

Investment Oversight Committee Report

**New Mexico Small Business Investment Corporation
July 2nd, 2010**

Historic Background

- **Created in 2000 based on Legislation put forth by Sen. Don Kidd (R) Carlsbad**
 - NM Small Business Investment Act, 58-29-1 et. Seq., NMSA 1978
- **Initial Capitalization in 2001 established at ¼% of STPF (\$9,600,000)**
 - Increased by ¼% in 2004, 2005 and 2007 Total Funded \$47,042,780
- **Board Appointed (6 Members by Governor, Plus State Treasurer & SIC Chief Investment Officer), and confirmed by the Senate**
 - Andrew Baca *Chair* Sam Cobb *Vice Chair* Marie Longserre *Treasurer*
 - Mary Garza *Member* Billy Knight *Member* Kit Caldwell *Member*
 - Greg Kulka *SIC Designee* Clarence Smith *State Treasurer Designee*
- **Original Purpose To create new job opportunities by making equity investments in NM small businesses that were seeking an SBA or USDA loan for land, building or infrastructure. The SBIC Board conducted analysis of the capital needs of the State and small businesses and recommended legislative language change amendments to fill those gaps**
- **Legislation Amended in 2001 and 2002 to establish programmatic, contractual relationships for efficient and effective delivery of both debt and equity, via formal relationships with Financial Professionals**
- **First formal lending partnership established with ACCION NM in 2003 for micro-lending. Initial commitment of \$1,500,000, ultimately increased to \$5,000,000**

NMSBIC Goals

- **Act as a very cost effective conduit of capital on a statewide basis to support economically targeted investments**
- **Implementation of the NM Small Business Investment Act**
- **Help provide financial support to NM small businesses to expand job creation or retention of employee base**
- **Identify missing strips of capital and act as the catalyst to create or expand specific delivery systems to meet that need (Equity or Debt)**
- **Preserve and protect the capital base while being mindful of targeted economic development investment role**
- **Diversify portfolio to mitigate investment and lending risks**
- **Leverage capital base to attract additional investors into NM based funds**

Lending Partner Results

The Loan Fund (NMCDLF)

– Current Commitment	\$ 7,500,000
– Total Loans Made to Date	\$ 14,759,056
– Average Loan Size	\$ 45,000
– Number of Loans	302
– Number of Jobs Impacted	1,909
– Loan Losses Since Inception	\$ 15,000
– Annual Loan Loss Ratio	NIL

The Loan Fund makes loans to larger, more mature businesses, and somewhat uniquely to non-profits, and has had outstanding results over the six year period since inception. The facility has been increased several times and now stands at \$7,500,000 making them the largest lending partner of the NMSBIC. They have had no loan losses over the past three years. Their client's businesses tend to have larger revenues and to employ a larger number of people, and tend to generate a larger economic impact than micro-loan clients. Non-profit lending has had significant impact on smaller communities for housing, education, social services and other critical needs

Lending Partner Results

ACCION NM

– Current Commitment	\$ 5,000,000
– Total Loans Made to Date	\$ 13,761,840
– Average Loan Size	\$ 11,500
– Number of Loans	1,583
– Number of Jobs Impacted	2,815
– Loan Losses Since Inception	\$ 837,828
– Annual Loan Loss Ratio	1.19%

ACCION NM is a true micro lender in the sense of both loan size and client size. Most of their clients are sole proprietorships, with a large portion being minorities. Their clients are the most economically exposed group, and a very large portion of their clients could not get loans from traditional lending sources, hence greater loan loss risk and actual loan losses. ACCION NM is the NMSBIC's most prolific lending partner (over 250 loans per year) with loans in virtually every community in the State

Lending Partner Results

WESST Corp

– Current Commitment	\$ 375,000
– Total Loans Made to Date	\$ 320,000
– Average Loan Size	\$ 16,000
– Number of Loans	24
– Number of Jobs Impacted	118
– Loan Losses Since Inception	\$ 10,375
– Annual Loan Loss Ratio	NIL

WESST Corp. is primarily a technical assistance provider and has recently opened a business incubator in Albuquerque. This portfolio is primarily aimed at artists and arts related businesses, which is a specialty of WESST Corp. and a business sector that is most difficult to finance

Lending Partner Summary

- **Since Feb. 2003, over \$28,000,000 has been lent to over 1,900 small businesses**
- **It is estimated that these business generated over \$2,000,000 in annualized general tax revenues**
- **The Loan Fund and WESST Corp. have experienced virtually no loan losses over the life of their partnerships with the NMSBIC. Loan losses have totaled over \$850,000 since 2003. While significant, those losses represent just over 3% of the loans made, and less than 1% on an annualized basis**
- **There is no other program in the State that has deployed lending capital in virtually every community. Many of these businesses would not qualify for traditional lending**
- **This is the most successful small business lending program in any of the Southwestern states**

