

Verge FUND

*The Boom in Venture Capital
in New Mexico*

AAII – New Mexico

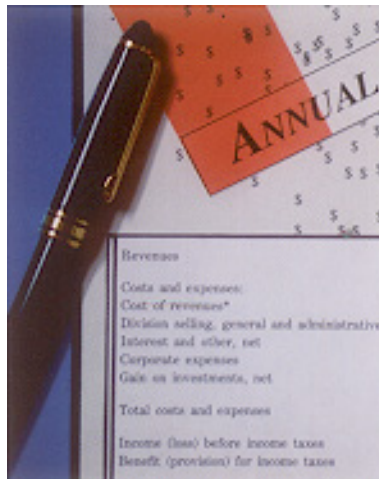
November 13, 2007

Alternative Assets

Where Venture Capital Fits

Alternative Assets

- Private Equity
- Real Estate
- Oil & Gas
- Hedge Funds



Private Equity

- Venture Capital
- “Private Equity”
- Buy-Out

Venture Capital

- Seed
- Early Stage
- Late Stage

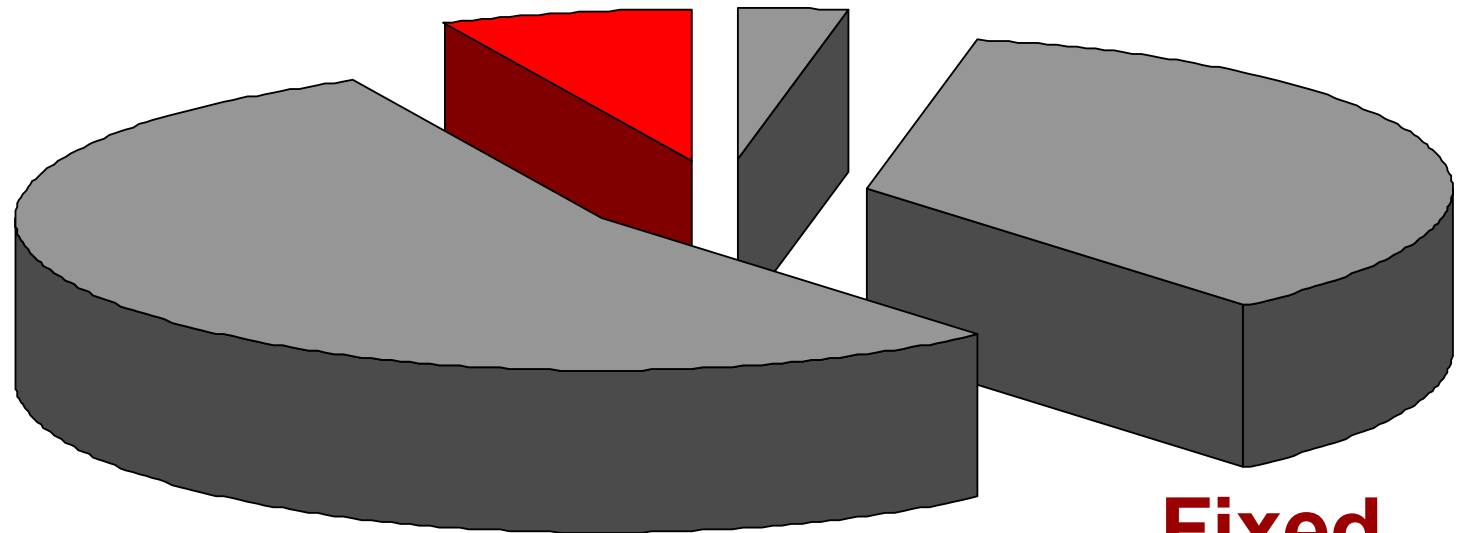
Alternatives as Part of a Diversified Strategy

Institutional Allocations

- Range: 0% - 35%
- Average: 7%

Alternative Assets

Cash



Public Equities

**Fixed
Income**

Pros & Cons of an Alternative Allocation

- **Pros**

- High Potential Return...with Diversified Portfolio
- Low Correlation to Public Market Returns
- Opportunity for Access to Proprietary Opportunities
- Potential to Strongly Target Investment Dollars



- **Cons**

- Illiquid
- High Beta for Individual Investments
- High Cost (Monitoring and Managing)
- Substantial minimums (\$50K plus)

Why VCs Are Important

A Brief History of Venture Capital

1950s

- Modern VC starts with AR&D in Boston

1960s

- Old-line East Coast money moving into new industries

1970s

- Early VCs in Northern California; Birth of Silicon Valley

1980s

- VC industry matures: some good years, some bad
- Rapid growth of the technology industry

1990s

- **Bubble Time, Baby!**

2000s

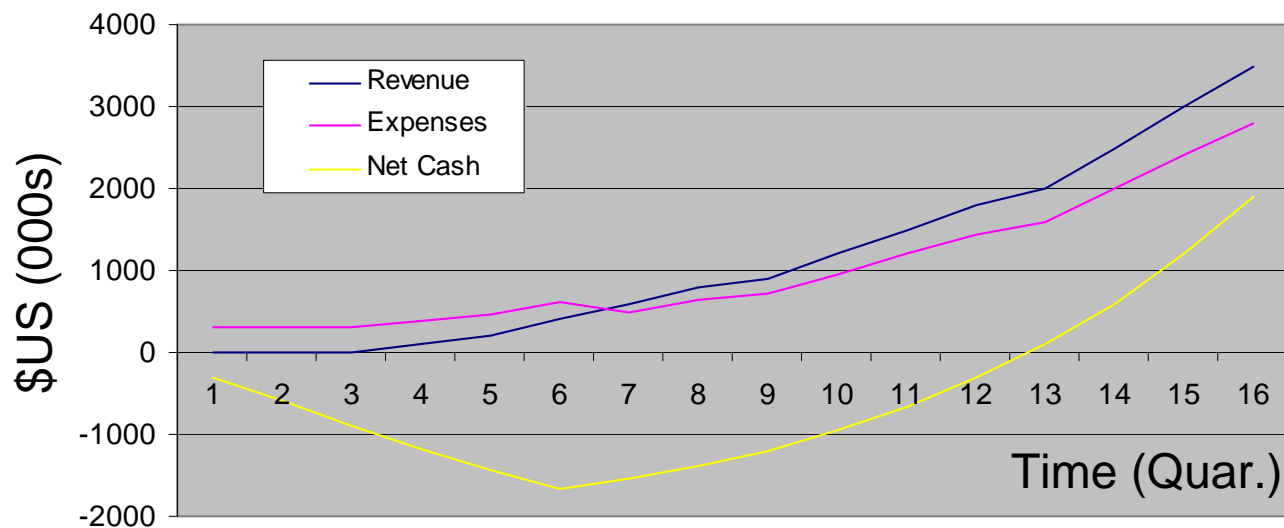
- Return to reality:
- The shakeout is coming

