PRIVATE EQUITY CANADA 2010

Preparing for the next wave of growth

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Printed in Canada.

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Preparing for the next wave of growth

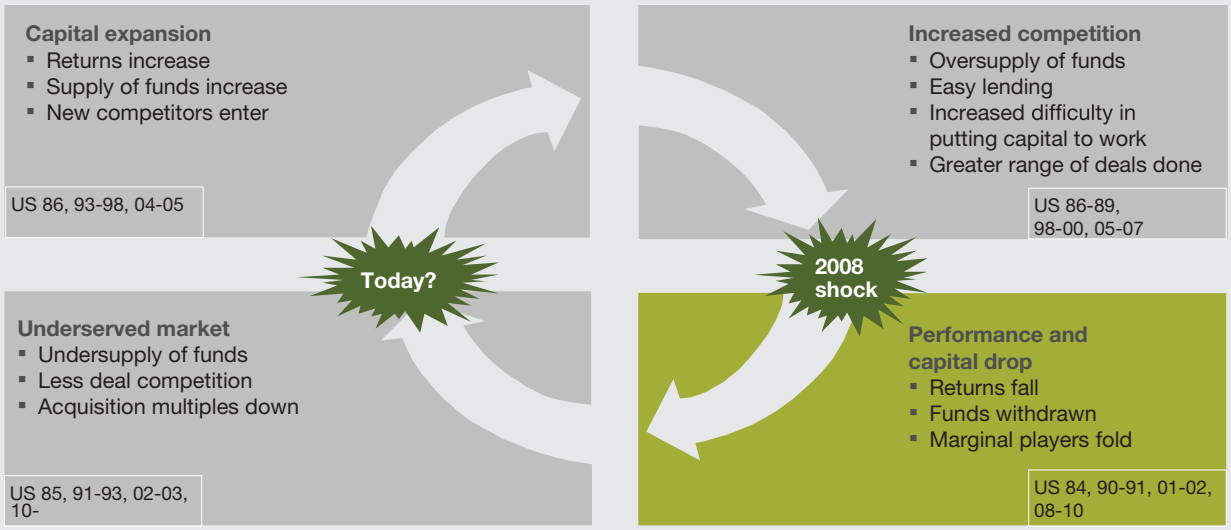
Private Equity Canada 2010: Preparing for the next wave of growth

Welcome to the latest instalment of *Private Equity Canada* – the 10th anniversary of this publication. Since its inception in 2001, *Private Equity Canada* has provided insights into the performance, drivers, and evolution of the industry, both in Canada and globally. We are proud that this report has recorded an entire industry cycle, from bust in 2001, to boom in 2007 and 2008, and then back to bust in 2009, and now rebounding in 2011.

In last year's report, we wrote about the significant contractions and challenges that the PE industry and capital markets more broadly were experiencing. Fundraising had shrunk almost 90 percent, from $506 billion in the United States and Canada in 2007 to $64 billion in 2009. The stock market had crashed and then bounced back. Oil prices had dropped to $35 a barrel and then soared to over $100. In 2010,

EXHIBIT 1

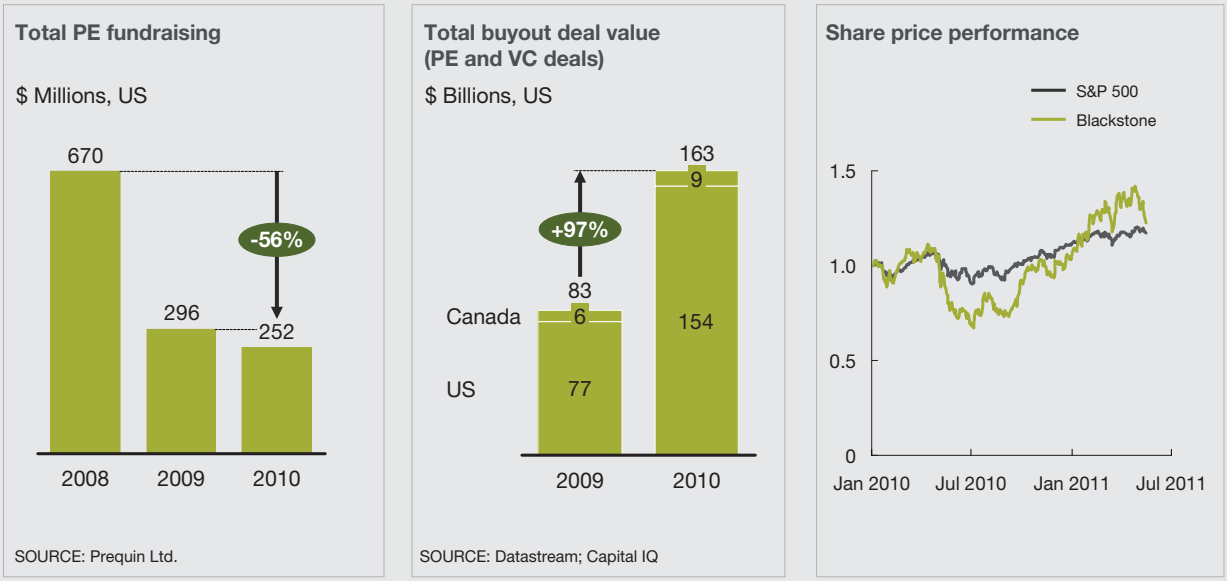
Private Equity market cycles



SOURCE: McKinsey analysis

EXHIBIT 2

Private equity performance indicators



the worst of the cycle appeared to have passed; in 2011, the story is about recovery and revival.[1]

This is not the first – nor will it be the last – economic cycle for the industry. By its nature, private equity is a cyclical asset class, repeating itself in the early 1980s, in the mid-1990s, and in 2003-2004. Generally speaking, these cycles were triggered by equity and debt market contractions and an oversupply of private capital.

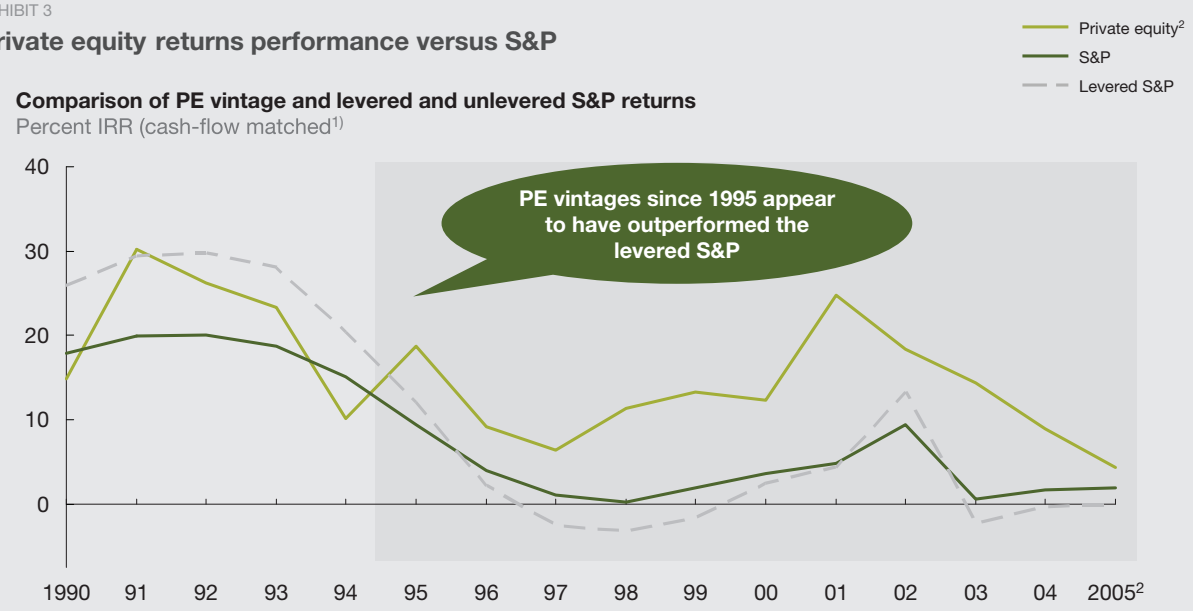
While fundraising has remained challenging, there are many reasons to be encouraged that private equity is on the rise. Buyout deal volume is increasing. LPs are indicating a strong desire to recommit or up their commitments to the asset class. Blackstone shares have recovered significantly from their lows, and Apollo undertook an IPO of its business in March 2011 to successfully raise $565 million. While nothing is certain, we believe all of these elements point to private equity's reemergence.

What makes this rebound different from those of the past is how LPs are thinking about and adapting their approach to private equity as an asset class and, therefore, how GPs will need to adapt their strategies to serve LP needs. We believe three macro trends will shape the LP-GP relationship, and thus the market.

1 As always, we have based our conclusions on McKinsey's proprietary research and the data Thomson Reuters collected and analyzed from its proprietary survey, supplemented with several related surveys, benchmarking, and interviews where we examined over 90 percent of the Canadian market.

EXHIBIT 3

Private equity returns performance versus S&P



1 Based on average percent of cash called by PE firms after raising funds for vintages 1999-2009
2 5.5 year returns of S&P used for 2004 and 2005

1. Unprecedented amounts of capital flowing into the PE and other alternative asset classes.

2. The decline of performance persistence, which is resulting in LPs developing more robust GP selection and management processes and building organizations to support them.

3. A clearer bifurcation in GP strategies and approaches to working with LPs.

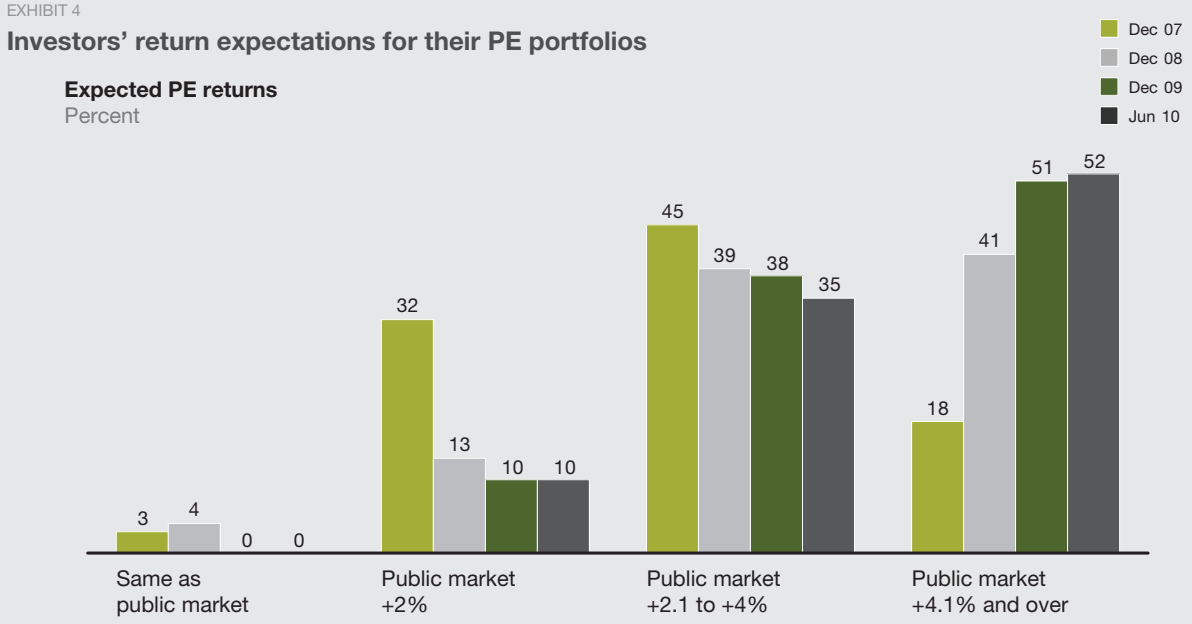
In the following sections, we examine each of these trends, identifying the implications for LPs and GPs, and then we highlight a number of elements that they are likely to incorporate into their strategies.

