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2004 Federal Budget: New Opportunities for Venture Capital Investors

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The venture capital community was presented with an important new opportunity in the 2004 Federal Budget of March 23, 2004. Any VC fund managers who are actively engaged in raising new funds within the next several months should be aware of these developments.

The Budget includes a section on the importance of venture capital to the economic development of Canada, reinforcing other recent developments that have shown a new higher priority for venture capital issues in Ottawa. The key priorities of Government in addressing the venture capital market appear to be: (i) the perceived financing gap surrounding the earliest stages of investment, and specifically relating to the commercialization of scientific research conducted at universities, hospitals and other public sector research facilities across the country; and (ii) the development of a stronger venture capital industry in Canada generally. The Budget extract on venture capital is attached.

The specific issue for VC fund managers to consider is the proposal for \$100 million in new capital for the development of new venture capital funds, through BDC, in a manner designed to lever additional private investment and support private VC fund managers:

“\$100 million to support the creation of specialized venture capital funds ... that will lever additional private equity investment in leading-edge technologies. This investment will support the development of a broader base of private VC fund managers.”

These funds form part of the total of \$250 million in new capital allocated to BDC. The additional \$150 million in new BDC funding is targeted at “pre-seed and seed investment to nurture the development of embryonic technologies” and

other direct investment “to further support the commercialization of enabling technologies”.

Most importantly, all of this new funding is not necessarily intended to flow through a traditional BDC fund-of-funds or direct investment process. BDC is specifically directed to prepare and submit, for Government approval, “a detailed plan for the implementation of specific seed-stage and venture capital initiatives.”

We have participated in a number of meetings and consultations in recent months with Government, VC funds, institutional investors and the research community relating to the development of the venture capital industry in Canada. These efforts have led to the design of a detailed proposal to address the early-stage financing gap for commercialization of scientific research. The centrepiece of this proposal is for Government to provide matching funding to new venture capital funds raised by private VC fund managers targeting commercialization opportunities. The proposal would allocate a specified percentage of each participating fund to seed-stage investment, with the majority of the fund to be used for follow-on rounds in successful seed companies, as well as later-stage investment in similar companies. We have emphasized that “seed only” funds are unlikely to be successful in current market conditions, and are therefore unlikely to attract significant participation from the venture capital community or the institutional investors who support them.

We understand that a number of similar proposals have been presented to Government in recent weeks. The Budget has responded by establishing this new funding process through BDC. It would appear that the full \$250 million in new capital could become available to support new VC funds targeting commercialization.

Venture capital fund managers should remain alert to these developments and the potential opportunities to obtain matching funding for new venture funds targeting this sector.

Please contact **Rick Nathan, Managing Director of Goodmans Venture Group**, at 416.597.5143 or rnathan@goodmans.ca if you would like to stay informed on new developments in this area, or if you would like any additional information on these issues.