Report
May 2022

Canada's Venture Capital Landscape

bdc

Message from the Executive Vice President

BDC Capital is pleased to present the 2022 edition of Canada's venture capital landscape report.

As was the case when we last provided an update, we've mined both internally and externally available data to produce a detailed evaluation of the current state of the ecosystem. The VC industry has garnered much international attention and scrutiny over the last five years, having offered numerous opportunities for putting capital to work in exchange for strong returns. Canadian VC has come into its own during this same period and we have outlined in this report the evidence of this significant progress.

The sustained momentum is a strong testament to the strength of our entrepreneurs and the continued maturation of our industry. More must be done to ensure continued success—with diversity, equity and inclusion, as well as sustainability, at the heart of our ambition to be a world-class place to innovate. We share in the excitement of seeing the industry become one of the powerful engines of the Canadian economy and will continue to find novel ways to build on the foundations that have been laid by all.

We are slowly learning to live with COVID-19 and businesses seem cautiously optimistic for 2022. We acknowledge that recent world events, as well as concerns regarding inflation, rising rates and labour shortages, have emerged and may dampen recent momentum. Yet we believe that the perseverance of the Canadian entrepreneurial spirit will prevail.

We hope you will find this report informative.

Jérôme Nycz
Executive Vice President, BDC Capital

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This study is based on information that was analyzed and interpreted by BDC. Any error or omission is BDC's sole responsibility. Reliance on and use of the information herein is the reader's responsibility.

Executive summary

There has been an incredible rise in funding for venture capital (VC) over the last five years. Global investment rose from US$200 billion in 2017 to US$621 billion in 2021. This is in stark contrast to 10 years ago, when total investments stood at US$60 billion.[1] With the low-interest environment of recent years, investors sought opportunities to earn higher returns, turning to private asset classes. VC is a direct beneficiary of this shift in asset allocation as investors looked to gain from its high internal rate of return (IRR), which amounted to more than 20% globally during the most recent five-year period (2017–2021).[2]

1 Gené Teare, "Global Venture Funding and Unicorn Creation in 2021 Shattered All Records," *Crunchbase*, January 5, 2022, https://news.crunchbase.com/news/global-vc-funding-unicorns-2021-monthly-recap/.

2 Pitchbook, *Global Fund Performance Report*, February 1, 2022.

It's with this global backdrop that Canadian VC continues to take strong steps forward. Ten-year returns to investors are now 14%, an all-time high. Deal activity and valuations are both up, with total investments reaching an unprecedented $14.7 billion[3] across 752 transactions in 2021. This spike in volumes was fuelled in no small part by the transactions occurring at the megadeal (over $50 million) level, which represented only 10% of total deals, but 72% of total investments. Increasing interest in VC-backed firms by non-traditional investors[4] had an impact as well. Our observations on the Canadian market align with the measured U.S. data.

Canadian exits remained strong in terms of activity and value, with median exit value rising to $90 million in 2021—a threefold increase over 2020 and an impressive jump versus 2019, when median exit value sat at $40 million. It was also a banner year in terms of initial public offerings (IPOs), with 12 VC-backed Canadian companies going public at home or abroad, generating exit values of $6.5 billion.

3 All dollar amounts are in Canadian dollars unless otherwise noted.

4 Non-traditional investors include groups such as asset managers, private equity (PE) funds, corporate venture capital and sovereign wealth funds.

Canadian fund managers continue to mature, with a dependable pipeline of new and emerging managers growing the ecosystem. The number of established general partners (GPs)—with four or more funds—represents a growing proportion (21%) of active GPs in Canada. Information, communications and technology (ICT) remains the most sought-after sector, with $9.5 billion in investments for the year, representing 64% of total transaction value. A growing number of new GPs have also come to the market with differentiated strategies that tackle issues around climate, sustainability and diversity.

These remarkable facts and figures are cause for celebration and renewed optimism among ecosystem members following the challenges faced during the COVID-19 pandemic. However, we would be remiss in failing to acknowledge the headwinds prevailing thus far in 2022: public market volatility and a decline in the value of U.S. publicly traded technology and life sciences companies, inflation concerns, and the war in Ukraine require vigilance if we are to continue growing the ecosystem and maintain the positive momentum that has lifted the industry in recent years.

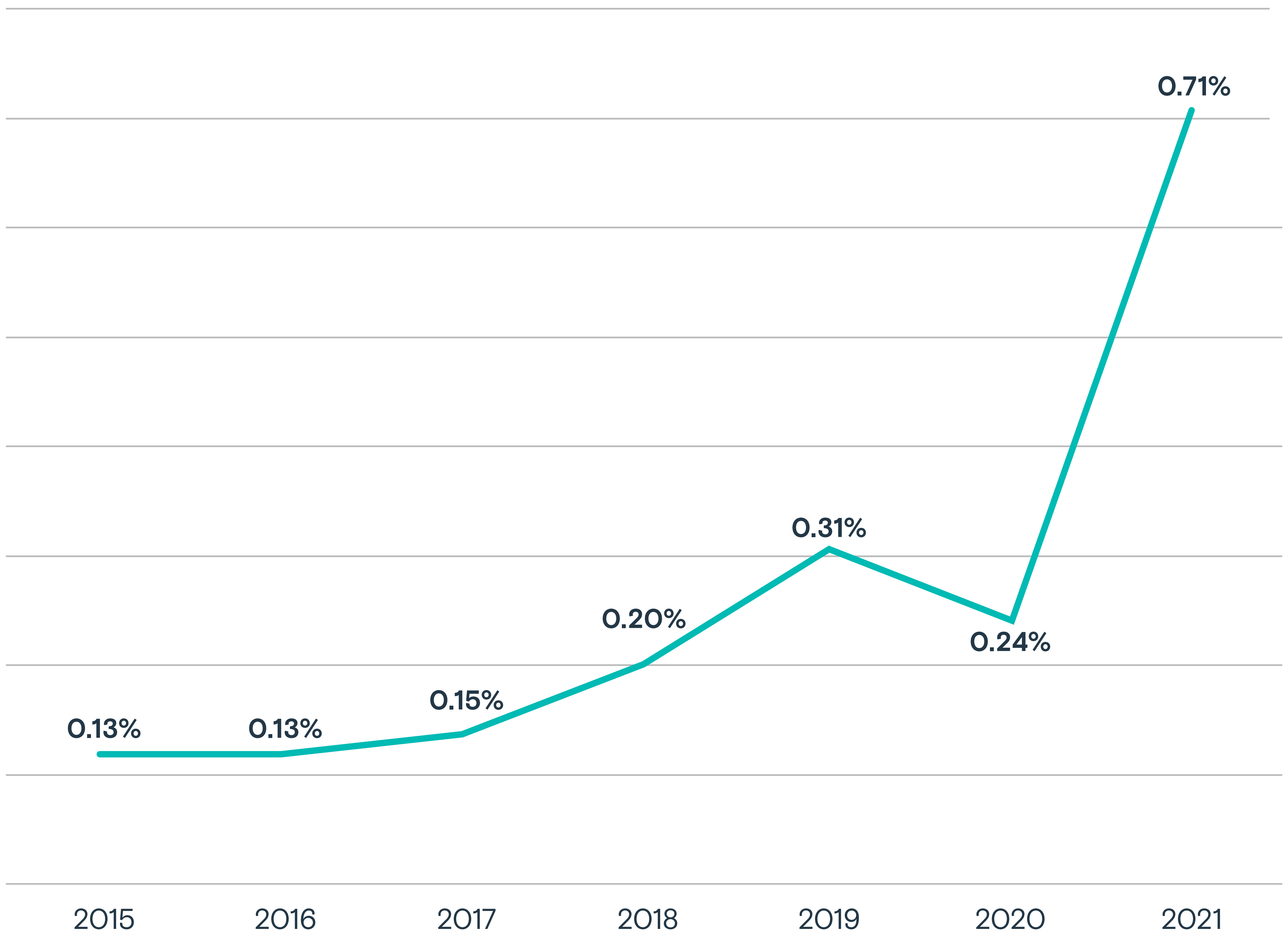
1

Venture capital grabs the spotlight

Global VC investment has experienced dramatic growth over the last five years, with appetite for VC-backed companies nearly tripling over this period, culminating with a record US$621 billion in investments in 2021.

Clearly, Canadian VC investment has benefitted from this global trend. VC investment as a ratio of Canadian GDP has grown significantly since 2018. This is a sign of the strong momentum driving the space in Canada.

Figure 1: VC investment in Canada as a percentage of GDP



Sources: Bureau of Economic Analysis; OECD; Pitchbook.

VC investment as a percentage of Canadian GDP nearly tripled in 2021

Over the last year, countries such as Germany, Denmark, Israel, Sweden and the U.K. more than doubled their VC investment as a percentage of GDP.

Canada's VC landscape has shown particularly healthy growth relative to its peers by almost tripling investment in 2021, bringing it much closer to leading OECD member states in terms of VC investment as a percentage of GDP.

The massive increase in megadeals (deals worth more than $50 million) has fuelled this growth. Megadeals represented 72% of the $14.7 billion invested in 2021.

Several other late-stage ICT companies also raised rounds over $200 million. This is a subset of the market that has grown to a level of maturity such that it can now attract both domestic and international investors.