Unprecedented amounts of capital

Private equity has outperformed the S&P, and even a levered S&P, for more than a decade. This used to be attributed primarily to top quartile performing funds, but recent analysis shows that even median performing PE funds have outperformed a levered S&P. Certainly, performance varies according to fund size, style of fund, and other fund characteristics; nevertheless, 100 percent of LPs surveyed expected their PE investments to outperform public markets, and half expected their PE portfolios' returns to beat public markets by more than 4 percent, in absolute terms.

EXHIBIT 4

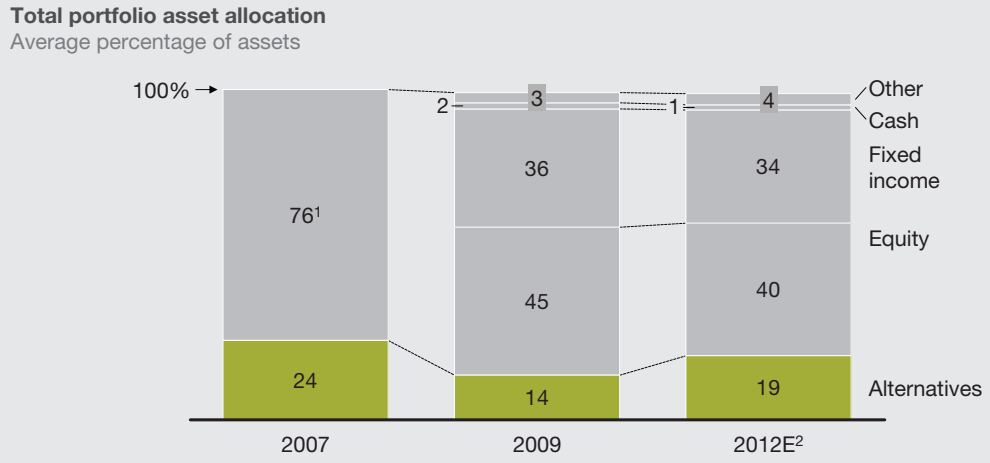
Investors' return expectations for their PE portfolios



SOURCE: Preqin Ltd., 2011

EXHIBIT 5

Investors' expectations for their own capital allocations



1 Includes equity, fixed income, cash, and other
2 Expected next 2-3 years
Note: Results based on simple average of firms' responses

SOURCE: 2010 McKinsey Global Survey on Alternative Investing

Naturally, this outperformance has drawn the attention of many investors that are seeking the type of risk-return profile that private equity can offer. In addition to performance, other external and timing factors are coming into play that will shape the industry evolution over the next few years.

- LPs are increasing their allocations to private equity given its attractive risk-return profile.
- LPs are catching up to their target allocations to private equity.
- The growing gap in long-term asset and liability matching for pension funds will require LPs to increase their exposure to asset classes yielding higher returns.
- Capital invested in PE funds and deals 5 or more years ago will be returning to LPs and will need to be reinvested.

While we recognize that some of these factors will be overlapping, it is likely they will compound and lead to significant flows of capital from LPs into private equity and other alternative asset classes.

Increasing allocations to private equity

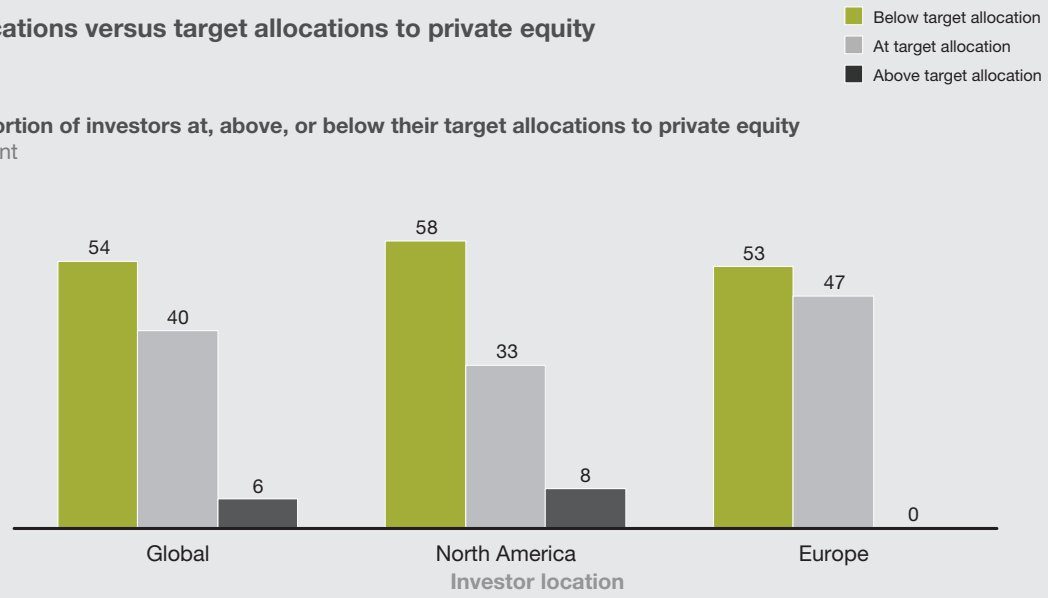
Private equity's performance compared to that of S&P and other indices over the past 20 years is driving many LPs to increase their target allocations once again. The LPs surveyed,[2] representing $1.3 trillion in assets under management, have increased their average target allocations to alternative asset classes from a low of 14 percent in 2009 to 19 percent in 2012 – resulting in an increase of $65 billion in new capital from those surveyed. The Canadian shifts would likely be of a proportionate magnitude. Although this is a material increase, it is still below the 2007 target allocations, indicating there is more room to grow.

A key example is OMERS, which recently announced a target allocation of 47 percent into private markets. If this is indicative of how other LPs are thinking, the amount of capital and dry powder coming into the asset class in the next 3 to 5 years could be unprecedented.

2 2010 McKinsey Global Survey on Alternative Investing.

EXHIBIT 6

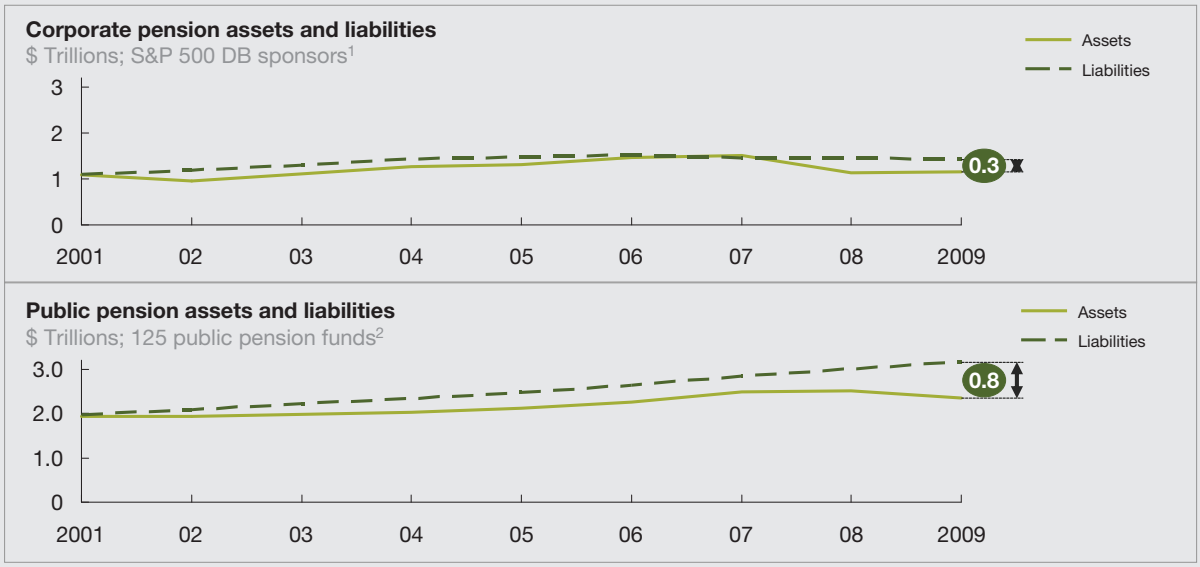
LP allocations versus target allocations to private equity



SOURCE: Preqin Ltd., 2011

EXHIBIT 7

Pension fund liability funding requirements



SOURCE: S&P; press search; McKinsey analysis

Catching up to allocation targets

Although LPs are increasing their target allocations, over half of them still have not committed their current and/or previous target capital to GPs. There may be many reasons for these LPs being below their target allocations – attempting to find the right GP, for example, or the right fund, or waiting until market conditions stabilize. What is clear, though, is that LPs' have a very strong intention of pouring more capital into private equity and other alternative assets.

Growing gap in long-term asset and liability matching

Many pension funds may have already recognized the growing gap between their obligations and future cash flows from investments and are thus reallocating capital into private equity to address this issue given private equity's potential for very attractive returns.

Reinvesting returning capital

The large amount of capital invested in private equity and venture capital deals in the 2006-2007 era will likely be freeing up over the next few years as the funds exit their investments. In the United States and Canada alone, $450 billion and nearly $500 billion was invested in PE deals in 2006 and 2007, respectively. Globally, LPs had committed $550 billion and $650 billion to GPs in the same period. LPs will need to reinvest this capital to continue to have the appropriate level of exposure to private equity, contributing to potentially record amounts of capital being redeployed in the industry.

The decline of performance persistence

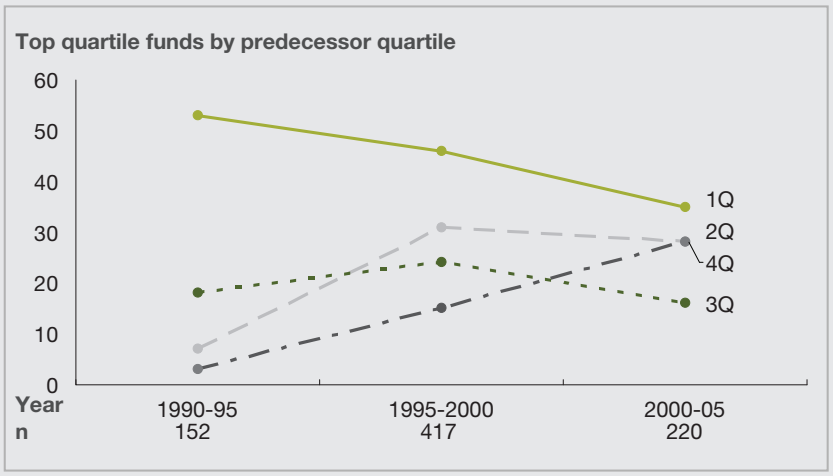
As LPs prepare to allocate, invest, and reinvest more capital into private equity than ever before, managing the sheer magnitude of the required investments is not the only challenge they face.

Most notably, the phenomenon of performance persistence – where a top quartile fund's successor is more likely to also make the top quartile – is declining. For LPs, therefore, picking a team that has delivered a high-performing fund in the past is not sufficient – they now face increasing pressure to pick the "right" GPs.

EXHIBIT 8

Persistence in returns in private equity

Percent



> **Most LPs pick based on past performance, which used to make sense since there has been persistence in returns. But that is changing and by the next cycle will probably not hold**
> *–CEO, large US PE GP*

SOURCE: Preqin Ltd., 2011; McKinsey analysis

As a result, LPs are developing more robust processes to screen the GPs, identify the right fit for their own investment strategies and needs, and then actively manage those relationships.