Equity Partnerships

- The NMSBIC is the primary catalyst for the establishment of NM based equity Funds. The NMSBIC is typically the first institutional investor and often the largest investor in these funds
- Prior to 2003, there were no equity funds headquartered in New Mexico. Each Fund was created to address very specific equity needs within the State. NMSBIC's capital can only be invested in NM companies
- Current there are 9 funds headquartered in NM

	<u>Total Fund Size</u>	<u>NMSBIC</u>	<u>Stage</u>
– Flywheel Ventures	\$31,000,000	\$ 1,500,000	Early
– Verge Fund 1	\$15,000,000	\$ 1,800,000	Early/Seed
– Verge Fund 1.5	\$ 5,250,000	\$ 3,000,000	Early/Seed
– NM Growth Fund 1	\$ 8,200,000	\$ 7,500,000	Growth
– NM Growth Fund 2	\$ 7,800,000	\$ 3,500,000	Growth
– NM Community Capital	\$14,600,000	\$ 7,000,000	Growth
– NM Gap Fund	\$ 1,750,000	\$ 1,500,000	Seed
– NM Mezzanine Fund	\$ 6,250,000	\$ 3,000,000	Growth
– Verge Fund 2 (new)	\$ 5,000,000	\$ 2,500,000	Early/Seed
– Totals	\$94,850,000	\$31,300,000	

Equity Partner Results (Economic Development Impact)

Fund	# of Investments	# of Employees	NM Payroll
• Flywheel Ventures	4	72	\$ 5,016,000
• Verge Fund 1 & 1.5	15	81	\$ 5,007,000
• NM Growth Fund 1	5	4	\$ 279,000
• NM Growth Fund 2	4	21	\$ 1,098,000
• NM Community Capital	9	122	\$ 3,277,000
• NM Gap Fund	11	36	\$ 2,488,217
• NM Mezzanine Fund	1	22	\$ 1,974,000
• Verge Fund 2 (new)	0	0	\$ 0
• Totals	48	358	\$19,139,000

There is some duplication in the number of investments due to the fact that some funds have invested in the same company, however the number of reported employees and NM payroll are reported accurately since credit is only attributed to the lead investor

Equity Partner Results Financial Performance (As of May 31, 2010)

Fund	Commitment	Called Capital	Returned	Current Value	Value Impairment
• Flywheel	\$ 1,500,000	\$ 1,365,000	\$ 0	\$ 818,006	\$ 546,994
• Verge 1 & 1.5	\$ 4,800,000	\$ 3,663,000	\$ 0	\$ 3,391,523	\$ 271,477
• NM Growth 1	\$ 7,500,000	\$ 7,472,913	\$ 0	\$ 1,337,735	\$ 6,135,178
• NM Growth 2	\$ 3,500,000	\$ 2,625,677	\$ 0	\$ 1,015,433	\$ 1,610,244
• NM Community Capital	\$ 7,000,000	\$ 4,291,323	\$ 0	\$ 2,513,828	\$ 1,777,495
• NM Gap Fund	\$ 1,500,000	\$ 1,065,000	\$ 0	\$ 724,334	\$ 340,666
• NM Mezzanine	\$ 3,000,000	\$ 621,000	\$ 510,000	\$ 70,233	\$ 40,767
• Verge Fund 2	\$ 2,500,000	\$ 375,000	\$ 0	\$ 324,889	\$ 50,111
• Total	\$31,300,000	\$ 21,478,913	\$ 510,000	\$10,195,981	\$ 11,282,932

As is the case with all equity funds, the first 3-4 years typical show losses due to management fees, fund expenses and initial portfolio losses. This is called the J-Curve. These reductions in value have been further compounded by the recession

All NMSBIC funds are performing somewhat according to expectations except NM Growth Fund 1 and 2. 4 of the 5 portfolio companies in NM Growth 1 have been written off, while both major investments in NM Growth Fund 2 had been written down. The majority of the NMSBIC's investment losses are attributable to these two funds

While all other funds have written down or written off portfolio companies, most have very viable portfolios, which should offset most or all of NMSBIC investment losses over the next several years. All NMSBIC funds have been in existence less than 5 years, so their portfolios are very early in the investment cycle

EQUITY INVESTMENTS

- **Altaview**
 - **Altela (b)**
 - **Avasca (a)**
 - **Boomtime**
 - **IntelliCyt**
 - **Nanocrystal**
 - **Noribachi**
 - **Nuvita**
 - **Metaphor (a)**
 - **Patchworks (a)**
 - **TruTouch Technology (b)**
 - **Vertical Power**
 - **Vibrant**
 - **Wellkeeper**
 - **ZTech**
- airsMobile**
 - Knowledge Reef (b)**
 - Locals Care (a)**
 - OnQueue**
 - Packet Analytics (a)**
 - Rarefied Technology**
 - SkyFuel**
 - Sustained Building**
 - Tred Display**
 - txtEagle**
 - US Retail Center**
 - CoMeT Solutions**
 - Miox**
- Agavue (b)**
 - Aridien (b)**
 - Cash Stream (a)**
 - Desert Power (a)**
 - Gourmet Pet Supply (a)**
 - ClingZ (b)**
 - Hatch Valley (b)**
 - Aero Mechanical (b)**
 - American Clay**
 - Armed Response Team**
 - Aspen Avionics**
 - ProtoHT**
 - Strategic Analytics**
- (a) written off
- (b) written down

