

The Venture Capital Industry in 2000: An Overview

Canada's venture capital industry managed to shatter all records as it completed 2000, with deal activity and capital flows that dwarf results in 1999. Pivotal to this milestone year was a greatly intensified focus by the industry on large deals involving technology companies – chiefly in communications, internet, software, life sciences and electronics – and particularly those that are new or in early stages of development. These and other trends lifted disbursements to an astonishing \$6.3 billion by the end of 2000 – reflecting a 132% increase over the \$2.7 billion invested in 1999.

A burst of activity in the last three months contributed substantially to this impressive final tally, with Q4 accounting for close to one-third of capital invested in 2000. Industry trends late in the year were comparatively stronger than those in the United States. Additional highlights include:

- In 2000, the industry disbursed a record \$6.3 billion, an increase of 132% increase over the \$2.7 billion invested in 1999.
- Capital deployments backed a record 1,441 rounds of financing (involving 2,566 investments), up by 46% higher from the 989 deals done in the prior year.
- Deals involving \$5 million or more continued to power industry disbursements in 2000, capturing 79% of aggregate disbursements. The average financing was \$4.4 million, up from \$2.7 million in 1999.
- The trend of a growing share of capital flowing to follow-on transactions that became evident in the first nine months of the year moderated somewhat in Q4, primarily because of a handful of very large first time financings (e.g. the \$115 million going into Innovance). As a result, 60% of the capital invested last year went to follow-on financings with a strong 40% share left for first time deals. We expect the share of capital available for new financings to tighten further over the coming year as investors conserve their cash to ensure they are able to continue to support existing investees until market conditions improve.
- 375 financings totaling \$2.0 billion were completed in Q4, 2000, adding substantially to year-end aggregates.
- Technology investing proved key to the industry activity, with disbursements to communications, life sciences and internet/computer products sectors, growing by 280%, 138% and 130% respectively.
- Communications firms captured 22% of capital invested, much of was disbursed in the fourth quarter.
- Internet companies held the industry's confidence, absorbing 19% of total spending, while computer-related firms accounted for 16% of disbursements.
- Led by biopharmaceuticals, life science firms confirmed their comeback in 2000, with their share of disbursements rising to 18%.
- Early stage transactions were also central to industry trends in 2000, taking a 45% share of overall activity, up from 35% in 1999. In particular, start-ups secured 310% more capital than invested in 1999, while disbursements to seed deals rose by 199%.
- Foreign and institutional investors continue to extend their influence in the market, disbursing a combined \$3.0 billion, or close to half of all resources in 2000.

- The activity of traditional industry players, including private independent funds and LSVCCs, was also up significantly in 2000.

The following is summary of venture capital market's progress in 2000 by Macdonald & Associates Limited, as well as detailed analysis of industry patterns in this period compared against those of 1999 and other years.

