Lexicon

Table of contents

Introduction to the lexicon

A. Stages in a company's development or transaction types
B. Asset classes
C. Types of investors – Canadian and Québec particularities
D. Classification for statistical purposes

Lexicon

INTRODUCTION TO THE LEXICON[1]

Private equity may be viewed from two standpoints: as an asset class in fund managers' portfolios (as in the case of pension fund managers) or as a way of investing in companies.

As an asset class, private equity (sometimes referred to as private placement) is part of the broader class of alternative investments that also include real estate, hedge funds, infrastructure and similar assets. This class stands out in particular from publicly traded stocks and bonds.

As an investment activity, private equity may be defined as the act of making equity or quasi-equity investments in companies through a negotiated process. Most private equity investments are made in private companies, though some consist of negotiated investments in publicly traded companies. Private equity generally goes together with an active investment strategy and relies on specialized investment teams that bring a constructive contribution to the companies in which investments are made.

The terminology used to designate the various components of investment capital can easily lead to confusion. The same set of terms is usually segmented on the basis of three different angles:

- The development stage of the company invested in (startup / early stage, or expansion / growth) or the transaction type (buyout, turnaround or purchase of minority positions);
- The asset class (venture capital, buyout, mezzanine);
- The type of investor,

leading to segmentations that do not overlap and to the use of the same terms with different meanings according to the situation.

A. Company development stages or types of transaction

Depending on a company's development stage, we refer either to (i) startup / early stage capital or venture capital, or (ii) growth equity. A company's various development stages are:

1. Early stage *(premiers stades, démarrage)*

1.1 Seed *(amorçage, prédémarrage)*

- An initial phase in creating a company. In the innovation chain, this stage follows the filing of a patent, if applicable, and also comes after the concept validation stage. Financing is aimed at research, assessment and development of an initial concept. This phase mainly involves companies with a high technological or scientific content.

1.2 Startup *(démarrage)*

- The company is just getting started. For companies with high technological or scientific content, financing is often aimed at product development or at validation or maturing of a technology. For companies in medium- or low-technology areas or in more traditional sectors, financing is often intended for getting commercial or industrial activity started.

---

[1] Some French terms are shown in parentheses. Where there are differences in terminology between Réseau Capital and the French venture capital association AFIC (Association française d'investissement en capital), this is noted.

1.3 Other early stage *(post-démarrage)*

- The company has already completed development of a product but is not generating significant profits. Normally, for companies with high technological or scientific content, the technological risk is significantly reduced, though commercial risk remains high. Biotech companies generally have not yet conducted clinical trials. Companies in medium- or low-technology areas or in more traditional sectors are generally at the stage of developing commercial or industrial activity prior to achieving sustained earnings.

2. Expansion, growth *(développement, croissance)*

- The company generally has a viable product, a developed market, significant clients and sustained revenue growth, and it has reached its break-even point, producing not only profits but also positive cash flows. Financing is often aimed at increasing production capacity, expanding the sales force and developing new products, services or markets, as well as financing acquisitions and/or increasing working capital.

3. Other transaction types

3.1 Buyout *(rachat)*

- Acquisition of a company or a controlling stake by private equity investors, executives of the company being bought and/or a new team as part of a financing package with a fairly high level of borrowing (which is why it may be referred to as a leveraged buyout), with repayment relying in part on future cash flows.

  There are several possible contexts:

  MBO (management buyout): buyout of a company with the management team (one or more executives, who may be non-shareholders or minority owners);

  MBI (management buy-in): buyout of a company with one or more outside takeover specialists;

  BIMBO (buy-in management buyout): buyout of a company with an outside takeover specialist in association with the seller and/or company executives.

3.2 Turnaround *(redressement d'entreprise)*

- Financing of a company that has faced financial difficulty, with measures providing for a return to profitability identified and instituted.

3.3 Secondary purchases *(achats de positions minoritaires)*

- Purchase by mutual agreement of shares held by one or more minority shareholders.

