



Quarter 3, 2002

**Deloitte & Touche Corporate Finance Canada Inc.**  
Fourth Québec VC Confidence Survey

## Québec Venture Capitalists Increasingly Opt for Traditional Sectors

### Introduction

Québec Venture Capitalists ("VCs") are a major driving force behind economic growth in the province. The substantial capital they invest in the Québec economy has a deciding impact, which is why their expectations and forecasts are very important for all Quebecers.

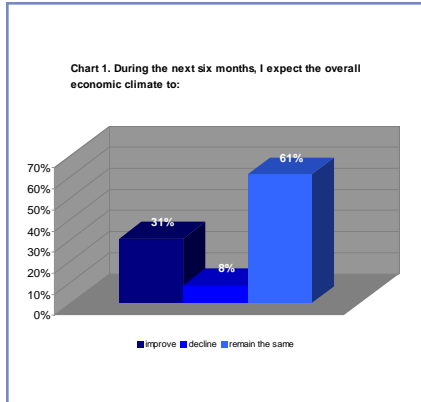
Within this context, Samson Béclair/Deloitte & Touche, in conjunction with Réseau Capital, Québec's venture capital association, presents the latest Québec Venture Capitalist Confidence Survey, which provides a comprehensive snapshot of Québec VC expectations for the next six months of:

- Overall economic climate;
- Deal activity; and
- Investment focus.

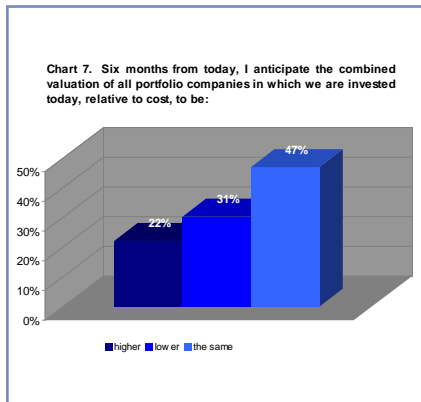
This report has been compiled from responses obtained specifically from Québec's VCs. For the Canadian results, please refer to Deloitte & Touche's Quarter 3, 2002 Canadian Venture Capital Association Survey.

### Results

Investors generally anticipate no change in the economy. Sixty-one percent of respondents expect the economy to hold steady, compared to 21% in Q2 2002, and 31% foresee a stronger economy versus 79% in the previous survey. Only 8% anticipate a decline, whereas no one expected a downturn in the second quarter of 2002. According to 56% of respondents, exit valuations for the next six months will be virtually the same as presently, while 14% predict an increase and 31% a decrease. Respondents are more conservative than in the second quarter of 2002, where predictions of steady exit valuations garnered 69% of responses, with 17% of respondents calling for a rise and 14%, a drop.



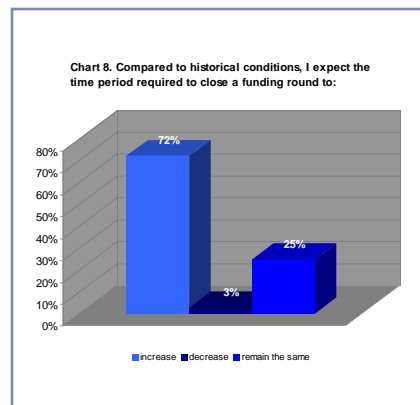
Opinions are mixed on competition for new investment opportunities with 44% of respondents reporting no change, 33% believing it to be on the rise and 22%, on the decline. When respondents are asked how long it will take to invest their current funds, 42% replied four or more years, 33% from two to four years and 25% less than two years. As to how they would exit their investments, 87% expect to sell them, 13% foresee an equal number of sales and initial public offerings (IPOs). No respondents expect to rely solely on an IPO scenario.



Nearly half of respondents (47%) expect the combined valuation of the companies in which they are invested to hold firm, a 15 percentage point increase over the 32% recorded in Q2 2002. The number of respondents anticipating a higher value dropped to 22% compared to 64% in the previous survey; 31% (versus 4% in the second quarter of 2002) expected a lower value.

