

Companies with Extraordinary Potential

2009 Report on Emerging Canadian Software Companies: The CEO Perspective



connecting
vision
to reality
2009

PRICEWATERHOUSECOOPERS 



Foreword



Dismal. Disappointing. Nuclear winter.

These are the words and phrases I expected the CEOs in our survey to use when describing their prospects for 2009. We are in the midst of what some are calling an economic “depression”. Venture capital (VC) funding has reached historic lows and stock market valuations have dropped by 40% in the past year.

But our CEOs are resilient. In 2009, 57% expect their sales to increase over 25%. While they acknowledge the weakness in the overall economy and have made some changes to their business plans, their belief in their companies and their ultimate success is not shaken.

The optimistic views of the CEOs is just one of the many insights arising from our sixth annual PricewaterhouseCoopers (PwC) Report on Emerging Canadian Software Companies: The CEO Perspective. Over the six years of the survey we have focused on the challenges faced by CEOs of emerging software companies. While challenges such as growing revenues, raising capital, competition, currency fluctuations, and intellectual property (IP) management are constants, the underlying economic climate over the life of our survey has been one of annual growth.

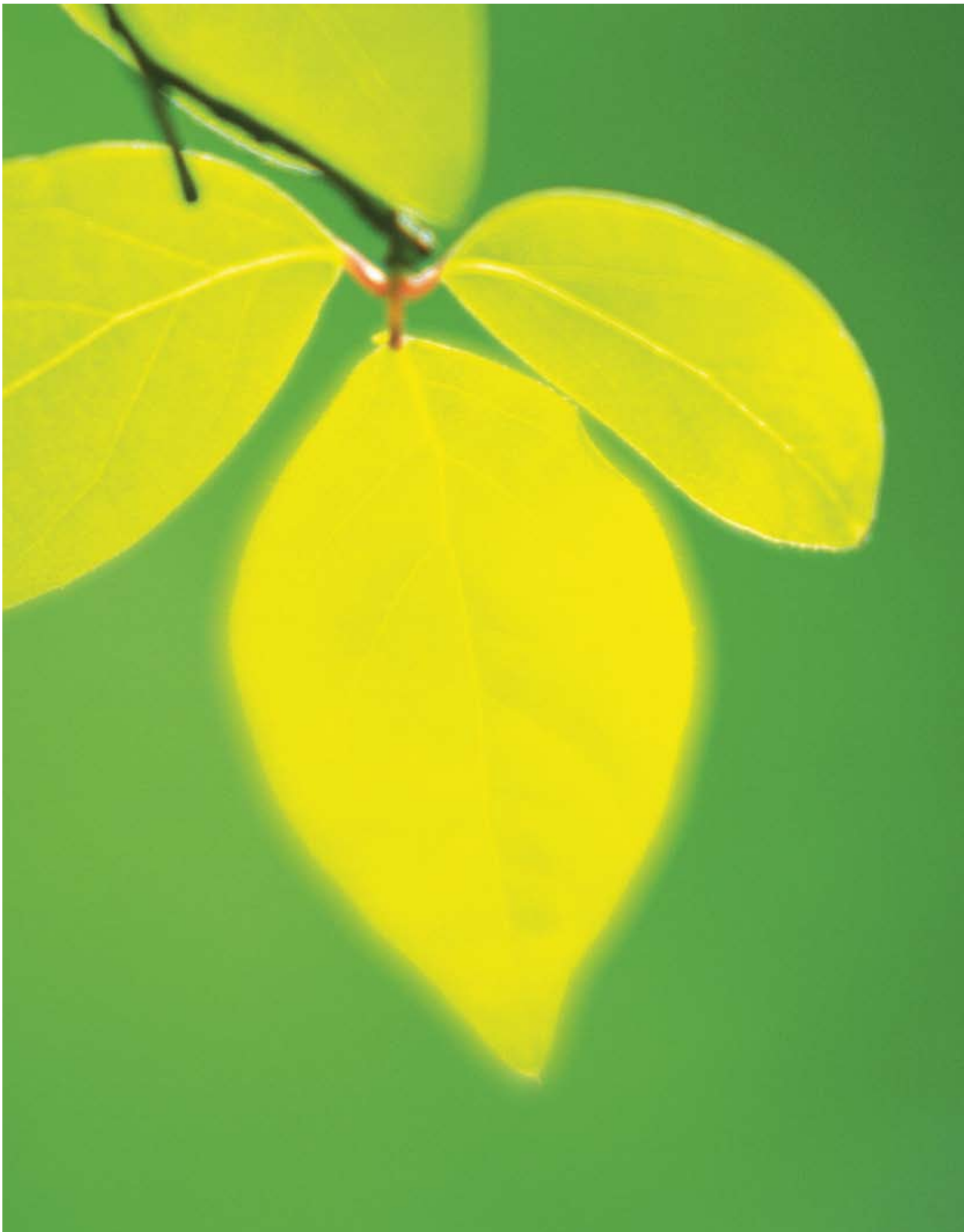
Now is the first time our CEOs are facing a serious recession. Yet, it is refreshing that they still believed their business would succeed in this environment. If there is one word that would define Canadian software companies, it is agility. Our report shows software CEOs are adapting well. They are growing the top line, pursuing channel partnerships, managing staff and costs, and raising money where they can.

Enjoy the report and I look forward to more stories of Canadian software companies connecting their vision to reality.

A handwritten signature in black ink, appearing to read 'P. Matutat'.

Peter Matutat

Partner and National Emerging Company Practice Leader
PRICEWATERHOUSECOOPERS LLP



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Highlights

The impact of the economy

- There is optimism for 2009. In 2009, 57% of CEOs surveyed expect their sales to increase over 25%. Only 43% achieved that level of growth in 2008.
- While 44% of CEOs surveyed are slowing down their growth plans in response to current economic conditions, another 34% said they have made no changes to their operations.
- 59% of companies surveyed are profitable.
- Only 38% of CEOs surveyed have a positive outlook for IT spending in Canada in 2009 and only 28% have a positive outlook for US IT spending – the lowest levels in the survey's history.
- Exit plans are being deferred and delayed. 81% of CEOs surveyed expect to be acquired, down from 95% last year. 25% expect their exit to take at least five years. In last year's survey almost all respondents expected their exit to be completed within four years.

The #1 challenge – growing revenues

- 48% of CEOs surveyed said their most challenging issues over the next two years will be growing revenues and developing sales channel partnerships.
- 80% of the sales of the companies surveyed continue to be through direct sales, consistent with the past year's results, although 70% of respondents are pursuing channel strategies.
- Consistent with prior years, while 71% of CEOs surveyed believe they have a superior product to that of their competition, 46% believe they have superior customer service and 43% believe they offer broader and deeper solutions, only 6% say they charge higher prices than their competition.

Raising capital

- 37% of CEOs surveyed successfully raised capital in the last two years, representing 70% of CEOs surveyed who attempted to raise capital. 40% of the funding came from angels and 51% from VCs.
- 54% expect to need additional outside funding in the next 18 to 24 months.

No staffing issues

- The CEOs surveyed continue to have relatively few staffing challenges. Forty-nine percent of respondents had less than 5% turnover in 2008. Furthermore, 31% said that attracting/retaining sales/marketing employees is not a challenge, 34% said attracting/retaining technical employees is not a challenge and 47% said attracting/retaining top level management is not a challenge.

Technology trends

- The “Selfsumer”: PwC believes that there is a significant trend in place of moving beyond the “consumer”, who shopped in stores and online, choosing products that were designed and advertised by others. Moreover, this trend has already moved beyond the “prosumer”, who shopped online, helped design products and enjoyed targeted, personalized advertising. Now the new Selfsumer has arrived, who searches for and discovers bits and pieces of offerings and advertising of products from multiple sources. Over 90% of CEOs surveyed believe that the Selfsumer will impact online searches and the way goods and services are produced and marketed.
- Video is coming: 36% of CEOs surveyed believe that video will be a significant means of communication in business in the next three years.

Profiles

Profile of companies and CEOs

The profile of the companies and CEOs in the 2009 survey was as follows:

Company revenues

\$0 – \$1 Million	38%
\$1 – \$5 Million	34%
\$5 – \$10 Million	16%
\$10 – \$25 Million	10%
\$25 Million +	2%

Ownership

Owner Managed (including friends and family funding)	61%
Angel Funding	13%
Venture Capital Backed	20%
Public	6%

Number of employees

1 – 25	60%
26 – 50	22%
> 50	18%
Average	41 employees

Profitability

CEOs surveyed who are currently profitable	59%
CEOs surveyed who are not yet profitable but expect to be profitable in two years	39%

Location

Ontario	83%
Western Canada	10%
Quebec	4%
Atlantic Canada	3%

Age of companies

Founded after 2002	39%
Founded 1996 – 2002	37%
Founded 1991 – 1995	11%
Founded before 1991	13%

Primary areas of business

Enterprise applications	50%
Application development	39%
Web services	23%
Application software	19%
IT Consulting/Systems integration	19%
Collaborative applications	16%
Internet portals/Search tools	12%

Within Enterprise applications, the most common responses were

Business Intelligence	32%
Customer Relationship Management	22%
Enterprise Resource Planning	19%
Supply Chain Management	12%

Geography of revenues

Canada	46%
United States	40%
United Kingdom	3%
Other Europe	6%
Rest of world	5%

Path to CEO

Founder	77%
Hired as CEO	13%
Promoted from within	10%

Previous experience of CEO

CEO	26%
Sales & Marketing	19%
Engineering	17%
Research & Development	13%
Consulting	10%
Finance	4%
Other	11%



Growing revenues and building channels

Performance and predictions

Once again, the CEOs surveyed indicated that they viewed growing revenues with quality customers to be their most challenging issue over the next one to two years. This is consistent with the results of the past five surveys and is no surprise.

What was surprising (and refreshing) was the confidence the CEOs expressed in their ability to grow revenues in 2009 in the midst of a global recession. Almost 60% expect sales to grow over 25% in 2009 – relatively consistent with the forecast made for 2008.

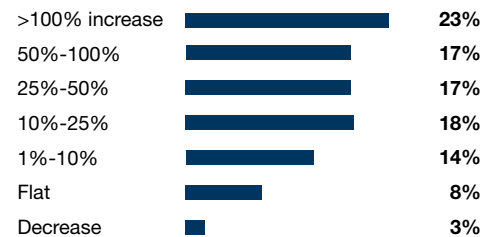
These expectations are certainly above the growth rates predicted by most experts for global software sales and is above the 3.8% growth rate predicted by IDC for software in Canada in 2009 and the 4.9% CAGR forecasted through 2012.¹

However, traditionally, our CEOs have overstated their forecasts and actual results are less than forecasted. In 2008, this happened, and actual results were not as strong as forecasted. In last year's survey, 46% of CEOs expected their sales to grow more than 50%. Only 26% were able to achieve this goal.

