



**Tech Futures:**  
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By [Michael Volker](#)

### **Is there any money out there? Capital Pool Corps Update and Local Events**

Is there any money out there? That's a question that many entrepreneurs are asking lately.

A recent **B.C. Technology Industries Association** survey on accessing capital, headed up by **David Raffa** of **Catalyst Corporate Finance Lawyers** found that lack of investor interest was the biggest hurdle regardless of the investor category - be it family/friends, angels, venture capitalists or underwriters.

Raffa's "Access to Capital" report concludes that "a lack of numbers of professional angel investors and a lack of both VC dollars and number of VC funds are the most pressing concerns to the technology community".

I thought it might be worthwhile taking a look at some numbers that are being reported. First, I'll examine who, among institutional VCs is doing what in B.C. Next, we'll see how much capital BC companies are raising from various financing sources according to filings made with the **B.C. Securities Commission** and the **TSX Venture Exchange** and finally there'll be some conjecturing on those many un-reported deals that are getting done.

But first, here are some of the key findings of the TIA's Access to Capital Survey:

- ? Financing has been difficult to secure by technology companies at every level. Thirty-five percent of respondents rated the \$750K - \$3.0M round (typically, the Series A venture capitalist round) as being the hardest round of financing to raise. The \$250K - \$750K round (typically, the angel round) and the over \$3.0M round (typically, the Series B or C venture capitalist round) were rated by 24% and 27%, respectively, as the next most difficult financing rounds to raise. The initial \$250K (typically, the friends & family round) was rated as the least difficult round to raise (cited by only 11% of respondents).
- ? Fifty-five percent of respondents believe that increasing the labour sponsored fund cap will have a significant or very significant impact on their ability to raise private equity. Lack of total venture capitalist dollars available, lack of total number of venture capitalists and lack of competition amongst VCs were all cited as significant problems.
- ? A significant majority of respondents indicated that the Provincial Government (70% of respondents) and Federal Government (73% of respondents) could significantly or very significantly improve access to capital by implementing general tax reform (income tax reduction, capital gains relief, improved rollover and stock option treatment, etc.).
- ? A lack of tax incentives to offer early stage investors was cited as the second most significant impediment to raising friends & family funding. The inability to find angels was also cited as a significant problem in securing early stage funding.
- ? One in three respondents accessed government loans or grants. The federal programs and specifically IRAP and SRED were much more favourably thought of by respondents as compared to provincial programs.

? A general lack of investment interest was cited as the biggest impediment to raising investment capital at all levels, public or private. Within the public markets, this was cited as far and away the biggest hurdle.

The **Vancouver Enterprise Forum** recently reported on Venture Capital investing activities during 2002. The results include investments only by B.C.-based VC's in B.C. companies. These data were compiled by **Darren Frew, Darren Frew & Associates, Tracey Gibb of Lang Michener, and Sukesh Kumar of KPMG.**

<b>B.C. based V.C. Investments in B.C. Companies in 2002</b>				
<b>VC Company</b>	<b># New Deals</b>	<b>\$Mil</b>	<b># Follow on Deals</b>	<b>\$Mil</b>
Venture West	3	\$37.5	14	\$17.2
RBC Capital	0	0	2	\$0.855
Bus. Dev. Bank Cda	6	\$11.3	7	\$12.6
BDC Seed Fund	(new)	0	0	0
Discovery Capital	0	0	8	\$5.2
MDS Capital	1	Private	0	0
Growthworks Capital	11	\$19	26	\$29.1
FutureFund	0	0	5	\$1.3
Telus Venture Capital	8	Private	0	0
Bank of Montreal	0	0	1	\$2
BIRC Corp.	0	0	5	\$1.1
Greenstone Ventures	1	\$2.2	6	\$6.5
Smart Seed Fund	3	\$4.5	0	0
Banyan Capital	0	0	1	\$3
Yaletown Ventures	0	0	0	0
Chrysalix Energy LP	1	Private	1	Private
Pangaea Ventures	1	\$1	0	0
Mitsubishi Corp.	1	\$0.45	0	0
Altura Growth Fund	N/A	N/A	N/A	N/A
<b>TOTALS</b>	<b>36</b>	<b>\$75.95M</b>	<b>76</b>	<b>\$78.85M</b>

In round numbers then, less (really, "more" because of the private, undisclosed deals) than \$160 million was invested by VCs with about half of that going into some 36 first-round VC deals.

