

MINUTES OF THE
PRIVATE EQUITY INVESTMENT ADVISORY COMMITTEE
OF THE
NEW MEXICO STATE INVESTMENT COUNCIL

Santa Fe, New Mexico

October 11, 2005

ROLL CALL

A regular meeting of the New Mexico Private Equity Investment Advisory Committee of the New Mexico State Investment Council was called to order on this date at approximately 9:00 a.m. in the State Investment Council conference room, 2055 S. Pacheco Street, Suite 100, Santa Fe, New Mexico. A quorum was present:

Members Present:

Mr. Gary B. Bland, State Investment Officer [excused at 11:15 a.m.]
Mr. Tom Bonafair, Public Member [by telephone]
Mr. Andrew Davis, NMSIC Member, Chairman
Mr. Willie Giron, Public Member

Members Excused:

Mr. Bill Enloe, Public Member

Legal Counsel Present:

None.

Staff Present:

Mr. Bob Jacksha
Mr. Greg Kulka
Mr. Adam Levine
Ms. Lori Romero
Mr. Charles Wollmann

Guests Present:

[See Guest List.]

INTRODUCTION OF GUESTS

Guests and Members were introduced.

APPROVAL OF AGENDA

Mr. Bland stated that the Funds recommended for approval at this meeting would be presented at the November meeting of the State Investment Council.

Mr. Bland moved approval of the Agenda, as published. Mr. Davis seconded the motion, which passed 3-0 by voice vote. [Mr. Giron was not present during this action.]

APPROVAL OF MINUTES: September 15, 2005

Mr. Bland moved approval of the September 15 meeting minutes, as submitted. Mr. Davis seconded the motion, which passed 3-0 by voice vote. [Mr. Giron was not present during this action.]

DISCUSSION AND VOTE ON *SERAPHIM FALLS* FILM INVESTMENT — PETER DEKOM

[Mr. Giron joined the proceedings in the course of discussion on this item.]

Mr. Dekom presented his September 26 Film Investment Recommendation Memorandum, which stated that Icon Productions, LLC, located in Los Angeles and owned by Bruce Davey and Mel Gibson, has submitted a request for a motion picture loan, with an equity rate of return in lieu of interest (5% of the upside), for \$15 million, including required legal fees to the State of New Mexico (estimated at \$25,000), with an outside payback date of two years. He stated that the loan represents 83% of the \$18,024,702 budget of this film.

Producer David Flynn and executive producer Stan Wlodkowsky reviewed the storyline of the film, entitled *Seraphim Falls*, which is set during the Civil War and stars Pierce Brosnan and Liam Neeson.

New Mexico Film Office director Lisa Strout stated that this film will receive a “soft R” rating and nearly all of it (95%) will be shot in New Mexico in Taos, Santa Fe and Lordsburg and possibly other locales. She said the shooting has a 45-day

schedule, with three days shot out of state. She stated that prep started in September and the first shoot day will be October 17.

Ms. Strout said there will be 297 crewmembers, 263 of them from New Mexico, and 64% of the payroll will go to New Mexicans.

Ms. Strout commented that there are six pictures being filmed in New Mexico when there are usually only three or four at a time, so the Film Office is extremely busy. She added that crewmembers will receive training from the film's cinematographer, three-time Academy Award winner John Toll, and costume designer Deborah Lynn Scott, who won an Academy Award for *Titanic*.

Mr. Dekom stated that Icon Productions operates out of London and Sydney and does direct distribution from those two cities. He added that Icon "has enough capital within itself to write checks, and they write the checks to pay for the opening of their motion pictures and they push and publicize their product. We've never had that level of insurance before in any of our applicants."

Mr. Dekom said the loan guarantor, Comerica Bank, has ratings at A1, A and A+ from Moody's, S&P and Fitch respectively, and that the completion bonding will be through International Film Guarantors.

Mr. Dekom stated that Icon will defer distribution fees until after the recoupment of the \$15 million New Mexico loan.

Mr. Dekom commented that an action film with an \$18 million budget and two major stars is considered "an exceptionally low budget motion picture in Hollywood parlance — so the upside in this film, the ability to market it, and the fact that Icon is probably going to get the best definition of DVD gross on the market, tells me that the upside in this motion picture may in fact be the highest of anything we've considered to date."

