TORYS LLP

2022 DEAL STUDY

Venture Financing Report

Contents

Methodology

This study analyzes the preferred share deal terms across financings for 192 Canadian headquartered startups that raised at least $500,000 on venture or venture-like terms between January 1, 2021 and December 31, 2021. Criteria included all categories of publicly reported preferred share venture financings, from series seed through to later stage financings. We have compared this data to our 2020 Venture Financing Report.

While we identified 675 publicly reported venture-backed financings for the 2021 calendar year, only 192 of such financings satisfied the criteria outlined above and had publicly accessible articles. In analyzing the financings to arrive at the 192 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 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).

This is our second annual Venture Financing Report and we have included comparisons to the data from our 2020 Venture Financing Report throughout.

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[1]. For a quick overview of all the data, including a Canadian vs. U.S. comparison, please see the Snapshot on page 23.

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.

[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**")

Executive Summary

Despite being the second year of a global pandemic, 2021 was another record year for venture capital financing in Canada.

2021 saw record amounts of money invested in the Canadian Venture Capital ecosystem giving startup companies choices as to who to seek investment from and creating a company-friendly (as opposed to investor-friendly) environment.

As outlined in our Report, this company-friendly investing environment was evident in the deal terms we reviewed. While the movements in deal terms were not dramatic, there was a clear directional trend towards more company-friendly provisions and deals.

These included:

- more deal activity in provinces that have not historically been financial centres, in particular Nova Scotia and Saskatchewan;
- fewer instances of Senior Liquidation Preferences which favour new investors; and
- more up-rounds and fewer down-rounds.

Additionally, in our 2020 Report, we predicted that as the Canadian startup ecosystem continues to mature, we will see an increase in later-stage deal activity (a natural evolution as companies grow). In 2021, we saw early evidence of this, with proportionately fewer Series Seed and Series A investments in 2021 as compared to 2020 and a greater number of Series B and later rounds in 2021 vs. 2020. Historically, most Canadian venture capital deals have been into early-stage companies and as these companies mature, we expect this trend toward later-stage financings to continue.

Our Report therefore illustrates that 2021 was a great year for founders and the Canadian startup ecosystem is evolving as expected.

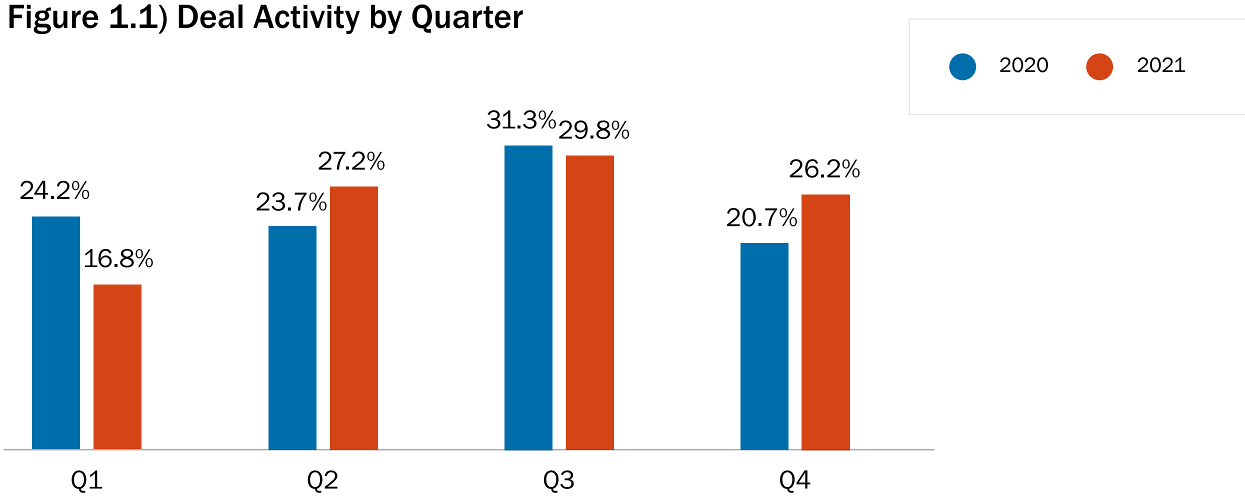
2021 Financing Activity in Canada

Overall, the second year of the pandemic did not slow Canadian VC investment down, despite a softer pace in the first quarter. Deal flow remained strong throughout 2021, including the 192 financings studied in this Report.

1) Deal Activity

Financings in the first quarter of 2021 started off slowly and were down compared to the first quarter of 2020, continuing the trend of slowing activity that we saw towards the end of 2020 (see Figure 1.1)[2]. Canada saw increasing lockdowns to tackle COVID-19 in the winter of 2021 which may partially explain the slowdown. However, this trend reversed course by the second quarter with deal activity surging past 2020 levels.