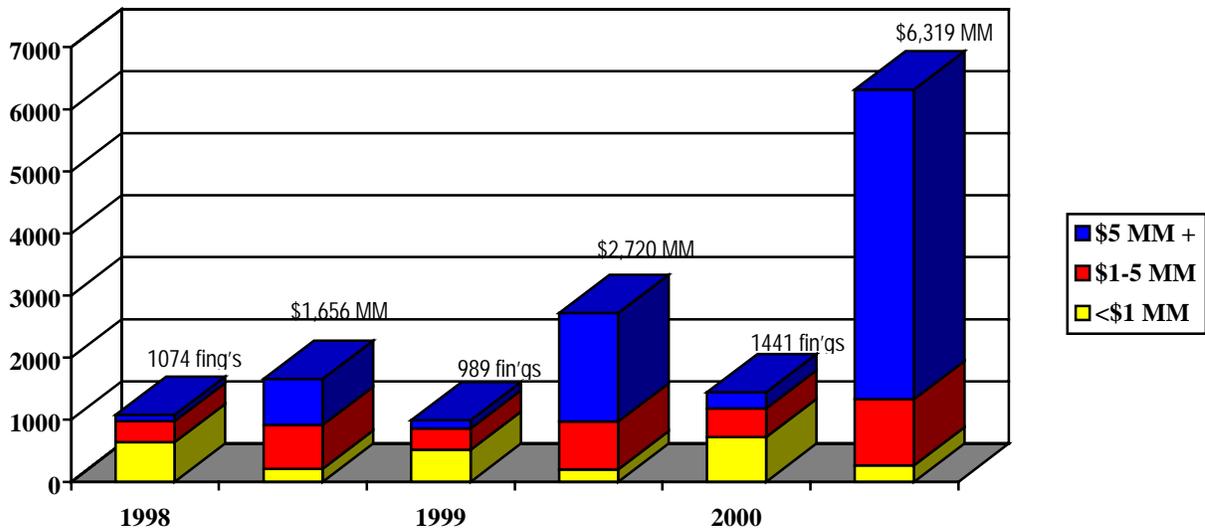
Industry Shatters All Records in 2000

With a last burst of activity in the fourth quarter of 2000, Canada's venture capital industry completed yet another milestone year, with capital flows and transactional rates that dwarf even the impressive results of 1999. Virtually every conceivable record was broken by the industry and its partners, beginning with the amount of capital disbursed, which grew to an astonishing \$6.3 billion by the end of December, reflecting a 132% increase over the \$2.7 billion invested in the prior year.

This capital flowed into an equally astonishing 1,441 rounds of financing in 2000, up by 46% from the 989 deals done in 1999. Financings involved 2,566 investments, also up by 59% from the year before while 1,089 companies were financed compared with the previous year's total of 824.

Deals involving \$5 million and above continued to power industry disbursements in 2000, capturing 79% of the aggregate, compared to 64% in 1999. The growing appetite of Canadian technology start-ups and expansions continues to explain the proliferation of large transactions. A total of 136 companies attracted more than \$10 million and, of these, 122 were in technology sectors.

INDUSTRY POISED TO SET YEAR-END RECORDS *\$ of Financings and \$ Invested by Deal Size; Canada*



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The average financing was \$4.4 million, up from \$2.7 million in 1999, while each financing involved an average of 1.8 investors.

The Canadian industry's overall tally in 2000 owes much to especially torrid activity in the concluding three months, when 375 deals captured an unprecedented \$2.0 billion, or close to one-third of total capital invested over the year. Fourth quarter disbursements built on comparably large capital flows between January and September when \$4.3 billion flowed into the 1,066 financings completed. These are revised numbers for the first nine months, accounting for late reports from two major venture capital institutions.

The intensified pace of investing in the last quarter occurred despite the turbulence in public markets and warnings of an impending economic slowdown. This suggests that Canadian venture professionals are continuing to express confidence in the quality of deals and in the long-term prospects of emerging technology companies, particularly in IT sectors, as they did in the whole of 2000.

Canadian industry trends late in the year also contrast with those in the United States. Activity in the American venture capital market showed evidence of softening in Q4, particularly in capital deployments which dropped by 31% from Q3, due partly to volatile public markets and flagging e-commerce IPOs.

Regardless, the American industry also reported a record-breaking year in 2000, investing \$103 billion (US), up by over 73% from 1999. When currency rates are factored in, Canadian industry disbursements at year's end stood at 4% of disbursements by the American industry, up from 3% earlier in 2000.

