



Tech Futures:
August 24, 2001

By [Michael Volker](#)

Silicon Valley Blues, Miscellaneous Musing, Technology Financings, Capital Pool Corps Update

Silicon Valley Blues

Just recently I was heading south on Hwy 101 towards Silicon Valley. Ironically, just as I was passing the huge **Excite@Home** (NASDAQ:ATHM) office complex, a local radio station was playing some moody blues tunes. Certainly, what's happening in the Valley these days is not music to many tech investors' ears.

I'm familiar with the fate of many small cap tech companies who couldn't make it, but I've never seen so many well-capitalized large cap companies bite the dust. At least with high tech, you don't have to wait long to see which ones make it and which ones don't.

The \$7bn merger of Excite and @Home was big news last year when the merged company decided to position itself as an internet content play.

The Excite part of Excite@Home got its start in a Mexican restaurant in the Valley in 1993 by a few computer geeks (PBS put out a great series on the history of the 'Net featuring Excite which, at that time, called itself **Architext**. I'm familiar with the company because **Simon Fraser University** actually owns the Excite trademark - dating back to 1989 when it used that as an acronym for **Exemplary Centre for Integrated Technology in Education**. In fact, SFU even has a written agreement with Architext in which they acknowledge SFU's rights in the trademark. The stock has crashed from U\$95 to \$0.48. Excite lost U\$7.4bn last year (how can you "lose" that much?) and needs *only* \$100 million to make it to the end of the year. Maybe some Vancouver angels can bail it out!

Lest you think trademarks are of intangible value, bear in mind that the **Coca-Cola** TM was recently assessed at U\$69 Billion! (yes, that's a "B" - it's not a typo).

Exodus Communications (NASDAQ:EXDS) of Santa Clara, CA, is another once promising firm struggling for survival. Exodus is one of those "server-farm" companies which provides internet hosting services to companies such as **Yahoo** and **eBay**. This week three of its ten directors bailed out. Cash is tight. Exodus' U\$3bn debt eats up \$75m in quarterly interest payments. With only \$600 million in cash (down from \$1bn in March), the company may run out of cash before year-end. A second quarter loss of almost the same amount, doesn't help the situation, either. The stock has dropped by 98% to \$1.10. If you're interested, the company is looking for a buyer.

Metricom (NASDAQ:MCOMQ) which, among other things, was offering a high speed wireless access service known as **Ricochet** in the USA, files for bankruptcy protection in July. The company was planning to liquidate its assets during August. Even with its 40,000 subscribers, it still had a U\$1Bn debt and no cash.

eBay Communications (NASDAQ:EBAY) is one of those companies which is likely to survive. After all, they're making a handsome profit by handling all the fire sales of the bankrupt companies. If you're in the market for some computer gear, you can find some good deals these days. eBay's stock is holding up at U\$58+.

It strikes me that CASH (even though it's been said many times by many folks) is perhaps *the most important* number to look at when assessing a company.

Unlike the Silicon Valley casualties, **JDS Uniphase** (NASDAQ:JDSU) has \$1.8Bn (and no net cash drain) while Nortel has some \$1.9Bn. Unfortunately, Vancouver's **360networks** (TSE:TSX) is the antithesis of this having recently filed for bankruptcy protection.

The examples of 360networks and Exodus point out that not only CASH on hand, but DEBT is just as important. You should really look at DEBT as negative cash. Since this will likely put you in the hole right of the bat, you might consider taking only the next 12 months of payments due against the debt and reducing the cash position by this amount.

One way to assess a prospective investment opportunity in a tech company is to analyze its cash position - especially those early stage ventures which can't report Price/Earnings data or Sales. Board room discussions these days tend to be focused on cash.

One problem which I've seen many times with small caps is hitting the big caps as well. It's this: when you start running out of cash when your stock price is down, it's very difficult to go back to the public trough for new equity. That's why Exodus is looking for a buyer. It has few alternatives.

Tech companies are getting whacked on two fronts: their own performance and current market conditions. In a bull market (I sometimes wonder if the term "bull" came from all the hype) such as we saw last year, non-performing companies, especially the pre-revenue ones, could still attract investors. As you can read below under "technology financings", companies with sizzle and promise can still raise capital even in tough times. But, you've got to have a good story.

