



**Tech Futures:  
March 9, 2001**

By [Michael Volker](#)

**Stimulating a Tech Rally, Stock Option Woes, New Ventures BC, Capital Pool Corps Update and Local News.**

**Stimulating a Tech Rally**

See what happens when I take a little holiday? The markets tank. I must confess that it was so nice not to have handy access to the internet for a few days. That's why I didn't write a column on Feb 23rd. Not hearing about Nortel's decline and further drops in the Nasdaq boded well for a week in the Bahamian sun. It's probably the best strategy for an investor these days - take a break from the markets.

It took almost two years for the Nasdaq index to go from 2000 (Jul'98) to 5000 (Mar'00) and less than a year to go back to almost 2000 today (hitting new lows just this morning - around 2060). That swing represents a value of U\$3.6 trillion. Its just like a roller coaster - slow and steady on the way up, and a rush on the way down. So, if you've been out of the market for these past few years, you can jump in now and not have missed a thing.

In spite of the huge declines we've seen, many investors I've spoken with recently, firmly believe that we're still in a long-trending bull market going through a period (which could last a year or two) of correction.

The question is how long will this correction take? The obvious answer rests with the economy's performance. If so, what will make the economy boom?

In the USA, two-thirds of the economy is determined by consumer spending. The theory is that if the fed drops interest rates, consumer spending will be stimulated. But, will it be enough? Another theory is that if the markets do well, the prosperity enjoyed by investors and, in particular, successful entrepreneurs will further stimulate growth through their own re-investing (e.g. as angels) activities. We certainly saw this happen last year at this time. Most of the wealth was created in the tech sector with dot-com and internet companies leading the way. The sudden rise in valuations allowed many to plow their unexpected good fortunes back into many new ventures. And I'm sure that it stimulated a heck of a lot more spending than a small percentage drop in lending rates. Note that recent rate adjustments had little impact.

Now, many of the investments made just a year-ago are well out of the money (some 100% out). And the original stock assets which provided some of that year-ago highly valued liquidity (look no further than Nortel for a good example of this) are now so low in value that their owners are not likely to consider trading such an asset for a stake in anything but an exceptional deal.

So we have kind of a chicken and egg situation here. Investment and spending is good for

economy and will cause markets to rise. But rising markets are needed to stimulate investing and spending.

If the economy does stall, we also run the risk that our tax rates may not come down as quickly as both federal and provincial politicians have been promising further impacting our propensity to invest or spend.

There's probably no better time than this to introduce some very aggressive tax *incentives* to boost investment. It's wonderful that the capital gains tax inclusion rate has come down to 50% from 75% last year. But that's an investment *reward* on the output side of the equation and not an inducement to stimulate investment on the input side. The Feb'2000 rollover provisions permitting investors to cash in and re-invest on a tax-deferred basis is a good start in this direction.

Maybe its time for our political leaders to be a little more innovative with respect to providing some aggressive tax incentives (that doesn't sound right - maybe I should say "untax" incentives) to pry loose those presently hard-to-find investment dollars.

For example, here's a simple idea: Allow investors to fully write-off an investment made in newly issued Canadian corporate shares. Investors can eventually do this anyway if the venture fails. By permitting an up-front write-off, you effectively reduce the stock's cost base to zero. If and when you sell your position, the full proceeds are taxed as if the stock were acquired for free. In the meantime though, you've got at least 25% more capital to reinvest. A particularly aggressive politician might even suggest that the investment be given ABIL (Allowable Business Investment Loss) treatment whereby the write-off is treated as a deduction to income (versus a capital loss), giving the investor 50% more capital to invest (or spend). In this case you'd have to take the ABIL back into income before you can apply the lower rate capital gains tax.

If these suggestions are too ambitious, we can always simplify and expand tax credit programs such as B.C.'s popular (but clumsy and limited) VCC (Venture Capital Corp) program which gives investors a 30% tax credit on qualifying new venture investments. Having more than one tax-driven "labour" fund in B.C. might not be a bad idea, either!

I doubt that such bold incentives will materially impact gross (indeed, they are gross!) government tax revenues insofar as the tax dollars given back to investors will almost immediately be given up by those employees who directly benefit from the new equity investments in their respective firms.

Regardless of how it's done, some action is needed to give a boost to stimulate investment to get the economy and the markets out of their tail spin and get them cruising again.