Investors are still on the lookout for fresh investment opportunities: 50% maintain half of their current funds available for new investments, apart from the funds reserved for follow-on investments in companies already included in their portfolios. For thirty-two percent, the ratio runs from 25% to 50% and only 18% have less than 25% of their funds available for investment in new projects.

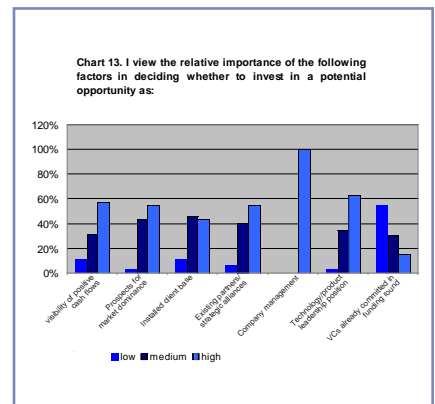
According to 64% of respondents, the most important factor behind an improvement in the VC market will be a recovery of public market values, while 21% and 15% point to an increase in technology spending and technological innovation, respectively.



Respondents expect to face longer periods to close a funding round. In Q2 of 2002, 59% of respondents shared this opinion compared to 72% in the present survey. Twenty-five percent now believe the time periods will remain the same, down from 41% in the previous quarter. Only 3% anticipate shorter periods, whereas no one predicted in Q2 2002 that less time would be required. Almost half of respondents (49%) expect it to take more than four months from the first meeting to the term sheet; 46% anticipate a period of two to four months; and a mere 6% foresee less than two months. In the previous survey, 28% of respondents predicted more than four months, 38% two to four months and 34% less than two months.

The percentage of respondents expecting to spend more time focusing on portfolio companies remains at 72%, unchanged compared to the previous quarter. The 28% of respondents anticipating no change in time spent also matches the previous quarter's figure. No respondents foresee devoting less time to portfolio companies. In fact, 61% will spend most of their time on portfolio management, about the same amount as in the previous quarter (62%); 33% will focus on new investments, versus 34% in the second quarter of 2002; and 6% will concentrate primarily on raising new funds, compared to 3% in the previous survey.

Among the criteria to be considered when making an investment decision, the strength of the management team dominates, as all of the respondents, bar none, attributed a high degree of importance to this consideration. A company's position as a technological leader came in second, with a ranking of high or medium importance by 63% and 34% of respondents, respectively. The ability of a company to generate positive cash flows within the short-term was considered of high or medium importance by 57% and 31% of respondents; the prospects of dominating the targeted market came next with 54% and 43% choosing high or medium importance and the existence of partners or strategic alliances garnered 54% and 40% of the high and medium importance rankings. Having an installed customer base was less of a concern for investors. Finally, whether or not VC funds have already been committed is a key concern for only 15% of respondents.



For investors, the economic outlook is the issue that will have the greatest impact on the VC climate, according to 87.5% of respondents compared to 12.5% who consider that the impact will be minimal. Portfolio valuations and liquidity are the next most important factors with 69% and 63%, respectively whereas 28% and 34% of respondents accord them only minimal importance: 3% of respondents do not feel either will be significant. Investors appear to view a recovery in corporate IT spending as less important: only 50% expect this issue to have a substantial impact, compared to 44% who anticipate a minimal impact and 6% who think it will have no bearing at all. As for a recovery in telecom spending, 44% of respondents predict it will have no substantial impact.

When respondents were asked whether they expected volumes of transactions to increase, decrease or remain the same in certain sectors over the next six months, Manufacturing came in first with 67% of respondents expecting an increase compared to 30% predicting no change and only 3% forecasting a decrease. These ratios are similar to the previous survey's figures. As for Biotechnology, the number of respondents who expect an increase in the number of transactions is lower than in the previous survey, dropping from 76% to 50%, whereas 34% expect transaction volumes will hold steady, up 15 percentage points from the 19% reported in the Q2 2002 survey. Sixteen percent of respondents, or 11 percentage points more than in the second quarter of 2002, predict transaction volumes in Biotechnology will drop over the next six months. As with Manufacturing, the figures for Consumer Products closely mirror the previous survey's findings, with 43% of respondents predicting increased transaction volumes, 10% a decrease and 47% no change. For Medical/Healthcare and Computer Software and related technologies, there are fewer investors than in Q2 2002 who expect an increase in transaction volumes; the percentage of respondents predicting volumes will remain the same increased by the same amount. In other words, generally speaking, the number of respondents expecting a decrease in transaction volumes for these industries has not changed. This is not the case for

