TORYS LLP

Venture Financing Report

Contents

Methodology

This study analyzes the preferred share deal terms across financings for 203 Canadian headquartered startups that raised at least $500,000 on venture or venture-like terms between January 1, 2020 and December 31, 2020. Criteria included all categories of publicly reported preferred share venture financings, from series seed through to later stage financings.

While we identified 442 publicly reported venture-backed financings for the 2020 calendar year, only 203 of such financings satisfied the criteria outlined above and had publicly accessible articles. In analyzing the financings to arrive at the 203 analyzable financings, the following financings were excluded from the study:

- non-preferred share financings, including common share financing rounds, convertible note and SAFE financing rounds;
- financings completed by companies governed by the Business Corporations Act (British Columbia), as the share terms for these companies are not publicly available. However, preferred share financings completed by companies that are headquartered in British Columbia and governed by another corporate statute, including the Canada Business Corporations Act, were included; and
- financings in which the preferred shares issued to investors departed significantly from standard venture style preferred share terms akin to those contemplated by the Canadian Venture Capital and Private Equity Association's model legal documents.

As the study solely focuses on legal terms negotiated in preferred share financings, certain data points may not perfectly align with other reports published on the Canadian venture capital market, which look at a broader range of financings (including SAFEs, convertible notes and common share financings).

In the U.S. several law firms publish similar reports, which are referenced in this study to provide additional context on where Canadian market practices align and/or diverge from U.S. trends. For a quick overview of all the data, including a Canadian vs. U.S. comparison, please see the **Snapshot on page 21**.

Unless otherwise noted, the study reports all financings in Canadian dollars. For financings where the announcement was reported in U.S. dollars, the applicable amounts were converted into Canadian dollars using the daily average exchange rate published by the Bank of Canada on the date the applicable financing was reported.

Executive Summary

The events of 2020 resulted in a series of knock-on effects for businesses and investors in Canada, and the venture capital and startup ecosystems were no exception.

Unsurprisingly, investors gained a higher degree of leverage amid the uncertainty brought upon by the global pandemic. The implications of this included a short-term increase in investor-friendly terms during Q2 and Q3. Specifically, throughout Q2 and Q3, we saw a higher concentration of senior liquidation preferences, participation rights and cumulative dividends.

The pandemic aside, the results of our inaugural study show that companies and startups appear to be looking to best practices to inform their dealmaking processes: the preferred share terms negotiated by Canadian companies in 2020 were by and large consistent with the terms outlined in the model legal documents prepared by the Canadian Venture Capital and Private Equity Association, although there was less consistency in the form of documentation used.

The results are also consistent with trends outlined in ***Torys' PE Pulse 2021*** sentiment survey of Canadian institutional investors, including a focus among investors on opportunities coming out of the technology sector, which was an attractive source for deals well before the pandemic. As remote business became the norm, many companies have looked to transform and advance their digital strategies, including through online commerce enhancements, video and electronic communications, and other sector-specific technological growth. These trends are working together to create a positive outlook for the technology startup ecosystem in Canada.

Longer term, we are still seeing the ongoing alignment among Canadian and U.S. deal terms as Canadian startups mature and attract more inbound foreign investment. In the current study, the key term where the Canadian financings deviated from comparable U.S. studies[1] was the slightly higher prevalence of

Canadian companies issuing preferred shares with redemption rights. As the U.S. remains the largest inbound source of foreign investment in Canada, trends in Silicon Valley continue to have a significant ripple effect on Canadian dealmaking. We expect this trend to continue with the increasing participation of U.S. investors in Canadian financing rounds.

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[1] See (i) **Silicon Valley Venture Capital Survey**, Fourth Quarter 2020, published by Fenwick & West LLP on February 17, 2021, and (ii) the **Entrepreneurs Report for Private Company Financing Trends for the Full-Year 2020**, published by Wilson Sonsini on February 18, 2021 (collectively, the "**U.S. Deal Studies**")

2020 Financing Activity in Canada

Despite the challenges and market confidence issues brought on by the pandemic, Canadian VC investment remained strong in 2020, including the 203 financings included in this study raising at least $500,000 through a preferred share financing on venture or venture-like terms.

1) Deal Activity

Financings saw relatively even distribution across each quarter, with a peak in Q3[2] (31.2%). This spike in deal activity can be attributed to an overall opening up of markets following earlier phases of the pandemic crisis. While a slowdown of activity in the 4th quarter may relate to the winter 2020 shutdown, initial 2021 information shows a record breaking Q1, indicating that deal flow spilled over to the new year.

