

MINUTES OF THE
NEW MEXICO SMALL BUSINESS INVESTMENT CORP.

REGULAR MEETING

December 12, 2011

A regular 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 the WESST Enterprise Center, 609 Broadway Blvd., N.E., Albuquerque, New Mexico.

A quorum was present:

Members Present:

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

Members Excused:

Ms. Roxanna Meyers, Vice Chair

Legal Counsel to Board:

None.

Financial Advisor to Board:

Mr. Paul Goblet

Consulting CFO:

Ms. Dee Brescia

Recording Secretary:

Ms. Judith Beatty

Guests Present:

Mr. Robert A. DePasquale, Pulakos CPAs
Ms. Kim Sanchez Rael, Flywheel Ventures
Mr. Trevor Loy, Flywheel Ventures
Mr. Andrew Jacobson, DFA

APPROVAL OF AGENDA

Mr. Fowler moved for approval of the Agenda, as presented. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

REVIEW AND ACCEPTANCE OF BOARD MINUTES: November 21, 2011

Mr. Cobb moved approval of the November 21 Minutes, as submitted. Mr. Fowler seconded the motion, which passed unanimously by voice vote.

REVIEW AND APPROVAL OF IRS 990 RETURN: ROBERT DEPASQUALE, TAX PARTNER, PULAKOS CPAS

Mr. DePasquale presented an overview of the NMSBIC Form 990, covering the period from July 1, 2010 to June 30, 2011.

Ms. Brescia suggested that the \$331,558 in line 3, column D, on page 9 (investment income, including interest and dividends) be narrowed to CDs, interest, etc., and that the rest – which would be ACCION, WESST and The Loan Fund – be listed in column B (related or exempt function revenue). She said she would provide the figures to Mr. DePasquale.

On page 20, Mr. DePasquale was asked to remove the Lt. Governor and State Investment Council from the list of entities receiving an annual report from the NMSBIC, as statute only requires that a report be filed with the Governor and Legislative Finance Committee.

Mr. Fowler moved approval of the IRS 990 return, as amended, subject to Ms. Brescia providing information to Mr. DePasquale, as discussed, and the language change on page 20.

Mr. Garcia seconded the motion, which passed unanimously by voice vote.

REVIEW OF FINANCIAL REPORT: DEE BRESCIA

Ms. Brescia reviewed the November financial statements, noting that the funds (with the exception of WESST and ACCION) reflect activity through September 30.

Mr. Fowler moved approval of the November financials. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

a. Approval of Corporate Resolution for All Bank Accounts

Mr. Goblet asked for approval of the corporate resolution for all bank accounts. He stated that there has been no change in the form of the agreement, but the signatories have changed with the election of new Board officers.

Ms. Waller so moved. Mr. Fowler seconded the motion, which passed unanimously by voice vote.

b. Review of Public Regulatory Commission Filing

Mr. Goblet stated that the NMSBIC is required to file annually with the PRC and pay a \$10 fee. Chairman Badal has signed the document, and Ms. Brescia will do the filing.

**FLYWHEEL VENTURES/NEW MEXICO GAP FUND:
TREVOR LOY AND KIM SANCHEZ RAE, GENERAL PARTNERS**

Mr. Loy and Ms. Sanchez Rael introduced themselves to the Board and made a slide presentation.

Addressing the two biggest challenges to deploying equity capital in New Mexico, Ms. Sanchez Rael said the business culture in New Mexico tends to be bootstrapped and self funded, and there are no role models yet where equity capital has grown a small business into a very large company that then has an exit in the portfolio. The other hurdle is economic; while ten years ago the capital landscape in New Mexico was being filled out by the SIC and NMSBIC, there have been no new commitments to funds by either in the last 3 years.

Mr. Loy added that management experience and entrepreneurial skills is still an issue. While it is much better now than ten years ago, New Mexico has not grown its talent at a fast enough rate to keep up with the competition in other states and countries. He said New Mexico's capital investment community is more biased toward asset-based investments (real estate, minerals, agriculture, etc.), and there is much less appreciation, understanding or comfort with the idea of investing in intangible assets.

-- Flywheel manages Flywheel Capital; Flywheel 1 LP; Flywheel/NMSBIC (parallel fund of Flywheel 1); NM Gap Fund (NMSBIC is anchor LP); and Flywheel 2, LP.

