Tech Futures:
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By Michael Volker

Accessing Capital, Capital Pool Corps Update, and Coming Events

Accessing Capital

Are there any investors out there? That's a good question to ask your friendly stockbroker. I haven't met one recently who knows any - at least any that are presently active in the market. What a difference from the comments I made in this column earlier last year. I recall not even being able to get a market order entered because of the heavy trading. I wonder what all those brokers do when their phones aren't ringing?

Next week at the **Technology for Success** conference in Edmonton, I'll be giving a talk titled "Accessing Capital - managing financial challenges in the downturn". As such, I've been asking many questions in preparation for this talk. I was trying to get a handle on the so-called "downturn" to see who is affected and how companies are coping.

Hopefully, some of my ramblings here will help investors avoid a dog while at the same time give some entrepreneurs and CEOs some ideas and encouragement. Although I've been a big fan of the junior markets, one strong conclusion that I've come to is that if you're a private company seeking capital, your prospects are probably a lot better than you think.

All you have to do is to take a look at trading volumes to get a pretty good picture of what is happening. In the junior cap markets especially, I wouldn't even use the term "volume" to describe the trading action. "Trickle" might be a more appropriate turn. Of course, prices - especially in infotech stocks are way down. Many juniors are trading between 1 and 10% of their levels last year. Without any volume, even a modest sell order can hammer a stock.

Even so, it doesn't appear to take much to get investors back into action. A little news with sizzle is all it takes. For example, **Imagis** (CDNX:TSE) has seen lots of action lately because of its facial recognition software that is getting attention post-Sept 11th. Similarly, **Silent Witness** (TSE:SWE) became hot because of its security products and the company used this interest to raise some $15 million through a sale of 1,395,351 Special Warrants toCanaccord Capital Corporation.

The biotechs are faring a little better and there are a few bright ones worth taking a look at. Companies such as **Inex Pharmaceuticals** (TSE:IEX), **Inflazyme Pharmaceuticals** (TSE:IZP), **ID Biomedical Corp** (TSE:IDB), **Micrologix Biotech** (TSE:MBI) all have a strong cash position giving them a 3-year+ window in which to hit some milestones.

Inex Pharmaceuticals (TSE:IEX) is planning an "Investor Night" later this month (Nov 21 & 22) at its Burnaby facility. Interested investors can use this as an opportunity to learn more about the company.

By the way, I couldn't help but notice that BC's best known biotech firm, **QLT Inc** (TSE:QLT) is now a $100 million company (in terms of annualized revenue). Did anyone notice? I believe it's the first biotech company to hit that milestone. Less than a decade ago, there were no $100 million tech companies to be found in B.C. Zero. Now QLT joins several others (e.g. **PMC Sierra, Creo Products, MDA, Sierra Systems**) that belong to this club.

The dilemma facing the juniors is that they cannot go back to the public trough if they need cash now. If they're not yet cash-flow positive, how much cash do they have on hand and when divided by their burn rate (see below), how many months do they have before they're broke? Any investor who digs at least this deep will know that even a bargain stock with a good technology and a good story isn't worth investing in if it's not going to survive. Many of theinfotech stocks are in this situation because the mean-time to profitability is always shorter for these than it is for biotechs. That's why biotech companies like to sit on huge cash reserves. For them that spells happiness. And the sharp CEOs took advantage of last years strong market by raising extra capital.

One of the few infotech companies which took advantage of last year's market strength was **Burntsand Inc** (TSE:BRT), which raised some $50 million at $10.50 per share in May, 2000. Smart! As reported a couple of weeks ago, Burntsand has commenced a normal course issuer bid to repurchase up to 4,217,452 of its shares. In essence, it's made a gain by "shorting" its own stock - selling it high and now buying it back low. This is almost the same number of shares that were sold last year to raise the $50 million. That means the company would be some $40 million ahead simply by taking advantage of the market. Now, *that* is cool!

Regardless of what type of stock turns you on, the one "must-do" bit of due diligence on your check list has got to be the burn-rate. Is there enough cash on hand to take the company to profitability or at least to last until the market turns around (wish and hope)?

Most people refer to the burn rate as the net monthly cash outflow. Some also refer to the committed monthly operating expenses before taking into account any gross margin contributed from sales.

What is management doing to conserve cash? Check to make sure that the month over month burn rate is decreasing - not increasing.