Figure 1.1) Deal Activity by Quarter

Q1 | 24.1%	Q2 | 23.6%
Q3 | 31.2%	Q4 | 21.1%

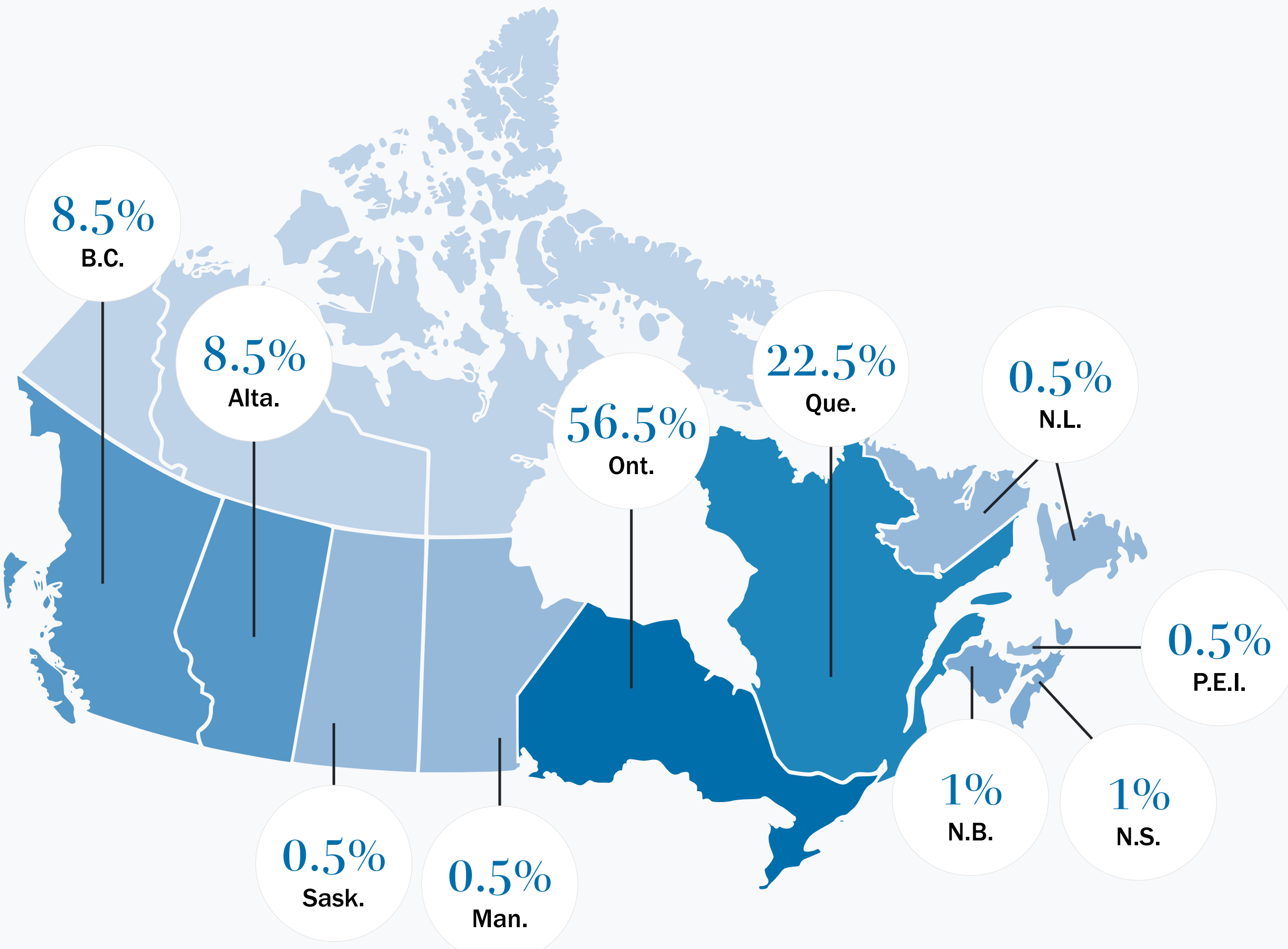
[2] PitchBook Data, Inc.; *Data has not been reviewed by PitchBook analysts.

As expected, Ontario and Québec lead in deal volume, with over half (56.5%) of these financings being completed by companies headquartered in Ontario, followed by Québec at 22.5%.

Despite Alberta and British Columbia both seeing the same percentage of deal activity (8.5% each[3]), 2020 was celebrated as a record year for venture capital in Alberta; by comparison, deal volume in BC continued its downward trend.

Going forward, we expect to see increased activity across many provinces, particularly in Alberta, where the ongoing focus on diversification away from fossil fuels continues to place innovation as a strong economic driver.

Figure 1.2) Deal Activity by Province

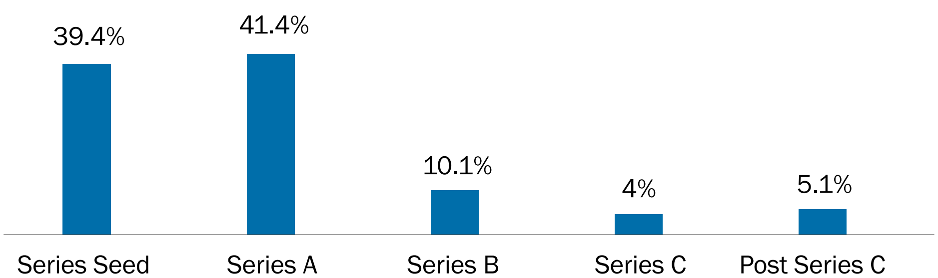


[3] The financing surveyed for the study do not include financings completed by companies headquartered in British Columbia that are incorporated under the *Business Corporations Act* (British Columbia) due to the absence of public access to such companies' articles.

In 2020, deals were highly concentrated on early stage financings, with 80.8% being either a Series Seed or Series A (including extension rounds), 10.1% were Series B (including extension rounds), and only 9.1% were Series C or later.

This concentration in early stage financings is reflective of the age and stage of Canada's tech ecosystem and, as these companies mature, we expect to see an increase in later-stage activity.