Why VCs Matter

- Banks have low risk tolerance

<i>Result</i>	<i>Strike Out</i>	<i>Base Hit</i>	<i>Home Run</i>
VC Return	Total Loss	Investment + ???	10 X Investment
Bank Return	Total Loss	Investment + Interest	Investment + Interest

- Technology Industries have high start-up costs
 - Non-recurring engineering costs, or product development



← **Financing Gap** →

VC Backed Companies....

- **Had 2006 Sales of \$2.3 Trillion**
 - 17.6% of U.S. G.D.P.
- **Employ Over 10.4 million people**
 - 9.1% of total U.S. private sector employment



VC Backed Names You Know...

Microsoft[®]

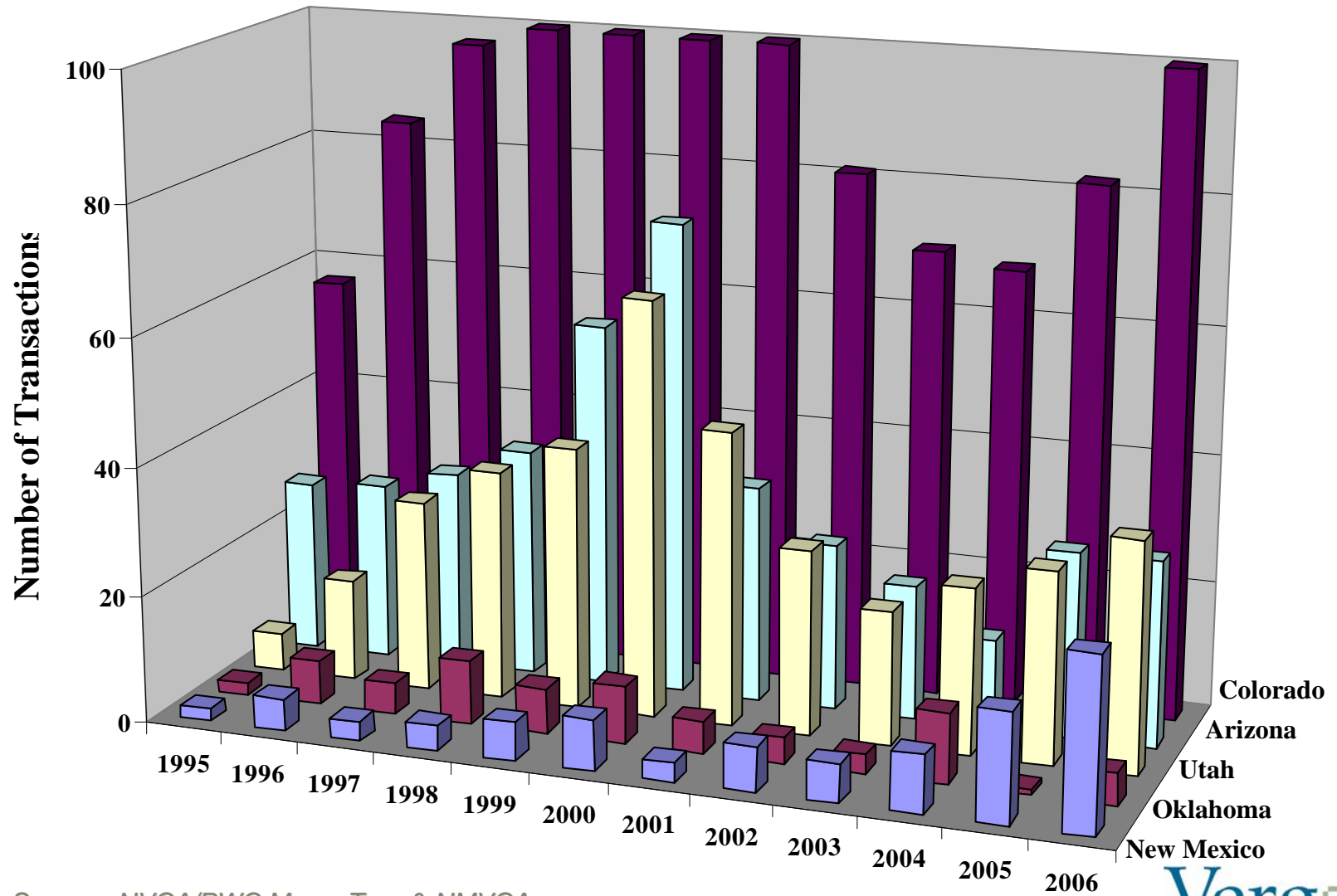
Google[™]

eBay[®]