-- Flywheel has been around for about ten years, has \$50 million of capital under management, has done 35 investments, had 5 exits, 5 write-offs and has 25 active companies across the portfolios.

-- Flywheel tends to be first institutional capital or coinvestors with angels or other small investors. Average first investment across the funds is \$600,000 for a first investment at a pre-money valuation of \$1.5 million.

- Flywheel has helped raise follow-on equity capital totaling \$170+ million.
- Flywheel Capital, a 2002 vintage fund, has a net IRR of 19+% versus the benchmark of 9.6%. This fund is running about a 2.7x multiple on invested capital.
- Flywheel 1, a 2005 fund, has a net IRR of 5.9% (still in J-curve), which is 3x the median. The fund is running a 1.7x multiple on invested capital.
- NM Gap Fund is at about .7x of invested capital.
- Flywheel 2 is very new and investments have just begun from this fund.
- Flywheel is a technology fund that invests broadly in the physical sciences in two major theme areas: information technology (mobile applications, semiconductors, business-to-business software and bionetwork computing) and infrastructure technology (energy efficiency, water technology, transportation-related technology).
- The NMSBIC made a \$1.5 million commitment to Flywheel 1 that is structured in a parallel entity because NMSBIC dollars can only go to New Mexico businesses. Each time Flywheel invested in a New Mexico company out of that fund, the NMSBIC parallel fund took its pro rata share of that investment. The fund invested in 13 companies, 4 of which were New Mexico companies. Flywheel has invested \$21 million from the fund to date and is carrying it at a market value of \$37 million. The fund is fully invested and no more new commitments will be made. Flywheel 1's gross IRR is 12% and net 6%.
- Flywheel has invested \$1+ million of the NMSBIC's commitment to date in 4 companies and is carrying that at \$400,000, or .4x capital, with a net IRR of -25%. Investments are in MIOX (70%), Blixel (24%), and TruTouch (6%). The fourth investment, in CoMeT, was written down to zero.

Responding to Chairman Badal, Ms. Sanchez Rael said about \$150,000 of the NMSBIC's commitment is remaining, but it is being reserved to cover audit fees and fund costs.

Ms. Sanchez Rael commented that the NMSBIC's parallel fund has not had the opportunity to enjoy the "portfolio effect" because there are not enough companies in the portfolio. Based on what Flywheel has learned in the 7-8 intervening years since the fund was established, they would not have this structure again because it ultimately was not in the NMSBIC's best interest. She said they expected the portfolio to be more heavily weighted towards New Mexico companies and thus have more diversification; but they had a fiduciary obligation to deploy the fund into the best investment opportunities they could find regardless of where they were, and it ended up being a portfolio with only 4 New Mexico companies. This limited the ability to enjoy the diversification of risk across a portfolio of 13 companies.

Mr. Loy pointed out that the NMSBIC's initial \$1 million commitment comprised one-third of Flywheel's fund. He said that commitment and the \$500,000 additional commitment by the NMSBIC catalyzed Flywheel's ability to raise not only State Investment Council money but also \$20 million from Cal Tech, the Kauffman Foundation and others. He said that catalytic effect has helped Flywheel to deliver capital to many companies that have created a lot of jobs.

Chairman Badal wondered if there are enough opportunities in New Mexico to really be in the venture capital business – are there enough companies out there but not enough capital, or are there not enough companies to consider investing in.

Mr. Loy responded that New Mexico's technology sector is world-class, but it turned out not to be the sector that was driving returns. Five years ago, the venture industry was three legs of a stool – one-third biotech, with the most untapped potential; one-third cleantech, which New Mexico has been a leader in; and consumer Internet (where New Mexico has no talent base). Mr. Loy said there is a culture issue in New Mexico – in other markets, there is more of a capitalist drive by young entrepreneurs; and while there is an equal drive here to create companies, the creators/CEOs are reluctant to raise capital and grow for fear they will have to relinquish control.

-- NM Gap Fund has a total of \$2.3 million in committed capital, with \$1+ million invested in 13 portfolio companies to date. The portfolio is valued at \$750,000, or about .7x. Because of the early stage of the fund, the IRRs are not yet material. Flywheel is targeting 17 companies in this portfolio with a maximum of 18. They are negotiating 4 potential investments – 2 new and 2 follow-ons. Nine of the 13 are active, and 3 of the original investments ceased and one was exited at a partial return. NMSBIC is anchor investor in the whole fund, with \$2 million.