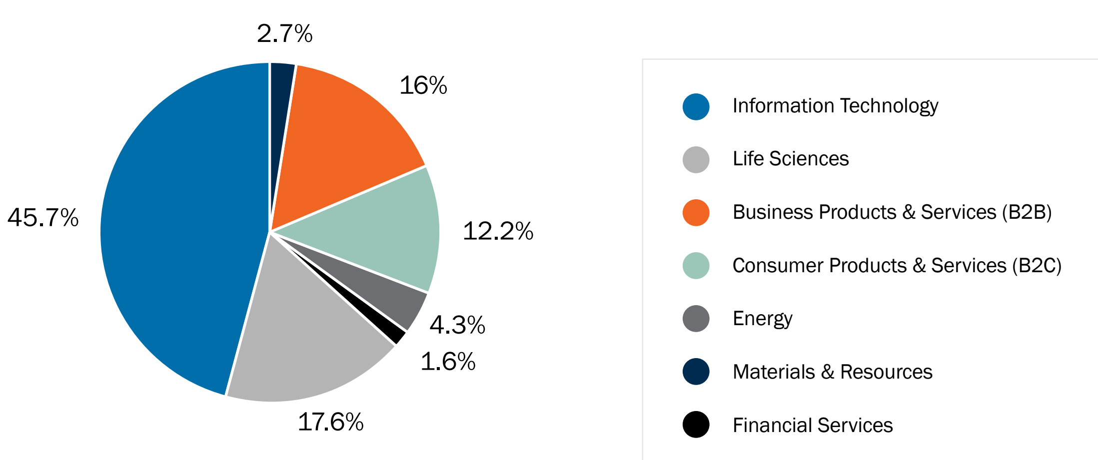
Figure 1.3) Financing Round



There was a high concentration of deals in the Information Technology (45.7%), and Life Sciences (17.6%) sectors, followed closely by Business Products and Services (16.0%).

Technology continues to disrupt all sectors of the economy and we expect that information technology is a central part of many of the companies that received financing in 2020. This is consistent with investor sentiment we have seen in [other recent studies](), underscoring the ongoing dominance of technology-related investment which was given further strength during the pandemic.

Figure 1.4) Deal Activity by Industry Sector

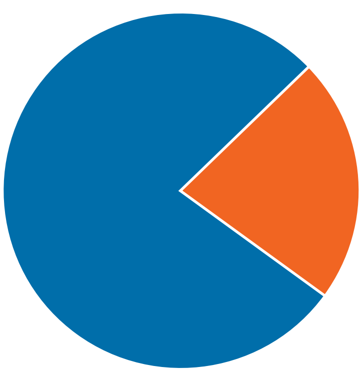


Deal Terms for 2020 Financings

2) Seniority of Liquidation Preference

Preferred shares issued in the deals surveyed were overwhelmingly ***pari passu*** (77.7%) to the existing classes/series of preferred shares, while only 22.3% of new preferred shares ranked senior to the existing preferred shares (a **Senior Liquidation Preference**).[4] The majority of the preferred shares issued with a Senior Liquidation Preference were issued in Q2 and Q3. The higher instances of Senior Liquidation Preferences in these quarters may be attributed to investors having a higher degree of leverage amid increased market uncertainty.

Figure 2.1) Liquidation Preference



77.7%

Pari Passu

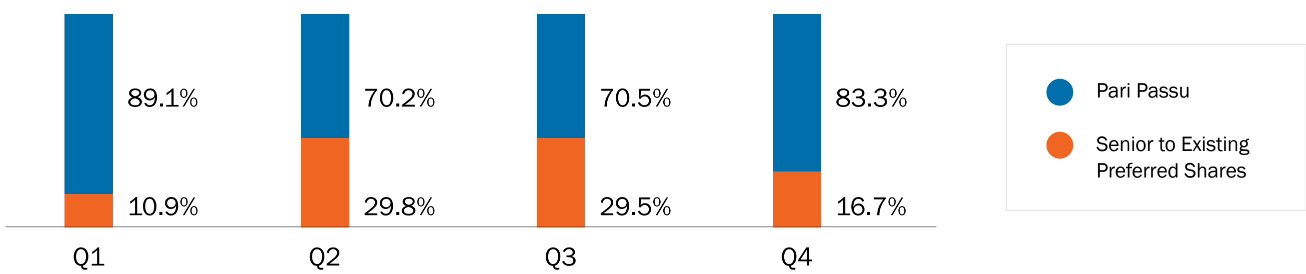
22.3%

Senior to Existing Preferred Shares

[4] Note that 57.7% of the financings included in our study were the first preferred share financing rounds for the surveyed companies. As a result, there were no existing preferred shares that the new preferred shares could be ranked against.

Throughout 2020, there was a higher concentration (87.5%) of Senior Liquidation Preferences that qualified as **down-rounds**.[5] This higher concentration is not surprising and reflects the fact that investors will utilize the leverage available to them to the extent it is possible.

Figure 2.2) Liquidation Preference by Quarter



3) Participation

The majority (92.4%) of the 2020 financings surveyed were **non-participating preferred shares**, while only 7.6% were **participating preferred shares**.

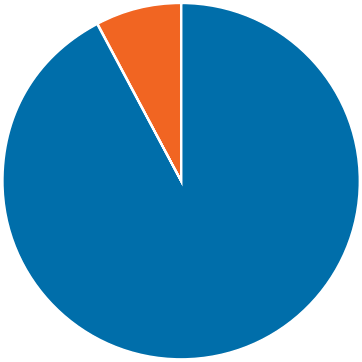
11.4% of the financings that included a Senior Liquidation Preference also included a participation feature, while only 4.3% of financings with a *pari passu* security included a participation feature. In deals where the preferred shares included a participation feature, 40% of preferred shares also included an entitlement to **cumulative dividends** (where cumulative dividends were only available on 5.5% of the preferred shares that were non-participating). This data shows that on deals where the investor had more leverage, that leverage typically carried through to all the major deal terms.