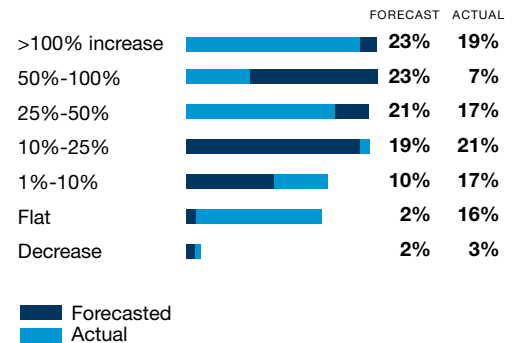
Another area where the CEOs have been unable to meet their targets, not surprisingly, is sales to the US. For the past two years, CEOs have predicted increases in their share of revenues to the US to approximately 45% of total sales. For both 2007 and 2008, sales to the US have remained stagnant at 38% and 40% of total sales respectively. In 2007, the weaker US dollar and the initial stages of the US recession hurt US revenues. In 2008, the US dollar strengthened by 25% at the end of the year, but this could not overcome the steep decline in economic activity in the US in the last four months of 2008.

¹ IDC, *Economic Crisis Response: Canadian ICT 2008-2012 Forecast Update*, Doc # CA8ICTE8, December 2008.

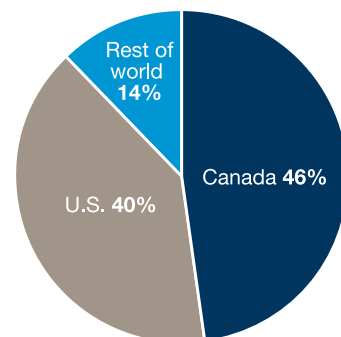
2009 Forecasted sales



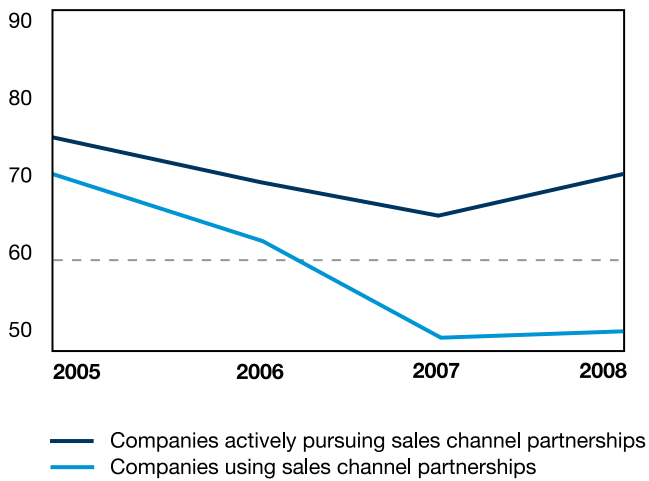
2008 Forecast and actual



2008 Revenues by geography



Use of sales channel partnerships



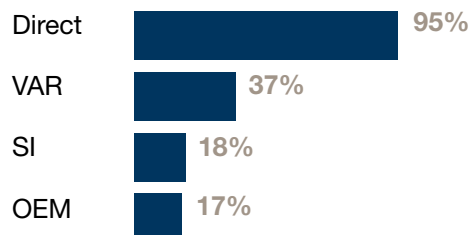
Developing partnerships

In previous reports, PwC has continually promoted the idea of Canadian emerging software companies using partnerships in order to leverage their financial resources and increase sales. A typical emerging Canadian software company has limited access to external funds and does not have the financial resources to build a large direct sales force that can effectively sell to the US or the rest of the world. Partners and distributors can help expand the reach and sales penetration of an emerging company.

Of course, building effective sales channels is easier said than done. The CEOs surveyed have been largely unable to implement their channel strategies. Approximately half of the CEOs surveyed manage all of their sales through direct channels and 63% have at least 90% of their sales generated through direct channels. While over 70% are actively pursuing channel partnerships, only 51% have had any sales through them to date. This is a decline from the 70% of companies that were actively using sales channels in 2005.

CEOs have struggled with each of the three main types of partnership channels: Value Added Resellers/Distributors (VAR), System Integrators (SI) and Original Equipment Manufacturers (OEM). Over 65% of the CEOs surveyed using the SI and OEM channels consider their relationships to have not yet been successful or to have shown limited success. The results were slightly more positive for the VAR channel with only 54% dissatisfaction.

Channel Usage



Maintaining partnerships

Why the lack of success developing partnership channels? A common mistake software companies make is to underestimate the effort required to nurture and maintain a channel partner.

Time and resources are required to integrate both products and personnel with a channel partner, as well as to train and educate the channel partner. The channel partner is an extension of the company and needs to be treated (and rewarded) appropriately. CEOs need to keep in mind the following:

- Partners don't generate demand – they fulfill it. It is critical to devote resources to supporting the sales partner.
- Develop pricing models that deliver incentives that will motivate the partner.
- Deepen the win-win with integrators by encouraging them to engage the service potential of each sale.
- Embrace patience – an effective partnership will take time.

CEOs need to be aware of the goals of their channel partners. Keeping their business strategy in mind will help unify goals and make the channel an integrated part of a company.



David Nyland, CEO of Blueprint Software Systems Inc.,

has extensive experience with sales channels. David was previously the President and CEO of NBS

Technologies, and was a C-level executive at Architel Systems Ltd. (sold to Nortel Networks and now part of Oracle Corp.) and Syndesis Ltd. (sold to SubexAzure).

He strongly believes in the need for an appropriate channel strategy to accelerate the growth of emerging software companies. Some of the keys to successful channel development that he's identified over the years include:

- The "channel" team must be a separate function within the company, with a dedicated team. The channel team is as important as the direct sales team and has to be as good as the direct sales team with the same level of skills. Many companies make the mistake of seeing channel activities as add-ons to the regular sales teams' functions. The channel team also needs good technical support.
- Realistic expectations have to be set for a channel strategy. Too often, expectations are too high and CEOs display little patience. Proper channel development takes time and a one-to-three

year time frame should be used to evaluate the channel's development.

- Channel choice is critical. OEMs are ideal for embedded software and should be an early target for these products. Software that is more exposed to the end user should likely be developed initially through reseller and integrator channels before approaching OEMs.

In a slower economic environment, David cautions that CEOs need to be aware that resellers will be an even more challenging group to initiate activities with. When times are tough and sales targets are challenging to meet, resellers will revert to the products that have worked best for them in the past and are less likely to spend time and effort on new products. It will be hard to obtain that critical mindshare with the resellers and to get them to make your product a priority.

David suggests that more CEOs should consider focusing on the system integrator channel. Systems integrators, such as CGI and Accenture, are the implementers of larger scale software solutions for larger organizations. Once a product is accepted and shown to work in one of their solutions, they are likely to use it again for their other projects. This also creates deep "referencability" for the product and proves its technical capacity.

Channel primer

Channel types

Value Added Resellers/Distributors

- Parties that will sell your product and solution along with products of many other companies
- Effectively, an expanded sales force
- VARs will typically not alter your software and are a pure seller
- May provide limited customer support
- Easiest channel partner to pursue
- Expected benefits are improved market visibility and geographic expansion

Systems Integrators

- Entities that provide large integrated solutions to their customers
- Need to incorporate the most appropriate software into their overall solutions to best serve their customers
- SIs can attract larger and higher quality customers and can validate an up-and-coming company in the marketplace
- SIs will have high requirements of the companies they partner with, including solid technology and an established customer base

Original Equipment Manufacturers

- Often considered the ultimate goal for many software vendors
- OEM arrangements can provide stability in terms of cash flows
- Can be a natural exit opportunity as the OEM may choose to acquire a company to ensure access to a certain solution
- The most challenging to establish and control
- Will likely require exclusivity.

An alternative approach

The classic business model for a Canadian software company is to develop an idea and build the code or product. Management will then try to raise funds in the range of \$5 million from VCs or banks to build a direct sales and marketing force. They then try to develop US and European sales channels, scale the business to \$10 million to \$20 million in sales over five to seven years, and finally sell to a large US software company at a decent revenue multiple.



Albert Behr, of Behr & Associates Inc., a recognized clean and information technology consulting practice aimed at emerging Canadian technology

companies, believes a different approach should be considered.

Albert suggests considering the following, “What if you could take the best technology available, regardless of geography, license it to the appropriate World-Scale Vendor, and leverage the product to both parties’ mutual benefit? The technology company achieves worldwide distribution and revenue immediately through a royalty with no form of cap table dilution, and the large worldwide entity achieves market penetration 12 to 24 months sooner than what it would have achieved organically and without having to fund the initial development.

And, what if you could get that ‘promising’ technology company capitalized by virtue of achieving that worldwide revenue bearing deal through ‘factoring’ that large contract?

To ‘finish the job’ corporately, get one or two more similar technology licence deals over the next 12 to 24 months. Do NOT build a direct sales force; do not market broadly and expensively. Wait for the CFO of the World-scale Vendor to get fed up of writing royalty cheques.”

This strategy won’t see you building the next Cognos, but offers a defined blueprint that might be the best way for you to connect your vision to today’s reality.



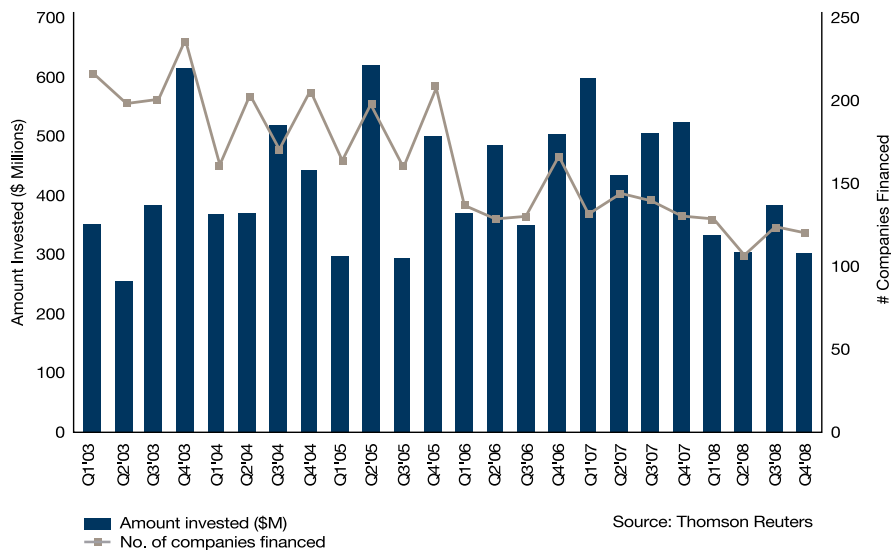
Where's the money?

Raising capital

Our respondents were once again relatively successful in their fundraising efforts. While only 54% attempted to raise capital in the past two years, 69% were successful, consistent with last year's results. This is a very positive result given the challenging fund raising environment in Canada. Raising capital in 2008 for emerging Canadian software companies was certainly not easy, and 2009 is not going to get any easier.