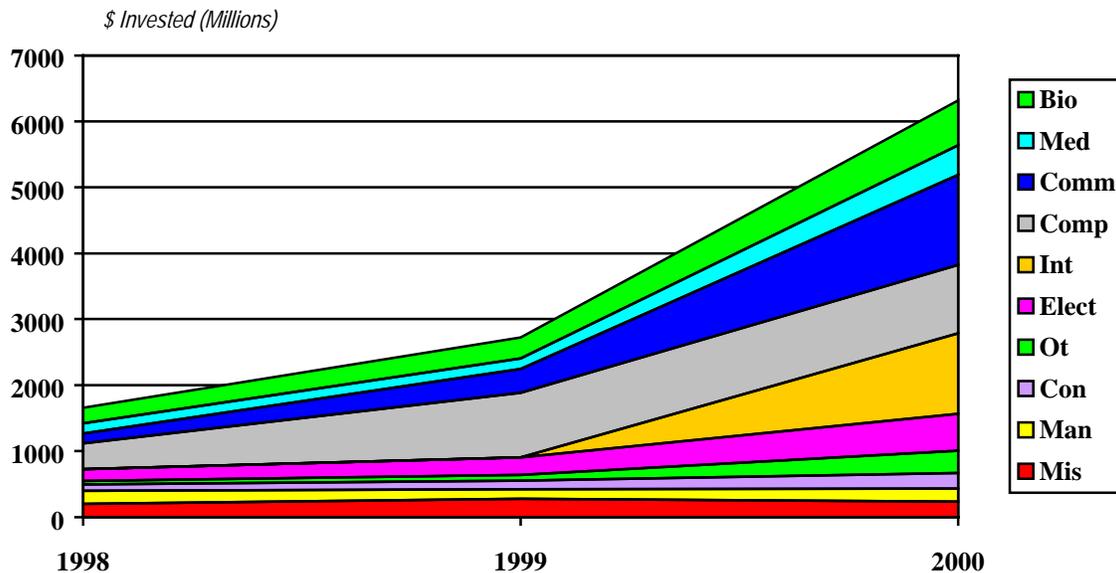
Burgeoning Technology Firms Key to 2000 Results

The key to an exuberant venture capital industry in 2000 is Canada's fast-growing technology sectors. Over the past two years, venture capitalists have paid ever greater attention to an increasingly diverse array of IT and other technology sectors, a trend that only got stronger in 2000, with 89% of aggregate disbursements going to these technology-oriented deals, up from 80% in 1999.

A closer look at those technology sectors preferred by the industry is even more telling. Technology majors saw remarkable backing in 2000, with disbursements to firms in communications, life sciences, internet/computer products and electronics increasing by 280%, 138%, 130% and 112%, respectively, over amounts invested in 1999.

INTERNET, IT FIRMS STILL LEADING THE PACK

Amount Invested by Sector; Canada



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Topping the list were communications and networking companies, 149 financings in which absorbed \$1.4 billion in 2000. Fibre-optic and photonics firms provided much of the heft, accounting for 27% of the total, followed by telecommunications services and connectivity products. Deals in this sector were particularly large— averaging \$9.2 million – helping to give it a sizable share of all disbursements. Exceptionally large financings in Q4 for companies like Innovance Networks, MetroPhotonics, Catena Networks and Futureways Communications, among others, added substantially to this end result.

After leading all year, companies with an internet focus took second spot, with 203 rounds of financing, totaling over \$1.2 billion – a level of support that tends to reject dire predictions about the commercial future of related technologies. The Canadian industry invested 19% of its resources in internet-related firms, with transactions averaging \$6.0 million. Among the biggest in Q4 were Watchfire and Mediatrix Telecom.

Driven partly by investments in financial industry software and connectivity/communications tools, firms in the computer products sector, particularly the software sector, also registered strongly, with 257 deals done which captured \$1.0 billion, or 16% of all deployments.

Life science companies also scored big, with 294 transactions and in excess of \$1.1 billion. Consequently, they took 18% of total activity. Following a period of reduced emphasis, Canadian venture professionals apparently regained confidence in life sciences during 2000, giving biopharmaceuticals heavy backing – 60% of sector disbursements, illustrated in the huge sums flowing to Sembyosis Genetics in Q4.

The electronics sector accounted for 112 deals, totaling \$555 million – more than three quarters of which flowed to companies focusing on semiconductors.

In the United States, internet-related investing was still commanding nearly half of all industry resources in the fourth quarter, followed by communications at 17% and computer software at 13%. At 7% of the total, American biotechnology and healthcare/medical companies continue to enjoy comparatively less emphasis than they do in Canada.