In financings that included participating preferred shares, the participation rights were more often **uncapped** (60%) than **capped** (40%).

Of the deals that had non-participating preferred shares, the majority (91.8%) included a 1x **liquidation preference**, with the remaining including a multiple liquidation preference (greater than 1x).

[5] Notably, the U.S. deal studies show that only 56% of the down-rounds surveyed included a Senior Liquidation Preference.

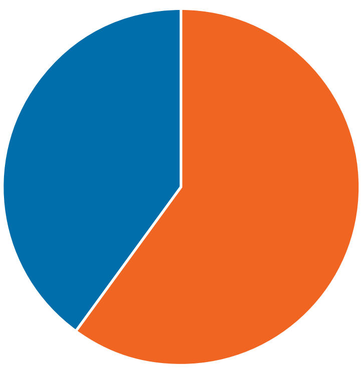
Figure 3.1) Preferred Shares Participation



92.4%
Non-Participating

7.6%
Participating

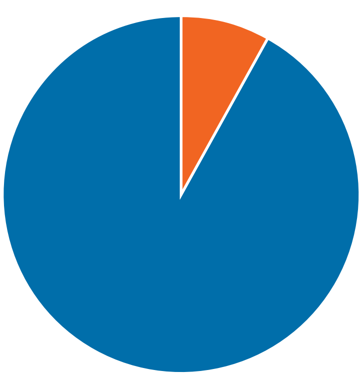
Figure 3.2) Percentage of Preferred Shares that are Capped vs. Uncapped



40%
Capped

60%
Uncapped

Figure 3.3) Preference Multipliers (Among Non-Participating Shares)



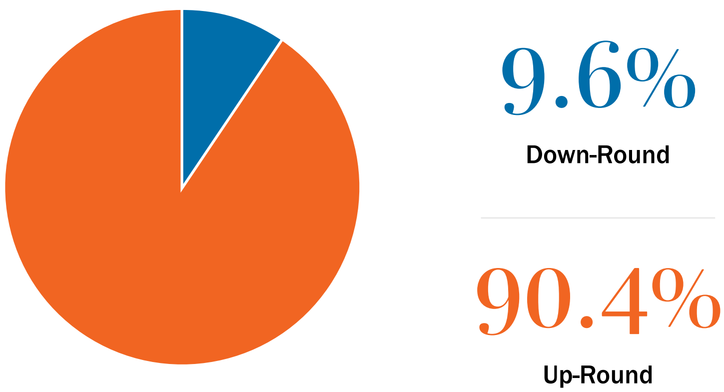
91.8%
1x Preference

8.2%
Multiple Preference

4) Valuation

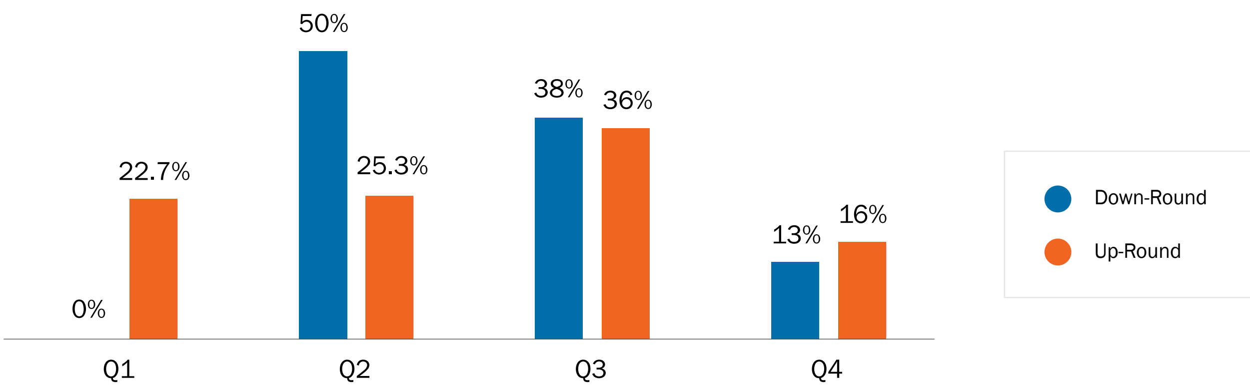
The vast majority (90.4%) of financings in 2020 were **up-rounds**, while only 9.6% were **down-rounds**. This reflects a growing economy and ecosystem and we expect this to continue through to 2021.

Figure 4.1) Financing Valuations



The majority of down-rounds closed in Q2 and Q3, coinciding with the spike in Senior Liquidation Preferences, participation rights and cumulative dividends.