Figure 1.1) Deal Activity by Quarter

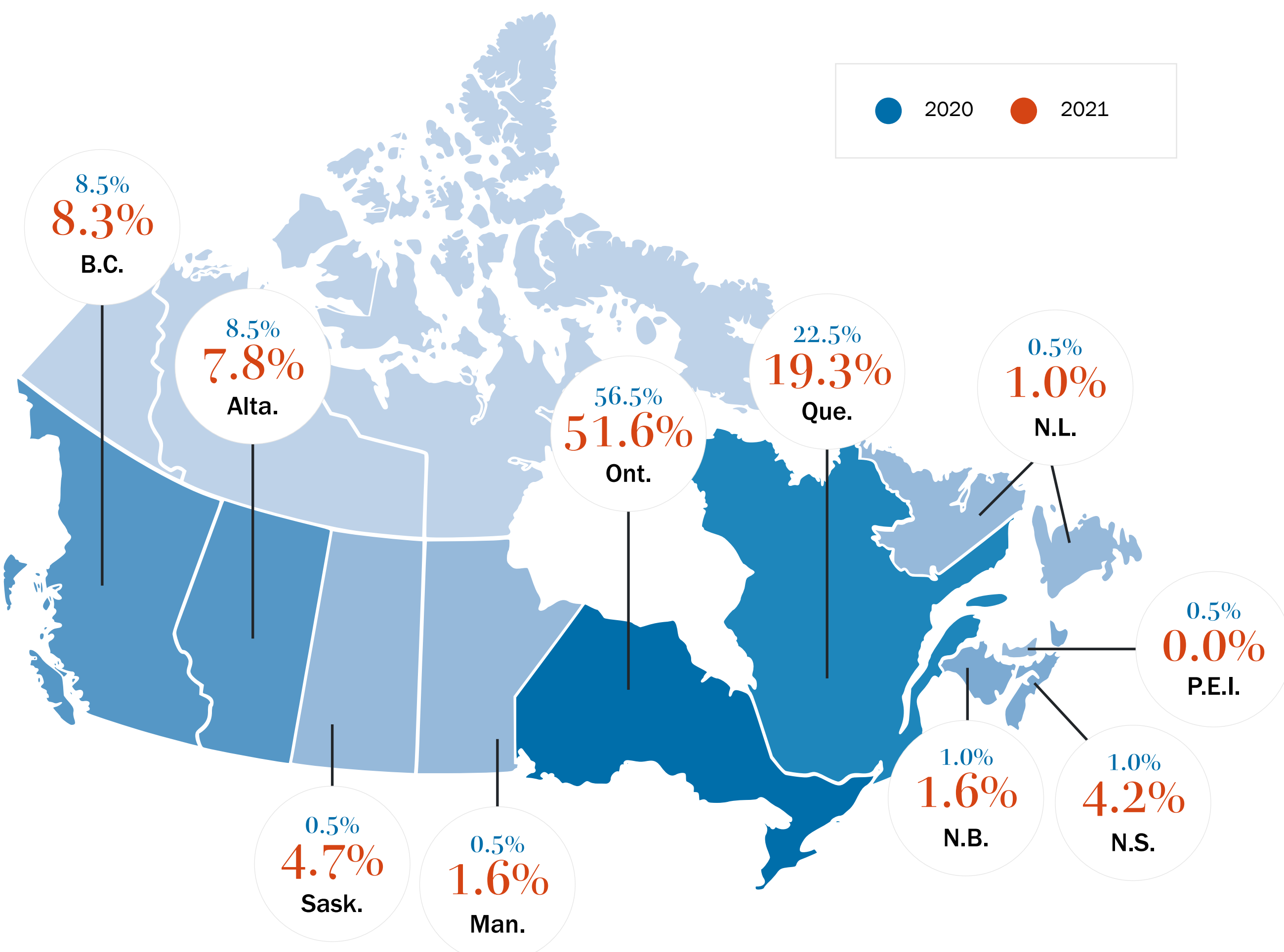


[2] PitchBook Data, Inc.; *Data has not been reviewed by PitchBook analysts.

While Ontario (51.6%) and Québec (19.3%) continued to lead in the number of financings, the 2021 data shows a proportionately greater number of deals in markets with historically low venture financing activity such as the Prairies and Atlantic Canada[3]. In particular, Nova Scotia increased to 4.2% of deals in our data set compared to 1% a year ago. This trend coincides with increased government funding and support for technology companies in provinces outside of Ontario and Québec, like Nova Scotia's [investment in computer science programs]() at local universities.

One of the effects of the pandemic has been the continued adoption of remote work in Canada and investors have been able to meet with and invest in companies outside of the key financial centres in Canada.

Figure 1.2) Deal Activity by Province



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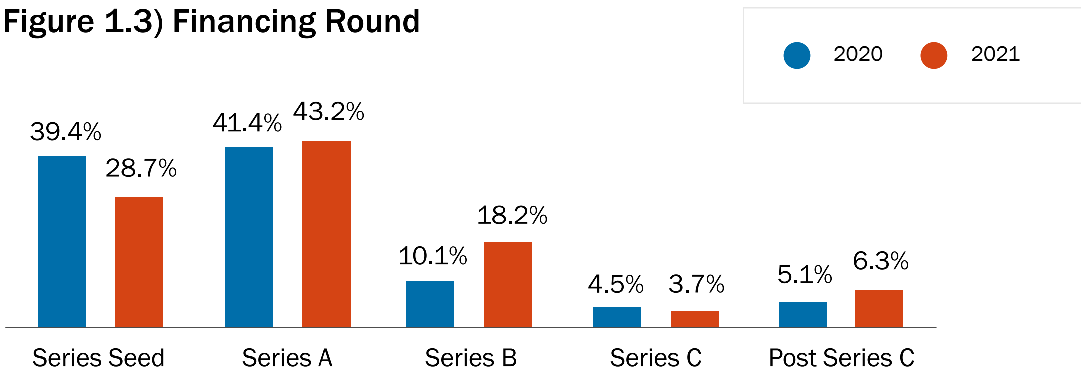
[3] The financing surveyed for the study do not include financings completed by companies headquartered in British Columbia that are incorporated under the *Business Corporations Act* (British Columbia) due to the absence of public access to such companies' articles.

In 2020, we predicted that there would be an increase in later-stage deal activity as the Canadian startup ecosystem continues to mature. In 2021, we saw early evidence of this, with proportionately fewer Series Seed and Series A investments (71.9%) compared to 2020 (80.8%). There was also a greater number of Series B and later rounds in 2021 (28.1%) vs. the year prior (19.2%). This is consistent with data outlined in Torys' study on Emerging Trends in Canada's Innovation Economy.

Historically, most Canadian venture capital deals have involved early-stage companies, however, as these companies mature we expect this trend toward later-stage financings to continue.

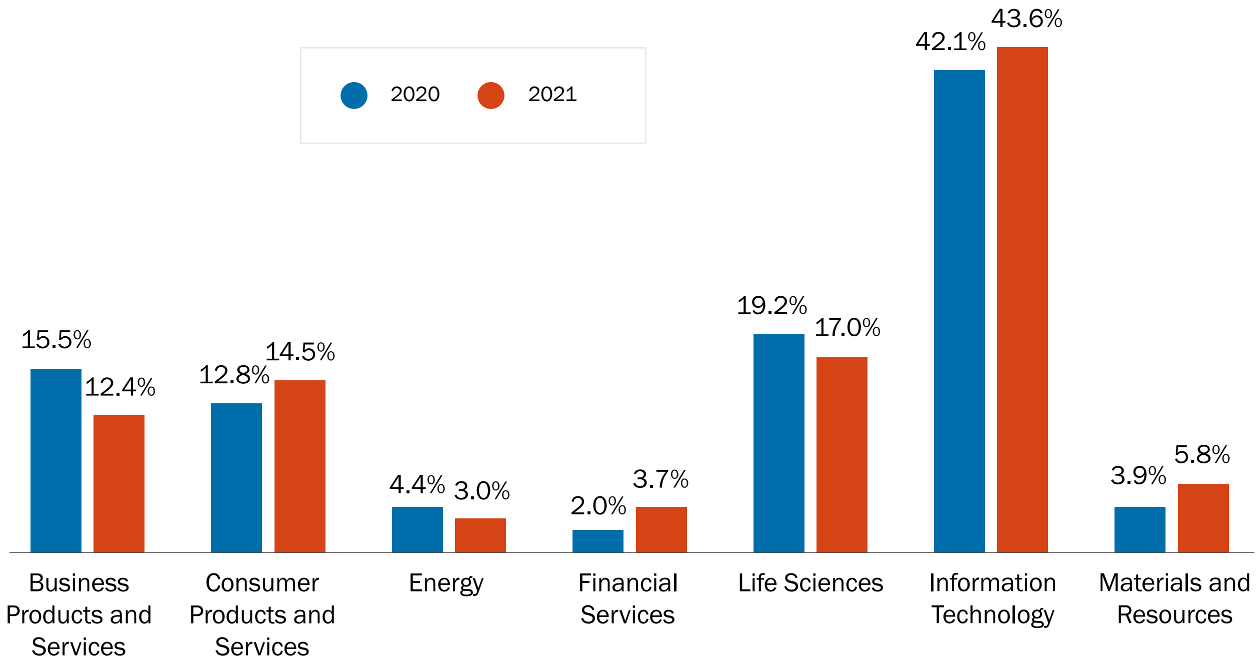
Figure 1.3) Financing Round



2021, much like the year prior, saw a high concentration of deals in the Information Technology (43.6%), Life Sciences (17.0%), Consumer Products and Services (14.5%) and Business Products and Services (12.4%) sectors.