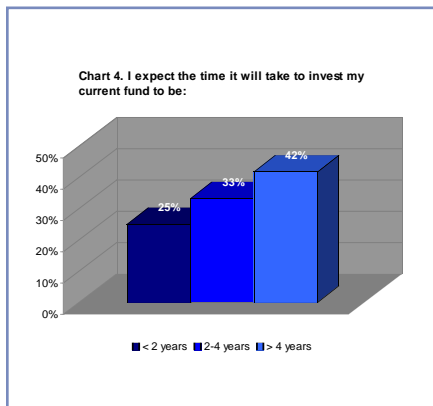
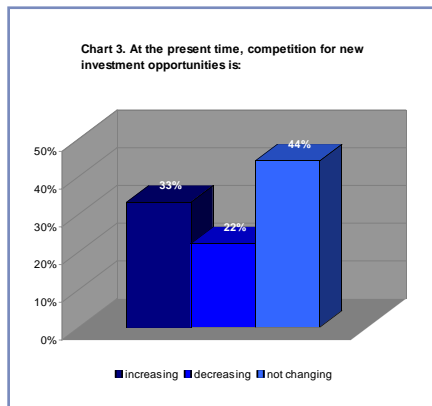
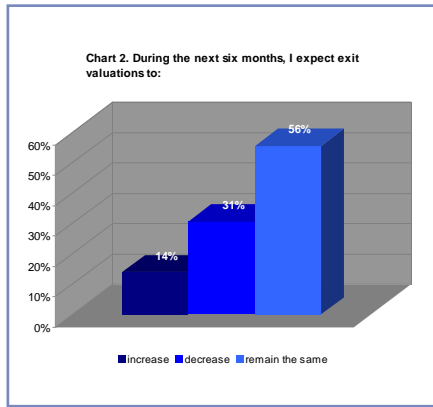
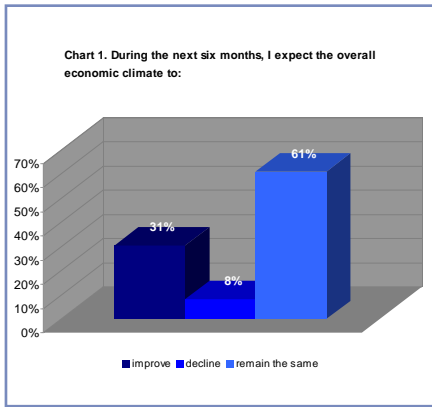
Communications, Semiconductors or Internet-related technologies, for which there were fewer respondents anticipating an increase in transaction volumes and a greater number expecting a decrease.

