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Venture capitalists stay focused on bird in the hand

'This year, you are spending 99% of your time on your existing portfolio': Investing in survival

Mark Evans
Financial Post

Canada's leading venture capitalists are still pursuing new opportunities, but they are primarily focused on ensuring that the companies in which they have already invested survive until the high-tech and initial public offering markets recovers.

"Everyone is focused on their existing portfolios of companies, and investing in what they know and what they've got," said Richard Prytula, president with Montreal-based TechnoCap Inc. "Last year, you spent 40% on your existing portfolio and 60% on new deals. This year, you are spending 99% of your time on your existing portfolio."

This sentiment is shared by Mark Skapinker, a partner with Brightspark Group, who said that although the Toronto-based VC has $40-million of cash, it is taking a cautious approach toward new investments. "It is a question of the right product, the right price and the right people."

Given these market conditions, most companies being financed have received an earlier round of venture capital and -- better yet -- already have products and revenue. This group includes such companies as Ottawa-based Solinet Systems Inc, Edmonton-based Yotta Yotta Inc. and Toronto-based DWL Inc., which raised US$93-million, US$26-million and US$31-million, respectively, this year.

Robin Louis, president with Ventures West Management Inc. in Vancouver, said there is growing interest in latter stage companies, such as DWL, because they can be picked up at much lower valuations than a year ago.

"What we are now seeing occasionally is opportunities to invest in latter stage companies at early stage valuations," he said.

In the first half of 2001, the amount of venture capital invested in Canada rose slightly to $2.5-billion from $2.36-billion in the same period a year earlier, while the number of deals fell to 521 from 680, according to Toronto-based research firm Macdonald & Associates Ltd. About two-thirds of the $2.5-billion invested went to existing companies, while the average deal size climbed to $4.8-million from $3.5-million. Macdonald & Associates will announce third-quarter venture capital statistics on Tuesday.

Mr. Prytula said the bar for companies seeking capital is getting higher. In addition to products and sales, he said investors are looking for companies that have complete management teams, that will be cash flow positive within nine months and operate in an existing multi-billion market.

At the same time, he said, the time required to close a deal is being extended because a larger number of investors are needed to do a financing, and these investors are doing more due diligence.

Despite the doom and gloom hanging over high-tech and stock markets, venture capitalists remain optimistic. In many ways, they believe market conditions are returning to "normal" after the dot-com frenzy that saw many start-ups attract enormous amounts of capital based on little more than a business plan and the idea that the Web would change everything.