Equity Partner Results

- **The funds supported by the NMSBIC are fairly small in size and do not compete with the larger funds in the SIC's NM Program. To date the NMSBIC has committed almost \$31,000,000 to these 9 funds. The SIC has committed capital to two of these funds, Flywheel Ventures 1 and Verge Fund 1**
- **The NMSBIC has a primary goal of economic enhancement and job creation or retention via targeted investments, which has an inherent cost, hence the NMSBIC's rate of return expectations should be lower than pure financial investment funds**
- **None of these funds existed prior to 2003, and several have been in existence for 3 years or less, so any investment results are very premature. The funds have collectively invested in 41 NM companies that employ 358. The NMSBIC in many cases helped establish each fund to address specific needs within the state.**
- **Most of these funds make investments in very early stage or early stage companies, often start-ups, which could not attract capital from banks or larger equity funds, so the investment risk is greater**
- **The economic recession of the last two years has been even more challenging for early stage companies which tend to have limited revenues and no profits, which creates very limited financial options for these companies**
- **Write-offs, write-downs and fund management fees have been the primary contributor of NMSBIC reduction in net asset value. As of 6-30-09, the last audited statements for the NMSBIC, the portfolio showed a negative 10.57% loss since inception.**
- **Further equity mark downs as of 5-31-2010 show a total impairment in value of the equity portfolios of \$11,282,932. Earned income over the life of the NMSBIC has lessened the reduction in total net asset value to \$8,400,781, which equals a 17.9% loss since inception. Most of the equity impairments has been experienced over the last two years due to equity mark-downs and losses leaving the NMSBIC with a net asset value of \$38,177,000 at 5-31-10**

Summary

- **The NMSBIC represents a very unique, cost effective conduit of capital that exclusively targets NM small businesses, which are a primary source of job creation in the New Mexico**
- **Since its inception, the NMSBIC has always offset all of its annual administrative costs (\$261,053 in 2009) via earned interest income received (\$820,545 in 2009), and prior to 2008 it had historically offset all its annual charges including equity fund management fees and expenses**
- **The NMSBIC has helped create 9 equity funds that have attracted over 3 times the amount of the NMSBIC's commitment, which has led to 48 equity investments over the past 6 years. These are economically targeted investments, hence a greater risk and typically, a lower return**
- **The NMSBIC's greatest success to date has been its support of micro and alternative lenders. With over \$28,800,000 in loans over six years to 1,900 small businesses in every community in the State, the NMSBIC's lending partners have made a significant impact on job creation and job retention. Over the last year, alternative lenders have had to play an even more important role as lenders, as traditional banks have reduced lending exposure to small businesses**
- **Annualized loan losses have been very low averaging approximately 1%**
- **The \$8,400,781 (as of May 31, 2010) reduction in net asset value over the life of the NMSBIC represents a 17.9% total decline in value that primarily reflects equity losses or mark-downs over the past two years caused by the incredibly difficult economy and the very early stage nature of the NMSBIC's equity investments**

Summary

- **Given its focus on economic development and business financial literacy, the NMSBIC created Finance New Mexico, the best business awareness website in New Mexico. Finance New Mexico has published over 130 business articles, which have been published weekly in most NM newspapers. Please visit www.financenewmexico.org**
- **Providing Access to Capital (either equity or debt) through its financial partners to support NM small businesses has been the primary focus of the NMSBIC, and it has made presentations in over 35 communities in conjunction with the Lt. Gov's Small Business Tour**
- **The NMSBIC has committed \$12,775,000 to its lending partners, which has resulted in over \$28,000,000 in loans, and \$30,800,000 to equity funds. It still has \$2,900,000 of uncommitted capital, which will be allocated over the next 12 months**
- **The economic impact of this investment activity is hard to accurately measure, and the NMSBIC cannot claim to have created numerous jobs, particularly not via small micro loans. However, it has positively impacted state income tax, sales tax, gross receipts tax and valuable business assistance via statewide efforts and the retention of over 4,800 jobs**
- **The NMSBIC currently has short term deposits of over \$17,000,000 in local NM banks, all of which are 100% collateralized**

Conclusion

- **Capital attracts capital – Three times the amount of NMSBIC commitments (\$31,300,000) have been committed to the 9 New Mexico headquartered funds (\$94,000,000). Over 5 times that amount of equity and debt capital has been invested in NM businesses over the last 10 years**
- **Capital attracts people - Without intellectual capital, investment dollars are somewhat meaningless. The NMSBIC has been the catalyst for the creation of capital delivery systems**
- **New Mexico is at a tipping point – The first SIC commitment to a fund was in 1996, just 13 years ago. There are now 20 funds that have deployed equity capital in NM business. There is not another western state with that many funds other than California or Washington**
- **There is no other western state that has created a small business lending system that comes close to broad impact of 1,900 loans over the last 6 years**