## Insights

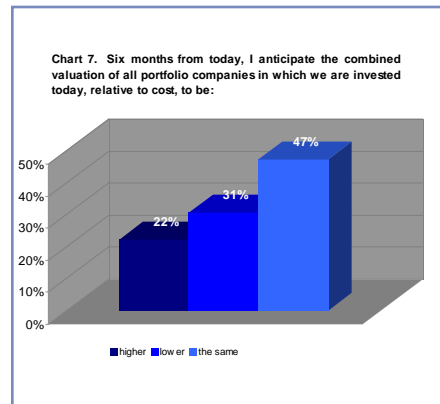
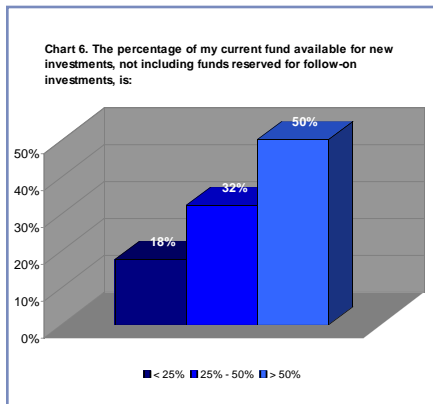
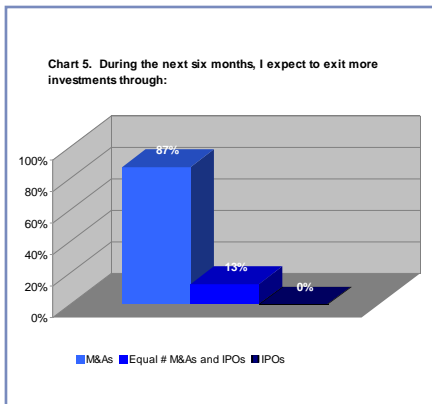
- Québec VCs expect to see little or no change in the overall economic climate in the next six months. Twice as many respondents foresee stable economic activity than those expecting some improvement. Very few investors anticipate an economic downturn. Over half of respondents expect no change, from current levels, in exit valuations in the next six months, compared to 69% in the previous survey. Predictions of a decline in exit values are more widespread than in Q2 2002.
- Two-thirds of respondents expect that the volume of transactions in the manufacturing sector will increase, while most others predict no change. These ratios are basically the same as in the second quarter of 2002. This can also be said of Consumer Products, with about 90% of respondents anticipating increased or stable transaction volumes. Compared to Q2 2002, forecasts for the Biotechnology, Medical/Healthcare and Computer Software sectors are more conservative as fewer investors predict higher volumes of transactions. Lower volumes are expected for the Communications, Semiconductor and Internet sectors. For the vast majority of respondents, the economic outlook will have the greatest bearing on the current VC climate and a return to optimism will not occur until the overall economy improves.
- However, investors are still open to new projects, as over half report having earmarked more than 50% of their current funds for new projects in non-portfolio companies. The criteria are clearly defined with greater weighting on the strength of the management team, the company's ability to generate positive cash flows within the short-term, the prospects for dominance in the targeted market, and the existence of partners or strategic alliances. Respondents foresee an increase in the time required to close a funding round. This leads us to believe that the above investment assessment criteria will be tightened. The significant amount of time respondents expect to devote to portfolio companies suggests they are taking a more prudent approach.

# VC Confidence Survey: Detailed Results - Québec

## Economic and market climate

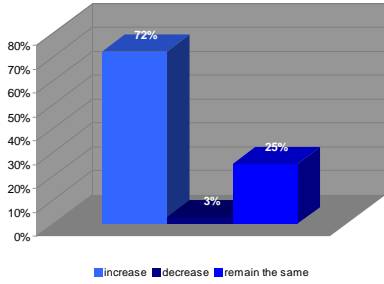


## Level of expected investments

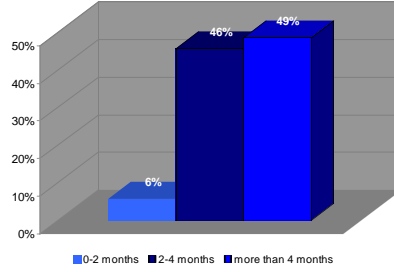


# VC Confidence Survey: Detailed Results - Québec

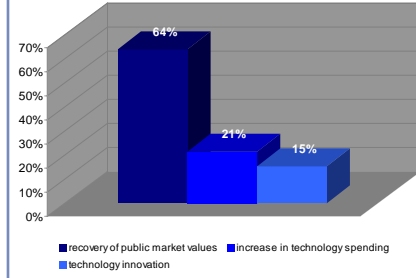
**Chart 8. Compared to historical conditions, I expect the time period required to close a funding round to:**