Figure 2: VC investment as a percentage of GDP, 2021

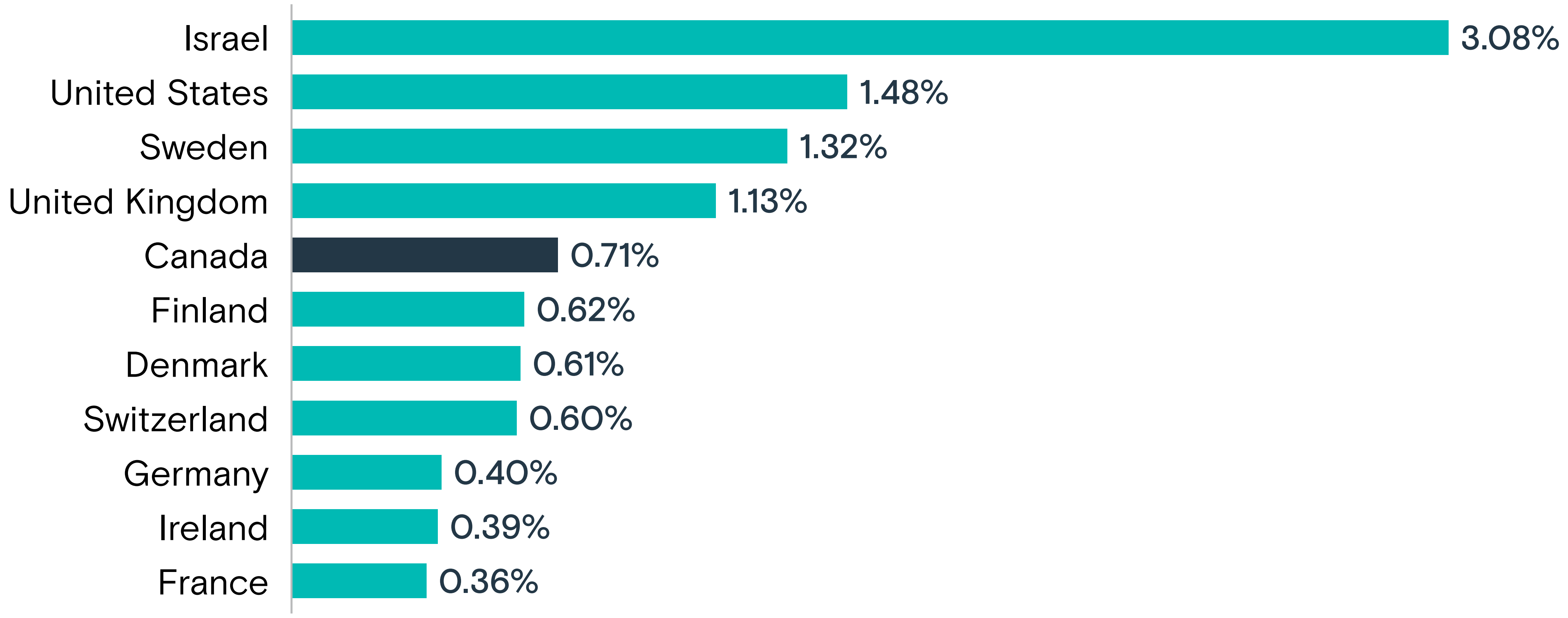
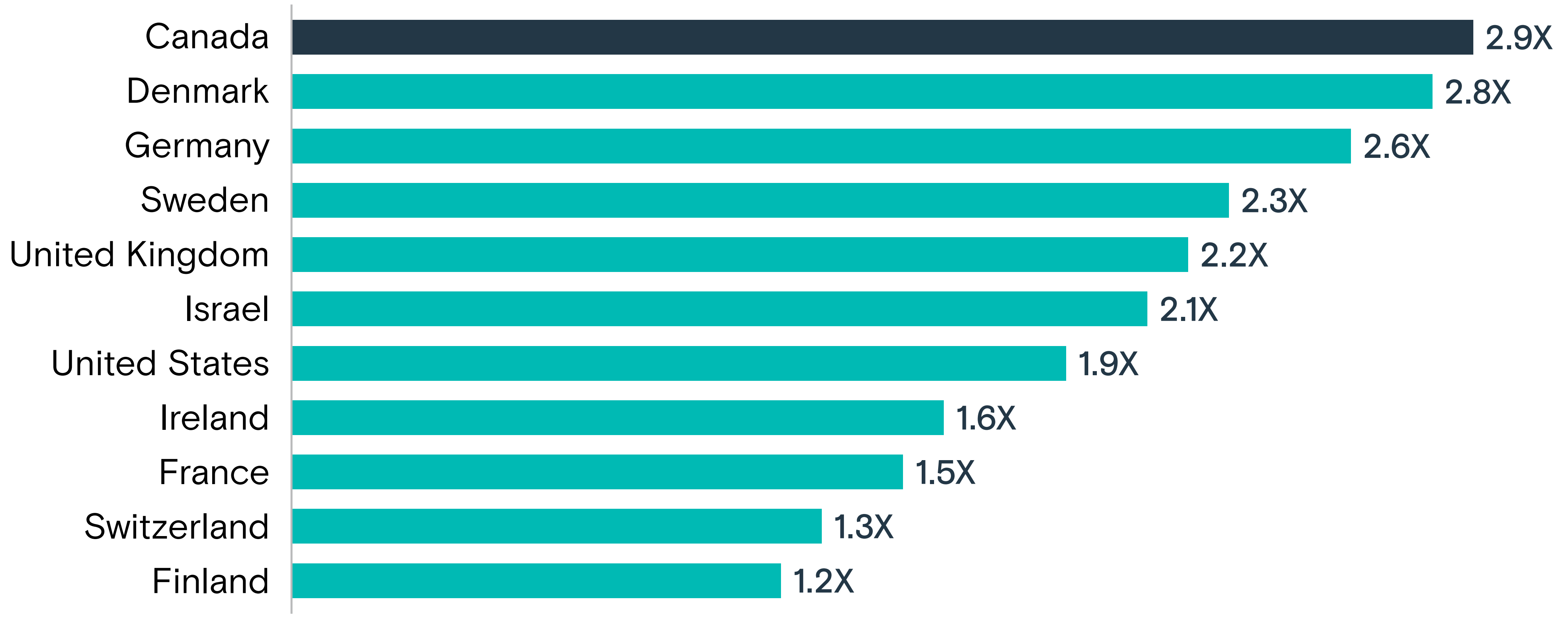


Figure 3: Increase in VC investment as a percentage of GDP, 2020 to 2021



Sources: OECD; Pitchbook, *Geography: Global*

Rising global IRRs are helping fuel growth in the global VC ecosystem

A low-interest environment and sporadic periods of public market volatility have combined to drive investments in private market assets in recent years. Meanwhile, global appetite for VC investments as a proportion of private asset investments has also been rising. The returns and scale of the VC market have encouraged this growth, particularly when it comes to non-traditional investors who previously shied away from the space. U.S. VC deal activity with non-traditional participation, for instance, increased to 75% of deal value in 2021, compared to 50% of deal value 10 years ago.[5]

A November 2020 working paper published by the National Bureau of Economic Research (NBER) demonstrated that VC firms' outperformance is much more broadly distributed than previously understood. The analysis shows that half of all VC funds launched between 2009 and 2017 generated returns to investors, net of all management and performance fees, outperforming the public market equivalents of both the S&P 500 and the Russell 2000.[6]

In recent years, global VC returns have exceeded those of other private asset classes. Investors were the beneficiary of IRRs of 29% over a three-year horizon and 22% over five years. The persistence of global VC returns is evidenced by the 16% IRR earned by investors over a 10-year horizon.[7]

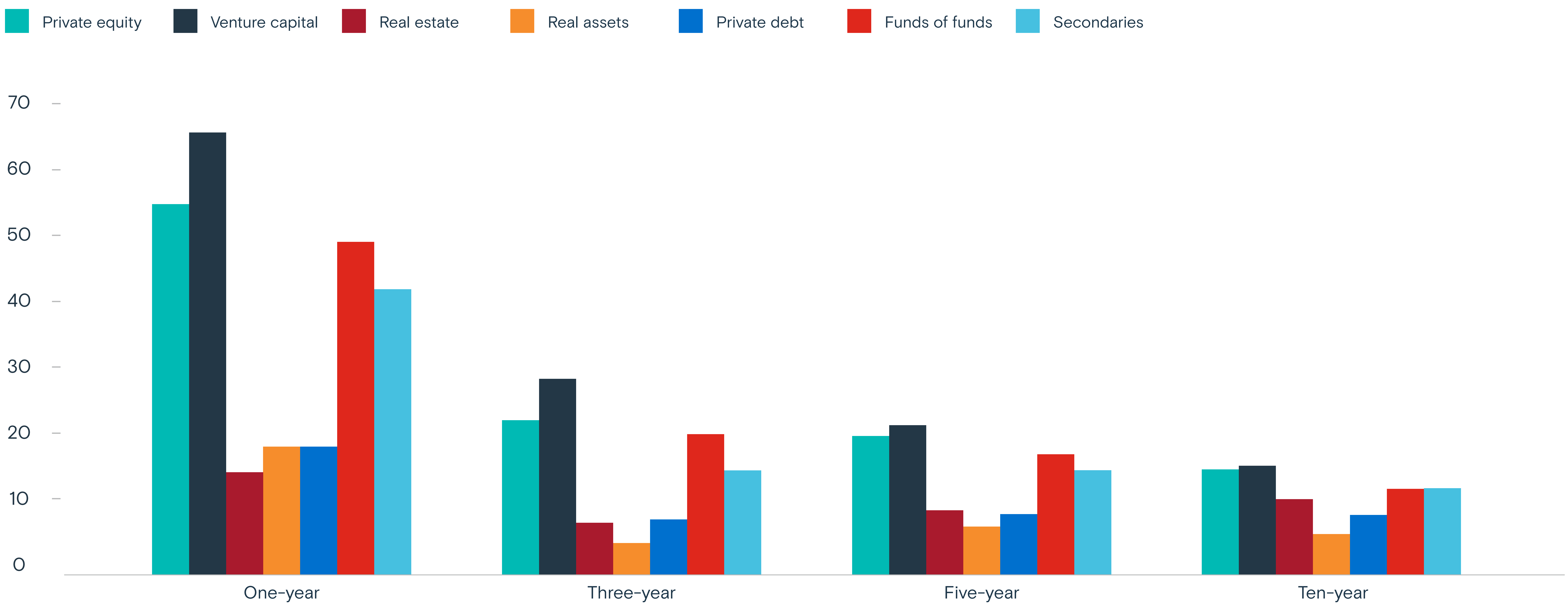
As we shall see in the following section, the evolution of the Canadian VC landscape has offered both Canadian and international investors an increasingly compelling arena to put capital to work and earn returns over long-term horizons.

5 Pitchbook, *Q1 2021 Pitchbook NVCA Venture Monitor*, April 13, 2021.

6 Robert S. Harris, Tim Jenkinson, Steven N. Kaplan and Ruediger Stucke, "Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds," NBER, Working Paper 28109, November 2020.

7 Pitchbook, *Global Fund Performance Report*, February 1, 2022.

Figure 4: Global horizon IRRs, by investment strategy (percent)*



Sources: OECD; Pitchbook, *Geography: Global*.