Among the processes LPs will need to address this evolving market reality are more rigorous scorecards and metrics to evaluate GPs' investment teams and fund strategies, a GP's ability to add value to a portfolio company, and a GP's deal-sourcing capabilities and ability to provide access to unique co-investments, among other criteria.

In evaluating a GP's strategy and whether it will be the right fit, LPs will want to ask themselves a number of questions. For example,

- What is their "house view" of the markets in which the GP intends to participate? Is there a large opportunity and is the GP well-positioned to capture that opportunity?

- If the GP is a larger, cross-industry or cross-geography fund, what is its overall investment philosophy? Will that philosophy enable it to generate more alpha[3] than other GPs?

- If the GP is specific to an industry or geography, what are the real opportunities in that area? And what is the GP's competitive advantage to generate incremental alpha relative to other GPs competing for similar assets?

In evaluating a GP's investment team, LPs will want to take a close look at the GP's organization, asking questions such as:

- What is the background and track record of the investment professionals supporting the investment committee?

- Does the GP have a full bench of highly qualified investment professionals who can source and evaluate potential deals and put capital to work, or is it only the GP's senior investment team that has these abilities?

- How aligned are the interests of the GP investment professionals with ours? Is there an opportunity to create even greater alignment?

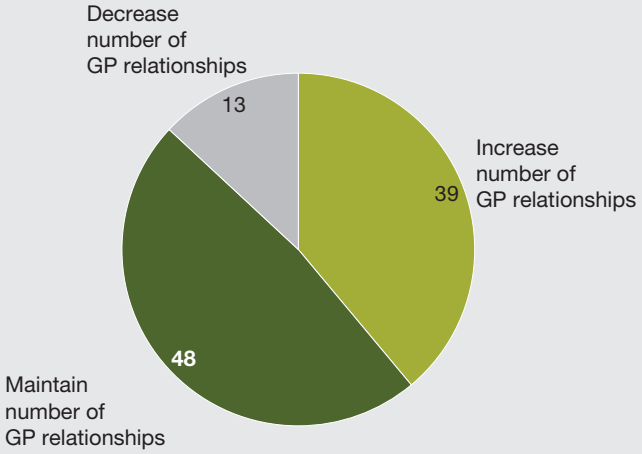
In addition to picking the right GP, LPs are changing the way they work with GPs. The ILPA[4] Principles have made great strides in standardizing the processes and protocols in the GP-LP relationship, and many LPs view them as the gold standard for these relationships. They are leveraging these guidelines, as well as the shift in negotiating power from GPs to LPs during the recent downturn, to increase their level of visibility into GP performance and better manage their relationships with GPs. Although it is not certain, the need for increased visibility may be one of the driving factors behind LPs limiting the number of GPs they work with, despite the need to commit more capital to the asset class.

3 Performance achieved in excess of a benchmark.
4 Institutional Limited Partners Association.

EXHIBIT 9

Likely changes to the number of GP relationships maintained by investors in the next 2 years

Percent



SOURCE: Preqin Ltd., 2011

A clearer bifurcation in GP strategies

GPs are evolving their investment strategies, operations, and fee structures in response to the changing industry landscape and are responding to LPs' demands for stronger relationships and increased reporting.

Investment strategies and operations

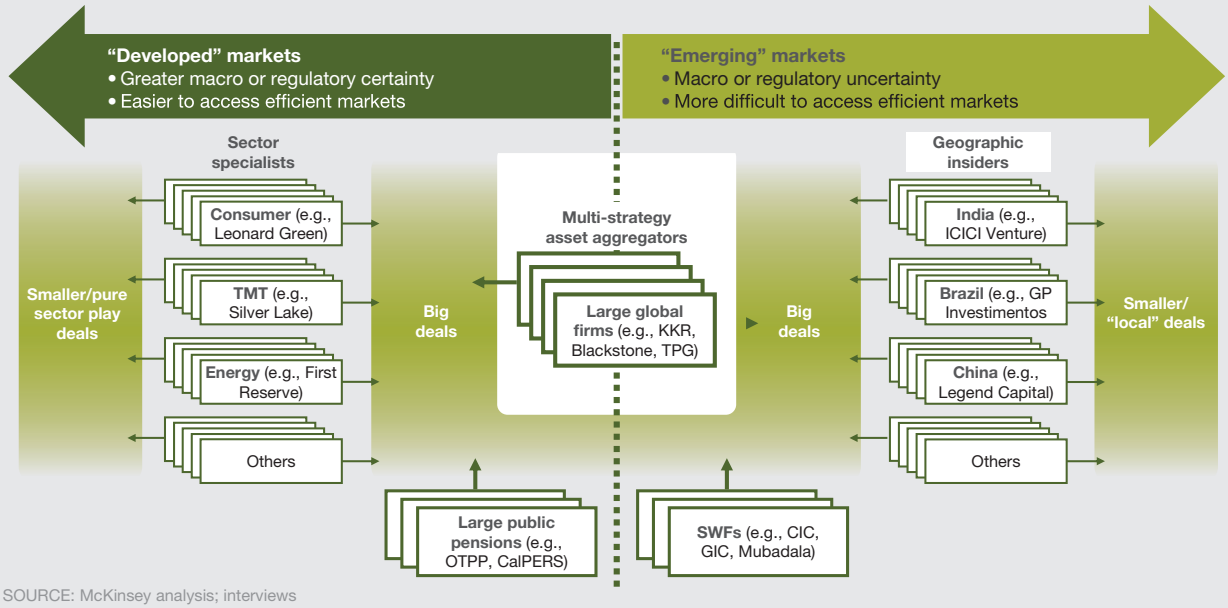
As more capital flows into private equity and as the needs and sophistication of LP investors change, PE funds will likely evolve their models into one of two macro strategies: large global firms and specialty geographic- or sector-focused GPs.

Size will be the key difference between the GPs that the market has become familiar with over the past 10 years and those we will see in the future. The traditional brand-name GPs from 2007-2008 will probably emerge as mega funds, focusing on buyouts in developed markets and most likely in a couple of industries or in a few established, stable industries and segments.

These mega funds will likely cater to the needs of smaller LPs seeking exposure to private equity and other alternative assets but lacking the scale to form their own direct investment team, as well as larger LPs looking to scale their PE investments, either by pooling assets or by gaining access to new teams of investment professionals. Larger LPs would be less likely to use mega funds, as their own investment teams could be competing with the mega funds' teams for the same assets.

EXHIBIT 10

A new ecosystem in private equity – bifurcation of strategy



SOURCE: McKinsey analysis; interviews

The second option for GPs would be to become a niche geographic or sector player. These niche players would differ from mega funds with a geographic or industry focus in their unique expertise or geographic presence.

Niche geographic GPs would focus on emerging economies and have experts on the ground who know and understand the local competitive, government, and regulatory issues that could have an impact on the quality of an investment. This would provide an advantage over mega funds competing for the same assets and attract LPs seeking a different risk-return profile associated with a specific geography.

Niche sector GPs' in-depth knowledge of an industry's entire supply chain and ecosystem would enable them to identify pockets of value, giving them a competitive advantage. Although they may compete with the mega funds for some of the larger assets in the industry, niche sector funds would typically compete for smaller targets.

In addition to niche sectors, we expect alternative assets outside of private equity to gain favour with GPs and LPs as a method of achieving a competitive advantage. Infrastructure is a good example of one asset class that is well-positioned and experiencing this type of growth. Within Canada, venture capital is another asset class that may be poised for growth after years of decline and underperformance.

Though VC fundraising has hit a 10-year low, and LPs are far from returning to the asset class, there are reasons to be hopeful for the future. Federal and provincial government initiatives – such as Teralys in Quebec, OVCF/Northleaf in Ontario, and BDC's new strategy across Canada – are being taken to strengthen the industry. The lack of competition for deals could generate strong IRRs – assuming exit markets do not dry up – and create a niche for GPs.

Fee structure

For many years, PE fees have generated much discussion in the industry. Many have argued that fees will decrease as competition increases; others have argued that LPs will always be willing to pay a premium to invest with the best-performing managers. What is certain is that fee levels are evolving along with the GP landscape to reflect the value GPs bring, which varies depending on their strategies and business models.

Mega funds may begin to move from the standard 2 and 20 model[5] to lower management fees that reflect the actual costs. Private equity is a highly scalable business and, at 2 and 20, mega funds would probably be generating management fees significantly above the amount needed to keep their businesses running. Nevertheless, top performing firms will likely continue to be able to command a premium fee.

Niche geographic and sector funds would likely continue to apply 2 and 20. In general, they are smaller and have less scale and, therefore, spend a higher percentage of their fund on operating costs and salaries. Furthermore, they bring expertise in deal evaluation. In this category, LPs typically accept a 20 percent performance fee to ensure their incentives and those of the investment team are aligned.

In future, fee structures could become increasingly creative – such as a fund with no management fee and a 30 percent carried interest, or a fund with different laddering/payment of carried interest, or a fund with a budget instead of management fees. GPs have experimented with these models and are likely to continue to innovate in response to more sophisticated and demanding LPs and a more competitive marketplace.

5 A 2 percent management fee and a 20 percent outperformance fee.

■ ■ ■

To adapt to these trends, GPs are likely to:

- More clearly define their investment strategies to target the right LP investors based on their return objectives and investment philosophies
- Solidify and develop their strategic relationships with LPs, enabling LPs to access more co-investments and enhance returns
- Pursue new alternative asset classes, including infrastructure and, especially in Canada, venture capital, to create a unique value proposition for LPs
- Build greater transparency into their investment strategy and investment performance, including the specific value-added capabilities GPs bring to their portfolio companies to improve performance
- Develop clearer performance management of their portfolio companies.

To adapt to these trends, LPs are likely to:

- Allocate a greater portion of their total assets into private equity
- Clearly articulate what they expect from GPs and how GPs can help them fulfill their investment requirements
- Develop enhanced performance management approaches for their GPs, both pre and post investments
- Continue to develop their internal investment team capabilities.

We are excited about the future of private equity and, more broadly, alternative assets in Canada and globally. The industry's rebound will likely bring substantial changes as significant amounts of capital return to the market and are redeployed.

As always, we hope you find our analysis and commentary useful and insightful.

Robert Palter
Director

Sacha Ghai
Principal

Jonathan Tétrault
Principal

Andrew Mullin
Engagement Manager

McKinsey & Company[6] is an international management consulting firm that specializes in helping clients achieve substantial and lasting improvements in their performance. Its Canadian Practice, with offices in Toronto, Montreal, and Calgary, draws on McKinsey's network of over 90 offices to provide objective counsel to management teams facing strategic, organizational, or operational opportunities and challenges. For more information, please visit us at *www.mckinsey.com* or contact us by phone at 416 313 3700, 514 939 6800, or 403 444 8000.

6 McKinsey & Company is not an investment advisor and will not provide investment advice.

Part 2
An in-depth review of the Canadian market in 2010

Introduction

Thomson Reuters prepared the following in-depth review of the Canadian private equity market in 2010 in partnership with McKinsey & Company. It is the 10th in an annual series of reviews featured in *Private Equity Canada* – dedicated to profiling key trends in the domestic market, as well as the global activity of Canada's fund management industry.

Data collected and analyzed by Thomson Reuters for this report were drawn from a proprietary survey of Canadian PE fund managers and several related surveys. Survey work was chiefly conducted in 4Q 2010 and 1Q 2011. The final respondents sample, totaling 123 contributors, reflects all of the largest investor groups based in Canada (see Appendix) – and 97 percent of the entire capital pool.

The data requested, and the questions posed, in the 2010 survey were consistent with those of 2009. This serves Thomson Reuters' objective of adding to, and updating, information received previously from fund managers. Consequently, the prior year's data will sometimes mark changes of note. Thomson Reuters provided supplementary data to augment survey findings to ensure this report reflects market activity as fully as possible.

