

MINUTES OF THE
NEW MEXICO SMALL BUSINESS INVESTMENT CORP.
REGULAR MEETING

November 8, 2010

A regular meeting of the New Mexico Small Business Investment Corporation was called to order on this date at approximately 9:00 a.m. in the conference room of the New Mexico Mortgage Finance Authority, 344 S. Fourth Street, S.W., Albuquerque, New Mexico.

A quorum was present:

Members Present:

Mr. Andrew Baca, Chair
Mr. Kit Caldwell
Mr. Sam Cobb, Vice Chair [teleconference]
Mr. Billy Knight
Mr. Greg Kulka [State Investment Council designee]
Ms. Marie Longserre, Treasurer
Mr. Clarence L. Smith [designee of State Treasurer James Lewis]

Members Excused:

Ms. Mary A. Garza, Secretary

Legal Counsel to Board:

Mr. Randy McDonald

Financial Advisor to Board:

Mr. Paul Goblet

Consulting CFO:

Ms. Dee Brescia

Recording Secretary:

Ms. Judith S. Beatty

Guests Present:

Mr. Jake Dopson, Pulakos	Ms. Kim Sanchez Rael, Flywheel
Mr. Brad Steward, Pulakos	Ms. Lillian Montoya-Rael, Flywheel
Ms. Michelle Hoeft	Mr. Mike Gallagher, ABQ Journal

REVIEW AND ACCEPTANCE OF AGENDA

Upon motion by Ms. Longserre, seconded by Mr. Caldwell, the Agenda was approved by voice vote, as published.

APPROVAL OF MINUTES: September 20, 2010

[Deferred to next meeting.]

FORMAL PRESENTATION OF AUDIT: PULAKOS, CPA: JAKE DOPSON, BRAD STEWARD

Mr. Dopson presented an overview of the audit process and reported that Pulakos has issued an unqualified clean opinion on the NMSBIC's financial statements.

Mr. Dopson commented that this is the first audit of the NMSBIC organization where there have been no audit adjustments, which is very important and speaks to the significant work done by Dee Brescia. He said Pulakos received the full and complete cooperation of Mr. Goblet, Ms. Brescia and all others who assisted in this audit.

Pulakos representatives submitted the representation letter to Chair Baca for his signature.

DISCUSSION AND POSSIBLE VOTE ON ACCEPTANCE OF AUDIT

Mr. Knight moved to accept the audit. Ms. Longserre seconded the motion, which passed by voice vote.

REVIEW AND ACCEPTANCE OF SEPTEMBER FINANCIAL REPORT

Ms. Brescia reviewed the September financial report.

Ms. Brescia clarified that the \$2,157 in Other Consulting expenses was the work done to organize the company files, plus supply costs involved, in response to the IPRA request from Matthew Lowe. Mr. Goblet noted that all of the requested documents were assembled in a room in WESST Enterprise Center, rented for that purpose, and the October financial statements will reflect the rental costs. He noted that Mr. Lowe was informed that the documents were ready and waiting for him, but he failed to appear.

Mr. McDonald agreed to document, in a memorandum to the Board, the process that the NMSBIC followed in meeting the IPRA request.

Mr. Caldwell moved to approve the September financial report. Mr. Knight seconded the motion, which passed by voice vote.

DISCUSSION AND POSSIBLE APPROVAL OF NMSBIC FORMAL LETTER

Mr. Goblet reviewed a draft letter addressed to the Governor reporting on the NMSBIC's financial status, an annual requirement of the NMSBIC upon receipt of its audited financial statements. He said this report is also delivered to the Lt. Governor, State Investment Officer, and the Legislative Council Service director.

Mr. Goblet said the letter notes the NMSBIC's continued ability to offset its operating expense, even with the reduction of earned income as a result of lower interest rates.

Board members reviewed the draft and suggested changes.

Mr. Goblet said he would include this letter when the Governor-elect's transition team approaches him for documentation and information on the NMSBIC.

Ms. Longserre stressed the importance of making clear the NMSBIC's mission. She said its role is not exclusively to make money, but to deploy money into New Mexico communities in order to create vibrant businesses and jobs.

FORMAL PRESENTATION ON NM GAP FUND: LILLIAN MONTOYA-RAEL, KIM SANCHEZ RAEL

Ms. Montoya-Rael distributed and reviewed an update on Flywheel Ventures and Flywheel New Mexico Gap Fund I.

