



**Tech Futures:  
January 26, 2000**

By [Michael Volker](#)

## **Winning on CDNX, Software Acquisitions Boom and Capital Pool Corps Update**

### **Winning on CDNX**

It seems as if it's almost daily that I somehow find myself defending the **Canadian Venture Exchange (CDNX)**. Far too many people still remember its legacy as a disreputable stock market. I had an interesting chat just recently with a local technology executive which once again reminded me why its worthwhile to support the CDNX.

It always surprises me when others, such as the knowledgeable fellow I was chatting with this week, are surprised when I mentioned some of the well-known public companies that got their start on the CDNX (or its progenitors, the Vancouver and Alberta Stock Exchanges). Companies like **QLT Inc.** (TSE:QLT), **Burntsand Inc.** (TSE:BRT), **Westport Innovations** (TSE:WPT) **Spectrum Signal Processing** (TSE:SSY), **ALI Technologies** (TSE:ALT), **Silent Witness** (TSE:SWE), **eDispatch.com** (TSE:EWD), **Infowave Software** (TSE:IW), **Inflazyme Pharmaceuticals** (TSE:IZP), **Forbes Meditech** (TSE:FMI), **StressGen Biotechnologies** (TSE:SSB), and many, many more. And, these are just the B.C. companies.

I like the CDNX because it provides an alternative early stage financing vehicle for emerging companies while at the same time giving venturesome investors an early "entry" opportunity.

I've likened the CDNX to a farm team operation. Companies get a "chance" to build themselves by gaining access to some risk capital. If and when they mature, they can then move onto the major leagues, i.e. the TSE or the NASDAQ. Indeed, a stated goal of the CDNX is to see their stars leave the local arena and shine on other exchanges. The problem with this is that the CDNX often does not get (or take) much credit for the early "incubation" which it provides. Not only that, but the dogs (walking dead as VC's call them), loiter around the exchange taking away some of the hard earned credit.

From an investors perspective, if I invest in 10 CDNX companies, I only need one big winner. I really don't care if 8 or 9 flop. As long as one moves on to the big top, I'm happy. Trouble is - many investors don't think like this. Many think that because you are a public company, you simply shouldn't fail. Well, the VCs don't think that, so why should small-time investors trying to act like VCs think any differently.

It really boils down to perception. If the media hears that 40 companies make it big, and 200 tank, guess which ones get talked about?

*Promotion* may be a bad word among CDNX officials, but this is exactly what the CDNX needs to do - promote awareness of its successes. Case in point: some Asian investors recently commented to

me that they were interested in investing in a B.C. tech company but they were apprehensive because it was listed on the CDNX and they had not heard anything positive ever said about the CDNX. In checking the CDNX website, I found little that I could direct them to in order to make them more comfortable. It was only when I identified the many graduates, that they realized what it was all about!

The CDNX ended its first year of operation having helped companies raise \$2.37 billion in equity financings. It also saw 45 of its listed companies graduate to the Toronto Stock Exchange (TSE). Yes! 45 of 'em! Many of these are from B.C.

All companies have as their so-called "exit strategy" or "liquidity event" the goal of doing an IPO (ie. going public) on a major stock exchange such as the NASDAQ. Canadian companies have traditionally targeted a listing on the Toronto Stock Exchange (TSE) because it has been slightly easier to get a TSE listing and because it avoids the burden of complying with U.S. rules and regulations.

What happens to a company when it graduates from the CDNX to the TSE? In the past year many companies have made such a transition. For example, **Intrinsyc Software Inc** (TSE: ICS) graduated from the CDNX to the TSE earlier this month. Companies will enjoy greater market exposure. In the case of Intrinsyc, the Globe and Mail picked up on its graduation and ran a half-page story last week commenting that two Canadian analysts are following the stock. CDNX companies usually have no analyst following. Loewen Ondaatje McCutcheon, for example, has issued a "buy" recommendation with a 12-18 month target price of \$9.70. The stock is presently around \$3.00. Intrinsyc makes software for Microsoft windows based embedded systems.

