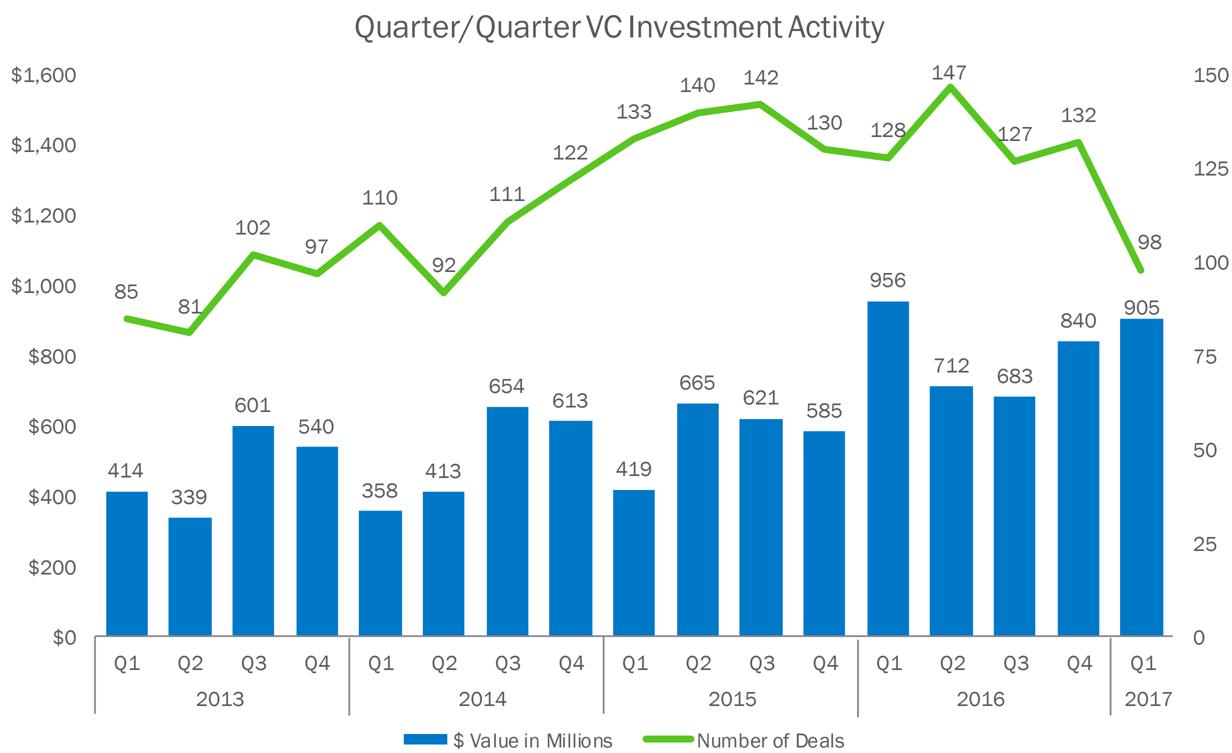
Valitas Insights: Canadian Venture Capital and Private Equity Activity Continue to Diverge

In our recent review of Canadian Venture Capital (VC) and Private Equity (PE) activity for the first nine months of 2016, we reported a significant difference in trends. While VC investment exceeded the four-year quarterly average, PE investment and deal volume lagged relative to the same period of the previous year.

