



**Tech Futures:
March 23, 2001**

By [Michael Volker](#)

Markets to Rally, A New Canadian Exchange?, Capital Pool Corps Update and Local Happenings

Markets to Rally

Did you always think penny stocks were "too cheap" for you? Not any more! What stock isn't a penny stock these days? Many of the high fliers of a year ago have been humbled - trading in the dollar, i.e. "pennies", range. Maybe that's why we're hearing about merger talks between the TSE and the CDNX. Perhaps the TSE want to become a penny stock exchange! More about this later...

I just wish I had a few "pennies" left over. Like many others a year ago, I thought there was no tomorrow and invested (or spent?) my pennies back then.

Just after writing my last column, the Nasdaq index was hitting its 52-week low, only to break through that on the downside the very next day - falling below the psychologically important 2000.

Wall Street is worried about fears over the soft economy and weak profits that have kept the tech-heavy Nasdaq and the broad Standard & Poor's 500 in bear territory, defined as a 20 percent drop from a market's peak.

I suggested that we need a little (I'm being sarcastic when I say *little*) economic stimulation such as a huge interest rate cut. While good old Al Greenspan obliged with a half percent cut in US rates, he disappointed the markets by not being aggressive enough. Many hoped for a three-quarter percent cut. What we really needed, though, was a full point or more reduction, i.e. a more dramatic statement.

In contrast to Greenspan's chicken-hearted approach, Japanese economist **Dr Motoshige Ito** of Tokyo University is advocating a return to Japan's zero-interest policy (remember those days?) in order to liberate the financial market. He believes that the pessimistic psychology due to stagnant stock prices and other factors are making the Japanese economy worse than it really is. In addition for the zero-interest policy, he is calling for an action plan which should include the speedy resolution of bad debts, counter-measures for deflation, and the initiation of long-term fiscal structural reform.

Although we generally think of Japan as being quite IT (i.e. Information Technology) literate, he suggests that Japan further advance its IT policies in order to increase its growth potential. Dr Ito will be giving a free lunch-time talk at UBC next Friday, March 30th. Call JETRO at 684-4174 before March 27th to book a seat.

Economics aside, the financial markets will recover. They always do. The upside that one can enjoy by investing in a tech stock today has increased substantially in the past year while the downside prospects have decreased. How's that for an optimist's view?

But then, I'm always optimistic. Sharing this optimism and giving his perspective on what's happening, here are some comments from **Neil Schatz at RBC Investments** on how long he expects the bear market to last:

"The markets have been ugly. Investor decision making has been driven by fear. People look at the downward trend and assume it will continue, therefore they want to sell with the intention of buying back in at a lower price. Although this is an appealing thought, it doesn't tend to work very well."

"The Problem: The underlying problem we are facing now is a lack of earnings visibility. Management cannot give any confident guidance for what the second half of the year will look like because they can't tell. They can't tell because their customers have stopped placing orders for future delivery. Customers have stopped placing orders because they know that there is excess supply and inventory at their suppliers, and they know they will be able to get delivery of what they need very quickly. This is the normal adjustment process that takes place in the economic cycle. The difference now is that things happen more quickly in the business world today, and customers know that even if the excess amounts of inventory are used up, their suppliers can manufacture/deliver in very short times."

"The Good News: The good news is that the economy is not in recession. So far this has been a classic soft landing for the economy, with a hard-landing like response from investors. Economic growth should be above 2% in the US. Inflation is at 3% or less. Interest rates are falling. Falling interest rates will help promote more economic activity, but with a lag. The lag is approximately six months, so we should start to see signs in the summer. Consumer confidence has fallen somewhat, but is still high in historical terms. There is a US federal budget surplus. Taxes in the US are coming down. The money supply in the US is growing. Employment is high. We have political stability. Energy prices shouldn't go too much higher given that the market has priced in a 500,000 barrel/day production decrease for OPEC. All of these factors point toward economic growth, not shrinkage. In addition we have some very positive macro level trends such as savings by the baby boomers, a generational wealth transfer, global economic expansion into new frontiers, and many new technology driven capabilities."

"Where is the bottom? No one knows this in advance, and we never are sure until well after the fact. Historically, the conditions necessary for the end of a bear market are: 1) An easy monetary policy - we are on our way to achieving this. Real interest rates are still a bit high; 2) Low valuations - the S&P500 is trading at 20 times earnings, down from a high of 26. This could go slightly lower, but is not an unreasonable ratio given the good prospects for many of these businesses in the next few years; and 3) Anticipation of increased corporate earnings - as discussed above, this is the missing element. Forecasted US corporate earnings growth has been revised downward to 4% for the year. This is a number that a lot of people either don't believe or are choosing to ignore."