Another one which recently made such a move from the CDNX to the TSE is Victoria-based digital imaging company, **ACD Systems** (TSE:ASA), a company which was also recently added to the T-Net20 placing it among B.C.'s 20 most valuable technology ventures. For investors, the challenge is to identify those CDNX companies, like ACD Systems, which you can buy "low" on the CDNX and then sell "high" on the TSE! Many of the junior companies followed in this column over the past couple of years have allowed investors to do precisely this. A good example of this is **Silent Witness Enterprises** (TSE: SWE), a Surrey-based electronic security and surveillance systems company, which was trading for pennies on the old VSE is now trading above \$10 on the TSE.

Who's next? If **you** think you know of some that are going to make such a transition, send me an email. Maybe these, and your reasons, are worthy of a mention in an upcoming column.

Companies on a senior stock exchange get more coverage from analysts. Institutional investors are more likely to invest. They know that the standards (i.e. entrance requirements are higher).

Once a company is a bona fide public company, it need only reach a certain level of maturity to qualify for an address on the TSE or NASDAQ.

Going public on the CDNX should be regarded as a stepping stone to going on the TSE or NASDAQ. I recently had a strange experience with a local tech venture. The founders, true to my remarks above, stated to their investors that their liquidity event was to be a public company on NASDAQ in about one year's time. However, they turned down an attractive financing and management offer on the grounds that they were "too early" to go public. They thought that they might end up as an "orphan" on the CDNX.

In my view, starting on the CDNX, especially with a good cash reserve, would more assuredly allow them to achieve their stated goal of being on NASDAQ. As we've seen in the IPO markets, companies pull their offerings when the markets are hard on them. But, moving from one exchange to another is far less onerous than starting an IPO from scratch. In not doing so, companies such as this run the risk of being an orphan, period!

**Westport Innovations** (TSE:WPT) is one company that clearly understood the value of going public early via the CDNX. Once it got to the TSE, it was able to raise over \$50 million. Here's a company you could have bought on the ASE for \$.60 and sold on the TSE for \$25.00 - a win-win - for both the company and its shareholders.

Now, with the NASDAQ operating in Canada (vive la Belle Province), sailing into NASDAQ is more attractive and easier. Technically, companies on NASDAQ Canada need not comply with any U.S. rules. Yet, the NASDAQ label gives them both the prestige and audience enjoyed by NASDAQ companies.

I'd sure like to see a closer alliance between the CDNX and NASDAQ to allow for a smooth graduation from the CDNX to NASDAQ. Also, increasing the CDNX's presence in the U.S. market (i.e. Silicon Valley), will raise its profile and increase liquidity for all companies listed there. Liquidity is one of the main problems facing all juniorpubcos.

A commonly asked question about NASDAQ listed stocks is how low can a company's stock price go before it runs the risk of being de-listed? Any NASDAQ listed company whose minimum bid price has been consistently under \$1 per share, for at least 30 consecutive days, will be issued a 90-day warning by a NASDAQ analyst who follows the company. The company must outline a plan for correcting the situation. If the company cannot rectify the situation in the next 90 days, then the exchange can move toward de-listing the company. A hearing will be arranged and the company can accept or refute the recommendations of the exchange.

In addition to maintaining a minimum bid price of \$1 for its shares, NASDAQ-listed companies must maintain several other "continued listing standards":

- At least \$4 million in net tangible assets
- A public float of at least 750,000 shares (i.e. shares not held by insiders, directors or 10% beneficial owners)
- A market valuation of at least \$5 million
- At least 400 round-lot shareholders (minimum holding of 100 shares)
- At least two market makers in its stock

"Deficiency in any continued listing requirement can prompt a red flag from one of our analysts who follows the company," said a Nasdaq official.

In contrast, on the CDNX, you have to be almost totally dead (I think some are already) before you get de-listed - another reason for the low-quality perception. On the other hand, there's no other place to go. Hence, investors simply have to understand that there will be lots of losers hanging around. But, why should the presence of losers discourage winners? We need to focus on

the 45 success stories - not on the 100's that don't make it.

### **Software Acquisitions Boom**

Having just talked about the merits of junior exchanges, please indulge me while I now present another alternative to raising capital from VCs or the public markets.

