

UCSD CONNECT NEWSLETTER
TUESDAY, OCTOBER 30, 2001
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TABLE OF CONTENTS

1. Weekly News Bulletins
 - a. CONNECT Says "Thank You" at Member Investor's Breakfast
 - b. Diving for Underwater Stock Options

2. High-Tech News
 - a. Titan and SureBeam to Provide Anthrax Protection for U.S. Postal Service
 - b. Making a Name for Itself: Quantum Magnetics' Weapons Detection System

3. Health Care Business
 - a. \$35 Million Alcohol Grant Awarded to Consortium Led by The Scripps Research Institute
 - b. San Diego and UK Researchers Find Cause of Liver Cirrhosis

4. The "Bits"
 - a. Hank Cunningham Named to City of San Diego's IEDC Board

5. Angel Angles
Q&A with Charles Mathews, President, San Diego Tech Coast Angels

6. Connections
 - a. mathews/mark's Sobriety Means Business
 - b. N-Life Opens Two New Offices in India
 - c. Procopio, Cory, Hargreaves & Savitch Make Additions to Senior Staff

7. Who's Doing What

8. Send Us Your News By Friday

9. Subscribe & Unsubscribe

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TUESDAY, OCTOBER 30, 2001

1. Weekly News Bulletins
 - a. CONNECT Says "Thank You" at Member Investor's Breakfast

By Brian Blazevic

More than 500 CONNECT members and sponsors turned out for the annual CONNECT Member Investor's Breakfast on Thursday, October 25. The event was a "thank you" from CONNECT to all members and sponsors for supporting the organization, and was the venue for distributing the first available copies of the new 2002 CONNECT Membership Directory.

The event was an opportunity for attendees to learn about CONNECT and to network with area business executives. David Backer, President of Molecular Medicine, attended "to find out which CONNECT programs would allow me to meet with other young entrepreneurs and executives. I identified two or three programs which sound very interesting." Deborah Jondall, Director of Public Relations & Communications for Barney & Barney, said, "I was very interested in hearing what Fred Cutler had to say about CONNECT and the business community it serves." She also appreciated the opportunity to network.

The highlight of the event was keynote speaker Dr. Fred Cutler, Executive Director of UCSD CONNECT. An automobile enthusiast, Dr. Cutler likened the San Diego region to a car engine, with IT, Wireless & Telecom, Life Sciences and the Military making up the individual cylinders. The military cylinder has largely been ignored since the 1980s, and that's changing, according to Cutler. Of the military sector, he said, "I firmly believe that this is the reason why San Diego is going to pull out faster, when things turn around, than any other region in the world. We're proud to be a part of that."

So where does CONNECT fit in with San Diego and this smooth running-engine? Capital is one of the ways. It's "fueling the engine," said Cutler. "We directly administer the Tech Coast Angels' operation here in San Diego, and we work very closely with the Aztec Venture Network." CONNECT works directly with the VC community and makes a point of knowing every firm in the region.

He highlighted several key CONNECT programs: CONNECT Entrepreneurs' Roundtable, which focuses on the needs of the CEO; CONNECT Entrepreneurial Development, entrepreneurial continuing education, in partnership with UCSD Extension; CONNECT HR, helping technology companies grow; CCAT, the Center for the Commercialization of Advanced Technology, a public-private collaborative partnership for speeding up the Department of Defense commercialization processes.

Springboard, led by John Busch and Dennis Leidall, helps entrepreneurs turn their business ideas into reality by helping them build and deliver their business plan, assisting with strategy, introducing them to capital sources, and providing follow-on mentoring.

Also at the Member Investor's Breakfast, the new 2002 Membership Directory was distributed. CONNECT would like to thank 2002 Directory Sponsors SAIC, SPAWAR, Agouron, Biogenesis, Enterprise Partners Venture Capital, Fleishman-Hillard, Foley & Lardner, The Gable Group, Goldman Sachs & Co., Howey Simon Arnold & White, Luce Forward, PricewaterhouseCoopers, QUALCOMM, San Diego Workforce Partnership, and UCSD Extension Marketing & Promotional Services.

CONNECT offered formal thanks to all members and sponsors for being a part of the organization. CONNECT's Platinum sponsors are: Andersen, Baker & McKenzie, Brobeck, Phleger & Harrison, Deloitte & Touche, Gray Cary, Hayes Simpson Greene, Heller Ehrman, KPMG, MARSH, and Morrison & Foerster. The Directory contains a full list of all of CONNECT's important members and sponsors.