**Chart 9. My expectation of timing from first meeting to term sheet is:**

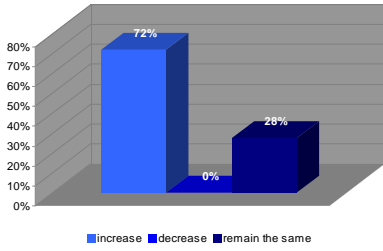


**Chart 10. I expect the most important factor behind a recovery in VC investment levels to be:**

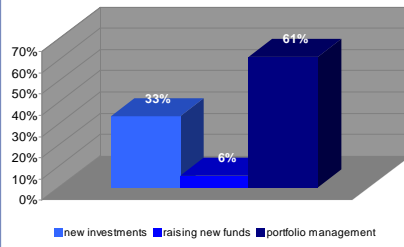


## Investment Focus

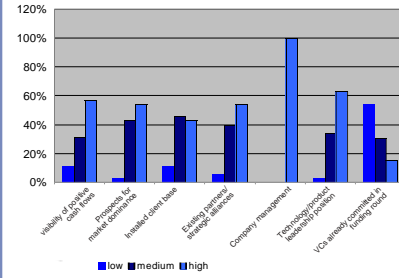
**Chart 11. During the next six months, I expect the amount of time spent with portfolio companies to:**



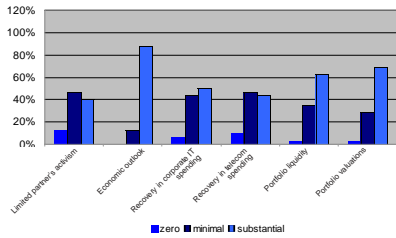
**Chart 12. During the next six months, I expect to spend the majority of my time focusing on:**



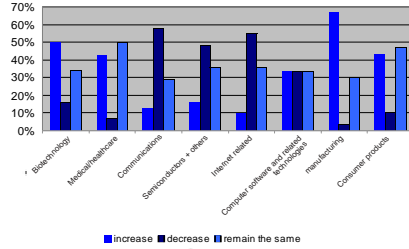
**Chart 13. I view the relative importance of the following factors in deciding whether to invest in a potential opportunity as:**



**Chart 14. I expect the near-term impact of the following issues on the current VC climate to be:**



**Chart 15. Over the next six months, I expect the numbers of transactions in the sectors listed below to:**



## Contacts

Deloitte & Touche Corporate Finance initiated this survey and collected results from August 6<sup>th</sup>, through August 22, 2002. The VC Confidence Survey is conducted on a quarterly basis.

For more information about this survey or to find out more about how Samson Bélair/Deloitte & Touche can assist the deal initiation and execution process, please contact us.

We welcome suggestions for issues to be addressed in future VC Confidence Surveys.

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Deloitte & Touche Corporate Finance provides deal initiation and lead financial advisory services for private equity and venture capital firms as well as growth companies. Main service areas include acquisitions, sales/divestiture, and corporate finance advisory. Deloitte & Touche Corporate Finance has a presence in all key global and U.S. financial centres.

Samson Bélair/Deloitte & Touche is the largest professional services firm offering assurance and advisory, financial advisory, tax and consulting services in Québec. Some 1,745 people regularly use their expertise to serve clients from all sectors of the economy. We are dedicated to helping our clients and our people to excel. Outside Québec, the firm operates as Deloitte & Touche with more than 6,600 people in more than 46 locations across the country. We are the only professional services firm, and one of only 16 companies to be named to the Globe and Mail's Report on Business Magazine annual ranking of Canada's top employers for two consecutive years: 35 Best Companies to Work for in Canada in 2001 and 50 Best Companies to Work for in Canada in 2002. Samson Bélair/Deloitte & Touche is part of Deloitte Touche Tohmatsu, a global leader in professional services with more than 95,000 people in over 140 countries.

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## About Réseau Capital

Réseau Capital, the Québec Venture Capital Association, has more than 550 members from investment companies and professional firms. Its mission is to advance the development of the industry and its members through training, information, networking and promotion of their interests. By helping to create an environment conducive to equity financing of businesses, Réseau Capital is proud to contribute to the economic growth of its members and their portfolio companies. In comparison with the major international venture capital associations, Réseau Capital is noted for the size of its membership, the quality of its services and the investment activities of its members.

For additional information on this survey or on Réseau Capital activities, please contact the following persons:

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