



**Tech Futures:**  
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By [Michael Volker](#)

**When to go Public, CDNX Tech Financing Stats, IPO Watch, & Capital Pool Corps Update**

### **When to go Public**

"When should we go public?" That's the question I often get asked by young technology companies seeking to grow and expand. I believe that all companies have a common goal: to be sold. Sometimes smaller, innovative firms are gobbled up by larger firms reaching into new areas. Others merge to form larger organizations and others go public (i.e. a piece-meal selling of the company).

Being a public company has its advantages and disadvantages. Among the advantages are: liquidity for investors and founders, the easy use of stock options to attract new talent, prospects for higher (less dilutive) valuations, the ability for founders to retain a high degree of control, a higher profile - useful in gaining credibility with customers, suppliers and employees, and perhaps most importantly - on-going access to the public market for subsequent financings. The disadvantages include: rigorous reporting requirements, forfeiture of privacy - especially with respect to financial results, additional costs associated with being public, and the requirement to pay attention to shareholders (there are now two categories of customers - the normal ones *and* the shareholders) which can be a distraction for management and employees.

Traditionally, companies raise capital from family and friends, business angels, venture capitalists and merchant bankers with a view to ultimately doing an IPO - Initial Public Offering - on a senior stock exchange like the TSE or the high-tech favorite, the NASDAQ. Founders and investors often refer to this process as their "exit" strategy, i.e. it gives them the chance to cash in on their original investment turning their ownership interest over to the public at large, mutual funds and institutional investors.

In this case, companies usually go public after they have started to produce revenues (or strategic partnerships in the case of many biotech firms) or when they have reached a certain critical mass in terms of assets (e.g. \$10 million) and a market value of at least \$50million. The public offering is generally in excess of \$10 million.

However, companies can also go public much earlier on a junior stock exchange like the Canadian Venture Exchange (CDNX). Many folks, especially the traditional venture capital ("VC") firms, view this as going public "too early". This is, of course, because an early public offering competes with these firms. Instead of being an "exit" for investors, such an offering presents an "entry" opportunity for smaller investors. As Bill Hess, CDNX president and CEO has said: "The public market venture capital alternative plays a vital role as mentor and incubator to start up companies."

Indeed, there are horror stories about small companies going public, getting hyped by promoters

who drive the stock up, then cast adrift only to flounder. And, it's also true that more of these ventures fail as compared to those listed on senior exchanges, but that's just a normal Darwinian process. On the other hand, those that succeed provide handsome returns to their backers.

There are also horror stories about companies staying private by raising VC money. Venture capitalists can drive a hard bargain on valuations which are generally lower than public valuations. They're also not that forgiving if mistakes are made and they may not make ideal partners. Via a shareholders' agreement, they can exert far more control than that which they'd have merely from their voting rights. If you run into cash flow problems or other hiccups along the way, they can take over your company.

There are no hard facts as to what is the best time for a company to go public. It's really a judgment call by each company's board given that both avenues are available - which is not often the case. In reality, companies may not be able to attract traditional venture capitalists (there aren't that many of them, either) and those which do may not come to terms on the valuation question. If there is a choice it may best be made by basing a decision on the quality and reputation of new people (directors, financiers, etc) that accompany the investment.

For junior companies, the main advantage in going public early is the access to the public markets, i.e. a larger investor base, for on-going financing. It is an established fact that emerging companies raise far more capital via private placements and public offerings than they do on their IPO round. In the first 6 months of 2000, technology ventures on the CDNX raised more than \$600 million on private placements - more than ten times the amount raised on IPOs! Investors are more likely to invest because of the liquidity factor - they no longer need to ask: "what's your exit strategy". Also, there are just too many deals that traditional VCs won't touch because they perceive them as being too risky (remember that most VC funds consist of other peoples' money managed by professional venture investors, not risktakers).

The public markets provide companies with a valuable currency: their stock. When the price of the stock is up, companies can benefit by raising extra capital or using stock to acquire other companies - smaller or larger - for expansion. Private companies are at a greater disadvantage in this regard. Even if a public company isn't in need of capital or isn't actively looking for an acquisition, a hot market may provide some unplanned windfalls.