**Growthworks Capital**, manager of B.C.'s (until now) only labour-sponsored fund, led the charge doing approximately one new deal per month.

How complete is this list? Bear in mind that many private investments in private companies are just that - very private. Legally, certain transactions must be reported to the **B.C. Securities Commission (BCSC)**, which then become public information. Here's the rule for reporting: "With the exception of the private issuer\* exemption (issuer is the technical term used for companies that issue securities, exemption refers to being exempted from having to produce a full blown offering prospectus), each time an issuer uses any of these exemptions, the issuer must file a report with the BCSC. (\*a private issuer is, in simple terms, a small private company). In other words, it's very confusing.

There are many small "boutique" VC firms that are excluded from the chart, likely because of their small size or because they are not true VC firms but rather may be investment companies set up by wealthy families and individuals which might better fit the "angel" category. Indeed, some angels have set up their own funds, creating a special - and growing - category.

The TIA survey found that, as companies move from earlier stage to later stage financings, the ease of securing investment capital decreased dramatically. For example, the family and friends group were the easiest investors to sway while VCs and underwriters were the most difficult to convince as demonstrated by the small number of financings in the table above.

This might explain why companies often fizzle out a few years after they get started. Investors, such as VCs, who come in at the later stages of corporate development are far more risk-averse than friends or angels. And, if they don't invest, companies will either fail or have to bootstrap themselves.

It's important that entrepreneurs understand these odds so that they are not surprised at how difficult it is to get VC investors interested in their deals. After all, VCs invest other people's money and must be very diligent in so doing.

In addition to the \$160 million in total that was invested, a whopping \$149 million was raised by **Ballard Power Systems** late in 2002. I'm not sure how much of this, if any, is reported in the \$160 million total since this total doesn't include investments in B.C. companies by VCs outside of BC. The Ballard investors include **RBC Capital Markets** and **CIBC World Markets**, **BMO Nesbitt Burns**, **National Bank Financial**, **TD Securities** and **UBS Bunting Warburg**. A quick look at the table will tell you that the VEF survey didn't include RBC's portion. One might also argue that the Ballard number should be excluded because publicly-trade Ballard is not an emerging private company (but, so what?).

Also, because outside-of-BC-VCs are excluded, the real total for investments in B.C. companies could be higher - but not that much higher. As a sanity check on this, I looked at the data reported by **Mary MacDonald and Associates**, the Toronto-based gurus of VC investing. MacDonald reports that in the first 9 months of 2002, \$170 million was invested in B.C. Doing the extrapolation you can see that it's in the ballpark.

VCs are not overly open about their track records with respect to return on investment. Some of the larger, public funds, such as those managed by Growthworks do report their numbers. I've added Growthworks' results in the chart below. Note many companies produce stellar payoffs. If it weren't for Growthworks' investment in companies such as **HotHaus** (sold to Broadcom for over \$400million), the results would be even worse.

<b>ROI Comparisons</b>					
Venture Economics' US Private Equity Performance Index (PEPI)					
(As of 12/31/2001)					
Fund Type	1 Year	3 Year	5 Year	10 Year	20 Year
WOF (Growthworks)	-11.50%	18.51%	12.41%	7.98%	
S&P/TSX	-12.57%	7.34%	6.95%	10.37%	
Early/Seed*	33.90%	77.40%	49.40%	32.10%	21.10%
Later Stage*	-20.00%	22.50%	21.10%	24.20%	16.90%
All Private Equity	-18.50%	13.20%	14.80%	17.30%	16.20%

I deliberately include the early/seed category in this chart to show that this can be an attractive niche for investors - unfortunately our local VCs are not (except maybe the BDC) are not interested in this and are leaving it up to angels and angel groups to do the job. You'd think that these numbers would attract more investors into the early stage arena!