VC investing activity in 2008 was \$1.3 billion, a 36% decline from the \$2.1 billion achieved in 2007, and the lowest level of activity since 1996. The decline from 2007 was due to lower levels of fund raising by VCs in the past few years combined with less money invested in Canada by US VCs.¹

Venture capital activity – Canada



¹ Canada's Venture Capital Industry in 2008, Thomson Reuters

Top Canadian VC fund raisers

Top 6 VCs represent more than ½ of total funds raised

Fund name	Fund size CA \$m
Summerhill Ventures I LP	\$175
BlackBerry Partners Fund	\$151
iNovia Investment Fund II LP	\$112
Avrio Ventures LP I	\$75
Chrysalix Energy LP III	\$73
Yaletown Venture Partners LP II	\$65
Total	\$651

Lack of fund raising leads to lower investments by VCs

Fund raising by Canadian VCs has now reached historic lows. The \$1.2 billion committed in 2008 was consistent with 2007, but the levels are the lowest since the mid-1990's and are down significantly from the \$2.2 billion and \$1.6 billion raised in 2005 and 2006.

The difficulty in raising funds is not surprising given the poor performance of VC funds over the past 10 years. A recent survey by Canada's Venture Capital & Private Equity Association and Thomson Reuters noted the following rates of returns for 138 VCs in Canada through December 2007:

1 Year	3%
3 Years	3%
5 Years	0%
10 Years	2%

The median Canadian VC has shown a cumulative-since-inception return of 0%. Even the VCs in the top quartile have only averaged a 7.5% cumulative-since-inception return.

US VCs have had much better results. Thomson Reuters and the US National Venture Capital Association noted the rates of returns for 1,941 venture capital and private equity firms as follows through December 2007:

1 Year	19.5%
3 Years	9.4%
5 Years	8.5%
10 Years	18.3%

Labour sponsored funds continued their decline in the market place as total funds raised by labour sponsored funds in 2008 declined to \$532 million from \$741 million in 2007 and \$907 million in 2006.² The decline is expected given the phase out of certain tax credits by the Ontario government that has limited the attractiveness of this vehicle for retail investors.

The reduced level of fund raising resulted in only \$954 million being invested in Canadian companies by Canadian VCs in 2008, a decline of 22% from 2007. Canadian VCs also reduced their investment in foreign companies by a similar margin, as investments outside of Canada declined from over \$250 million to a little over \$200 million.

The US did not fill the void

In 2007, investments by US VCs masked the reduced level of funds available for investment by Canadian VCs. 2007 activity was highlighted by the \$160 million investment in GeoSign by American Capital Strategies Inc., an investment representing 8% of total activity in 2007. US VCs made up a full 41% of total investments in 2007.

However, in 2008, the level of investment by US VCs declined to \$371 million from \$845 million and US VCs have now declined to 28% of total funds invested in emerging Canadian companies.³

Canadian venture capital investment

	2008	2007
Total funds disbursed to Information Technology companies	\$644M	\$1.1B
Total funds disbursed to Software/Internet companies	\$290M	\$664M

Canadian vs. US activity

Canadian activity	2008	2007
Total VC investment	\$1.3B	\$2.1B
Number of companies funded	371	412
Average investment per company	\$3.6m	\$5.0m

U.S. activity	2008	2007
Total VC investment – \$US	\$28.3B	\$30.9B
Number of companies funded	3,808	3,952
Average investment per company – \$CA	\$9.4m	\$10.1m

² Canada's Venture Capital Industry in 2008, Thomson Reuters

³ Canada's Venture Capital Industry in 2008, Thomson Reuters



Why companies chose not to raise capital

Current revenues and cash flows are sufficient to cover operating costs and investment in R&D	73%
Do not want to dilute ownership	42%
Able to obtain sufficient financing from personal sources	25%
Solution is too early in the development stage to attract investors	16%
Do not know how to attract investors	10%
Solution is too mature to attract investors	6%

Bootstrapping – the Canadian way

Approximately 46% of CEOs surveyed did not attempt to raise capital in the past 24 months. The most common reason why is that they are able to make do with what they have. Over 73% of CEOs surveyed stated that they have sufficient current cash flow to cover operating expenses. Given the current funding climate in Canada, many emerging software companies will likely have to be able to make do with what they have for a while. Another 42% also said that they did not want to dilute ownership. This has increased from 14% in last year’s survey and is a reflection of the high cost of financing in the current funding environment.

The CEO – Key to raising capital

We asked the CEOs who successfully raised capital in the past two years to tell us the key factors that made them successful. They identified the following:

Experience of management team	70%
Market opportunity for the solution	77%
Effective articulation of the value proposition	62%
Solution identified as a 'hot' idea	32%
Product identified as a superior technology solution	15%

Two of the top three factors depend largely on the credentials of the CEO and his ability to speak to his/her vision. When we asked this question of VCs and other investors, the response was the same. The CEO and his ability to articulate his vision is critical to raising capital.



Leading and motivating

The widespread impact of the current economic downturn has meant all industries, including technology, are facing similar challenges, including:

- Lack of credit or limited availability of financing;
- Difficulty in forecasting future business scenarios; and
- Customers who are wary of making purchases or taking a leap of faith with a product or service that is new, preferring what is tried and tested.

While businesses struggle to successfully manage operations in the face of these challenges, emerging software companies recognize these challenges as ones they face in both good and bad times.

We asked the CEOs if they were doing anything different, given the current economic climate. While 44% of CEOs surveyed stated they were slowing down growth plans, 34% stated they were not doing anything different. It would seem that start-ups are confident that their long-term approach is the right one. Slowing growth is about staying the course, but adapting to the mood and pace of the market, not a radical rethink of the long-term objectives and goals of the company. By staying the course it appears that many CEOs believe that their product/service offering can carry the company despite the economic situation.

However, despite slowing their growth plans our CEOs also told us that they are still planning to expand and are investing in their people and their sales efforts. Some of the actions being taken by our CEOs include:

- Ramping up sales and channel efforts;
- Creative compensation structures (e.g. non-cash benefits and increased vacation);
- Focused/targeted/segmented marketing;
- Reinvesting in R&D and marketing; and
- Bringing in the right people.

Actions taken due to recession

44%	Slowing down growth plan
34%	Not doing anything different
16%	Downsizing operations and sales
16%	Downsizing R&D development
18%	Delaying new product launches
14%	Downsizing management group

60% of companies surveyed issue stock options to employees.

Staff retention

Over the course of conducting the annual survey there have been three consistent trends:

1. Turnover at emerging software companies is low – 49% of CEOs surveyed had turnover of less than 5% in 2008.
2. The CEOs do not believe that staff retention is a major challenge – 60% of respondents do not believe that staff retention is an issue.
3. The CEOs believe they need to improve their people skills.

While the current economy has certainly played a role in the ability of companies to retain staff, we believe that the CEOs surveyed understated their ability to create a positive and exciting work environment for their employees and this has contributed to reduced levels of turnover. Some of the ideas and suggestions provided by the CEOs on how they maintain and grow a solid team illustrate this:

“Allow team to take on more responsibility and accountability for success.”

“Being calm in the storm. Staff and clients appreciate a steady demeanor. It turns out to be a strong competitive advantage when so many others are prone to panic.”

“Empower the quality assurance team.”

“Enable staff to be successful based on their strengths.”

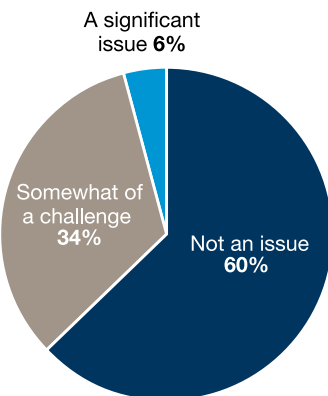
“Established monthly employee meetings and weekly management meetings to update on company’s directions and activities.”

“Get to know staff and clients better.”

“Give junior people room to grow quickly into critical resources.”

“Hiring great people – at the end of the day it’s all about people.”

Is staff retention an issue?



Staff turnover in 2008

< 5%	49%
5%-10%	23%
10%-15%	17%
15%-20%	3%
20%-25%	5%
> 25%	3%

Generation Y

A new demographic of workers is cause for CEOs to rethink or re-evaluate how they motivate and reward their workforce. As Generation Y (those people born between 1980 and 1996) takes a more prevalent role in the emerging software industry, CEOs need to be conscious of what keeps them engaged and passionate about an organization.

Much in the same way that the nature of start-ups makes technology companies well-suited to navigate the ups and downs of the current economy, emerging companies focus on teamwork and collaboration is an important first step in making them appealing career stops for this generation. While many organizations are still resistant to adapting to the work approach of this demographic and expect Generation Y workers to in essence adapt to the existing culture of work, the decline in IT talent resulting from the slow decline of enrollments in technology programs¹ potentially has a more immediate impact on the talent pool for start-ups, leading to a greater need to address Generation Y's needs.¹

Creating a supportive work environment for Generation Y employees means an increased focus on the following:

- Continuous, frequent feedback and mentoring;
- Teamwork and group activities;
- Communication tools; and
- Career management and development opportunities.

For Generation Y, the yearly performance review as a means for feedback fails on several fronts, most importantly with regard to frequency and formality. For a generation focused on interacting and learning through direct discussions, positive reinforcement and real-time feedback, formal conversations at prescribed intervals leave Generation Y with many questions and uncertainties about their performance and contribution. Leaders need to be prepared and make time for timely and relevant feedback – be it mid-project or mid-conversation so that staff understand and can act on what is working and

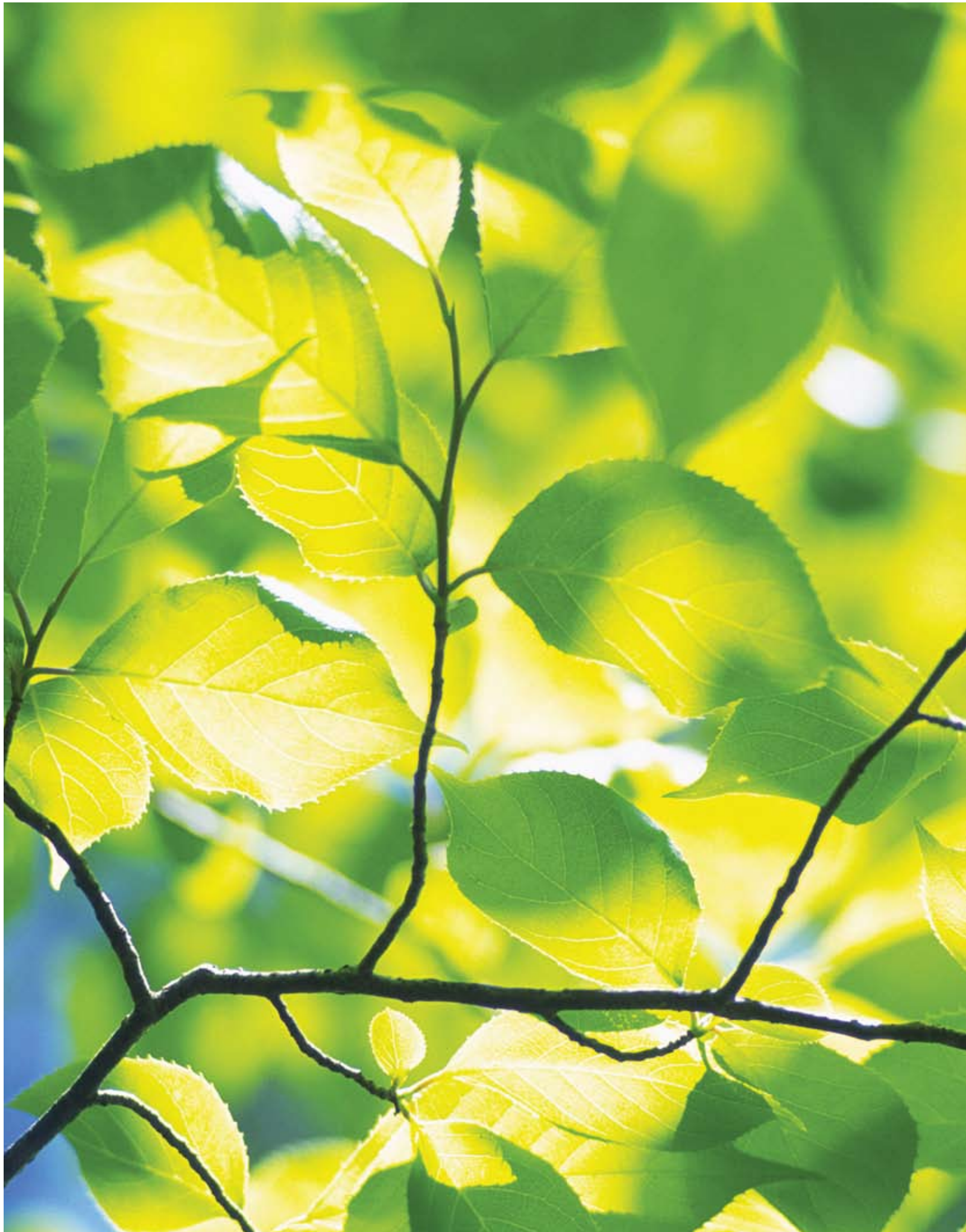
what is not working. The dynamic nature of emerging companies where people have multiple responsibilities and roles also gives management varied opportunities to mentor workers through situations where they can grow and contribute to the team.