Technology continues to drive venture financings in Canada and, with the changes to the Canadian economy brought on by the pandemic and the growing interest in emerging sectors such as digital currencies, fintech and blockchain, we expect this trend to continue.

Figure 1.4) Deal Activity by Industry Sector



Deal Terms for 2021 Financings

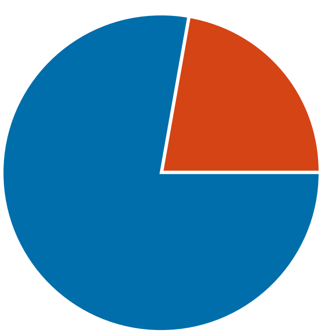
2) Seniority of Liquidation Preference

Deal activity accelerated in 2021 as the market adjusted to the effects of COVID-19. Startups had more financing options and, as a result, we saw a reversal of the relatively small uptick in investor friendly terms that were identified in our 2020 study.

Not surprisingly, we saw a decrease in Senior Liquidation Preferences[4] in 2021 (16.8% vs 22.3%), with the overwhelming majority of deals continuing to involve pari passu terms.

Figure 2.1) Liquidation Preference

2020



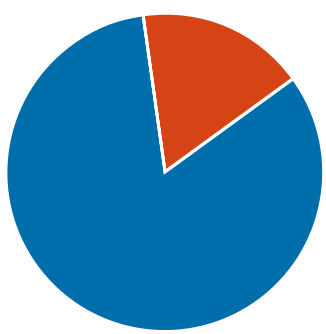
77.7%

Pari Passu

22.3%

Senior to Existing Preferred Shares

2021



83.2%

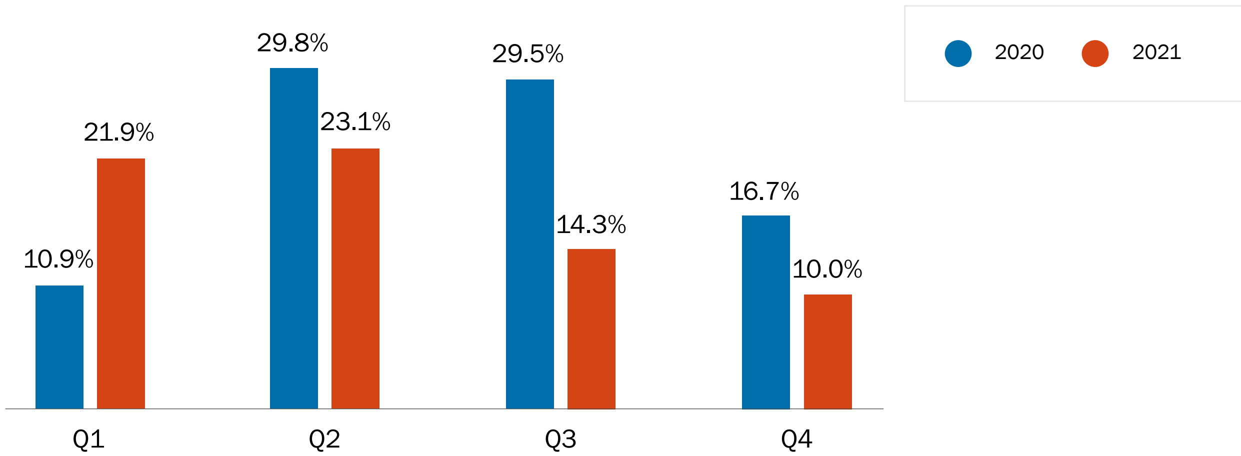
Pari Passu

16.8%

Senior to Existing Preferred Shares

[4] Note that 57.2% 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. These were counted as "pari passu" for the purposes of our study.

Figure 2.2) Liquidation Preference by Quarter



3) Participation

The majority (96.4%) of the 2021 financings surveyed were non-participating preferred shares, while only 3.6% were participating preferred shares.

In deals where the preferred shares included a participation feature, 29% of preferred shares also included an entitlement to cumulative dividends (where cumulative dividends were only available on 11.9% 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, similar to 2020.

In financings that included participating preferred shares, the participation rights were more often uncapped (57.1%) than capped (42.9%).

Of the deals that had non-participating preferred shares, the majority (95.7%) included a 1x liquidation preference, with the remaining including a multiple liquidation preference (greater than 1x). This represents an increase from 91.8% in 2020. This move to the almost universality of 1x liquidation preference is consistent with a maturing venture capital market and sophisticated and educated founders able to push for market terms.