One way to reduce the burn, especially for startups is to cut salaries. Last year, I noticed that a lot of start-up CEOs and senior managers were paying themselves handsomely. They like to compare themselves to others in the industry with like education and experience and often feel that their pay is out of line. These people, in my view, are not true entrepreneurs - they're more focused on short term income versus creating and building real value for the long term gain. In fact, I must say that some of their pay cheques were offensive - especially to stakeholders. So one obvious source of capital is the replacement of cash with human capital. After all, owner-operators really don't need to pay themselves anymore than they need to scrape by. This also means putting off the fancy car, house, and boat for a little while (till the burn is extinguished).

As for pre-revenue companies, one great way to reduce the burn is to work on sponsored projects. That is, get someone else to pay you for your development work. A great local example of this is **Creo Products** (TSE:CRE). Back in the late 80's, Creo received various government contracts to work on certain projects. This allowed the company to offset some of its development expenses while developing its intellectual property. Lately, I've seen more and more companies taking this tack. Software developers should be able to do this quite readily. Although it may push back a project, it may be the ticket to survival.

I once had a very wise CFO working for me. His favorite line was "happiness is positive cash flow" - obviously we weren't a biotech firm. Whenever he wasn't "happy", he would pressure me to cut costs. Of course, I would respond by saying that we've cut just about everywhere except for our fixed costs (rent, leases, management). At that point, he'd remind me that there's no such thing as a fixed cost! Can you imagine an accountant saying that? Well, of course he was right. Sometimes these are the most obviously overlooked targets.

If you're a public company, and if you've cut your burn to the bone (sounds good, doesn't it?), but still need capital, here are some ideas for you. Before going to the equity market, make sure that you've tapped into all the freebies - what I call "golden" sources of capital. There are tons of federa and provincial programs that companies can tap into. A few years ago, I put together a chart (updated often) which summarizes many of the popular programs that tech companies can apply for. This chart is available on the **Vancouver Enterprise Forum's** site at www.vef.org/moneylnk.html .

This same chart includes what I refer to as "red" and "green" money. Red is for debt (shows up as red ink on the balance sheet) and green is for equity (makes things grow).

Last year, I noticed that many companies used their cash to buy equipment. A lot of that stuff can now be purchased for pennies on the dollar at the many auctions taking place around town. Sadly, that's because they should have conserved their cash and leased, or even rented, a lot of this equipment. Even term loans, i.e. finance plans, would have made a lot more sense.

Companies which have unencumbered assets on their balance sheets can look at conventional bank financing. Small companies may not have enough substance in this respect. For them, there are credit cards. Yup, credit cards. I've known entrepreneurs who've had over $100K on their various credit cards to help them through tough business times. If you go on the hook personally by doing something like this - and if you are a public company - your extra exposure can be rewarded by a company bonus - paid in shares. There's even a CDNX policy covering this scenario.

If you're a large-cap pubco, you have a few additional red arrows that you can pull out of your quiver. Example: Burnaby's **PMC Sierra** (NASDAQ:PMCS). Recently PMC sold US$275 million in convertible subordinated notes carrying a 3.75% coupon rate - not bad - one of the pluses in these economic times (in 1979 I was borrowing at a prime around 21%!). Obviously, at today's stock prices, PMC management figures it's in the shareholders' best interests to avoid dilution by selling cheap stock - especially at such attractive debt rates.

Private companies have a few additional avenues to pursue. One of the most overlooked and most misunderstood - and in my view one of the best - sources of "golden" capital is the **CCRA's SRED** program (translation: **Canada Customs and Revenue Agency's Scientific Research and Experimental Development program**). The neat thing about this program is that you don't have to beg for a handout or convince anyone about the merits of your business. You need only meet the criteria - i.e. that you are spending money on real research and development. If you qualify, you can get a cheque (i.e. cash) from Her Majesty amounting to approximately $.68 on research dollars which you've already spent! That's because the SRED is a "refundable" tax credit - meaning that if you aren't yet paying taxes (a likely story), you get the credit in cash. More than $1 billion is spent on this program annually - and there's no limit!

How do I calculate the 68 cents? The official percentage quoted by CCRA is 35%. However, they let you tack on an overhead proxy - a straight percentage. And, in B.C., the provincial government contributes an additional 10% on top of it. Do the math and you get 68 cents. Don't lose out on this one. There are a number of local experts who can help you discover overlooked eligible refundable R&D expenditures.

If you're a pubco, or otherwise do not qualify as a Canadian Controlled Private Company, you still can tap into the SRED program - but the percentage is less and you only get a credit against taxes payable.

Unfortunately you can only get so much from golden and red sources. Indeed, both the red and gold folks like to see a little green (that's leverage) in the game before they commit. As companies grow, green becomes more important and plays a bigger role.

Green investors come in many flavors. The best place to start is with the entrepreneur (after all she *is* "green") - her contribution may be red on her balance sheet but it should be green on the company's. Then there's the progression we're all familiar with: love money (family, friends), angels, seed investors, and finally venture capitalists.