Ms. Montoya-Rael said The Gap Fund has invested in 12 companies to date, all pre-seed or seed stage investments, with \$1.9 million in committed capital. She said six companies are on track, but it remains too early to confidently assess the ultimate outcome. She said the GP has significant concerns about the outcome of two others, and four have been discontinued or are redirecting their operations.

Ms. Sanchez Rael commented that The Gap Fund is at the bottom of the J-curve at this point and could go a bit lower, but they are where they expect to be in terms of the fair market value of the portfolio. She said the demand for pre-seed capital remains very strong. She added that the greatest risk for these companies is finding

follow-on capital, so The Gap Fund tries to focus on companies that have a good prospect of early cash flow.

INTRODUCTION: MICHELLE HOEFT

Ms. Hoeft introduced herself to the Board. She said she was a founder and director of High Desert Discovery District, aka HD3, a new organization that will be launched in December. She said HD3 is modeled after the Mars Discovery District, a high technology accelerator in Toronto that has been very successful at leveraging and putting into better productivity the assets of the Toronto region, and accelerating the high tech assets in that region, by bringing forward new fresh faces of capital, business expertise, etc.

Ms. Hoeft said HD3 will be located at the Sanbusco Market Railyard Center, and will act as a hub for local entrepreneurial activity, accelerating connections and weaving into that the additional assets that New Mexico has, i.e., capital and highly experienced business executives who relocate to New Mexico. She said their board has representatives from LANL, Sandia and NMSU. She said they will also work toward importing a variety of companies to New Mexico that are established companies that have connections all over the world through the HD3 network.

Ms. Hoeft invited the Board to the ribbon cutting and launch of HD3, which will be scheduled in the near future.

DISCUSSION AND POSSIBLE VOTE TO INCREASE NM GAP FUND COMMITMENT

Mr. Goblet stated that The Gap Fund is theoretically the highest risk equity fund commitment by the NMSBIC due to the very early stage investments it makes, but it is also the most diversified portfolio due to the smaller commitments it makes, and 8 of the 12 companies are still alive.

Mr. Goblet stated that, due to the management fees generated by the parent funds, Flywheel Ventures has been able to underwrite the time and cost of making very early stage investments like those in the Gap Fund. They have also been able to attract capital and leadership from the New Mexico Angels. He said virtually every Gap Fund investment has also been supported by investments from the Angels or others, and The Gap Fund has been able to identify and close 2-3 new investments every year. He said it is now down to its final 1-2 investments.

Mr. Goblet recommended that the NMSBIC commit an additional \$500,000 to the Gap Fund based on the following reasons:

- Quality leadership and staffing from a NM domiciled fund.
- Track record of attracting capital and leadership from others.
- High quality, consistent, professional due diligence.
- Possibility of select follow-on investments from parent fund.
- Visible need for incubator-like equity investments for startups.
- Relatively low management fees due to presence of parent fund.

Mr. Goblet said the terms and conditions would be identical to the amendment that increased The Gap Fund two years ago, and would be based upon the approval of the existing LPs. While there is a possibility that some of the existing LPs would make additional commitments and they might even attract a new strategic investor, neither is a criterion of closing. Mr. Goblet said the GPs would contribute a small amount of additional capital, which would maintain their 4% level. As in the past, he said the \$50,000 management fee would be paid in one installment, and the fund life would be extended by a year or two.

Noting that a new administration will be taking office in January, Mr. Kulka suggested tabling this and letting the new Board make a decision on whether or not to make this funding commitment.

Mr. Goblet commented that, as the Board will recall from its strategy session last summer, it mentally allocated \$1 million of its remaining \$2.9 million of uncommitted capital to micro equity investments, and discussed a potential addition to The Gap Fund. He said he felt this Board should continue to conduct itself as outlined in statute. Based on his own experience, he said it can take several months to seat a new board, and he felt it would be doing a disservice to statute and to the State of New Mexico to cease doing business as usual.

Ms. Longserre pointed out that the Board has always been very apolitical, and asked if Mr. Kulka was suggesting that this could change.

Mr. Kulka responded that he was not suggesting that. He said that he thought the new Board could be seated in January, and was saying that this Board should focus between now and then on finalizing the audit, getting the financial statements in proper form and establishing procedures, so everything will be in place for the new Board. He said a new Governor is coming in, and he thought the proper way to deal with that is to table items at the end of the year to see if there will be changes starting in January.