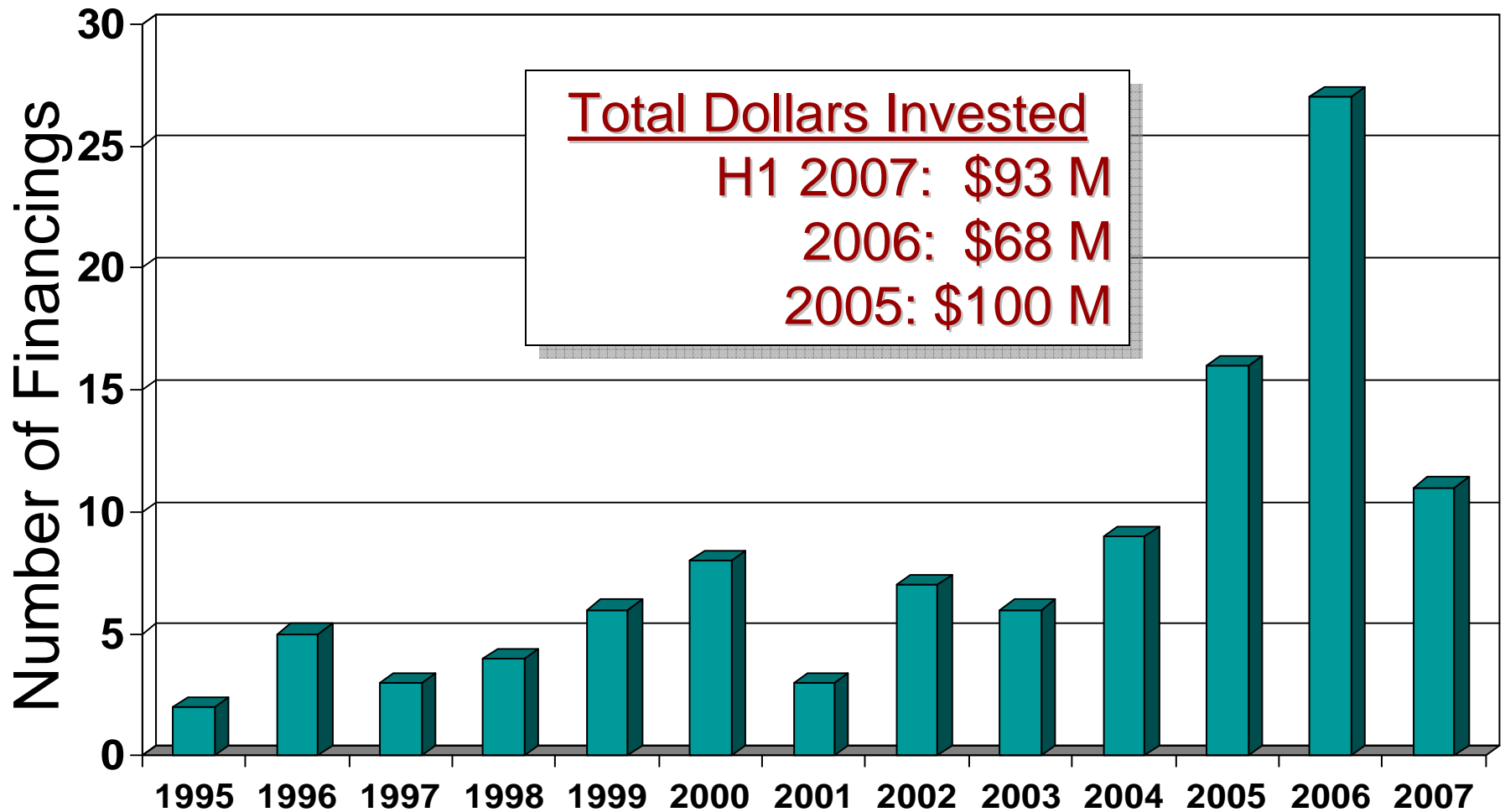


What about New Mexico?

NM & Southwest VC Investments



VC Investments in New Mexico

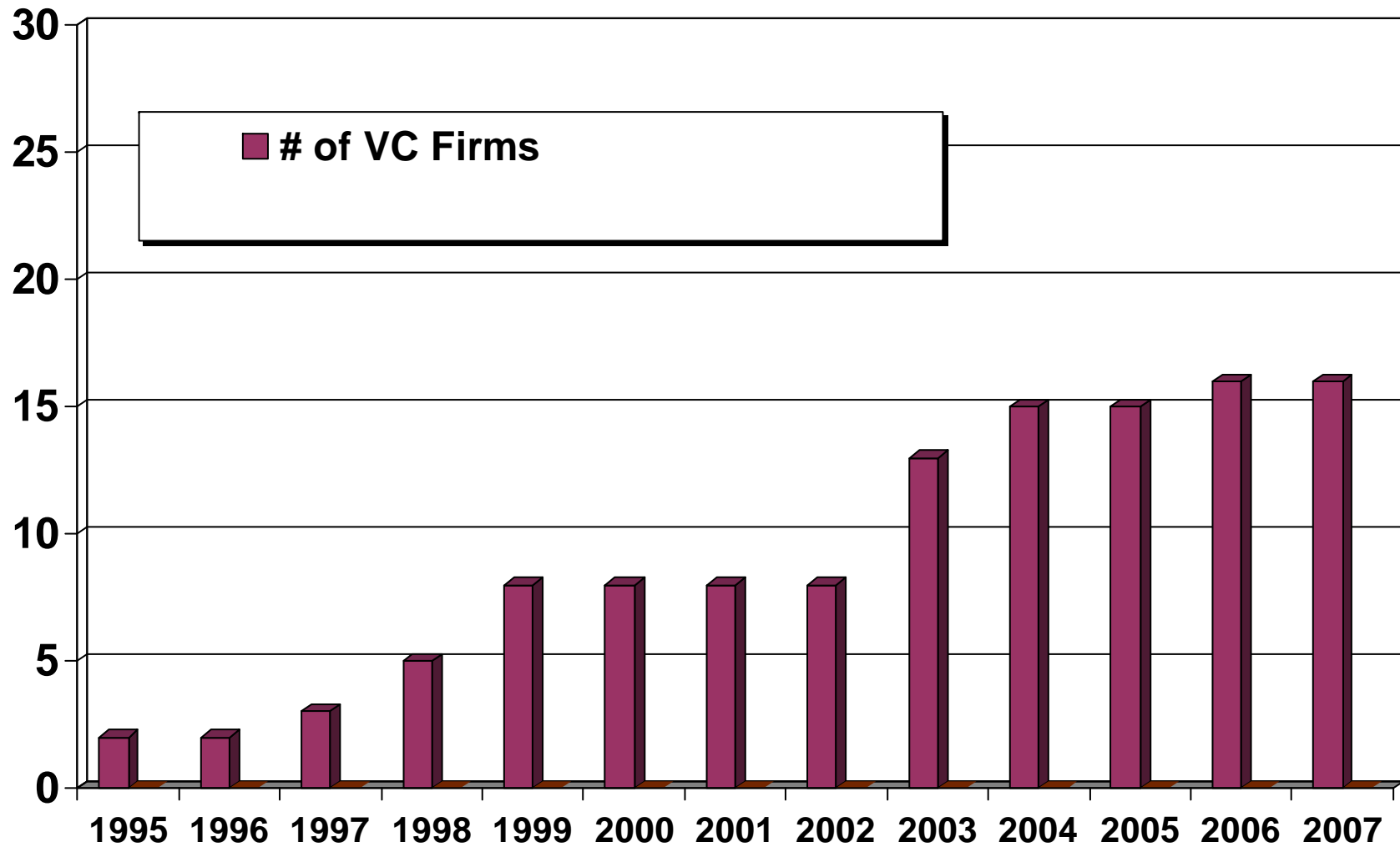


1995-2004 Numbers courtesy of NVCA/PWC MoneyTree 2005 numbers courtesy
ABQ Journal/NMBW; 2006-2007 Numbers courtesy NMVCA