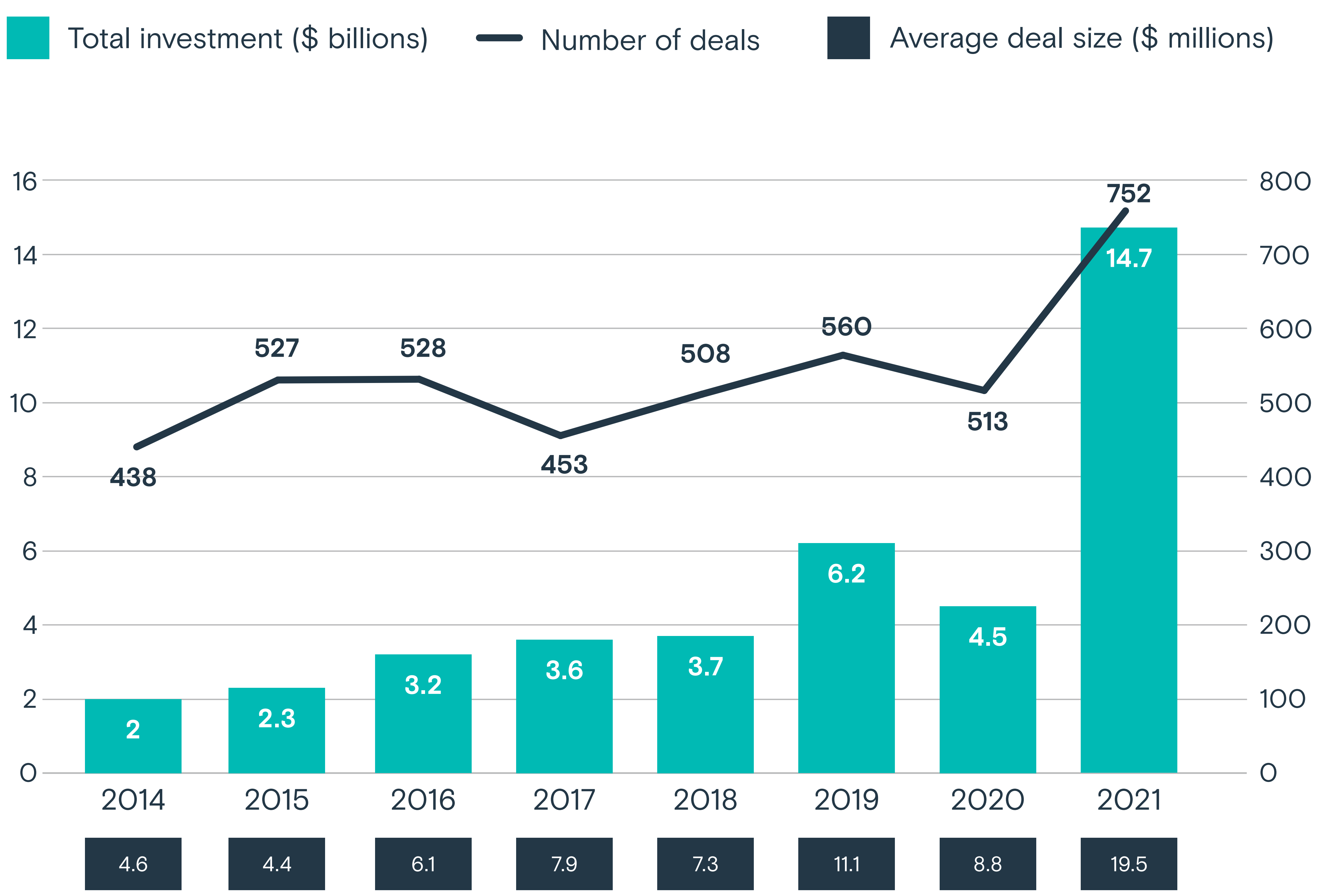
* Yearly horizons are as of June 30, 2021.

②

A landmark year for Canadian VC

2021 was a banner year for Canadian VC, with surges across all important metrics. This includes a doubling of average deal size and total dollars invested compared to 2019. Even in 2020, when investments slowed due to the uncertainty caused by the COVID-19 pandemic, total investment levels increased from 2018 and prior years.

Figure 5: Total VC investment and number of deals in Canada



Source: Canadian Venture Capital and Private Equity Association (CVCA).

Exit values at a record high

It was clear by late 2020 and into early 2021 that the COVID-19 pandemic had increased the need for technology in most, if not all, industries—with the rise of remote work as an example. Expanding prospects for tech companies and substantial amounts of dry powder in the ecosystem were major factors behind the growing number of megadeals in 2021.

Megadeals were also driven by a favourable exit environment. Valuations have been rising and unicorns (companies valued at more than $1 billion) are no longer a rarity. Median exits in 2021 reached a remarkable $89.4 million, a striking increase over prior years, and a more than twofold increase compared to 2019.

Perhaps as a result of these rising exit values, we notice that Canadian investors have been more than willing to reinvest in their portfolio companies. This includes any stars that have the potential to go public. In the past, they may have been more open to letting them be acquired by incumbent U.S. players.

Figure 6: Median VC exit values in Canada and the U.S.

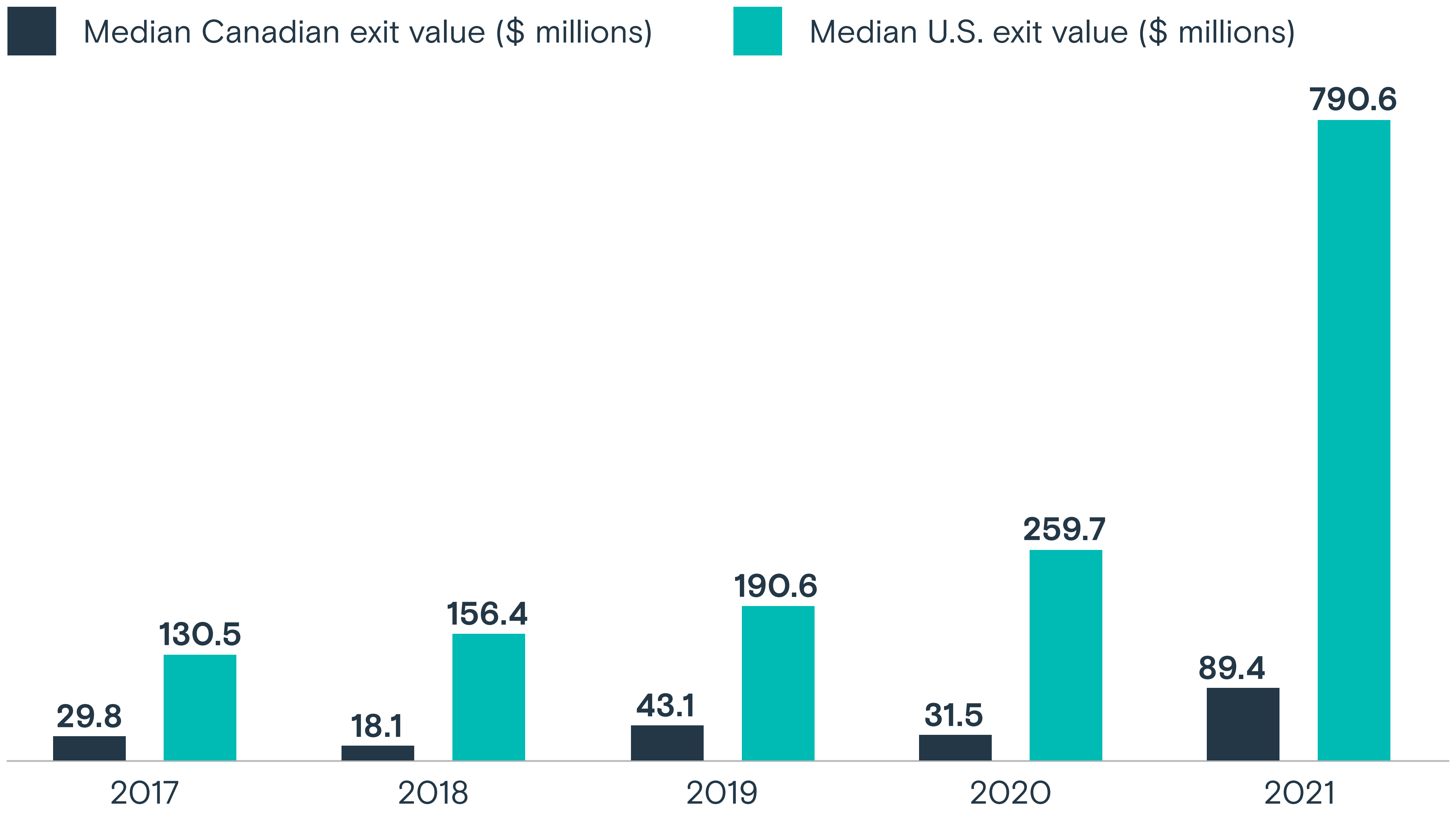


Table 1: Maximum VC exit values in Canada and the U.S. ($ millions)

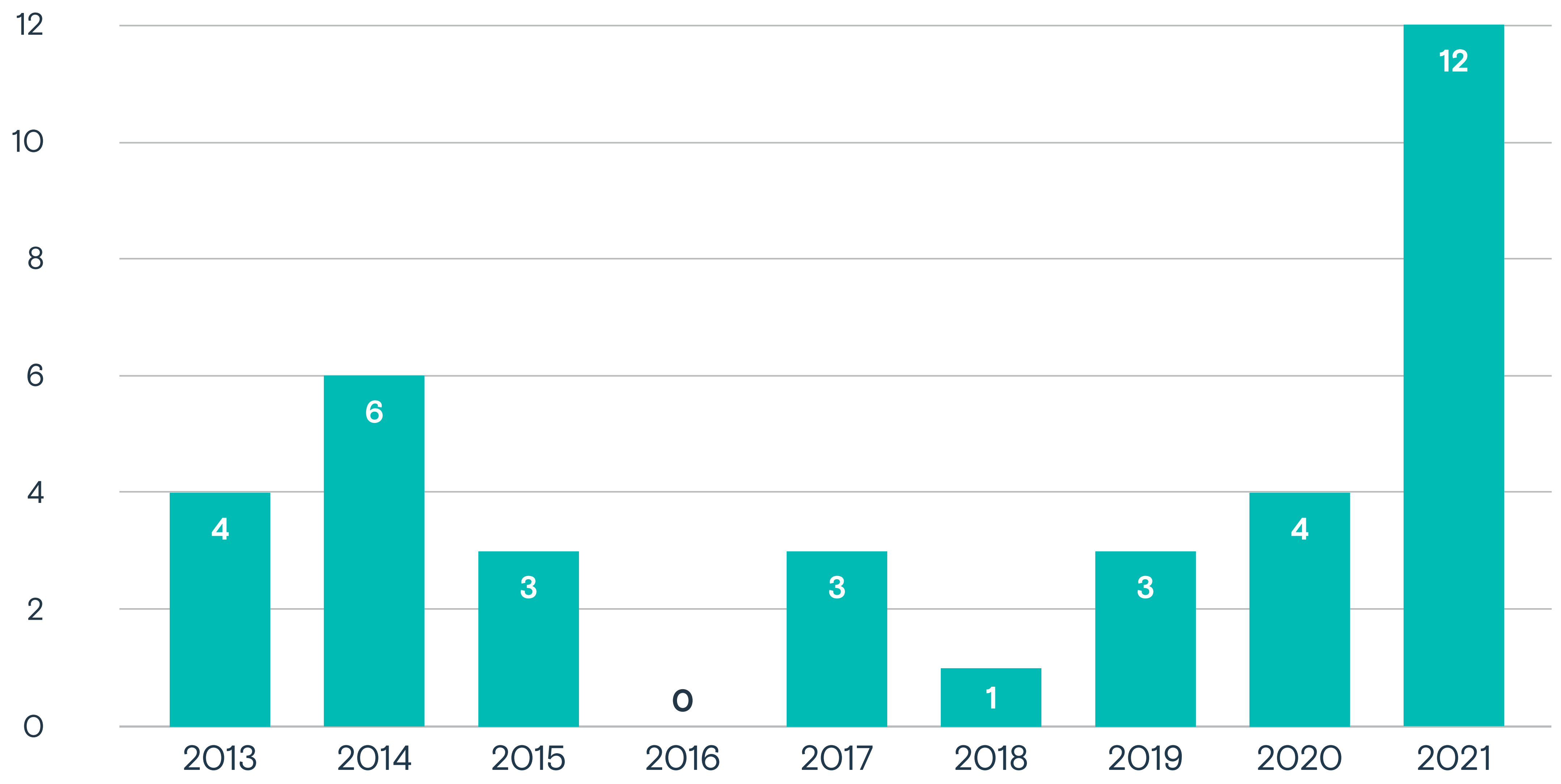
	2017	2018	2019	2020	2021
Maximum U.S. exit value	25,821	10,607	101,614	52,799	107,757
Maximum Canadian exit value	1,117	559	1,409	6,897	1,516

Source: Pitchbook, *Geography: Canada and U.S.*

VC-backed Canadian IPOs also had a record year

2021 also saw the greatest number of IPOs for VC-backed companies on record, with 12 companies going public for a total value of $6.5 billion. Canadian start-ups with strong engineering or C-suite talent, focused on industries where there is tremendous global demand, are increasingly commanding high valuations.