I can't help but wonder if a company's survivability isn't improved by being public. I've seen many cases where private companies get themselves into serious cash flow crunches by being off a little on their revenues or by missing some milestones. When they've painted themselves into a corner, it may be very difficult and painful to get out. Very few investors want to throw money into what may appear to be a sinking ship.

Public companies have more options in this regard and because of liability concerns around so-called forward looking statements, these companies have an interesting advantage. Being public is like living in a fishbowl - but only with respect to the past and present. The future is rarely disclosed or predicted in any great detail. This turns out to be an advantage in that investors aren't disappointed by missed targets because they don't know what the targets are. Valuations may drop and financings may be very dilutive, but at least they are still possible.

If you look at the top 20 BC companies in the T-Net20 list, you will see many companies that went public "early" and have used this approach as their primary financing strategy. These include: **Westport Innovations Inc** (TSE: WPT), **QLT PhotoTherapeutics** (TSE: QLT), **Burntsand Inc.** (TSE: BRT), **Infowave Wireless Messaging Inc** (TSE: IW), **Inflazyme Pharmaceuticals** (CDNX: IZP), **StressGen Biotechnologies** (TSE: SSB) and **Micrologix Biotech Inc**

(TSE:MBI). Although many now trade on the TSE, these companies all went public via the VSE - the CDNX's progenitor.

Going public early seems to work well for firms where future earnings are more distant and where the risks and rewards are much greater as is typically the case with biotech ventures.

**Westport Innovations** went public via a reverse-takeover of a junior capital pool ("JCP") company on the former Alberta Stock Exchange and started trading at less than \$1.00. Today, having progressed to the TSE, it now trades in the \$20 range giving it a market valuation of \$600+ million.

**Burntsand Inc** also went public on Alberta via a JCP. It, too, started under \$1.00 and is presently trading around \$7 with a market cap close to \$500 million.

The JCP program has been so popular that the CDNX has introduced its rendition, the Capital Pool Corp (CPC) program. This is a low-risk way for companies to go public early, often inheriting new board members who are knowledgeable in the public arena. CPCs provide a vehicle for business angels and others to provide venture funding to the firm while guaranteeing liquidity to the investors.

I believe that CPCs on the CDNX are *the best* way for junior companies to go public. The other two ways are reverse takeover ("RTO") of an old, defunct, listed company or by initiating an IPO. CPCs are really like RTOs, but with a "clean" shell, better escrow terms (i.e. longer hold periods), committed people, and less prone to quick promotional flips. IPOs, on the other hand, are ideal in principal but in practice they tend to be risky, slow (lots of red tape), and expensive for novices.

As to choice of junior exchange, there's only one: the CDNX. Some companies are traded on the U.S. over-the-counter market, and they mistakenly refer to this as a NASDAQ OTC listing (which is simply not correct). This is not a "recognized" exchange with any degree of scrutiny. Interestingly, a goal of the CDNX is to see its companies graduate to the TSE or NASDAQ.

There's no simple answer to the question of when a company should go public. My own view is that it's never too early to go public, but it can be too late!

### **CDNX Technology Financings**

Having just talked about one of the advantages of being a public company - raising additional rounds of capital - here are some facts released by the CDNX.

In the first six months of 2000, CDNX listed technology companies raised \$667 million - more than half of the \$1.142 billion total raised by all companies. Of the 20 largest financings, 14 were completed by internet, software, telecommunications, life science research and other technology companies.

The B.C. companies on this list include:

**Micrologix Biotech** (CDNX:MBI) \$40.0 million  
**eDispatch.com Wireless Data** (CDNX:EWD) \$31.5 million  
**ACD Systems** (CDNX:ASA) \$22.5 million  
**stox.com** (CDNX: URL) \$14.0 million  
**Sideware Systems** (CDNX:SYDu) \$11.0 million

**International Sales Information** \$10.4 million (CDNX: ISI)

**Kast Telecom** (CDNX: KST) \$10.0 million

Private placements dominated the equity financings accounting for 94% of all financings (921 companies!). Initial public offerings for all CDNX companies - tech and others - accounted for only \$60 million and an additional \$11 million was raised via secondary public offerings.

