

MINUTES OF THE
NEW MEXICO SMALL BUSINESS INVESTMENT CORP.

September 19, 2014

A meeting of the New Mexico Small Business Investment Corporation was called to order on this date at 9:00 a.m. in the conference room of WESST Enterprise Center, 609 Broadway Boulevard, N.E., Albuquerque, New Mexico.

A quorum was present:

Members Present

Mr. Joseph H. Badal, Past Board Chair [by telephone]
Mr. Alan Fowler, Vice Chair
Mr. Lupe Garcia [by telephone]
Mr. Clarence L. Smith [designee of Hon. James Lewis, State Treasurer] [by telephone]
Ms. Launa Waller [by telephone]

Members Excused:

Ms. Roxanna Meyers, Chair
Mr. Steven E. Morgan, Secretary/Treasurer

Financial Advisor to Board

Mr. Russell Cummins

Board Legal Counsel:

Mr. Randy McDonald

Recording Secretary:

Ms. Judith Beatty [by telephone]

Guests Present:

Mr. Jake Dopson, Pulakos CPAs

REVIEW AND ACCEPTANCE OF AGENDA

Mr. Garcia moved to accept the agenda, as published. Ms. Waller seconded the motion, which passed unanimously by voice vote.

PULAKOS CPA'S, AUDITOR BOARD COMMUNICATION

Jake Dopson, Audit Senior Manager with Pulakos CPAs, made a slide presentation highlighting the following audit results:

- No instances of fraud, opinion shopping or improper activity noted during audit
- No audit adjustments
- Verge and NMGFII valuation adjustments
- No new accounting policies in 2014
- No management letter issued for June 30, 2014; a “No Material Weaknesses” letter will be issued upon request
- Transmission to NM State authorities
- Full and complete cooperation by NMSBIC representatives
- Independent auditor’s report
 - Unmodified (“clean”) opinion on the financial statements
 - Opinion on Supplementary Information (debt and equity schedules)
 - Emphasis paragraph included because of the nature of valuation in equity investments

Mr. Dopson noted that, overall, the investment balances on the equity side decreased by about \$840,000 in 2013-2014. There were two reasons for this: on a net basis, there was an excess return of capital over capital calls, so money is coming back from investments was about \$1.1 million. This reduction in equity investments was offset by realized gains and valuation adjustments of about \$400,00.

Mr. Cummins stated that a couple of material adjustments were made by NMSBIC before it provided the financials to Pulakos. Because Verge’s March 31 financials are lagged, they were not available until June, and reflected write-downs in three companies totaling \$3.5 million. However, the capital account reported to NMSBIC by Verge didn’t drop, and Verge explained they were planning to wait until the end of their fiscal year (December 2014) before adjusting the capital account. Mr. Cummins said he contacted Jake Dopson at Pulakos CPAs, and it was agreed among Mr. Dopson, Dee Brescia and Mr. Cummins that if NMSBIC has information from the GPs saying that valuation in companies has dropped significantly, NMSBIC needs to reflect that in its year-end audited financial statements. He said the NMSBIC’s share in the reduction of these companies was about \$1.2 million, so it reduced the value of its investment in the three Verge funds by about that amount.

Mr. Cummins also stated that, after year-end, he attended an advisory meeting for Mesa/New Mexico Growth Fund II. They have received pricing information from a potential buyer that their one remaining company investment is worth between \$1 million and \$1.5 million based on EBITDA of about \$100,000 per year. The company has large amounts of debt and probably cannot raise any capital because of that. He said the company has about \$800,000 of senior secured debt, and they have \$2 million of subordinated debt and \$300,000 of

payables to the executive officers. He stated that they have about \$3.1 million of debt and payables that takes priority over the common shareholders, and his conclusion was that the common stock was worth zero. The partnership was valuing the company on their balance sheet at around \$450,000. The New Mexico Growth Fund II GPs indicated that they plan to write the company value down to zero by their fiscal year end later this year. Mr. Cummins said the NMSBIC's share of the write-down is around \$329,000, which was recorded in the NMSBIC's financial statements as of June 30, 2014.

Mr. Cummins stated these adjustments to the Verge Funds and New Mexico Growth Fund II totaling about \$1.5 million were made to the NMSBIC's financials before being provided to Pulakos.

NET EXCESS FUNDS

a. Letter from Randy McDonald

Mr. McDonald stated that, at the last meeting, the Board asked him to review the statute that requires the NMSBIC to return funds to the Severance Tax Permanent Fund and to provide a recommendation and a legal opinion as to how that statute should be interpreted. The statute, Section 58-29-7 NMSA 1978, requires that the NMSBIC annually return to the Severance Tax Permanent Fund the amount of "net excess of funds" held by the corporation. The statute includes a formula to be used in the calculation of the amount of net excess of funds.

Mr. McDonald referred the Board to his written opinion, dated September 15, 2014. He also provided a brief summary of his opinion.

Mr. McDonald pointed out that the statutory formula includes a mixture of financial and tax-related terms, some of which were clear, and some of which are not so clear, particularly with respect to investments made in limited partnerships, the primary vehicle used in the equity investment program.

Initially, Mr. McDonald stated that it was his opinion, as discussed in his memo, that the calculation of net excess of funds was to be done based upon annual activities of the corporation, rather than on a from inception basis.

With respect to the inclusion of interest in the calculation, Mr. McDonald stated that, with most of the NMSBIC's investments, interest received has in the past been treated in its calculation of net excess of funds on an accrual basis, and the statute requires that it reflect interest actually received. Going forward, the amount used for the interest element should be the amount of interest actually received.