Noting that the NMSBIC's unfunded commitment to The Gap Fund is at \$285,000, and speaking to Mr. Kulka's point, Mr. Caldwell asked Ms. Sanchez Rael if they could wait until the Board revisits the new commitment recommendation in January.

Ms. Sanchez Rael responded that this would impact the pace of commitments. She said two more investments are still in the queue, but they would wait before making those investments until they knew what the NMSBIC's next step would be.

Mr. Cobb agreed that the Board has always prided itself on making apolitical decisions, which is why the NMSBIC has been so successful. He said what impacts his decision with this recommendation is whether or not there is any traction for additional sources of capital. If not, he said the Board should decide how to best utilize the \$2.9 million in capital it has left, because interest rates are not going to go up in the near future, and the NMSBIC will need to look at its cash flow needs in order to keep operating.

The Board tabled further discussion until after the strategic discussion scheduled later on the agenda.

[Gap Fund representatives left the proceedings.]

ADVISOR'S REPORT

ACCION NM

Mr. Goblet stated that, for the third month in a row, ACCION reported higher than expected loan losses of \$16,835, bringing total loan losses for the first three months of 2010-11 to \$83,740. He said the outstanding portfolio now stands at \$2.7 million, the lowest level in over six years. He stated that this reflects not only a softer economy, but also lower quality loan applicants. He said he has encouraged them not to compromise their credit standards in the interest of increasing loan volume.

Mr. Goblet noted that ACCION NM does an independent CAMEL review every three years, and in every category ACCION NM has received a satisfactory or excellent rating.

The Loan Fund

Mr. Goblet reported that The Loan Fund now stands at \$7,258,000 with 153 loans outstanding, or an average of \$47,439 per loan.

Mr. Goblet stated that, based on the NMSBIC's approval to amend its agreement with the Loan Fund for an expanded facility, The Loan Fund will not be able to call additional capital until their portfolio has expanded to at least \$10 million. He said their September balance was at \$8.3 million. He stated that the amendment transaction is expected to close in November, and he would assume they would be in compliance with the NMSBIC's requirements beginning in January 2011.

WESST Corp.

Mr. Goblet said WESST Corp had a relatively large loan repay prematurely, which created a larger-than-normal paydown. He said the loan portfolio now stands at \$66,373.

Verge Funds 1 and 1.5

Mr. Goblet stated that, unexpectedly, both funds had a repayment of interest and principal to the NMSBIC of \$248,902, which was broken up into \$97,472 from Verge 1 and \$151,430 from Verge 1.5. He said one of the portfolio companies, Altela, was successful in recapitalizing the company and securing \$6 million of fresh capital from new sources. He said Verge Funds converted some of their convertible debt into shares, and the company repaid all other outstanding debts on the balance sheet.

Verge 2

Mr. Goblet said the Fund has made its fifth cross investment, and it appears there will be a second closing prior to year end. He said they intend to have a capital close by the end of December.

Mr. Goblet said Verge would like the NMSBIC to renew its original commitment of \$3 million, made almost 18 months ago, subject to the NMSBIC not being greater than 50% of that fund. He said they closed at just slightly over \$5 million, and the NMSBIC's commitment ended up at \$2.5 million. He said Verge would like the NMSBIC to reissue the last \$500,000 of that commitment at the December meeting. He noted that Verge just secured a \$2 million commitment from Sandia Pueblo, and Verge thinks they can have a close of about \$3 million at the end of December, bringing the fund to \$8 million and the NMSBIC's ownership down to 35%.

NM Mezzanine Fund

Mr. Goblet reported that the NM Mezzanine Fund committed \$1 million to Exagen, an Albuquerque-based medical testing company, and the company is now rolling out product. He said the company has raised a significant amount of capital over the past five years from multiple sources, including several funds supported by the SIC. He said the Fund Advisory Committee had to review and approve this investment as an exception to the Fund's investment policy.

Flywheel Ventures

Mr. Goblet said Flywheel held its annual meeting on October 19, where it dedicated much of the meeting to its largest investment, which is in Astria, a California-based company. He commented that he heard the first positive comments

on TruTouch at the meeting, which would have significant implication to the NMSBIC because investments in the company are held in three NMSBIC funds.

