



**Tech Futures:  
August 9, 2002**

By [Michael Volker](#)

**Look at the Bright Side, R&D Downturn, New Tax Credit Proposal, A "Junior Junior" Exchange?, Capital Pool Corps Update, and Local Events**

### **Look at the Bright Side**

A recent Financial Post column on stock winners and losers over the past year identified three technology companies from B.C. as the biggest losers stock-price-wise. These included **Sierra Wireless** (TSX:SW) down 96%, **Burntsand Inc.** (TSX:BRT) down 94.6% and **Pivotal Corp** (TSX:PVTL) down 92.8% and covered the period from Sept, 2000 to July 2002. The biggest loser was **Nortel** (TSX:NT) which lost 98.7% of its value!

When I look at my own portfolio, now so small I can hardly see it, I realize that I'm one of the many people whose retirement nest egg has been blown away.

As I looked at those 90% plus losses (I have a some stock in all of these companies), I was wondering just how much worse things can get. The answer is obvious: not much. Even if these companies all fold, which I consider highly unlikely, I can't lose more than 100% of what I risked in the first instance. Going back to basic principles, the whole reason why I invested (i.e. speculate) in these technology (i.e. high risk) companies was to take a chance on seeing a multiple return - not 20% or 30% - but perhaps 10X or 100X my investment.

The technology sector has been hit very hard. Investors in this sector all have a little egg on their collective face. Just two years ago, the aggregate value of B.C. tech companies (i.e. the public ones) was approaching \$100 billion. Now, that number is closer to \$5 billion.

In 1998, when we created the T-Net index (set at 1000 on January 1, 1998) to track the performance of the B.C. technology sector, I was arrogantly predicting that we'll see the index hit 2000 by the year 2000. It easily passed that goal and soared to 10,000! More recently it's been hovering in the 1100 to 1400 range.

What's the lesson to be learned from this? Unlike running your own business where you have a lot more control, you are at the mercy of the economy, the stock market, and the integrity and ability of the management in the companies you invest in. Furthermore, high technology companies are inherently risky because of possible technology obsolescence, market adoption and rapid growth. No matter how solid a prospect looks, it's a gamble. And when you're gambling you can get wiped out if you have all your capital at risk. So the lesson I've learned from this is that "money management" is critical. By that I mean how much of one's "financial pie" should be exposed at any given time?

As an example, suppose you had \$1 million in tech stocks (easy if you started with \$100K in 1998 or earlier), you would have - if you practiced prudent money management - converted some equity and held about \$200K in cash. Today, you could take half that cash (still being prudent) and buy into some of the many "bargains" that are out there. Result: your \$1 million (reduced to \$800K pre-tumble) would now be worth only around \$40K. Add that to your new \$100K. A "modest" tech multiple of 10X will get you up to \$1.5 million (including your \$100K cash reserve). I'm certain this will happen. It's only a question of "when".

Regardless of the numbers and how crazy you think a 10X or 100X return may be, the key point here is that by always holding back some cash you can buy-in when others are forced into selling out (which I'm sure has happened to many people lately).

These net worth declines remind me of one of the "standards" applied by securities regulators to determine if an investor is "sophisticated" or not - i.e. the \$1 million test. If you are an angel investor who had a portfolio of \$1 million plus which is now under \$100K, are you still considered "sophisticated" enough to be able to make an early-stage investment in a startup?

Although the shine is certainly off the tech sector for the time being, I firmly believe it will rebound and when it does, good old fear and greed will once again propel stock prices. Why? Because in terms of investment options, there may be safer, lower-return, non-tech stocks people can invest in, but it's in high tech that you can enjoy multiples and it's the lure of that huge win that will get investors back in the game. But, when it happens, remember to hold a little cash in reserve!

## **R&D Downturn**

In July, **Statistics Canada** reported that, for the first time in thirty years, Canadian companies plan to reduce R&D spending in 2002 by 6.1% to \$11.2 billion. Telecommunications equipment companies are expected to reduce their R&D expenditures by 23% while semiconductor firms forecast a decline of 12% this year. And, it could get much worse, given the uncertainty as to corporate recovery especially in these sectors.