Chairman Badal asked Flywheel to return to a future NMSBIC meeting prepared to respond to the following questions:

1. Starting out today, how much money would Flywheel need, what would its orientation be, what would they try and accomplish, what does the environment look like, and how would they take advantage of that?
2. How can opportunities be found given the culture here? Can the culture be tweaked somehow? Students coming out of school today aren't entrepreneurial – it will take some time, and they will need some experience. What does that look like?
3. What is the venture capital business plan going forward, and why should NMSBIC be involved, and to what extent? What has changed since Flywheel got into this business and the NMSBIC made a commitment, and how might the NMSBIC take advantage of that?

Mr. Cobb thanked Mr. Loy and Ms. Sanchez Rael for being groundbreakers in venture capital in New Mexico and for staying here to keep the momentum going. He commented that,

while the NMSBIC may need to be more judicious in making future commitments, entrepreneurs around the state are now familiar with venture capital and where they might apply for it, something that was not possible just a few years ago.

Mr. Goblet also asked Flywheel to return with their projections on what the value of each of the NMSBIC's investments will be in Flywheel 1, and in the Gap Fund, two years from now.

REVIEW AND DISCUSSION REGARDING STRATEGIC PLANNING REPORT:

MEETING WITH GOVERNOR AND LFC: JOE BADAL

Chairman Badal stated that he received the strategic planning report this morning, and has forwarded a copy to each Board member and asked for feedback.

Chairman Badal stated that he has hand-delivered the SBIC annual report to the Governor's Office, Legislative Finance Committee, Lt. Governor's Office and the SIC.

Chairman Badal stated that he has not yet been successful in scheduling a meeting with the Governor to discuss what the SBIC is trying to do as an organization and what its goals are.

[Break.]

LUNCH

FINANCIAL ADVISOR'S REPORT

Mr. Goblet reported on the following financial highlights as of November 30:

- The NMSBIC shows current cash deposit balances of \$14.7 million.
- Based on conversations with the NMSBIC's lending and equity partners, balances in the operating account (\$970,000) will be sufficient to cover all capital calls through February 2012.
- Remaining capital is primarily held in CDARs deposits, with \$6.7 million maturing on March 8, 2012, and a second block of \$3 million maturing on August 30, 2012. The most recent collateralized CD deposit of \$4 million matures on March 29, 2012.
- The NMSBIC has \$12.7 million in commitments to the lending partners, the largest of which is to The Loan Fund at \$7.5 million, soon to be increased to \$8.5 million. Of those

commitments, \$9 million is currently called. Once The Loan Fund agreement is signed, NMSBIC will have \$13.7 million in outstanding commitments that could be called.

-- Between \$1 million and \$1.5 million of capital is expected to be called collectively by the three lending partners over the next 12 months.

Mr. Goblet noted that the size of ACCION's outstanding portfolio continues to shrink, reflecting the reality of tougher economic times, less ability by potential clients to post collateral or service more debt, and tougher underwriting criteria.

Chairman Badal suggested that, if the NMSBIC has fundamental structural issues in terms of ACCION's ability to draw any or all of the \$2.6 million that remains as a contingent liability, the NMSBIC discuss negotiating with ACCION to get the balance back so it can be deployed in another way.

Mr. Goblet agreed to make a recommendation at the January meeting on what steps to take with ACCION in reducing the balance, and by how much.

-- The NMSBIC has commitments to 9 equity funds, but the only real likelihood of capital calls (other than management fees and expenses) would be from Verge II.

-- While the committed amount of capital stands at \$32.3 million less the amount called, the remaining uncalled capital now stands at \$6 million. That leaves a significant contingent liability on paper, but the projected amount of capital to be called over the remaining life of each fund is likely to be less than \$2 million. Verge 1 and 1.5, Flywheel Ventures, NM Mezzanine Fund, NM Community Capital and both NM Growth Funds are all at the end of their investment cycles.

Mr. Goblet stated that, going forward, he believed the NMSBIC would have \$8 million of available capital for the next 12 months.

Chairman Badal commented that there seems to be a fundamental problem with the way NMSBIC is using venture capital - by definition, seed money ends up being diluted -- and part of the discussion going forward should be finding a better way of going into venture capital deals so that the NMSBIC's money isn't diluted.