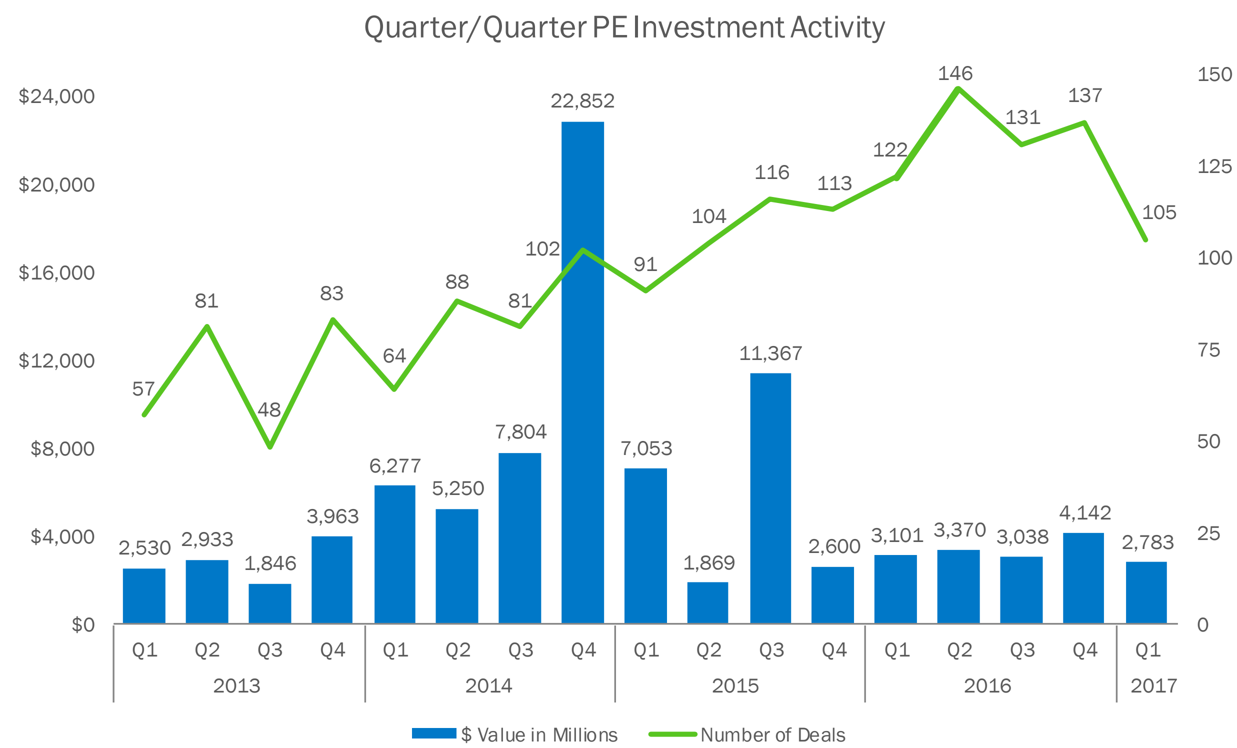
According to the latest first quarter 2017 VC and PE update by the Canadian Venture Capital and Private Equity Association, this divergence in activity continues.

Canadian VC investment was $905 million for the quarter, 41% above the four-year quarterly average, and only $51 million less than the first quarter of 2016, the quarter with the highest investment since 2013. Although deal volume was 23% lower than the previous year, this was offset by an increase in average deal size, which was up a whopping 84% from the first quarter of 2016.



Source: CVCA

Activity for Canadian PE tells a different story. According to Pitchbook's 2017 Canada PE & VC Breakdown, fundraising fell to its lowest level since 2012. Deal volume decreased to 105, 14% below the previous year, and year to date investment fell 10% to $2.8 billion.



Source: CVCA

This result is not a surprise to us.

The North American PE environment has been changing rapidly in recent years. Valuations are rising due to increased competition from sovereign funds, pension funds, family offices, and strategic buyers. General partners have become more industry focused to stay competitive, resulting in greater selectivity when deciding whether to make an acquisition.

While Canadian limited partners (LPs) have put their investment on a pause, U.S. LPs remained favourable towards PE, with U.S. first quarter fundraising on pace to a ten-year high. In addition, uncertainty associated with the renegotiation of NAFTA has negatively affected Canadian PE fundraising, given trade's far-reaching effect on Canadian businesses.

On the other hand, Canadian VC activity has seen a steady increase since the Great Recession. Government support and less competition from strategic buyers within the early stage category, as mentioned in our previous article, continue to fuel the industry's growth.

However, given the smaller size of Canadian VC funds compared to those in the U.S., mega deals often need cross border involvement – over 60% of late-stage deals since 2012 involves foreign investors, according to Pitchbook. Canadian Venture Capital may want to become more industry focused to stay competitive with large cross-border investors. It will be interesting to see how the competitive dynamics change, as our domestic VC industry matures.