



Quarter 4, 2002

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

Cautious Recovery in Confidence among Québec Venture Capitalists

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 Québécois.

Within this context, Samson Bélair/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:

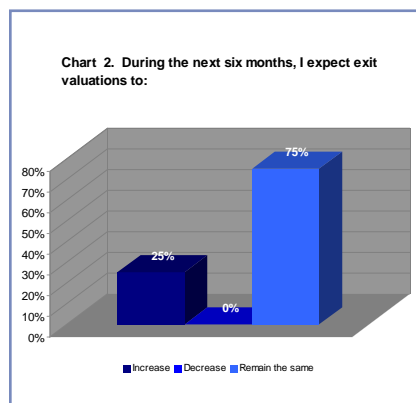
- Overall economic climate;
- Deal activity; and
- Investment focus.

This report has been compiled from responses obtained specifically from Québec's VCs. For the Canadian results, please refer to Deloitte & Touche's Quarter 4, 2002 Canadian Venture Capital Association Survey.

Results

Two thirds of respondents expect the overall economic climate to remain the same for the next six months, slightly higher than the 61% recorded in Q3, 2002. The percentage of respondents who foresee a deterioration is holding steady at 8%, while the percentage anticipating an amelioration fell from 31% to 25%.

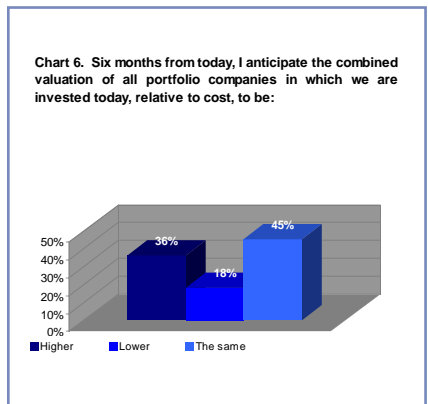
Three quarters of respondents are expecting no change in exit valuations for the next six months, while the percentage of respondents predicting an increase rose from 14% in the last survey to 25% this quarter. None of the respondents is anticipating a decrease, compared to 31% in Q3, 2002.



The percentage of respondents who feel that there is decreased competition for new investment opportunities at the present time has risen from 22% in the third quarter to 42% in the current survey. The percentage of VCs who feel competition has increased is steady at 33%, while 25% believe competition is unchanged, down from 44% in the previous quarter.

VCs seem more confident than in the third quarter about their ability to invest their current fund within a shorter timeframe, with 36% expecting to invest in less than two years and 36% in two to four years, up from the previous survey results of 25% and 33%. A decline from 42% to 27% is observed in the percentage of respondents who expect to need more than four years.

The trend in exit methods is in line with last quarter's results, with 90% of respondents preferring to exit their investments using mergers and acquisitions and none expecting to rely solely on an IPO scenario.

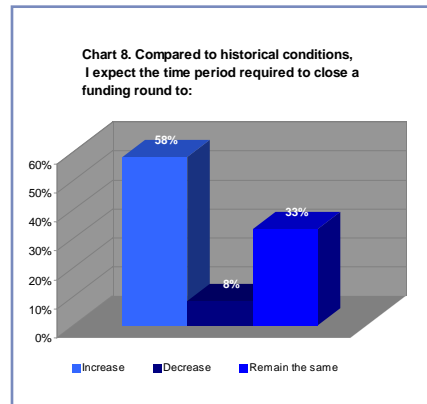


Forty-five percent of respondents, or almost half, expect the combined valuation of all portfolio companies in which they are currently invested to remain more or less the same, on par with the 47% recorded last quarter. The percentage of respondents who anticipate an increase grew from 22% to 36%, while a smaller proportion-18%, compared to 31% last survey-anticipated a decline.

The percentage of the current fund available for new investments, not including funds reserved for follow-on investments, is higher than in the last survey, with 67% of respondents stating that they have more than 50% of their current fund available for this purpose, a 17 point increase over Q3, 2002.

Meanwhile, 25% of respondents put the portion of their current fund available for new investments at between 25% and 50%, a decrease from the 32% figure observed last quarter.