The **CATAAlliance** is pushing the **Department of Finance** to revise the **SR&ED** (Scientific Research and Experimental Development) Tax Credit Program so that it can stimulate industrial R&D especially when times are tough.

Even as it is, I'm convinced that the SR&ED program is underutilized and that many companies are leaving money on the table. It always amazes me at how few people know about it, how it works, and how easy it is to access it.

Here's a quick reminder of how it works: For every dollar that companies spend on "eligible R&D", they can recover up to 68 cents in cash. That's the best case scenario and it applies to CCPCs - Canadian Controlled Private Companies. **Canada Customs and Revenue Agency** (CCRA) offers a *refundable* tax credit of 35% on R&D expenditures while the **B.C. Government** offers an additional 10%. However, these percentages are applied to a grossed-up amount of expenditure (taking into account an "overhead proxy" of 65%). Example: \$100 spent on R&D salaries works out to \$165, including the overhead allowance. B.C. offers 10%, i.e. \$16.50 while Canada offers 35% of  $(165.00 - 16.50 =)$  \$51.98 for a total of \$68.48 in tax credits. In the case of a CCPC, the tax credits are *refundable* - which means that CCRA will send you a cheque!

There's no competition involved. As long as the rules are followed, you can claim this very attractive credit. Some \$1.5 billion annually is provided to companies under this program - another under-publicized reason from locating in Canada (and B.C.). Even individuals (start-up entrepreneurs take note) can take advantage of this (although the percentage is less). The [Vancouver Enterprise Forum](#) web site (under "resources") lists many experts on this program.

However, for non-CCPCs such as public companies or foreign-controlled entities, the Federal incentive percentage is reduced (e.g. from 35% to 20%). Furthermore, the tax credit is not, alas, refundable.

In these difficult times, the SR&ED credit is of little value to unprofitable companies (which most are - note that of the top 20 B.C. public companies, less than one-quarter are reporting any profits!).

CATAAlliance has recommended that the government revise the SR&ED rules to let public companies use the tax credits they earn whether they are profitable or not - during extreme

downturns, like now. As for the percentages, I've never really understood the rationale for a reduction just because a company has many (rather than a handful) of shareholders.

I suspect that the original proponents of the SR&ED program viewed public companies as "big, strong, and well-funded" and not in need of the extra support. They likely had a myopic view of public companies as being of the TSE or Nasdaq caliber. They disregarded, and hence treated unfairly, those companies that opted to go public early on a junior stock exchange such as the TSX-Venture in order to raise their equity capital.

It's sacrilegious for technology companies to cut R&D spending in difficult times. It may help prolong their life slightly but it won't ensure their future competitiveness. That's why an SR&ED policy update is needed right now.

### **New Tax Credit Incentive Program**

This is hot off the press - "**The B.C. Ministry of Competition, Science & Enterprise** is developing a new tax credit incentive program to assist small businesses to raise private sector investment capital. Small businesses often have difficulty finding the capital they need to start up and expand. The new program, if implemented, would provide a 30% tax credit to BC investors to stimulate investment into early stage BC companies."

"The tax credit program would be governed by existing legislation called the *Small Business Venture Capital Act*. The Act currently provides tax credits to investors who invest in small businesses through registered venture capital corporations. A venture capital corporation ("VCC") is a holding company that raises money from investors and makes investments in qualifying small businesses."

"In response to demands from program users to reduce red tape and regulatory burden, the Ministry is considering amendments to remove the holding company requirement. This change would allow the province to provide tax credits for direct investments in qualifying small businesses (i.e. a "direct investment model"). The direct investment model will be in addition to the current VCC model. The VCC structure will be retained for fund managers wishing to establish a holding company to invest in a variety of different small businesses." This sounds promising. The current requirement to have a holding company only adds an unnecessary corporate layer. For more information and or to comment, contact Ms. Hilary Vance via email at [hilary.vance@gems5.gove.bc.ca](mailto:hilary.vance@gems5.gove.bc.ca).

### **A Junior Junior Exchange?**

I find it amusing that so many **Nasdaq**-listed companies are finding themselves short of meeting the Nasdaq listing requirements. The most senior companies trade on the so-called Nasdaq National Market (NM) and are regarded as the jewels of the industry. The next rung of companies trade on the Nasdaq Small Cap (SC) market - still part of the esteemed Nasdaq club. Those companies that don't make the grade are relegated to the non-Nasdaq Over-the-Counter Bulletin Board market (soon to become the **BBX** junior market - see my comments in [last month's column](#)).

