STORY STOCK. (VALENCE TECHNOLOGY)

By Jeffrey Young
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What levitates technology companies on Wall Street? Look at the case of **Valence Technology** and the curious merry-go-round of insiders, underwriters and journalists that keeps its stock spinning.

Want to get on the tech stock bandwagon? Here's an exciting company for you: **Valence Technology**, a San Jose, Calif. outfit that is developing a rechargeable lithium/polymer battery. Valence's battery packs more energy per pound than the well-established nickel/cadmium alternative, and it costs much, much less to manufacture. So says an "independent" scientist who has evaluated the technology. Valence has landed a $100 million order from Motorola--so say news reports. And Valence, though now in the red, will be a thriving company, earning $3.25 a share in 1997. So says a stock analyst report.

If you believe all that, you must be one of the investors who have bid Valence stock up to outlandish levels. At a recent 19 a share, Wall Street is putting a $310 million valuation on the company--a company whose main asset, besides $69 million in cash remaining from proceeds of stock offerings, is an unproven technology purchased for $2 million (plus royalty rights) from Mead Corp.

And if you believe the story that goes with Valence, you probably don't know about these drawbacks: The Motorola contract is much less than meets the eye; the largest shareholder in Valence has been involved in two other Silicon Valley startups that failed; and the outside scientist who evaluated the battery just took Valence insiders' word for it in judging manufacturing costs and durability.

No question, the folks at Valence can put on a good show. Their prototype battery is a flat, pliable sheet of plastic and metal foil layers, altogether about a quarter-inch thick.

Lev Dawson, chief executive and the second-largest shareholder (with a stake now worth $67 million) is sitting at the head of a conference table with a grin on his face and a pair of scissors in his hands. Dawson, 54 years old, pulls out a small flashlight. "This is the same demonstration I've given in investment houses all over the country--you name 'em," he says. He attaches two alligator clips that snake out of the hollow flashlight to two terminal tabs that stick out of the battery. The flashlight bulb flickers to life. Then he takes up the pair of scissors and slices across the plastic package, directly through the battery. The bulb continues to shine.

"Try that with nickel/cadmium," he crows.

Very impressive in the boardroom, although the audience may forget to ask how long the battery will keep working when exposed to the air. (Not long, it turns out.) More important is that investors don't look behind the road show to what is really energizing this stock: a triad that includes insiders unloading shares for a price hundreds of times what they paid, an underwriting firm that pulls in fees for helping them do that, and journalists who are only too willing to take at face value the boastful pronouncements of the company's publicity department.

As an experiment, compare these three documents: a Montgomery Securities buy recommendation on the stock from last May, the government-sanctioned prospectus that came out with a 4.6-million-share offering in November, and a Valence press release issued in December. It's sometimes difficult to tell the three documents apart.

The press release, for example, contains a scientific-looking diagram of the lithium/polymer battery, marred by an arithmetic error on the dimensions of the battery's layers. Now look at the bullish report from Montgomery analysts Thomas Lloyd-Butler and Peter McGratty. It contains the same diagram, complete with the same error. And then there's the authoritative prospectus--with the same diagram and the same error.

The Montgomery analysts say that **Valence Technology** is in to rake in precisely $536,050,000 in revenues in fiscal 1997. How do they know that? Well, the battery will sell like the dickens because it's much more compact and cheaper to make than competing batteries. The manufacturing cost of the Valence battery is going to be only 7 1/2 cents per watt-hour of energy capacity, says the Montgomery report, a tenth the figure for nickel/cadmium batteries, the current standard in computers, telephones and the like. The battery keeps a charge better than nicads, says the report, losing 0.5% of its juice per month, against 5% to 20% for the nicad.

And how do the analysts know all this? They got it from Digby Macdonald, a materials science professor at Penn State, described as an "independent consultant."

How does Macdonald know about the Valence battery's performance and cost? He spent a day watching Valence scientists record measurements. He didn't take away a sample for testing, so he had to take their word for long-term performance measures. The cost projections are also from inside Valence. Independent? Montgomery Securities paid Macdonald for his analysis, but he won't say how much.

If you don't put much stock in analysts' reports, maybe you will be persuaded by the glossy reprints distributed by Valence and its public relations firm. They include an item from Fortune's 1993 Investor's Guide, quoting the Lloyd-Butler sales projection for 1997 and reciting as fact the Valence claim that its battery can be recharged 300 times and loses only 0.5% of its charge per month when left on a shelf.

What about the Motorola purchase order, which boosted the stock 43/8 points when it was announced in December? Look closely. It's not the same as, say, a purchase order from GM for tires. Motorola merely agreed to buy batteries if Valence can make them cheaply and if the batteries work. If they don't work, Motorola isn't on the hook for a dime.

Is Montgomery Securities an independent source? Judge for yourself. Montgomery got the lion's share of $7 million in total underwriting fees for two stock offerings, one last May at 8, and another in November at 18. It may also be earning substantial spreads or commissions for helping insiders dribble out small amounts of their holdings to the public under the Securities & Exchange Commission's Rule 144. Immediately after the November offering, 4.7 million additional insider shares were eligible for sale, subject to Montgomery Securities' permission.

Most of the proceeds from the two underwritings went into Valence's coffers. But the largest shareholder, Carl Berg, with originally 33% of the shares outstanding, unloaded 495,000 of them in November, shares he bought at a penny each. He didn't sell in the first offering, but the company used $6.2 million of the proceeds to repay Berg loans he made to Valence to get the company going.

The prospectus omits some interesting details on Berg, 55, a California real estate developer and high-tech investor. He was a director and significant shareholder in Actrix, a closely held computer maker that went under in the mid-1980s. Berg was also an insider in International Memories, Inc., a hard-drive company. In that capacity he was accused of securities fraud in a lawsuit filed by Minnesota Mining & Manufacturing Co. in 1978, a case that was eventually settled. IMI shareholders wound up with stock in Corvus Systems; Berg became Corvus' largest shareholder and creditor. Corvus filed for Chapter 11 in 1988. Berg is now the largest shareholder in Integrated Device Technology, a semiconductor firm that lost money in its last fiscal year. It has paid Berg at least $20 million in real estate transactions over the past four years.

The pattern seems to be this: Outside investors may do poorly, but Berg usually gets his money out. Says Berg: "I like big rewards and big risk. Probably no one else would have put their money in {Valence}." A case can be made that the technology stock rally of the past year still has a ways to go (see p. 114). Maybe so, but investors ought to be a little choosier.

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