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By Michael Volker

Good Tax News, High Tech ETIFs, Stock Commentary, IPO Watch, Capital Pool Corps Update

Well, I'm pleased to report that Paul Martin has taken my advice and reduced the capital gains tax inclusion rate to 50% - meaning a net tax of just under 25% on capital gains at the top marginal rate. He's also reducing personal income taxes slightly.

In high tech circles there has always been a plea for the reduction of both cap gains as well as personal income tax cuts. Not all company CEOs agree as to what the priorities are - i.e. investment vs income related taxation, given a choice. Small companies which aren't paying huge salaries need investment capital and hence they prefer investment incentives whereas the more mature companies need the personal tax breaks to make it easier for them to recruit. In this regard stock options also benefit from the lower cap gains tax.

The American tax advantage gap over Canada's is narrowing. The tax cuts announced this week create a more level playing field. In some cases, Canadian taxes are lower.

With regard to the human resource question, the budget had two features supporting post-secondary education. For full-time students it doubled the education credit to $400 per month. It also provided a further $600 million to the Canadian Foundation for Innovation to invest in university research facilities. $100 million will also be provided over 5 years to the Social Sciences and Humanities Research Council for research in management skills and education in the New Economy.

The new lower capital gains tax will certainly benefit the high tech industry and the Canadian economy. Not only will it make stock options, a critical element of compensation, more attractive, but it will also reduce Canadian capital gains tax rates to U.S. levels. The only headache is going to be felt next spring as people try to figure out their taxes for 2000 - a year in which three different inclusion rates (75%, 66% and 50% apply for different time periods.

A further investment incentive has been created by the increase in the tax-free rollover of capital gains on small business investments to $2 million (from $500K). This allows investors to transfer their gains from one company to a new company without "cashing out" thereby deferring any tax.

The general corporate income rate cuts have also been accelerated, to stimulate investment and growth in the economy and jobs. This is good news for investors in that corporate earnings and hence earnings per share, will increase due to a 2%/year reduction in the general federal corporate income tax rate from 27% in 2001 down to

21% by 2004.

Since most tech employees and investors find themselves in the upper tax brackets (which has been increased to $100K+), here's a little summary for you top income earners in British Columbia (btw - a good summary of the mini-budget can be found on the Canadian page of www.pricewaterhousecoopers.com).

	Capital Gains	**Dividends**	**Income**
B.C.	24.35%	35.96%	48.70%
Ontario	23.21%	31.34%	46.41%
Alberta	19.75%	24.71%	39.50%
Federal	14.50%	19.58%	29.00%
US Fed	20%		39.60%

The provincial rates are *combined* provincial and federal taxes. The Canadian federal rate has been shown for reference. For comparison, the US rate is the federal rate *only*. The tax brackets are much broader in the USA, but at the $100K income level, they are still around 31%. State taxes are additional. In California, count on tacking on up to 9.3% applied to your net income. So who said the U.S. is such a good deal?

Although the BC Tech Industry has not yet commented publicly (at least not via their website), the **Canadian Advanced Technology Alliance** notes that the mini-budget has come very close to addressing its requests and proposals. Those items that were not acted on involved stock options. CATA's proposal that tax should be calculated only when optioned shares are sold was ignored as was the suggestion to provide a $1 million capital gains tax exemption on employee stock options. More B.C. input at national levels and more cooperation with national industry orgs wouldn't hurt.

Whoa! Take a look at B.C. compared to Alberta! And, don't forget when you buy goods in Alberta, there's no PST! I wonder why we couldn't just annex B.C. with Alberta and get rid of some overhead to boot! Come to think of it, have you noticed a lot of Alberta license plates in the streets these days?

Already a number of Canadians live south of the border and commute in to B.C. to benefit from lower U.S. taxes. It seems to me that living in Alberta and working in B.C. is akin to a tax haven. Maybe we could convert Bowen Island into a Leichtenstein of sorts, eh?