B. Asset class

As viewed by many investors and asset managers, such as pension funds, private equity is subdivided into three asset classes usually managed by different types of investors or funds: venture capital, expansion / buyout, and mezzanine.

Venture capital *(capital de risque; AFIC: capital risque)*

- A specialized form of private equity characterized mainly by investments in companies in early stages of development. The investment generally carries high or very high risk. Venture capital funds normally target, in particular, companies in early stages of development in sectors with a high technological or scientific content, these being companies with high growth potential.

Expansion / buyout *(développement / rachat)*

- A specialized form of private equity intended for companies at the expansion or growth stage and not constituting mezzanine investment. This can be in any sector, although some growth equity funds focus on particular sectors. This covers investments aimed at acquiring majority ownership (buyouts, in reality) as well as those aimed at acquiring minority ownership to help the company grow or to finance a buyout or turnaround. Buyout funds (in the meaning of the asset class) often are active in both majority and minority transactions, depending on the economic environment (e.g., access to bank debt). They may also become involved from an early stage after startup, depending on the exit period sought for the investment (position in the investment cycle).

  The term "buyout" thus does not have exactly the same meaning, varying in reference to asset class or to transaction type. Only the context can determine exactly what is meant.

Mezzanine[2]

- A specialized form of private equity characterized mainly by the use of debt, with repayment subordinated to reimbursement of senior debt or preferred shares. It generally contains an option for access to equity (warrants) in the company under some circumstances. This type of equity is usually directed toward companies at the expansion or growth stage.

C. Types of investors – Canadian and Québec particularities

The dominant model in venture capital in the United States is the private independent fund (with equity coming from several sources and no shareholder holding a majority), most often structured as limited partnerships. These funds generally specialize either in venture capital, in buyouts in the broader sense, or in mezzanine financing, with these three types of activity requiring different manager profiles and skill sets.[3]

The situation is different in Québec and Canada as a whole. Private independent funds account for only part of the sums invested. Alongside private independent funds, several types of investors play a major role, notably:

- **Government funds**

  Government agencies or state-owned corporations.

- **Institutional investors**

  Funds managed by big financial institutions: banks, insurers or retirement funds.

- **Growth equity funds (tax-advantaged funds)**

[2] Certain types of investors active in private equity also invest in the form of debt, with or without the assets as security, with repayment subordinated to reimbursement of senior debt and no options or rights to equity. The interest rates that apply are generally higher. Since no type of investor or fund specializes in this type of investment, it is not recognized as an asset class.

Funds that collect capital from individual investors who receive a tax incentive. There are three such funds in Québec: the Fonds de solidarité des travailleurs du Québec (FTQ), Fondaction CSN and Capital régional et coopératif Desjardins.

These investors often have activities that produce overlaps in the three asset classes (venture capital, buyouts and mezzanine). This applies in particular to the tax-advantaged funds, which play a very important role in Québec. They are involved in all three asset classes:

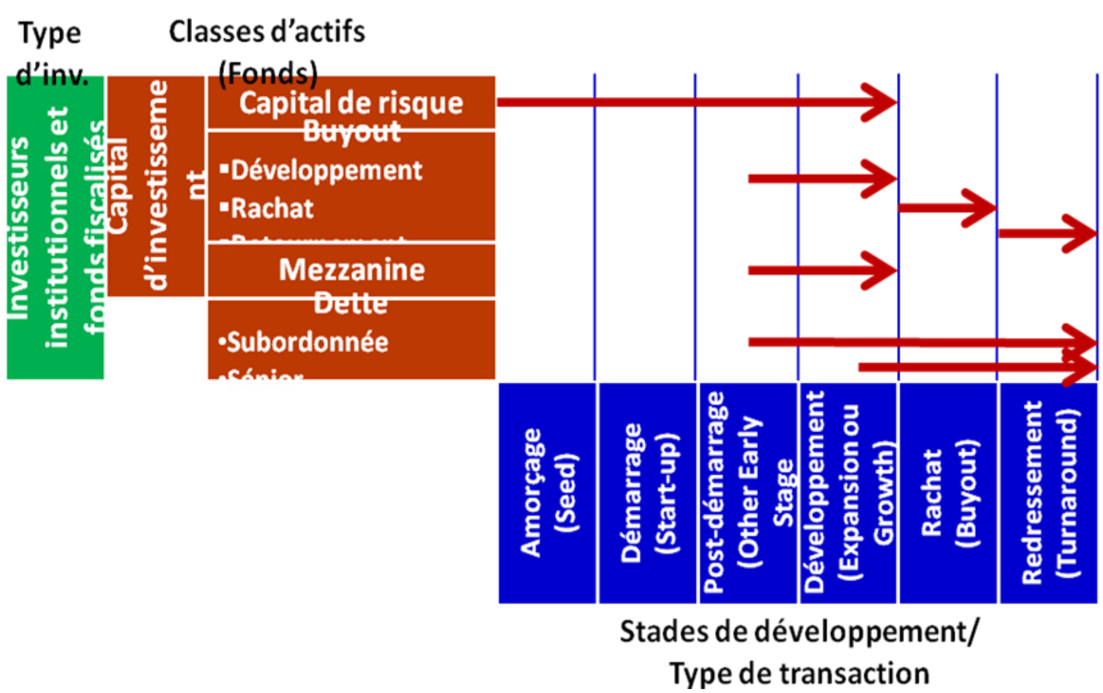
- Venture capital, both in companies with high technological or scientific content and in those operating in other sectors;
- Buyouts, mainly in the form of growth or buyout equity (minority transactions to finance buyouts) and, in some cases, in the form of buyout capital (majority transactions);
- Mezzanine financing (subordinated debt, generally unsecured, with or without options on equity).

Also, as in the United States, angel investors play a significant role in private equity in Québec.

The table below sums up the overlay in terms of development stage, type of transaction, asset class and type of investor.

Summary diagram

Development stages, asset classes and types of investor



Type of inv. Asset classes (funds)
Institutional investors and tax-advantaged funds
Private equity
Venture capital
Buyout Expansion Buyout Turnaround
Mezzanine
Debt Subordinated Senior
Stage of development / Type of transaction

D. Classification for statistical purposes

The Canadian database on the private equity industry is maintained by Thomson Reuters. It covers two aspects, namely investments and fund raising. A report is also produced twice a year, in collaboration with CVCA, on the returns from Canadian private equity funds.

Thomson Reuters classifies the follow investments as venture capital investments:

1. Early stage investments made by any type of fund are usually classified as venture capital investments, except for investments in the mining, oil and gas and certain other traditional sectors by funds specializing in these areas. The latter are usually classified as growth equity investments.

2. Investments made by venture capital funds are usually classified as venture capital investments regardless of a company's stage of development. Even if a company is at the expansion or growth stage, investments that follow up on venture capital investments are classified accordingly as venture capital investments until there is an exit event, an acquisition or a significant investment by one or more non-venture capital funds.

3. Later investments by institutional investors or growth equity funds (including tax-advantaged funds) are usually classified as buyout or mezzanine investments unless they are follow-ups to venture capital investments or are made as co-investments with venture capital funds.

Data on the two other asset classes are significantly less comprehensive than those for venture capital.

For statistical purposes, the following are considered as growth / buyout equity investments:

- All buyout funds, except for cases involving investments in early-stage development in areas of innovation or co-investments with venture capital funds;

- For other types of investors, this category covers only investments that are not classified as venture capital or mezzanine financing.

As regards mezzanine financing, the following are included for statistical purposes:

- All investments by mezzanine funds;

- For other types of investors, all transactions conducted in the form of subordinated debt, whether secured, with or without options on equity.

LEXICON

- **Angel investors *(anges investisseurs)***
  Experienced entrepreneurs who help in the launch and growth of companies by investing their own cash and, sometimes, by providing opinions, advice or access to their business network.
- **Balanced fund *(fonds équilibré)***
  Strategy of a private equity fund aimed at building a varied range of investment targets, as opposed to a specialized fund.
- **Bridge financing *(prêt relais)***
  Short-term capital, generally in the form of a loan, to a company prior to its initial public offering or its next major private equity operation.

