of total dollars invested in Québec, or \$256 million. The Hull-Gatineau region assumed second spot with an 11% share, followed by Québec City with 6%, and Sherbrooke with 5%.

**QUÉBEC IT LEADS IN QUIETER VC MARKET**

Slower market conditions in Québec impacted activity throughout technology and non-technology sectors. In contrast with trends of the year before, deal activity generally preferred IT sectors in 2008, with these attracting 45% of all disbursements, up from a previous 33%. In 2007, it was life sciences sectors that attracted the top share.

However, in real terms, levels of IT-related activity in Québec were reduced on a year-over-year basis. A total of \$157 million was invested in 43 IT companies in 2008, or 25% below the \$209 million invested in 62 companies one year ago.



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Electronics led other IT sectors this time around, actually increasing its activity to \$43 million invested, or close to double the \$23 million of 2007. This trend was assisted by Q4 2008 financings involving two Saint-Laurent based firms, DFT MicroSystems and LxDATA. Not far behind was internet-related activity, which secured \$41 million, and telecom activity, which secured \$37 million, though these levels were down a respective 22% and 48%.

IT-related activity also drove trends across Canada last year, reflecting nearly half of all disbursements. However, real activity plunged an even greater 39%, or \$644 million invested in 2008 versus \$1.1 billion one year ago.

Despite several important VC deals, including the fourth quarter financing of Québec City's Biopharmacopae, life sciences sectors registered a substantial drop in activity in 2008. A total of \$112 million was invested in 26 companies, or less than half of the \$256 million that went to the same number of companies in 2007. This gave life sciences activity a 32% share of total Québec activity, which is at some distance from its prior 40%.

### Top (Disclosed) Québec VC Deals of 2008

Company	City	\$CAD MM Invested
Gemin X Pharmaceuticals, Inc	Montréal	\$38.0
Diablo Technologies Inc.	Gatineau	\$15.0
LxDATA	Saint-Laurent	\$14.0
Osprey Pharmaceuticals Ltd.	Saint-Laurent	\$11.8
Neuralitic Systems Inc.	Montréal	\$10.0
Accedian Networks Inc.	Saint-Laurent	\$7.5
Inscape Software Inc.	Montréal	\$7.0
Ryma Technology Solutions Inc.	Montréal	\$7.0
BioSyntech Inc.	Laval	\$6.1
Vantrix Corporation	Montréal	\$5.3

Canada-wide, life sciences activity was also reduced in 2008, with \$359 million invested, or 43% less than the \$632 million of one year ago. At 27%, its relative market share was also eroded.

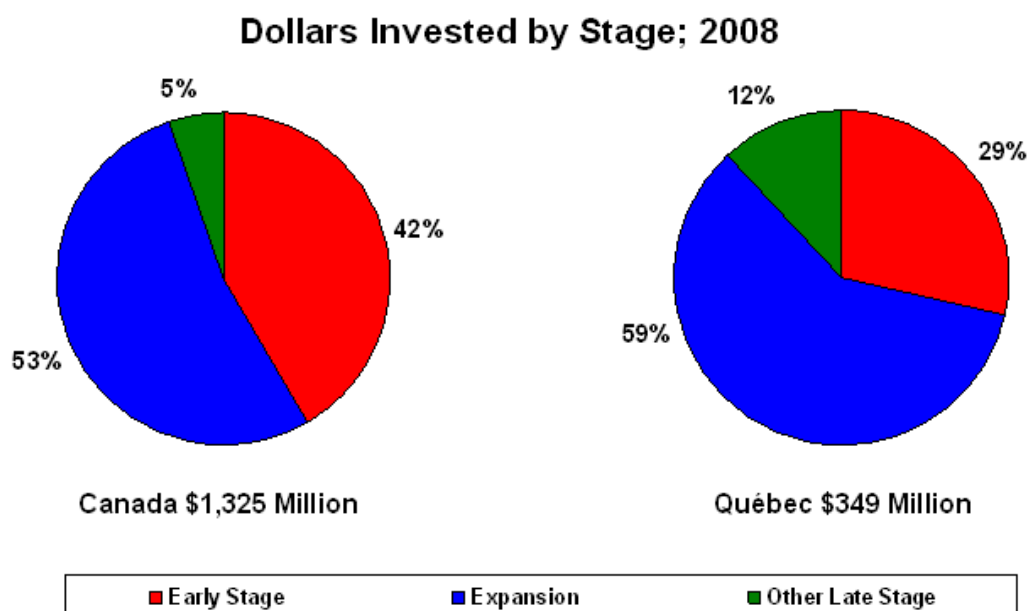
Between October and December, a major innovative firm based in Boucherville, Nanoledge, was financed. This deal contributed to clean-tech and other technology sectors in Québec consuming a total of \$36 million in 2008, or 10% of all disbursements, though this was also down from the \$73 million invested in 2007.