Figure 7: Number of VC-backed IPOs in Canada

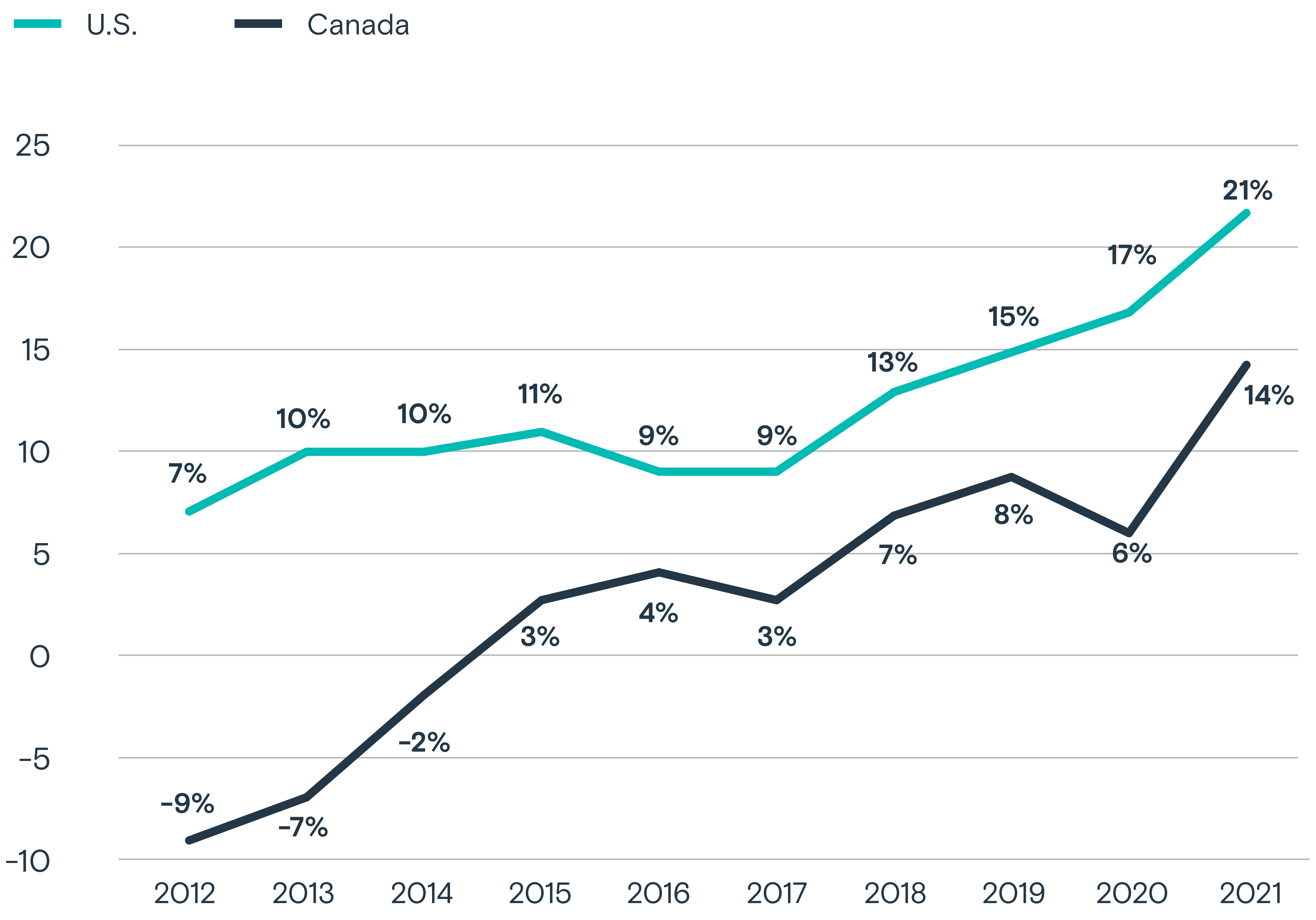


Sources: Pitchbook; CVCA; BDC internal data; team analysis.

Canadian IRR growing in lockstep with the U.S.

The U.S. VC sector has experienced a fevered boom in deals in recent years. This has spilled over into Canada—as well as other nations—as U.S. fund managers scour the world looking for less competitive deals with similar compelling returns. By this measure, Canadian VC has made major strides over time, generating 14% returns over a 10-year horizon in 2021.

Figure 8: 10-year VC IRRs in Canada and the U.S.

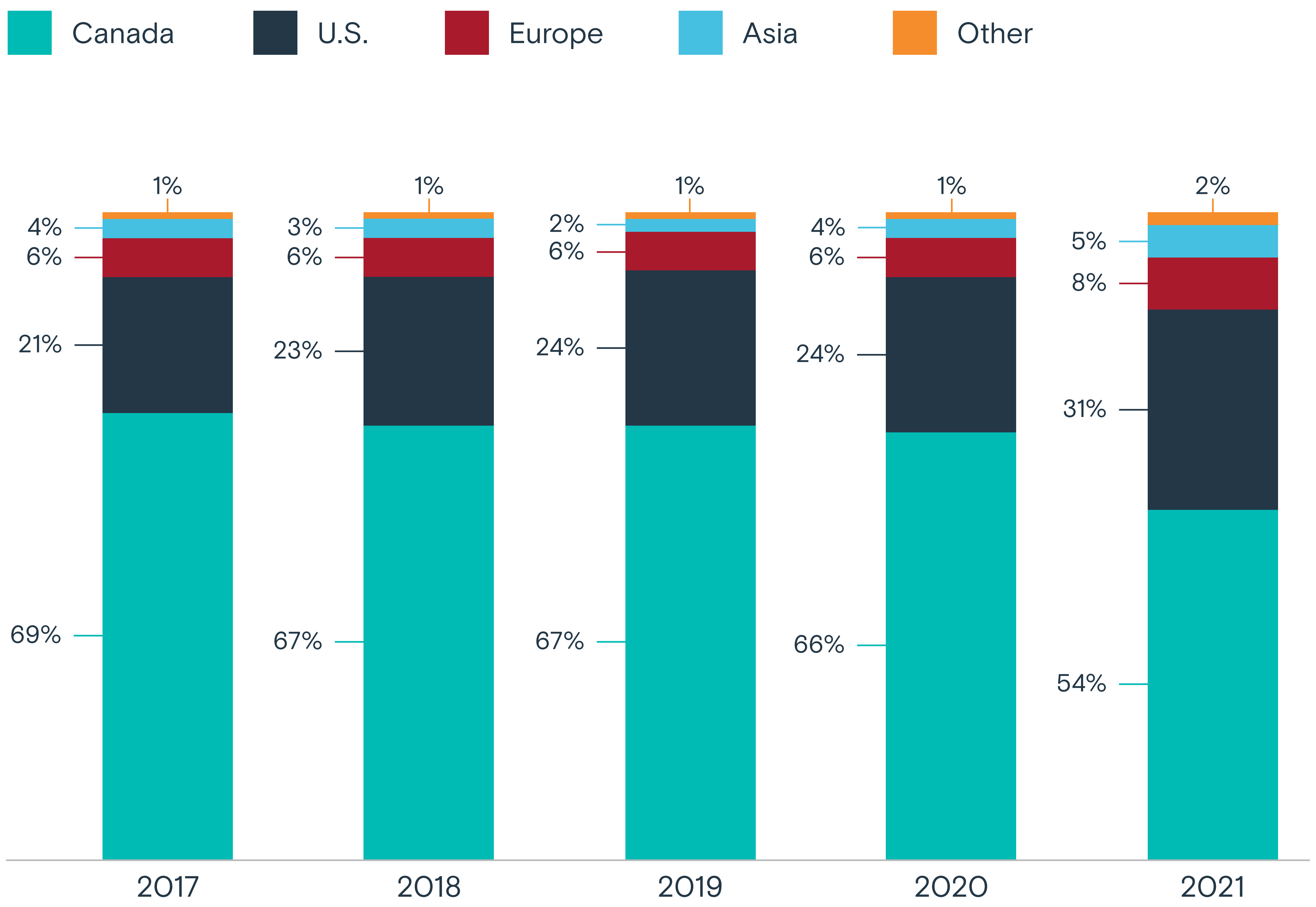


Sources: Cambridge Associates, U.S. VC benchmark data; BDC Capital fund investment data for VC funds headquartered in Canada (excluding any foreign-based funds active in Canada).

Almost half of investments in Canada came from abroad in 2021

Canadian VC has come of age as an international asset class since 2018. This can be seen in a marked increase in total investment, as well as rising international appetite for the country's VC-backed companies. In 2021, 46% of the investor transactions in the Canadian VC space came from foreign investors, primarily those based in the U.S.

Figure 9: Percentage of VC investor transactions in Canada, by nation of origin



Sources: Refinitiv; team analysis.

Note: Unknown investors have been prorated across the five categories. Total amounts may not equal 100% due to rounding.