Footnote - this week, both Federal (Paul Martin and Brian Tobin) and Provincial (Gordon Campbell) politicians were speaking to the BC Tech Industry. A day after Gordon Campbell clearly stated that his government would not give industry subsidies, Tobin announced \$11m in support for local BC firms. It would seem to me that, consistent with Campbell's thinking, some broad tax incentives would serve us better than investing our tax dollars in trying to pick a few specific winners!

### **Stock Options Woes**

You can bet that there are a lot of unhappy campers (i.e. tech company employees) who got seemingly attractive stock options last year. I'm sure that those deep out-of-the-money incentive stock options are not doing a lot to stimulate and motivate employees. Many companies are finding themselves having to re-price options to the dismay of their stockholders due to adverse

accounting consequences under U.S. Generally Accepted Accounting Principles (GAAP).

However, by re-pricing options, it is possible that the 50% deduction allowed when calculating tax owing, may be *forfeited*. Canada Customs and Revenue Agency (CCRA) allows the deduction only if the exercise price is not less than the fair market value on the date the options are granted. Re-pricing them violates this requirement!

Even in up-markets, there are still some problems with stock options. I have never seen such complicated tax rules and I have never found a "lay" person who fully understands the pros and cons of options. I sure don't.

One of the major advocacy issues that **CATAAlliance** continues to pursue is an improvement in the tax treatment of employee stock options. The federal government has tried to respond by introducing a number of changes in the February 2000 budget. Unfortunately the changes implemented, although conceptually correct, do not function adequately. In some situations a tax liability can be incurred by an employee even though no real benefit has accrued to the employee as a result of exercising his/her stock option.

Note that under some scenarios employees have incurred a tax liability on the paper gain realized at the time the stock is exercised, irrespective of whether or not there is a real monetary gain on the value of the stock (versus the option price) at the time when the stock is sold, or deemed to be sold.

Employees may not be aware of these risks and not set aside the funds to cover the tax liability incurred.

Under certain circumstances where there is a 'deemed disposition' of the employee's stock (i.e., at the employee's death, etc.) the employee's estate and heirs would be forced pay any outstanding tax liability pertaining to the stock option's 'paper gain'.

Another problem is that gains achieved by exercising stock options are categorized as income (although the tax rate is equivalent to the capital gains rate on such income). This means that a subsequent loss on a stock acquired via options exercising - and held rather than sold - can not be used to offset the employment "income" which is taxed. For example, if you buy \$100K worth of shares at a cost of \$10K by exercising an option, you have to report \$90K in income (reduced by 50%) although you can defer this tax (under the new rules) until you actually sell the shares. But if you were to sell the shares for zero (like in a busted dot-com), you still have to pay this tax. Although you have a capital loss of \$100K, you cannot apply this to reduce your "income".

With respect to the deferral rules, few optionees seemed to know that there was a Feb. 15 deadline for making a filing in order to benefit from a deferral of tax on a paper gain. Ottawa has extended the deadline by 60 days because so many employees were not aware of this requirement to file by Feb 15th. Those failing to file would be faced with a tax bill on unrealized gains made on shares which they have yet to sell. By filling out the forms, employers would not report the employees' income on their T4 slips as has been the practice up until the end of last year.

Another aspect that many folks don't pay much attention to relates to the corporate status of a company. In B.C., for example, many of the pre-public high tech companies are not so called Canadian Controlled Private Corporations (CCPCs). They may be incorporated in the U.S. even though the head office is in B.C. or they may have sufficient foreign investment (e.g. investors with

effective "control" via shareholder agreements) such that they are not CCPCs in which case different option rules apply. For example, the deferral rules referred to above may not apply!

The solution to all this nonsense may be to forget about Incentive Stock Options (SOs) altogether and implement an Employee Share Ownership Plan (ESOP) whereby employees actually buy shares in the company (the company loans them the money to do so, secured by the shares as the only collateral). In this case they become true owners, shareholders, and risk takers!

## **New Ventures BC**

The most common reason given for the failure of tech companies is management (i.e. lack thereof). How can entrepreneurs better prepare themselves and tap into the network of experienced angels, investors and mentors to help them build their businesses?

And the answer is: a new venture competition designed to foster innovation and the entrepreneurial spirit with Canada's biggest prize package: a chance to win a total of **\$125,000!** This exciting new initiative was formally launched this past week.