Figure 3.1) Preferred Shares Participation

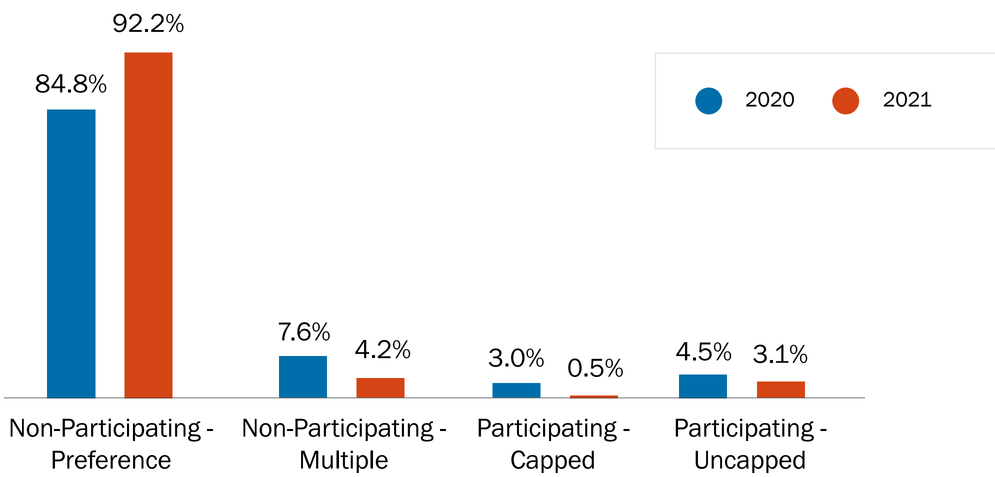


Figure 3.2) Percentage of Preferred Shares that are Capped vs. Uncapped

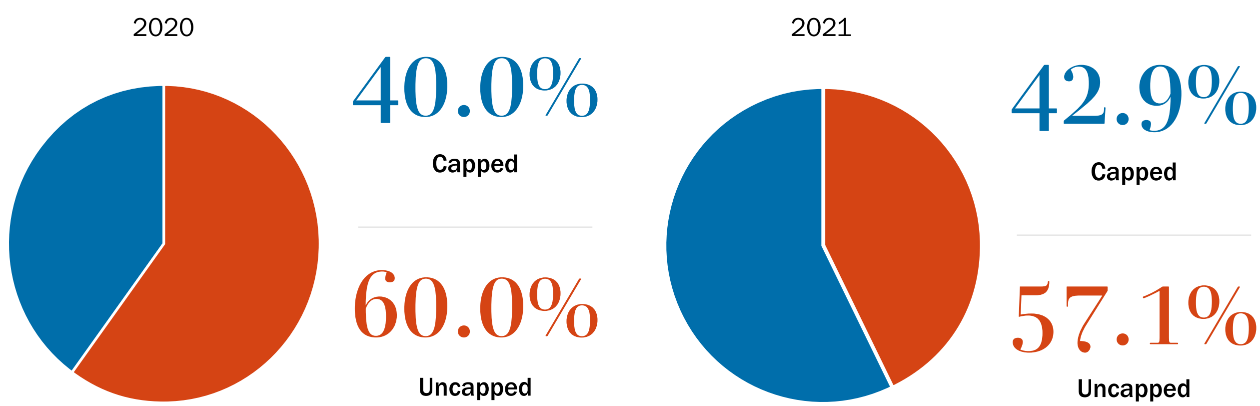
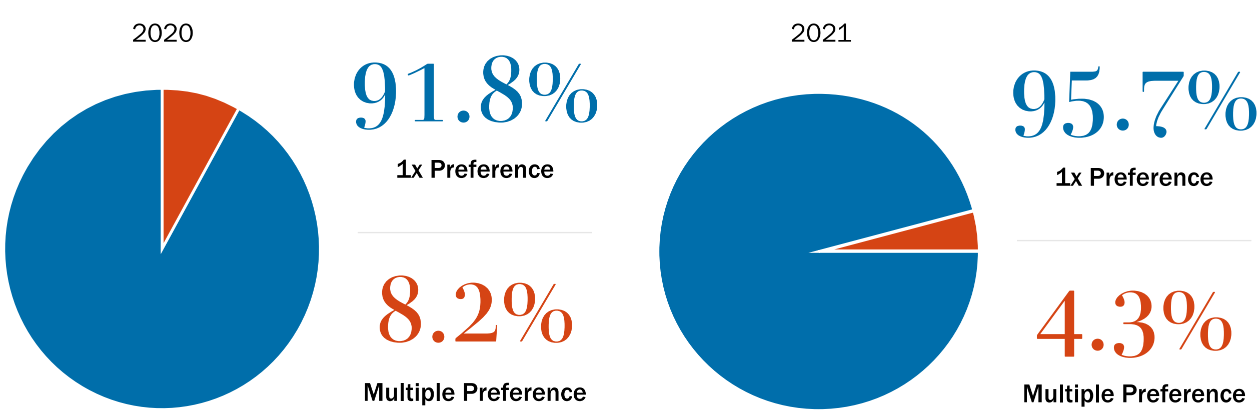


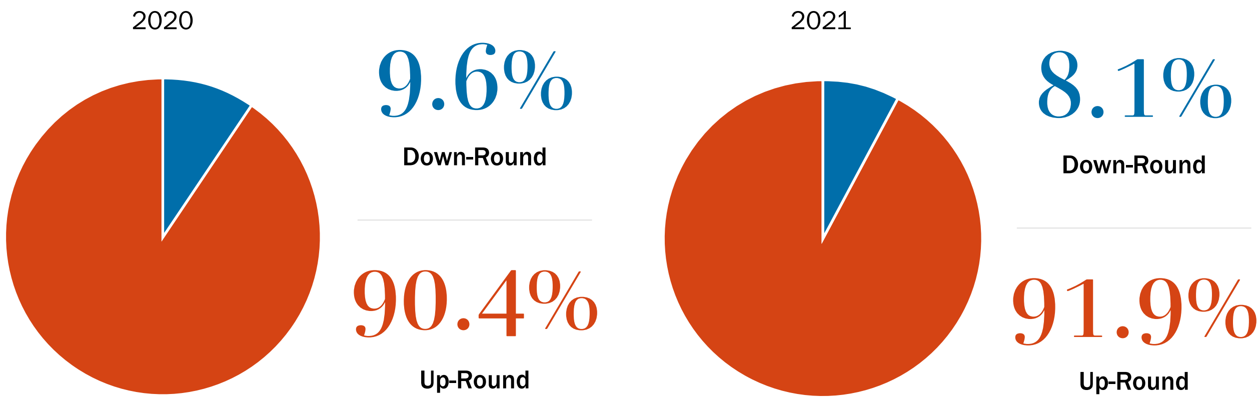
Figure 3.3) Preference Multipliers (Among Non-Participating Shares)



4) Valuation

The Canadian venture ecosystem continued to thrive in 2021 with an even greater portion of reported up-rounds (91.9%) compared to down-rounds (8.1%), coinciding with a decrease in Senior Liquidation Preferences and participation rights.

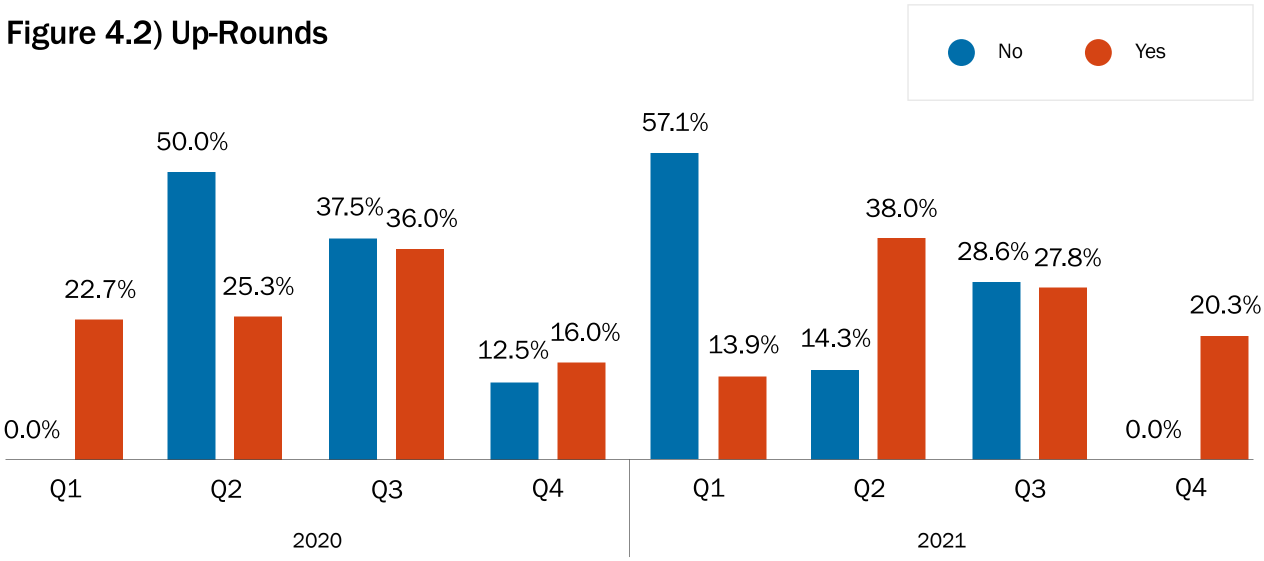
Figure 4.1) Financing Valuations



The prevalence of down-rounds tracks the uncertainty created by the pandemic. Our data did not identify any down-rounds completed in the first quarter of 2020. Throughout 2020 and early 2021, the incidence of down-rounds ebbed and flowed-culminating in a downward trend in 2021 that ended with zero down-rounds in the fourth quarter of 2021.