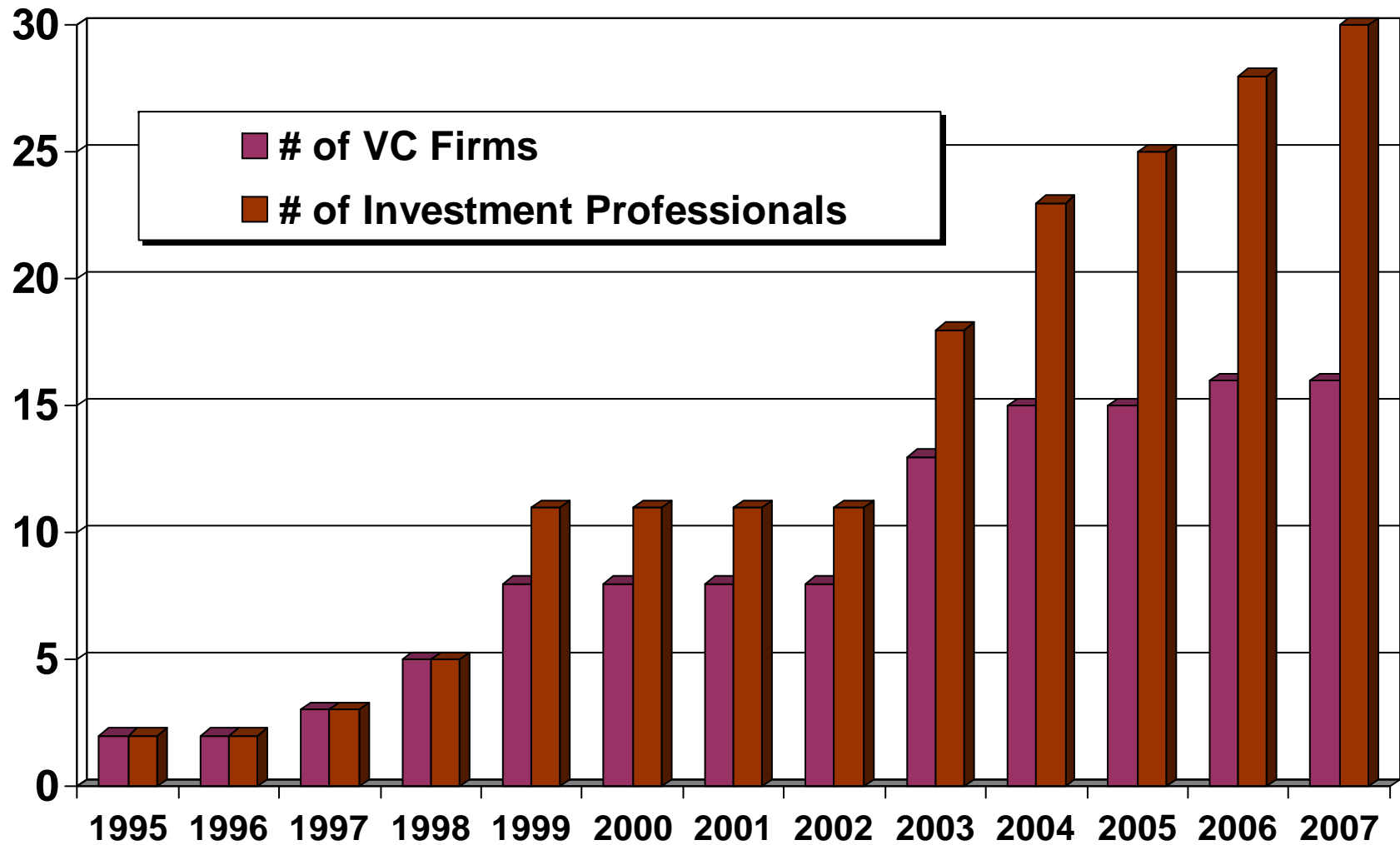
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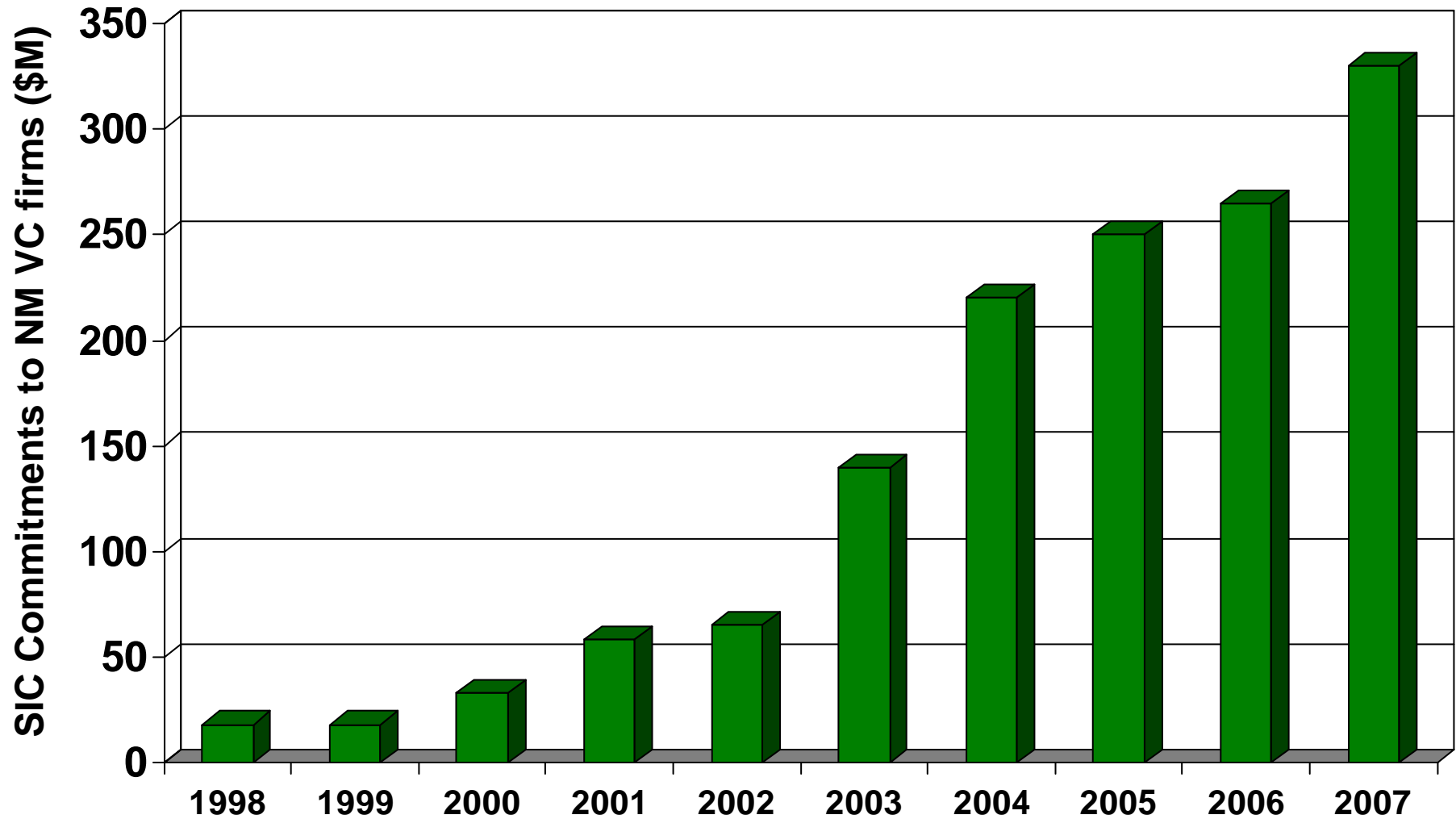
VC Firms and Professionals in NM