Consumer, manufacturing, retail and other traditional sectors in Québec witnessed \$44 million going to 59 companies last year, or 13% of VC activity in total. However, in actual terms, this outcome reflected a year-over-year decline of 58%, given the \$104 million invested in non-technology sectors in 2007.

## QUÉBEC EARLY-STAGE ACTIVITY PLUMMETS IN 2008

Since the beginning of 2008, early-stage VC activity has fallen sharply in the Québec market. By the end of the year, seed, startup and other early-stage activity accounted for only 29% of all disbursements, or one of its lowest relative shares on record. In 2007, this share was a more substantial 37%.

The plummet in real early-stage activity in Québec was just as sharp, as a total of \$100 million was invested in 44 firms this time around, or 57% below the \$235 million of the year before. Seed and startup activity obtained \$3 million and \$47 million, respectively, down a respective 66% and 24%. Other early-stage deals experienced the largest year-over-year drop, with \$49 million invested in 2008 versus \$162 million in 2007.



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Partly as a consequence, late-stage activity dominated Québec trends last year, capturing 71% of total activity, or \$250 million going to 98 firms. However, dollars invested was also reduced 39% from the \$407 million invested in 2007. Expansion deals absorbed the most sizeable decline, reflecting \$207 million invested in 2008, or 45% less than the \$379 million of one year ago.

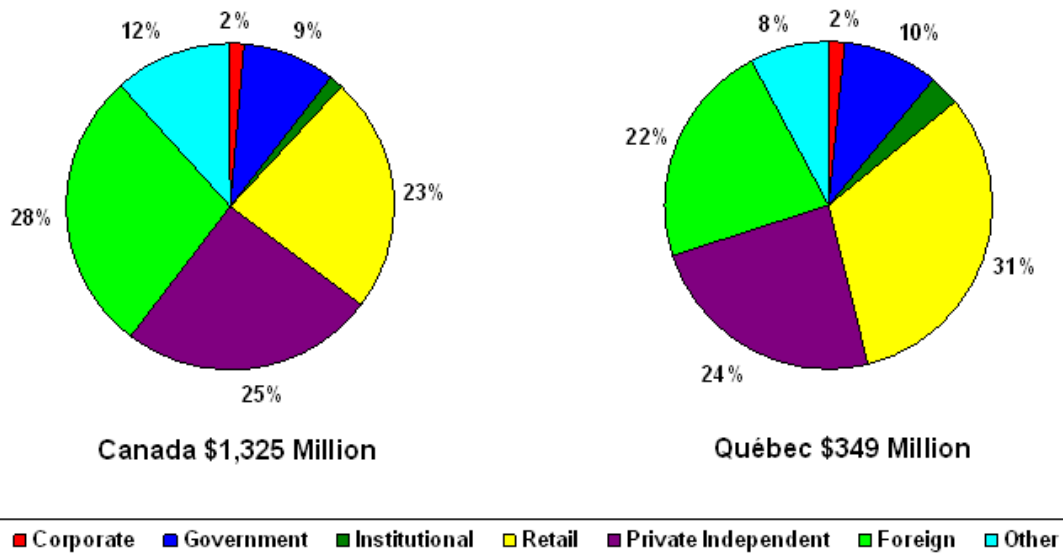
In contrast, consolidation deals and other late-stage VC activity in Québec made some gains in the slower market environment. Later-stage activity attracted \$42 million last year, up 50% from \$28 million in 2007.

In the Canadian market as a whole, VC trends by stage contrasted somewhat with those in Québec. While early-stage activity also fell in actual terms, from \$714 million invested in 2007 to \$553 million in 2008, it nonetheless accounted for 42% of the total. Late-stage deals consumed \$772 million, Canada-wide, down 43%.

**FOREIGN VC ACTIVITY IN QUÉBEC HITS 5-YEAR LOW**

As noted above, a major factor in Québec trends in 2008 was the greatly reduced market presence of American VC funds and other foreign investors. Since 2003, cross-border activity has been steadily growing in real and relative terms. This activity peaked in 2007, as foreign investors proved to be the largest source of cash in Québec, accounting for \$204 million, or a one-third share.

**Dollars Invested by Investor Type; 2008**



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Last year, levels of foreign VC activity in Québec dropped 62%, with \$78 million invested in total, or the lowest in five years. As a result, they reflected only 22% of all disbursements.

A comparable trend was evident across the country, as American and other cross-border investors brought a mere \$371 million to Canadian deals in 2008, or 56% below the \$845 million they contributed the year before. As in Québec, this had a particular impact on VC activity in Ontario, where foreign disbursements declined 66% year-over-year.