Early data in 2022 has shown that the IPO market is experiencing a slowdown. As a result, later stage companies may be finding it more difficult to raise funding in later rounds and we may see an uptick in flat or down financing rounds in 2022.

Figure 4.2) Up-Rounds

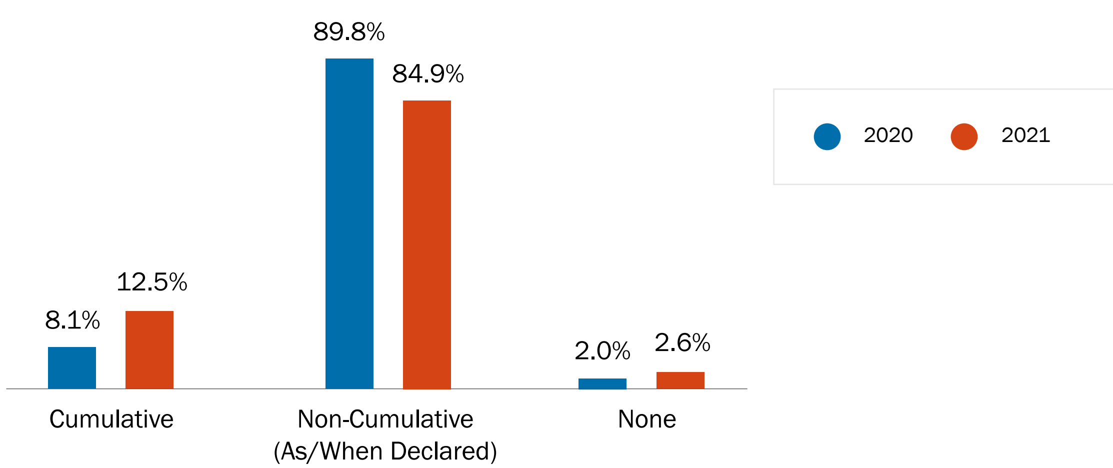


5) Dividend Entitlements

The vast majority (82.9%) of the financings surveyed included a **non-cumulative discretionary dividend**, with 12.5% including a **cumulative dividend**. A majority (54.2%) of financings that included a cumulative dividend took place in Q1 and Q2, which is consistent with the higher incidence of other investor-friendly terms seen during that timeframe.

2.6% 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, 71.7% of these dividend entitlements did not include a stated dividend rate. Where a dividend rate was specified, the most common rate was 8%[5].

Figure 5.1) Dividend Entitlements for Preferred Holders

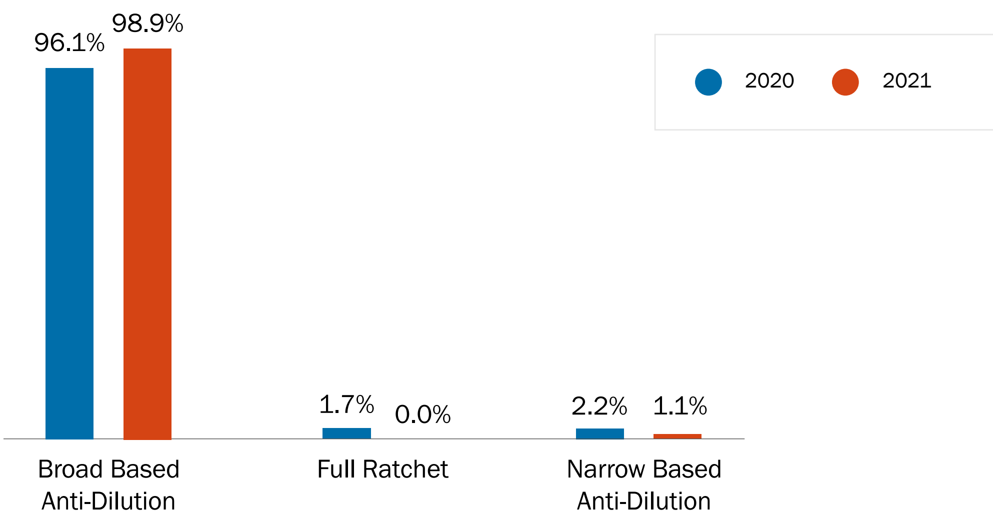


[5] We note that both the median and the mode for the dividend rate in the 2021 Financings surveyed was 8%.

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 (98.9%) of preferred shares issued featured broad-based weighted average anti-dilution protection.

Figure 6.1) Anti-Dilution Protections



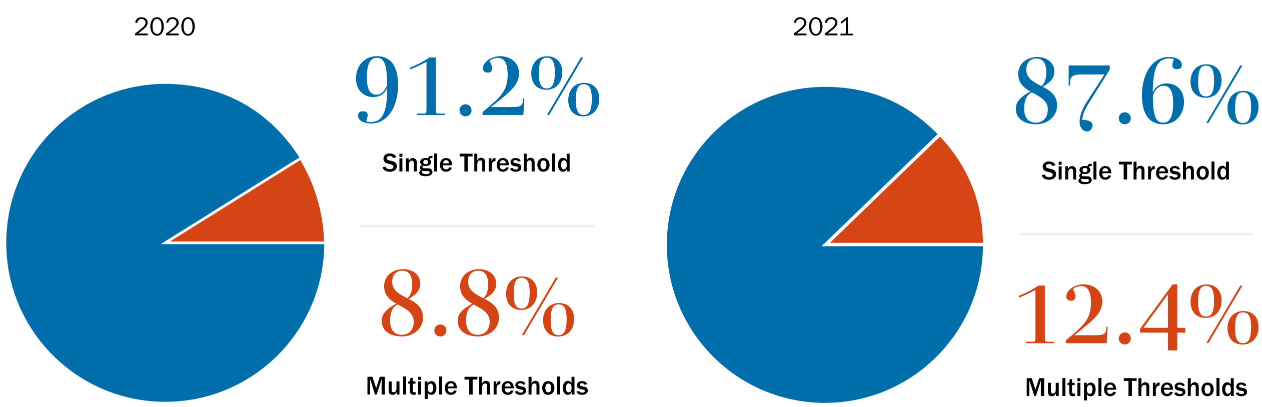
7) Protective Provisions

We analyzed the approval threshold required to waive the application of the protective provisions typically provided to the holders of preferred shares[6]. The majority of the protective provisions (87.6%) could be waived by a single threshold of all classes/ series of preferred shares, voting together as a single class. Only 12.4% required the approval of multiple classes/series of preferred shares, voting separately, to waive the application of the protective provisions.

[6]We note that a small number of the financings surveyed in 2021 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.

When compared to 2020, these numbers seem to indicate that there is a growing trend toward protective provisions that require approval of multiple classes/series of preferred shares; however, this increase is likely due to the increases in later-stage financings. As previously highlighted in this Report, as the Canadian market matures, we expect Series B and later stage financings to make up a greater proportion of total deals as compared to prior years. In later rounds, investors will expect more protection and control in exchange for larger cheques and higher valuations.