How does the money raised by junior public technology companies compare to venture capital raised by private companies? According to Macdonald & Associates Limited, \$2.7 billion in venture capital was invested in Canada last year. That's in the same ballpark as the \$1.14 billion raised in the first half of this year by the pubcos.

Conclusion: there's a relatively healthy flow of capital going to emerging public companies (i.e. those who went public "too early").

### **IPO Watch**

**CST Coldswitch Technologies Inc** (CST) is moving forward with its IPO (refer to my column of June 30th). CST is offering, through its agent, **Canaccord Capital Corp**, a total of 4 million common shares at \$1.00 per share. This represents just over 22% of the company on a fully diluted basis. The offering is now being subscribed and the IPO will likely be completed within the next two weeks.

CST's primary product, The Coldswitch™, is a practical and inexpensive fibre optic switch that uses light instead of electricity to provide an elegant solution to many electrical switching problems.

**John Kidder**, CST's tenacious founder has put together a good board of directors. Perhaps because of this, I've heard that the offering is "over-subscribed" - words that IPO CEOs love to hear!

**Chromos Molecular Systems Inc** (TSE: CRH), a Burnaby-based Biotech firm founded in 1995, closed (July 17th) its initial public offering consisting of a new issue of 3.75 million common shares at a price of \$8.00 per share for a total offering of \$30-million - just as planned. The stock has traded in the \$8.05 - \$10.95 range.

Alistair Duncan, president and chief executive officer of Chromos, said the successful initial public offering will enable the company to accelerate the development of its unique artificial chromosome expression system, called ACes, in the fight against gene-based disease. "The advances being made by the Human Genome project and other breakthroughs in the genomics field bring great opportunities for our technology -- and the proceeds of this financing will help us meet these opportunities," said he.

Chromos is pursuing two strategic business paths, both involving co-development of multiple applications of the technology with large biotechnology and pharmaceutical companies -- and receiving royalties on sales of the products. The first strategy is to license its technology to partners for the development of their protein-based products. The second is to in-license or otherwise acquire therapeutic gene targets -- and then apply the ACes platform to the development of the company's own protein-based products.

**MacDonald Dettwiler & Associates Ltd** (TSE: MDA)'s completed its IPO on July 11th and

started trading on July 12th. In my July 14th column when I said that the IPO is getting closer", I didn't realize that it was that close (that's the trouble with trying to write these columns ahead of time in order to take some vacation!). The stock was offered at \$14 and in the first few days traded up to \$15.25 in the first couple of days - which to me is a sign of a well placed IPO. Recently, the stock went as high as \$20 and is now trading around \$19.

Of the 6 million shares offered on the IPO, 2 million were offered by other shareholders (likely VCs and founders looking for their "exit"). **Orbital Sciences** (NYSE:ORB) continues to hold majority control in MDA - slightly more than 50%.

You can get a full prospectus on any of these companies 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 less than \$1.00. And when it does what is expected you can reap a nice reward. On average, CPC share prices have appreciated over 200% from their IPO pricing. The real money, though, will be made once they complete their acquisitions of real operating companies.

New additions to the list since the July 14th update, are **ADR Global Enterprises Ltd., Clarity Telecom Networking Inc., Coastport Capital Inc., Corra Capital Corp., e-Quisitions Inc., Goose River Capital Inc., PanGlobe.com Inc., and QIS Ventures Inc.**

These CPCs all originate from Alberta, except for ADR Global and Corra Capital.

Since the previous update, the following six companies have come to trade: **Advanced Sensing Systems Inc., Belltech Ventures Ltd., Diversaflow Corporation Ltd., New Xavier Capital Corp., Norstar Ventures Corp. and Trinity Ventures Ltd.** (scheduled to begin trading today).

Also since the previous update, the following companies have been deleted from the list because they have completed their Qualifying Transactions: **Bellwether Capital Corp., Ex Fund (A) Capital Corp., and IX Capital Inc.**

Check our [Capital Pool Corporation chart](#) 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**

Information on local tech events may be found on-line at <http://www.vef.org>.

For a convenient printable 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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