Thomson Reuters developed the original research methodology for survey work in this and previous *Private Equity Canada* reports going back to 2001. This is comparable to methodologies used internationally for profiling national or regional private equity markets.

Thomson Reuters and McKinsey & Company wish to thank the many GPs, investment managers and staff at Canadian buyout, mezzanine, venture capital, and other PE funds who gave freely of their time to provide confidential data and share their advice and perspectives. *Private Equity Canada* would not have been possible without their generous contributions.

We would also like to thank Thomson Reuters professionals who assisted in the report's production, including analysts Wei Dai and Gavin Penny.

Kirk Falconer
Director of Research, Private Equity
Thomson Reuters (Canada)

Thomson Reuters is the authoritative source of information on activity in Canada's private equity market. Its extensive network of contacts and its proprietary data sources have made the firm a focal point for information on Canadian private equity deals and deal-makers. For this reason, Thomson Reuters is a vital, value-adding resource for understanding the full universe of market players in Canada, as well as those based in the United States and other countries that are engaged in cross-border investing. For more information, please visit us at *www.thomsonreuters.com,* or *www.canadavc.com,* or contact us by phone at 416 687 7500.

If you have any questions about the *Private Equity Canada* survey methodology or data findings, please contact Kirk Falconer at 613 747 4441 or kirk.falconer@thomsonreuters.com.

Executive summary

Private equity market activity was renewed on an international basis in 2010, with deal volumes and portfolio realizations increasing for the first time in 3 years. According to a survey conducted by Thomson Reuters, these trends were also evidenced in Canada, with moderate to significant growth in investments across the spectrum. In addition, Canadian funds had unprecedented influence in shaping deal activity around the globe.

The survey found that the market renewal fueled expansion in capital managed by Canadian-based investor groups. Private equity resources under management totaled $84.9 billion in 2010, up 12 percent from 2009.

As a result of partnership closings and increased activity by institutional captive funds, most new dollars flowed into buyout and related PE funds, which oversaw $63.4 billion in total last year, or 18 percent more than the year before. This gave the buyout segment a 75 percent share of the market as a whole.

A comparative lack of new fund formations helped ensure that supply managed by mezzanine and other quasi-equity groups, totaling $6.6 billion in 2010, instead reflected a decline of 10 percent compared to 2009, along with a lower relative market share.

Canada's PE market in 2010

Quick facts

- Capital under management: **$87.9 billion**
- Number of active PE fund managers: **198**[1]
- Disclosed PE disbursements in Canadian businesses: **$6.2 billion**[2]
- Disbursements-to-GDP: **0.4%**

1 Includes buyout, mezzanine, venture capital, and other private equity
2 Includes domestic and foreign deals

SOURCE: Thomson Reuters

Venture capital under management totaled $14.9 billion in 2010, approximating levels of the year before and making up 17 percent of the overall pool. As in previous years, inflows attributable to successful fundraising activity were offset by outflows in other quarters.

Based on survey findings and supplementary data, Thomson Reuters estimated the entire Canadian private equity fund universe to total $87.9 billion in 2010.

New commitments to partnerships made more resources available to private-independent funds of all varieties. As a result, private funds continued to lead Canadian PE industry players in 2010, with 56 percent of the capital pool, or $47.1 billion.

Canada's institutional funds exerted a major influence on PE trends in 2010, both at home and abroad. Their direct portfolio assets grew commensurately, reaching $26.7 billion and comprising a 31 percent share of the aggregate amount.

Despite continuing consolidations, labour-sponsored and other retail funds remained a key market presence, with capital managed totaling $7.5 billion, or a 9 percent share. Corporate captive funds had stewardship of $2.0 billion in 2010, reflecting 2 percent of the total, as did government funds.

While North American market fundamentals for making and exiting PE investments improved last year, the climate for raising new fund capital remained weak. In Canada, conditions were essentially unchanged from 2009. Consequently, new commitments to buyout, mezzanine, and other PE funds, totaling $2.6 billion, fell 8 percent year over year. This occurred despite LP interest in mid-market and energy partnerships.

In addition, VC funds absorbed new commitments totaling just over $1 billion in 2010, down 7 percent from the year before. However, this trend obscures several important new partnerships, especially in the area of clean technology.

As in the past, a diverse range of LP sources accounted for the $3.7 billion that went to fund managers in 2010. Characteristic of last year's trends were the continuing relevance of foreign LPs to buyout and related partnerships and the role assumed by individual investors in funds of all types.

Foreign LPs accounted for 47 percent of new supply to the buyout segment, or $1.2 billion. Taking second spot, Canadian individual investors, like high-net-wealth investors, brought $510 million to the table, followed by various domestic corporate, pension, and other institutional funds.

Individual investors in partnerships and retail funds were essential to VC fundraising in 2010, accounting for 45 percent of the total, or $448 million. Government sources followed, committing $196 million, while foreign LPs increased their role, accounting for a 15 percent share.

In what might remain a challenging fundraising environment in 2011, the survey found 36 Canadian fund managers with new product offerings in the market at the present time, down marginally from 2010.

After 2 years of slowdown, increased economic stability and greater liquidity lent encouragement to North American private equity investment levels. Fresh signs of vitality spurred deal-making in virtually all segments of the Canadian market, as well as very considerable international activity on the part of leading Canadian funds.

The survey found Canadian buyout, mezzanine, and other PE funds invested a total of $7.4 billion in domestic and foreign businesses in 2010, which is up 120 percent from the year before. This marks the highest level of disbursement since 2007. Equity and quasi-equity dollars were channeled through 369 deals, or 18 percent more than in 2009.

Over three-quarters of transactions engaged firms in Canada, helping to propel the first year-over-year uptick in domestic market activity in 3 years. However, in contrast with the previous market up-cycle, when mega-transactions dominated trends, growth this time relied on activity in the mid-market.

Canadian large-cap and mid-cap buyout funds were acknowledged global deal-leaders in 2010, sponsoring or co-sponsoring some of year's biggest acquisitions. Underlining this fact was the survey's finding that 70 percent of reported dollars invested went to non-resident businesses.

Canadian VC funds deployed just under $1 billion to domestic and foreign businesses last year, up 16 percent from 2009. In addition, the number of financings led by or syndicated with Canadian funds rose 11 percent, with 454 deals done in 2010.

Eighty-five percent of deal-making was directed to locally based early-stage and expanding firms in core innovative sectors, such as clean technology, IT, and life sciences. Consequently, increased Canadian fund activity was key to domestic market trends, which saw year-over-year growth for the first time in 3 years.

Canadian VC funds also quickened the pace of their activity in global technology markets in 2010, with dollars invested in opportunities increasing 39 percent from 2009.

Private equity-backed exits surged in 2010. Buyout, mezzanine, and other PE investor exits from Canadian-based businesses numbered 77, more than double the 2009 total. Venture capital portfolio realizations also underwent a 28 percent rebound, with exits from domestic businesses totaling 32.

Canada's private equity market in 2010

Market renewal fuels growth in capital pool

Private equity activity was renewed in 2010, with deal volumes and portfolio realizations increasing across North American and global markets for the first time in 3 years. This trend had an impact on capital managed by Canadian-based funds, which showed significant growth on a year-over-year basis.

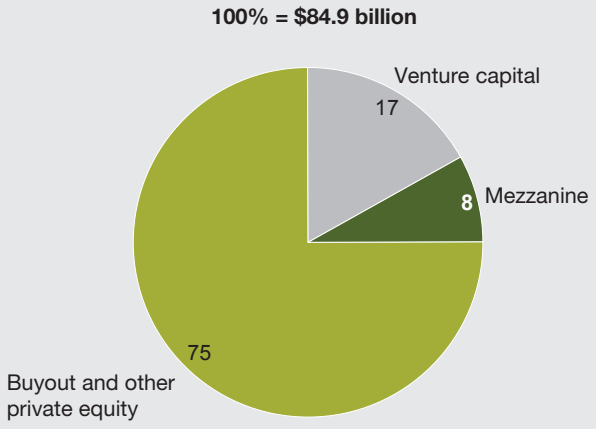
According to the survey (and supplementary data from Thomson Reuters), the private equity fund management industry in Canada oversaw capital totaling $84.9 billion in 2010. This is 12 percent greater than the $76.0 billion reported the year before.[1]

By far the largest portion of the new dollars flowed into buyout and related PE funds. Domestic investor groups had $63.4 billion under management last year, or 18 percent more than the $53.7 billion of 2009. This gave the buyout segment a 75 percent share of the market as a whole.

EXHIBIT 1

Total capital under management by PE market segment; 2010

Percent



SOURCE: Thomson Reuters

1 Growth in capital managed is primarily due to fundraising or changes in the supply of captive funds. Other factors may include data obtained from new survey contributors.

Contributing to this result were several partnerships that closed in 2010, despite a challenging fundraising environment. On the buyout side, examples include Birch Hill Equity Partners IV LP, Carpédia Capital, Catalyst Fund LP III, Clairvest Equity Partners IV LP, and HSBC Capital (Canada) Private Equity Fund 2010. Energy-focused PE funds, such as JOG LP V, KERN Energy Partners III Funds, and Lex Energy Partners LP, also played a key role.

Increased direct deal activity on the part of CPP Investment Board (CPPIB) Private Investments, OMERS Private Equity, Teachers' Private Capital, and other Canadian institutional funds was an equally important factor in the buyout pool's expansion.

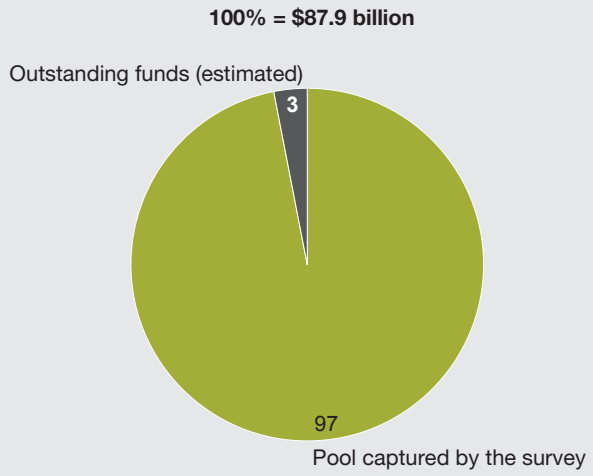
In contrast, dollars managed by domestic mezzanine and other quasi-equity funds, totaling $6.6 billion, reflected a decline of 10 percent compared to 2009, along with a lower relative market share. This resulted from fund wind-downs, which to date have not been sufficiently offset by fund formations. However, last year's successful first close of Norrep Credit Opportunities Fund might signal a change in direction.

Fundraising in the VC segment was also beset by challenges in 2010. However, a number of partnerships emerged or made advances, including Chrysalix Energy LP III, Real Ventures, Renewal2 Investment Fund, and XPV Water Fund LP. New commitments to retails funds located in Québec and other Canadian regions also added to the capital stock.

EXHIBIT 2

Total PE capital under management (estimated) and survey sample pool; 2010

Percent



SOURCE: Thomson Reuters

As in prior years, inflows of new market supply were matched by outflows precipitated by other investor groups. On balance, Canadian venture capital under management totaled $14.9 billion in 2010, approximating levels reported the year before and making up 17 percent of the overall PE market.

When survey findings are supplemented with Thomson Reuters' data, the entire Canadian PE fund universe is estimated to total $87.9 billion, up from $79.5 billion in 2009.

This indicates that survey and related data accounted for 97 percent of all resources residing with PE fund managers based in Canada.