Being part of a team is also particularly important for Generation Y workers to feel a connection to the greater goal of the project or organization. Keeping them cooped up in an office to work on solo projects does not make the best use of their collaborative skills. Not only do they want the opportunity to bounce ideas off one another, but they want the chance to learn and develop together in new ways. They want to be challenged and at the same time engaged with the process to build even better solutions than can be developed on their own.

As early adopters of technology, Generation Y and emerging companies have yet another thing in common. Having the ability to communicate quickly, easily and succinctly is important for a sense of connection, but also to prioritize and make decisions. These tools, like instant messaging, are as critical as word processing applications or spreadsheets in helping staff to do their job. Though there are concerns about the mix of business and personal communications interfering with one another, Generation Y workers are adept at either effectively separating the two or intertwining the two for mutual benefit such as networking.

While no Generation Y worker expects his/her career to take place in one organization or to be the responsibility of their organization, he/she is as focused on their career as they are on their lifestyle. Again, it is about one supporting the other as opposed to interference of one on the other. In the same way that a continuous dialogue about expectations and performance is important to keep them engaged, understanding their career development and opportunities within the organization and industry is something leadership needs to recognize. Skills development and the chance to grow within their position is not necessarily about the next promotion, but about new challenges.

¹ Statistics Canada, "University enrolments by program level and instructional program", CANSIM, Table 477-0013, March 17, 2009.



When can I retire?

Exit valuations

The M&A Dream

The goal of the vast majority of CEOs surveyed is to be acquired, with over 80% of respondents considering this to be their most likely exit strategy. However, this is a significant decline from last year where 95% expected to be acquired. We also noticed an increase in the expected time to exit. Last year, almost all CEOs surveyed expected their exit to take place within four years. Now, one year later, 25% expect their exit to take place in five years or longer and 15% have no plan to exit.

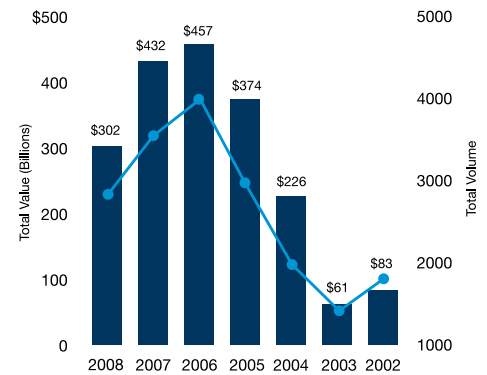
These results are consistent with recent merger and acquisition (M&A) trends. According to The 451 Group, an independent technology industry analyst company, the technology sector saw deal activity decline to 2,962 deals worth \$302 billion U.S., down from the 3,640 deals worth \$432 billion U.S. in 2007¹, M&A activity has cooled significantly from the peak years of 2005-2007 and is now approaching the levels of 2004.

Software activity mirrored the overall M&A market. In 2007 there were about 800 software deals worth \$69 billion U.S. In 2008 the number of deals dropped slightly to approximately 750, but the total dollar value of the deals fell to only \$31 billion U.S.

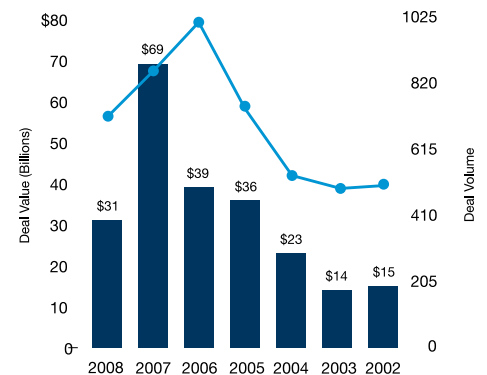
The IPO reality

Only 2% of CEOs surveyed consider an IPO as a likely exit. A new low over the history of our survey and down substantially from the 35% who expected an IPO exit in 2004. This is not a surprise however, given the IPO window is currently effectively closed in both the US and Canada for software IPOs. In Canada there were no IPOs of software companies in 2008 and the US fared little better with only one. Many do not expect the IPO market to open soon. The US National Venture Capital Association found 72% of its members do not believe the IPO market will open until 2010 or later.

Overall Tech M&A



Software M&A Totals, 2002-2008



■ Value of deals in billions
● Number of deals

Source: The 451 M&A KnowledgeBase

¹ Tech M&A Outlook 2009, The 451 Group, January 2009

Cash in the tech space (\$ millions)

Company	Current cash
Cisco	29,530
Apple	25,650
Microsoft	20,300
Google	15,850
IBM	12,910
Oracle	11,290
HP	11,260
EMC	6,810
Yahoo	3,450
Sun	2,640
SAP	2,040
Symantec	1,530



Bruce Lazenby, is the head of the Ottawa software cluster and is the regional director for Corum Group Ltd. He is well positioned to give his views on

the market for Canadian software companies.

The global perspective

The worldwide slowdown will indiscriminately kill good software companies as markets contract and funding disappears. M&A activity levels will drop in 2009 and large deals will be much less likely due to credit problems, but hundreds and hundreds of smaller deals will get done – mostly as cash deals. Many buyers have been hoarding cash, a good portion of which they will use to undertake targeted acquisitions. As valuation expectations between buyers and sellers align – mostly as sellers back off from irrational expectations – many good deals will be completed. This is a six to nine month process, so sellers need to be proactive. They should not wait until the wolves are at the door and the value of their company has collapsed.

The Canadian perspective

We at Corum believe that Canada is a bit of a bubble. As the only industrialized nation not to have had a bank failure, and with employment and housing prices more stable than in most countries, Canada hasn't really seen the pain, yet. However, Canadian software companies are huge exporters and some companies are starting to find that buyers for their products are getting harder to close and pipelines are getting pushed out. Many Canadian software companies are about to feel the pinch. Some banks are calling credit lines, and new equity capital is almost impossible to find. For many companies, a strategic merger with a larger player is the best option. Even if valuations are down broadly, some really good deals will be done with the right buyers. Unfortunately, many companies will wait until it is too late and will be sold as distressed companies at rock bottom prices.

CORUM
MERGERS & ACQUISITIONS

Notable transactions – Canadian targets

Target	Buyer	Market	Value (\$ millions)
Tilcon Software	Wind River	Development Tools	\$3.5
Cyence International	Davis Henderson Icome Fund	Financial Services Software	\$38.0
Teranet Income Fund	Borealis Infrastructure Management	Commerce	\$2,020
Q9 Networks	ABRY Partners	Infrastructure	\$361
Zi Corporation	Nuance	Communications	\$40
Xmark Corporation	Stanley Works	RFID Solutions	\$45
PlateSpin Limited	Novell Inc.	Virtualization	\$205

Public Company Valuations – Sales Multiples at March 31, 2009

Category	Multiple	Description
Internet	1.60	Search, navigation, commerce enablement, content
Infrastructure	1.43	System management, storage, security, VOIP
Vertical applications	1.14	Software aimed at specific industries
Horizontal applications	1.12	ERP, CRM, BI, HR, CM and SCM
Consumer applications	0.64	Digital content, games
IT Services	0.56	Consulting, integration, outsourcing



Intellectual property

Introduction

We have once again examined how CEOs view the importance, value and role of IP in their business. Particularly in times of economic downturn, emerging software companies need to fully understand the scope and value of their IP assets and the extent to which such assets could serve both as the basis for increased competitiveness and as a potential revenue stream. John Beardwood (Technology Law Group) and Mark D. Penner (Intellectual Property Group) of the national law firm Fasken Martineau assisted with our analysis again this year.



John Beardwood



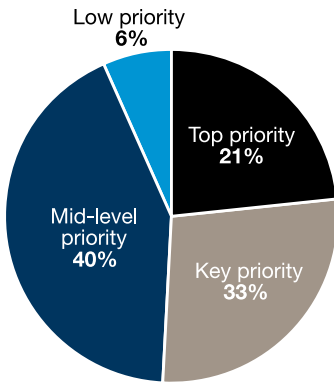
Mark D. Penner

Similar trends but a few surprises

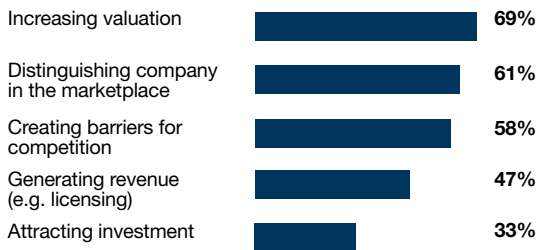
The 2009 survey results identified similar trends from last year's survey but with a few surprises:

- The majority of CEOs continue to view IP as driving their business model or as a top priority.
- When considering IP protection, a higher percentage of CEOs over last year are looking beyond Canada, reflecting a more global outlook.
- The results continue to illustrate a disconnect between the importance of IP and a more specific understanding as to the nature of each IP asset and how to best leverage those assets.
- There appears to be an enhanced understanding of the role of third party IP in their businesses. This does not, however, appear to be accompanied by a greater understanding of how to minimize the risks associated with third party IP.
- A surprising number of CEOs indicated they had been involved in a legal dispute involving IP, which suggests that CEOs may be unaware of the steps necessary to reduce the significant risk of IP litigation.