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

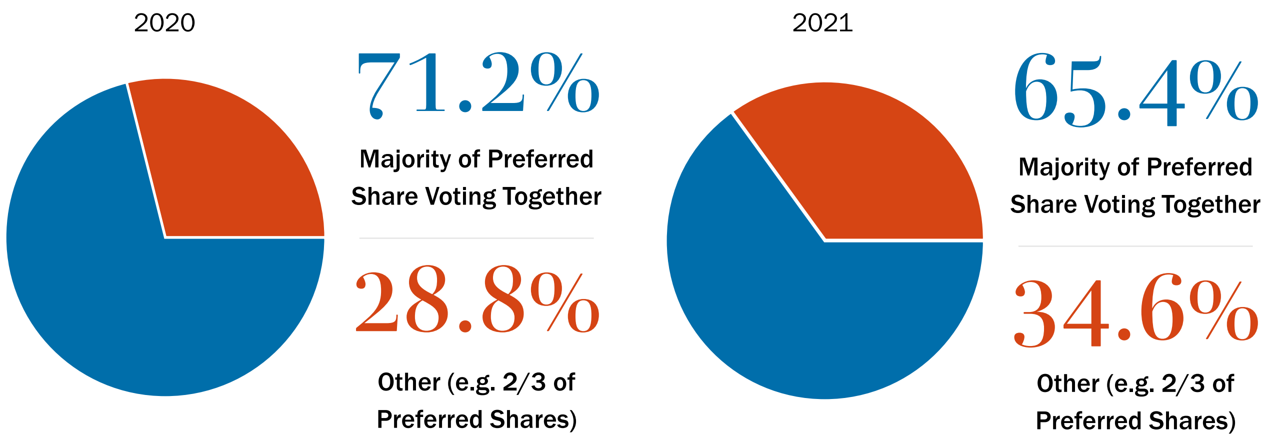


Given that the majority of deals were early stage, most of the startups do not have an expansive number of classes/series and have presumably not faced the issue of dealing with different classes/series of preferred investors. That being said, we expect startups to insist on maintaining a single waiver 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, 65.4% of the companies surveyed set the threshold at a majority of the preferred shares, voting together as a single class.

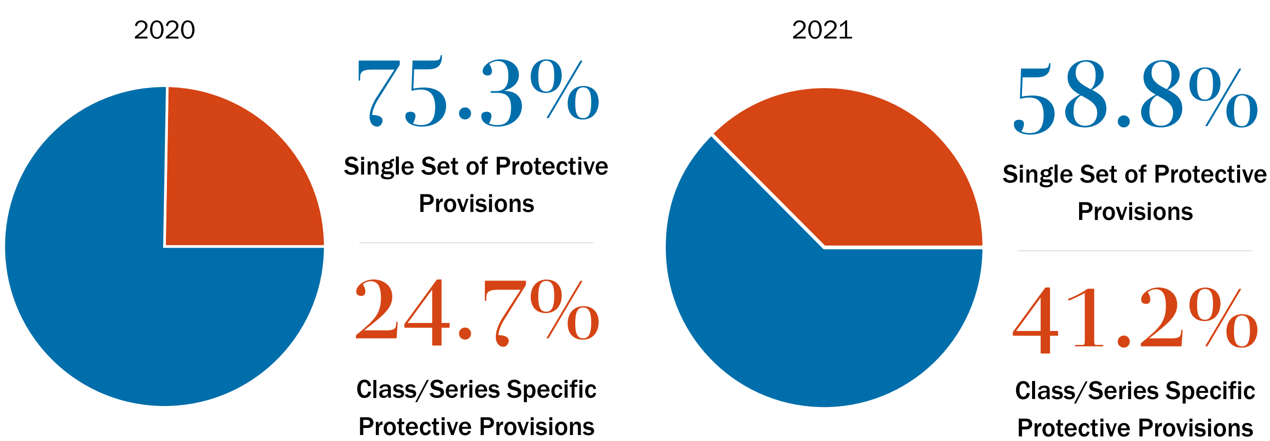
Only 34.6% included a threshold other than a majority of the preferred shares (e.g., 66 2/3% of the outstanding preferred shares).

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



The majority (58.8%) of the 2021 financings surveyed included a single set of protective provisions for all classes/series of preferred shares. In comparison, only 41.2% 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)[7].

Figure 7.3) Class/Series Specific Veto Rights

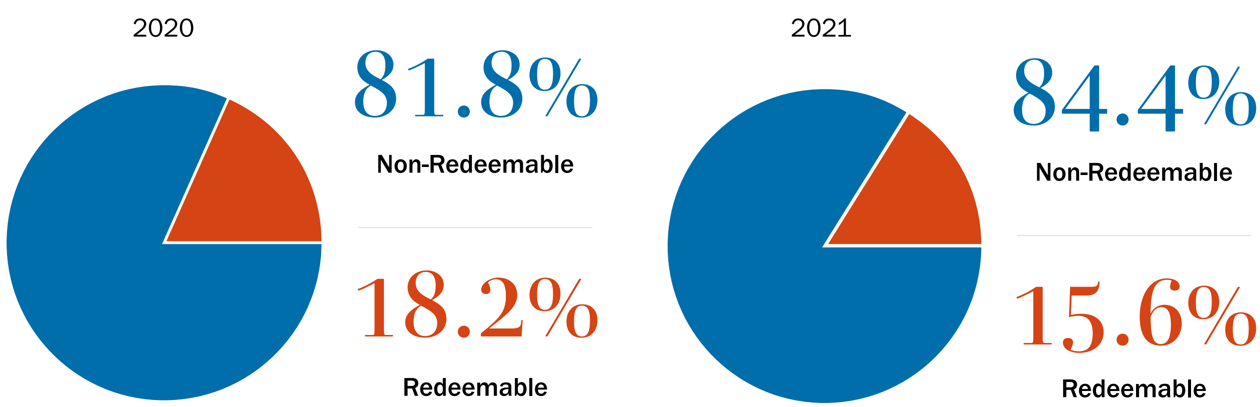


[7] This data excludes those financings that are the first round of preferred financing for a company, as there will only be one class or series and therefore only one set of protective provisions.

8) Redemption

A minority (15.6%) of the financings surveyed included redeemable preferred shares, either at the option of the shareholder or the company. This represents a decrease from 18.2% in 2020 and indicates a growing alignment with U.S. financings during the same time period, where only 3%-10% included a redemption feature[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.