EXHIBIT 3

Canada's PE market in 2010

Quick facts

- Capital under management: **$87.9 billion**
- Number of active PE fund managers: **198**[1]
- Disclosed PE disbursements in Canadian businesses: **$6.2 billion**[2]
- Disbursements-to-GDP: **0.4%**

1 Includes buyout, mezzanine, venture capital, and other private equity
2 Includes domestic and foreign deals

SOURCE: Thomson Reuters

Canada's private equity market players in 2010

Institutional captives extend market influence

In 2009, the survey found private-independent funds dominating Canada's PE industry, with close to 60 percent of total capital under management. While private funds continued to occupy the top spot last year, institutional captive funds made major gains.

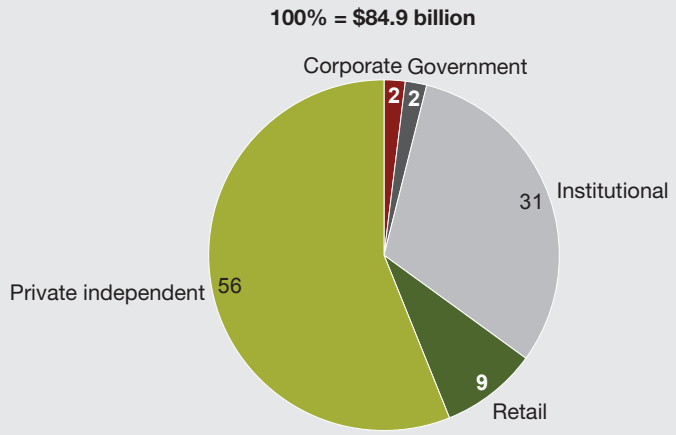
Canada's institutional funds exerted a particular influence on buyout and other PE trends in 2010, growing their direct investments, co-sponsorships, and co-investments at home and around the world. The direct portfolio assets of institutional funds grew commensurately, reaching $26.7 billion. This is up from $20.0 billion in 2009, reflecting a 31 percent market share.

Leading this activity were such groups as CDP Capital – Private Equity, CPPIB – Private Investments, Manulife Capital, OMERS Private Equity, and Teachers' Private Capital. 2010 also saw a new market role for the $71 billion Alberta

EXHIBIT 4

Total capital under management by PE fund type; 2010

Percent



SOURCE: Thomson Reuters

Investment Management Corporation (AIMCo). In addition to its traditional focus on making commitments to funds, AIMCo Private Equity has expanded its in-house capabilities for undertaking direct control-equity investments and co-investments.

New institutional commitments to buyout, mezzanine, VC, and other PE partnerships helped ensure that resources available to private-independents also increased year over year. Private funds had stewardship of $47.1 billion this time around, or 6 percent more than the $44.6 billion of 2009, giving them 56 percent of the total pool.

Over the past couple of years, some PE funds managed inside Canadian financial and industrial corporations have tended to be less active vis-à-vis direct deal-making. One exception to this general rule was the recently established Rogers Ventures, a subsidiary of Rogers Communications Inc., which has steadily grown its investments in company startups utilizing internet protocol technology.

Corporate funds under management totaled $2 billion in 2010, down slightly from the year before. As a consequence, they accounted for more than a 2 percent share of the market aggregate.

Despite continuing consolidations, labour-sponsored and other retail funds remained major investors in multiple segments. For example, Capital régional et coopératif (CRC) Desjardins, FondAction (CSN), and Fonds de solidarité des travailleurs du Québec (FTQ) have been active both as direct PE investors and as LPs and were engaged in several high-profile transactions in 2010. Other retail funds have also been integral to local market trends, while GrowthWorks continues to play a Canada-wide role.

At year's end, capital managed by retail funds in Canada totaled $7.5 billion, or a 9 percent share, down somewhat from 2009.

PE funds directed by federal and provincial government agencies had supply totaling $1.7 billion in 2010, or 2 percent of the overall pool. Among the most active government funds have been those operating in the VC space, including BDC Venture Capital, EDC Equity Fund, and Ontario Emerging Technologies Fund.

BDC Venture Capital unveiled a new strategy in 2010, following a review of the Canadian VC industry. Going forward, BDC will support development of high-performing, at-scale GP teams, as well as innovation and commercialization ecosystems for entrepreneurs. With this in mind, it has taken several steps, including launching internal funds and reinforcing its approach for making commitments to private funds. [2]

2 For further details, please see: Business Development Bank of Canada, *Venture Capital Industry Review,* February 2011

Trends in private equity fundraising in 2010

Fundraising still sluggish

Despite improved fundamentals for making PE investments in 2010, the climate for raising new fund capital remained weak. In the United States, fundraising experienced its third straight year of decline, affecting all segments of the market. Consequently, new commitments to buyout, mezzanine, and VC partnerships, totaling US $77.3 billion, were the lowest since 2004.[3]

In Canada, market conditions were also essentially unchanged last year, with buyout and related PE fundraising activity continuing to approximate pre-2006 levels. In addition, technology-oriented VC partnerships once again encountered long-standing challenges to securing fresh supply.

Mid-market funds make gains in tough environment

New commitments to Canadian buyout, mezzanine, and other PE funds totaled $2.6 billion in 2010, or 8 percent below the $2.8 billion recorded for 2009.[4] This being said, a bright spot in the overall picture was the increased LP attention paid to buyout partnerships focused on mid-market deals.

This trend was illustrated in the final close of the fourth fund of Birch Hill Equity Partners, Birch Hill Equity Partners IV LP, which emphasizes acquisitions and investments in mid-sized businesses valued between $30 million and $600 million, located in a diverse range of domestic industry sectors and regions. At the end of last year, the partnership had attracted committed capital totaling $1.04 billion, or 22 percent above its original target.

Birch Hill Equity Partners IV LP is also distinguished for being the largest fund ever raised with an exclusive focus on Canadian-based PE opportunities.

Clairvest Group's latest fund offering also surpassed its goal. Clairvest Equity Partners (CEP) IV LP, which closed in January 2011, secured $467 million – 17 percent above the targeted fund size. CEP IV LP resources will be used for investments ranging from $15 million to $40 million, often in sectors in which

3 Thomson Reuters' *Buyouts*, January 3, 2011, and Thomson Reuters-NVCA, April 11, 2011.
4 Survey data capture incremental fundraising over time, from partnership launches to closings, drawing on confidential reports from fund managers.

Clairvest has developed a track record, such as casinos and gaming, healthcare, waste management, and others identified through top-down domain research.

HSBC Capital (Canada) completed the first close of its fourth institutional fund, Private Equity Fund 2010 (PEF 2010). In addition, in September 2010, HSBC Capital's management team agreed to outlined terms with HSBC Bank to acquire HSBC's domestic PE and mezzanine business. This spinout, which is expected to be completed in summer 2011, will establish an entirely new Canadian fund manager, Fulcrum Capital Partners, with offices in Vancouver and Toronto.

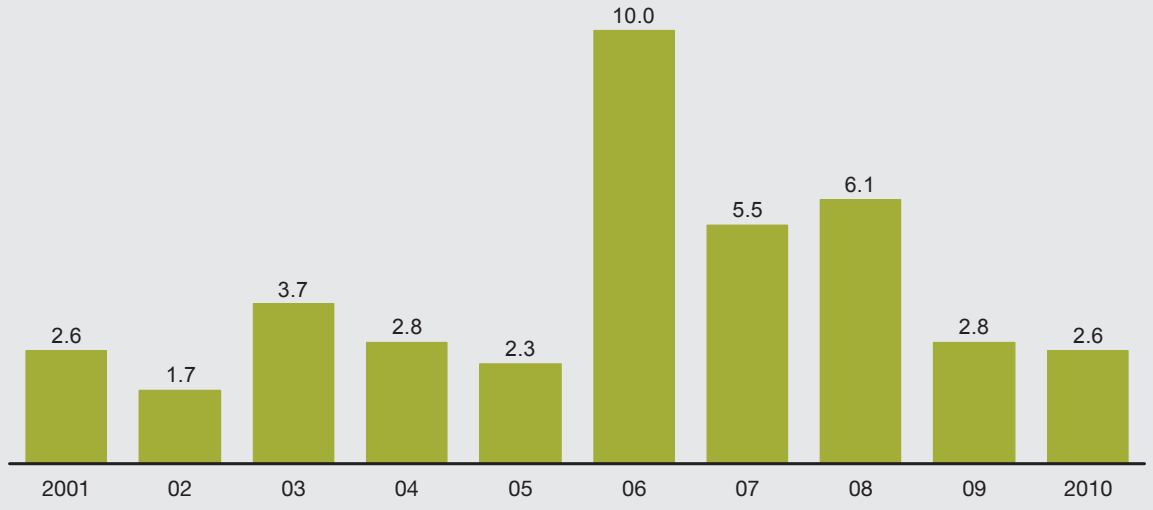
Fulcrum will build on HSBC Capital's 18 years of performance in mid-market PE investment, mezzanine financing, and bridge lending. Fulcrum investments will range from $5 million to $25 million in Canadian firms in such sectors as business services, consumer products, distribution, manufacturing, real estate, and retail trade. Fulcrum will manage two PE funds totaling $300 million and a mezzanine fund with in excess of Cdn $400 million.

2010 also saw the debut of a new investor in lower mid-market opportunities – Carpédia Capital. Carpédia Capital acquires domestic firms with $2 million to $4 million of adjusted EBITDA in industries about which Carpédia has developed domain knowledge, such as manufacturing, distribution, transportation, and food

EXHIBIT 5

New buyout, mezzanine, and other PE funds raised, all fund types; 2001-2010

$ Billions



SOURCE: Thomson Reuters

production. The initial fund pool of $10 million, supplied by Carpédia International and select partners, is operating in advance of a broader fund launch.

Financial distress and turnaround funds also remained popular with LPs, a fact that was borne out by Catalyst Capital Group's 2Q 2011 announcement of the closing of Catalyst Fund LP III. Specializing in control-stake activity in distressed or undervalued Canadian situations, the partnership secured over US $1 billion, to which Catalyst GPs added a further US $20 million.

Fundraising in the mezzanine segment has been slow in recent years, but this situation changed last year with the $75 million first close of Norrep Credit Opportunities Fund (NCOF), managed by Crown Capital Partners in partnership with Hesperian Capital Management. NCOF's focus will be alternative debt transactions, including second-lien debt, mezzanine, and bridge financing, ranging from $5 million to $25 million or more, in a variety of Canadian companies.

Energy-focused PE funds have renewed momentum

PE fundraising in 2010 also featured a new crop of energy-focused partnerships, most of them based in the Prairie heartland. Topping the list was KERN Energy Partners (KEP) III Fund, which held a final close totaling $445 million last year. Managed by Calgary's KERN Partners, KEP III Fund will invest in Canadian and global opportunities in upstream oil and gas, energy infrastructure and technology, oil and gas services, and related industries.

In early 2011, JOG Capital also announced the final close of JOG LP V, which targets investments in junior energy exploration and development companies primarily active in the Western Canadian Sedimentary Basin. The new partnership, which is JOG's fifth in a series since 2002, was capped at $325 million.

In addition, Regina-headquartered Lex Capital raised a $57 million fund, Lex Energy Partners LP, focused on early-stage oil exploration and development firms in Western Canada, with a weighting toward southeastern Saskatchewan. Along with a 2009 partnership emphasizing acquisition and management buyout deal flow in the region, capital managed by Lex Capital now totals almost $100 million.