Extent of IP as a priority



The role that IP plays



Value and role of intellectual property

As was the case last year, a majority of CEOs surveyed this year know and understand that IP is important to their business. 54% of respondents consider IP to be a key or top priority, while only 6% consider IP to be a low priority.

Emerging companies also have a clear, and remarkably uniform view of the role that IP plays within their organizations. The majority of respondents indicated that IP distinguishes their company in the marketplace (61%), increases the company’s valuation (69%) and/or “creates barriers for competitors” (58%).

Interestingly, while slightly down from last year, 69% of the CEOs indicated that one of the key roles of IP within the business was to increase their company’s valuation. This reflects that most CEOs understand the value of IP as an asset. However, significantly down from last year, only 33% of CEOs surveyed in 2009 (52% in 2008) placed the same importance on the role of IP in attracting investment. This is likely a reflection of the current funding environment and is consistent with the fact that only 31% of CEOs surveyed are planning on obtaining financing from new investors in the next 18 months.

More puzzling, however, was the fact that only 47% of the CEOs surveyed reported that IP played a significant role in generating revenue for their company – for example, through licensing. This result, identical to last year’s result, is difficult to reconcile with the fact that the business model for most software companies is a licensing model (even software-as-a-service models require that the user have a licence). It may also suggest that a majority of CEOs continue to overlook opportunities to generate revenue from IP licensing more generally – opportunities which, in challenging economic times, companies cannot afford to overlook.

Which IP rights do emerging companies own?

IP protection in countries other than Canada is clearly important for the Canadian CEOs surveyed with 93% reporting that they sell outside Canada. The majority (59%) of the CEOs indicated they had sought to protect their IP rights outside of Canada, with the US and Europe being the most important jurisdictions. However, increasing significantly from 2008, Canadian companies are now seeking IP protection in emerging countries like China (13% in 2009, 6% in 2008) and India (9% in 2009, 3% in 2008). This not only reflects the growing role that these countries are playing within an ever increasingly global software industry, but may also reflect a perception that the IP protection in these jurisdictions is likely becoming more effective.

Much like the 2008 survey results, there still appears to be a disconnect in the responses between the scope of the IP assets which the companies claim to own or not own, and the CEOs' understanding of the specific nature of each particular form of intellectual property. There continues to be a significant underestimation of the ownership of copyright, trademarks and trade secrets and a possible overestimation of industrial designs:

- When considering what specific IP rights were owned by emerging software companies, a significant percentage of CEOs (60%) indicated that they owned copyright. While this is a small increase over last year (57% in 2008), the results remain troubling, as it means that 40% of CEOs do not recognize those copyright assets which they do possess. Copyright arises from the act of creation and can apply to a wide variety of material, which is key to the business of an emerging software company (e.g. developed software, user documentation, and websites, etc.) and further, remains a primary means by which software in Canada is protected. As such, we expected the correct level of response for copyright ownership to be approaching 100%.
- Nine percent of the CEOs surveyed indicated that they owned IP rights other than patents, copyrights and trademarks, etc. However, when asked to identify those rights, the examples included processes (potentially patentable) and source code (protected by copyright).
- A significant majority of the CEOs surveyed (59%) indicated that they owned trademarks, down from approximately 71% in 2008. Again, it is surprising that the number of respondents that recognized that they owned a trademark actually dropped by almost 10%. Each company generally has at least one trademark, whether or not it has registered that mark. The response may reflect a lack of understanding, evident in the 2008 survey as well, that trademarks can arise through simply using any word, symbol, logo and slogan, etc. or combination thereof that identifies the wares and/or services of one company from those of another (referred to as common law rights) – that is, trademarks need not arise through registration only.
- Only 39% of the CEOs surveyed this year indicated that they owned trade secrets, down from 45% in 2008. Trade secrets per se are a concept under US law. The Canadian equivalent is confidentiality obligations. Given that trade secrets are effectively a form of confidential information that has some commercial value (e.g. customer lists and supplier information, etc.), respondents would appear to still be significantly underestimating the trade secrets held by each company.
- While patent ownership this year (35%) seems consistent with 2008 (34%), 9% of respondents indicated that they owned industrial designs in 2009, an increase from 2% in 2008. While patents protect the functional aspects of software, industrial designs are directed to the features of "...shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye." These are not features that are generally associated with software; although industrial design protection is available for computer icons. Unless there has been a

IP ownership

	%
Copyright	60
Trademarks	59
Trade Secrets	39
Patents	35
Industrial designs	9
Other	9
None	10

There is a common misconception that open source software is free.

significant increase in the number of respondents who are endeavoring to achieve industrial design protection for their icons – an unlikely scenario – this response again suggests that there is a general lack of understanding as to the nature of the industrial design right.

- Finally, 10% of the CEOs surveyed indicated that they did not own any IP at all (compared to 6% in 2008). For the reasons explained above, this seems highly unlikely.

Third party IP and in-licensing of IP rights

For some IP rights, the degree of in-licensing of IP rights appears to have increased over last year. Of particular note, copyright licensing increased from 10% in 2008 to 17% in 2009, while trademark licensing increased from 6% in 2008 to 12% in 2009. Despite this, however, it appears that the 2009 CEOs surveyed, much like the 2008 CEOs, still are not fully taking into account in-licensing of IP. As seen in 2008, the majority of the CEOs surveyed do not license any IP rights from third parties (nearly 74% in 2008; 68% in 2009). We would have expected this number to be significantly less, but this high number could be explained by the respondents, making the strategic decision:

- To develop and market products that are solely proprietary and not to use any third party or open-source code in their products; and/or
- To avoid bundling products with third party products to create a single solution, or to bundle in such a way that their product is licensed to the third party selling the solution, without any licence-back to the respondent company.

The first point would be surprising in light of the increasing prevalence of open source in software development. It is a common misconception that open-source software is “free” in the sense of not being subject to license, when in fact, open source may be subject to various forms of licences. Open source licences contain many pitfalls. For example, their terms may impose restrictions on claiming

ownership in a company's software to the extent it is based on such open source. Or if "viral" imposes the terms of such licences on the developer's proprietary software to the extent such software interacts with the open source. It is, therefore, important for software companies to understand how open source is used internally, and to implement an open source policy regarding such use.

IP Management

In a positive, but slight, increase over last year, 67% of CEOs surveyed indicated they have a formal policy governing IP issues (versus 62% in 2008), such as disclosure of inventions and employee developments. While a majority of the companies are taking the protection and ownership of IP rights very seriously, 33% have not implemented any formal IP policies. Given that software is developed either by employees or independent contractors, the absence of policies increases the probability of there being disputes regarding IP ownership in the future. In our experience, after actual IP registrations, one of the first pieces of data an investor will evaluate in assessing the status of a target's IP portfolio is the status of this policy.

Basic IP definitions you need to know

Copyright grants the owner the exclusive right to reproduce a wide variety of copyrightable material, including software, user documentation, websites, etc. It arises automatically from the act of creation. There is no requirement to register, but certain advantages are obtained through registration. Copyright remains a primary means by which software is protected in Canada.

Trademarks grant the owner the exclusive right to use any word, symbol, logo, slogan, etc. or combination thereof to identify the wares and/or services of the owner from others. Trademark rights can arise automatically by simply using the mark or through registration of the mark. As with copyright, there is no requirement to register, but certain advantages are obtained through registration.

Patents are statutory granted monopolies for the exclusive right to make, use, or sell the patented invention for a period of 20 years. Patents can protect the functional aspects of software. Only available through registration, patents are enforceable against third parties only after they have been issued.

Patents can be a powerful tool as, unlike copyright, they do not require "copying" of the invention. In other words, independent development of a patented invention does avoid infringement.

Trade secrets are effectively a form of confidential information that has some commercial value (e.g. customer lists, supplier information, etc.). Trade secrets exist because of their confidential nature and cannot be obtained through registration. Once confidentiality is lost, however, the trade secret ceases to exist.

Industrial Designs protect the features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye. While patents protect the functional aspects of software, industrial designs are directed solely to aesthetic features of physical items such as tea pots, running shoes, etc. Owners must apply to register their industrial designs as they do not arise automatically. While industrial designs can cover electronic icons, they typically are not part of a software company's portfolio.

33% of CEOs surveyed have no formal IP policy.

56% of CEOs surveyed believe their IP strategy requires improvement.

Just over half of the CEOs surveyed (56%) agreed that their their companies' IP strategy requires improvement. When asked what would be the factor that would push them to implement the policy changes, 46% indicated that more funds and 31% indicated that better knowledge of the benefits versus the costs would provide them with an incentive to take the next step to improve their IP strategy.

While this at first appears to be a recognition of the disconnect between the CEOs' acknowledgment of the value of IP and their failure to implement effective IP protection, only 7% indicated that an IP dispute involving the company would lead the CEO to improve their IP strategy. Further, only 11% stated they would make improvements if they became aware of a dispute involving one of their competitors. This is puzzling – what external event would force respondents to improve their IP strategy, if not a lawsuit?

Assessing the Risk of Third-Party IP Claims

Before launching a new business, product or service, 74% of CEOs indicated that they would conduct a market analysis of existing businesses, products or services, a positive increase of 12% over 2008. Also, an increase over last year, 35% indicated they would search IP databases (18% in 2008). However, while this is a significant improvement, almost two thirds still do not conduct any IP database searches – one of the best steps to take to help avoid particular IP disputes. While there are some costs associated with conducting IP searches, the relatively minor investment can pay off significantly by identifying IP risks and help to eliminate the much more significant costs associated with IP litigation.

The degree to which conducting IP searches can assist a company to mitigate third party claims will vary based on many factors, including the number of competitors in the market, the nature of the product and the applicable jurisdiction. Certain IP databases may not accurately reflect the state of protection for particular products. In the case of patents, for example, there is an 18-month window of confidentiality in which patent applications are not published.

Perhaps more importantly, before going to market, a company should at least confirm its own internal records regarding ownership of IP directed to that business, product or service. While representing an increase over last year's survey, only 26% of the CEOs surveyed in 2009 take this step, compared to 13% in 2008 – meaning over 70% of CEOs still fail to take this step. Each company should ensure that it has completed its own internal IP due diligence, including obtaining assignments of copyright and waivers of copyright from its personnel, prior to going to market with its product. If there are key employees or independent contractors that are involved in the development of significant software, the company should confirm ownership of the software internally to avoid personnel contesting ownership, in particular, where personnel are then hired by a competitor.

What about general monitoring of the marketplace for potential IP issues? Of the CEOs surveyed 53% indicated they did nothing, consistent with 2008 survey results. Of the 47% in 2009 that did monitor the market, 72% did so through reading industry-focused publications (e.g. *Wired*), up significantly from 34% in 2008, and 46% read national newspapers (e.g. *The Globe and Mail* and *National Post*), up from 25%. Twenty-nine percent sought information from other sources, such as on-line search engines, legal conferences and, helpfully, in-house counsel. While those that are actively monitoring the marketplace have clearly taken more steps to inform themselves in 2009, these efforts are still less than effective. CEOs should be cautious about an over-reliance on publicly available material – not only is it likely to provide improper definition to any such IP issues

that could form a significant concern, but by the time the issues are referenced in the media it is likely too late to mitigate the risk.