VC Firms and Professionals in NM



NM SIC Commitments to NM VC Firms



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Numbers courtesy of Sun Mountain Capital

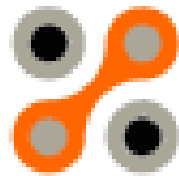
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... VC Backed Names in New Mexico

ADVENT[®]
S O L A R



ALTELA



ECLIPSE
AVIATION



boomtime



TRU TOUCH
technologies



Lumidigm[™]

[17]

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(*Success Story: MicroOptical Devices - MODE*)

- **Vertical Cavity Surface Emitting Lasers (VCSELs)**
 - Spun-out from Sandia National Laboratories
- **Formed in 1995**
 - Seed round in 1995
 - Series A round in 1996
- **Sold in 1997 to EMCORE**
 - Company operations continue and grow in Albuquerque
- **Realized IRR >60% for Series A investors**



Success Story: HealthFirst

- **Founded by UNM Grad Ron McPhee in 1992**
- **Successful Transition from Services to Products**
- **Received 1st investment round in June, 1997**
- **Sold to Polar Electro in 2000**
 - Cash on Cash Return multiple of ~8x
 - Realized IRR of 67.3%
 - HealthFirst operation continues to grow in New Mexico



Success Story: MesoFuel

- **Small scale Hydrogen generation for Fuel Cells**
 - Spun-out from another NM Start-up
- **Experienced entrepreneur was in place**
 - 3rd start-up for entrepreneur
- **Formed in January, 2002**
- **Sold in April, 2004 to Intelligent Energy**
 - Company operations continue in Albuquerque



INTELLIGENT ENERGY

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More Success Stories

- **FatCow (Acquired by Endeavor International)**
- **MesoSystems (Acquired by ICX Technologies)**
- **ProLaw Software (Acquired by Thomson West)**
- **Superior Micropowders (Acquired by Cabot)**

How to Invest in Venture Capital

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3 Ways to Participate in Venture Capital

- ***Do It Yourself: Become an Angel Investor***
 - Lowest “Cost” option
 - Most time and effort intensive
 - May require direct investment
- ***Pick a Manager: Invest in VC Fund(s)***
 - Someone else manages the money
- ***Pick a Class: Invest in Fund-of-Funds***
 - Greatest diversification
 - Highest direct cost (fees + carry)