Mr. Davis asked Mr. Dekom what kind of letter grade rating he would give this film, and Mr. Dekom responded A-.

Mr. Bonafair asked Mr. Dekom when the SIC will begin to see the results of its decisions on the various films it has approved; in other words, what is the so-called incubation period.

Mr. Dekom responded that different movies have different parameters built into them — those with locked-in distribution probably take 18-24 months, while those without distribution will take longer. He stated that typically it takes two to three years from preproduction until meaningful revenues begin to come in.

In discussion on the upcoming status report of the SIC's film investments to date, Mr. Kulka stated that the SIO's outside attorneys, under a separate contract, are pulling together the accounting statements from all of the film projects the SIC has funded to date "so we can make sure we're getting what we should be getting." Mr. Dekom added that, if he sees these investments nearing the breakpoint, he plans to recommend an audit.

Mr. Davis noted that the Committee has received a preliminary report prepared by Messrs. Dekom, Kulka and Jacksha that discusses all of the film projects and assigns a letter grade rating based on whether or not it is expected that the SIC will receive upside in the project, get its principal back, etc. He asked Mr. Bonafair to provide input so that he can present a final version to the SIC at its next meeting.

Mr. Dekom pointed out that the SIC's principal is not at risk on any project.

Mr. Dekom also stated that, when the Legislature raised the limit to \$15 million, "it basically improved the quality of the motion pictures that we were able to approve, and even though it looks like we're giving up more money, the truth is with better product, you have better upside. The public likes seeing stars, the public likes seeing more production value. And on the lower budget motion pictures, we were relying much more heavily on high concept, which is much more subject to the vagaries of public taste; it's either a homerun or you're out."

Mr. Dekom's report recommended approval of this transaction by the PEIAC for submission to the State Investment Council, pending finalization of all relevant documentation in accordance with the following parameters:

1. Securing the loan guarantee (letter of credit) from Comerica Bank (or other SIC-approved guarantor) for the full amount of the \$15 million loan to Icon from New Mexico in accordance with the above payback/ recoupment structure in a form reasonably acceptable to the SIC appointed legal counsel.
2. Solely if the above Comerica letter of credit is conditioned on the completion and delivery of the Film, securing the relevant bond as described above from either International Film Guarantors or Film Finances.
3. Securing the necessary written commitments to pay the State directly (with underlying security agreements as recommended by counsel to the SIC) from the various sales agents and other distributors of the film as to recoupment of above principal amount and negotiated upside.
4. Finalizing agreements with Pierce Brosnan and Liam Neeson (or lead actors who sustain or exceed the international presale/

advance estimates from Icon International) and the director.

5. Finalizing an agreement or agreements with Icon setting forth: their detailed production and delivery obligations as required in the SIC/PEIAC approval, their detailed compliance obligations to insure that all relevant statutes and regulations are followed, the State's right of recoupment from the cash flow of the film as set forth above, the State's right to participate in the upside percentage from the film's revenues, if such upside is in fact generated, together with normal auditing and accounting provisions, verification and the relevant representations that all promised distribution arrangements are in fact finalized and in place, normal and customary representations and warranties that the chain of title is intact, that production of the film will not violate any third party rights, full indemnification of the State against claims, verification that all necessary insurance is in place and such other and customary provisions that are contained in agreements of this type are appropriately set forth. Additionally, Icon would agree to the State of New Mexico's normal and customary credit requirements.

Mr. Davis moved approval of a recommendation to loan \$15 million from the New Mexico Film Investment Program, with a final maturity of two years at zero interest plus a 5% profit participation, to Icon Productions, LLC, for the production of *Seraphim Falls* contingent on Items 1 through 5 in the Summary Section of Peter Dekom's Recommendation and subject to negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Bland seconded the motion, which passed 4-0 by voice vote.

DISCUSSION AND POSSIBLE VOTE ON QUADRANGLE CAPITAL PARTNERS II, L.P.

Quadrangle partners Steven Rattner and David Tanner were present for this item.

Aldus Equity advisor Marcellus Taylor stated that Quadrangle Capital Group, a New York-based second generation buyout fund, seeks to raise \$1.25 billion for their second Fund with a hard cap of \$1.6 billion. He said they raised their first Fund in 2000, and this \$1 billion Fund is essentially fully invested.