British Columbia's technology business innovators now have the chance to win a grand prize package worth \$50,000 with more than a little help along the way from their friends at the **BC Venture Society**. The **New Ventures BC** Competition is an annual event open to all BC residents, with prizes totaling \$125,000 - which is believed to be the largest of its kind in North America. Individuals with a new business idea can attend seminars and networking information sessions that will give them the chance to turn their idea into a successful startup.

(NB - the *real* prize is *not* the prize money - it's the fact that venture capitalists will be attracted. I cannot imagine the winners not getting offers in addition to the prize money. They can apply the venture capital to their business and the prize money to the big celebration party.)

Entrepreneurs of any age and background with an idea for an innovative product or service involving a new technology are encouraged to log on to [www.newventuresbc.com](http://www.newventuresbc.com) to register. Everything necessary – including seminars and networking opportunities – will be available online. The aim of the competition is to increase the number of startup businesses in the province and to help establish an entrepreneur-friendly business environment that nurtures new ideas.

"Entrepreneurs are the engine of the BC economy, bringing new jobs, tax revenue, human capital and investment capital to the region. The New Ventures BC Competition is a unique partnership of industry, government and academia that is working together to establish British Columbia as a great place to develop a new business," says **Don Calder**, Chairperson, BC Venture Society.

The financial backing for this initiative comes from a combination of government, industry and academia as well as other non-profit industry orgs. **Western Economic Diversification Canada** will invest \$338,000 in the project. Further to my earlier comments, providing modest infrastructure support such as this which will benefit many companies, a superb way of providing economic stimulation!

Lead sponsor **Bank of Montreal** has joined other inaugural sponsors Palmer Jarvis DDB, Western Economic Diversification Canada, SFU Business, TAP Ventures, Caldwell Partners, and Campney & Murphy in a three-year commitment to fund the grand prize. It recognizes that successful venture investing looks to the long term relationship between the entrepreneur and the investor. Venture capitalists work in partnership with entrepreneurs to become the architects of future success for

BC's economy.

"Venture-backed companies are leaders in innovation and competitiveness. We look forward to working with the team behind the winning idea in this inaugural competition to give them the capital and management expertise they'll need to grow and prosper," says **Gail Cocker**, Sr.VP at BMO.

The competition is broken down into four phases, and anyone intending to participate should register by April 7, 2001. Up to 100 of the best ideas will be selected to move on to Round Two, the Feasibility Test. During this time participants will have opportunities to attend seminars on legal, accounting, marketing and more. The jury will choose 35 finalists to compete in Round Three, the Venture Plan, all of whom can take advantage of mentoring, and networking opportunities. The 30-page Venture Plan is due August 20. From there, the jury will select six finalists, each of which will win \$5,000 in cash and proceed to Round Four, the Finale. The final six teams will make an oral presentation to the jury on September 21 and the first and second prize winners will be announced at a Gala Wrap-up to be held on September 27, 2001.

The BC Ventures Society is a cooperative endeavor of business, academic and government partners, sponsors and contributors that have banded together to help stimulate a strong, healthy economy in British Columbia. It will work closely with many other organizations in B.C., such as the Vancouver Enterprise Forum.

The goal of the New Ventures BC Competition is to support British Columbia's emerging technology sector and to motivate researchers and developers to commercialize their ideas. By participating in the annual competition, entrepreneurs will build business skills and help to create a sustainable diversity in the province's investment community. Contest details and registration forms can be found at [www.newventuresbc.com](http://www.newventuresbc.com).

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

In this column, I keep track of Capital Pool Corporation ("CPC") companies (see chart below) as defined by the 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. CPCs are the continuation of the former VCP and JCP programs on the Vancouver and Alberta Stock Exchanges.

This program, which has been very popular in the West, is now heading East - to Ontario. The Ontario Securities Commission has finally given its support. Thanks to our screwy system of having provincially regulated securities commissions (instead of a national one), Ontario investors have been shut out of the IPO offerings by CPCs in Alberta and B.C. Now they can get in on the action. It means that B.C. companies can now offer their IPO stock to Ontarians.

I like CPCs from an investment perspective. Although one may regard them as speculative (indeed, they are), they are also an inexpensive way of getting in early and inexpensively. You can pick up 10,000 shares of a typical CPC for pennies.