Spotlight on clean-tech venture capital funds

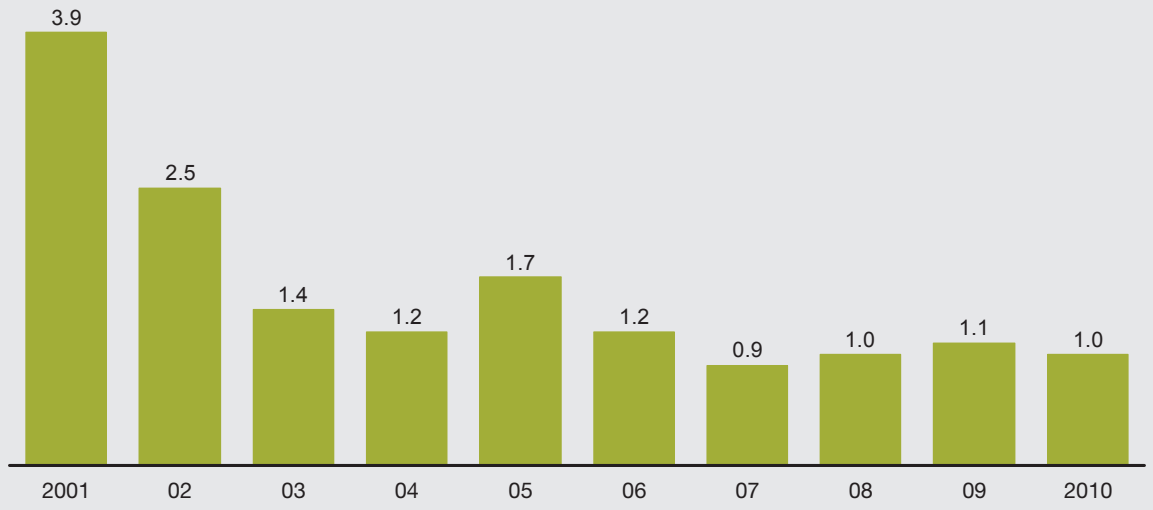
Canadian funds operating in the VC space absorbed new commitments totaling just over $1.0 billion in 2010, which is down 7 percent from $1.1 billion the year before. However, this trend obscures several important examples of first-time and follow-on partnerships, especially in the area of clean technology.

One of the year's biggest announcements was the final close of XPV Water Fund LP, the first institutional fund of Toronto's XPV Capital, which garnered US

EXHIBIT 6

New venture capital funds raised, all fund types; 2001-2010

$ Billions



SOURCE: Thomson Reuters

$150 million, or 50 percent more than its targeted US $100 million. The new partnership will invest across all stages, focusing on companies with traditional and technology product applications in the fast-emerging water sector. Many of the best deal opportunities are expected to be found in Canada and the United States.

In addition to being one of the most active international clean-tech investors in 2010, Chrysalix Energy Venture Capital continued to grow commitments to Chrysalix Energy LP (CELP) III. With proceeds going to financings of early-stage businesses in energy generation, energy use, transmission control, resource management, and other sectors, the CELP III pool currently stands at US $123 million.

Vancouver's Renewal Partners was also successful in closing its latest fund offering, Renewal2 Investment Fund, which finances young enterprises in green building and consumer products, organic and natural foods, and other sectors. Renewal2 raised $35 million from a mix of North American private and public foundations.

A number of IT-focused VC partnerships also gained traction in 2010. Among these was Real Ventures which, like its predecessor Montreal Start Up, is a value-adding seed-stage investor in web, mobile, and digital media opportunities. Real Ventures was launched in 2010 with $50 million in committed capital.

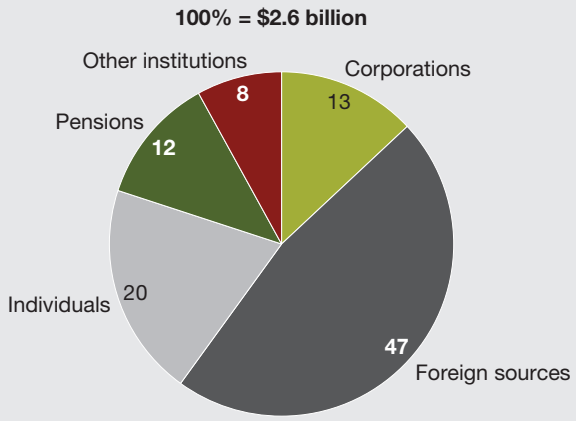
In contrast with private funds, new supply flowing to labour-sponsored and other retail VC funds increased in 2010. Fundraising activity, which continued to be led in Québec by CRC Desjardins, FondAction (CSN), and Fonds de solidarité (FTQ), brought a combined $408 million into the market, up 21 percent year over year.

Retail funds located in Western Canada, Ontario, and Atlantic Canada also contributed to this trend. Among the most active last year were Working Opportunity Fund and other funds managed by GrowthWorks, PFM Capital's SaskWorks Venture Fund, VentureLink Funds, and Westcap Management's Golden Opportunities Fund.

EXHIBIT 7

Sources of buyout, mezzanine, and other private equity funds raised; 2010

Percent



SOURCE: Thomson Reuters

Foreign LPs, individual investors lead PE fundraising

As in previous years, a highly diverse range of LP sources accounted for the $3.7 billion that went into the stores of PE fund managers in 2010. The continuing relevance of foreign LPs to buyout and related partnerships and the major role assumed by individual investors in funds of all types were characteristic of last year's trends.

US-based, European, and other foreign investors were, once again, the leading source of new commitments to the buyout segment, providing 47 percent of the total, or $1.2 billion. While foreign sources actually contributed slightly more

dollars the year before, their LP activity was spread out across a larger number of Canadian partnerships in 2010.

Canadian individual and family investors increased their activity in this segment of the market in 2010, bringing $510 million to the table, or one-fifth of the aggregate amount, which is up 64 percent from 2009. Indeed, entrepreneurs and high-net-wealth individuals assumed an especially influential role in several successful fund closings this time around.

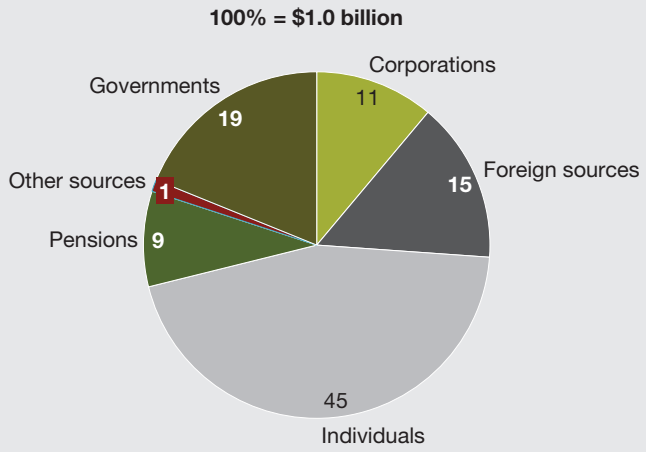
Relative to 2009, domestic corporations (including banks) and pension funds were somewhat less prominent in buyout and other PE fundraising last year, contributing $341 million and $303 million, respectively. However, other institutional investors (e.g., endowments and insurance companies) compensated for this shortfall in part with new supply totaling $197 million.

Individual investors were also essential to VC fundraising in 2010, accounting for 45 percent of the total, or $448 million, versus the 32 percent accounted for the year before. The largest proportion of these resources originated with Canadian households buying tax-assisted shares in retail funds and with high-net-wealth investors active in partnerships.

EXHIBIT 8

Sources of venture capital funds raised; 2010

Percent



SOURCE: Thomson Reuters

In 2009, government LPs topped individual investors as the primary VC supplier, accounting for 36 percent of total funds raised. One year later, government sources finished in second place with $196 million committed, or 19 percent.

The third-largest single source of Canadian VC funds in 2010 was foreign LPs, which contributed $156 million, or 15 percent of the total. This level of activity greatly exceeds the mere $18 million contributed by non-resident investors the year before. Domestic corporations and institutional investors accounted for much of the balance in 2010 – a combined $200 million.

Fundraising outlook for 2011

Recent indications suggest that constraints on raising PE funds are easing. Several Canadian fund managers reported greater impetus on the fundraising trail in late 2010 and in early 2011. On the other hand, although experienced LPs – and particularly North American LPs – remain bullish about private equity, some are cautious and are waiting for the right time to return to actively making commitments to funds.

The survey found a total of 36 investor groups with new fund product offerings at the present time, down marginally from the year before. Of this total, 17 fund managers were seeking fresh commitments for buyout, mezzanine, and related PE partnerships, while 19 fund managers were comparably active in the VC segment.

The survey counted partnerships that were approaching final closes, as well as those that have only recently been launched.

Trends in private equity investment in 2010

Deal-making back in growth mode

After 2 years of slowdown, PE market activity was renewed on an international basis in 2010, with deal-making showing moderate to significant growth. This was decidedly the case in North America, as increased economic stability, greater liquidity, and more portfolio realizations encouraged investment. Moreover, higher levels of activity were apparent in virtually all segments of the market.

In the United States, buyout and related PE activity bounced back with disclosed deal values reaching US $77.3 billion in total, or nearly double those registered in 2009. Venture capital investment levels were also on the rise, with disbursements totaling US $23.3 billion, up 20 percent from 2009.[5]

Fresh signs of market vitality also appeared in Canada as a result of improved fundamentals that benefited from a comparatively fit domestic economy. While many Canadian fund managers remained cautious, the changed environment inspired some confidence, spurring higher deal volumes and dollar flows at home, as well as the pursuit of strong value opportunities abroad.

Increased Canadian buyout activity led in mid-market

The survey found Canadian buyout, mezzanine, and other PE funds invested a total of $7.4 billion in domestic and foreign businesses in 2010, which is up 120 percent from the $3.3 billion invested the year before. This marks the highest level of disbursement since 2007. Equity and quasi-equity dollars were channeled through 369 deals, or 18 percent more than the 312 deals of 2009.

Over three-quarters of transactions engaged firms in Canada, helping to propel the first year-over-year uptick in domestic market activity in 3 years. Thomson Reuters reported disclosed values totaling $4.5 billion in 2010, up 7 percent from 2009. However, in contrast with the previous market up-cycle, when mega transactions dominated trends, growth this time relied on activity in the mid-market.

Only one deal done in 2010 was sized greater than $500 million – the $894 million investment by CPPIB Private Investments in 407 Express Toll Route (ETR), a key

5 Thomson Reuters' *Buyouts*, January 3, 2011, and MoneyTree™, May 2011.

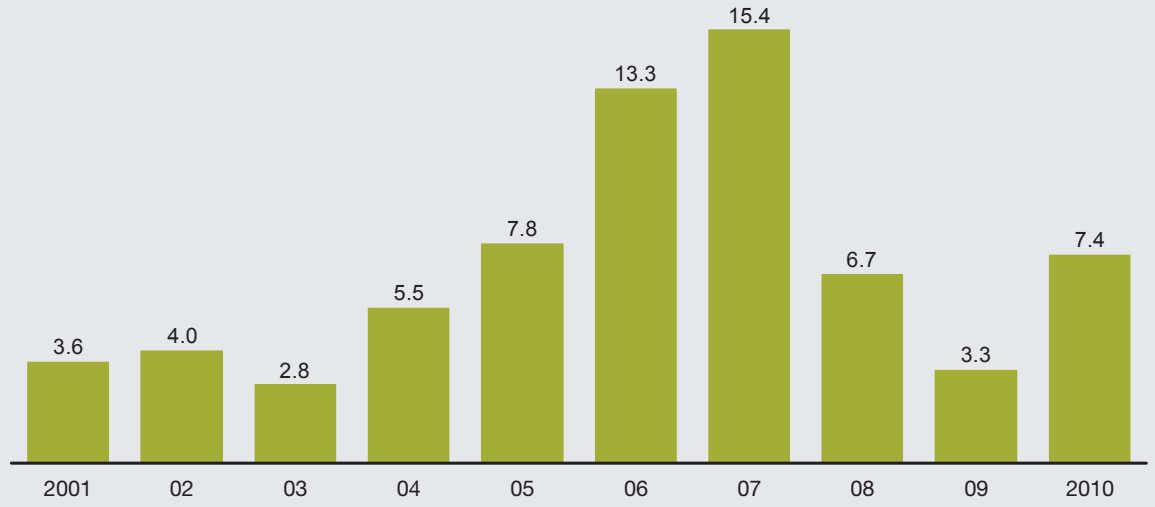
piece of traffic infrastructure in the Greater Toronto Area.[6] Instead, CPPIB's and Sterling Partners' acquisition of Livingston International Inc., a leading provider of customs brokerage, transportation, and integrated logistics services, was more illustrative of Canadian-based trends. This public-to-private deal, which closed in January 2010, totaled $324 million.