Mr. Taylor stated that Quadrangle focuses specifically on the media and telecommunications sector — and while the sector is fairly narrow in and of itself, it is broad in terms of investment opportunities, and Quadrangle focuses on a broad group of content and distribution companies in the upper middle market.

He said Aldus was very impressed with their top-down investment approach, i.e., Quadrangle researches an industry for several months, sometimes up to year, before effecting an investment strategy. He added that Quadrangle focuses on a broad array of transaction types ranging from buyouts to distressed to growth equity-type investments.

Mr. Taylor said Quadrangle's team itself boasts over 75 years of media-related experience, and in their prior lives they served as investment bankers at Lazard Freres, where they advised on some of the most high profile media and telecom-related transactions in the industry. He said media executives such as Rupert Murdoch, Barry Diller, David Dorman, Mel Karmazin and Timothy Donahue "rely on Quadrangle for advice on a lot of their strategic initiatives, and a lot of these media executives are actually investors in Quadrangle's Fund."

Mr. Taylor said Aldus was also very impressed with Quadrangle's investment performance; they have accumulated a 62% gross IRR on their realized investments and have returned \$460+ million of capital from Fund 1. He said this Fund was invested during a very challenging vintage year (2000) and a large portion of their portfolio is yet to be realized: "It's important to note that, from our perspective, their portfolio hasn't had the opportunity to experience the type of impact that they typically have on their investments. Nine of the 13 investments that are unrealized were made since 2003, and this highlights the fact that they are very disciplined and conservative investors — they actually waited for the market to turn around a bit before fully investing large amounts of capital, and the media and telecom sector cycle has started to improve, and we believe that the portfolio companies that they currently have under management are poised to realize the same types of returns that their realized investments have."

Mr. Taylor stated that the background check on Quadrangle turned up some lawsuits but none that Aldus felt substantive enough to not warrant an investment from New Mexico. He asked Mr. Rattner to speak to one issue, however, in which he purchased a seat on the New York Stock Exchange right before the NYSE was planning an IPO, and there were a number of articles published on whether there was some inside information associated with that purchase.

Mr. Rattner stated, "I did purchase a seat on the New York Stock Exchange. That purchase was actually begun a year or a year and a half before I completed it, and there's lots of records and documentation. The New York Stock Exchange has a very byzantine and complicated process to buy a seat. You have to register, you have to have a background check that's approved, and we did. So all that started a year, a year and a half before anyone had any idea what they were going to do, and it was simply a personal investment... Basically what happened is when they announced the deal, there were a number of people who had sold seats right before who were very unhappy, and so they were trying to create enough commotion to have something happen. But it all disappeared."

Mr. Rattner and Mr. Tanner gave a presentation. [Hard copies of this slide presentation were distributed.]

Augmenting Mr. Taylor's presentation, Mr. Rattner pointed out that Quadrangle also has a separately managed distressed debt fund that invests in distressed debt across all industries. He noted that, of the investments reviewed in Aldus' presentation, five of them included an element of distressed debt expertise in the investing process. He said, "We think that is an enormous advantage that we have. There are really no other firms in our space that have that capability, and we think it's just one of our value-added pieces."

Mr. Tanner noted that the five General Partners will be committing at least \$60 million to this Fund. He said they have about \$100 million in their two private equity funds and about the same amount in the distressed debt fund.

Mr. Davis asked what percentage of the institutional investors in Fund 1 will be in Fund 2, and Mr. Tanner responded over 90%. He said they had a lot of commercial banks in the first Fund and those have mostly disappeared, and so they have replaced them with high quality institutional investors in the second Fund who obviously are new.

Mr. Davis asked what happened to the rest, and Mr. Tanner responded that there was actually only one that didn't return to Fund 2, and that was because they felt they were overexposed to the media communications space.

Mr. Taylor added that, in 2000, a lot of commercial banks wanted to venture into private equity, and were subsequently burned and decided to dismantle their private equity investment programs.

Mr. Rattner said the biggest investors in Fund 1 were the State of Pennsylvania, CalPERS and an individual family foundation, and all of those have returned to Fund 2. He said they have added CalSTERS, State of New York and State of New Jersey to Fund 2.

Addressing Aldus, Mr. Davis remarked, "We're hearing the term 'upper middle market' an awful lot, and everybody's talking about being under the radar, and not getting the auction deals and so on, and everybody's compelling — that's the problem, is everybody's story reasonably compelling in that regard. How are you differentiating for us?"