For many years in these columns, I've been touting the value of the junior public markets and the role that they (actually there's really only one at the moment, i.e. the **TSX Venture Exchange (TSX-V)** - formerly the **CDNX** and before that the good old **VSE**) can play in getting risky technology companies financed.

Local VCs don't think highly of the TSX-V. Partly, that's because the TSX-V is competition and

partly because they believe - some VCs really do believe this - that companies shouldn't go public too early (but that may be their only option).

If you believe that "there's no money out there", just take a look at what theTSX-V reports for 2002.

For 2002, theTSX-V reports that more than *\$1.4 billion* was raised by its listed companies! In comparison to the handful of VC financings, there were 1,911 financing deals on theTSX venture market that raised a total of \$1.44 billion, an increase of 33% from the same time last year of \$1.08 billion through 1,540 financing deals. *Caution:* this is the total for ALL companies - regardless of location and industry category. Nonetheless, I'm including the information here to point out that, yes, there is money out there! If you compare this \$1.4 billion to the total Canada-wide VC investment you're looking at \$2.3 billion (estimated from the 9-month total of \$1.69 billion as reported by Macdonald & Associates). Yet, theTSX-V figure refers only to small cap companies - not the big-boardTSX financings.

I checked with the good folks at theTSX-V and they promptly advised me that for 2002 B.C. technology companies raised \$56.9 million (About 10.3% of total B.C. companies financing) B.C. oil & gas companies raised \$26.3 million (About 4.8% of total B.C. companies financing) B.C. mining companies raised \$385.8 million (About 69.8% of total B.C. companies financing). The B.C. total was \$552.5 Million - a nice slice of the total pie!

Here are some of the facts as reported by theTSX-V:

- The average size of each financing in 2002 was \$0.75 million, an increase of 7% from an average of \$0.70 million in 2001.
- The Mining sector led the way in financing, raising a total of \$572.6 million. This represented 40% of the total financing onTSX Venture in 2002. The Oil & Gas sector followed with \$402.3 million of financing, which accounted for 28%. The Technology sector captured 12% of the total financing with \$170 million raised (\$56.9 million in BC).

[Note: The TSX-V will present at the next Vancouver Enterprise Forum event on Feb 25th. Don't miss it!]

Now let's turn our attention to early-stage investors which would include love money and angels (i.e. successful entrepreneurs reinvesting their gains). It's a challenge to get meaningful data in this category. However, let's see what we can deduce from other sources.

First of all, how many wealthy individuals, lets say "millionaires", do you suppose we have in B.C.? I ask that question because I just noted an on article on angel investing in Business in Vancouver in which **Bob Chaworth-Musters**, founder of the "angel forum" (see below for link) notes that there are some 40,000 millionaires in B.C. This seemed like a huge number (even though it's only 1% of the population) so I checked the web and found that, according to **Statistics Canada**, there were 56,218 millionaires living in British Columbia in 1999. Their average net worth was a cool \$2.7 million. Together they accounted for well over one-third of all the personal wealth in the province. BC's 56,218 millionaires (actually family units with a net worth of at least \$1 million) made up a surprisingly large 3.3 percent of all the family units in the province or one family unit in every 33. The percentage of millionaires in BC was the highest of any province, and their average net worth was also the highest of any province. Now that's an email list that I'd like to have!

It's hard to know what individuals are investing. The **B.C. Securities Commission (BCSC)** filings that I referred to earlier are a good starting point. According to these, during 2002, the total capital raised by B.C. companies is **\$595 million** This breaks down as to **\$374 million** in VC financing and **\$221 million** in Seed capital for 116 companies. The Seed number is based on the Commission's "exemptions" relating to family, friends, relatives (love money) and accredited

investors (mainly angels). It should be repeated that many companies, especially nascent ones, do not (although they are required to do so) report to the Commission and hence, cannot be included in this tabulation.

The \$595 million also includes debt-equity conversions and is skewed by **360Network's** \$190 million reorganization. This has the effect of reducing the VC portion to only \$184 million! (which jives with the Macdonald & Associates data). Hence, although the data require further interpretation and analysis, the preliminary analysis is nonetheless revealing.