But before you join the stampede to take up residency in Alberta, I'll repeat some remarks I made in the last column about a recent speech by Gordon Campbell, leader of the B.C. Government's Opposition Party. His promise: "there will be dramatic cuts in the first 90 days in office...and....BC will have the lowest base rate of taxation in Canada within the first term of office". If you don't believe me, ask him yourself. His email is gordon.campbell.mla@leg.bc.ca. Two years ago, B.C. marginal rates were at 52%. Although the cuts at the federal level are welcomed, a 48%+ rate is still simply too high. Now it's the Province's turn. In the meantime, if you like being abused, consider moving to Quebec. Taxes there are just slightly worse than in B.C.

However nice these cuts are, let's not be too myopic. There's still a $500B+ mountain of debt that our kids have to deal with someday. Now that times are good, there are surpluses but what happens when the current up-wave (expected to last 20 years or so) abates? We've got to reduce that debt so that if the going gets tough, we don't have to once again increase tax rates.

It's nice to see that some of Canada's high tech entrepreneurs that left Canada for the greener grass south of us are taking initiatives to provide assistance to new startup entrepreneurs. Case in point, **Jeff Skoll**, the Canuck who got eBay rolling, has put some seed money into the Leaf (www.the-leaf.com) to achieve such a purpose.

High Tech ETIFs

Exchange Traded Index Funds - ETIFs - have been in the papers quite a bit lately. These ETIFs are becoming popular because they allow investors to effectively buy baskets of stocks, like mutual funds. Unlike a mutual fund, though, the composition of an ETIF is defined by its underlying index. Hence, there are no investment management decisions involved. Such funds simply mirror an index like the Nasdaq, TSE, DOW, etc. The main advantages are huge liquidity, highly visible, bought and sold just like stocks, and very low fees.

For high tech investors, here are some suggestions. Although I mentioned some of these earlier this year, in light of current interest in the subject, please forgive any repetition.

A very innovative way in which to play the technology sector is by investing in the Nasdaq market, through the **CIBC Nasdaq Index RRSP Fund**. Even though the underlying securities are U.S. based, the shares are actually eligible for your RRSP. How can that work? Very clever - the CIBC is not actually investing in the securities per se. It places the funds in secure, interest-bearing notes and uses the interest to invest in highly leveraged derivatives products (e.g. options and futures) in such a way as to *mirror* the performance of the Nasdaq 100 shares. Very cute!

Of course, you can also buy the **Nasdaq 100** directly by purchasing a fairly new product created by the Nasdaq itself. This is the "**QQQ**" or Nasdaq100 share which trades on the Nasdaq under the QQQ symbol. The only advantage of this over the CIBC play, is that investors may have better liquidity but would lose out on the RRSP eligibility.

Notwithstanding my afore-mentioned comment about liquidity and visibility, a quasi-ETIF for internet (not dot-coms!) is the **Business Development Bank's** (TSE:BDB.N) Special Notes. The BDC has produced a very interesting low risk vehicle for investing in the internet.

Here's how it works: By buying so-called special notes traded on the TSE under the symbol, "BDB.N", you are investing in a basket of stocks of U.S. internet companies. When the BDC issued these notes in Aug'99, the price per note was US$10. This price is *guaranteed* by the BDC such that, upon their expiry in August 2009, the holder of a Note will at least be reimbursed the US$10 face value. And, this guarantee is from Her Majesty, herself!

The Notes trade on a daily basis and are presently in the US$7.50 area. So, if you buy at US$7.50 today and hold until maturity in Aug'09, you will get back at least the US$10 guaranteed amount. On the other hand if, in 10 years, internet stocks continue to perform, the Notes could appreciate substantially. That's a low-risk way to play a high risk volatile industry. If you buy today at US$7.50, you not only is your capital guaranteed, but so is a profit of US$2.50.

The basket of stocks which the BDC tracks consists of the top 20 internet companies. It includes these companies: **Yahoo**, **Etrade**, **Ebay**, **Sun**, **Microsys**, **VerisSign**, **CNET**, **Amazon.com**, **Doubleclick**, **Microsoft**, **Inktomi**, **AmericaOnline**, **CMGI**, **At Home**, **Cisco**, **Entrust Tech**, **Infoseek**, **Qwest**, **Psinet**, **Macromedia**, and **Qualcomm**. These are not your typical dot-coms.