Mr. Meyer responded that he was worried about the megafunds, and would address that issue later in this meeting. He commented that Quadrangle, with its \$1.6 billion cap, "is actually in the smaller end. I'm not sure that I would actually even term them mid-market as much as large, but certainly today it's been called

the upper mid market. It's very competitive. You have to have relationships, you have to deal with the source of the deal flow. There are a lot of deals in that area, but there are a ton of firms that are going after that space. So if we want exposure to the media space, which is a hot space — people think it's going to do something that's meaningful — then we need to go after and utilize the ones we think have the best ability to source those transactions through their relationships, through the guys on the board that'll give us that advantage. We're not saying make a massive bet on this space, because we do think it's very competitive."

Mr. Taylor stated that Aldus was impressed with the fact that Quadrangle positions themselves as experts: "When you sit back and you study an industry for a year before you even decide exactly how you want to attack that industry, it really gives you a leg up in terms of how you go about sourcing your investments, and more importantly how you go about determining what investments aren't attractive for your fund at all."

Mr. Bland moved approval of a recommendation to commit \$20 million from the National Private Equity Program to Quadrangle Capital Partners II, L.P., subject to negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Davis seconded the motion and it passed 4-0 by voice vote.

Mr. Bonafair asked Aldus if their due diligence and analysis on funds also includes close scrutiny of the individual partners.

Mr. Meyer responded that it does, and in fact, a fund they looked at last month turned up a personal situation that occurred 15 years previously against one of the principals.

Mr. Bonafair said he was impressed with the Quadrangle investment recommendation and agreed with it, but commented, "It's important to look at the individuals, because some of the individuals on these funds — Quadrangle is one example — are so powerful that they have a lot to do with whether this thing moves to the right or to the left."

Mr. Taylor agreed with Mr. Bonafair. He said the issue associated with Mr. Rattner's purchasing the NYSE seat was not related to the Fund, but rather was related to research on the particular individual.

DISCUSSION AND POSSIBLE VOTE ON CLAYTON, DUBILIER & RICE FUND VII, L.P.

Mr. Meyer stated that CD&R is currently in the process of raising a \$3.5 billion global buyout fund and has closed on approximately \$3 billion to date.

Speaking to a recent change in the investment environment, Mr. Meyer commented that Aldus is beginning to see the so-called megafunds, now, the most recent one at the \$12 billion level — and while the partners have a great track record, Aldus decided they didn't feel comfortable making a big bet with it: "They're really in a new space and we're not sure how you can find that many transactions that you could possibly purchase correctly."

Mr. Meyer said, "The other change in the environment, and this is why we really like CD&R, is that how you get your returns, whether it's from financial engineering or operations, goes through cycles. In the recent cycle, you saw Blackstone do it, and you saw Oak Hill do it, they used the financial market to refinance out of a lot of deals. So it had nothing to do with operations; it had to do with where the debt markets were, where the financial markets were. We're entering a place where we think banks are going to start becoming a little more hesitant about going out as far, and you're not going to be able to generate those same returns off financial engineering, so we really wanted to find a group that focused on operations, and CD&R is a group that does it. In fact, they're the guys who really invented it. They're the guys the industry looks to as an example of operational improvement in companies."

Mr. Meyer said this is Fund VII for CD&R, which has a long history of investing in this space. He said their 32 realized and public investments, representing aggregate capital investments of \$4.1 billion, have generated an IRR of 59.6% with a total value of \$8.7 billion, or 2.2x capital invested; and including CD&R's unrealized investments, which are held at the lower of cost or fair market value, the total value of the Firm's 37 investments is \$9.9 billion, or 1.9x capital invested.

Mr. Meyer said Fund V, a 1996 fund, was a disappointment with a 1.6x return of capital and a 7.3% gross IRR; but that their Pre-fund and Funds I through IV had IRRs of 57.4%, 116.8%, 84.1%, 34.4% and 31% respectively. He said Fund VI, a 1999 fund, is immature at this point because a large number of investments were made relatively recently.

Aldus's report stated that CD&R had setbacks in its investment performance, namely in Fund V and the first few deals of Fund VI – essentially the period from 1998 through 2000 where CD&R incurred seven write-offs totaling \$1.5 billion.