Figure 4.2) Financings Including a Senior Liquidation Preference (Down Rounds vs. Up-Rounds)

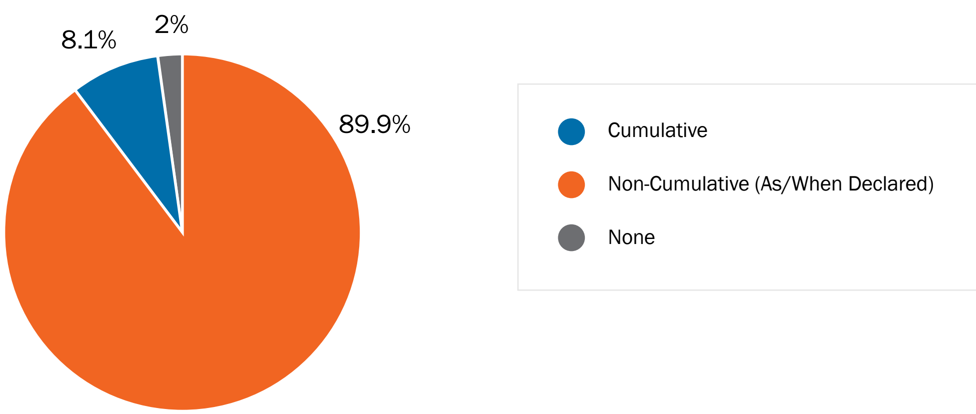


5) Dividend Entitlements

The vast majority (82.9%) of the financings surveyed included a **non-cumulative discretionary dividend**, with 8.1% including a **cumulative dividend**. A significant number (75.3%) of these financings took place in Q2 and Q3, which is consistent with the higher incidence of other investor-friendly terms seen during that timeframe.

Surprisingly, 2% of financings did not provide any form of dividend entitlements on the preferred shares being issued. To the extent that the preferred shares issued did include a dividend entitlement, 76.4% of these dividend entitlements did not include a stated dividend rate. Where a dividend rate was specified, the most common rate was 8%.[6]

Figure 5.1) Dividend Entitlements for Preferred Holders

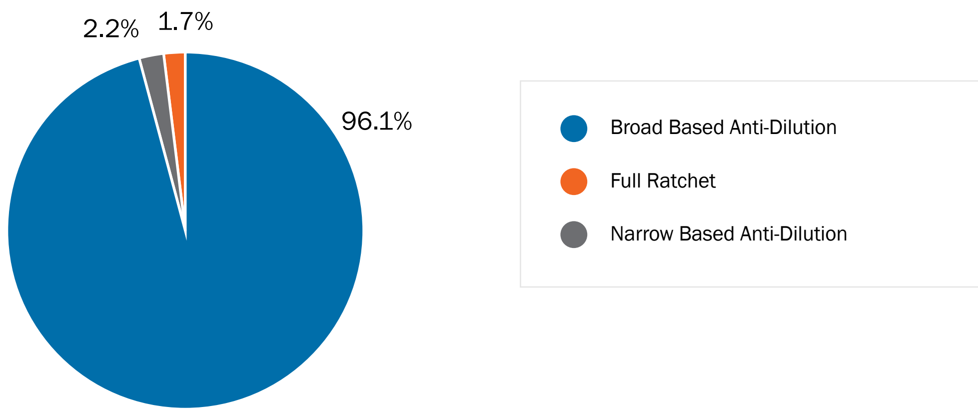


6) Anti-Dilution

Out of the three most common types of price-based **anti-dilution protection** (**broad-based weighted average anti-dilution**, **narrow based weighted average anti-dilution**, and **full ratchet anti-dilution**), the vast majority (96.1%) of preferred shares issued featured broad-based weighted average anti-dilution protection.

[6] We note that both the median and the mode for the dividend rate in the 2020 Financings surveyed was 8%.

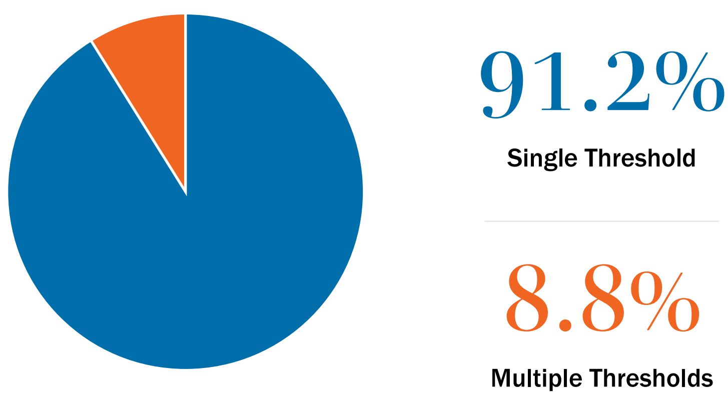
Figure 6.1) Anti-Dilution Protections



7) Protective Provisions

We analyzed the approval threshold required to waive the application of the **protective provisions** typically provided to the holders of preferred shares.[7] The majority of the protective provisions (91.2%) could be waived by a single threshold of all classes/series of preferred shares, voting together as a single class. Only 8.8% required the approval of multiple classes/series of preferred shares, voting separately, to waive the application of the protective provisions.