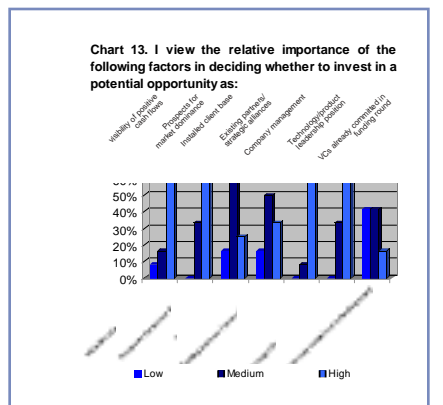
For 50% of respondents, 14 points fewer than in the previous survey, a recovery in VC investment levels is contingent on a recovery of public market values. The proportion of respondents for whom the most important factor is increased technology spending is up from 21% to 33%, whereas technological innovation is the most important factor for 17%, the same as in Q3.



The percentage of VCs anticipating an increase in the time required to complete a funding round dropped from 72% in Q3 to 58% in Q4. In the opinion of 33% of respondents, 25% more than last quarter, the timeframe will remain unchanged, while a decrease is anticipated by 8% of respondents, compared to 3% last quarter. As for the timing from first meeting to term sheet, expectations are relatively unchanged from last quarter, with 50% indicating four months or longer (49% in Q3) and 42% two to four months (46% in Q3).

The percentage of respondents who expect to spend more time with portfolio companies has fallen from 72% to 33%. Meanwhile, 58% expect the amount of time to remain the same, up from 28% in the last survey, and 8% expect it to decrease, compared to none in Q3, 2002. Of the VCs who responded, 42% expect to spend the majority of their time on new investments, up from 33% in the last survey, 42% will focus on portfolio management, down from 61% in Q3, 2002, and 17% will raise new funds, against 6% in the last survey.

As in the last survey, management team strength topped the list of factors to consider in decisions whether to invest, with 92% rating its relative importance as high. The visibility of positive cash flows ranks second, with 75% of respondents viewing it as highly important, compared with 57% in Q3, 2002, followed by company prospects for market dominance, with 67% viewing this factor as highly important and 33% as having medium importance, compared with 54% and 43% last quarter. A company's technology leadership position is also significant, with 67% giving this factor high importance and 33% medium importance, similar to Q3, 2002. Existing partners and strategic alliances are next down on the list, with 33% giving this factor high importance and 50% feeling it has medium importance. Investors are less concerned about whether there is an installed client base or VCs already committed in the funding round. In fact, only 25% of respondents consider these factors as having a high importance, compared with 58% who feel they have medium importance. Lastly, 42% attach low importance and 42% medium importance to the existence of VCs already committed to the funding round.



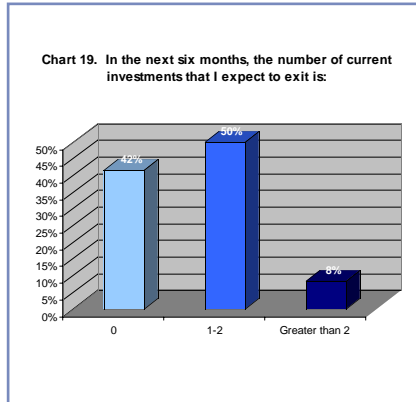
All respondents feel that the economic outlook is having a substantial impact on the current VC climate, up from 88% in the last survey. Portfolio liquidity is considered as having a substantial impact by 73% of respondents, against 27% who see it as having a minimal impact. Both recovery in corporate IT spending and portfolio valuations are regarded as having a substantial impact by 73% of respondents, compared with 27% who feel that the impact is minimal and 9% who believe it is nil. Finally, only 64% and 18% of respondents feel that the recovery in telecom spending and limited partner activism have a substantial impact.

Investors prefer the manufacturing and consumer products sectors, bearing out the trend observed in the previous survey. In fact, the percentage of respondents who expect more transactions in the manufacturing and consumer products sectors is 70% and 60%, respectively, compared with 30% and 40% who feel the number of transactions will remain unchanged. None of the respondents predicts a decrease for these sectors. The medical/healthcare sector ranks third, with 30% predicting that transactions will increase in number and 70% expecting no change. Meanwhile, the percentage of respondents who anticipate more transactions in the biotechnology sector has declined since the previous survey from 50% to 30%, with 60% not expecting any movement from current levels. This is followed by computer software and related technologies, with 58% of respondents expecting no change, 17% an increase and 25% a decrease. According to 58% of respondents, the number of transactions in the semiconductors sector should stay the same, while 8% expect an increase and 33% a decrease. The communications sector is next, with 58% expecting no change, compared with 9% who anticipate an increase and 55% a decrease. The Internet-related technologies sector trails the pack, with 55% of VCs anticipating a decline, 36% predicting no change and only 9% foreseeing an increase.

When asked what the number one challenge was for VCs in Québec, 50% said difficulties in exiting their investments and 33% the management capabilities of potential investee companies. Other challenges mentioned were the lack of quality deals and the inability to secure appropriate leverage.