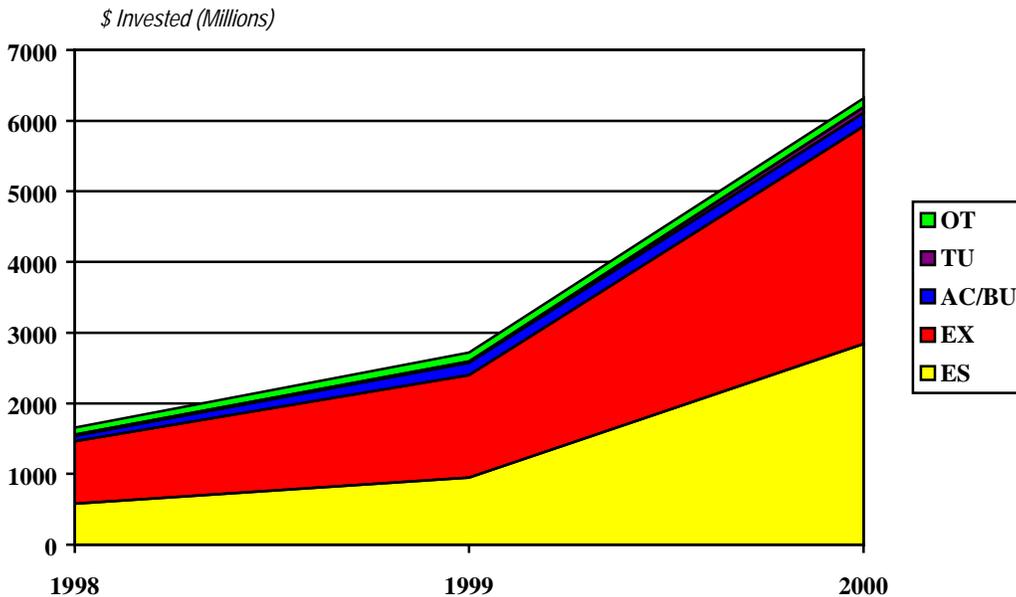
Industry Sees Future in Early Stage

A second key factor in the Canadian venture capital industry's record-breaking year was the upward trend favouring early stage companies. As part of its focus on emerging technology sectors, the industry poured unparalleled resources into seed, start-up and other early stage firms, with 682 rounds of financing, totaling over \$2.8 billion – raising the early stage portion of overall activity from 35% in 1999 to 45% in 2000.

In particular, company start-ups made extraordinary gains in their share of capital invested - \$1.1 billion, or a spectacular 310% more than was secured in 1999. Seed financings did almost as well, with a 2000 capture of 199% more in disbursement dollars than in the year before. This is a major event, considering that seed deals were all but unheard of in the market in the mid-1990s.

EARLY STAGE DEALS NET MORE DOLLARS

Amount Invested by Stage; Canada



Macdonald & Associates Limited

In addition, early stage deals have never been quite so large – fully 78% involved \$5 million or more compared to 57% in 1999, while the averages for start-up and other early stage financings were \$3.8 million and \$4.9 million, respectively. Examples of the very largest include the start-ups Innovance Networks and Pharmacor, and the early stage MetroPhotonics and Watchfire, all four deals occurring in the fourth quarter of 2000.

Larger early stage transacting also required above average numbers of co-investors in 2000. Industry syndications for start-ups involving \$5 million or more averaged 3.4 investors, while for other early stage deals, the average was 4.2 investors.

Expansion transactions still edged out early stage ones with their take of 49% of capital deployments in 2000, with \$3.1 billion flowing to the 614 deals done. In absolute dollar terms, this represents a near doubling of expansion capital invested, as compared to the end of 1999.

The average expansion financing was sized \$5.0 million – well above the \$3.6 average in 1999. The 2000 average was raised by such large Q4 expansion deals as Caprion Pharmaceuticals, Soft Tracks Enterprises and Silicon Access Networks.