New additions to the list are **Agile Ventures Inc.**, **Gateway Capital Corp.**, **Golden Valley Mines Ltd.**, **Luxor Developments Inc.**, **Apsley Management Group Inc.**, **Legend Capital Corp.**, **Leitrim Group Inc.**, **Semco Technologies Inc.**, and **The Ulysses Group Ltd.**

Agile Ventures is from B.C. Gateway Capital is from Saskatchewan. Golden Valley Mines is from Quebec. Apsley Management Group, Legend Capital, Luxor and The Ulysses Group are from

Alberta. Leitrim Group and Semco Technologies are from Ontario.

Since the previous update, the following companies have come to trade: **ABI Capital Corp.**, **B2B Solutions Inc.**, **Buckeye Energy Corporation**, **King Capital Corporation**, **Aqua Capital Corp**, **Aspire Capital Inc.**, **eVenture Capital Corp.**, **Holy Smoke Capital Corp.**, **MaxTech Ventures Inc.**, **Neptune Capital Corp.**, and **Smart Api Capital Corporation**.

The following companies have been deleted because they have completed their Qualifying Transactions: **Context Energy Inc.** and **E-Quisitions Inc.**

Check our [Capital Pool Corporation chart](#) (in .pdf format) for a complete updated list of the CDNX's CPC and VCP companies, thanks to **David Ing** of **Pacific International Securities**

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

### Local News & Local Buys

The next [Vancouver Enterprise Forum](#) event will be held on March 27th at Science World. The topic will be: "Building a Bankable Management Team". How have successful companies built their Bankable Management Team, and what is a Bankable Management Team anyway? What attributes would a team of people have for them to be bankable and how is the synergy built and maintained? The event will be moderated by **Susan Koch**, Controller, **Cellex Power Products** and presenters will include **Chris Reid**, President & CEO, Cellex Power Products and **Sheila Moynihan**, VP Human Resources, **Bandgap Photonics**.

**The ASI Exchange** takes place on Tuesday, March 13, 2001 (all day) at Enterprise Hall in Vancouver's Plaza of Nations. This year, as The ASI Exchange celebrates its tenth anniversary, it expects to host more than 3,000 participants, a remarkable increase from the 60 who attended in the first year. Over 2,300 participants attended last year - not only hundreds of high-tech industry professionals, but also hundreds of post secondary education institution researchers and corporations.

Because there will be more than 100 companies, it provides a great opportunity to learn more about these companies - be it for a possible job, general interest, or even a possible investment (or future investment) for that matter. Complete details are available at [www.asiexchange.com](http://www.asiexchange.com).

For **Biotech Angels and Biotech companies** - there will be a special Vancouver Angel Network meeting in early April which is specifically dedicated to biotech deals. Check [www.vef.org/vantec.html](http://www.vef.org/vantec.html) for details.

In our "local buys" category, **Canaccord Capital** is recommending **Westport Innovations Inc.** (TSE:WPT) and **Infowave Software** (TSE:IW).

Westport is currently at \$11.95 with 39.9M issued shares because the company announced a landmark joint venture agreement with Cummins to develop, build, and sell a complete line of natural gas engines. A planned 50:50 split on engine profit supports Westport's longstanding stance that it would not "just" be a component supplier. Canaccord is maintaining their SPEC BUY rating and a \$20 target price. **Rob Millham**, an analyst with **Research Capital Corp.**, had a \$30 target price in mind but according to today's Globe, he's considering a downward adjustment to that

target because he can't see another Cummins-like deal on the horizon.

Infowave Software is in their STRONG BUY category trading at only \$3.89 with 34.4M shares issued. The company reports record revenue of US\$1.5 million for fiscal 2000 with Compaq and Intel forming a foundation for US\$10.0 million for fiscal 2001. Canaccord is revising its price target to \$10.00.

Local industry leader, **PMC-Sierra** (NASDAQ:PMCS) is written up in today's Globe. **Wendy Stueck** provides some useful insights. Her bottom line: "PMC-Sierra looks like a bargain - but analysts say the stock could take a further pounding before it recovers." Of course, nowadays you can say that about almost *any* tech stock.

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

---

*Michael Volker is the Director of the University/Industry [Liaison Office](#) at Simon Fraser University, past Chairman of the [Vancouver Enterprise Forum](#), and a technology entrepreneur. He owns shares in many of the companies he writes about. Copyright, 2001.*

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

---

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

Contact: [mike@risktaker.com](mailto:mike@risktaker.com)

[Tech Futures Archive](#)

[T-Net 20 High Tech Stock Index](#)

---