Mr. Cobb said the NMSBIC's investments are actually more early stage -- and there should be a priority to the value of the NMSBIC's money, because its commitments have brought in other investors. He suggested that this be part of the strategy discussion in looking at early stage venture capital.

Chairman Badal agreed. He said the NMSBIC's real value may be providing the seed money and then basically saying that any follow-on investment has to take the NMSBIC out, even if it doesn't share in the upside. He pointed out that the NMSBIC's mission is to create

entities, create employment, and help economic development – so even if it only gets its money back with a nominal coupon rate, it has accomplished what it was created to do.

Given the NMSBIC's economic development goals, Mr. Cobb said the Board always has the ability to give up some of its preferential rights if a major investor comes in, for instance, and wants a larger share, particularly if it creates jobs, gross receipts taxes, etc.

a. Flywheel Request to Recycle Capital

Mr. Goblet reported that Flywheel Ventures has invested \$4.7 million in a California-based company that they think will be sold for about \$125 million, of which their proceeds will be \$25 million. He said Flywheel has asked for approval to reinvest/recycle a portion (\$4.5 million) of the distribution proceeds into existing portfolio companies.

Mr. Goblet stated that he is one of the 5 members on Flywheel's advisory committee and consulted Chairman Badal about Flywheel's request. He noted that the SIC, which holds 2 seats on the committee, has \$15 million invested in this \$31 million fund. Mr. Goblet said the advisory committee ultimately gave unanimous consent.

Mr. Goblet stated that this will have no financial impact on the NMSBIC, but it is possible that some of the reinvestment of capital might be in a New Mexico-based portfolio company, which would be of benefit to the NMSBIC.

b. NM Community Capital's Request to Amend LPA

Mr. Goblet reported that NMCC has entered into the end of its investment period and has asked for an amendment to the Limited Partnership Agreement so they can commit up to 100% of the remaining uncalled committed capital for add-on investments. This request must be circulated to all 10 of the LPs and calls for 72% approval.

Mr. Goblet said there is \$3.5 million of uncommitted capital, of which \$1.4 million is the NMSBIC's.

Mr. Goblet asked for direction from the Board. He said NMCC has not explained why they are making this request, and so he had no recommendation.

Upon Mr. Cobb's suggestion, Chairman Badal and Mr. Goblet said they would meet with NMCC and return to the January meeting with a recommendation.

c. Possible Proposed Legislation

Mr. Goblet circulated a discussion draft of a Senate bill that would increase the percentage of the Severance Tax Permanent Fund allocated to the NMSBIC, among other provisions.

Chairman Badal stated that the NMSBIC should do everything possible to educate legislators about its efforts to get money to small businesses in every corner of the state.

DISCUSSION AND POSSIBLE VOTE ON NM GROWTH FUND 1

- a. Extension of Fund's Life**
- b. Waiver of Audits for 2011 and 2012**

Mr. Goblet stated that Mesa Ventures, GP of NM Growth Fund 1, has put forth recommendations and requested approval from the LPs of the following:

- 1. NMGF 1 continues as a holding company through 11/30/2012 with no activity other than the liquidation of Aridien, Inc. assets.**
- 2. No further expense costs to be called. Current cash in the fund will be used to pay for 2011 and 2012 tax filing and eventual fund closure fees in New Mexico.**
- 3. LP consent to extend the fund through 11/30/2012 and consent to waive the audit requirements for 2011 and 2012.**

Mr. Goblet stated that assets in the fund are about \$48,000, and he thought all three requests were reasonable. He stated that, should this Board demand an audit, NMSBIC would have to pay 96% of the expenses, but there is virtually nothing to audit.

Mr. Goblet noted that the previous Board called for an audit in 2010, at a cost to the NMSBIC of about \$10,000, and which resulted in a clean opinion.

Chairman Badal said he personally would have no problem with any of the three recommendations provided there would be no implications for the NMSBIC in terms of statutory issues, its audit, its 990 filing, etc.

Mr. Goblet responded that he would consult with NMSBIC counsel Randy McDonald and Pulakos and report back electronically.