The activity of domestic investors in Québec was also sub-par between 2007 and 2008, though not to the same degree as foreign investors. Taken as a whole, Québec based and other Canadian VC funds invested \$272 million, which is down 38% from the \$483 million they accounted for one year ago.

Québec labour-sponsored and other retail funds led this time around, investing \$111 million in 96 companies, or almost one-third of all disbursements, which is up from 26% the year before. As with other investor groups, the actual activity of retail funds was below their 2007 level, however, when \$168 million was reported.<sup>1</sup>

Private-independent funds assumed second spot in Québec in 2008, with a total of \$83 million invested in 37 companies, though this was also shy of their \$94 million one year ago. Private funds nonetheless accounted for close to one-quarter of all disbursements, which improves on the 15% share they have averaged in recent years.

Levels of activity of other funds reflected a similar pattern. After retail and private funds, government VC funds were the most active in Québec last year, with \$33 million invested, though this was off by 42% from their \$58 million of 2007.

#### **VC FUND-RAISING DIPS MODERATELY IN 2008**

New commitments of capital going to VC funds across Canada also declined in 2008, as they have almost every year since 2001. However, the year-over-year drop was relatively 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 in the Canadian market in both years were nonetheless the lowest on record since the mid-1990s.

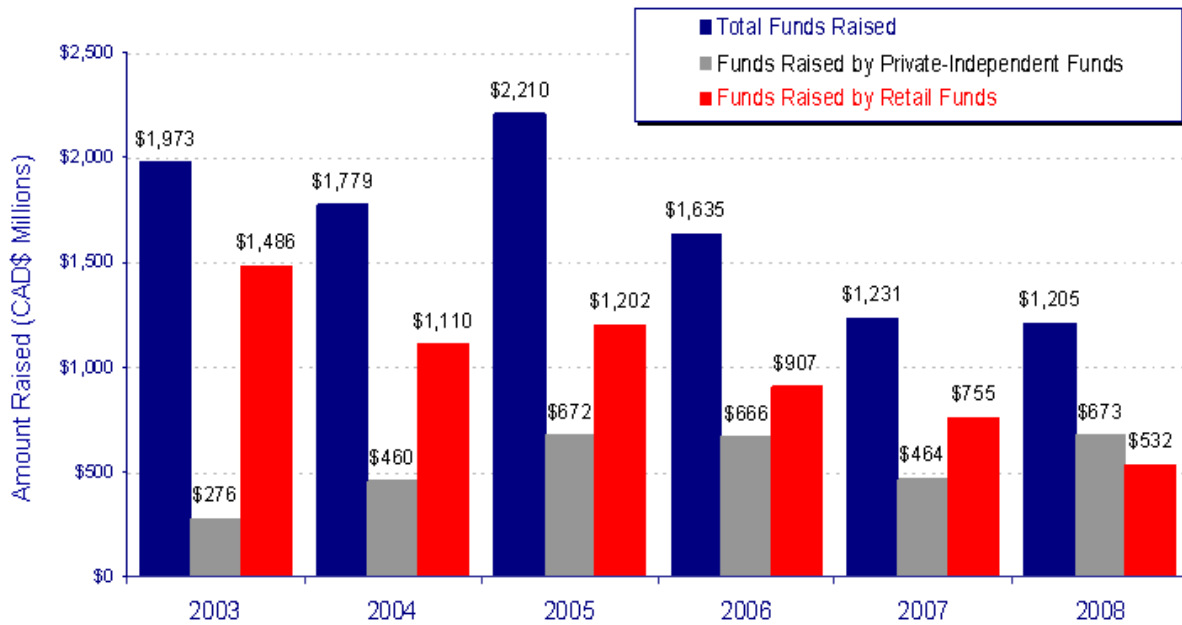
Private-independent funds attracted the largest volume of new commitments this time around, or \$673 million, which is actually up an appreciable 45% from the \$464 million netted the year before. Consequently, fresh partnership capital comprised 56% of the total in Canada last year, as compared to its previous 38% share.

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

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<sup>1</sup> Québec labour-sponsored and other retail funds are increasingly doing a mix of direct VC activity and limited partner activity (i.e., making commitments to private funds – see next section). Both roles are relevant to reports of market trends.

### New Capital Commitments; Canada



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The largest share of new commitments made across Canada, or 46%, flowed to fund managers regularly focused on deal opportunities in Québec. This translated into an actual \$552 million raised in Québec last year. As part of this overall activity, Québec labour-sponsored and other retail funds contributed a total of \$174 million of new supply going to a range of private funds in 2008.