- **Capital available for investment** ***(capital disponible aux fins d'investissement)***
  Total value in dollars of capital under management, after deducting the resources invested or committed by a private equity fund. Also called liquidity.
- **Capital commitment** ***(engagement de capital)***
  Capital from outside sources, in particular from individuals and institutions, offered to private equity funds.
- **Capital pool company (CPC)** ***(société de capital de démarrage) (SCD)***
  The CPC program is a business-financing program directed toward emerging companies, run by the TSX Venture Exchange. The program twins an eligible private company with a capital pool company that serves as a vehicle for converting a private company to a public company.
- **Capital under management** ***(capital sous gestion)***
  Total value in dollars of a private equity fund's capital resources, whether or not invested or committed.
- **Capitalization table (cap table)** ***(tableau de capitalisation)***
  A table describing the distribution of a company's equity before and after an equity investment is made, taking account of the dilution mechanisms that exist or that must be instituted.
- **Carried interest** ***(participation aux profits)***
  Profit-sharing for managers of a fund, calculated on the basis of proceeds and surpluses generated by a private equity fund.
- **Closing** ***(clôture)***
  The final stage of an operation, with the signing by all participants (executives and private equity investors) of the legal documentation (in particular the shareholders' agreement) and with the disbursement of funds.
- **Co-investment** ***(coïnvestissement)***
  The involvement of two or more equity investors in a given operation under the same terms and conditions. Also called syndication. The average co-investment rate corresponds to the total number of investments made in the total number of operations over a given period. This term is used mainly when presenting venture capital industry statistics.
- **Common share** ***(action ordinaire)***
  A share providing voting rights at any shareholders' meeting, the right to receive any dividends declared by the company on these shares, and the right to share in the remaining property if the company is dissolved.
- **Convertible debt** ***(prêt ou dette convertible en actions)***
  A security providing access to equity issued by a company and subscribed by an equity investor, consisting of a debt security (debenture or loan) and a facility for converting this security into shares in the company under certain circumstances at a set price.
- **Development capital, growth equity** ***(capital de développement)***
  Capital invested in a company that generally has a viable product, a developed market, significant clients and sustained income growth and that has reached break-even point and is producing not just profits but also positive cash flows. Financing is often intended to increase production capacity and the sales force, to develop new products, services or markets, or to finance acquisitions and/or to increase working capital.
- **Disbursement** ***(débours)***
  The real amount in dollars moving from one or more private equity funds to the company.
- **Due diligence** ***(vérification diligente, vérification au préalable)***
  A set of information search and control measures enabling equity investors to base their judgment on a company's activity, financial position, results, development outlook and organization before making an investment.
- **Exit mechanism** ***(mécanisme de sortie)***
  Strategic means through which a private equity fund liquidates its interest in a company and obtains optimal returns. There exist several exit mechanisms, in particular sale of the interest, buyout of the company, buyout by the company of the investor's holding or sale on a public market as part of, or following, an initial public offering.
- **Financing and investment** ***(financement et investissement)***

Each operation conducted by one or more private equity funds in a given company in the portfolio represents a financing. Each financing consists of one or more investments, depending on the presence of co-investors. This term is used mainly when presenting venture capital industry statistics.