Mr. McDonald said the NMSBIC's operating expenses can be easily calculated; however, it becomes complicated in terms in how the NMSBIC treats the financial transactions inside the

limited partnerships where it has equity investments. This issue also arises in regards to capital transactions occurring inside of a limited partnership in which NMSBIC has an investment. The primary question becomes whether the limited partnership is treated as an aggregate entity or as a separate entity in applying the net excess of funds calculation. In the former case, transactions within the limited partnership would be reflected in the net excess of funds calculation. In the latter case, only the transactions between the limited partnership and the NMSBIC would be reflected in the NMSBIC's net excess of funds calculation.

This tension between the aggregate and entity treatment had been discussed at the prior Board meeting in connection with the sale of ZTEC, and Mr. McDonald stated that his initial reaction, as stated in that meeting, that the entity concept might be appropriate, turned out to be wrong. Mr. McDonald said that, after carefully considering the language of the statute itself and as a part of the entire New Mexico Small Business Investment Act, it is his opinion that the appropriate manner of performing the net excess of funds calculation is to treat the activities related to an investment in limited partnerships on an aggregate basis, which is the way they are treated on the NMSBIC audited financial statements. The Act in numerous places contemplates that the NMSBIC would make its reports to the state and Severance Tax Permanent Fund based on the audited financial statements, and it is Mr. McDonald's opinion that should be reflected in the manner in which the corporation calculates net excess of funds under Section 58-29-7.

Mr. McDonald said that is a brief summary of his conclusion.

Mr. McDonald also stated that the statute allows a deduction in the calculation of net excess of funds for "amounts reasonably reserved for losses," and that in the past, the NMSBIC had always included in the calculation amounts reserved for losses related to its lending activities, but that it has never reserved an amount for losses related to its equity activities. He expressed his opinion that the statute is clear that the deduction it is not limited to losses on the loan program, but could include any reasonably reserved losses related to the equity program that the NMSBIC anticipates should be taken into account, and he therefore includes in his recommendations that the Board consider whether or not it should reserve amounts for equity losses in the future.

Mr. Cummins referred the Board to the Notes in the Audited Financial Statements, reflecting that no funds are due to the Severance Tax Permanent Fund for the past two years.

Mr. McDonald added that the differences between how these calculations are being made now as opposed to in the prior year (and for the most part, all prior years) is the NMSBIC is taking into account interest only on a cash basis and is including a reserve for losses on the equity side.

b. Letter from Pulakos CPAs

Mr. Cummins noted that the Board has also requested an opinion from Pulakos CPAs. In discussing this request with Mr. Dopson, Mr. Dopson said Pulakos could not issue such an opinion, but could issue an Agreed Upon Procedures (AUP) Letter.

Mr. Dopson said the AUP is a set of procedures agreed upon between the CPA and management, the result of which is a simple report stating what was done and what was found. He said Pulakos proposed that they report back on the calculation and its accuracy in consideration of Mr. McDonald's legal opinion. He said this report is in process and a draft should be ready in the next two to three business days.

Mr. Garcia moved approval of Mr. McDonald's legal opinion and the engagement with Pulakos CPAs for the AUP letter; and to authorize Steve Morgan to execute the engagement letter and any other documents that need to be done in relation to the AUP. Ms. Waller seconded the motion, which passed unanimously by voice vote.

NMSBIC AUDITED FINANCIAL STATEMENTS: JAKE DOPSON, PULAKOS CPA'S

Mr. Badal moved approval of the Audited Financial Statements. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

NMSBIC ANNUAL REPORT

Mr. Cummins reviewed the NMSBIC Annual Report and highlights and made minor changes as suggested by Board members.

Mr. Cummins said he and Roxanna Meyers made a presentation last week to the Investments and Pensions Oversight Committee (IPOC), and also spoke with Steve Moise and Vince Smith of the State Investment Council before the meeting. The presentation was well received and he thought the quality of the questions was quite good. With respect to the possibility of the NMSBIC receiving additional monies from the Severance Tax Permanent Fund, Mr. Smith explained that the state can now use up to 95 percent of the revenues going into the fund for bonding programs, so the prospect of receiving any significant amount of funding from that source over the next several years is low.

Mr. Cummins commented that the NMSBIC is in the business of making investments, and so over time might incur losses. If it has gains that result in "net excess funds," it has to pay them back to the Severance Tax Permanent Fund. Theoretically, the NMSBIC might gradually see its assets ratchet down under that scenario. If the NMSBIC can realize gains, it should be able to grow the program going forward. He said Ms. Meyers feels that, while the NMSBIC might not get support for an allocation increase, perhaps it would make sense for the NMSBIC to propose legislation that would repeal the net excess of funds calculation altogether. He said Ms. Meyers

would like to approach the Governor with this proposed legislation. Ms. Meyers asked Mr. Cummins to discuss this with the Board to determine if there is support for this.

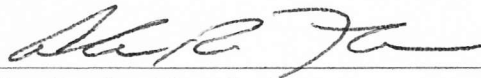
Mr. Cummins said he and Ms. Meyers will be scheduling meetings between now and October 1 with the Governor or her chief of staff, the executive director of the Legislative Finance Committee, and Steve Moise at the State Investment Council, to deliver the Annual Report and discuss the proposed legislation.

Mr. Badal said he would encourage members of the Board to contact Mr. Cummins to see where they might be of help during the legislative session or prior to the session in working with particular legislators to try and get support for the changes.

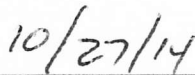
Mr. Badal moved to approve the Annual Report with the changes suggested by Mr. Cummins. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

ADJOURNMENT

Its business completed, the NMSBIC Board adjourned the meeting at 10:05 a.m.



Alan Fowler, Vice Chair



Date