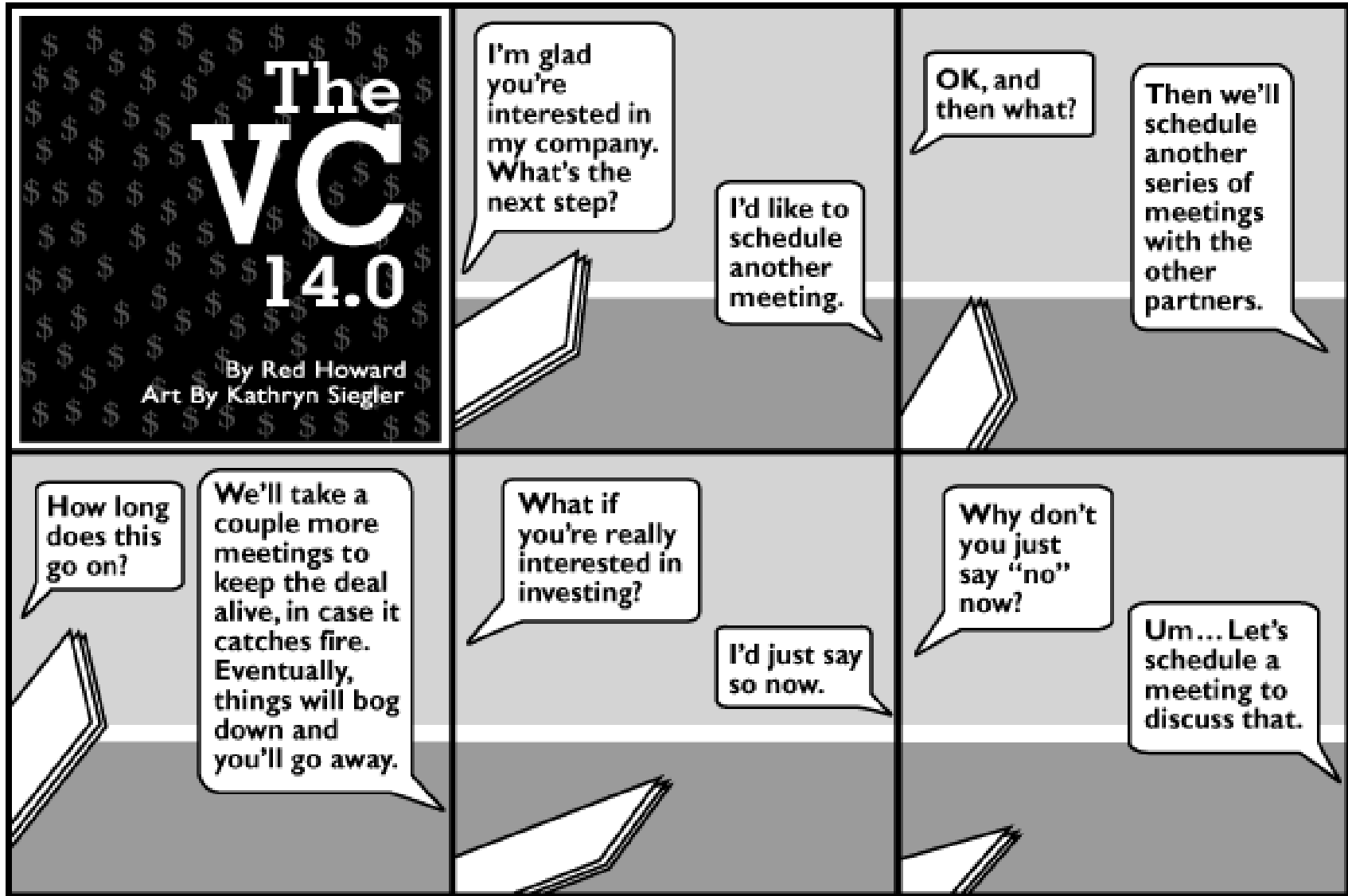
What's Best in VC Investing?

	Do It Yourself <i>(Angel Investing)</i>	Use a Manager <i>(VC Funds)</i>	Invest in a Class <i>(Fund of Funds)</i>
Control	High	Low	Low
Diversity	Low	High	Highest
Effort	High	Low	Low
Cost	Low	Medium	High

Tips for Angel Investing

- **Pick Your Strategy: Drive or Draft**
 - If You Drive: Invest only in what you know
 - If You Draft: Expect zero control
 - **Keep Spare Fuel Handy**
 - VCs reserve at least \$1 for every \$1 we invest
- **Diversify**
 - Invest in at least 5-6 companies

How Verge Makes Investments



Approach: How a “Verge Company” is Built



- **A Strong Opportunity Must Exist**

- Understandable product and target market
- A plan to dominate at least one clear market niche
- Presence of key pieces: technology, entrepreneur (novice or experienced)

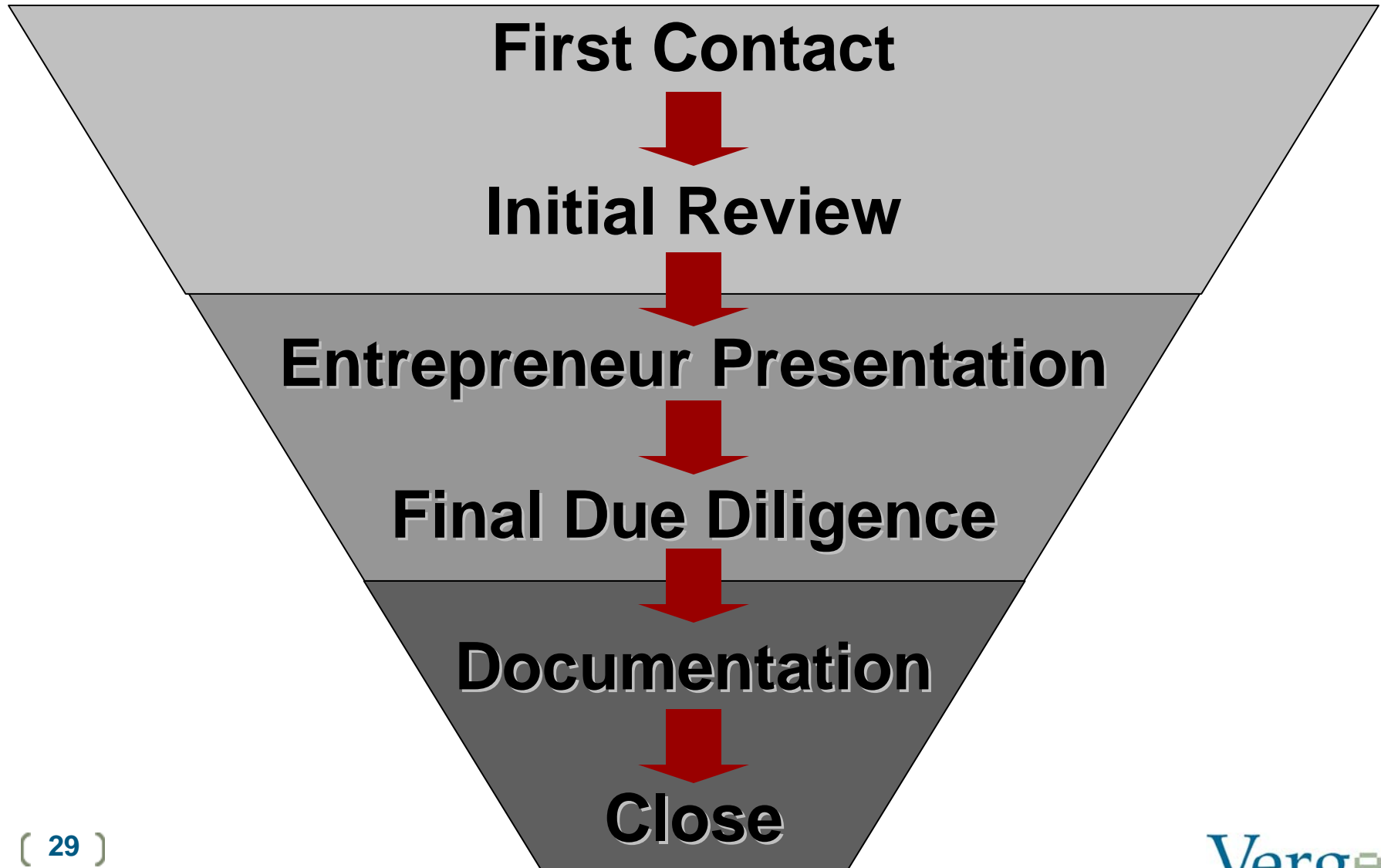
- **The Opportunity Must Have Potential to Become a Deal**