On the subject of market performance, using the P/E ratio as a measure, one could conclude that stocks are still priced on the high side - in spite of recent declines. Last week, according to Thomson Financial/First Call, the Standard and Poor's (SP500) stock index of 500 stocks had an overall P/E ratio of 22.2 (keep that number in mind if you're trying to pitch your company to investors) which is above the long-term historical average of 14.5. But, that's not comparing apples with apples. Thomson used something called "operating earnings" for earnings used in the P/E calculation. Operating earnings are not well defined and companies can "cook the books" to show healthier earnings than what they should report under GAAP (Generally Accepted Accounting Principles). Using GAAP, the P/E for the SP500 works out to 36.7 according to a Wall Street Journal report. Possible conclusion: stocks are still overpriced based on performance.

In the tech world, though, we might as well check P/E's out the window. P/E's may be OK for old economy companies (industrials, banking, foods, etc) which, by their nature, are not speculative. I'm convinced that tech stock prices are driven entirely by investors' perception. Indeed, many tech stocks don't have earnings and many don't even have a top line. One of the worst things that can happen to a tech company - from a stock performance perspective - is when it actually achieves its business plan. Then, reality sets in, and the potential no longer seems limitless. That's why, in addition to the fear of technological obsolescence, tech companies always need to be breaking new ground in the R&D area or looking at acquiring new R&D. Like it or not, it is hype that drives valuations. Just keep that in mind when buying in - but don't forget to check the cash situation.

Miscellaneous Musings

Small cap, CDNX-style, public are often criticized for improper disclosure and dealing on insider information. Well, such improprieties are not limited to the small players. Case in point: **Air Canada** was fined \$1 million for divulging inside information to a group of analysts prior to a making a full public disclosure - after which its stock sank by around 12%.

Have you ever wondered what happens to the cash collected from these fines? The Commissions which collect them - in this case the **Ontario Securities Commission** (same thing holds for the BC Securities Commission) - use them for "investor education". Seems to me that it might be better to use this money for "corporate executive education". In this regard, the **B.C. Securities Commission** is very keen to help companies practice better corporate governance. For some time now, **Simon Fraser University** (SFU) in conjunction with the CDNX and other firms, has been offering regular courses to executives on this very topic. Check www.sfu.ca for further information.

Whereas securities commissions are generally set up as watchdogs to protect investor interests, the new B.C. government is making an interesting structural change. Historically, the **B.C. Securities Commission** has reported to the **Ministry of Finance and Corporate Relations**. Now, the Commission will fall under the **Ministry of Competition, Science and Enterprise** (interesting new name, but why not shorten it to something catchy like **Innovation BC?**) headed up by **Rick Thorpe** and the Ministry of State for Deregulation headed up by **Kevin Falcon**.

In other government news, the Premier announced the composition of his special Premier's Technology Council. It consists of fourteen fairly well-known figures in the tech sector. Eleven of these are CEOs or executives of companies, 6 of which are CEOs from companies listed in the T-Net20 (**Ballard Power**, **Burntsand**, **CREO**, **Pivotal**, **Inflazyme Pharmaceuticals**, and **PMC Sierra**). It strikes me as being a fairly well-chosen group and the strong industry/company orientation is good - maybe even a bit on the heavy side. There could be a little more representation from the R&D sector in B.C. The only rep with in this regard appears to be **Dr. Victor Ling**, VP of Research at the **BC Cancer Agency**. Also, the small emerging tech sector, with the possible exception of **Shannon Byrne**, CEO of **Paradata Systems Inc**, does not appear sufficiently represented. The needs of new enterprises can be quite different - especially with respect to government policies - from those of more established enterprises. For example, there's always been some debate about trade-offs between income tax breaks for professionals (to reverse the brain-drain) and investment tax breaks or incentives (which is required to encourage angel and other start-up investors). I never thought I'd hear myself say that there's too much industry (especially senior) representation! OK, I confess my bias: I think Universities are key drivers for the tech sector and it all begins with small entrepreneurial companies. The Premier ought to have their ear, too.