Figure 7.1) Single vs. Multiple Approval Thresholds (Protective Provisions)



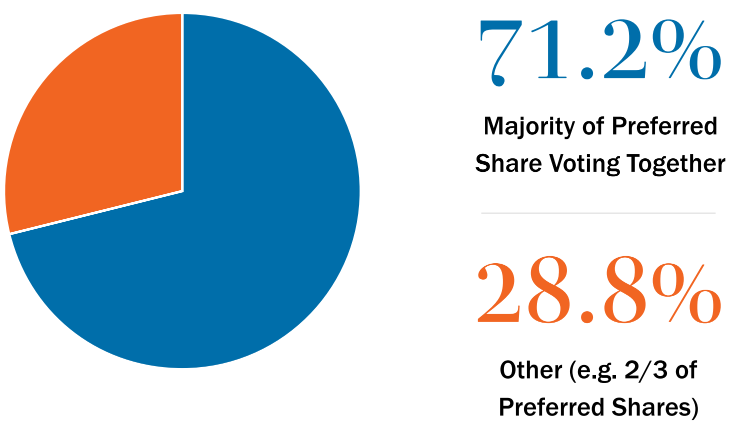
[7] We note that a small number of the financings surveyed in 2020 did not include protective provisions in favour of the preferred shares. Although not market practice for venture backed financings, we suspect for many of these financings, the companies elected to include the protective provisions in their unanimous shareholders agreements (which are not part of the public record) instead of in the company's articles. Under most Canadian corporate statutes, a unanimous shareholders agreement, alongside a company's articles and by-laws, is treated as a 'constating document', which allows the company to bind all shareholders by its terms.

Given that the majority of deals were early stage, most of the startups do not have an expansive number of classes/series and have presumably not faced the issue of dealing with different classes/series of preferred investors. That being said, we expect startups to insist on maintaining a single waiver threshold for all investors, consistent with U.S. practices.

The most common threshold to waive protective provisions was a majority of the preferred shares, voting together as a single class. Where a single threshold was used, 71.2% of the companies surveyed set the threshold at a majority of the preferred shares, voting together as a single class.

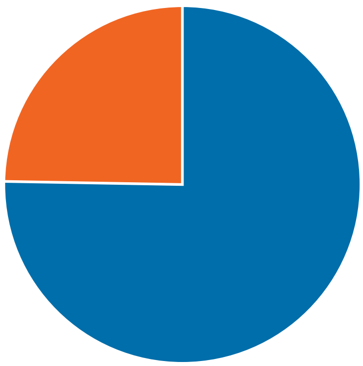
Only 28.8% included a threshold other than a majority of the preferred shares (e.g., 66 2/3% of the outstanding preferred shares).

Figure 7.2) Type of Protective Provision Approval Threshold (Single Threshold Only)



The majority (75.3%) of the 2020 financings surveyed included a single set of protective provisions for all classes/series of preferred shares. In comparison, only 24.7% of companies surveyed included new preferred shares with their own class/series-specific set of protective provisions (e.g., a specific set of protective provisions, where only the vote of the majority of the new class/series of preferred shares is required to waive the applicable protective provisions).

Figure 7.3) Class/Series Specific Veto Rights



75.3%

Single Set of Protective Provisions

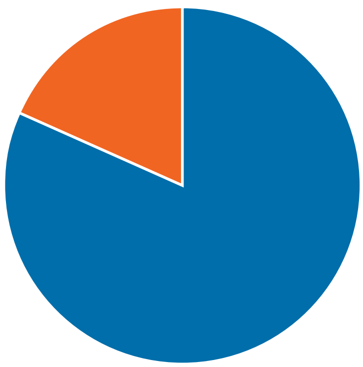
24.7%

Class/Series Specific Protective Provisions

8) Redemption

A minority (18.2%) of the financings surveyed included **redeemable preferred shares**, either at the option of the shareholder or the company. While this is substantially less than the 81.8% of deals that did not provide redemption rights, it does exceed the number of U.S. financings for the same period that included a redemption feature (3%-10%)[8]. The lower ratio in the U.S. reflects the maturity of the U.S. ecosystem, where market norms and higher levels of competition between investors to participate in financing rounds disfavour the inclusion of redemption rights.

Figure 8.1) Redeemable Preferred Shares



81.8%

Non-Redeemable

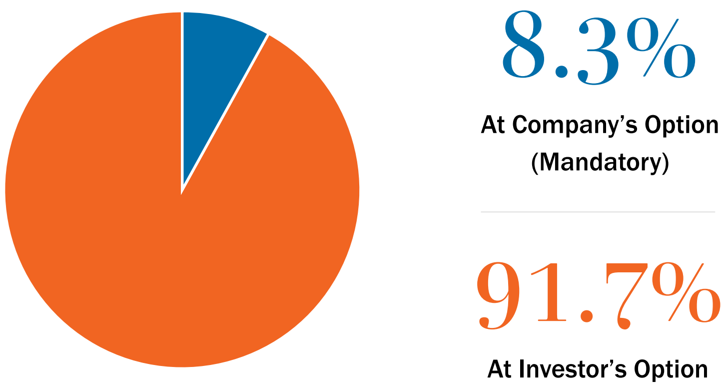
18.2%

Redeemable

[8] U.S. Deal Studies.

In deals where redemption rights were included, 91.7% of the preferred shares issued were typically at the election of the preferred shareholder rather than the company. This was often after a specific time period had elapsed, for example, 5-7 years from the date of the financing.