The respondents do not foresee any change in the value multiples on transactions. Sixty-seven percent feel the current ratios will remain the same, 17% that they will increase and the remainder that they will decrease. The amount of leverage available for financings should decrease according to 64% of respondents and remain unchanged according to 27%.

Only 8% of investors expect to exit more than two investments in the next six months, while 50% expect to sell two investments or less. Of the respondents, 42% do not anticipate exiting any investments during the period.



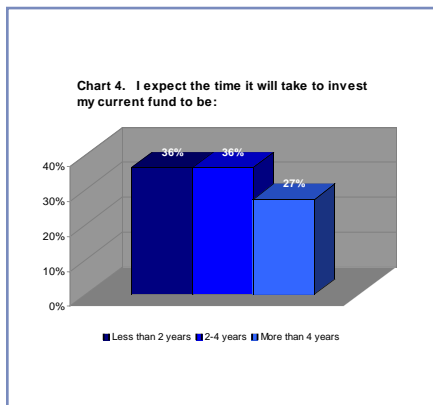
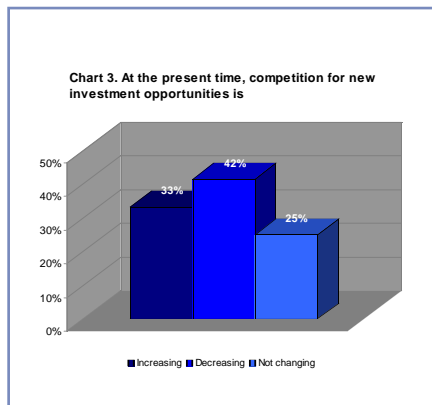
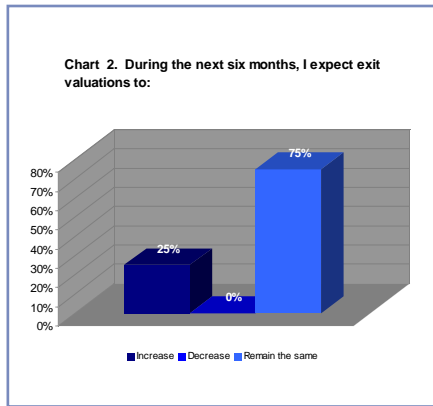
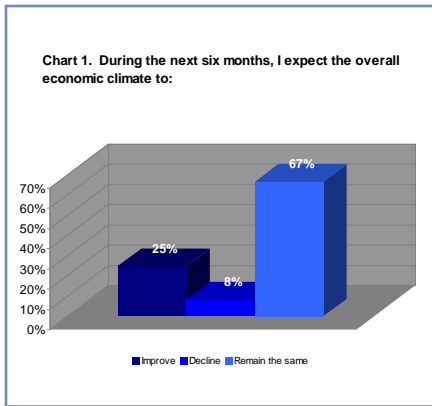
Investments under \$5 million are preferred by 58% of Québec VCs, compared to 17% who prefer an investment size of between \$5 and \$10 million and 25% who favour investments over \$10 million. These levels are not expected to change significantly in the next months, with 58% of respondents predicting no change in the average deal size, 33% foreseeing an increase and 8% anticipating a decrease.