- **Foreign investors *(investisseurs étrangers)***
  Non-resident private equity funds that are active in Canada.
- **Fund of funds *(fonds de fonds)***
  A mutual fund that invests mostly in the shares or units of other mutual funds (Ménard).
- **Fund raising *(levée de fonds)***
  Activity conducted by a private equity fund seeking fresh capital commitments. In Canada, the most active fund seekers are growth equity funds and private independent funds.
- **Gatekeeper *(gardien)***
  A professional intermediary or advisor who acts for institutional investors on the private equity market.
- **Governmental funds *(fonds gouvernementaux)***
  Government agencies or state-owned corporations that make equity investments.
- **Holding period *(période de detention)***
  Time during which investors hold all or part of their interests in a company.
- **Hurdle rate *(taux épreuve)***
  A minimum percentage of earnings provided to investors in a private equity fund before the managers can share in the profits.
- **Initial public offering (IPO) *(premier appel public à l'épargne) (PAPE)***
  A sale or initial distribution on public markets of privately owned shares in a company in the portfolio. This exit mechanism is common for private equity funds, especially venture capital funds.
- **Institutional investor *(investisseur institutionnel)***
  Funds managed internally by certain large institutions. Retirement funds, insurance companies, endowments, charitable foundations and other non-bank financial institutions are often key providers of capital to private equity funds. In Canada, some large institutional investors also have internal programs that engage in direct activities on the market.
- **Internal rate of return (IRR) *(taux de rendement interne) (TRI)***
  The rate measuring average annualized earnings of an equity investment consisting of negative flows (disbursements) and positive flows (collections). It is used to measure and follow changes in the performance of private equity operations.
- **Investor types *(types d'investisseurs)***
  Key stakeholders in the private equity sector, based on the funds' particular structures and the sources of supply of capital. In the United States, private equity is dominated by private independent funds, whereas in Québec activity is spread among several major groups. See the Introduction to the lexicon.
- **Lead investor *(investisseur principal)***
  The member of a syndicate of equity investors who leads other co-investors in the successful closing of a corporate financing. Lead investor statements started in January 2004.
- **Leveraged buyout *(rachat)***
  See the Introduction to the lexicon.
- **Limited partnership (LP) *(Société en commandite)***
  A fiscally transparent investment structure, used mainly by managers for investing private equity. The limited partnership is managed by an independent management company (the "general partner" or "management company"). The other associates are called limited partners. They generally provide monetary support, and their responsibility is limited to providing the amount agreed upon.
- **Management company *(société de gestion)***
  A vehicle used by the professional manager of one or more private equity funds.
- **Market capitalization *(capitalisation boursière)***

The total value in dollars of a company's outstanding shares. This is calculated by multiplying the number of outstanding shares by the shares' current market price. It is also called market value.

- **Mezzanine *(mezzanine)***
  Financing that complements senior debt, to which it is subordinated. It pays more than senior debt and sometimes provides, through options, access to the company's equity. It is arranged either in the form of debt or preferred shares.
- **Milestone *(jalon)***
  Designates the goals that are to serve as criteria to trigger certain clauses, such as price supplements, release of an additional tranche of private equity, etc.
- **New investment *(nouvel investissement)***
  The initial phase of financing in a company. Companies receiving venture capital usually benefit from subsequent financing as they grow and develop. Also called initial operation.
- **Offering size *(taille du placement)***
  The total amount in dollars mobilized during an IPO.
- **Other investors *(autres investisseurs)***
  Investors who hold interests in specific private equity operations without a permanent market presence. This term is used mainly when presenting venture capital industry statistics for the purposes of separating the dollars invested by investor type.
- **Portfolio company *(société de portefeuille)***
  A company that has obtained at least one phase of financing from one or more private equity funds. Also known as an investee company.
- **Post-investment value *(valeur postinvestissement)***
  Valuation of a company following the entry of capital or of investors.
- **Preferred share *(action privilégiée)***
  A category of shares providing rights, privileges or restrictions (such as a greater right to information, the right to a representative on decision-making bodies, the right to a priority dividend and the right to priority recovery of the amounts invested in case of liquidation or disposal of the company), negotiated at the time of subscription.
- **Pre-investment value *(valeur préinvestissement)***
  The valuation of a company prior to the entry of capital or investors.
- **Price adjustment *(ajustements de prix)***
  A set of measures, involving a time dimension, that allow an "initial" price for the subscription or acquisition of shares by an equity investor to be adjusted based on events subsequent to the entry of the said investor to the company's equity.
- **Private equity *(capital d'investissement)***
  See the Introduction to the lexicon.
- **Private equity fund *(fonds de capital d'investissement)***
  A vehicle bringing investors together to make private equity investments and share in the results. These funds generally consist of private partnerships, managed by a specialized team and having a minimum duration of ten (10) years.
- **Private independent fund *(fonds privé indépendant)***
  A private equity fund under professional management that mobilizes capital from outside sources such as institutional investors. Most private independent funds make use of limited partnerships and related vehicles.
- **Private investment in public entity (PIPE) *(Placement privé dans une société ouverte)***
  An operation as part of which accredited investors are authorized to purchase shares in a public company through an exemption provided under provincial securities regulations.
- **Public company**
  A joint stock company with shares officially listed on a stock exchange, sold on the over-the-counter market or that may be offered to the public in some other way.
- **Retail funds (tax-advantaged funds) *(fonds de capital de développement) (fonds fiscalisés)***