The way in which the Note value is determined is interesting. The top 5 and the bottom 5 of this top 20 list are removed, leaving the middle 10. It is the price appreciation of this group of 10 on which the Notes' value is based. The actual trading price of theBDC may not exactly track this valuation since that is based more on daily supply and demand of the BDC Notes versus the underlying value of the Notes. In fact, the BDC says that as of Sep 30th, the basket level (i.e. the theoretical performance index) was at US$12.10 but the Notes were trading at only US$8.25 on that date. These values are updated monthly at the BDC website. Could it be that no one knows about these? Likely. The volumes are very thin - sometimes only 100's trade in any given day.

More details can be found in the original prospectus, which you can find on theBDC website at http://www.bdc.ca/ (you need to search for it by using "internet notes" under *investor relations*). The BDC sold these Notes to get revenue for general operating purposes. But doesn't this expose them to a huge risk? Why would the BDC do this? Since this answer cannot be found in the prospectus, I called them up to find out that they have hedged their position via en equity-swap, giving them extra working capital at minimal risk.

Finally, it should be noted that there are a mere 1.5 million of these notes in existence. The BDC sold only $15 million dollars' worth. The lack of publicity about this vehicle, the apparent under-market pricing, Her Majesty's guarantee and the hot internet arena would all seem to be good arguments for using these to invest in *the internet.*

A good way to check up on the performance of internet stocks is the Internet-100 stock index, as reported by USA Today. This Index consists of 50 e-Business and 50 e-Commerce companies.

What we really need is an ETIF for BC's tech stocks. Then local investors can invest in BC's high tech sector without having to create their own portfolio.

Stock Commentary

In previous columns, I mentioned the matter of Insider Trading. Insider trading is, of course, quite legal provided that trading is not being done when an insider possesses privileged information.

Recently, **Air Canada** has been under fire for giving analysts some inside tips. In the U.S., the Securities and Exchange Commission (SEC) has an answer for this: Regulation FD, also known as "Regulation Fair Disclosure" or "Reg. FD" is a new SEC rule that requires companies to make all "material" information available to all investors at precisely the same time. This landmark ruling challenges public companies' longstanding practice of giving the news earlier to analysts, institutional investors and selected news services. This fair disclosure rule will take effect on Oct. 23. I wonder if Canada will follow suit?

QLT PhotoTherapeutics (TSE:QLT), B.C.'s best known biotech firm, has reported a quarterly profit. It has now joined the elite group of about 20 biotech firms out of around 500 which are actually generating a real profit. QLT first started trading over a decade ago when it listed on one of theCDNX's progenitors, the Vancouver Stock Exchange. At the time the stock was trading in the $1.00 area. Yesterday it closed at $82.

QLT posted its first-ever profit in the third quarter ($4.3-million, or six cents a share) from the sales of Visudyne, a new treatment for blindness in seniors. Quarterly revenue was $15.4-million with Visudyne sales contributing $11.6-million.

Last week, the federal and provincial governments announced a new initiative under WEPA, a joint federal-provincial agreement to encourage economic development and job creation in B.C. Under the agreement, $13 million will be invested in the fuel cell industry This includes roughly $1 million to establish **Fuel Cells Canada** as a non-profit organization to manage funding for new projects.

Some of the companies which stand to benefit from this initiative are **Ballard Power** (TSE:BLD), **Methanex Corp** (TSE:MX), **QuestAir Technologies** (Private, Ballard recently invested $16.7 for 10% of QuestAir), and **Cellex Power Products** (Private).

Dynetek Industries Ltd (TSE:DNK) is an Alberta-based alternate fuel play. Last month, Dynetek closed its IPO of 5.3 million shares, offered to the public at $7.50 per share to raise some $40 million. Dynetek makes fuel storage systems for compressed natural gas and hydrogen for fuel cell vehicles.