"What to do? These factors suggest that we're not done yet, so more patience is required. The markets have come down so far and the underlying fundamentals are so solid that it doesn't seem likely that there is too much more downside. When the recovery starts it may take some time, so it will be difficult to know when the bear market is actually over. Professional money managers are actively adjusting their portfolios to be well-positioned for the next bull phase. For the most part

they're not holding cash in anticipation of further drops, they're fully invested now. Try not to pay too much attention to the valuations today. Focus on your end goal and let the short term fluctuations look after themselves."

Feel free to can contact Neil directly by email at neil.schatz@rbcinvestments.com .

Further to getting a market rally going I was suggesting in my previous column that we need a lot more than an interest rate cut to stimulate the economy (although the idea of a zero-interest rate sure sounds interesting). To further stimulate investment, I advocated some aggressive tax incentives such as allowing investors to fully write-off an investment made in newly issued Canadian corporate shares or the simplification and expansion of investment tax credit programs such as B.C.'s popular (but clumsy and limited) VCC (Venture Capital Corp) program which gives investors a 30% tax credit on qualifying new venture investments.

With regard to the notion of having more than one tax-driven "labour" fund in B.C., I received some interesting feedback from a reader who suggested that the Working Opportunity Fund had a deal with the NDP giving it a "guarantee" of exclusivity for some time to come. Hmmm...

What are some good B.C. investment prospects? Check out **Campney and Murphy's** (Vancouver law firm) annual **Small Cap Forum** which will be held in Vancouver next Tuesday, March 27th. Information on "The Best of BC" can be found at: www.thebestofbc.com . I've been to these before and they are a great way to meet face-to-face with some of our local shining lights.

A New Canadian Exchange?

What's this rumour about the **TSE** and the **CDNX** merging their operations? Actually, it's more than a rumour. Bill Hess, CDNX president and chief executive, yesterday confirmed that the CDNX has received a takeover bid from the TSE and that its board will consider the bid at its meeting on March 28.

The CDNX (Canadian Venture Exchange) was created just over a year ago (Nov 29th, 1999) as a merger of the Vancouver (VSE) and Alberta (ASE) Stock Exchanges. The new name and image and its focus on junior emerging companies, such as technology ventures, was a welcome change. The tarnished reputation of the scam-capital VSE, as it was called, would no longer haunt CDNX-listed companies in their quest for investment capital.

So, the ivy-league easterners and the western cowboys are thinking about co-habitation. I've always liked the CDNX (and its progenitors) because it gives small companies an alternative to hard-to-get traditional venture capital. And, it gives investors a chance to get into a tech deal, albeit riskier, earlier.

At first, the CDNX got off to a good start - lots of enthusiasm in a rising market which was kind to tech firms. However, in spite of the make-over, there are still many investors for whom the CDNX name conjures up images of the VSE and ASE. Putting the CDNX under the wings of the TSE might just address that particular concern.

The Nasdaq exchange already has something along these lines with its small-cap market designation (not to be confused with the OTC market which many mistakenly confuse with the Nasdaq small cap). But small-cap on Nasdaq is not small-cap when compared to the micro-caps on the CDNX. The CDNX handily addressed this particular niche - i.e. a regulated exchange for companies under US\$50 million in market capitalization.

One problem with the CDNX has been that it is seen as a Western Exchange although it has been attempting to shed that image by courting the Ontario Securities Commission. It has made some progress in this direction. As I've often lamented, securities trading in Canada is regulated provincially and this creates unnecessary confusion and red tape for both companies and investors. I firmly believe that Canada needs a well-regulated *national* junior exchange. The TSE may move us closer to this goal.

I still wonder why Nasdaq and the CDNX haven't been a little more cosy with each other. Nasdaq made an interesting move when it entered Canada (via Quebec) last year, giving the TSE a run for its money - especially in the tech sector. Hey - maybe Nasdaq will make a takeover bid for the merged entity? Or, why not outbid the TSE in its offer to the CDNX?

One merger downside from a listed company's perspective is that the TSE may present an even greater bureaucratic nightmare than that which has evolved out of the ASE/VSE combo.

Tony Chan, vice president of Vancouver's Golden Capital Securities Ltd. (a member of both exchanges), was recently quoted by Dow Jones as saying: "My feelings off the top are a bit mixed," he said. "I think their (the TSE) franchise is more endangered than the CDNX franchise. I believe that there is probably a lot more competition for the TSE's business than there is for the CDNX business."

Chan said that the CDNX, in return for short-term gain, will likely wind up losing some autonomy. Dealers and exchange officials involved in the venture capital business tend to have a more entrepreneurial philosophy, while larger bureaucracies in eastern Canada "tend to be more bank-like in their mentalities," according to Chan.

Others have suggested that a merger may bring increased liquidity for CDNX-listed companies. While some have debated this point, I fail to see how it would decrease liquidity. So, why not?

Certain CDNX member firms are concerned about the TSE's trading systems technology and its inability to deal with huge trading volumes, particularly in high volume stocks like Nortel Networks Corp. In this regard, I recall the VSE receiving awards for its trading engine. This may fix the TSE's computer problems.