Funds that seek capital from individual investors who benefit from a tax incentive. There are three of them in Québec: the Fonds de solidarité des travailleurs du Québec (FTQ), Fondaction CSN and Capital régional et coopératif Desjardins.

- **Reverse takeover *(prise de contrôle inversée)***
  A strategy of a privately held company to obtain access to public markets by taking control of a publicly traded company.
- **Secondary funds *(fonds secondaires)***
  Funds specializing in buyouts of shares in existing venture capital funds from investors who wish to pull out before the funds mature.
- **Senior debt *(dette senior)***
  In the financing structure, this corresponds to the provision of amortizable secured debt by banking institutions, with repayment guaranteed by disposal of the company's assets in favour of the latter. Annual interest and annual capital reimbursements must be repaid before the junior debt, namely the mezzanine debt.
- **Shareholders' agreement *(convention entre actionnaires)***
  An agreement reached by some or all of a company's shareholders (founders, existing shareholders and equity investors) aimed at delineating equity ownership and changes in how it is divided as well as the exercise of power. The most common clauses cover rights aimed at protecting the minority shareholder(s), such as rights of first refusal and certain veto rights over key decisions as well as exit mechanisms (Ménard).
- **Spin-off *(essaimage)***
  The creation of a new company based on assets and individuals from an existing company.
- **Stock options *(options d'achat d'actions)***
  A type of equity access rights, reserved for employees and executives of a company and its subsidiaries, at a set price for a certain period of time, sometimes subject to conditions.
- **Subscription agreement *(convention de souscription)***
  A contract regulating subscription to shares or other securities (such as subordinated debt) signed by the equity investor and including payment of the subscription price. This contract generally contains representations and guarantees related to the company, provided in the equity investor's favour.
- **Succession plan *(plan de relève)***
  The basis for transferring ownership of a company from one generation to managers in the succeeding generation, often with the assistance of private equity.
- **Syndication *(syndication)***
  See Co-investment.
- **Term sheet *(lettre d'intention)***
  A document summarizing the main terms and conditions on the basis of which equity investors agree to invest in a company, including, among other matters, the prior conditions.
- **Turnaround *(capital de redressement; AFIC: capital retournement)***
  Capital invested in a company that has had financial difficulties and for which measures providing for a return to profitability have been identified and instituted.
- **Unit *(Unité)***
  Attached to a share issued by a company is a warrant providing the right to subscribe to new shares in the company.
- **Valuation policy *(politique d'évaluation)***
  The method or guidelines used by a private equity fund to set the value of its portfolio assets.
- **Venture capital *(capital de risqué; AFIC: capital risque)***
  Capital invested in a company in the early stages. This investment generally carries high or very high risk. See the Introduction to the lexicon.
- **Vintage year *(cuvée)***
  The year in which a private equity fund was initially created.
- **Warrant *(bon de souscription)***
  A security providing access to a company's equity at a price determined over a certain period of time, sometimes subject to certain conditions.
- **Write-off *(radiation)***

Reduction of the value of an asset in the portfolio to zero.