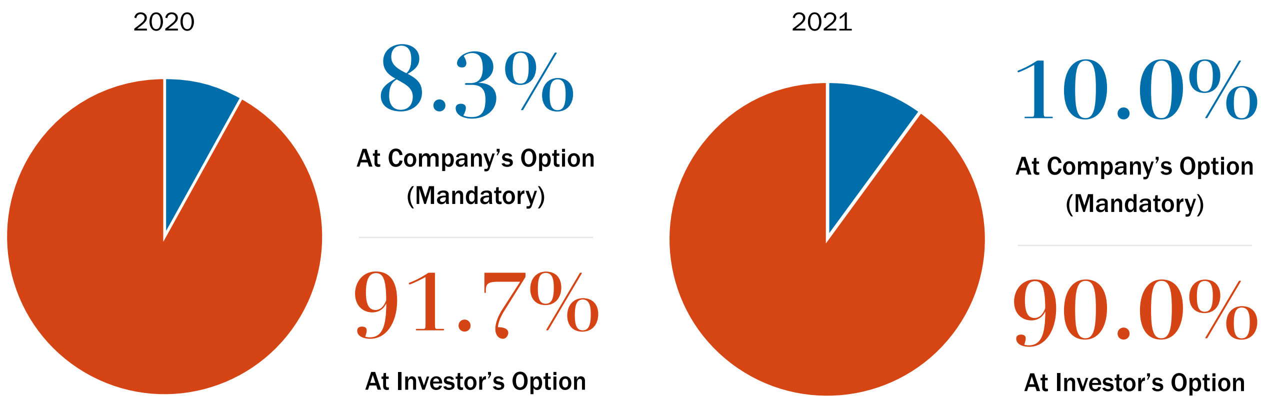
Figure 8.1) Redeemable Preferred Shares



In deals where redemption rights were included, the preferred shareholder rather than the company overwhelmingly had the right to trigger a redemption (90%). This was often after a specific time period had elapsed, for example, 5-7 years from the date of the financing.

[8] U.S. Deal Studies.

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

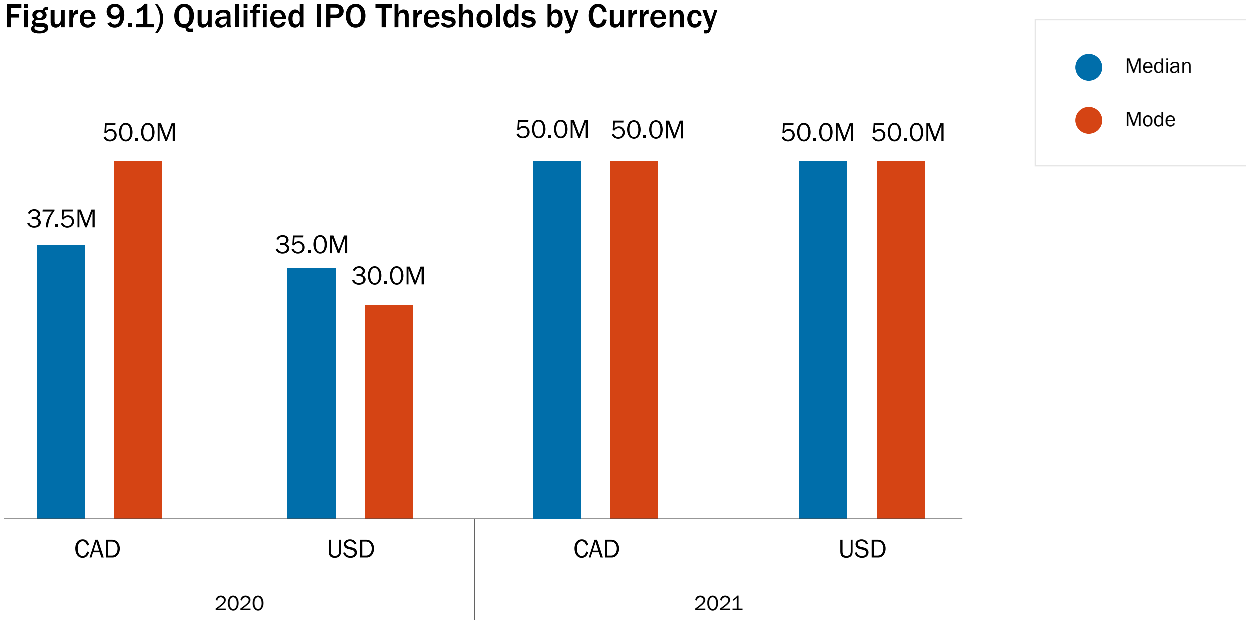


9) Qualified IPO Thresholds

The most common threshold for a **qualified IPO** was C$50,000,000, which was also the median threshold. When the articles were denominated in U.S. dollars, the most common qualified IPO threshold was US$50,000,000, which again was also the median threshold.

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%-3% of deals surveyed by U.S. Deal Studies[9], 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

2021 saw a continued shift towards companies capping the total amount of authorized shares.

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 2021, for those companies surveyed, the authorized capital of preferred shares issued was evenly split between capped (58.1%) and uncapped (41.9%). When just looking at those companies headquartered in Ontario, the majority (73.3%) of the companies surveyed capped the authorized capital of their preferred shares.

68.8% of companies surveyed left the authorized capital for their common shares uncapped, with 31.2% placing a cap on their authorized number of common shares. For companies headquartered in Ontario, 37.4% 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.

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[9] U.S. Deal Studies.

Figure 11.1) Capped vs. Unlimited Preferred Shares

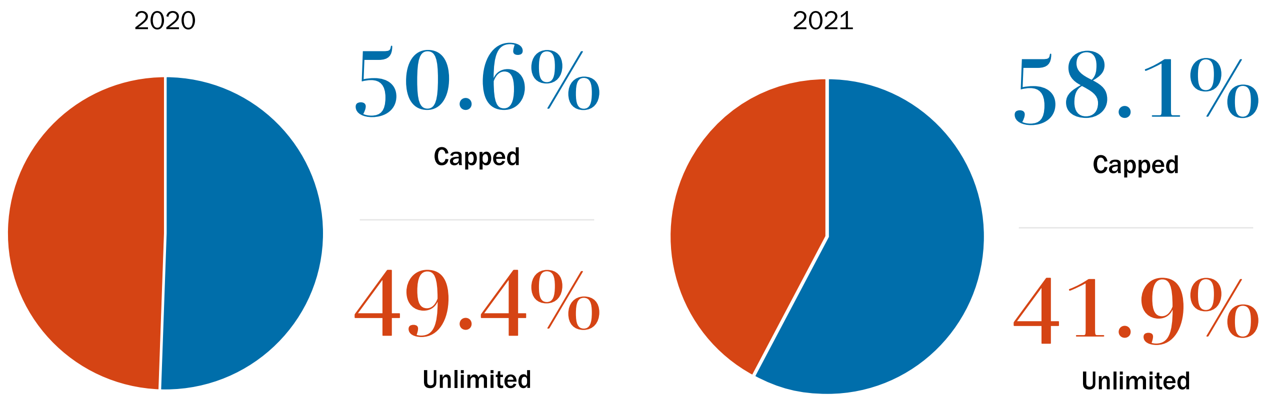
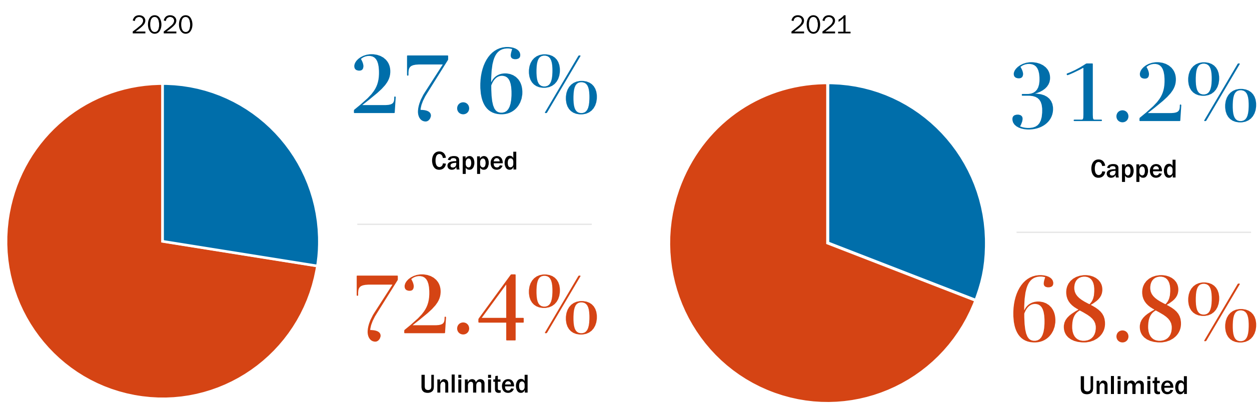


