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U.S. investors still hungry for Canadian startups

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(In Canadian dollars unless noted)

By Ian Karleff

TORONTO, Feb 25 (Reuters) - Start-up capital flowing to nascent Canadian firms dropped by a quarter in 2001 although a strong contribution from U.S. investors, hungry for a stake in Canada's technology sector, mitigated the decline, an industry study released on Monday said.

U.S. investors, while shying away from their home market, were responsible for 34 percent of the C\$4.9 billion (\$3 billion) invested in Canadian startups in 2001, compared with 24 percent of the previous year's C\$6.6 billion.

In dollar terms, year-over-year U.S. investment rose to C\$1.7 billion from C\$1.6 billion, said a Canadian Venture Capital Association (CVCA) study.

"A driving force behind our numbers has been the increase in activity by foreign investors. The U.S. has a growing interest in Canada, particularly in technology startups," said Mary Macdonald, president at Macdonald & Associates Ltd., a venture capital research firm.

Volatile equity markets in 2001 dealt a blow to the amount of capital raised by Canadian startups, which fell 27 percent. But this pales in comparison to the U.S. experience, where start-up funding dropped 65 percent to US\$104 billion, the study said.

"If we thought we had a correction it's nothing compared to south of the border, where venture capital literally fell off a cliff," said John Eckert, managing partner at McLean Watson Capital and president of the CVCA.

The drop in capital raised was less dramatic in Canada because of the U.S. contribution and the diversity of companies looking for cash, compared with the singular focus on dot-com companies in the United States in 2000, Macdonald said.

"Obviously in this environment, the supply of capital and how long it will last is an issue," she said.

Of the top 10 deals by size in 2001, all had U.S. contributions, and 90 percent had Canadian investors. Leading the pack was Ottawa-based Ceyba Inc., raising C\$144

million, followed by SS8 Networks Inc. with a C\$96 million deal.

"With this limited supply situation, it's virtually impossible to do deals of C\$144 million without bringing in foreign investors," Macdonald said.

The value of technology stocks dropped about 50 percent on the Toronto Stock Exchange in 2001, with Nortel Networks causing most of the damage. Despite this souring of investor support for listed technology firms in 2001, the appetite for promising technology plays remained robust.

Technology firms attracted 93 percent of the capital invested in 2001, with communications firms absorbing 25 percent of the total investment, and biotechnology grabbing a 17 percent share. Both sectors saw their share of the investment pie increase over 2000 levels.

And while venture capitalists are more cautious and selective in how they allocate their funding, "the smart money knows that there is no better time to invest," Eckert said.

Innovance Networks, an Ottawa-based optical networking firm, said on Monday that it had raised over C\$88 million in capital from the likes of JDS Uniphase, Corning and seven major investment firms. This follows on a C\$115 million round of financing in early December 2000, which marked the largest amount of capital raised in a single deal for a private Canadian technology firm.

Companies based in the province of Ontario continued to grab the lion's share of investment dollars, with 42 percent of the total, followed by Quebec at 20 percent. The Ottawa Valley, with a history of technology innovators, including Corel Corp, JDS, and Nortel, cemented its role as Canada's high-tech hotbed by raising C\$1.1 billion in new investment, or about 25 percent of the total.

(\$1=\$1.60 Canadian)