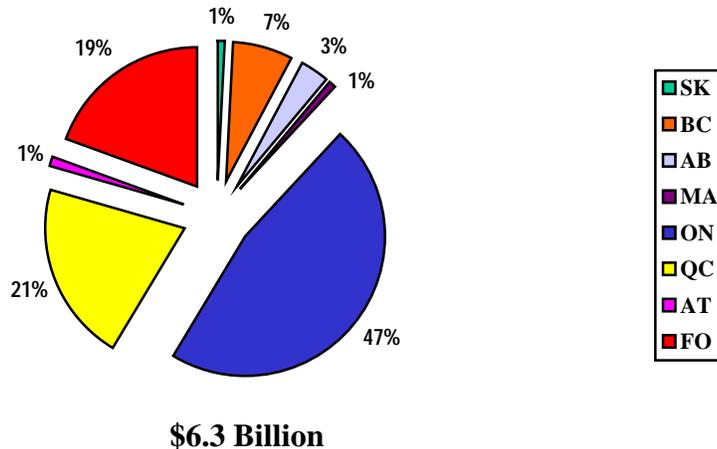
In contrast with the Canadian industry, early stage firms attracted only 23% of capital disbursed by the American venture capital industry in 2000. Indeed, the market trend in the United States has clearly been with expansions, at better than 54% of total amounts invested, especially towards the end of the year when increasing focus was applied to existing portfolio companies. In Canada, the ratio for spending on new versus follow-on financings was 40:60 in 2000.

Ontario Takes Almost Half of Disbursements

As in 1999, Canada's venture capital industry was also characterized by greater concentration of transactional activity and capital flows in central regions in 2000. Of the \$6.3 billion disbursed by the industry during the year, \$3.0 billion, or 47% of the total, went to Ontario-based firms. Incidence of a high number of large, technology-intensive deals in Greater Toronto and the Ottawa Valley goes a long way to explaining this rising share.

Quebec-based companies captured the second largest portion of aggregate deployments – 21%. With 615 deals of the 1,441 deals done across the country, however, Quebec was the scene of 43% of the financings completed by the industry in 2000.

LARGEST SHARE GOES TO ONTARIO *\$ Invested By Region*



Another major development in 2000 was the growth in capital invested outside of Canada. By the end of the year, external investment activity involved 172 transactions and totaled a whopping \$1.2 billion, or 19% of all industry resources. The latter compares with only 8% in 1999 and 10% in 1998. Quebec's CDP subsidiaries currently remain the most active investors in other countries.

In the United States, 41% of venture capital industry disbursements went to California-based companies, while New York and New England each captured about 10% of the total amount.

Foreign, Institutional Investors Vital to 2000 Deals

Partly due to the high proportion of early stage technology deals, Canada's venture capital industry relied heavily on strategic partnerships in 2000. Foreign investors played an especially critical role, bringing \$1.5 billion to Canadian transactions, lifting their share of disbursements to around one-quarter of the aggregate. In fact, foreign sources came close to tripling their capital invested between 1999 and 2000, suggesting the attractiveness of emerging Canadian technology sectors to these investors.

Foreign names that were prominent in 2000, and especially in Q4's large technology financings, included Advanced Technology Ventures, BancBoston Ventures, Baker Capital Corporation, Bay City Capital, Bessemer, Charles River Ventures, Comdisco, Dain Rauscher Wessells, Intel, Kodiak, Matrix, Menlo Ventures, Morgan Stanley Dean Witter, Morgenthaler, Polaris, Seimens and Thomas Weisel Partners.

In 2000, Macdonald & Associates revised data methodology to account for the increasingly important role being assumed by Canadian institutional sources, and particularly Quebec's CDP, OMERS and Ontario Teachers Pension Plan, as direct investors, as distinct from their making commitments to private funds, which is more common in the United States. As a group, these investors were responsible for a significant share of disbursements— almost \$1.5 billion, through 419 investments.

Together, foreign and institutional investors brought nearly half of all resources to venture capital deals in 2000.

Trends in 2000 were also influenced by traditional market players, whose pace remained strong from the beginning. Private independent funds finished the year with a greatly improved industry presence, deploying \$929 million in 640 investments – close to twice the amount attributed to them in the previous year – raising their share of disbursements to 15%.

With \$768 million backing 578 investments, LSVCC capital invested also increased substantially – by 20%, as compared to 1999, leaving them with 12% of the total.

Corporate venture groups (which no longer include CDP subsidiaries) spent \$558 million, or 9%.

In summary, despite the cracks emerging in the public markets through the fourth quarter of last year, the Canadian venture capital community powered itself to record levels barely thought possible 12 months earlier. While the public markets have continued to deteriorate along with the general economic environment through the early part of this year, the venture industry has matured significantly in recent years and should be in a position to weather the storm.