Public companies, large or small, are having the toughest time in the green fields. That's because their market caps (i.e. market valuations) are so abysmal. Companies can't find willing investors and when they do, they suffer horrendous dilution. This may be a tough pill to swallow. But it has to be done. I have a lot of respect for companies such as **Marine Bioproducts International** (CDNX:MBP) which announced a financing for $640k by selling 4 million shares at $0.16 per share. Although investors who came in at previously at much high levels may be annoyed, the company has little choice. The company is getting closer to zero burn and it saw that as its survival route.

A few more examples: **Brainium Technologies** (TSE:BNU). Brainium announced $625,000 in new financing from its principal investors and debenture holders includingHSBC Capital Canada, HSBC Bank Canada, Adex Enterprises and Brigill Investments. **Softcare EC** (ARE EC) announced it will complete a non-brokered private placement of up to 1,000,000 Special Warrants at a price of $0.12 per Special Warrant, for total proceeds of up to $120,000.

Because of the lack of interest in the public arena, almost no private companies are attempting to raise capital by going public via the IPO route. There are a couple of recent exceptions to this. **Power Measurement Inc.,** a Victoria company that makes web-enabled meter readers is shooting for a $100m IPO on the TSE and Nasdaq. This company is no small potato. In its first quarter of 2001, it reported sales of US$15M with a bottom line just over 10%, i.e. $1.7 million. In 1996 its annual sales were running just over US$22 million. And**Wireless DataScan** has filed a preliminary prospectus to go public on CDNX.

Private companies wishing to remain as such are having it a little easier. Firstly, their valuation isn't being driven by a non-existent, disinterested public market. Secondly, there are more investors in this arena. And this deserves emphasis: There is a lot of investment capital out there. I'm simply amazed at how many deals are getting done. There's cash and there's an appetite! In recent columns, I've reported on numerous deals that are getting done.

A few new ones (private company financings) to note are:

Convedia Corp, a telecom network products maker, raised US$20 million earlier this month from a number of VC investors including the **Mayfield Fund** (Calif), Entrepria Inc (NY), and Ventures West Management (BC).

FinancialCAD raised $3.9 million and **Altus Solutions,** producer of telecoms software raised $2 million from **Roynat Capital** and **Smart Seed** while **Wavemakers** completed a placement from **GATX / MM Venture Finance Partnership.**

What's attracting investors is the combination of reasonable valuations and prospective returns. Investors expect returns in line with the stage of corporate development at which they commit funds. Angels and seed investors like to measure their returns in multiples, i.e. 10X, 100X or even 1000X. Traditional venture capitalists and institutional investors measure their returns in percentages. Even though they like to get a few hundred percent on their winners, they tend to, on average, get double-digit returns.

So, what's my bottom line on all this? yes, the markets suck - prices are down and there's little liquidity yet investors are there - ready to jump into private or public companies (the latter being favored) if the price is right and if the deal looks attractive.

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 CPC program was launched in B.C. a few years ago, more than 250 CPCs have been formed and more than 30 have completed their so-called Qualifying Transactions (QT). Right now, there are dozens just sitting there with modest amount of cash - usually around $500K - not knowing what to do with it. I'm even seeing a number of CPCs looking at merging with one another to pool their capital.

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. As of next week, the Chart will be current to October 31, 2001.

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

Coming Up

The next **Vancouver Enterprise Forum** event will be held on Nov 27th and the topic will be "From Research to Commercialization" and will discuss corporate challenges in moving from the development phase to product commercialization. Questions such as "What are the key manufacturing issues that come up when a company transitions from R&D to commercialization?" will be covered. Details at: www.vef.org . The VEF's new tag line is: "VEF - Advancing Technology Entrepreneurship."

Next week (Nov 4-6), the **Softworld 2001** conference will take place in Vancouver. This is the best place for Software execs to meet potential partners drawn from business executives from all over the world including leading companies like **Cisco**, **Sun**, **Adobe**, **BSQUARE**, **Electronic Arts**, **Macromedia**, **Intel** and **Nortel**. They are coming to listen to, and learn from, the partnering war stories,best practices and elevator pitches. And they are coming to do business. Register now for Softworld 2001 at: http://www.softworld.org /cfm/regpro.cfm .

A complete calendar of technology events can be found on T-Net's Events page.

Footnotes

New interest rates make it easier to avoid the income attribution rules by loaning (then collecting and declaring interest on same) the money to one's spouse or children to make investments.

A reminder: **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.

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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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Tech Futures Archive

T-Net 20 High Tech Stock Index