Another recent market debutant in the Energy sector is **Stuart Energy Systems Corp** (TSE:HHO), a Toronto-based firm which is developing products to separate hydrogen from water so it can be used as an energy supply in fuel cells. Stuart priced 5.8 million shares in its initial public offering at $26 each, the top end of a range of $24 to $26, in a deal which was typically "oversubscribed". (I've never heard of an under subscribed IPO - in fact, the price is always adjusted to ensure an over subscription). Love that ticker, though - HHO!

Don't forget to get rid of all those OTC-BB stocks cluttering up yourRRSP account. **Canada Customs and Revenue Agency** ("CCRA"), is disallowing OTCBB stocks in RRSPs and RRIFs.

Even though it is quite acceptable to have some "foreign content" in one'sRRSP, OTC-BB stocks - even Canadian issuers - have got to go. Shareholders have until December 31, 2001 to get rid of them. You can sell them for cash or transfer them to a non-RRSP account in exchange for cash. And if you don't, you will be taxed on your holdings of such

If you don't believe me, CCRA has set up a page on their website at (its short enough to easily remember): http://www.ccra-adrc.gc.ca/tax/registered/rrsp_eligibility-e.html .

Sideware Systems (CDNX:SYD.U) has seen better days. Sideware has collapsed from a US$25/share high last January down to the US$1 range. Quarterly sales are only $267,000 with a net loss of $6.5M. However, the company has signed over 20 deals to market Internet based dispatch systems. In Q3, it contracted $900K revenue for delivery over subsequent quarters. Also, Rahul Bardhan, a veteran of **Oracle Corporation**, has joined Sideware as Chief Technology Officer. With 58M shares outstanding and stock trading around US$1.50, the market cap is US$89 million.

One of BC's long-standing tech companies and one of my personal favorites, **Epic Data International** (TSE:EKD), is also undergoing some rough times. I renewed my interest in the stock when well-known tech entrepreneur Barclay Isherwood (of Mobile Data Systems International fame) took control of the company in a proxy fight. However, today Epic announced that it is reducing its work force by one-third or approximately 100 employees in response to declining revenues. Revenue will be below expectations and sequentially down from the third quarter due to lower than expected demand in enterprise resource planning (ERP) markets in both Europe and North America. At the same time, the company announced the departure of senior vice-president, software marketing, Normand Pigeon. Alas, the stock is hovering at $1.15, near its low of $.90. C'mon fellows- pitch in and make it hum.

IPO Watch

There are no recent IPO announcements. Here are some upcoming previously mentioned BC offerings.

Sourcesmith Industries Inc. is a software technology company that is proposing to raise $1,000,000 through an IPO on the CDNX. The company designs "business process management software". It also provides custom development and consulting services - a good way to get cash flow going while being attuned to market needs and opportunities. Barry Swanson, 46, is President and CEO of the company. He was formerly a consultant with Microsoft and has 20 years experience in the computer industry. Haywood Securities is acting as the agent for the offering. It looks like this offering is limited to BC and Alberta. The company, based in North Vancouver, is 6 years old and has some revenues - about $500K (annual).

WaveCom Electronics Inc. is a Victoria, BC company which designs broadband transmission equipment for data over cable and fixed broadband wireless networks. Its products address some of the "last mile" needs allowing cable operators to connect their systems to end users. Two powerful endorsements of the company's products come from Cisco and Harris Corp. Cisco has agreed to buy US$24 million ofWaveCom's upconverter equipment - annually- and Harris has placed an initial order to purchase up to US$34.5 million ofWaveCom's 3.5 GHz broadband wireless equipment commencing in early 2001. The company has a 12-year history of sales and profits. In its most recent fiscal period (June 2000), sales were almost $22 million with a $4.5 million net income - after tax! Gross margins are 44% - good for a hardware manufacturer. Furthermore, the Company's order backlog at the end of August was $45.6 million. In reading the preliminary prospectus, I note that he credentials of the management team look pretty good. The founder is Dr Surinder Kumar, President and CEO with a track record in R&D in the telecommunications field. I haven't seen any pricing information yet, but if you're keen, contact one of their underwriting agents - Goepel McDermid, Yorkton Securities, TD Securities, or CIBC World Markets.