How do the two exchanges compare? The TSE's market cap (the total value of all of its listed companies' stock) was \$773 billion whereas the market cap of the CDNX was \$107 billion. Not bad, actually. Who'd have thought it was *that high*?

The TSE is itself contemplating going public through an initial public offering within a couple of years. I wonder if it will do this on the TSE or on Nasdaq (haha!). Some think that having the CDNX could make the IPO more attractive.

For those of you who don't know, or haven't thought about it, stock exchanges are "self-regulated" organizations. They are *not*, contrary to popular belief, government bodies. They simply adhere to securities laws and make their own policies and rules on top of those. In essence, a stock exchange is a business in its own right - with income and expenses and, hopefully, a profit to boot!

In case you are thirsting for some great Trivial Pursuit ammunition, here are some tidbits for you to chew on. Of 2,343 listed companies, 1,233, or 52.6 per cent, are based in B.C. Another 590, or 25.2 per cent, are in Alberta. Only 299 listings from Ontario. Another 57 are from Quebec. A mere

80 hail from the United States and 32 are based internationally. TheCDNX was, and still is, primarily a resource-stock company. However, high-tech companies now account for 13% of listings, manufacturing for 6% and financial services for 3%. Having aTSE parent will undoubtedly garner more Eastern Canadian listings. Maybe we'll see some good Ontario tech startup investment opportunities!

What will the TSE pay for the CDNX? I've heard guesses in the \$20 million to \$50 million range. Gee! - maybe we should form a CPC shell (see below) that could be used to do a take-over of the CDNX!

Thanks to **David Ing** of Pacific International Inc for his help in following theTSE/CDNX story.

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 and Alberta Stock Exchanges.

This program, which has been very popular in the West, is now heading East - to Ontario. The Ontario Securities Commission has finally given its support. Thanks to our screwy system of having provincially regulated securities commissions (instead of a national one), Ontario investors have been shut out of the IPO offerings by CPCs in Alberta and B.C. Now they can get in on the action. It means that B.C. companies can now offer their IPO stock to Ontarians.

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. You can pick up 10,000 shares of a typical CPC for pennies.

In this space, I normally identify all the new CPC companies, as well as those which are about to begin trading and those which have completed their qualifying transactions (i.e. graduated from the CPC designation). Starting today, this updating will be done on a monthly basis, hence every second column will report on these changes.

Check our [Capital Pool Corporation chart](#) (in .pdf format) for a complete list of theCDNX'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>.

Local Happenings

The next [Vancouver Enterprise Forum](#) event will be held on Tuesday, March 27th at Science World. The topic will be: "Building a Bankable Management Team". How have successful companies built their Bankable Management Team, and what is a Bankable Management Team anyway? What attributes would a team of people have for them to be bankable and how is the synergy built and maintained? The event will be moderated by **Susan Koch**, Controller, **Cellex Power Products** and presenters will include **Chris Reid**, President & CEO, Cellex Power Products and **Sheila Moynihan**, VP Human Resources, **Bandgap Photonics**. **Michael Brown**, Nepal Management, will

question the presenters on their strategies. Mike was recently honored at the Vancouver Board of Trade's annual dinner as one of BC's technology pioneers, having been an early backer of many of BC's successful tech ventures.

For **Biotech Angels and Biotech companies** - there will be a special Vancouver Angel Network meeting in early April which is specifically dedicated to biotech deals. Check www.vef.org/vantec.html for details on how the angel network works.

British Columbia's technology business innovators now have the chance to win a grand prize package worth \$50,000 with more than a little help along the way from their friends at the **BC Venture Society**. The **New Ventures BC** Competition is an annual event open to all BC residents, with prizes totaling \$125,000 - which is believed to be the largest of its kind in North America. Individuals with a new business idea can attend seminars and networking information sessions that will give them the chance to turn their idea into a successful startup. The kick-off meeting event will take place next week - in the evening of Wednesday March 28th. Check www.newventuresbc.com for details.

It's about **TIME!** TIME Centre, that is. TIME is an acronym for Technology, Innovation, Management, and Entrepreneurship. It is Simon Fraser U's innovation initiative - to support the growth and development of the tech industry in B.C. TIME features a "BusinessCentre" (looks like an Air Canada 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.

The ASI Exchange took place last week at Enterprise Hall in Vancouver's Plaza of Nations. This year, as The ASI Exchange celebrated its tenth anniversary, it hosted more than 3,000 participants, a remarkable increase from the 60 who attended in the first year. It provided a great opportunity to learn more about B.C. tech companies - be it for a possible job, general interest, or even an investment (or future investment) for that matter. Complete details are available at www.asiexchange.com. Hats off to the folks at ASI for making this B.C.'s premier technology showcase event!

Writing about all these things makes me truly appreciate the great tech community we have here. Now, if we only had a little more time....

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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