



Tech Futures:
November 3, 2000

By [Michael Volker](#)

Stock Contributions, Stock Commentary, Warrants or Options?, IPO Watch, Capital Pool Corps Update

Stock Contributions - Favourable Tax Treatment

I'm delighted to see so many reports of altruistic tech entrepreneurs who have cashed in a few of their chips for the benefit of society. Back East, RIM founder, Mike Lazaridis, recently donated \$100 million for Physics research and Matrox co-founder Lorne Trottier donated \$10 million to McGill.

There's a very strong tax temporary tax incentive in place which makes donation of company stock very attractive - more so than a mere contribution of cash. Here's an example of how it works.

Suppose you're a co-founder of a successful technology firm. For your efforts, you are rewarded with a \$2 million cash bonus - one of many such bonuses. Taken as salary, you'd be left with about half that amount, after paying taxes. Of course, it is unlikely that you would earn such a bonus in cash. Earning it through capital appreciation on your zero cost founders shares is a more likely scenario.

Because of the more favorable tax treatment on capital gains coupled with the tax credit (of 50%) on charitable contributions, let's take a look at what you can do with a \$2 million windfall on stock. (Feel free, of course, to apply the same logic to lesser amounts!)

Instead of selling your founders shares, you contribute \$1 million worth of stock to your alma mater (or your favorite foundation) as a charitable donation. You also sell another \$1 million for yourself. On your donation, you are deemed to have disposed of the shares but instead of being taxed on one-half of the gain (as per the recent mini-budget reductions in cap gains taxes), you are taxed on only one-quarter of this at your full marginal rate of, say 50%, implying a tax liability of approximately \$125K.

On the \$1 million which you sold for yourself, you will have a net tax liability of \$250K. However, on the other \$1 million in stock donations, you get a tax credit of 50%, i.e. \$500K, which more than wipes out your entire tax bill of \$375K arising from these two transactions (with an unused credit of \$125K). You are effectively left with \$1.125 million.

Sure, if you had not been quite so generous, making no donations, you would

have netted \$1.5 million on a \$2 million sale (assuming, as above, a zero cost base on founders stock). But look at it this way: by donating \$1 million in gains your real cost of making a \$1 million donation is therefore only \$375K - i.e. the after-tax difference between the \$1.5 million you would pocket without making any donations and the \$1.125 million you're left with after a donation - which is still more than if you had earned the same amount in the form of a salary bonus. Regardless of how you might rationalize it, it really isn't all that painful.

High technology entrepreneurs know that research and higher education are the lifeblood of their enterprises. Sustaining this valuable resource through generous stock donations makes good business sense.

Business in Vancouver recently reported on the good fortunes enjoyed by various B.C. tech execs. What we don't know is if some of their reported stock sales were dispositions for charity. Being an optimist, I'll bet some were!

Stock Commentary

Fickle or what? It was hard for even the most seasoned investor to understand the **Nortel** (TSE:NT) meltdown and its impact on other tech stocks. Last week, on the day that Nortel was to report its quarterly results, it reported earnings slightly better than expected. The company's earnings from operations (before taking into account any amortization of acquisition costs) of US\$0.18 per share was just ahead of the US\$0.17 per share which analysts were looking for, according to First Call/Thomson Financial.

Revenue rose 42% over last year to \$7.3 billion, only \$200 million shy of the average analyst estimate compiled by First Call. However, even though Nortel's revenue from its optical business grew 90% in the third quarter from the same period a year ago, it was slower than the 150% growth reported in the second-quarter.

Nortel also said that it sees percentage growth in its share earnings in the low 40s - higher than it had previously expected - and that it expects to grow faster than the market in 2001.

In spite of this no-surprise news, Nortel's stock plunged to US\$48.75 in after-market trading on the day of the announcement setting the stage for a tumble the next morning - exacerbated by margin calls, program trading, and nervous investors and day traders. It is still hovering in the low US\$40's range. Nortel, being Canada's most valuable company, accounts for 30% of the TSE 300 composite index. Hence "the market" felt the impact.