In contrast, an increasing number of respondents appear to recognize the importance of legal risk management – in addition to seeking information from in-house counsel, the number of respondents seeking advice from IP counsel in 2009 more than doubled (34% versus 15% in 2008).

As noted earlier, the vast majority of CEOs surveyed (more than 93%) indicated they sell products or make services available outside of Canada. However, only 55% had taken steps to identify third party IP rights in applicable foreign jurisdictions. While it is up from 27% in 2008 it does not correlate well with the global scope of many of the respondents.

It is difficult to overstate the importance of conducting sufficient IP due diligence prior to taking a product or service to market. Due diligence assists in avoiding not only third party infringement claims, but also claims by licensees or purchasers for breach of contract, given each licensee or purchaser will likely require that the CEO provide contractual representations and warranties regarding ownership and non-infringement. It is difficult to see how many of the CEOs could be comfortable in making such representations and warranties, given over 74% of the CEOs surveyed failed to complete internal IP due diligence prior to taking a product or service to market.

IP Disputes

The adoption of an IP strategy that includes the implementation of an IP policy, the registration of IP and the conduct of IP searches prior to going to market is, of course, intended to forestall IP disputes. 14% of CEOs surveyed indicated that they had been involved in an IP-related dispute. However, this is a relatively high percentage, given that this survey covered emerging software companies. Given the high percentage of CEOs involved in IP disputes, we decided to explore in greater detail the nature of these disputes.

Not surprisingly, a majority (75%) of those CEOs were involved in an IP dispute in the US. However, a further 50% were involved in a dispute in Canada. A majority of CEOs (60%) indicated that a third party was asserting its rights against the respondent, while only 25% were asserting their IP rights against third parties. What does this mean?

- A significant number of those CEOs involved in an IP dispute were sued, as opposed to suing, in the US. As a general rule, US litigation tends to be more expensive and can place a greater demand on company resources than in Canada.
- A large number of the disputing CEOs were being sued in both the US and Canada.
- Almost 15% of the CEOs surveyed indicated that they were both defending a claim by a third party and asserting their own IP rights.

When asked which IP rights were involved in the disputes, 35% identified patents and copyrights. This was not unexpected given that for most software products, these two IP rights would be the most significant. Thirty percent identified trademarks as being the IP rights involved in the dispute, with 20% identifying other IP rights, such as trade secrets or industrial designs.

Interestingly, 55% indicated that the IP dispute significantly or somewhat altered or impacted their business plans. Using that result as a proxy for the significance of the IP litigation, it is difficult to understand how, of those respondents whose business plan was altered, only 15% felt that searching IP databases or engaging IP counsel could have avoided or reduced the impact of the IP dispute.

Despite the fact that 45% and 30% of the disputing CEOs indicated that patents and trademarks, respectively, were involved in the disputes, and all issued patents and registered trademarks are publicly available for searching, even with the benefit of hindsight, only 10% of CEOs surveyed indicated that they thought that searching IP databases could have avoided the litigation. This is significantly lower than the percentage of respondents who agreed that they would conduct a search prior to launching a new product or service. Again, while searching is somewhat less useful for copyright, trade secrets and common law trademark rights since there is no registration requirement for these IP rights, searching is still one of the most cost-effective means of reducing the risk of an unexpected IP dispute. Put another way, sophisticated business will complete a market analysis prior to developing and taking to market a new product or service – looking at the IP landscape prior to undertaking such development and marketing efforts is equally prudent.

Another surprising result is that only 5% thought that consulting with IP counsel could have assisted in avoiding the litigation and 20% indicated that there were no steps that could have been taken to reduce the impact of litigation. When you balance the costs of defending and settling disputes and the significant distraction they can cause for the business against the ready availability of mechanisms to avoid this risk, this fatalism is difficult to understand.

How did these disputes conclude? Sixty-five percent of the IP disputes were settled before trial, with only 5% proceeding to trial. A small number (5%), provided that there was a licence agreement, a surprising low number given that the implementation of licensing or cross-licensing arrangements, is a common feature of IP settlements.

Many themes

The 2009 survey results reveal a number of themes. First, it is clear that the CEOs of emerging Canadian software companies continue to view IP as driving their business models and that further, when considering IP protection and enforcement, a higher percentage of CEOs are adopting a more global outlook. Second, the survey results continue to show that there is a disconnect between the CEOs' general understanding of the importance of IP and their more specific understanding as to the nature of each IP asset in their businesses and how to best leverage those assets. Third, a surprising number of CEOs indicated they had already been involved in a legal dispute involving IP. And, finally, despite this litigation risk, CEOs have been slow in adopting the appropriate risk mitigation strategies. It remains to be seen whether, in tough economic times this was the right choice.





Technology trends

Introduction

In this year's survey, we examined the roles that search, discovery and social networking technology and applications are playing and will play in the future of marketing and purchasing products in personal and business communities.

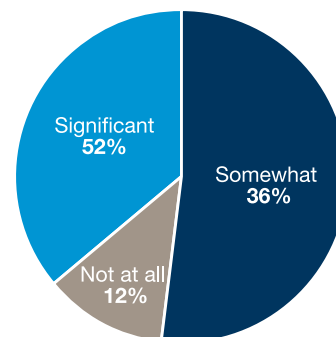
With the rapid increase of blended or multimedia search results, such as video, images and blog posts, as well as personalization searches and the long awaited launch of the "Semantic Web" business is well and truly headed into a new era. The newly-emergent Selfsumer trend is stimulating a number of new activities and innovative applications in society and business. This will transform how companies obtain the most benefit from new media advertising, both online and offline.

We also examined effective collaboration systems for product innovation and development as important business tools for the second decade of the 21st century and how companies are exploring how to gather and use unstructured information and tacit knowledge.

The rise of the Selfsumer in society and business

PwC believes that there is a significant trend in place of moving beyond the consumer who shopped in stores and online choosing products that were designed and advertized by others. Moreover, this trend has already moved beyond the prosumer, who shopped online, helped design products and enjoyed targeted, personalized advertising. Now the new Selfsumer has arrived, who searches for and discovers bits and pieces of offerings and advertising of products from multiple sources. This emerging trend is yet another fundamental change for advertising agencies and retailers to contend with, and will require them to think more creatively about the development of new product, promotional content and e-commerce channels to service the Selfsumer. Advertisers will have to adapt more and more to purchasers' new online skills and tastes enabled by search, discovery and social networking technology.

Impact of Selfsumer behaviour on online search and related software



Those who advertise will have to make the content ingredients available in new ways and new forms including creative video, allowing Selfsumers to assemble their own selection of possible purchases, in other words, their own, self-created advertisements, product selections and reviews. This will completely change the nature and structure of online marketing, advertising and sales, not only on the Internet, but also on TV, which is becoming more and more interactive and personalized. Both conventional and today's recently emerged personalized advertising is going to be largely ignored by Selfsumers who will prefer to assemble their own bouquet of information, comparative advertising knowledge and product selection, thereby enabling truly personalized e-commerce. The effect on mobile commerce will be enormous. Up to now, mobile commerce has largely been wireline e-commerce, somewhat adapted to a mobile platform, but with the rise of the Selfsumer, and the emergence of powerful smartphones, this is changing drastically as consumers themselves make an experience tailored to them, and their lifestyle as they move through their daily lives.

The Selfsumer will use powerful, easy-to-use, adaptive software mashups tools (web applications that adaptively combine data and functionality from more than one source) to decide on the fly when to buy, what to buy, what combinations to buy, and where to buy it. Selfsumers will not work alone and will collaborate to seek out and decide on their own purchasing preferences through social networking, brand and product awareness reinforced by "advertainment", rather than commercials as we know them today.

Our survey respondents clearly appreciated the importance of these consumer and business trends, and 98% recognized that Selfsumer behaviour is becoming a major driver of changes to online search, discovery, and associated consumer and business software applications.

Blended results are also being provided by search engines at a rapid rate. These include video, images and blog posts, along with more traditional forms of information such as articles. Of these varied formats, video is of particular importance. ComScore data from November 2008 showed that YouTube accounted for 25% of all Google searches in the US. If YouTube were a standalone site, it would be the second-largest search engine after Google, larger than Yahoo¹. Interestingly, among blog readers, (who are exhibiting Selfsumer behaviour), blogs have become a more important tool for identifying new content than search engines. For frequent readers, 38% said blog links were the top tool for discovering new blog content as compared with 34% who voted for Web search. Blogs also have more impact than social networks, with frequent blog readers saying they trust relevant blog content for purchasing decisions more than content from social networking sites.²

Personalization is also going mainstream. Google is leading the way with applications like SearchWiki and Preferred Sites, with the search engine including the user's location, recent searches, and which datacenter his/her search is sent to when determining the top ten results for a search. Perhaps most important, is the growing awareness of the authority of a site, determined in part, by the number of links to a site and buzz about it, garnered from social networking sites.

¹ ComScore: YouTube Now 25% of All Google Searches, TechCrunch, December 18, 2008.

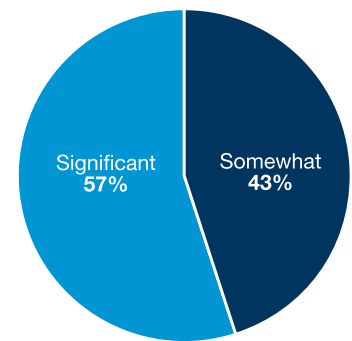
² *Blog Influence on Consumer Purchases Eclipses Social Networks: BuzzLogic Study Reveals the Evolution of Blog Reader Behaviour*; Monthly Readership Spiked 300 % Since 2004, PR Newswire, October 28, 2008.

The Semantic Web, long predicted as the holy grail of the Internet is finally taking shape as a significant factor in online search. These technologies let computers process the meaning of web pages instead of simply downloading or serving them up blindly. Indicative of the rising importance of the semantic web is Microsoft's acquisition of semantic search engine Powerset in 2008, and Twine, a web organizer, based on semantic technology, launched publicly in October 2008. On its website, Twine describes itself as a "new way for you to collect online content – videos, photos, articles, web pages and products – and bring it all together by topic, so you can have it all in one place and share it with anyone you want." Twine is "powered by semantic understanding, which means Twine gets to know you. It automatically learns about your interests and makes connections and recommendations tailored to you."³ Search has come of age and is now enabling true discovery.

Customer-focus in business and marketing

It is both interesting and significant that survey respondents unequivocally saw that the rise of the Selfsumer would change the ways in which companies reach and convince their customers and clients to purchase their goods. In recognizing that Selfsumer behaviour worldwide would have a high impact on companies' marketing and sales strategies, PwC published two reports emphasizing themes of special importance during 2008: *How the Consumer Conversation Will Transform Business* and *Navigating the Era of the Empowered Consumer*.

Impact of Selfsumer behaviour on the way companies market and sell their products and services



³ Twine (2009). About us. Retrieved April 9, 2009 from <http://twine.com/>

“Consumers are leading a massive, global conversation about products, services and companies... Consumers use online media, phone calls, emails, chats, and text messages to discuss what, when, and how they buy. And consumers, not marketers, lead the discussion.”