To learn more about CONNECT, membership and sponsorship opportunities, or to get a copy of the 2002 Membership Directory, contact Rebecca Van Stelle, Membership Coordinator, at 858-534-8410 or connect3@ucsd.edu. More information about CONNECT and its award-winning programs is available at <http://www.connect.org> or by calling 858-534-6114.

b. Diving for Underwater Stock Options

By Carlos D. Heredia and Kenji Funahashi, Morrison & Foerster LLP, Corporate Finance Group

Stock options comprise an important component of the compensation packages of many new and old economy companies. Employees who recently were drawn to start-up companies now may find, however, that their stock options are “underwater,” such that the current fair market value of the capital stock underlying the vested stock options is below the exercise price of the options.

Companies concerned about the effect of underwater stock options on employee retention and morale have alternatives. A company may “reprice” underwater stock options by lowering the exercise price to the current fair market value of the underlying capital stock. A repricing may jeopardize, however, the status of outstanding incentive stock options (ISOs) if the repriced stock options do not comply with federal tax rules.

A company can also “regrant” stock options at a lower exercise price by canceling or settling for cash its outstanding underwater stock options, and granting replacement stock options after more than six months have passed from the cancellation date of the stock options. By waiting more than six months before granting replacement stock options, a company can reduce the risk that it will have to record a compensation expense for the replacement stock options.

Granting shares of capital stock to optionees in exchange for the cancellation of underwater stock options is another alternative. This grant of shares of capital stock would dilute, however, the equity interests of your company’s existing stockholders and create income that is immediately taxable to the share recipients.

There are a number of other methods that your company may consider in addressing underwater stock options, including extending the life or accelerating the vesting of underwater stock options, or offering cash or other bonuses. Any stock option repricing method will require strict compliance with federal and state securities laws, tax and accounting rules and stockholder approval issues. Your company should analyze carefully each alternative before diving for underwater stock options.

About the Authors

Carlos D. Heredia is a partner and Kenji Funahashi is an associate in the Corporate Finance Group of Morrison & Foerster LLP. Their practices involve the representation of private and publicly traded high-tech and emerging growth companies.

2. High-Tech News

a. Titan and SureBeam to Provide Anthrax Protection for U.S. Postal Service

SureBeam Corporation of San Diego announced that the U.S. Postal Service would use its electron beam systems to eliminate the threat of anthrax in the U.S. mail system. SureBeam will be the exclusive provider of electron beam and x-ray products and system integration services to The Titan Corporation, the prime contractor with the U.S. Postal Service. Titan’s newly established Office of Homeland Security awarded approximately \$26 million to SureBeam for eight systems.

Under the award, SureBeam will be working with several business units of the Titan Corporation in providing a turnkey solution to the Postal Service. SureBeam will be a primary subcontractor to Titan in the execution of the contract. The Postal Service has an option to expand the award with Titan.

b. Making a Name for Itself: Quantum Magnetics' Weapons Detection System

Quantum Magnetics was awarded the 2001 Aviation Security International Award of Excellence in the Aviation Security Technology category at the Aviation Security World 2001 conference in Atlanta. The award was based on the company's weapons detector product, i-Portal 100, which has the capability to decrease the time to scan passengers (during secondary screenings) by up to 50%. The detection system displays threats such as guns or knives as a colored dot superimposed on a digital image of each traveler. Visit <http://www.qm.com> for more information.

The i-Portal 100 is also a finalist in the CONNECT Most Innovative New Product (MIP) Awards. On November 17, the product was chosen as a finalist in the Hardware/Physical Device category. MIP honors the vision, hard work, and perseverance that transforms ideas and technologies into products. Winners will be announced on December 5. Visit <https://www.connect.org/programs/mip/finalists.htm> for additional information.

3. Health Care Business

a. \$35 Million Alcohol Grant Awarded to Consortium Led by The Scripps Research Institute

The National Institute on Alcohol Abuse and Alcoholism (one of 18 institutes that comprise the NIH) has funded a multi-year consortium headed by researchers at The Scripps Research Institute (TSRI) to identify the molecular basis of alcoholism. Despite years of independent study of alcoholism, the mechanisms are still unclear, according to George F. Koob, Ph.D., program director of the grant and professor in the Department of Neuropharmacology at TSRI. The aim of the consortium grant is to address the basic science of alcoholism and to establish a platform upon which future treatments can be built.

The grant, titled "Integrative Neuroscience Initiative on Alcoholism," aims to combine physiological, molecular, and cellular models to derive the genetic and environmental factors that form the basis for individual differences in developing excessive drinking. A large portion of the funding will be dedicated to setting up common facilities that will centralize and enhance some of the tasks common to the researchers with independently funded research projects.