Insights

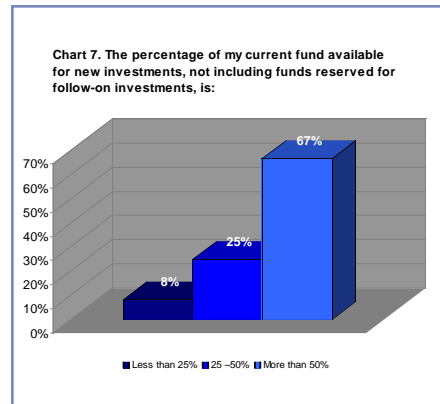
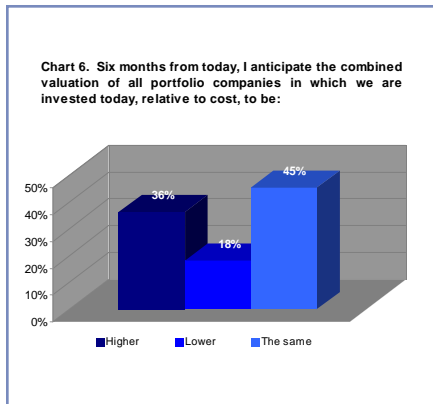
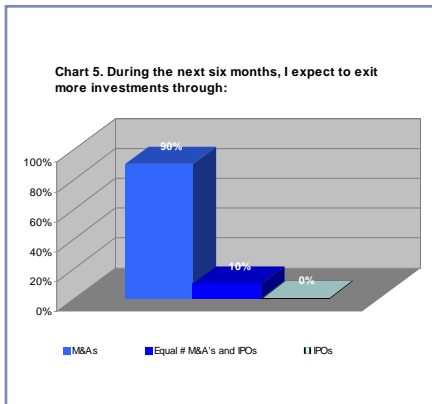
- Québec venture capitalists appear more upbeat than in the last two surveys. This change is reflected most clearly in their take on exit valuations, with a substantially larger percentage of respondents than in the last two surveys expecting them to increase or remain the same. A proportionately higher number of respondents expect the combined valuation of the portfolio companies in which they are invested to remain the same or rise.
- This attitude is mirrored in the amount of time VCs expect to spend on their activities: they plan to devote more time to new investments and raising new funds and less time to portfolio management. They also expect to allocate a larger percentage of their current fund to new investments. The percentage of VCs expecting to take less time to invest their current fund is higher than in Q3, 2002.
- VCs are still cautious when assessing investment opportunities. Company management team strength continues to be the key consideration, followed closely by the visibility of positive cash flows. The company's prospects for market dominance and its technology or product leadership position are also regarded as important.
- As observed in the third quarter, the sectors most favoured by VCs are manufacturing and consumer products, while the number of transactions in other sectors, particularly the Internet, are expected to stay the same or even fall off. No change is expected in entry multiples on transactions. Most respondents prefer an investment size of less than \$5 million and expect this level of investment to remain basically unchanged for the next six months.

VC Confidence Survey: Detailed Results - Québec

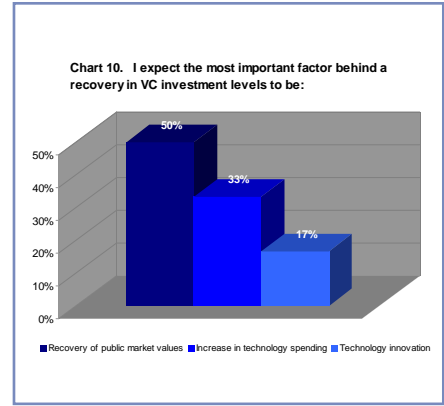
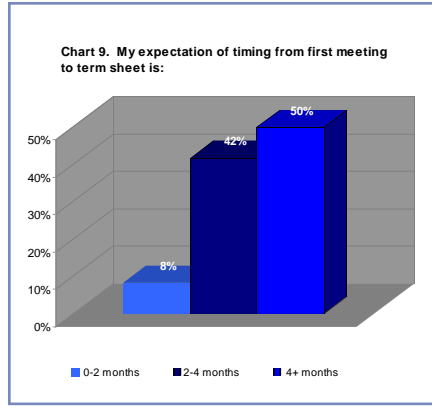
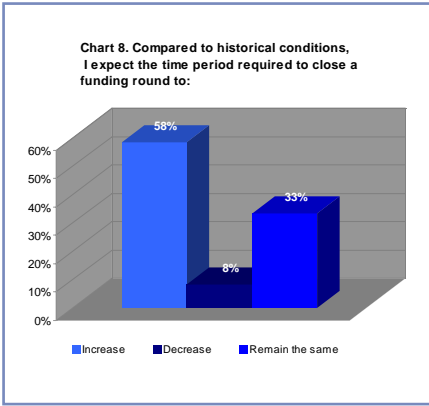
Economic and market climate