It's almost as if the markets were looking for a reason - any reason - to dump some stock. Sure, some of it was profit-taking (why not?). Other telecom stocks like Cisco and Lucent were also being attacked because of the over-heating in this sector and less-than-stellar results being reported.

Even so, Nortel's P/E is still over 60. The P/E (Price/Earnings ratio) should be considered along with the PEG (Price/Earnings ratio divided by growth rate). A PEG of 1.0 means that the P/E is comparable to the growth rate. A higher figure could indicate (when compared to other companies) an overvalued

situation whereas a figure less than 1.0 could be interpreted as a relatively undervalued situation. Presently, Nortel's PEG is at 2.1, about the same as Cisco's. Given that, it would appear to be fairly priced - at least for the moment.

Recent economic data shows that the rise in U.S. GDP dropped to 2.7% in Q3 from 5.6% in Q2. Inflation climbed to only 2.2%, up slightly from 2.1%. The U.S. economy seems to be moderating to a sustainable level meaning that inflation is likely to remain in check and hence the U.S. Fed is unlikely to raise interest rates in the near term. Some say a decrease may even be forthcoming. On the positive side, such news is good news for stocks which always retreat on any signs of interest hikes.

And then there's Intel, a company highly regarded as a barometer for tech stocks. Yesterday, Intel predicted its sales growth over the next year to be in the high teens - news to which there was a strong positive market reaction.

Corporate forecasts such as this, along with the economic data mentioned above, lead to the conclusion that growth is still high, just not quite as high as predicted earlier this year. This should mean that further market corrections are unlikely, at least not substantial ones, and stocks should start gaining some momentum again. (Hope, Hope!)

Indeed, this may be a good time to get into those companies that you were keen on back in the Spring but which seemed pricey at the time, e.g. Burntsand Inc.

Burntsand Inc (TSE:BRT) was added to the TSE 300 Index after the close of trading on November 1st. Being a part of the country's leading stock index is good for a company in that it gives it a higher profile and can attract more investors. Burntsand replaces Teleglobe in the TSE 300 Index. Burntsand also reported positive quarterly operating results.

NORSAT International (TSE:NII) of Burnaby gained \$1.15 to \$10.00 after the company said it will begin trading on the Nasdaq National Market on Monday. The company has previously traded on the Nasdaq SmallCap Market.

Explanation: the "Nasdaq National Market" is *the Nasdaq* - the one which everyone aspires to be listed on. The Nasdaq SmallCap is a junior Nasdaq for companies with smaller market capitalizations - a very respectable market at that. Why care about this subtle distinction? I recently discussed this with the CEO of a Nasdaq SmallCapper. He explained that many institutional investors only invest in Nasdaq Nationals - hence the desire to be in that market place. It opens the doors to many new (large and well-heeled) investment funds.

It should be noted that the Nasdaq SmallCap is sometimes confused with the so-called NASD OTC-BB market - which is not an official exchange. Many OTC companies call themselves junior Nasdaq's because it makes them feel more important. But, that's a real stretch.

How can you tell which is listed where? If you look up quotes on a service like quote.yahoo.com, you'll clearly see suffixes to identify the specific market. For

example, Nasdaq Nationals are listed as NasdaqNM whereas OTC stocks have a ".OB" appended to the ticker symbol (e.g. PCSP.OB).

Forbes Medi-Tech Inc. (TSE:FMI, NasdaqNM:FMTI) started its trading days on the VSE, then progressed to the TSE. It, too, is now interlisted on both the TSE and Nasdaq.

Here's something for you net savvy investors. To listen to an audio interview with Mr. Tazdin Esmail, President & CEO of Forbes Medi-Tech Inc. (TSE:FMI), please follow the instructions below using the supplied link:

<http://www.ceocast.com/company.cfm?cid=3508>. You will be asked for an email address & password. There is no cost for this.