- Risks (technology, market, team) can be significantly and quickly reduced
- Profitability within a market niche can be achieved at low capital cost

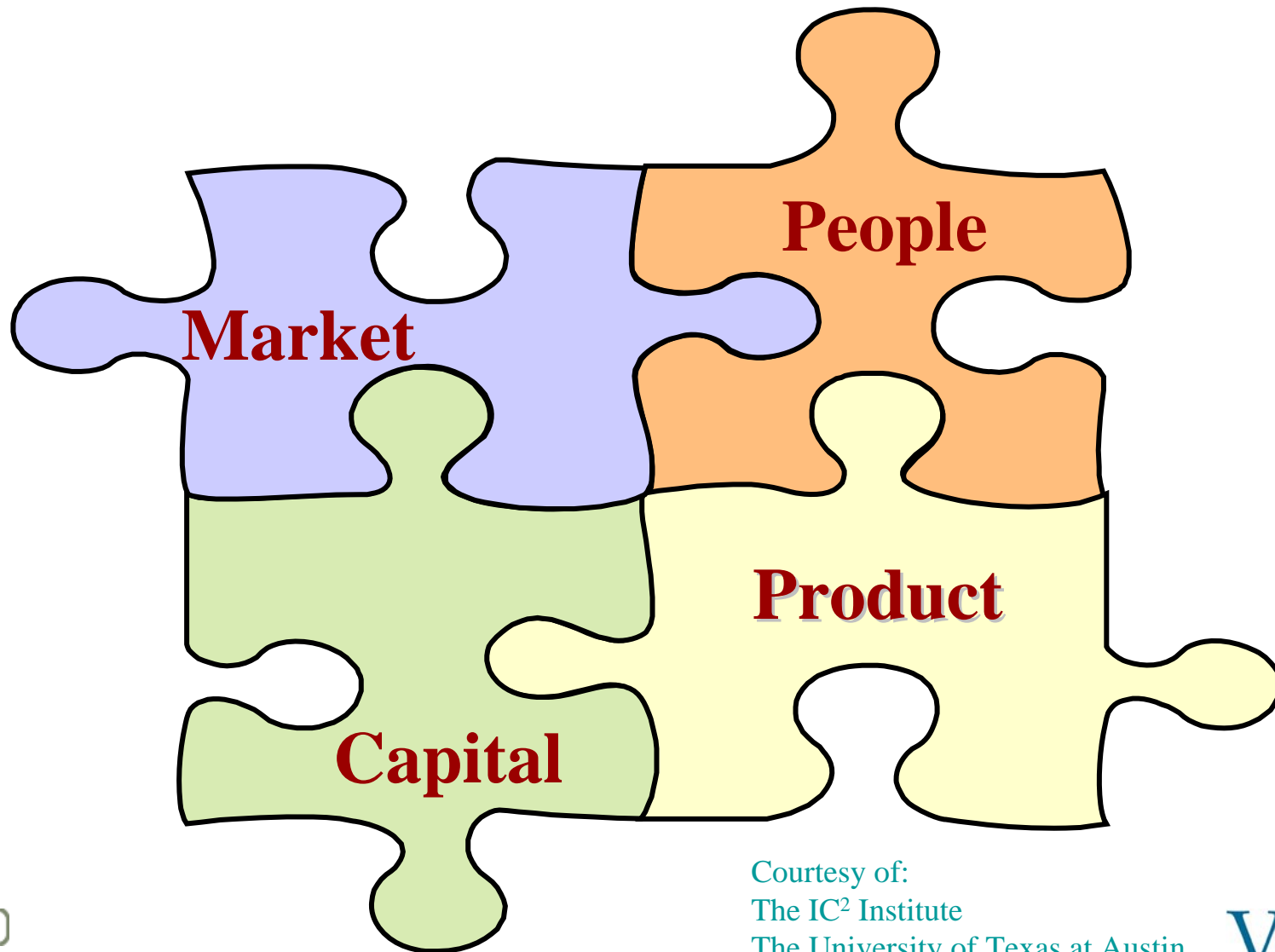
- **The Deal Needs Verge to Become a Company**

- Potential involvement of Verge Principals as part of management
- Significant Strategic & Tactical Contributions

Verge Investment Process



Elements of a Successful Growth Company



Courtesy of:
The IC² Institute
The University of Texas at Austin

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Verge: How We Evaluate Deals I

Start with Market Opportunity



- How much of a need exists today?
 - Market reports are OK, but primary research is better
 - Interview customers when possible
 - **Not just the *opportunity*, but the *pain***
- What does the competition look like?
 - Who are they?
 - How will they react to this new threat?
- What is the adoption history of new technologies?
 - Example: Healthcare devices vs. Healthcare IT

Verge: How We Evaluate Deals II

People, People, People



- Look closely at the founding team
 - Do they take advice and direction?
 - What are their post-funding salary expectations?
 - **Conduct reference checks**
- What holes remain in the team?
 - Are they relatively easy or hard to fill...in NM?
- How much time and energy can *you* spend?