Figure 11.2) Capped vs. Unlimited Common Shares



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;

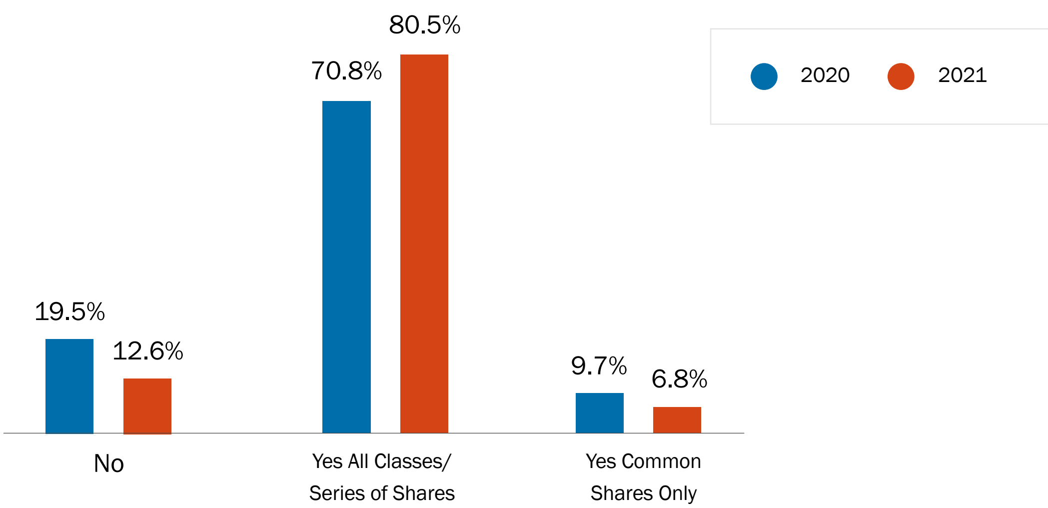
(ii) to effect an exchange, reclassification or cancellation of all or part of the shares of such class[11]; or

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

This allows companies to raise financing without necessarily going to each class of shareholders for approval. This is particularly useful to investors where the common shareholders hold a relatively small portion of the company and the investors have negotiated the ability to make decisions

Over eighty percent (80.5%) of companies surveyed place limitations on class voting on all classes/series of shares (including the newly issued preferred shares), while 6.8% 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."

2021 Financings Snapshot

Deal Term	2021 Financings	U.S. Deal Studies
Liquidation Preference		
Senior Liquidation Preference	16.8%	18% to 24%
Pari Passu (to other preferred shares)	83.2%	75% to 82%
Participation Feature		
Non-Participating Preferred	96.4%	90% to 97%
Participating Preferred	3.6%	3% to 10%
Participation Rights – Capped	42.9%	40% to 44%
Participation Rights – Uncapped	57.1%	56% to 60%
Liquidation Preference		
1x Liquidation Preference	95.7%	N/A
More than 1x Liquidation Preference	4.3%	N/A

Deal Term	2021 Financings	U.S. Deal Studies
Dividends		
Non-Cumulative (as/when declared)	84.9%	56% to 98%
Cumulative Dividends	12.5%	2% to 5%
No Dividend Entitlements	2.6%	0% to 39%
Dividend Rate	8%[12]	N/A
Up-Rounds vs. Down-Rounds		
Up-Rounds	91.9%	94% to 95%
Down-Rounds	8.1%	4%
Anti-Dilution Protections		
Broad-Based Weighted Average	98.9%	97% to 99%
Narrow-Based Weighted Average	1.1%	0% to 1%
Full Ratchet	0%	0% to 1%
Protective Provisions		
Approval Thresholds		
Single threshold (all preferred shares voting together, as a single class)	87.6%	N/A

[12] To the extent that preferred shares issued in the 2021 financings surveyed included a dividend entitlement, 71.7% 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	2021 Financings	U.S. Deal Studies
Multiple threshold (multiple classes / series of preferred shares voting, separately as a class and/or series)	12.4%	N/A
For Single Threshold, the most common threshold used		
Majority of Preferred Shares (voting together as a single class)	65.4%	N/A
Other (e.g. 66 2/3% of the preferred shares)	34.6%	N/A
Class / Series Specific Veto Rights		
All classes / series of preferred shares provided a single set of protective provisions	58.8%	N/A
New class / series of preferred shares provided a stand-alone set of protective provisions	41.2%	N/A
Redemption		
Non-redeemable preferred shares	84.4%	90% to 97%
Redeemable preferred shares	15.6%	3% to 10%
Redemption at company's option	10.0%	N/A
Redemption at investor's option	90.0%	N/A

Deal Term	2021 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)	$50,000,000	
Most Common Qualified IPO Threshold (when reported in USD)	$50,000,000	N/A
Median Qualified IPO Threshold (when reported in USD)	$50,000,000	
Pay-to-Play		
Pay-to-Play provision included	0%	2% to 3%
Authorized Share Capital		
Authorized Capital for Preferred Shares		
Unlimited	41.9%	N/A
Capped		N/A
All Canada:	58.1%	
Ontario:	73.3%	

Deal Term	2021 Financings	U.S. Deal Studies
Authorized Capital for Common Shares		
Unlimited	68.8%	N/A
Capped		N/A
All Canada:	31.2%	
Ontario:	37.4%	

Limitations on Class Voting

All classes / series subject to limitations on class voting	80.5%	N/A
Only common shares subject to limitations on class voting	6.8%	N/A
No limitations placed on class voting	12.6%	N/A

About Torys' Emerging Companies and Venture Capital Group

More than legal advisers, we are strategic partners to our clients in the emerging companies ecosystem, giving both founders and investors deep insight and experience and a unique cross-border presence to support their goals. Whether on standalone projects, a phase of a larger project, or ongoing assignments, we support early- to late-stage companies in all aspects of the creation, acquisition and commercialization of their business. We also help investors realize their investment strategies in high-growth companies. We bring together leading transactional and sector knowledge from across the firm to advise VC funds, strategic investors, growth equity funds, private equity funds and pension funds. From fund formation and shareholder arrangements to buyouts and other exits, we work closely with investors on some of their most innovative work.

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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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