Mr. Fowler moved approval of Items 1 and 2. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

Mr. Fowler moved approval of Item 3, subject to Mr. McDonald and Pulakos verifying that there would be no negative impact to the NMSBIC. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

- c. New Mexico Broad Band Holding (NMBBH) Options**

Mr. Goblet stated that, at the October Board meeting, he and Board legal counsel Randy McDonald were asked to provide possible options regarding a commitment from the NMSBIC for consideration. Those are as follows:

- 1. Subscribe for the NMSBIC's pro rata share of NMBB Holding, which would call for an immediate investment of approximately \$17,000, plus an annual fee for reporting and tax filing of approximately \$500 per year, *or***
- 2. Advise Mesa Ventures that the NMSBIC does not wish to subscribe, *or***
- 3. Request a 3-to-5-year option to purchase its pro rata ownership position at the current subscription price (approximately \$17,000) plus the annual pro rata costs incurred.**

Mr. Goblet said that, based on the historic performance of the GPs and the preferential returns allocated to the class A shareholder, Woodside Capital, he was unsure that there would be any economic value to the class B holders. By securing an option to purchase, the NMSBIC would have little, if any, downside risk, but would retain the possibility of recapturing some of its investment in OneConnect IP if the venture were successful and if there is value after Woodside's preferential return.

Mr. Goblet stated that a simple option to purchase would involve a small amount of legal fees to put the document together, it wouldn't be carried on the NMSBIC's balance sheet, and the NMSBIC might get to exercise it three years from now based on whether NMBBH is a success or not.

Chairman Badal asked Ms. Waller if she sees any value in the company's endeavor, and Ms. Waller responded that the services they are touting sound almost too good to be true. For them to receive any subsidies or the like, they will have to go through PRC hearings and receive various approvals in a lengthy and expensive process.

Ms. Waller said she would abstain from the vote based on a conflict of interest, but would personally be uncomfortable with putting any more money into this.

Ms. Waller stated that they are not an ETC, either, and the Universal Service Fund will be undergoing drastic changes over the next five years. She said the environment right now is very challenging.

Chairman Badal said he would abstain from the vote because he is on the board of Sacred Wind Communications.

Mr. Goblet recommended that the NMSBIC request a 3-to-5-year option to purchase the NMSBIC's pro rata ownership portion of New Mexico Broad Band Holding.

Mr. Goblet said this option would cost the NMSBIC nothing, with the exception of approximately \$500 in legal fees to draw up the documents.

Mr. Cobb moved that the NMSBIC request a 5-year option to purchase the NMSBIC's pro rata ownership portion of New Mexico Broad Band Holding. Mr. Fowler seconded the motion, which passed by voice vote, with Chairman Badal and Ms. Waller in abstention.

FINANCE NEW MEXICO

Mr. Goblet stated that Finance New Mexico (FNM) is produced and maintained by the Holly Company, which contracts with the NMSBIC for two services: 1) weekly articles are generated by financial partners and others, sent to all the statewide newspapers, and electronically broadcasted to about 1,500 organizations and individuals; and 2) maintaining the current status of the NMSBIC website by posting articles, meeting schedules and other pertinent information.

Mr. Goblet stated that Holly Company has submitted a bill of \$1,980 plus GRT for annual services in maintaining the website from 12/1/11 to 11/30/12. He said this is based on two hours per month at \$75 per hour, times 12 months, plus the cost of hosting the domain and registration.

Mr. Goblet said this cost would be in addition to the \$35,000 annual contract that the NMSBIC has with Holly Company.

Chairman Badal asked that Holly Company representatives make a presentation at the January Board meeting.

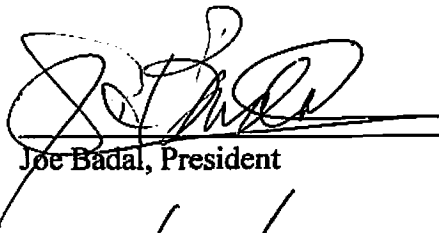
The Board approved the continued service of Holly Company for web-site management, but deferred approval of the invoice from Holly Company to the January meeting.

NEXT MEETING: Monday, January 23, 2012 [WESST Enterprise Center]

Board members received the draft meeting schedule and agreed to review it and communicate electronically on any conflicts.

ADJOURNMENT

Its business completed, the NMSBIC Board adjourned the meeting at approximately 1:30 p.m.



Joe Badal, President

1/23/12

Date