Yet another Victoria firm, **Beanstream Internet Commerce Inc**'s filed a preliminary prospectus on September 11th to raise $1.575 million by selling $1.75 million shares at $0.90 per share to BC investors only. Haywood Securities is acting as the agent. This is a very young company, being less than one year old. Its business is to provide secure on-line credit card transaction processing for internet commerce transactions. It provides a proprietary Application Service Provider (ASP) solution for merchants requiring financial transaction processing in a secure environment. Craig Thomson, 36, is CEO and President. Check the prospectus for more details.

You can get a full prospectus on any Canadian IPO offering (or any Canadian public issuer for that matter) on the Sedar website at http://www.sedar.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. CPC's are the continuation of the former VCP and JCP programs on the Vancouver and Alberta Stock Exchanges.

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 **Aqua Capital Corp**., **Buckeye Energy Corporation**, **Hawkeye Ventures Inc**., **Outside Ventures Inc**., **Rainmaker Capital Corp**., and **Smart Api Venture Capital Corporation**. All of the new entries are CPCs.

All of the new entries are from B.C. except for Hawkeye Ventures and Outside Ventures, which are from Alberta, and Smart Api Venture Capital, which is from Quebec.

Of particular interest is Aqua Capital. It is the second CPC from the **Discovery Capital Corp**. (CDNX:DVY) group of John McEwen, Harry Jaako and Randy Garg.

Since the previous update, the following companies have come to trade: **Balsam Ventures**, **CCPC Biotech**, **Clarity Telecom Networking**, **Hollingfield Capital**, **Intercedent Ventures**, **Larkfield Capital**, **Millennium Ventures**, **Red Oak Trail**, **SNL Enterprises**, and **Yes Capital** (they're going to have a tough time saying "no" to entrepreneurs).

Because they have completed their Qualifying Transactions, the following companies have been removed from the list: **Darwin Capital Corp**., **Detec Resources Ltd**., **Fountainhead Projects Corp**., and **Patfind Inc**.

One CPC worth mentioning is **Vast Capital Pool** (CDNX:VST). I mention it for two reasons: 1. Because it has acquired **User Friendly Media Inc**; and 2. because of its creative use of special warrants to not only raise capital but also advance a good chunk of it to the company prior to closing. Vast Capital has received regulatory approval for, and closed the first tranche of, its private placement of 4.2 million special warrants. Advances up to $604,500 in total will be made to User Friendly under a loan agreement as additional closings occur.

Vast is paying approximately $4 million in stock to acquire the "geeky" company. User Friendly is an Internet media company which has attracted a large following of IT professionals to their entertaining and informational website. It is best known for the comic strip userfriendly.org, which is based on the daily lives of Internet workers at a fictional ISP, Columbia Internet. It features the Dust Puppy as its central character. With over a million monthly visitors, User Friendly is one of the largest independent geek destinations on the Web.

One big complaint about CPCs is the fact that it does take anywhere from four to six (or more) months to complete an acquisition. Not much can be done about this due to the regulatory and legal processes required in the public arena. However, deals such as Vast's are innovative ways to allow companies to access capital in the meantime.

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 .

Footnotes

The Vancouver Enterprise Forum started up again this Fall with its 2000-2001 season. The first event was held on September 26th and the topic was early stage financing for new ventures. This was a popular event and was sold out. There were a number of presentations dealing with seed investors, incubators and high tech business angels. Some of the presentations are available on-line. Details are at http://www.vef.org as is information on various upcoming local tech events.

The October 24th event will feature a company presentation by **NxtPhase**. Richard MacKellar, took this small start-up with innovative fibre-optic technology and attracted the interest of the established power industry. He will lead us through his company's decision process over the last two years, as NxtPhase formed several high-profile strategic partnerships (for technology, in the market, and with investors) to fuel early-stage growth.

For a convenient printable, pdf version of this column, click here.

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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.

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