There now appears to be an avalanche of companies whose stock price (and hence value) and performance put them offside with the Nasdaq standards. NM companies are turning into SC-designated entities while many SC companies are facing a de-listing from the hallowed Nasdaq halls.

What's so amusing is that the **Toronto Stock Exchange** (TSX) is thinking about launching a 'junior junior' exchange. This will provide a home for those companies that no longer meet the listing criteria for the TSX-Venture Exchange. Many of these companies got onto the TSX-V with so-called "Tier-3" status. This was done to accommodate those companies that moved over from the "unlisted" or Canadian OTC market, previously referred to as the CDN. There are only about

230 such listings.

Interestingly, as an aside, a recent tax expert noted that these companies were, according to CCRA, *not* considered to be public companies because they do not trade on a *recognized* exchange (i.e. CCRA regards them as large private companies, e.g. CCPCs) and hence investors in such companies could benefit tax-wise from this status. For example, the \$500K life-time capital gains exemption for CCPC investments would apply - a real nice deal! Similarly, the SR&ED program benefits referred to above would be greater for such firms. Putting these companies on a "*recognized*" exchange, however junior it may be, might remove that benefit.

[Note that pubco definitions vary depending on who you speak to. Securities regulators and the Tax Department have inconsistent definitions as to what constitutes a "public" company.]

An argument given by the TSX in favor of a new exchange is that the current TSX-V will appear more credible with the riff-raff gone.

Another possible explanation for the proposal is that it might thwart the efforts of the new **Canadian Trading and Quotation System Inc.** ([www.cnq.ca](http://www.cnq.ca)), an electronic market for some 1,000 "list-less" reporting issuers in Canada.

Apparently, the TSX has also reportedly shown an interest in purchasing the Cincinnati Exchange, an electronic trading system based in Chicago. (I've been advocating a U.S. move by the TSX-V for many years!).

Are we heading in the right direction? **David Raffa**, writing in **Business in Vancouver** recently, hit the nail on the head. He suggests that the TSX's time would be better spent in figuring out how to make the TSX-V work more effectively for tech companies in raising equity capital. Catering to the tech sector and promoting itself more - building on its success instead of worrying about the black sheep is what's needed.

I agree that focusing on the opportunities in the tech sector would be more productive than fussing around with an even more junior market. Let's make the one that we've got work.

The proposed exchange has no name yet although I expect it will be unique in that the TSX likely doesn't want to be seen as playing in an arena of flaky companies that operate under minimal parental guidance. Suggestion: let's call it the corporate leper colony. Nobody will want to touch them!

Securities Regulators may have some reservations about giving this proposal a green light in view of the U.S. accounting scandals that have investors heading for the hills.

Tier 3 is the bottom rung of TSX Venture Exchange listings. Most of the current Tier 3 TSX-V companies have a ticker symbol that starts with the letter "Y". Wouldn't something like this achieve the same purpose? That is, attach a highly visible label of some sort to companies that are off-side. It eliminates the listing and de-listing to and fro that could occur.

Such a categorization could also make it easier for companies to go public earlier (yes, I know that's a contentious topic but if that's what it takes to get capital, it should be an option to companies) and then migrate to the higher ranks by removing the "Y" rather than going through a more complicated process.

I had to chuckle at a recent article in **Red Herring** about a Vancouver-based software company, **Imagis Corp** (TSXV: NAB). It refers to the TSX-V as the Vancouver "penny stock market—and the characters who lurk there." It goes on to say that "this isn't a market in which value, like cream, rises to the top. It's a world where prices tend to go up because someone is helping them up."

Let's focus on making the current TSX-V really hum. A lot of work needs to be done in the public

education area. Rather than fighting the futile battle of trying to operate a "clean" market, let's be more pragmatic. There are always going to be scams and cheats. As we've now seen, by several recent examples, the junior markets aren't the only places where you'll find mis-dealings. What's been happening in the major U.S. markets makes the "characters" on Vancouver look like kids caught dipping into the candy jar.