1. Click on link
2. Click on "First time users, please click here"
3. complete form and click on register.

To locate interview please follow down the page on the right hand side to 10/26/2000 Forbes Medi-Tech Inc. - Tazdin Esmail.

Warrants or Options?

This week's stock tutorial: What's the difference between warrants and options? Both warrants and options give the holder thereof the right to buy shares in a company at a certain price (the exercise price) for a specified period of time.

We often hear about employee incentive stock options - the kind every high tech employee likes to get as part of her compensation package. We also hear about warrants which a company issues to investors, usually as part of a financing package, giving investors the right to buy more stock from the company (just like employee options).

But then there are also tradable stock options - the kind you see listed in the newspaper. These are created (i.e. written) by owners of stock and do not obligate the company in any way. E.g. If I hold Nortel stock, I can sell options on my stock. Technically, employee incentive options are really warrants. Warrants represent dilution as the issuing company "prints" more stock to fulfill the obligation whereas tradable options deliver already available stock, so there is no dilution. Employee stock options can not be traded whereas warrants often are. Confused yet?

IPO Watch

Local biotech company (and UBC spinoff) **Kinetek Pharmaceuticals Inc** is planning an IPO on the TSE to raise \$25 million for drug research. Kinetek is a UBC spin-off formed in 1992 by Professor Steven Pelech to develop new drugs to treat cancer, inflammation and metabolic diseases and anti-diabetic compounds. Goepel McDermid in Vancouver is the lead underwriter for the offering which is expected to be completed in December. The shares will be offered in the \$6.50 range. QLT's cofounder Julia Levy sits on the board. Investors WOF, Royal Bank Ventures Inc., and Ventures West hold a combined 35% interest in the company.

Previously mentioned pending IPOs include the following:

Sourcesmith Industries Inc. is a North Vancouver software technology company that is proposing to raise \$1,000,000 through an IPO on the CDNX. This offering is limited to BC and Alberta. The company, based in North Vancouver, is six 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. It seeks to raise approximately \$75 million at \$13-\$15 per common share. Pricing will be finalized in the week of Nov. 13th with a closing expected in the last week of November. 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! If you're keen on this one, contact one of their underwriting agents - Goepel McDermid, Yorkton Securities, TD Securities, or CIBC World Markets.

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.

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.

There are *nine* new additions to [the list](#). These are: **ABI Capital Corp**, **Avic Technologies Inc.**, **E-amigos.com Inc.**, **Environmental Management Solutions Inc.**, **Killam Properties Inc.**, **MaxTech Ventures Inc.**, **Mountainview Energy Ltd.**, **My Venture Inc.**, and **One Click Ventures Inc.**

All of the new entries are from B.C. except for **ABI Capital** and **Avic Technologies**, which are from Alberta; **E-amigos.com** and **Environmental Management Solutions**, which are from Ontario; and **Killam Properties**, which is from Nova Scotia (welcome! Nova Scotia!)

Since the previous update, the following two companies have come to trade: **Celest Medichem Inc.**, and **Navan Capital Corporation**

Because they have completed their Qualifying Transactions, the following three companies have been removed from the list: **Duke Capital Corp.**, **Techgroup Ventures Inc.**, and **Yes I.C. Technologies 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>.

Footnotes

The [Vancouver Enterprise Forum](#)'s October 24th event featured 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. Unfortunately for many of us investors, the company is still private, but hey - there was a hint of an IPO somewhere down the road.

The upcoming November 28th event is titled "Mobile Commerce: Emerging Wireless Technologies and Companies". The moderator will be Norman Toms of **Sierra Wireless** (TSE:SW). Mr. Toms will make a general presentation on the state of wireless technology and pervasive computing, where the technology is going and which companies are taking us there. Panelists for this session include Barry Jinks, President & CEO, **SynchroPoint Wireless, Inc.**, Juliana Cafik, President & CEO, **Soft Tracks Enterprises**, Karim Khoja, Chairman & CEO, **EXI Wireless**, and MC'd by Pyarali Jamal, VP Corporate Finance, **Ernst & Young**.

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

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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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