Mr. Meyer said, “We spent a lot of time trying to understand why this happened and whether they’ve solved those problems. One thing that’s very interesting with the team — this is an organization that’s been together for more than 25 years — is that the top three partners hold less than 25% of the carry. This is a broad team and the carry spread is impressively flat, more so than any of the other organizations we’ve looked at. But the other reason that we really liked this, and this is something we haven’t seen before, is the operating partners have more carry than the financial partners, and we always see the opposite.”

Mr. Meyer said CD&R has made moves to correct these problems by implementing a screening committee, “where instead of having the partners operate autonomously, they have a lot more interaction and they challenge each other a lot. They’ve implemented a lot of the processes that they try to implement in their portfolio companies. And within the operating committee, which is chaired by Jack Welch, and he’s very involved — and again, a very senior, a very involved operating committee and operating committee executives is another reason why we like CD&R when it comes to finding a group that we feel can implement operational change in organizations.”

Mr. Meyer also stated that, since 2001, CD&R “has done one deal after another which is the kind of deal that we’re looking for and the kind of deal that we want to be investing with, we think, in this coming environment. And furthermore, they’ve returned over \$4 billion since they’ve reworked their team and their processes.”

Mr. Davis remarked that CD&R’s returns are extraordinary, although a cynic could argue “that there are those in a bull market that are A investors and in a bear market they’re F investors.” Mr. Meyer responded that this is why Aldus is so interested in CD&R.

Mr. Meyer noted that CD&R anticipates closing its first investment prior to year-end in Hertz, a \$15 billion transaction, which is the second largest private equity transaction in history. He said CD&R worked on this transaction for three years before signing it up, and that there were other co-investors in this deal including The Carlyle Group.

Mr. Meyer stated, “The reason why we’re focusing on CD&R, the reason we brought CD&R in front of you today, is because they are the lead in the deal and Carlyle is taking a backseat. And that’s something that we’re worried about with the larger buyout funds; they’re getting into these deals where they’re partnering and they’re just co-investing in groups, and we can’t understand why we’re paying 1.5% for guys to go co-invest with each other in these groups, and we’re skeptical as to the amount of influence those groups are going to have. So one of the things I want them to address is the fact that no matter what size their

investment, these guys are going to be in control and implementing the operational change.”

Don Gogel, CEO of CD&R, stated, “What Saul’s referring to, and that goes to the core of our strategy, is someone has to add the value by controlling the operation. One of our operating partners will be an executive chairman of the company. In the case of Hertz it’s George Tamke — full partner of the firm, full carry in all of our deals, no greater interest in Hertz than anything else, but he calls the shots. Every major hiring, every pricing decision, capital expenditures, budget, all of those operating issues flow through a CD&R operating partner. That’s the control that you’re really in effect paying us for, because we think we can dramatically transform Hertz just as we have dramatically transformed a lot of businesses that we’ve purchased from major companies around the world. Even though we’re delighted to have Carlyle — and Merrill Lynch, by the way, on its own balance sheet helped us finance this deal because it is very, very large — there’s no doubt that the real value added comes from us. In this case, Carlyle and Merrill will be in effect a free rider when we succeed, but nonetheless we couldn’t do that without a larger fund, and we concluded we’d rather have a portfolio that had one or two Hertz in them where we have to grab some outside partners, and the rest of them in a target zone where we can control the whole transaction.”

Mr. Gogel spent the next few minutes making a presentation to the Committee.

Mr. Gogel stated that CD&R actually runs its businesses, and in every case one of their partners is the executive chairman of the board, and in about half of the cases steps in as the actual CEO of the business. He said this unique model has kept CD&R sustainable since its inception in 1978.

Mr. Gogel stated that CD&R was established in 1978, and just when they began raising larger funds, a number of the partners reached retirement age and two of them died, “and shame on us, but we didn’t recognize that the organic way the firm had always worked really wouldn’t work as we grew. We were a very small firm — I was the fifth partner ever hired by CD&R — and the firm worked as one whole group. We met everyday, we saw each other eight to ten hours everyday, so there really wasn’t a need for the formality of screening committees.... and we didn’t make a mistake for 22 years. As we added a couple of people, we kept that model, and that was our mistake. A number of the newer partners weren’t necessarily seasoned investors, and we gave too much responsibility in the investment process and in the operating control to some relatively new guys. They took us into deals where we lost some money. Fortunately, we recognized that in the late nineties and we stopped investing. There was a full year where we made no investments, and that was when I took control of the firm as CEO, but it took me another year until I could really

recognize what changes we had to make, and the changes you see here now are five or six years old, and they've been working.... The screening committee now says, I don't care how good you were in your previous job, you have to subject yourself to the most seasoned investors in the firm, which is Welch, myself, Joe Rice and Kevin Conway, and you've got to prove your mettle on every deal."