## **Capital Pool Corporation (CPC) Comments and Update**

In this column, I keep track of **Capital Pool Corporation** ("CPC") companies as defined by the TSX Venture Exchange (the former CDNX) because they may provide funding and management to, and in the process acquire, technology companies. They provide companies with an alternative to traditional venture capital financing. It lets the public investor get into the game.

Check our [Capital Pool Corporation chart](#) (in .pdf format) for a complete list of the CDNX's CPC and VCP companies, thanks to **David Ing** of **Pacific International Securities**. This list is updated on a regular, e.g. monthly basis. It is now current to the end of July, 2002. (previous update was June, 2002).

There's only one new addition to the list since the previous update last month. It is **Sigma Ventures Inc.**, which is from Quebec (even though it's contact phone number is from Alberta).

In the past month, the following CPC companies have come to trade: **Desco Exploration Ltd.**, **Ergo Ventures Inc.** and **Nutramed Capital Corp**

The following companies have been removed from the list because they have completed their Qualifying Transactions and are no longer considered to be CPC companies: **E-amigos.com Inc.**, **EREZ Inc.**, **Silicon Acquisition Inc.**, **Sydenham Capital Inc.** and **Trio optimum Capital Corp**.

An introductory article explaining CPCs may be found at <http://www.bctechnology.com/statics/mvolker-jun0200.html>.

## **Local Events**

Today, **Allan Rock**, Minister of Industry, **Herb Dhaliwal**, Minister of Natural Resources Canada, and **Stephen Owen**, Secretary of State (Western Economic Diversification) (Indian Affairs and Northern Development) were on hand to open **NewMIC's** state-of-the-art **Human Computer Interaction (HCI) Lab**. This facility, made possible through funding from **Western Economic Diversification Canada** (WD), is the only one of its kind in Western Canada. Funding was also announced for **New Media BC**, which will be now collocated with NewMIC in downtown Vancouver.

Summertime is not usually a busy time for networking and tech events. The **BC TIA** will hold its third annual **BC TIA Fall Golf Classic** to be held on September 10, 2002. This is turning into a key charity event for BC's technology community.

Organized by the **Technology Committee for Children's Hospital** (TECCH) and the BC TIA, this year's event has already secured sponsorship from **Telus**, **Nortel Networks**, **Cisco** and **Digital Pioneer**. The net proceeds will go towards much-needed equipment, research and programs at BC's Children's Hospital. More info on this can be found at [www.tecch.com](http://www.tecch.com).

Another very worthwhile golf-fundraiser to support Alzheimer's research takes place on August 16th at Pitt Meadows Golf and Country Club. This is organized by the Aasen family (**Greg Aasen** is a founder of **PMC-Sierra**). Check [www.acegolfpro.com](http://www.acegolfpro.com) for more information on how you can participate in this event.

A complete calendar of technology events can be found on [T-Net's Events page](#).

## Footnotes

If you're an entrepreneur looking for a place to get your company started; there's some great space available at Harbour Centre downtown. The **New Media Innovation Centre** (NewMIC) and **SFU's TIME Centre** have teamed up to provide not only office space but also access to various resources, e.g. tech advisors, access to capital, mentors, etc. Worried about the high cost of being downtown? Well, not to worry - they'll even reduce the fees and take some payment in the form of equity. Check [www.sfu.ca/time](http://www.sfu.ca/time) for contact info.

A reminder: SFU's TIME Centre is open for business - business folks, that is. TIME is an acronym for **Technology, Innovation, Management, and Entrepreneurship**. TIME supports the growth and development of the tech industry in B.C. TIME features a "BusinessCentre" (looks like an airport business lounge) which is open to technology entrepreneurs and business people to use as a drop-in downtown office facility. Need to plug-in? Make some calls? Do some work? Hold a meeting? There are some great facilities for holding your company's AGM. Why hang out at MacDonald's when you can work productively at the TIME Centre? Drop by and check it out! It is located at SFU's downtown campus at 515 West Hastings St.

For a convenient printable, pdf version of this column, [click here](#).

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### [What Do You Think? Talk Back To Mike Volker](#)

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**Tech Futures** is a bi-weekly column that focuses attention on new and emerging BC publicly listed technology companies.

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