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A maturing ecosystem

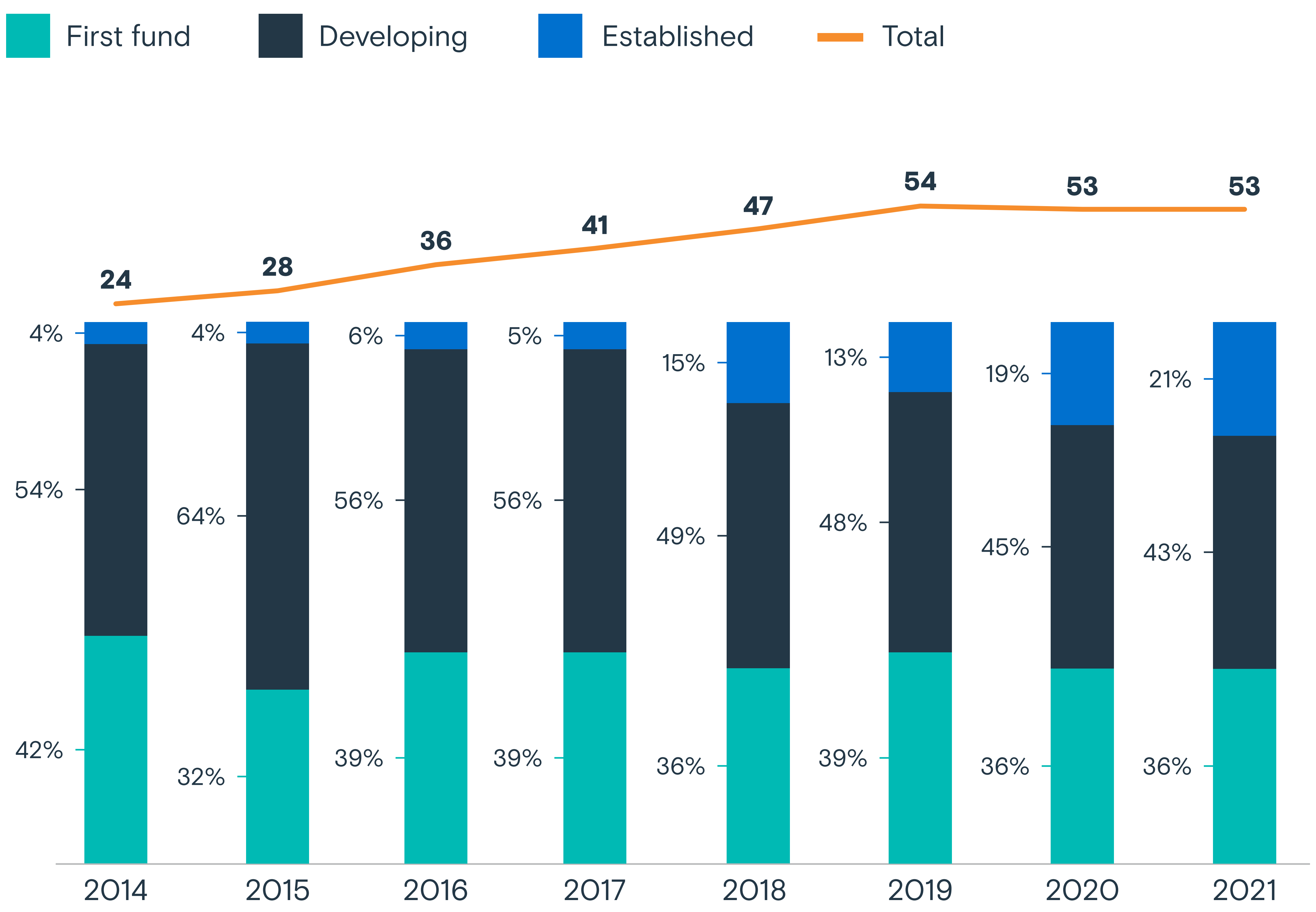
The rising number and scale of Canadian VC fund managers provide evidence of a thriving market.

Growth in the number of first-time fund managers continued throughout the pandemic. By 2021, they represented 36% of fund managers. Meanwhile, established GPs represent a growing part of the ecosystem, now making up 21% of all Canadian fund managers, as compared to 5% in 2017.

The increasing number of established GPs is clear evidence of the maturation of our ecosystem, supported by the diversity of fund managers. These types of GPs can only exist where quality and longevity inspire limited partners (LPs) to continue investing in GPs whom they trust to consistently deliver expected returns.

Encouragingly, there is a fairly constant stream of new GPs. As such, further expansion in the total number of GPs seems likely.

Figure 10: Percentage of active GPs in Canada, by maturity* **



Source: BDC internal data.

* Active GPs are defined as those being within their investment periods and headquartered in Canada.

** Data includes private VC funds of all strategies and across sectors, but excludes accelerators, company creation studios and private equity funds.

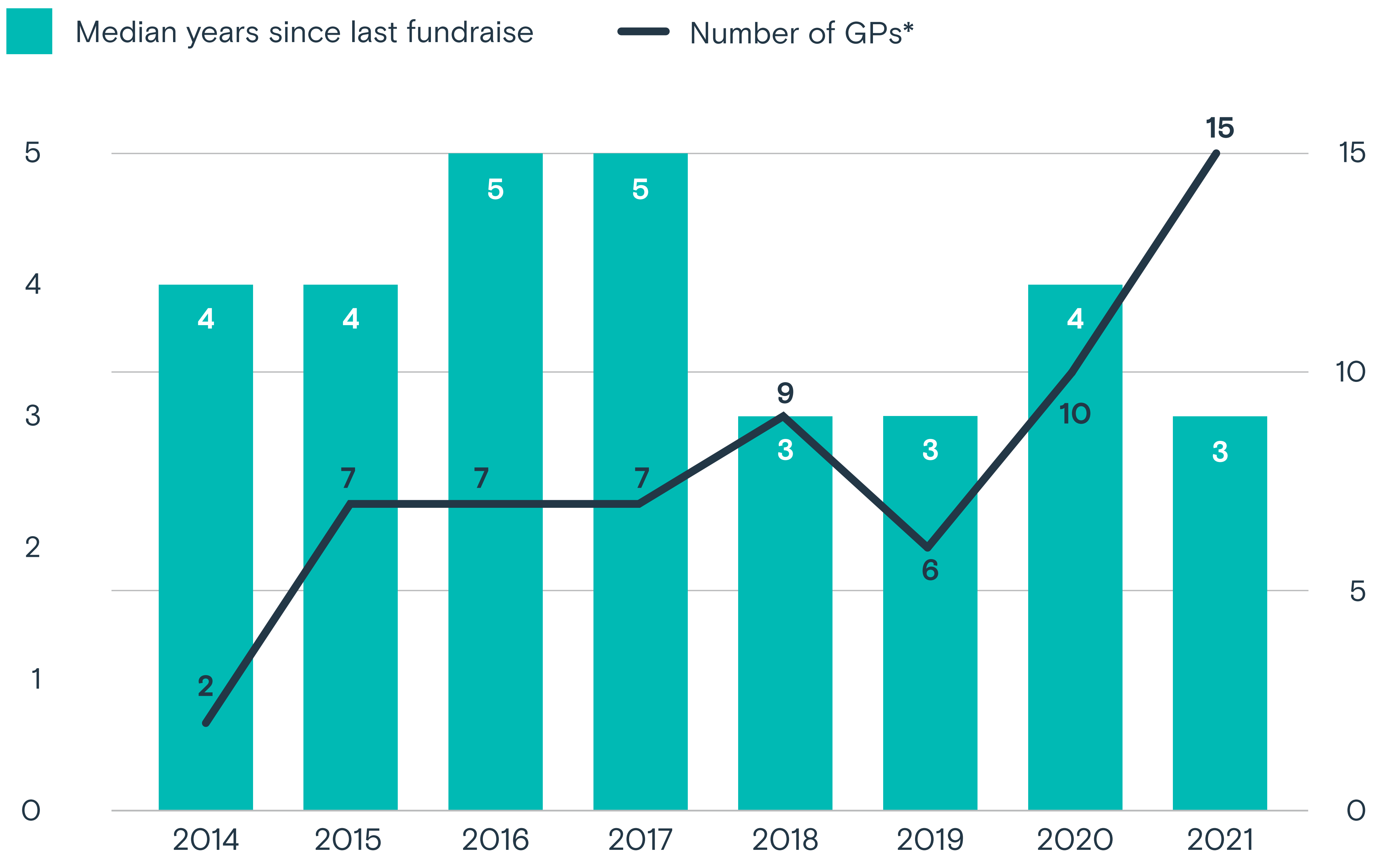
Note: Total amounts may not equal 100% due to rounding.

Faster fundraising, bigger funds

With the average deal size moving up from $6 million in 2016 to $20 million in 2021, fund managers have been putting more dollars to work, faster than ever before. As a result, fund sizes have increased and the number of years between fundraisings has decreased. From 2014 to 2017, the median number of years between funds was four to five years, whereas it has decreased to three years since 2018, except for 2020, when it rose slightly to four years.

Fund managers with active funds of $100 million or more represent 51% of the fund managers we track. Within that cohort, the average fund size is now $274 million (median of $145 million), which is an important uptick in available capital. These fundraising dynamics are undoubtedly impacted by increased interest from foreign and non-traditional LPs who recognize the growing sophistication and maturity of Canadian managers.

Figure 11: Fundraising velocity in Canada



Sources: Pitchbook; BDC internal data; team analysis.

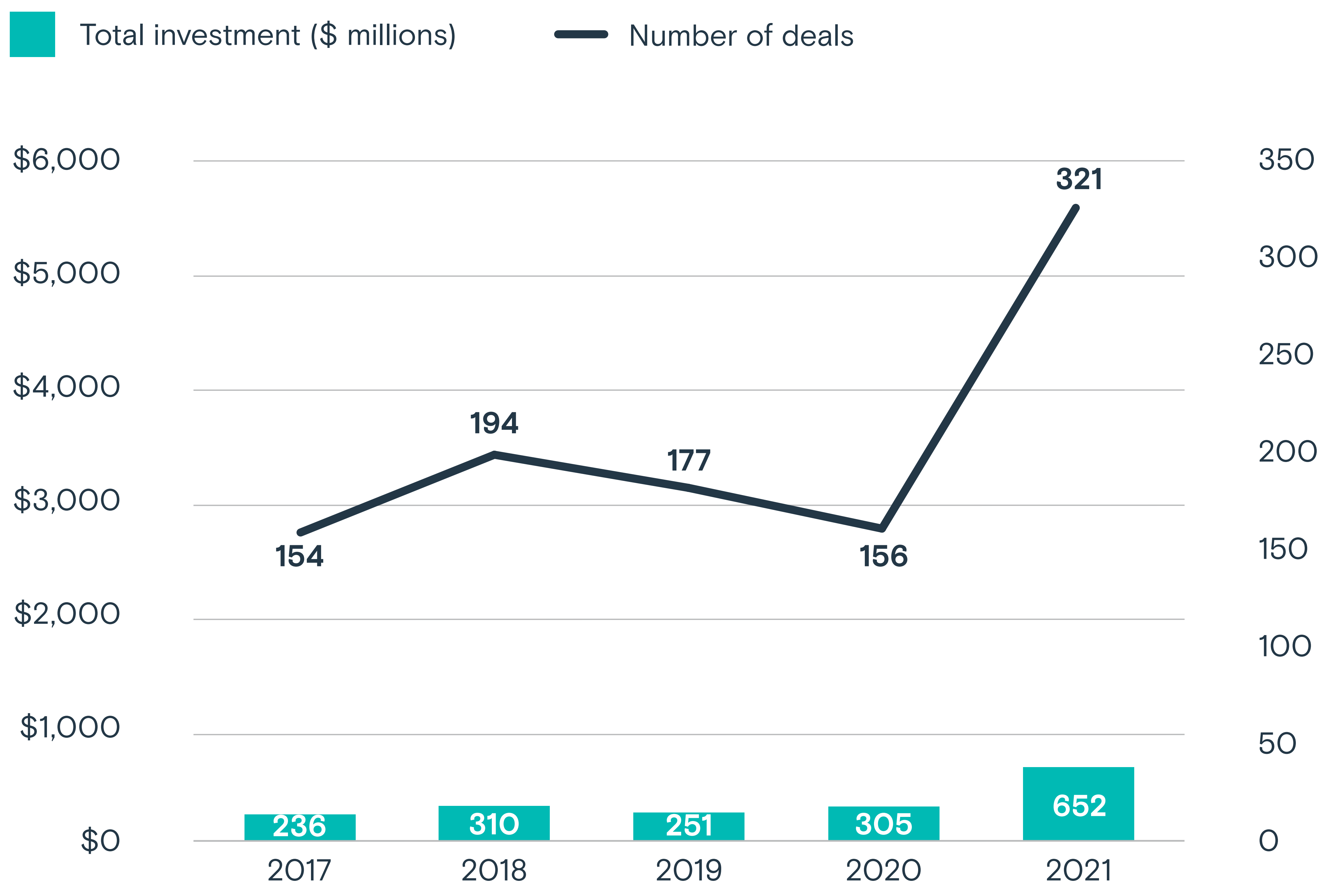
* Includes GPs on their second fund onwards.