For the past four years, I've been involved with local (i.e. Lower Mainland) angel investors (there are hundreds that I'm aware of) that meet monthly on an informal basis to look at early stage companies (usually 4 or 5 each month) that other angels bring forward. I don't keep track of deals done, but my guesstimate for 2002 is that some \$40 million-plus was placed by such investors (in BC to BC tech companies). This is somewhat corroborated by the BCSC data. For comparison, reports on Ottawa-area angel groups have them investing upwards of \$50 million.

This source is growing. I expect some substantial increases this year. For example, B.C.'s Venture Capital Corporation (VCC) program, something that many angels take advantage of, is slated to get a big boost this spring when new rules come into effect (touch wood). This program, which gives B.C. investors a 30% refundable tax credit (without affecting the cost base of their investment), is seen by many as a very positive step towards attracting more early stage risk investors to technology firms. In the past, the total amount of tax credits under the program has been severely limited and difficult for many investors to access because it required the establishment of special investment corporations. Under the new rules, the so-called "direct investment model", will allow individuals to make investments personally thereby avoiding the cost and hassle of setting up a special VCC holding company. This will attract many smaller investors of the \$10K variety. The true potential of the VCC program is still constrained by an annual budget limitation of \$15M - thereby allowing only \$50M to be raised.

The [Throne Speech](#) read in the B.C. Legislature earlier this week gave us a sneak preview into the upcoming budget. It referred to, and I quote, "changes to the **Small Business Venture Capital Act** (that's the VCC program) to increase access to seed capital, eliminate red tape and provide funding opportunities for all regions of the province". Great! More details will be forthcoming when Minister **Gary Collins** presents his budget speech at 2pm on February 18.

I'd be remiss if I didn't mention that we seem to be off to a good start this year with a few noteworthy deals already done this year. This includes a \$24 million investment in **Octigabay Technologies** (not to be confused with Orca Bay - although both like hockey sticks). It is said to be the largest information technology seed financing deal in Canadian history from four top-tier investors: **Celtic House Venture Partners**, **Ventures West Capital**, **Working Opportunity Fund** (managed by **GrowthWorks Capital**) and **Business Development Bank of Canada**. The Octigabay guys are the former **Abatis Systems Corporation** guys who sold out to **Redback Networks** for over \$1 billion in 2000 in one of the largest acquisitions of a private high tech company in Canada. It helps to have a track record! [The reader is left to ponder the question as to why they needed to raise \$24 million when they once had \$1 billion. *Hint*: next time, take cash - not stock.]

**Celator Technologies Inc.**, secured \$10.5 million in its first round of venture capital financing with **Ventures West** and **Growthworks** leading the round, which also included **Business Development Bank of Canada**. The company had previously received seed funding from **Genyous Life Sciences** and **Hearthstone Investments Ltd**. Celator was founded in 2000 as a spin-off from the **British Columbia Cancer Agency**.

**Simon Fraser University** spin-off **Twinstrand Therapeutics** closed a \$10 million VC round and **Dyaptive Systems Inc.** reportedly raised somewhere between \$1 and \$5 million.

Just how much did BC tech companies raise - from all sources? Although, it's not easy to deduce, I'd say it's at least \$500M! Compare that to aggregate industry revenues of just under \$5Bn and

it's not that unhealthy.

So there you have it. There is money out there - maybe not enough (it's never enough), but it's getting better.

The thought of those 50,000+ millionaires has really got me thinking. If they each put just \$10K in a seed fund, we'd have \$600 million of fun money - just imagine!

When someone says that there's not enough capital available or that they can't get financed they're really voicing a euphemism for "we're a marginal company and no one believes in us enough to support us."

Many companies are "life-style" companies that get started because of a need for independence or perhaps because of an opportunistic entrepreneurial moment. VCs, and astute angels, simply aren't interested in such companies.

The bottom line: complaining about the lack of capital or lack of investor interest is a misdiagnosis of the real problem: a corporate inadequacy that the company has thus far failed to address to the satisfaction of potential investors.