I always thought that the tech sector was moving into second or third spot in GDP contributions to the province. Now I hear that the **BC Pot Industry** is grossing some \$6Bn annually. Still being illegal, the government seems to be missing a huge tax revenue opportunity here. Why not legalize it (to quote BobMarley who has been wailing for some time about this) and collect some hefty taxes (would luxury taxes apply?). This could eliminate the deficit.

Technology Financings

Technology companies are still managing to raise capital. Here's a sampling of some recent financings:

Nxtphase Corp (still private) rounded up \$30.4 million earlier this summer from about ten VC investors.

Datawest Solutions Inc (TSE:DS) received \$20 million (actually \$20,000,002 - no, the extra \$2 wasn't mine) from a dozen investors including Pivotal Corp (NASDAQ:PVTL). Whenever I see investors such as Pivotal Corp getting into a company, it's worth watching as a potential 100% acquisition down the road.

Ignition Point Tech (CDNX:IPN), a developer of broadband communications technologies raised && and, because its stock price is cheap (at least to the board), it is planning to re-purchase some of its own shares.

NTS Computer Systems Ltd (TSE:NTS) completed a refinancing which included a \$1.55 million loan and a conversion of \$1.8 million in bank debt into common shares.

Sideware Systems (TSE:SYDu) got 88 investors to ante up with some \$6.3 million.

Kinetek Pharmaceuticals, a private company which was shooting for an IPO raised \$16.5 million from **QLT Inc** (TSE:QLT) - see my earlier remarks regarding the Pivotal/Datawest deal.

Ballard Power (TSE:BLD) raised \$7.6 million from a single investor, **Graftech Inc**.

Avcorp Industries (TSE:AVP) has agreed to a private placement of up to two million units at a price of \$1.75 per unit, to raise gross proceeds of up to \$7-million.

These financings are mainly of the private placement type reserved for angels or well-heeled investors. But in the joe public category, **eMedia-IT Solutions** has just filed its preliminary prospectus to raise between \$1.5 million and \$3 million via an IPO on CDNX.

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 (VSE) and Alberta Stock Exchanges.

Since the program was launched, more than 250 CPCs have been formed and more than 30 have completed their so-called Qualifying Transactions (QT). It takes at least a year - usually longer - for a CPC to find a suitable takeover candidate and another six months to a year for a deal to be finalized. One way to expedite the process is to eliminate the need for a special shareholders meeting to approve the deals - leave it up to the CPC boards.

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 monthly basis. The Chart is now current to July 31, 2001.

Recent additions to the list include **American Reserve Energy Corporation**, **Broadgate Capital Inc.**, **Caravelle Capital Inc.**, **Coronado Capital Corp.**, **First Integrated Enterprises Ltd.**, **Olympic Ventures Ltd.**, **Rap Capital Corporation**, **Rocky Old Man Energy Inc.**, **Sydenham Capital Inc.**, and **Vanguard Investments Corp.**

Caravelle, Rap and Rocky Old Man are from Alberta. Sydenham and Vanguard are from Ontario. American Reserve, Broadgate, Coronado, First Integrated, and Olympic are from B.C.

Since the previous update, the following companies have come to trade: **Canden Capital Corp.**, **Coventry Charter Corporation**, **Duft Biotech Capital Ltd.**, **Glenwood Ventures Inc.**, **The Jenex Corporation**, **Nortec Ventures Corp.**, **OMNItech Capital Corp.**, and **Xceleron Inc.**

Since the previous update, the following four companies have been removed from the list because they have completed their Qualifying Transactions: **Amex Ventures**, **Envirotrain**, **EPS Capital** and **King Capital**.

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

Footnotes

Now that summer's almost over (drat! And, where's that mid-August rally anyway?), it might be time to check out upcoming Fall meetings in the tech sector. A complete calendar of technology events can be found on [T-Net's Events page](#).

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 "Business Centre" (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? 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 Harbour Centre campus at 515 West Hastings St. More information can be found at www.sfu.ca/time. PS - there are some great facilities for holding your company meetings.

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: risktaker@volker.org

[Tech Futures Archive](#)

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