Deal value has been increasing at every investment stage

Fundraising velocity has been accelerated by large rounds occurring at all investment stages. The scale of the market has directly benefitted from successful investment in early-stage companies over the last three years.

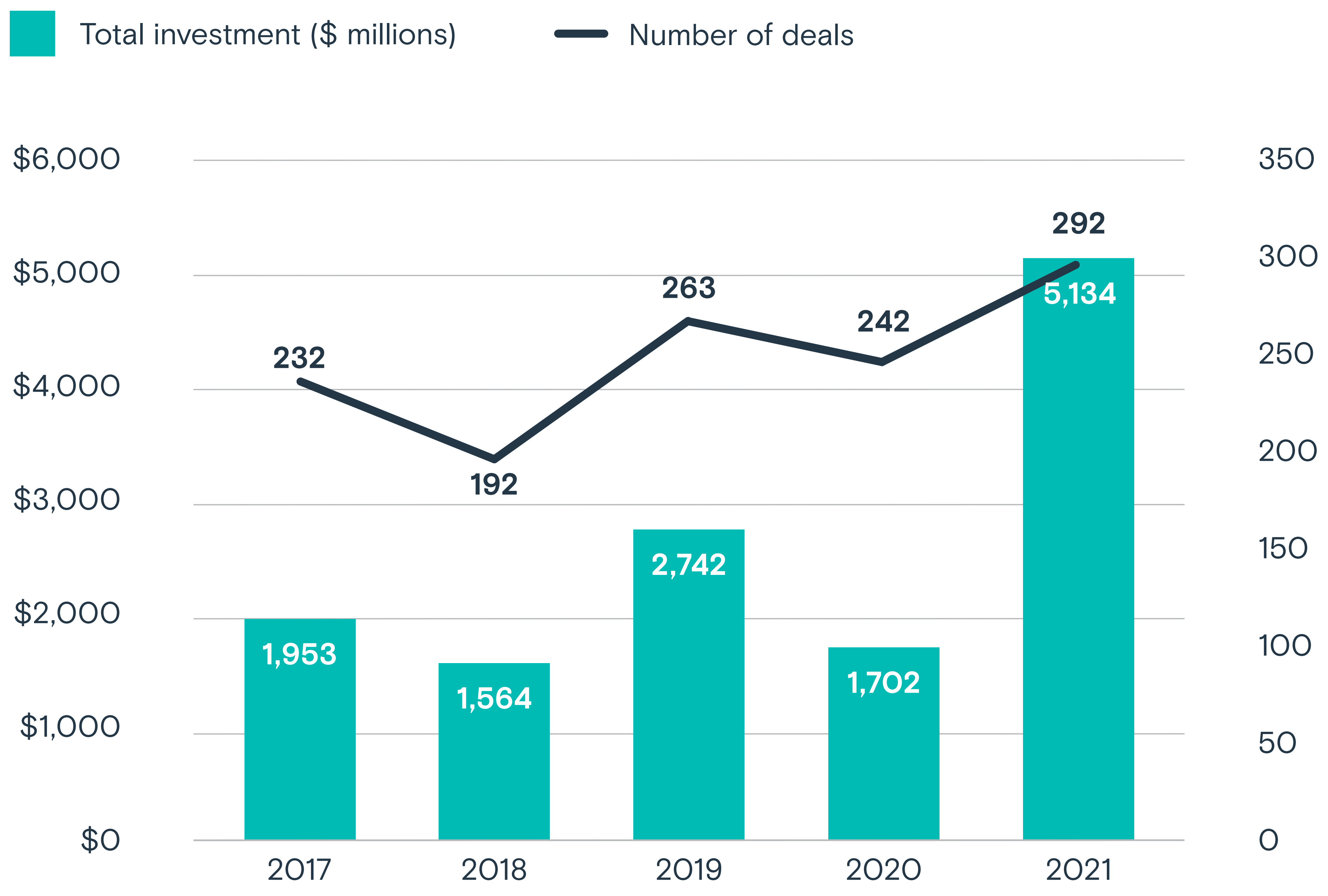
Note that much of the recent increase in VC investment was focused on later-stage and growth-equity companies, with impressive uptake in 2021. Capital deployment in early-stage companies via Series A and B rounds has kept pace with volumes at the later stage. Dollars put to work at the seed stage have also increased significantly from 2020.

Figure 12: Canadian VC investment activity at the seed stage



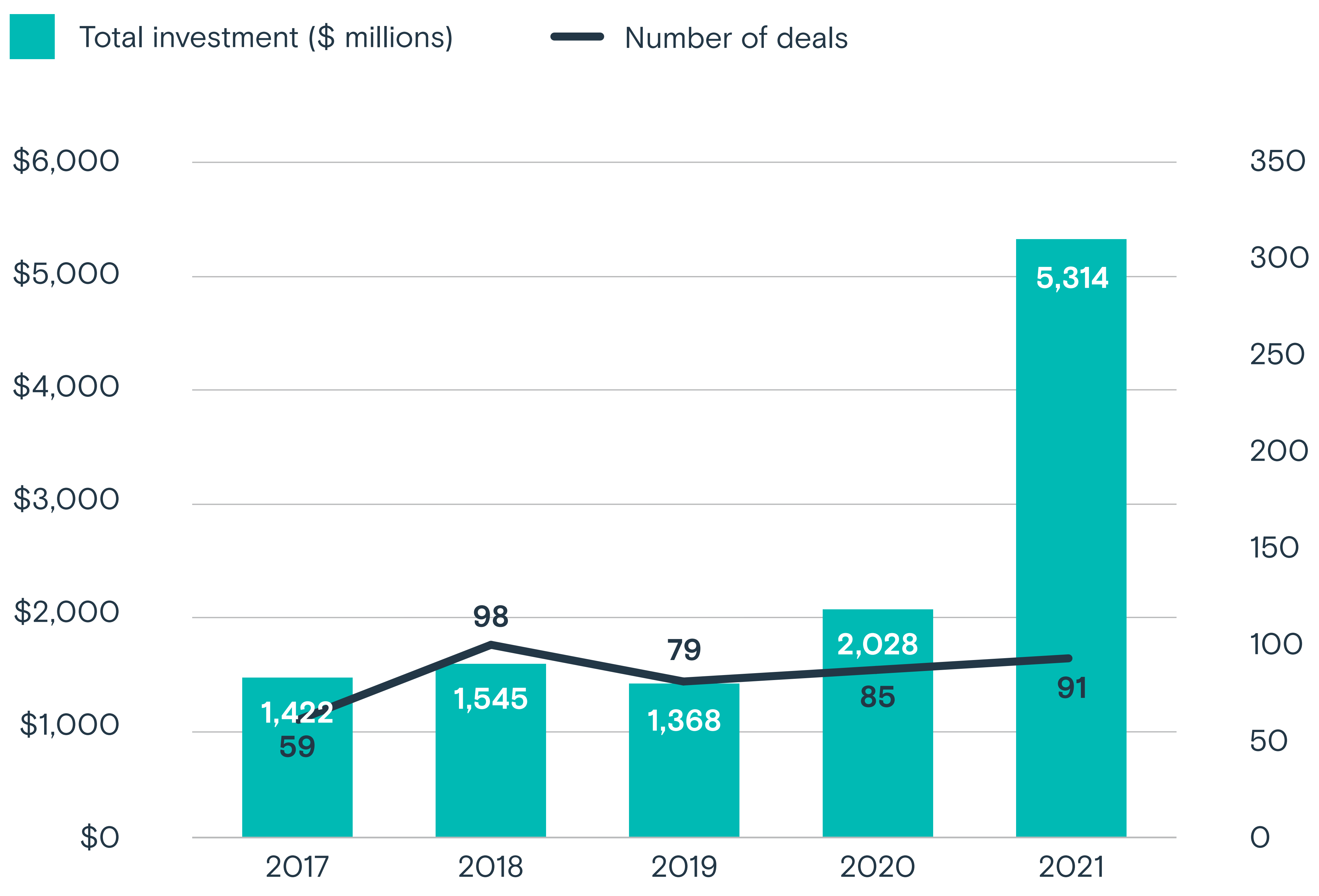
Source: CVCA.

Figure 13: Canadian VC investment activity at the early stage



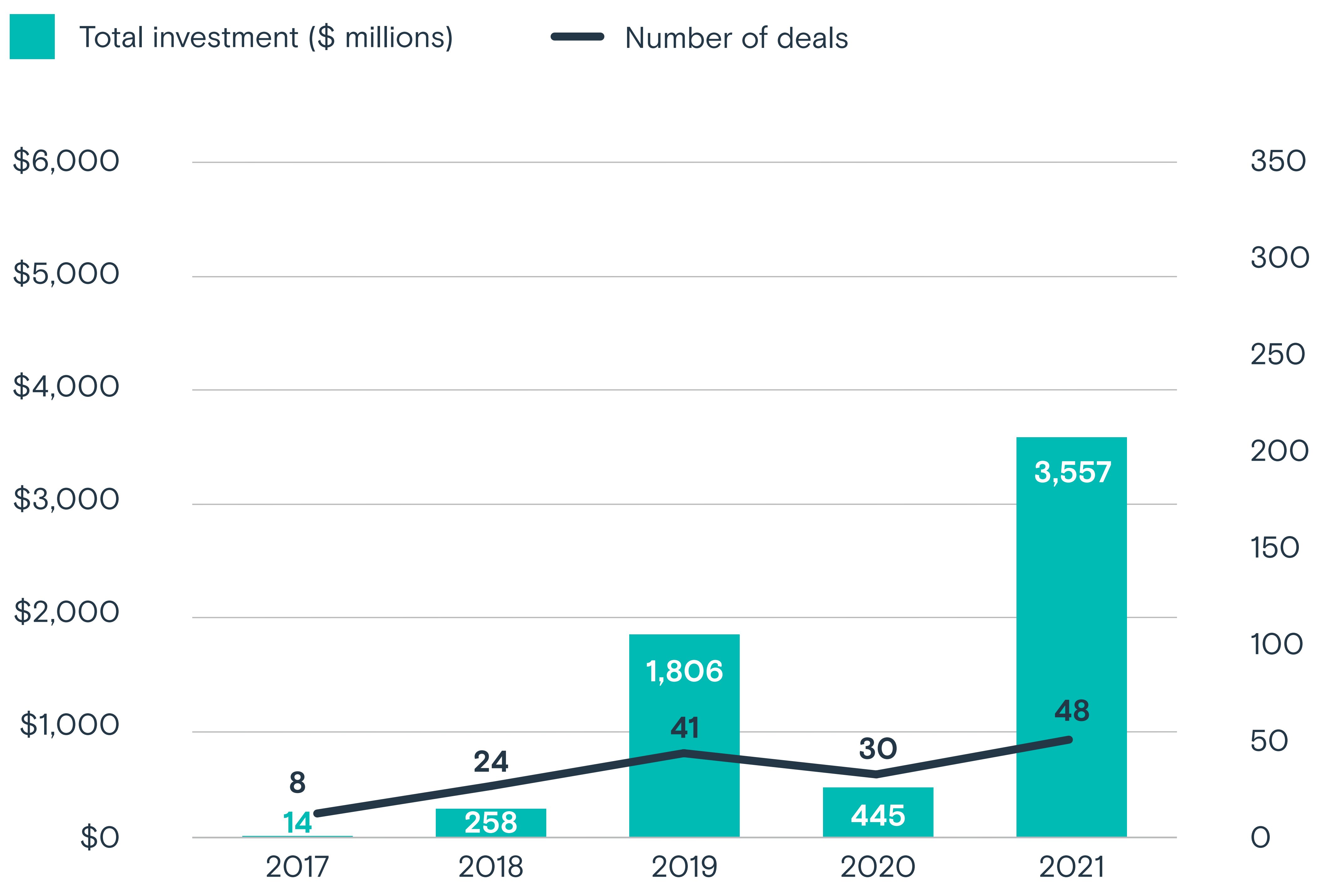
Source: CVCA.