Mr. Gogel stated that Fund VI is now fully invested and will end up with about a 3x return; even though there were some losses in 1998-2000, the record since then is virtually unblemished.

Mr. Bland remarked, "Normally, the size of these funds bothers me a bit. I happen to like the size of this one. I think it fits the space very well."

Mr. Bland moved approval of a recommendation to commit \$50 million from the National Private Equity Program to Clayton Dubilier & Rice Fund VII, L.P., subject to negotiation of final terms and conditions and completion of appropriate paperwork.

Mr. Davis seconded the motion and it passed 4-0 by voice vote.

Mr. Gogel thanked Aldus Equity Partners, "who scrutinized my litigation record — I think they know whether or not I had a parking violation in 1967...."

[Mr. Bland excused himself from the meeting.]

REVIEW AND OVERVIEW OF NATIONAL AND NEW MEXICO PRIVATE EQUITY PROGRAMS.

Aldus — National Program

Matt O'Reilly reviewed performance in the NMSIC National Program versus Venture Economics in private equity since 1988 and noted that performance has been in the top or second quartile in every year with the exception of 1999, when performance was third quartile — overall, an outstanding record.

Mr. Meyer said it was important to note that the nature of the program significantly changed in 1998, when the NMSIC became a sizable investor in the market.

Mr. Kulka added that, up until the law was changed in 1998, the program was 100 percent venture investments.

Mr. O'Reilly stated that returns for 2004 remain negative in the National Program (-3.73%) because of the J curve. Mr. Meyer added that this was

“phenomenal, because we really haven’t even given time for a lot of our current return investing to really kick in, so we’re really, really happy with that.”

In reviewing a snapshot of the weightings, Mr. O’Reilly noted that 61% of the vintage years were in the first quartile and 33% in the second.

Mr. O’Reilly reviewed a venture capital performance chart for the National Program versus Venture Economics in all vintage years since 1988 and stated that, with the exception of 1991 and 2002, performance beat the median or was in the top quartile, which was outstanding performance. Looking at the weightings chart, he said New Mexico was in the first quartile 47% of the time and in the second 41% of the time.

Mr. O’Reilly noted that buyouts are the largest part of the overall private equity portfolio across the country in terms of putting money to work. Reviewing performance in the NMSIC National Program versus Venture Economics in the buyout sector since 1988, he noted that New Mexico ranked in the first quartile 60% of the time and in the second 30% of the time.

Reviewing 2004 Vintage Fund updates, Mr. Meyer stated that 14 deals are performing as expected and two above expectations. He noted the following: Aurora, 209% IRR; Landmark, 57% IRR; Levine Leichtman, 71% IRR through exit of Falcon; and Lehman Brothers, with 127% IRR.

Fort Washington — New Mexico Program

Mr. Birk referred to a Summary of Partnership Commitments as of 12/31/04, reflecting a portfolio IRR of –12.5% and a multiple of .83x. He said most of these investments are experiencing the so-called J-curve effect because 65% of the capital, or about \$140 million, was committed in 2003 and 2004.

Mr. Kulka commented that most of these funds are very early stage venture funds, and it is going to take a while for the winners to show themselves — six or seven years or more.

Mr. Kulka pointed out that Blue Sage, reflecting a –93.5% IRR, is an SBIC fund, where the accounting assumes that the SBIC is paid first and the rest of the LPs second; and while the number appears very negative, in actual fact this 2003 fund is actively making investments and has another two or three years to go.