Figure 8.2) Preferred Shares Redemption Option (Among Redeemable Shares)

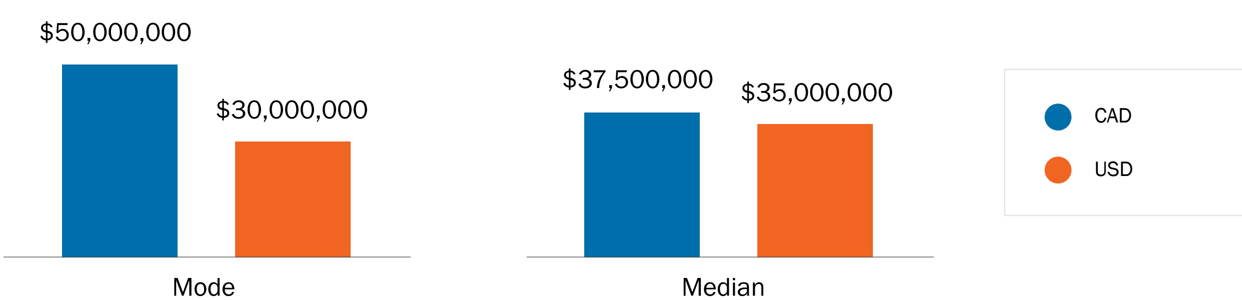


9) Qualified IPO Thresholds

The most common threshold for a **qualified IPO** was C$50,000,000, with the median threshold being C$37,500,000. When the articles were denominated in U.S. dollars, the most common qualified IPO threshold was US$30,000,000, with the median threshold being US$35,000,000.

For context, the above qualified IPO thresholds are consistent with the average IPO size for Canadian markets for the same period (based on data reported by Bloomberg).

Figure 9.1) Qualified IPO Thresholds by Currency



10) Pay-to-Play

While pay-to-play provisions were included in 2%-6%[9] of deals surveyed by U.S. Deal Studies, none of the Canadian deals included these provisions. Given the low utilization of pay-to-play provisions in the U.S., it is not surprising that these were not utilized in the Canadian market.

11) Authorized Share Capital

Unlike the U.S., not all venture-backed Canadian companies cap the number of authorized shares of a particular class or series. In Canada, companies have two options with respect to their authorized share capital, a specific class/series of shares can either be:

(i) uncapped (in which instance the company is authorized to issue an unlimited number of such shares without further amending its articles) or

(ii) capped (in which instance the company would need to amend its articles to authorize the issuance of shares beyond the stated cap).

In 2020, for those companies surveyed, the authorized capital of preferred shares issued was evenly split between capped (50.6%) and uncapped (49.4%). When just looking at those companies headquartered in Ontario, over half (58.3%) of the companies surveyed capped the authorized capital of their preferred shares.

Nearly three-quarters (72.4%) of companies surveyed left the authorized capital for their common shares uncapped, with 27.6% placing a cap on their authorized number of common shares. For companies headquartered in Ontario, 43.8% of them placed a cap on the authorized number of their common shares.

The large number of uncapped authorized preferred shares is likely a reflection of the practice taken by the wider Canadian market, outside of the startup and venture capital space, to have uncapped share authorizations. As the Canadian market continues to evolve, we anticipate more companies will place a cap on their authorized capital to align with U.S. practices.

[9] U.S. Deal Studies.

Figure 11.1) Capped vs. Unlimited Preferred Shares

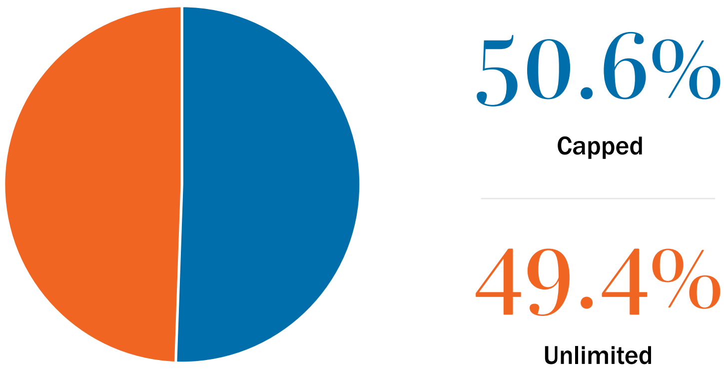
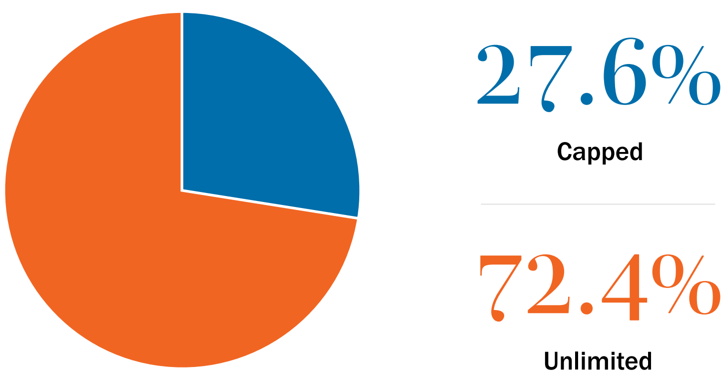


Figure 11.2) Capped vs. Unlimited Common Shares



12) Limitations on Class Voting

Under Canadian corporate statutes, a company can limit or remove the right of its shareholders to vote separately as a class or series upon the following enumerated actions by adding specific language to its articles:[10]

[10] For example, see OBCA s.170(1) and CBCA s.176(1)