– *How the consumer conversation will transform business*

“With consumers undoubtedly in control, companies need to step away from traditional business models and collaborate in new ways both with each other and directly with their customers. ... Listening to the wide variety of digital consumer conversations underway today – about your customers, your company and your competitors – and incorporating their perspectives into your organization’s day-to-day operations can help illuminate the path forward.”

– *Navigating the era of the empowered consumer*

In *How consumer conversation will transform business*, PwC notes that “there is a great deal of investment and innovation occurring in technologies that translate vast amounts of free-form, “unstructured” consumer conversation into metrics and indicators. This activity verifies that the technical functionality necessary for analyzing consumer conversation is a rapidly maturing business, and will continue to fuel even greater capabilities leading to better insight and decision-making.”⁴

The number of US patents for customer analytics/customer-centric technology has increased sevenfold over the past nine years, and 125% over the past four years. This compares to a gradual decline of 13.9% in the overall number of patents during the same period. In Canada, one start-up in this area is Sysomos. Sysomos mines information from social media sites such as Twitter and Facebook and close to 30 million blogs. Findings are graphed by time, sentiment and demographics to provide a full picture of the buzz around products, brands, public figures or issues. Co-creator Nilesh Bansal says, while other companies already monitor web conversations, they generally only track how often a brand or product is mentioned. Sysomos’ offering is unique in that it captures what is being said, who said it, and the sentiment.⁵

⁴ *How consumer conversation will transform business*, PricewaterhouseCoopers, January 2008.

⁵ Nicole Baute, *Tracking web chatter to uncover trends; Sysomos mines data on brands, personalities from social media site*, The Toronto Star. 31 January 2009, GT01, via Factiva.

Companies recognize the importance of being online in order to promote their products and brand. Almost half of online adults read ratings and reviews at least once a month, and 19% post them. Statistics show that nearly twice as many read reviews in 2008, compared to 2007. One in three online adults now read blogs at least once a month, while 18% comment on them. Blog readers as a group grew by nearly 50% over 2007. Social networks have also taken off in 2008, with 24% of those online now visiting a social network at least once a month.⁶ Correspondingly, online advertising spending is forecast to grow from \$23.6 billion in 2008 to \$42 billion in 2013. Online video, in particular, will see high growth, as spending in this area is forecast to grow to \$4.6 billion in 2013. This represents a sevenfold increase from the \$587 million spent on the same format in 2008. Experts predict that, by 2012 more than four out of five Internet users will watch online video ads, an increase of two thirds from 2008.⁷

Companies are also relying on less direct approaches, such as social influence marketing. This allows online users to provide positive social influence, by word-of-mouth marketing for a product, company or website. In his article about the persuasive consumer, Josh Bernoff notes that just fewer than 50% of US adults currently online are classified as “persuaders”. He describes these as “those who tell others about products that interest them. They’re brand-motivated, open to ads, and highly active in social applications. To energize persuasive customers, marketers should listen and respond to their feedback, give them content to pass around, and appoint them as product ambassadors.”⁸

The Coca-Cola Company has used the analysis of consumer conversation, in combination with traditional market research, to create and market new products for changing taste profiles. By analyzing consumer conversation, the company realized that words such as “diet” and “light” produced a markedly negative reaction among certain demographics. By understanding the nuances of words in conversations (and the behaviour that necessarily stood behind them), Coca-Cola was able to recognize that there was a portion of the population that would in fact want a diet beverage if it wasn’t labelled as such. Hence the birth of Coke Zero.

– *How the Consumer Conversation Will Transform Business*

⁶ Josh Bernoff, *The Growth of Social Technology Adoption*. Forrester Research, Inc., October 20, 2008.

⁷ *Marketers Eye Online Video for 2009*, eMarketer, January 9, 2009.

⁸ Josh Bernoff, *Persuasive Consumers Are Socially Connected*, Forrester Research, Inc., February 17, 2009.

Hewlett-Packard (HP) is one company paving the way of social influence marketing. Over the past year, it has undertaken some campaigns with social media elements. The company's slogan is, "The Computer is Personal Again," and initiatives included a contest in partnership with MTV inviting participants to submit designs for a special edition HP laptop. Called "Take Action, Make Art," the winner was rewarded with the design featured on an HP laptop. The event drew 8,500 submissions from youth across the world with regional winners being selected by popular vote, and the final winner being chosen by a panel of judges. The site drew 5 million hits."⁹

HP has also launched a line of computers in partnership with Vivienne Tam targeted at fashion-conscious buyers. The line includes matching clothes and a virtual catwalk, and the initiative "has attracted a lot more attention in the blogosphere than one might expect." This demonstrates that women in particular, seem to be targets for social influence marketing; this was reinforced in a New York Times article that discussed a subset of affluent women dubbed "marketing multipliers". The label refers to women who spend

The empowered consumer

"Net generation" panelists who participated in PwC's day-long summit on evolving technologies and changing consumer behaviour noted the following:

Pull, don't push: While they may skip ads on their Digital Video Recorders (DVR), the Net generation says they still receive plenty of marketing, on their terms. As one Net Generation panelist noted, "It's the responsibility of advertising executives to get us to want to be involved in their marketing." The best advertising for her generation, "is not pushed on us ... be interesting," she says, "and you'll draw us in."

Be transparent: The Net generation appreciates efforts to leverage their personal information to deliver more relevant content and advertising, but companies must be upfront about how and when they use this data. "If you try and hide it, someone will find out. Who do you want your consumers to hear it from?"

Offer choice and a deal: If you want to experiment with close monitoring and use of online behaviour, allow consumers a choice of whether or not they want to participate. Better yet, give them incentives, such as discounts or free add-on services.

Make information easily accessible: Young consumers say they hear about products and services primarily through word of mouth. Once they hear about your brand, make sure it's easy for them to get information. Panelists specifically gave kudos to Amazon and Progressive Auto Insurance for offering one-stop price comparisons. "Amazon will show you the prices from other stores, even if they are lower," noted one panellist. "Often, I'll buy from Amazon, because I feel they've earned it."

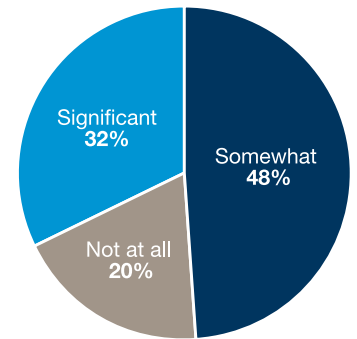
Incorporate the net generation's viewpoints into your operations: As one panellist aptly put it, "We all need mentors twice our age and half our age."

⁹ Shiv Singh, *HP becoming a truly social brand*. *Going Social Now*, October 22, 2008

twice as much as other affluent women on technology and fashion, and use dramatically more online and offline word of mouth to increase purchases. The study labels the subset “powerful catalysts for purchase behaviour and brand influence.” It goes on to say, “Marketing Multipliers have different media behaviour, especially, online, and are active contributors to the virtual world, not just passive readers. They are twice as likely to post to blogs or to publish their own web pages, compared to other women...Marketing Multipliers are more likely to seek out in-depth information on products.” In the investment category, for example, 45% follow up on new investment products they see advertised, and 53% of Marketing Multipliers in the automotive category “follow information related to new safety features.”¹⁰

In his article on social influence marketing, Shiv Singh takes a different stance. He differentiates between brand advocates who focus on gathering product information and purchasing them, rather than spreading the word through social media sites and influencers, who are “the people who are solicited for advice while a consumer is in the consideration phase of a purchasing decision.” Singh maintains that retailers cannot reach out to the influencers because they cannot know who they are; they vary according to the purchaser. Instead, he suggests that businesses need to be more deeply integrated within social networks in order to make it easier for consumers to solicit feedback from peers. He also suggests linking to third party review sites, leveraging employees to build online communities. Connect more directly with the offline shopping experience, and perhaps most importantly, make the product a discussion point so that it will naturally attract the attention of online conversations.¹¹

Impact of the selfsumer on products and services provided



¹⁰ *Affluent Women Dramatically “Multiply” Major Purchases with Word-of-Mouth*, New York Times, October 22, 2008.

¹¹ Shiv Singh, *Social Influence Marketing: Understanding those Peer Influences*, Going Social Now, May 2, 2008.

Consumerization of technology now enhancing companies

Companies are experiencing the “consumerization” of technology, where consumer technologies are increasingly being adopted by companies and used to improve productivity, develop software faster, share knowledge, track projects, and make information systems more accessible to employees. The trend is being driven in part by the entry of “digital natives” to the workforce. Gartner analyst, Steve Prentice says “innovation is now coming from consumers and their favourite technologies. Consumers are increasingly in charge. They are driving the specifications of technology. They are driving disruption and changing the balance of power.” Apple is one company that is looking to benefit from this trend; it is taking a “skim and penetrate” strategy, in which it “skims” a group of early consumer adopters, and later hopes that these adopters will evangelize the product and help it reach broader adoption.”¹²

This has also extended to social networking technology. Forrester found that 56% of North American and European businesses considered Web 2.0 a priority in 2008. The adoption of Web 2.0 technologies is expected to grow at a healthy rate through 2013, from US\$455 million in 2007 to US\$4,646 million in 2013, with social networking accounting for nearly half of spending through the forecast period.¹³ Businesses generally are becoming adventurous in using technologies to accelerate their successes and are introducing novel approaches beyond merely adopting technologies driven by consumers. Life science companies, for instance, anticipate being able to shorten R&D processes by as much as two thirds by 2020, using virtualization technology to predict the effects of new drug candidates

before they enter human beings. Other benefits include reduced clinical trial costs.

Virtual man could ultimately evolve from the deployment of existing technologies that are connected in a new way. Models of the heart, organ, cell systems and musculoskeletal architecture are already being developed by academics around the world. Such technologies can be used to simulate the physiological effects of interacting with specific drugs, and identify which drugs have a bearing on the course of a disease. Some companies using virtual technology have reduced clinical trial times by 40%, and reduced the number of patients required by two thirds.¹⁴

Collaboration in product innovation

There is increasing realization among business executives, designers, researchers, developers and manufacturers that we now are well and truly in the age of collaboration.

With geographical separation between teams, and even between team members a reality, the need for effective collaboration tools and systems has been heightened during the past year. The drive toward effective collaboration systems is being strengthened by the fact that product innovation is increasingly taking place outside of companies. “Open innovation is about how you get to ideas faster and more efficiently. It’s recognizing that a good idea can come from anywhere, and creating structures that can recognize good ideas more efficiently.” With technology facilitating and reducing the cost of collaboration, open-source innovation offers tremendous new efficiencies to companies around the world.¹⁵ PwC believes that collaborative systems will be the

¹² *Gadgets at Work: The Blurring Boundary between Consumer and Corporate Technologies*, Knowledge@Wharton, April 16, 2008.

¹³ G. Oliver Young, “Global Enterprise Web 2.0 Market Forecast: 2007 to 2013,” Forrester Research, Inc., April 21, 2008.

¹⁴ *Pharma 2020: Virtual R&D, which path will you take?* PricewaterhouseCoopers LLP, August 2008.