In the course of discussion, Mr. Birk stated, “Now that there is a reasonable stable of funds that exists here in the geography, our role is really to increase the overall quality of the funds. When you look down the IRR column, our role, regardless of the J-curve, is to ensure that every fund that comes to New Mexico is either a top quartile performing fund or is somehow accreted to the overall

funding ladder in a strategic way, i.e., fills a very specific niche. Because now we have the luxury of actually being selective, and I'm convinced that every reasonable and worthy deal in New Mexico gets vetted and is likely to receive investment dollars. And it does nobody any good to just put more money to work — rather, it's, let's put better money to work or let's do it strategically such that we've got the full spectrum covered. And that's been our mandate, I think.”

Mr. Davis wondered how relevant Blue Sage's number was, for example, given the SBIC factor and given that they haven't invested 80% of the money yet. He also expressed concern that none of the companies on the list have had enough time to get to work and demonstrate their prowess.

Mr. Birk agreed. He commented that the negative IRRs on the list are actually to be expected for the first two or three years, but in Blue Sage's case the negative aspect is amplified because of the SBIC requirements and because they have barely invested 20% of the capital.

Mr. Jacksha asked if some standard should be set that says a return is not meaningful until some kind of hurdle is reached in terms of amount invested, age of the fund, or something of that nature.

Mr. Kulka noted that most organizations consider IRRs not meaningful on funds that are two or three years old.

Mr. Birk said Fort Washington internally has a metric that a fund is not meaningful in the first 12 months, and added that in an early stage venture fund it is simply not possible to construct deals that quickly. He stated that their rule of thumb is there has to be at least 25% of the capital put to work or that the fund is more than a two-year vintage. He pointed out that there is no FASB or other ruling on what is appropriate or not, but agreed with Mr. Davis that there is the prospect that people could be misled by these numbers because they don't understand what they represent.

Mr. Davis suggested eliminating 2003 and down, and rolling the others on at an appropriate period that shouldn't be based on result, but on a reasonable amount of time and/or money that is put to work.

Mr. Jacksha said he would personally put more weight on the amount of money invested.

Mr. Bonafair agreed. He said, “If you're going to do it, I would throw at least another standard in just for the sake of proper analysis, and to dispel the wrong impression. But what's important is that we look at how much of this money is being invested.”

Mr. Davis noted that the chart includes a clear description about how much money has been drawn down by the funds — of the \$213 million committed since 1994, \$98 million has been drawn down, and obviously that is weighted inappropriately. He said 2002 should be used as a cutoff date.

Mr. Davis asked Mr. Birk to work with staff on the reporting figures. He commented, “This program is working, and that’s not coming across here.”

In the course of continuing his report, Mr. Birk noted that the Program has had a significant impact on the New Mexico economy. He said the total annualized impact, which is purchases and payroll, is about \$87 million, with an average salary for the jobs created of over \$80,000.

Mr. Birk presented a second report on New Mexico Co-Investment Partners, L.P. (NMCIP), which was established on March 30, 2004, and initially funded with \$30 million. He said the Fund size rose to \$46 million that November when the SIC transferred in its investments in Earthstone International and TCI Medical. Mr. Birk stated that, as of June 2005, the Fund has reviewed over 90 companies for potential investment and invested in six (including TCI and Earthstone).

Mr. Birk said the Fund is 48.4% invested and 62.9% committed, and by the end of November will be 54.4% invested and 78.7% committed.

Mr. Birk gave summary progress reports on the current portfolio holdings (CoMeT Solutions, Advent Solar, Eclipse Aviation, Lumidigm, Earthstone and TCI Medical).

Mr. Birk commented, “We’re seeing very strong deal flow in New Mexico. By any metric, it’s going to be a record year not just in the quantity of money put to work but also in the number of deals and in the quality of deals.” He said outside firms like DFJ, Motorola Ventures and Intel Capital are now coming in to invest in New Mexico, which is unprecedented in the Program.

OLD BUSINESS

None.

NEW BUSINESS

Mr. Kulka stated that, based on a suggestion by Saul Meyer, staff will be presenting a policy change recommendation to this Committee at the next meeting. He said it will be similar to a provision in the film investment policy

where an investment approval expires if it does not close within a certain timeframe.

NEXT MEETING DATE: WEDNESDAY, NOVEMBER 9, 2005, IN SANTA FE AT 9:00 A.M.

ADJOURN

Its business completed, the Private Equity Investment Advisory Committee adjourned the meeting at approximately 12:00 p.m.

Accepted by:

Andrew Davis, Chairman

Respectfully submitted,

Judith S. Beatty, Committee Reporter