Other major deals also saw public firms moved to actively managed private ownership. For example, after 24 years of public listing, Montréal's Logibec Groupe Informatique Ltd., a specialist in developing, marketing, and supporting data systems in North America's fast-expanding healthcare sector, was acquired by OMERS Private Equity. Completed in partnership with Société générale de financement du Québec (SGF), this transaction was priced at $237 million.[7]

EXHIBIT 9

Buyout, mezzanine, and other PE capital invested by Canadian funds; 2001-2010

$ Billions



SOURCE: Thomson Reuters

Similarly, IPL Inc., a Saint-Damien, Québec-based producer of moulded plastic goods for packaging, materials handling, and environmental uses by industrial customers in Canada and the United States, was bought by Novacap Industries III LP, managed by Novacap – which took a controlling interest – and co-investor Fonds de solidarité (FTQ). Like other take-privates, this $94 million acquisition is intended to enhance IPL's competitiveness and growth prospects in a changing economy.

6 CPPIB's investment in 407 ETR formed part of a larger international transaction that included the pension fund's takeover of the Australian tollroad operator, Intoll Group, for A $3.4 billion. This deal was also closed last year.

7 OMERS and SGF received the 2010 Canadian Dealmakers Mid-Market Private Equity Award for the acquisition of Logibec Groupe Informatique Ltd.

As in 2009, domestic activity also featured several rescue and restructuring deals last year. Among these was the purchase of TLC Vision Corporation of Mississauga, Ontario, which provides eye-care and laser surgery services, by American sponsors Charlesbank Capital Partners and HIG Capital. This $143 million deal facilitated the company's emergence from Chapter 11 bankruptcy.

A substantial proportion of Canadian deals were also targeted to core activity in the energy sector. Examples include the $250 million investment of CPPIB in oil and gas developer Laricina Energy Ltd., and the $160 million investment of ARC Financial Corporation and Teachers' Private Capital in renewable energy producer BluEarth Renewables Inc., both headquartered in Calgary.

Canadian PE funds exercise clout on global stage

In addition to their domestic deal activity, Canadian investors exerted considerable influence in markets around the world in 2010. In particular, Canadian buyout funds were acknowledged international deal-leaders, sponsoring or co-sponsoring some of the year's biggest acquisitions. Underlining this fact was the survey's finding that 70 percent of reported dollars invested went to non-resident businesses.

In the United States, the top buyout transaction completed in 2010 involved IMS Health Inc., headquartered in Norwalk, Connecticut, which provides market intelligence products to the pharmaceuticals and healthcare industries. Collaborating on this public-to-private deal, valued at US $5.1 billion, were TPG Capital and CPPIB.

Onex and CPPIB teamed up as sponsors of the US $5 billion acquisition of Tomkins plc, an industrial holding firm that operates businesses serving global industrial, automotive, and construction markets, with a corporate head office in Denver, Colorado. The deal was funded with equity of US $2.2 billion, which included a commitment by Tomkins' management team. [8] At the end of 2010, the Tomkins and IMS deals were the two largest leveraged buyouts completed on a global basis since the start of the market slowdown.

Canadian mid-cap funds also found value opportunities abroad last year. For example, ONCAP acquired the Dallas-based Sport Supply Group, a leading marketer, manufacturer, and distributor of sporting goods, equipment, and branded team uniforms in the United States. The US $200 million deal will support Sport Supply's continued expansion through organic and acquisition-led growth.

8 CPPIB and Onex received the 2010 Canadian Dealmakers Private Equity Award for the acquisition of Tomkins plc.

In addition, TorQuest Partners created a platform business, Pinova Holdings, Inc., through carve-outs from two chemical firms operating in the United States. In early 2010, TorQuest purchased Pinova from Ashland, Inc., for US $75 million. Backed by TorQuest, Pinova then acquired LyondellBasell Industries' flavour and fragrance ingredient business for US $150 million, establishing a global leader in specialty chemicals derived from natural, renewable resources.

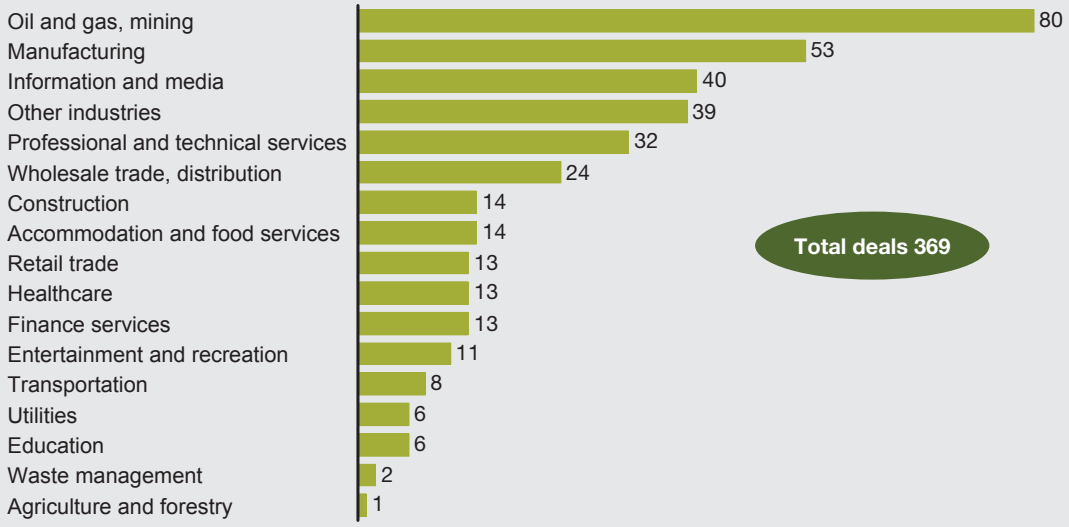
Where did buyout and mezzanine money go?

Domestic and foreign deals done by Canadian buyout, mezzanine, and other PE funds were widely diversified by industry sector in 2010.

Resource extraction industries led this time around, capturing the largest number of transactions, or 22 percent of the total completed. Manufacturing and processing took second spot with a 14 percent share, followed by information and media with an 11 percent share. Other preferred sectors included professional and technical services, wholesale trade, accommodation and food services, and construction.

EXHIBIT 10

Canadian buyout, mezzanine, and other PE deals by industry sector; 2010



SOURCE: Thomson Reuters

Canadian venture capital activity also regains stride

According to the survey, Canadian VC funds deployed just under $1 billion to domestic and foreign businesses in 2010, which is up 16 percent from the $848 million they invested the year before. In addition, the number of financings led by or syndicated with Canadian funds rose 11 percent over this period, with 454 deals done last year versus 410 deals in 2009.

In keeping with the nature of this technology-oriented activity, 85 percent of deal-making was directed at sector clusters at the local level. Consequently, increased Canadian fund activity was key to domestic market trends. Thomson Reuters reported dollar flows totaling $1.1 billion in Canada last year, which is up 10 percent from 2009 and represents the first year-over-year growth since 2007.

Domestic activity was powered by higher levels of investment in firms moving from the early stages of development to rapid expansion. Canadian and foreign VC funds put more dollars to work in related financings, with an eye toward emerging opportunities in clean technology, life sciences, and IT sectors such as communications, internet-focused products, and software.

The year's most dollars-intensive deal involved Montréal-headquartered Enerkem Technologies Inc., which has developed proprietary technology for converting non-recyclable waste into advanced fuels and green chemicals. Enerkem secured $53.4 million from a syndicate comprising Braemar Energy Ventures, BDR Capital, Cycle Capital Management, and Rho Ventures, as well as a new strategic investor, Waste Management of Houston, Texas.

Toronto's ENBALA Power Networks was another prominent clean-tech company financed in 2010. ENBALA pioneered a Smart Grid services network that creates cost savings for large consumers of electricity, as well as efficiencies for regional providers. The firm obtained $8 million from Chrysalix Energy Venture Capital, Enertech Capital, EDC Equity Fund, Walsingham Fund, and XPV Capital.

Several Canadian life sciences firms received especially large capital infusions in 2010. For example, CellFor Inc. of Vancouver, which supplies high-tech seedlings to the global forestry industry, entered its next phase of growth with a US $35 million investment from BDC Venture Capital and GrowthWorks and foreign groups including Capricorn Investment Group LLC and CSFB Equity Partners LP.

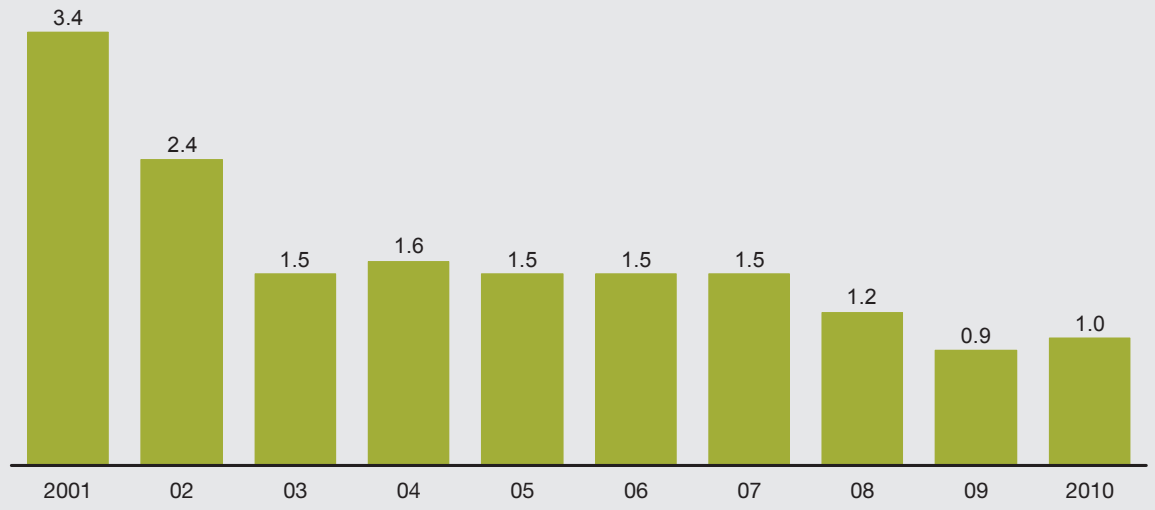
Another West Coast company, Aquinox Pharmaceuticals Inc., scored a US $25 million round of financing, the proceeds of which will advance clinical trials for the development of novel and targeted small-molecule therapeutics used in the treatment of inflammatory disease and cancer. This deal was led by Ventures West Capital, and included Bakers Brothers Investment, Lions Capital Corporation, Johnson & Johnson, and Pfizer Venture Investments.

As in the past, Canadian IT firms took the lion's share of the money in 2010 – 43 percent of all disbursements. INVIDI Technology Corporation of Edmonton, Alberta, a leader in addressable advertising solutions for television, was among these. A syndicate driven by tech icon Google, and including BDC, Enertech Capital,

EXHIBIT 11

Venture capital invested by Canadian funds; 2001-2010

$ Billions



SOURCE: Thomson Reuters

GroupM, InterWest Partners, Menlo Ventures, Motorola Ventures, and others, brought US $23 million to INVIDI's expansion plans.