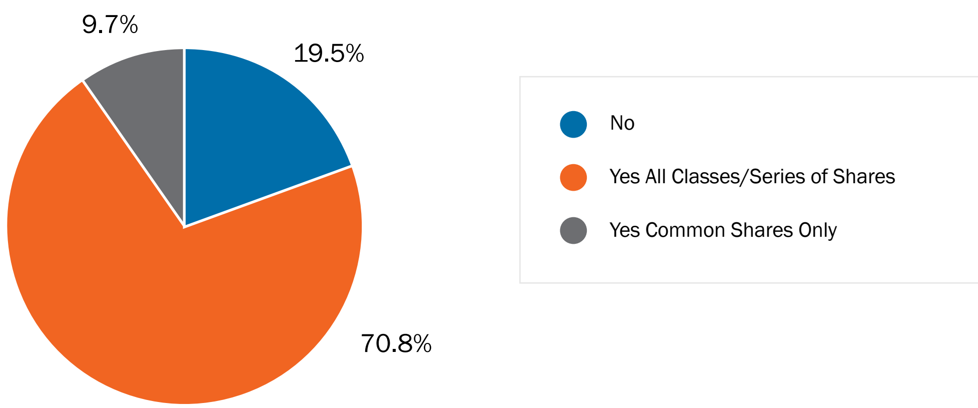
(i) to increase or decrease the maximum number of authorized shares of such class, or increase any maximum number of authorized shares of a class having rights or privileges equal or superior to the shares of such class;

(ii) to effect an exchange, reclassification or cancellation of all or part of the shares of such class[11]; or

(iii) to create a new class of shares of equal or superior to the shares of such class.

Over seventy percent (70.8%) of companies surveyed place limitations on class voting on all classes/series of shares (including the newly issued preferred shares), while 9.7% of such companies only placed such limitations on their common shares.

Figure 12.1) Limitations on Class Voting



[11] We note that the CVCA Model Documents specifically indicate that "although the CBCA and provincial corporate statutes allow for a carve-out from the class voting rights in respect of an exchange, reclassification or cancellation of all or part of the shares of a class, including this carve-out can be considered somewhat extreme, as the shares of a particular class may be cancelled without a vote of the shares of that class."

2020 Financings Snapshot

Deal Term	2020 Financings	U.S. Deal Studies
Liquidation Preference		
Senior Liquidation Preference	22.3%	14% to 35%
Pari Passu (to other preferred shares)	77.7%	65% to 86%
Participation Feature		
Non-Participating Preferred	92.4%	88% to 96%
Participating Preferred	7.6%	4% to 12%
Participation Rights – Capped	40%	25% to 50%
Participation Rights – Uncapped	60%	50% to 75%
Liquidation Preference		
1x Liquidation Preference	91.8%	70% to 94%
More than 1x Liquidation Preference	8.2%	6% to 30%

Deal Term	2020 Financings	U.S. Deal Studies
Dividends		
Non-Cumulative (as/when declared)	89.9%	79% to 90%
Cumulative Dividends	8.1%	4% to 10%
No Dividend Entitlements	2%	0% to 10%
Dividend Rate	8%[12]	N/A
Up-Rounds vs. Down-Rounds		
Up-Rounds	90.4%	72% to 86%
Down-Rounds	9.6%	5% to 15%
Anti-Dilution Protections		
Broad-Based Weighted Average	96.1%	95% to 99%
Narrow-Based Weighted Average	2.2%	0% to 1%
Full Ratchet	1.7%	0% to 1%
Protective Provisions		
Approval Thresholds		
Single threshold (all preferred shares voting together, as a single class)	91.2%	N/A

[12] To the extent that preferred shares issued in the 2020 financings surveyed included a dividend entitlement, 76.4% of such dividend entitlements did not include a stated dividend rate. Where a dividend rate was specified, both the mode and median dividend rate was 8%.

Deal Term	2020 Financings	U.S. Deal Studies
Multiple threshold (multiple classes / series of preferred shares voting, separately as a class and/or series)	8.8%	N/A
For Single Threshold, the most common threshold used		
Majority of Preferred Shares (voting together as a single class)	71.2%	N/A
Other (e.g. 66 2/3% of the preferred shares)	28.8%	N/A
Class / Series Specific Veto Rights		
All classes / series of preferred shares provided a single set of protective provisions	75.3%	N/A
New class / series of preferred shares provided a stand-alone set of protective provisions	24.7%	N/A
Redemption		
Non-redeemable preferred shares	81.8%	88% to 97%
Redeemable preferred shares	18.2%	3% to 12%
Redemption at company's option	8.3%	23%
Redemption at investor's option	91.7%	77%

Deal Term	2020 Financings	U.S. Deal Studies
Qualified IPO Threshold		
Most Common Qualified IPO Threshold (when reported in CAD)	$50,000,000	N/A
Median Qualified IPO Threshold (when reported in CAD)	$37,500,000	
Most Common Qualified IPO Threshold (when reported in USD)	$30,000,000	N/A
Median Qualified IPO Threshold (when reported in USD)	$35,000,000	
Pay-to-Play		
Pay-to-Play provision included	0%	2% to 6%
Authorized Share Capital		
Authorized Capital for Preferred Shares		
Unlimited	49.4%	N/A
Capped		N/A
All Canada:	50.6%	
Ontario:	58.3%	

Deal Term	2020 Financings	U.S. Deal Studies
Authorized Capital for Common Shares		
Unlimited	72.4%	N/A
Capped		N/A
All Canada:	27.6%	
Ontario:	43.8%	

Limitations on Class Voting		
All classes / series subject to limitations on class voting	70.8%	N/A
Only common shares subject to limitations on class voting	9.7%	N/A
No limitations placed on class voting	19.5%	N/A

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About Torys LLP

Torys is a respected international business law firm with a reputation for quality, innovation and teamwork. Clients look to us for their largest and most complex transactions, as well as for ongoing matters in which strategic advice is key.

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