A neuroinformatics group, for instance, will make use of the newly solved human genome to interpret "gene chip" screens needed to identify the genes involved. Certain gene clusters are regulated by alcohol and may be differentially regulated during the development of excessive drinking. Another group will establish animal models of alcoholism that will be used to study these genes in action.

b. San Diego and UK Researchers Find Cause of Liver Cirrhosis

Researchers have identified a protein segment and the mechanism that underlies excess fibrous tissue growth leading to conditions such as liver fibrosis and cirrhosis. In addition, they've developed a mutated version of the protein that blocks this excess scar tissue in mice. The study is published in the October 26 edition of the journal "Molecular Cell" by researchers at the UCSD

School of Medicine, the VA San Diego Healthcare System, the Salk Institute for Biological Studies, and the University of Dundee, United Kingdom.

Lead author Martina Buck, Ph.D., a UCSD and VA research scientist, found that a small piece of an important regulatory protein called C/EBP beta was responsible for fibrous tissue growth – which is excessive scar tissue – following injury or chronic illness. An appropriate amount of fibrous tissue growth is valuable, such as the formation of a scar over a skin wound. When normal healing goes awry, however, excessive build up of fibrous tissue can produce disfiguring scars externally or clog vital internal organ functions and lead to serious complications. By isolating a small section of the protein and changing one of its amino acids, Buck and her team developed a mutated protein that stopped excessive fibrous tissue growth.

Although the study focused on liver injury in mice, the findings may also apply to fibrous tissue growth in other organs, such as the kidneys, lungs and skin, said the study's senior author Mario Chojkier, M.D., UCSD professor of medicine and a liver specialist at the VA Medical Center. Further refinements might allow for the development of a peptide that could be administered orally or inhaled by people who are susceptible to cirrhosis and other diseases where excessive scarring is a problem, according to Chojkier. He added that the research team hopes to study the peptide in human clinical trials in the next year or two.

4. The "Bits"

a. Hank Cunningham Named to City of San Diego's IEDC Board

Hank Cunningham, CEC.D, director of the City of San Diego's Community and Economic Development Department and assistant executive director of the City's Redevelopment Agency, has been appointed to the board of directors of the International Economic Development Council (IEDC). During his 25-year career in the field, Cunningham has worked for a national consulting firm specializing in strategic planning and cost/revenue analysis, as well as three major southern California municipalities where he directed large-scale economic development programs.

5. Angel Angels

The San Diego Tech Coast Angels welcome questions from CONNECT Newsletter readers. E-mail your questions to connect5@ucsd.edu with the subject "Question for the SD TCA."

Q&A with Charles Mathews, President, San Diego Tech Coast Angels

How does SD TCA establish the pre-money valuation at which it invests?

Pre-money valuations are always established by negotiation among the entrepreneur and the funding sources for an investment round. Setting them is an art, not a science, and is largely based on a combination of perceived risk-reward and what the market will bear. The more funding sources the entrepreneur has, the higher the valuation, and the more desperate the cash needs of the company or the greater the slippage from previous projections, the lower the valuation. So, in today's world of fewer participating funding sources and more desperate cash needs, pre-money valuations are down, way down, for new and follow-on investments.

It is not uncommon for investment opportunities to be marked down in degree of interest by an unrealistic demand in a funding application (see Bill Carpenter's article on Screening in the August 21, 2001 issue of the Newsletter).

What is realistic? While there are no absolutes, entrepreneurs should be aware of three approaches commonly used by angel investors (always on a fully-diluted basis and allowing an adequate option pool). First: a money-ownership ratio objective, where the investor expects a certain percentage of ownership for the money subscribed (typically 20-35% in early-stage investments). Second: a fixed valuation objective, which for early stage deals is typically \$1 million for an idea and an outline business plan, \$2 million for a workable business plan and an acceptable management team, \$3 million for the preceding and proof of principal, \$4 million for the preceding and demonstrable market traction, \$5 million for the preceding and break-even revenue so the funding is for expansion. Third: a valuation that, allowing for the anticipated dilution of subsequent rounds, and at a supportable exit valuation, should provide the rate of return the investor requires to offset the perceived risk (see Charles Mathews' article on Q&A in the September 25, 2001 issue of the Newsletter).

How does SD TCA provide 'value-added' other than invested dollars?