New Mexico Community Capital

Mr. Goblet said NMCC is in the process of creating a second fund, which could be Native American-focused. He stated that NMCC has sufficient capital for at least one more new investment and reserves for a few follow-on investments.

New Mexico Growth Fund 1

Mr. Goblet reported that only one company, Aridien, remains in the Fund 1 portfolio. He said Aridien continues to have conversations with potential strategic partners and now valued at approximately \$1.2 million versus a cost basis of \$1.6 million. He stated that OneConnect (now Agave) is carried at zero valuation.

Mr. Goblet said the Fund is coming to the end of its stated life in late November, and the GP will provide some written recommendations as to LP options. Since there are only two portfolio companies remaining and there is a decent possibility that Aridien may be sold, one recommendation is to cease the requirement for a formal fund audit and related expenses. If the Fund's life were extended for a year or two, with operational expenses reduced to a fairly low level of about \$2,000 a year, there may be some merit to consider such an extension.

New Mexico Growth Fund 2

Mr. Goblet reported that ClingZ and High Desert Chile (now called Hatch Valley Farms) seem to be making progress. He said the Fund will not be making any new investments and so management fees have been reduced by 30%.

LEGISLATIVE FUNDING STRATEGY

Mr. Goblet stated that, with the election results in hand, the Board can now consider possible options and formulate a strategy going forward. He reminded the Board that the enabling legislation that created the NMSBIC was put forth by a Republican senator and supported by a Republican governor.

Mr. Goblet stated that, as of 10/30/10, the NMSBIC has approximately \$17 million in cash and cash equivalents, of which all but \$2.9 million has been committed but not yet called. He said he could assure the Board, however, that not all of that capital would be called, and he believed the NMSBIC could safely identify up to \$2 million of previously committed capital that could be recaptured from current financial partners and redeployed with others. He said \$1 million in added capital to The Loan Fund has

been verbally committed and is in the process of being documented, and the Board will be hearing requests for \$500,000 each from The Gap Fund and Verge Fund 2.

Mr. Goblet said New Mexico Community Capital and NM Mezzanine Fund will be looking at a second fund in 2011, and a very preliminary request has been received from Enchantment CDC.

Mr. Goblet stated that the NMSBIC might have two funding options provided the Board is convinced it can successfully deploy additional capital (\$5-\$10 million) over the next 2-4 years, but unless the funding percentage is increased from 1% of the STPF, added capital would probably not be available based on the STPF's current value. If increased to 1-1/2%, a small additional contribution could be available on an annualized basis.

Option 1: The NMSBIC could begin the process of conversations with the SIC and State Investment Officer, Governor and key legislators in advance of the upcoming Legislative Session.

Option 2: New Mexico might qualify for a portion of up to \$13 million in federal contributions based on HR-5297, an expanded version of the Stimulus Bill. An organization like the NMSBIC might be best qualified to serve as a conduit for this capital, which organizations like The Loan Fund, ACCION, etc. would apply for.

Responding to a question from the Chair on whether the NMSBIC might be precluded from working on such a mandate, Mr. McDonald said he did not think there was any prohibition, but he would research this further.

Option 3: The NMSBIC will have ample cash reserves for the next two years based on likely capital calls to be made between now and 12/31/12. In addition, the NMSBIC should begin to get a small flow of distributions in 2011 and 2012 that will be sufficient enough to allow new commitments to better performing funds and other potential lending organizations.

Mr. Goblet outlined the steps he would take based on any one of the three options.

Mr. Goblet noted that the new Governor has the prerogative of replacing Board members; and while this is a distinct possibility, each Board member serves until replaced. He said the Board has served the NMSBIC with diligence and integrity and he assumed and hoped it would continue to conduct business in accordance with the statutory mandate.

Mr. Goblet said he believed it could be several months before any Board members are replaced, and it would be a disservice and inconsistent with its statutory mandate for the NMSBIC to simply halt its usual activities. He said he was not in any

way suggesting that the NMSBIC commit all of its remaining capital before the end of the year, nor was he suggesting that the NMSBIC should hold its capital back in anticipation of some change in direction. He therefore suggested that the Board hear Verge's request in December for the NMSBIC's renewed commitment for an additional \$500,000.

Mr. Goblet recommended further researching Option 2. He said he saw no reason at this time to approach the SIC or legislators in a quest for additional capital from the STPF.