¹⁵ “Navigating the era of the empowered consumer,” PricewaterhouseCoopers, 2008.

core tool of innovation in businesses of all kinds, and that software companies in Canada have good opportunities to enhance the effectiveness of clients' collaborative efforts by supplying them with collaborative tools, products and/or Software as a Service (SaaS) solutions. Collaborative techniques are evolving rapidly as new ideas emerge from online experiences.

Wharton uses the term "crowdsourcing", which it defines as open innovation allowing collaboration with partners to solve business problems. The archetype of that model is Waltham, Mass.-based InnoCentive. It matches corporate "seekers" who have science, engineering and business problems with amateur "solvers" worldwide. The "solvers" then compete for bragging rights and, often, token rewards, to provide the best answers to the corporate problems. "Most companies are not looking for a big innovation they can knock out of the ballpark," Day says. Rather, they want a relatively quick fix for a specific piece of a larger puzzle."¹⁶

Using consumers as innovators is another area of collaboration being explored by companies. It has the added benefits of providing better insights into customer needs, greater loyalty and potentially, reduced costs for customer acquisition and product development. As noted above, involving consumers in product development helps to engage the Selfsumer and increase a company's visibility in online communities. Some recent examples include the shirt retailer Threadless, who sells merchandise online and now in a physical store in Chicago that is designed interactively with the company's customer base. Peugeot invited people to submit car designs online, and attracted four million page views on its site. The company built a demonstration model

The four most widely accepted core requirements of an effective collaborative system in PwC's view are:

- A single database storing all content, enabling easy access to stored multimedia by members of the collaborating team;
- The ability to keep communication between members of the collaborative team entirely within the collaborative system and not have to use external mechanisms (e.g. conventional email, which entails leaving the confines of a collaborative system);
- Enabling secure communication with allowed parties outside the enterprise's firewall;
- The ability to store, work on and mine multimedia or "unstructured information" rather than only conventional text and numbers.

¹⁶ *Why an Economic Crisis Could Be the Right Time for Companies to Engage in 'Disruptive Innovation'*, Knowledge@Wharton, November 12, 2008.

of the winning design to exhibit at automotive marketing events, and partnered with software developers to get it included in a video game. Even business-to-business companies are starting to co-create with customers. Corporate users of SugarCRM's customer relationship management software customize it to meet the specific needs of their customers' industries.

Unstructured information and tacit knowledge

"Unlike structured knowledge, tacit knowledge is knowledge that people carry in their minds or keep in their own personal environments and is, therefore, more difficult to access. Its transfer requires personal contact, because tacit knowledge has been found to be crucial to innovation and increasing the efficiency of processes. It is important for the enterprise to collect and share it."¹⁷ Tacit knowledge is a further extension of what now is commonly known as "unstructured information" which refers to the following many forms:

- Numbers
- Text
- Spreadsheets
- Charts
- Digitized hand-written notes, i.e. from smartpens
- Voicemails
- Photos
- Videos

- Web scans of "what customers say about you" in words, blogs, reviews, pictures, cartoons, videos, and
- Collaborative artwork, design.

Companies remain challenged to capture unstructured and tacit knowledge. By some estimates this accounts for as much as 80% of an enterprise's knowledge.¹⁷ For example, traditional search and find does not always yield the desired results. Unified communications and collaboration tools integrated into social networking platforms make information and knowledge available anytime, anywhere, via any device. This is achieved by allowing users to click-to-call, click-to-chat or click-to-conference (audio, web and video) an expert or group of experts. Enterprises can facilitate the transfer of tacit knowledge. In addition, users can record the interaction, and transform it into a new document containing the knowledge of all participants. This can in turn be made available to other people.

PwC's Winter 2009 Technology Forecast notes that the current challenge facing organizations is not just to capture and mine unstructured information, but to combine it with structured data. Unstructured information is typically associated with strategic functions and tends to be captured by content management systems rather than relational databases, while structured tends to be more operational. However, there is limited communication between the two types of systems. As a result, software companies are introducing new types of software such as strategy management tools, to push information from strategy down into operations so those operations remain aligned with strategic objectives. Another new tool is performance

¹⁷ A. Ohayon-Dekel, *Connected Knowledge – Connecting the brains of the Enterprise in Real Time, Enriching Communications*, v3, Issue 1, 2009.

management software, which pulls data from operations, translates it into financial impact, and makes it visible to management in decision-making dashboards. Together these new tools create a two-way connection between strategy and operations. “Unstructured data is in its infancy when it comes to business intelligence; if we can overlay unstructured data on the structured data, that’s where the big win is.”¹⁸

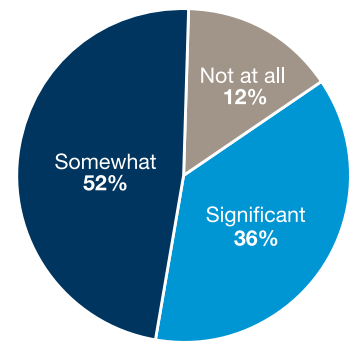
Keys to successful real-time collaboration include:

- A single database for documents of all types;
- A single database for information of all types, “unstructured information”;
- Discovery going beyond search;
- Social networking, and;
- Ease of use.

Video communications in business

Video in business is another effect of the commoditization of technology. The consumer who uses technology has become the driver of applications of that technology in business. Already, it is possible to search pictures and videos not only using textual “tags,” but also by direct comparisons of faces and places. Companies providing application software and services include, Idee Inc. in Canada, VideoSurf and Digitalsmiths.

Impact of video as a medium of communication in business



Already, webcams inbuilt into laptop computers enable inexpensive video conference calls, anytime, from anywhere. And it is not only tiny cameras embedded in smartphones and other hand-held devices that will be responsible for the emergence of “video in everything”. Current research at MIT’s Media Lab on developing “the sixth sense”, using a tiny wearable video camera and projector, provides a vision of what is to come in integrating video into personal and business computing in the years ahead.

Survey responders clearly agree that video will play a significant role as a medium of communication and information exchange in business, with only 12% of respondents dissenting.

¹⁸ Jonathan Becher of SAP Business Objects in Technology Forecast. PricewaterhouseCoopers LLP, Winter 2009.



Vision

Future challenges

Every year, in order to gain insight into the challenges experienced by emerging software company CEOs, we ask CEOs to rate the issues facing their companies over the next two years.

Revenue growth continues to be the most challenging issue facing emerging software companies. Over 90% stated that growing revenues would at least be somewhat of a challenge and 85% stated that establishing effective sales channel partnerships would be a significant challenge.

While 77% of CEOs surveyed stated that raising capital will be a challenge, fortunately, 75% believe that achieving profitability and positive cash flow will not be a challenge or only somewhat challenging. Given the current state of funding availability in Canada, it is a positive that the CEOs of emerging Canadian software companies have extensive bootstrapping experience.

Challenging issues to be faced over the next two years

Growing revenues



Building a brand



Attracting and retaining sales employees



Establishing effective sales channel partnerships



Raising capital



Attracting and retaining technical employees



Maintaining a technology lead



Achieving profitability and positive cash flow



Attracting and retaining top-level management



Strengths against the competition

Best-in-class functionality and features



Strength and effectiveness of management team



Breadth and depth of solution



Proximity to customers



Superior customer service



Strength and effectiveness of sales team



Competitive pricing



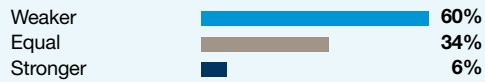
Strategic partner relationships



Niche market



Funding sources available



Agility



The competitive landscape

The CEOs surveyed continue to believe strongly in their companies and their products. Over 80% believe their solutions are at least equal to their competition in terms of breadth and depth, services and best-in-class functionality. Interestingly, despite a better product than their competition, about 46% also discount their price versus the competition. This suggests that perhaps CEOs do not need to compete on price if they have such a superior product.

Once again this year, CEOs recognized that their access to funding is weaker than their US competitors as discussed earlier. 60% see their company trailing their competition.

Other areas of concern include the strength and effectiveness of the sales team and the development of channel partnerships. These weaknesses help explain why growing revenues continues to be such a challenge for CEOs.

Industry outlook

The CEOs surveyed have a decidedly negative view of the overall IT industry in Canada and the US, displaying the most pessimistic outlook on expected IT spending in the history of the survey. Only 38% have a positive view of the Canadian industry, down dramatically from 90% in the prior year, and only 28% have a positive view of the US industry, down from 56% last year.

However, as stated earlier, the CEOs are confident they can survive and build their companies in this environment. The vast majority of CEOs believe they can increase revenues in 2009. And, while they face many challenges to achieving their ultimate goals of an exit, most believe their goals will only be delayed and will still be attained.



Survey methodology

This is the sixth report on Emerging Canadian Software Companies: The CEO Perspective released by PwC. Each year, we provide insights to the industry on issues being faced by emerging Canadian software companies and their CEOs.

Our goal in 2009 has been to continue with our research and provide critical information to CEOs with respect to performance and strategy currently in operation and also to explore the challenges brought on by the current economic climate.

A team of technology professionals at PwC have developed the survey over several years and have also benefited from personal discussions with CEOs to incorporate the most relevant questions of today's market place. Questions were organized into eight sections.

- Emerging company profiles
- Growing revenues and building channels
- Raising capital
- Intellectual property
- Leadership
- Technology update
- Exit valuations
- CEOs' vision for the future

The results of the survey were based on the responses, either online or in-person, from 145 CEOs. PwC identified a national cross-section of emerging Canadian software companies from publicly available lists, including the Branham 300, the Canadian Business Tech 100, the ROB 1000, Profit 100, Profit Hot 50 and others.

Contact with the CEOs was made via regular mail, email and telephone to direct them to the online questionnaire. Face-to-face in-depth interviews were also conducted with a number of CEOs, which involved administration of the questionnaire at the CEO's place of business by PwC's technology partners.

The intention of this research is not to conclude on the opinions of all CEOs across the Canadian software industry but to provide insight into the companies in the emerging segment and the CEOs who lead them. The survey results have been analyzed and the findings have been used as the basis for this report. We have responded to the findings and our views are noted within the pages of the report.

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The survey respondents

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PwC partners and staff

PwC prides itself on the concept of Connected Thinking. For this study we drew on support and expertise from PwC staff with varied experience and knowledge from around our firm. A core team worked diligently to help produce this publication. The tremendous efforts of each team member helped make this project a success. This group includes:

Eugene Bomba	Paul Hendrikse
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Carolyn Forest	Simone Knott
Joanne Gulliver	Carrie Maynard
Justin Groen	Bruce Raganold
David Jacobson	Margaret Sutton

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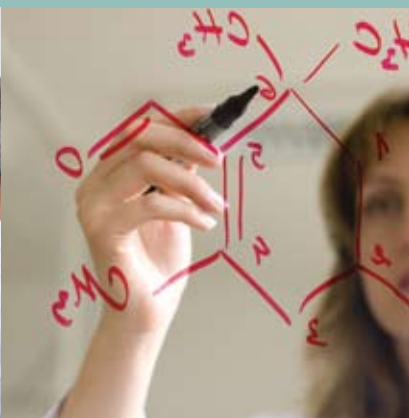
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