I recently read a CATAAlliance study which showed that buying market share by the merger route is an attractive alternative to raising new capital. Here are some excerpts from a CATA news release on this subject.

Mergers and acquisitions in the Canadian software industry rose 72% in 2000, from 67 to 105 deals, according to a new CATAAlliance study.

The total value of the deals more than doubled, to \$11.4 billion. Canadian software companies acquired 44 foreign firms, with a value of \$3.4 billion, and 34 Canadian firms, worth \$1.4 billion. Foreign firms bought 27 Canadian software companies, for \$6.6 billion.

"The acquisition explosion is a result of the critical importance of speed to market in the high tech sector, and high stock prices which provided ready currency for acquisitions," said John Reid, CATAAlliance President.

The number of deals tailed off somewhat in the second half, as the tech stock market declined. The second half number was 47, versus 59 in the first half, and the value slipped from \$6.2 billion to \$5.3 billion.

"Acquisitions will play an increasingly key role in software companies' growth strategies in 2001," says David Paterson, CATAAlliance's Executive Director. "The IPO market has dried up, and venture capitalists are pulling in their horns to some degree. Buying market share by the merger route will be an attractive alternative to raising new capital. On the other side of the deal, selling out may be the most attractive exit strategy."

Of course, if you build your company with an IPO always in mind (or a graduation from the CDNX if you do an early IPO), then you will always be very attractive to a potential acquirer.

(For more on mergers and acquisitions, read the footnote at the end concerning an upcoming Vancouver Enterprise Forum event on this subject.)

### **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.

But alas! Because there has been such a flurry of them (close to 250), some are even trading

below their IPO prices. I can comment that, from first hand experience, CPC deals are not that easy to do. It's like a courtship. It takes time. You might almost get to the altar and then find out that you are not meant for each other. On the other hand, that makes them work better for investors, i.e. the odds are better than with traditional RTO's (reverse take-overs).

One reason why CPC deals are difficult to consummate is because of what it is that constitutes an appropriate CPC deal. The range of choices - for both the CPC in identifying its target and for the target company in being comfortable with the CPC - is very limited. In approximate terms, CPC acquisitions usually involves targets that have a negotiated valuation in the range of \$1 to \$10 million dollars. The CPC's original shareholders usually end up with between 10 and 20% of the resulting merged company. Any investors which are concurrently brought in (which is, after all, the whole point of using a CPC as an RTO vehicle) usually end up with another 10-20% of the company. So if these parameters meet with your approval, go for it!

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 last [Vancouver Enterprise Forum](#) event held earlier this week featured the very popular sold-out annual venture finance session, i.e. who's got the dough and what does it take to get it. For those who missed it, on-line summaries (and great contact information) is available on the VEF website. Four companies, including a public one, **Westport Innovations** (TSE:WPT) talked about their experience in raising equity capital and what lessons they learned.

The next event, to be held on February 27th, will be on Mergers and Alliances, featuring some B.C. success stories as examples.

Last week, Silicon Valley manufacturers warned Davis that the state had better get its energy supply in order, or they would look to move their operations. The head of Intel Corp. declared that the unreliability of power in California means that the company would build its new manufacturing facilities out of state. Psst...Intel....check out B.C. Wouldn't a nice little fab facility by the beach (one with lots of silicon) be neat?

Yet another B.C. Technology stock index was recently introduced by the CIBC. This index, pegged at 100 as at January 1, 2000 appears to be a copy of the T-Net20 index which was created two years earlier. Like the T-Net20, the CIBC BC Tech Index is also based on the top 20 BC companies, ranked by market capitalization. Who said that imitation is the greatest form of flattery?

Can you believe this: last October, Finance Minister Paul Martin announced the goal of having our national expenditures on R&D (i.e. the driver of our high tech industry) increase from the current level of \$14.5 Bn to \$47.5 Bn by 2010 - a tripling! Yet, in B.C., at the B.C. Business Summit in November, business leaders stated their goal: a paltry one-quarter increase by 2005! It seems to me that the roles of the political and industry leaders are reversed! Where's the leadership from industry in this picture?

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

Technology Futures - January 26, 2001.

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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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