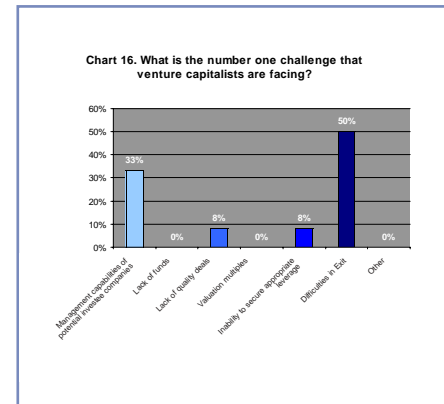
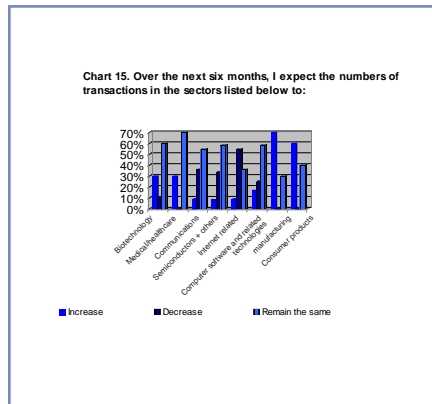
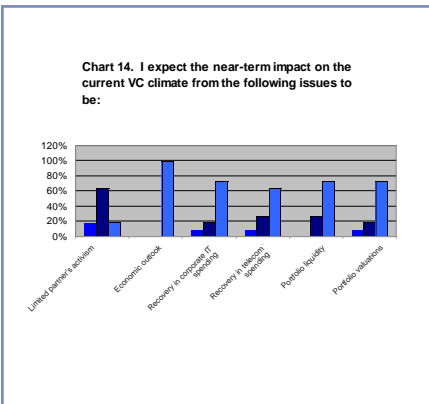
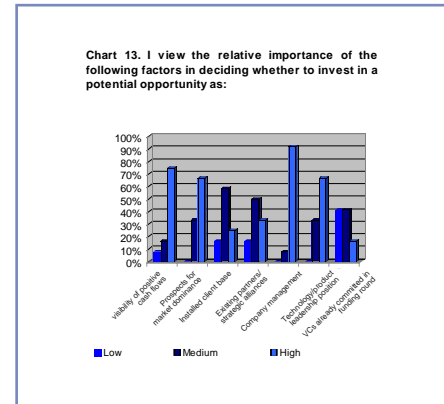
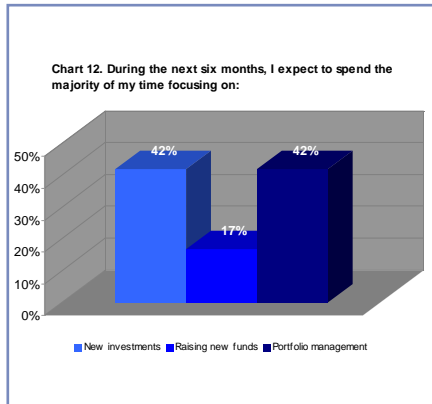
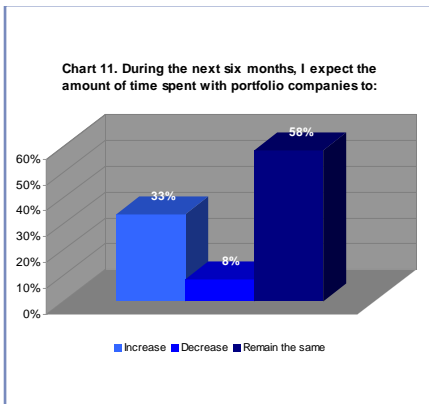
Level of expected investments



VC Confidence Survey: Detailed Results - Québec



Investment Focus



VC Confidence Survey: Detailed Results - Québec

Chart 17. Over the next six months, I expect entry multiples on transactions to:

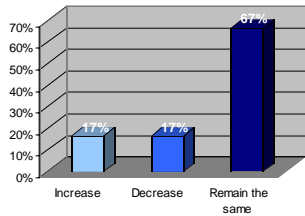


Chart 18. During the next six months, I expect the amount of leverage (senior and sub debt) available for financings to:

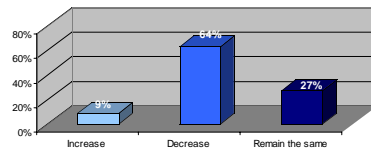


Chart 19. In the next six months, the number of current investments that I expect to exit is:

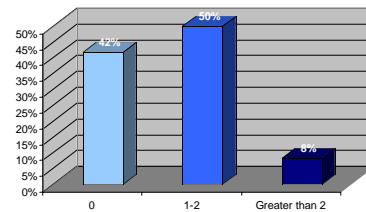


Chart 20. My current investment size preference is:

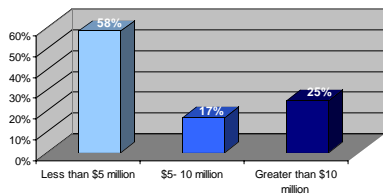
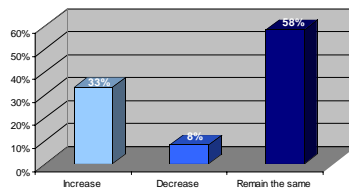


Chart 21. Over the next six months, I expect the average deal size to:



Contacts

Deloitte & Touche Corporate Finance initiated this survey and collected results from December 12th, through December 23, 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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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.

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