See [www.vef.org](http://www.vef.org) - the front page has links to BOTH the "Angel Forum" and the "Angel Network (Vantec)". These are for technology based business - ranging from atomic physics to zoology.

Reader beware: there's a lot of data that is omitted in this article simply because it's not collected anywhere. On the other hand, there may also be some double-counting if you simply add up all the numbers as stated above (for example an angel investment may be counted in both the BCSC reports and the TSX-V numbers).

[P.S. I just spent a few days in Silicon Valley this week and for once the grass isn't greener on the other side. Quite the contrary - the mood in the valley is anything but upbeat. In 2002, only US\$1.9B new capital went into venture capital (VC) funds, down 95% from the \$40B-plus of just a few years ago.]

### **Capital Pool Corporation (CPC) Comments and Update**

In this column, I keep track of **Capital Pool Corporation** ("CPC") companies as defined by the TSX Venture Exchange (the former CDNX) because they may provide funding and management to, and in the process acquire, technology companies. They provide companies with an alternative to traditional venture capital financing. It lets the public investor get into the game.

Originally, these CPCs were limited to raising \$750K. After legal and accounting fees, this didn't leave much for actually doing acquisition. Recently, though, the Exchange has permitted a combination of CPCs in order to up the ante. Check our [Capital Pool Corporation chart](#) (in .pdf format) for a complete list of the CDNX's CPC and VCP companies, thanks to **David Ing** of **Pacific International Securities**. This list is updated on a regular, e.g. monthly basis. It is now current to the end of December, 2002.

An introductory article explaining CPCs may be found at <http://www.bctechnology.com/statics/mvolker-jun0200.html>.

### **Local Events**

Are you interested in getting yourself a good board of directors? Are you on the board of a company or are you just plain bored? On Feb. 25th, there'll be a day-long course titled: **Better Boards Build Better Businesses**". This course is being presented by **David Raffa** of Catalyst Corporate Finance Lawyers and myself at **SFU's TIME Centre**. We've got 15 great panelists lined

up - seasoned entrepreneurs, CEOs, directors and professionals to provide some insights on what it takes to make a company tick, board-wise. When we first ran this last December, it was a totally sold-out event. It's being offered again at \$195 and you can sign up or get more details by email to [denham@sfu.ca](mailto:denham@sfu.ca) or calling (604) 291-3844.

This month's **Vancouver Enterprise Forum**, also on Feb 25th (why not take in both events?) will deal with the subject of raising capital from the public market. The event is titled, **Going to Market...the Public Market**". The President of the TSX Venture Exchange and executives from two B.C. technology companies that have successfully obtained public financing will take on these issues. They will discuss the public market environment, how to position your company to effectively raise funds in this arena, and recount their experiences – both positive and negative – of financing through the public market(see [www.vef.org](http://www.vef.org) for more info).

A complete calendar of technology events can be found on [T-Net's Events page](#).

### Footnotes

If you're an entrepreneur looking for a place to get your company started; there's some great space available at Harbour Centre downtown. The **New Media Innovation Centre** (NewMIC) and **SFU's TIME Centre** have teamed up to provide not only office space but also access to various resources, e.g. tech advisors, access to capital, mentors, etc. Worried about the high cost of being downtown? Well, not to worry - they'll even reduce the fees and take some payment in the form of equity. Check [www.sfu.ca/time](http://www.sfu.ca/time) for contact info.

A reminder: SFU's TIME Centre is open for business - business folks, that is. TIME is an acronym for **Technology, Innovation, Management, and Entrepreneurship** TIME supports the growth and development of the tech industry in B.C. TIME features a "BusinessCentre" (looks like an airport business lounge) which is open to technology entrepreneurs and business people to use as a drop-in downtown office facility. Need to plug-in? Make some calls? Do some work? Hold a meeting? There are some great facilities for holding your company's AGM. Why hang out at MacDonald's when you can work productively at the TIMECentre? Drop by and check it out! It is located at SFU's downtown campus at 515 West Hastings St.

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