Verge: How We Evaluate Deals III

Technology & Product



- How unique is the product?
 - Do IP searches (or have the company do them)
 - **Understand what the Competition WILL have**
- How much risk is there in development?
 - Software: Low; Medical Devices: High
- Are you in love with the technology?
 - Very easy to focus on the product and not the rest of the business: sales, service, administration

Verge: How We Evaluate Deals IV

Financial Statements



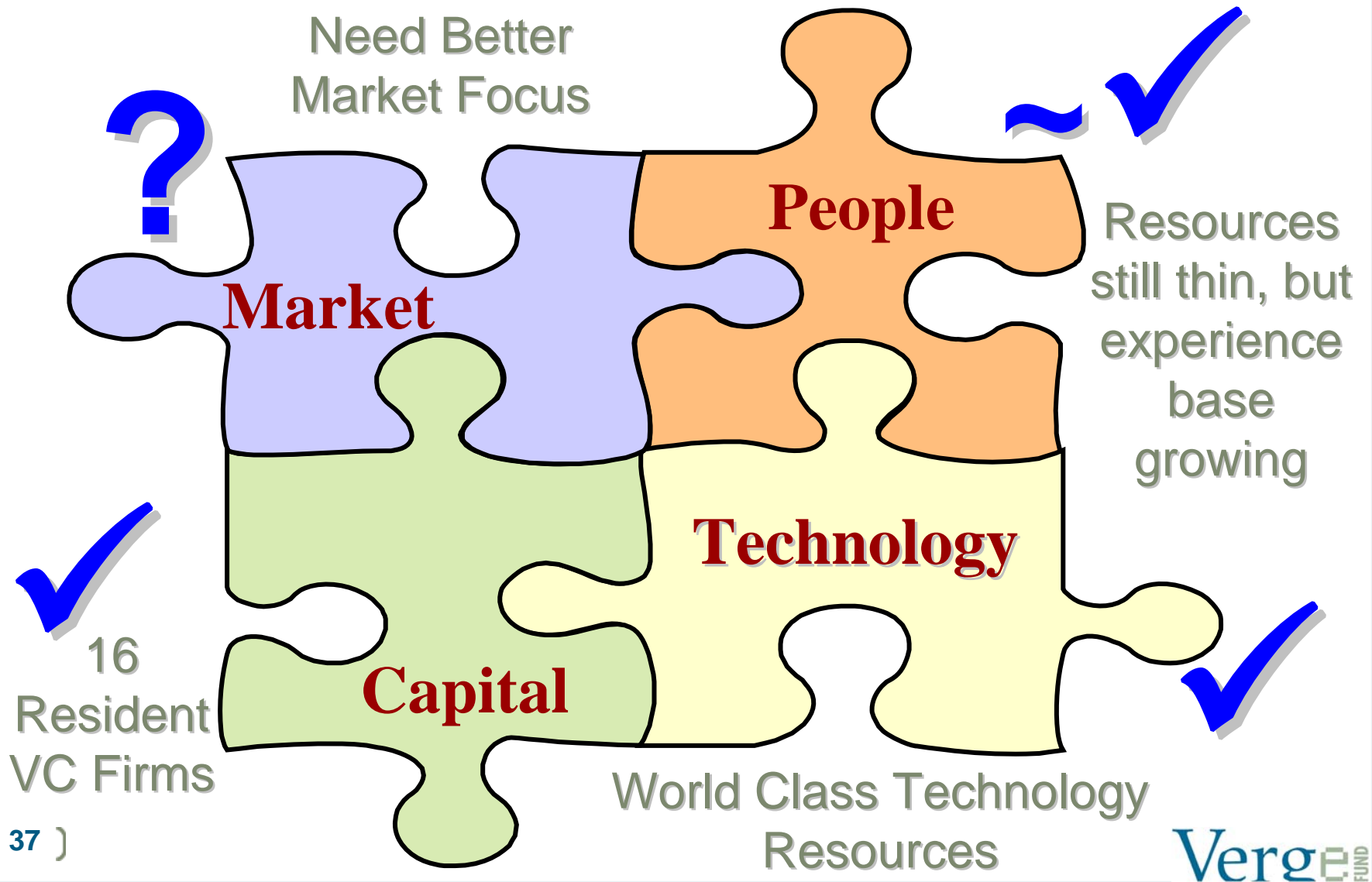
- These are the price of admission
 - The only certainty is that they will be wrong
- Review the following as a “Reality Check:”
 - Founder salaries
 - Gross Margin in out years
 - Additional capital requirements

The Critical Piece: Service after the Sale

- **When the deal closes, the real work begins**
 - 1st time entrepreneurs require LOTS of help
 - Their experience base is seldom complete
- **Plan on weekly interactions**
 - More than board meetings, these allow for near real-time discussions
- **Leverage your own network**
 - You bring two things: experience and rolodex

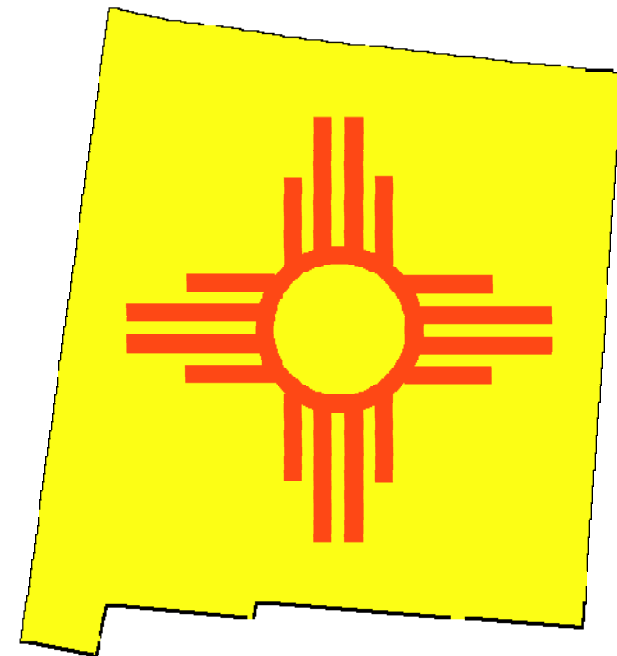
Special Considerations for Investing in NM

How Do the Pieces Fit in New Mexico?



[*New Mexico Investing : Unique Opportunities*]

- **Market: Practice World Domination**
 - Must serve national/global markets
- **People: Recruit Hard, Train Hard**
 - Employees may be hard to get, but are easy to keep
- **Product: Fundamentals Apply**
 - Build companies around IP and product, not speed
- **Financing: Capital Pool is Still Shallow**
 - BUT, it is deepest just past the seed round



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