Figure 14: Canadian VC investment activity at the late stage



Source: CVCA.

Figure 15: Canadian VC investment activity at the growth-equity stage* **



Source: CVCA.

* Growth equity is defined as significant minority investment to drive growth and scale that can be combined with a secondary transaction to facilitate liquidity for existing VC investors.

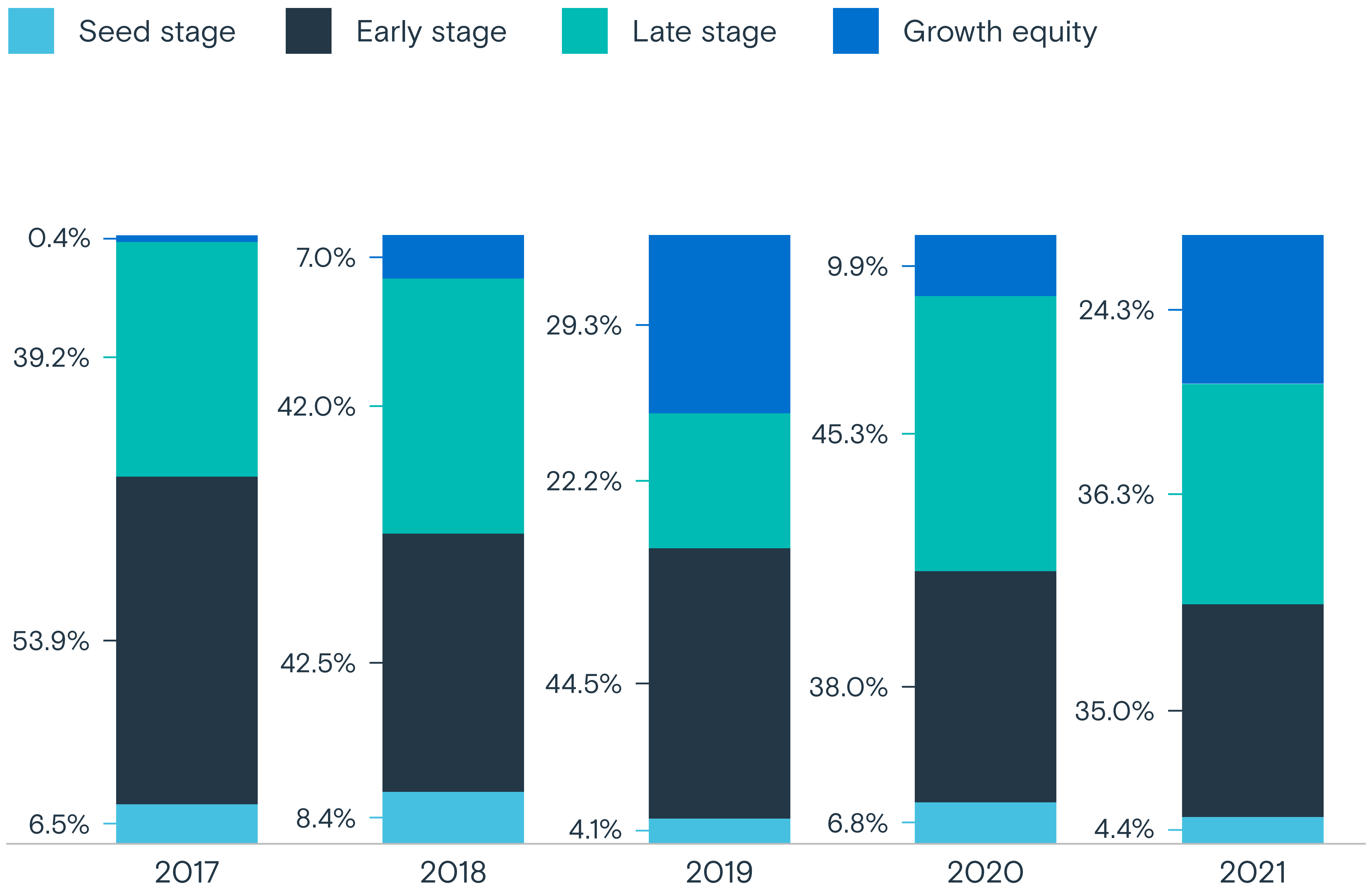
** We also include other types of investments with growth equity.

Late stage and growth equity are an expanding part of total VC investments

The number of seed investments has grown more than twofold since 2017, yet they still represent less than 5% of dollars invested in 2021. Canadian fund managers at the seed stage are complemented by a growing number of angel investors. Many of these angels are former founders or employees of successful Canadian VC-backed companies, who are "paying it back" by supporting disruptive business models. In addition, corporate interest in Canadian VC continues to rise.

While the overall momentum of the VC space is positive, we note that angel and seed investing will be critical for the Canadian ecosystem to maintain its scale and continue its ascent.

Figure 16: Canadian VC investment activity, by stage, as a percentage of total investment



Source: CVCA, *Year-End 2021—Canadian VC & PE Market Overview*. March 1, 2022. https://www.cvca.ca/research-insight/market-reports/year-end-2021-canadian-vc-pe-market-overview

Note: Total amounts may not equal 100% due to rounding.

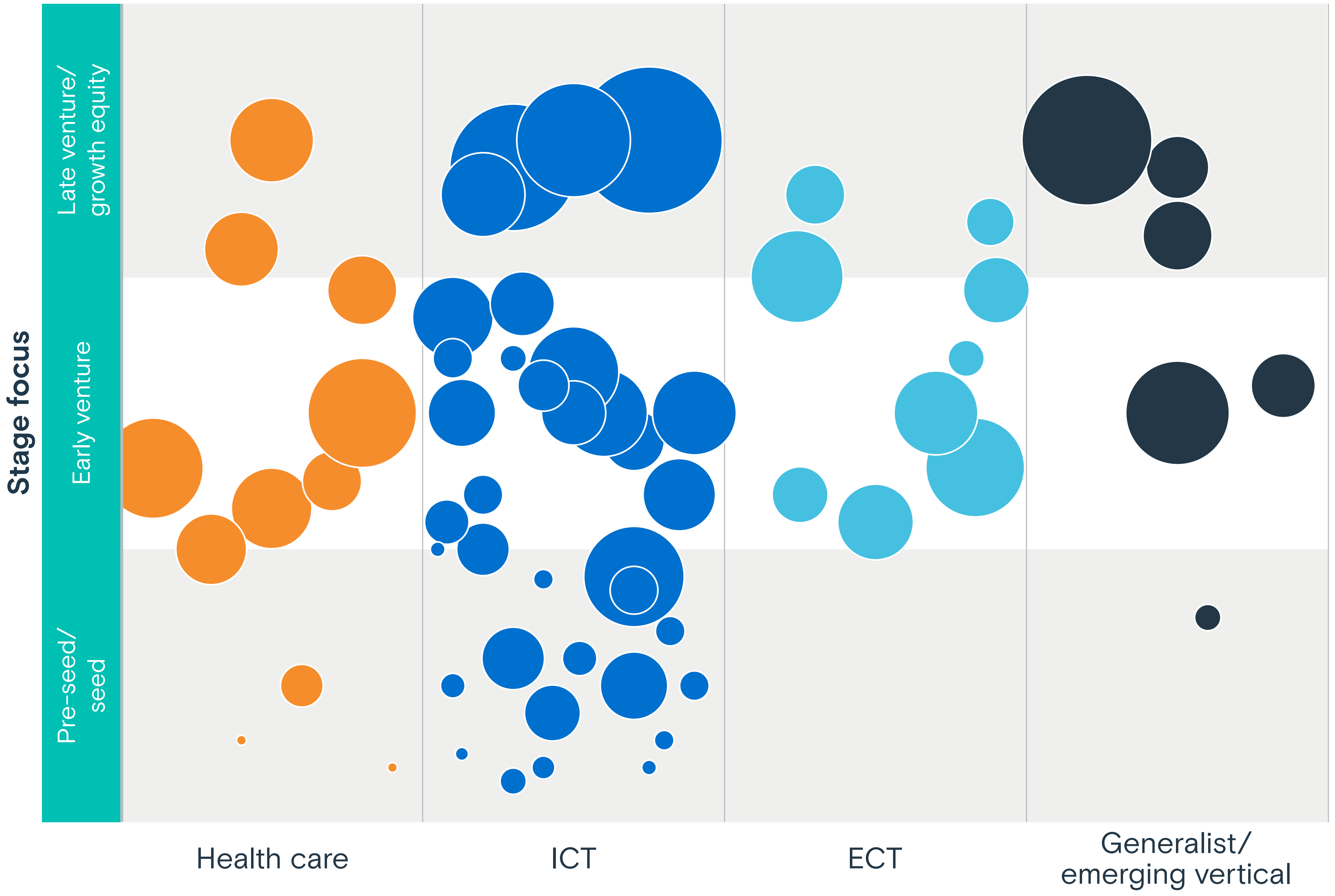
ICT remains the dominant VC sector in Canada as ECT gains ground

Comparing the universe of active funds shows just how much the ecosystem has developed over time. There were fewer funds in 2016 and they tended to be smaller. Many industry verticals or growth stages were not as well covered. There was very little coverage of the energy/cleantech (ECT) space, for instance, and only a few generalist firms were active.