While attention was chiefly paid to late-stage activity last year, early-stage deals still got done. Celtic House Venture Partners and Tech Capital Partners co-led a $15 million financing that took Avvasi Inc. from seed stage to startup. Founded by Waterloo entrepreneurs that helped build the highly successful PixStream Inc., a Celtic House Fund I firm bought by Cisco Systems, Inc. in 2000, Avvasi develops solutions that enable mobile network providers to measure, improve, and monetize mobile video.

2009 startup Beyond the Rack, a members-only shopping website that offers steep discounts on designer brand clothes, accessories, and other goods, also accelerated development through a series of deals involving BDC, Highland Capital Partners, MMV Financial, and Real Ventures. To date, the Saint-Laurent, Québec-based firm has garnered $17 million.

Canadian investors open more international doors

Canadian VC funds also quickened the pace of their activity in global technology markets in 2010, with dollars invested in opportunities in the United States, Europe, and other regions increasing 39 percent from the year before.

Among the most active investors was BlackBerry Partners Fund, launched in 2008 and focused exclusively on mobile software opportunities. Previously co-managed by JLA Ventures and RBC Venture Partners (now Clairmont Capital), Blackberry's GP teams were merged in 2010 under the name Albright Talbot Partners and are currently raising BlackBerry Partners Fund II, targeted at US $150 million.

Along with three Canadian investments – made in Anomalous Networks and Neuralitic Systems Inc., of Montréal, and Fuse Powered Inc., of Toronto – BlackBerry Fund did four international deals last year. These include a US $19 million follow-on financing of the New York-based mobile payments firm PayFone, led by a syndicate of American Express, Verizon Investments, and Rogers Ventures, and including PayFone's existing investors BlackBerry Fund, Opus Capital, and RRE Ventures.

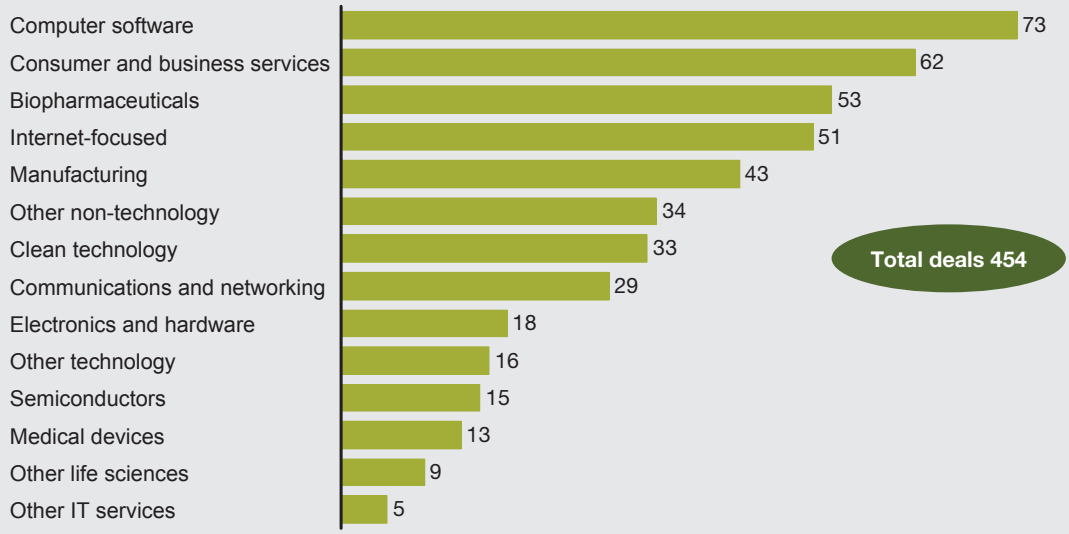
BlackBerry Fund also collaborated with Trident Capital and Tomorrow Ventures on a US $15 million round of financing for Appia (formerly PocketGear) of Durham, North Carolina. The high-growth Appia operates white-label app stores for over 40 carriers, handset manufacturers, and other consumer brands around the world.

Where did venture money go?

The domestic and foreign activity of Canadian VC funds continued to be heavily weighted to innovative and knowledge-based sectors in 2010, though non-technology sectors also gained some ground.

EXHIBIT 12

Canadian venture capital deals by industry sector; 2010



SOURCE: Thomson Reuters

As suggested earlier, the largest portion of deals – 42 percent of the total number – involved businesses in communications, computer software, internet-focused, electronics and hardware, and other IT sectors. Non-technology followed with a 31 percent share, while biopharmaceuticals and other life sciences and clean technology accounted for 17 percent and 7 percent, respectively.

Canadian PE-backed exits surge

The healthier financial climate of 2010 contributed to frothier exit markets for PE investments. Across the North American market, investors exited portfolio holdings at a far greater rate than in 2009 and, in some segments, surpassed pre-slowdown realization levels.

Thomson Reuters found 77 buyout, mezzanine, and other PE investor exits from Canadian-based businesses in 2010, which is more than double the previous year's total. Indeed, with a particularly strong number of strategic sales, domestic exit activity turned in one of its best years on record.

Canada's largest PE-backed exit was Teachers' Private Capital sale of its 25 percent ownership in CTVglobemedia Inc. to Bell Canada Enterprises Inc. (BCE), for a total value of $3.2 billion. Along with Torstar Corporation and Woodbridge Company Ltd., Teachers' took an equity stake in the media conglomerate, which owns the national daily newspaper *The Globe and Mail* and the television broadcaster CTV Inc., during the period 2005-2006.

Brookfield Special Situations Group, a subsidiary of Brookfield Asset Management, also exited Concert Industries Corporation of Gatineau, Québec, through a strategic takeover by P.H. Glatfelter Company, priced at $247 million. Brookfield originally acquired Concert, a supplier of feminine hygiene products to major corporate customers, in 2004 and sponsored the firm's successful restructuring plan.

Realizations of VC fund portfolio investments also underwent a rebound last year. According to Thomson Reuters, exit activity involving Canadian-based companies totaled 32, up 28 percent from 2009.

Higher-value acquisitions by strategic technology investors drove trends in this space. For example, Ottawa-based Protus IP Solutions, Inc., which provides communications tools to small businesses, was purchased by j2 Global Communications, Inc., for $213 million. Previous backers of Protus included BEST Funds, BMO Capital Corporation, Covington Capital Corporation, and EdgeStone Capital Partners.

Covington Capital Corporation also won Canada's Venture Capital and Private Equity Association's "Venture Capital Deal of the Year" for its 2010 exit from SXC

Health Solutions Corporation, a provider of tools, technology, and expertise to the healthcare benefits management industry. Covington, which backed SXC in partnership with GrowthWorks in 2001, realized a multiple of 13.3 times on the original investment.

Conclusion

The 2010 rally in deal activity in PE markets around the world was welcome after 2 years of painful decline. In North America, improved economic and liquidity conditions helped prime higher levels of investment. Of equal importance was the opening up of exit markets to PE funds seeking investment realizations, which appeared to unlock considerable pent-up demand.

Renewal was clearly a prevailing theme for Canadian funds and for the domestic market in general. Activity at home emerged from the trough of 2009, with moderate growth in deal volumes and dollars invested across the spectrum last year. In addition, Canadian investor groups – particularly large-cap buyout funds – had unprecedented influence in shaping international market trends.

All signs point to a continuing market up-cycle in 2011, though the character of deal-making appears to be very different from the last cycle. In domestic buyout and related PE activity, for example, there has been more emphasis on core mid-market activity and fewer mega transactions. In the VC arena, the focus has been on later-stage investments, along with some new interest in cutting-edge sectors like clean technology.

While the survey found investor confidence growing, it also detected some caution, which is understandable in light of recent economic and financial shocks. A healthy deal climate also depends on fundraising – one key PE indicator that has not yet shown much improvement. As they look to take advantage of opportunities implicit in a renewed market, however, Canadian fund managers should be able meet this and other challenges with the same skills and ingenuity they have demonstrated in the past.

Appendix

Data contributors to *Private Equity Canada 2010*

32 Degrees Capital
AIMCo Private Equity
ARC Financial Corp.
Argosy Partners Ltd.
AVAC Ltd.
Avrio Ventures Management Corporation
Banyan Capital Partners
BC Renaissance Capital Fund
BDC Subordinate Financing
BDC Venture Capital
BEST Funds
Birch Hill Equity Partners Management Inc.
BlackBerry Partners Fund
Bond Capital Partners Ltd.
Brookfield Asset Management Inc.
Brookfield Special Situations Group
CAI Private Equity
Callisto Capital LP
Canadian Retail Venture Capital Association
Canterbury Park Management Inc.
CAPE Fund
Capimont Inc.
Capital St-Laurent sec
Carpédia Capital Inc.
CDP Capital – Private Equity Group
Celtic House Venture Partners
Chrysalix Energy Venture Capital
CIBC World Markets, Merchant Banking
CIT Group, Inc.
Clairmont Capital Inc.
Clairvest Group Inc.
Covington Capital Corporation
CPP Investment Board – Private Investments
CPVC Financial Corporation
Crown Capital Partners Inc.
CTI Capital Inc.
Cycle Capital Management Inc.
Desjardins Capital de risque
Discovery Capital Corporation
EDC Equity Fund
EdgeStone Capital Partners Inc.
Emerald Technology Ventures Inc.
FondAction (CSN)
Fonds de solidarité des travailleurs du Québec (FTQ)
GeneChem Management Inc.
Genesys Capital Partners Inc.
Georgian Partners Capital
GrowthWorks Ltd.
GTI Capital Inc.
HDL Capital Corporation
HSBC Capital (Canada)
ID Capital Management Inc.
Imperial Capital Group Ltd.
Innovatech Québec
iNovia Capital
Integrated Asset Management Corporation
Investment Accelerator Fund
Ironbridge Equity Partners
JLA Ventures
JOG Capital Inc.
KERN Partners Ltd.

Kilmer Capital Partners Ltd.
Lex Capital Management Inc.
Lions Capital Corporation
Macquaire Canadian Infrastructure Management Ltd.
Manulife Capital
Manvest Inc.
Maxam Capital Corp.
McKenna Gale Capital Inc.
McLean Watson Capital Inc.
MMV Financial Inc.
Moneta Capital Partners Ltd.
Network Capital Inc.
New Brunswick Innovations Foundation
New Brunswick Investment Management Corporation
NorthRock Capital Partners
Novacap Investments Inc.
Nova Scotia Business Inc.
OMERS Private Equity
ONCAP Management Partners LP
Onex Corporation
Ontario Growth Capital Corporation
Orchard Capital Group Inc.
Pangaea Ventures Ltd.
PCP Management Inc.
PenderFund Capital Management Ltd.
Penfund
PFM Capital Inc.
Primaxis Technology Ventures Inc.
PRIVEQ Capital Funds
Propulsion Ventures Inc.
Real Ventures
Renewal Partners
Rho Canada
Richardson Capital Limited
ROI Management Ltd.
Roynat Capital Inc.
Signal Hill Equity Partners Inc.
Skypoint Capital Corporation
Summerhill Venture Partners
Tandem Expansion Fund
TD Capital
Teachers' Private Capital
Tech Capital Partners Inc.
TechnoCap Inc.
TELUS Ventures
Teralys Capital Inc.
TorQuest Partners Inc.
Trellis Capital Corporation
TriWest Capital Partners
VanCity Capital Corporation
Vanedge Capital Inc.
VenGrowth Private Equity Partners Inc.
Venture Coaches
VentureLink LP
Ventures West Capital Ltd.
Victoria Park Capital Inc.
Wellington Financial LP
Westcap Mgt. Ltd
Whitecastle Investments Limited.
XPV Capital Corporation
Yaletown Venture Partners Inc.
Yellow Point Equity Partners LP

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