Chair Baca agreed that the Board should continue with business as usual, but at the same time, he was not clear on how the NMSBIC should deploy the remaining \$2.9 million of uncommitted capital and what the best choices are.

Ms. Longserre recalled from discussion at the Board's strategy session that it discussed allocation of further capital to lending activities and micro-equity commitments, but would hold back a reserve of its uncommitted capital

Mr. Caldwell noted that the NMSBIC has about 25% of its capital committed on the loan side, with most of the remainder in technology, startups and very high-risk transactions, but there are dozens, perhaps hundreds, of existing companies that are being cramped by a lack of capital because they can't get money from the banks. He asked if there is a vehicle for shoring up these companies and getting them over the hump so they do not go out of business.

Mr. Goblet responded that, in terms of delivery systems, there is The Loan Fund and ACCION. He said the only other delivery system in the state he knows of is Enchantment, an SBA-504 lender, and he has spent more than a year meeting with their CEO and Treasurer to discuss pursuing a lending relationship with the NMSBIC.

Ms. Longserre commented that there is lending out there, but it is cautious, and the companies still have to be able to pay back their loans.

Mr. Kulka noted that the loan programs the NMSBIC partners with have been much more useful than on the equity side, where some companies have only two or three employees and may not exist in another year. He said putting equity into the types of companies mentioned by Mr. Caldwell doesn't make sense either because there is no potential financial plan for exiting.

Ms. Longserre asked if the NMSBIC could continue to expand its lending portion, maintaining restrictions against loss, through small programs like WESST Corp.

Mr. Goblet responded that WESST Corp. is not really a lender. He said the dichotomy is that companies really want a loan, but it's equity that they need.

Mr. Goblet added that this is a nationwide problem. He said the best delivery system in the country is the SBA, which takes on 75-80% of loan loss exposure for a lender, but SBA volume in the midst of this challenging environment is down because of the banks.

In discussion on adding commitments to The Gap Fund and/or Verge, Mr. Cobb said he was envisioning doing something different with the \$1 million, which was to create, or help create, a unique new fund or vehicle. He said he briefly discussed this at the strategy session.

Mr. Goblet responded that the number of new funds approaching the SIC is nonexistent.

Mr. Cobb said perhaps there is a fund outside of New Mexico that could be encouraged to come to New Mexico.

Mr. Goblet commented that he was not sure that \$1 million would be enough of an incentive.

Mr. Kulka pointed out that the Board has talked about vSpring and KickStart, where \$1 million would be more than sufficient, and Mr. Goblet responded that he has invited them many times to talk, but the NMSBIC would need a side fund and they have never followed up.

Mr. Cobb said he could not imagine that there is not another fund in Colorado, Arizona or Texas that might have a different industry that they are investing in. He stated that the NMSBIC lost its bricks and mortar partner on the venture side with Mesa Ventures, but there are still businesses out there that need equity capital.

Following discussion, the Board agreed on the following:

- Continue the discussion on strategy at the December meeting. Should the NMSBIC go to its existing partners or find someone new?
- Mr. Goblet should talk to WESST and possibly other smaller lenders on what the NMSBIC can do to help them expand their lending.
- Have Verge provide an update at the December meeting.

LEGAL COUNSEL UPDATE

Mr. McDonald reported that Matthew Lowe, who made the IPRA request discussed earlier in this meeting (page 2), never followed up on his request.

[Chair Baca excused himself from the proceedings and turned the meeting over to Vice Chair Cobb.]

WEB UPDATE

Mr. Goblet distributed a 15-page draft snapshot of the website and compared it to the SIC website. He recommended posting the following: Board listing; 2 years of audits; 1 year of minutes; 2011 meeting schedule; bylaws; Investment Policy; investment partner information and link; and economic impact.

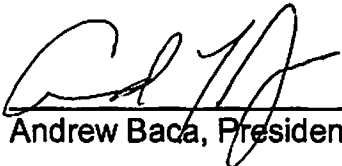
Board members made suggestions for modifications.

Mr. Caldwell moved for approval. Mr. Knight seconded the motion, which passed by voice vote.

NEXT MEETING: December 13, 2010, Albuquerque

ADJOURNMENT

Its business completed, the NMSBIC Board adjourned the meeting at approximately 12:05 p.m.



Andrew Baca, President

December 22, 2010



Mary A. Garza, Secretary

December 20, 2010