Today, Canadian GPs remain clustered in the ICT space along the seed, early-stage and later-stage axis. Health care also remains an active sector with a strong cluster of GPs focused on early-stage opportunities. Returns across both the ICT and health care verticals remain impressive, generating a gross IRR of more than 35% over a five-year horizon and more than 25% over 10 years.[8] Ten years ago, ICT was dominated by enterprise software-as-a-service companies. There is now increasing diversity in how technology is applied to fields such as financial services, marketplaces, hardware and cybersecurity, not to mention Canada's growing expertise in artificial intelligence and quantum computing.

8 BDC internal data.

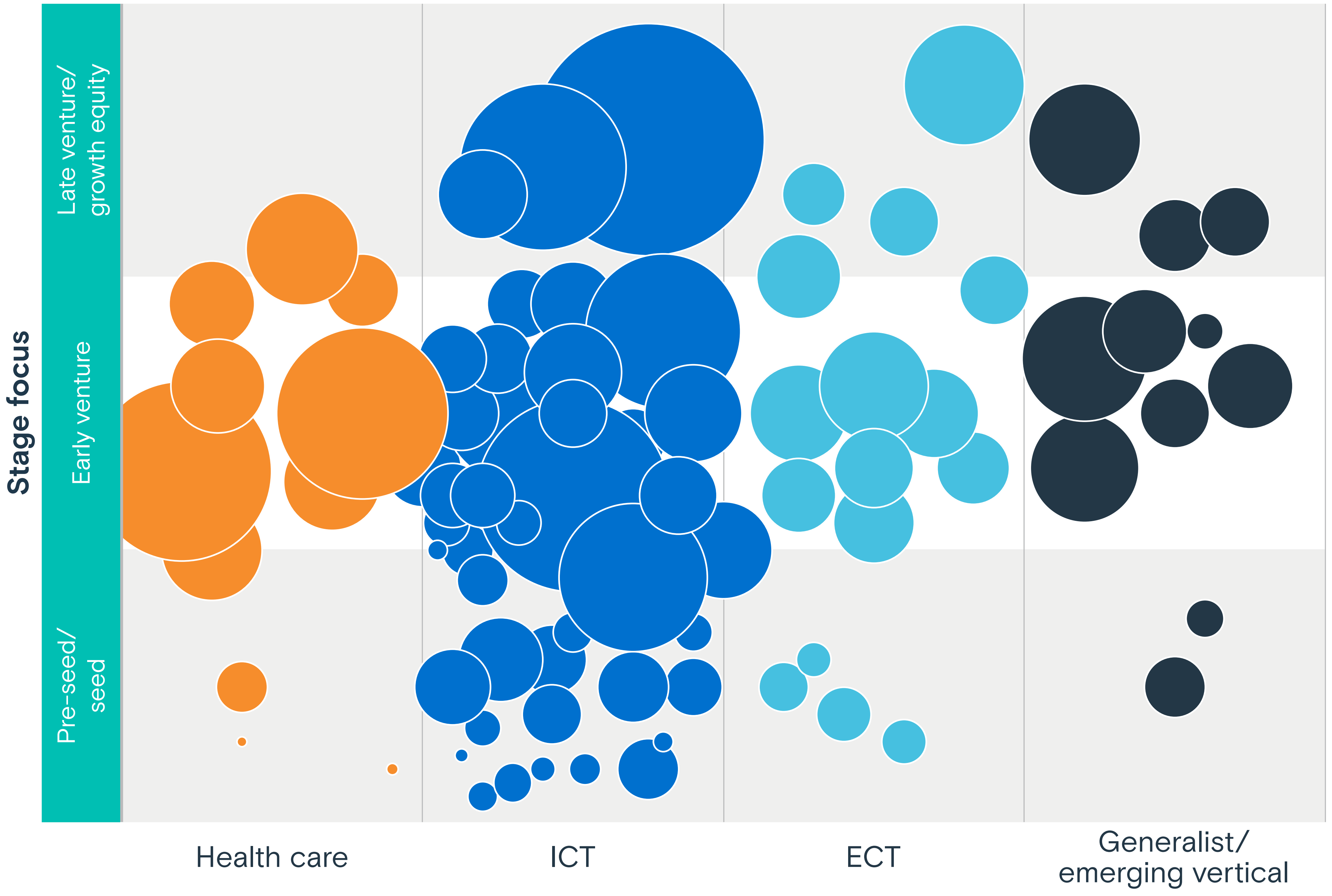
Figure 17: Active funds in Canada, 2016



Source: BDC internal data.

Note: Bubble size represents actual/target fund size—not all capital may be deployed in Canada.

Figure 18: Active funds in Canada, 2022



Source: BDC internal data.

Note: Bubble size represents actual/target fund size—not all capital may be deployed in Canada.

The cleantech and health care sectors still have room to grow

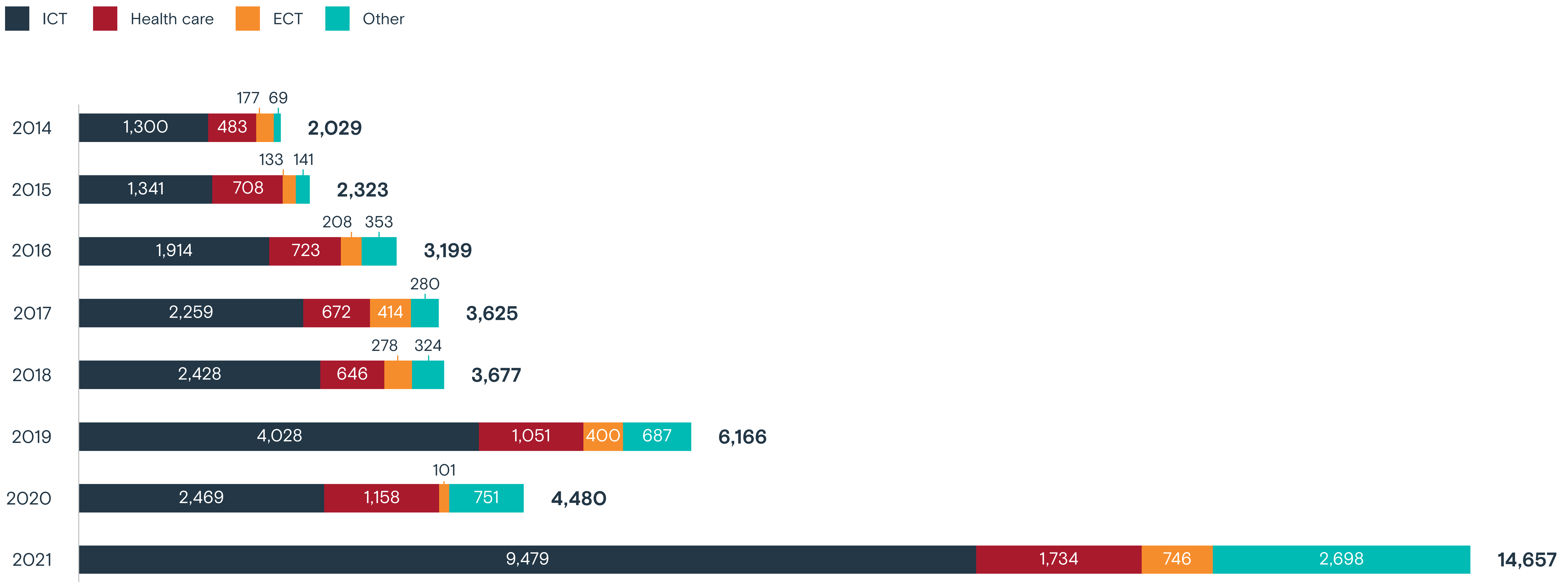
Cleantech has attracted a growing amount of investment—so much so that Canada is now ranked second on the Global Cleantech Innovation Index[9] (behind the U.S.).

Given the need to accelerate investment in sustainable innovation to support Canada's net-zero commitments, and with only 5% of Canadian VC investment put toward cleantech in 2021—versus 14% globally—we expect an important increase in capital deployment in this area over the next several years.

Health care remains a sector that is underdeveloped, with few funds added over time compared to other sectors. We expect this gap to be somewhat remedied by virtue of the $50-million envelope dedicated to the sector within the renewed Venture Capital Catalyst Initiative program in 2022.

9 Ankit Mishra, "Leading Experts Weigh in on Growing Canada's Cleantech Sector Post Covid-19," *Forbes*, July 19, 2021, https://www.forbes.com/sites/ankitmishra/2021/07/19/leading-experts-weigh-in-on-growing-canadas-cleantech-sector-post-covid-19/.

Figure 19: Canada VC investment activity, by sector ($ millions)



Source: CVCA.

Note: CVCA refers to the life sciences and cleantech sectors, whereas we refer to these sectors as the health care and energy/cleantech sectors.

Building from a position of strength

Much of what has been discussed above can be considered as positive for both the industry and investors. Growing deal volume, average deal size, transaction values and capital deployment have provided investors with 10-year returns at an all-time high.

These high returns create a virtuous cycle of continued interest and increasing fund sizes. With so much capital to put to work, smaller and earlier-stage companies may struggle to attract attention, as investors favour late-stage and growth equity opportunities. The seed and angel spaces are important building blocks for a thriving ecosystem and need to be nurtured.

This report highlights the ongoing maturation of the Canadian VC ecosystem. Established fund managers now represent 21% of active GPs, enabling them to support companies longer and into later stages thanks to progressively larger funds. Programs such as the Venture Capital Catalyst Initiative and the Venture Capital Action Plan have been fundamental to the rise of established funds and the emergence of new fund managers. The renewal of the Venture Capital Catalyst Initiative should maintain this positive dynamic.

Vintage-year risk becomes increasingly important, given that valuations achieved incredible peaks in 2021. We note the recent public market turbulence, which may adversely affect the prospects of future VC-backed IPOs. With climbing inflation and the likelihood that interest rates will follow, investors could turn away from VC to allocate capital to other areas.

There is now a global recognition of Canada’s world-class tech talents. In turn, many international businesses are now opening offices in Canada, creating recruitment and retention challenges for start-ups. Canadian entrepreneurs will need to be creative to address the labour shortage, expending more effort to recruit, manage and retain personnel.

Over the last few years, stakeholders across the country have engaged meaningfully to build a diverse, equitable and inclusive (DEI) culture within their respective organizations and throughout the private capital network. We note that various efforts have been made to develop and improve DEI best practices. BDC strongly supports all efforts in this area as we believe they are vital to the continued development of the VC space.

Given Canada's net-zero commitments, innovative technologies provide the only path forward to achieve our aims. This goal is too important to rely on foreign sponsors alone; creating scalable Canadian champions is therefore critical to achieve these considerable ambitions.

With these considerations in mind, we remain vigilant and active in our efforts to support the Canadian ecosystem at large. We're also extremely excited for the years ahead as Canadian VC continues to mature and come into its own.

BDC is here to help.

Learn more about BDC Capital and our work with some of the country's most innovative firms.

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