Many SD TCA members are active angel investors. They want to be involved in the development of the company and in offering the entrepreneur their experience. Most management entrepreneurs will be involved in one or two start-ups in their working life, while many experienced angel investors will have been involved in 10 to 20, or more. As a result, they have a depth and breadth of experience, and have often "been there, done that," many times before.

Many SD TCA members make vital contributions as a member of the board of directors or an advisory board of the company. In addition to offering guidance and mentoring based on their experience, active angel investors can often make invaluable contributions by, for example, introducing their contacts to the entrepreneur, causing the entrepreneur to reassess assumptions or courses of action, and helping the entrepreneur continually review the appropriateness of his or her own contribution – and possibly come to the realization that their skills no longer match the needs of the changing company.

For the motivation of many angel investors, see Dave Flowers' article on Mentoring in the September 18, 2001 issue of the Newsletter.

Editor's note: More information about the SD TCA is available at <http://www.techcoastangels.com>, and all referenced Newsletters can be found at <http://www.connect.org/newsletter/archive.cfm>.

6. Connections

a. mathews/mark's Sobrian Means Business

Camille Sobrian, vice president of marketing at mathews/mark, recently won a San Diego Business Journal "Women Who Mean Business" award. The annual awards recognize women for outstanding achievement in their fields. Sobrian was one of about 40 women honored, and the only one in the advertising industry. She has been successful in raising the agency's profile both locally and nationally.

b. N-Life Opens Two New Offices in India

N-Life, Inc. has opened two new offices in India to take advantage of ambient vision research and its affects on augmented vision. One is in the high Himalayas, and the other in New Delhi. Researchers have experienced unbounded circumspatial sight when they entered an episode of internal absorption. N-Life seeks to take advantage of the way internal absorption extends its visual awareness into a circumspatial field. The company hopes the research will lead to the development and marketing of products for the next generation of astronauts.

c. Procopio, Cory, Hargreaves & Savitch Make Additions to Senior Staff

San Diego law firm Procopio, Cory, Hargreaves & Savitch LLP announced that Troy Schmelzer and Michael Changaris have joined as partners, and Stephen LaSala has joined as an associate. Schmelzer will support IP and high-tech, and was formerly with Lyon & Lyon; Changaris will be a member of the tax and business and technology teams, and was formerly with Sheppard, Mullin, Richter & Hampton; and LaSala will be on the business and technology team, and was formerly with Cooley Godward.

7. Who's Doing What

AT CONNECT

**** "CONNECT Most Innovative New Product (MIP) Awards Luncheon." Finalists were announced October 17 in the annual competition that honors the vision, hard work, and perseverance that transform ideas and technologies into products. Winners will be announced at the MIP Awards Luncheon on Wednesday, December 5, from 10:00 a.m. – 2:00 p.m. at the Sheraton Harbor Island, and receive a letter of commendation from Governor Gray Davis. Between 700-1000 people are expected to attend one of the most prestigious business events in San Diego. Register & Info: <https://www.connect.org/programs/mip>.

At UCSD

**** "The Five Faces of Genius" is an interactive presentation hosted by UCSD Athena. Attendees will identify their creative profiles and be shown how to master all five genius skills and develop a portfolio of creative thinking skills. Annette Moser-Wellman, author of "The Five Faces of Genius," will explain the principles upon which the book is based. Tuesday, October 30, 7:15 to 9:00 a.m.; Radisson Hotel, 3299 Holiday Court, La Jolla; Cost: \$40/Athena members, \$50/non-members, \$60 at the door. RSVP & Info: 858-822-4988.

**** "Leading An Innovative Business" is presented by the UC Extension Leadership and Management Institute for Technology Professionals. Five prominent San Diego executives will cover diverse views on how to lead innovative businesses – Johan Brundell of Ericsson Business Innovation, John Dobak of INNERCOL, David Grooms of ShellCase, Stacy Lindsey of Triton Network Systems, and moderator Craig Wright of PDG Hightower. November 12, 6:00 to 9:00 p.m.; La Jolla Radisson Hotel; Cost: \$45 EPSE/LAMP Alumni, \$65/public; Register & Info: use section #033598, 858-882-8000, 858-882-8030 or esparker@ucsd.edu.

**** UCSD Extension offers courses and certificate programs in the biotech, clinical research/clinical trial, engineering and high-tech areas. The list below is only a small sample of available courses. Visit the listed Web sites for complete information.

UCSD Extension Upcoming Biotech Courses:

- Microarray Technologies for High-Throughput Gene Expression Analysis: Nov. 6
 - From Gene to Biological Function: An Overview: Nov. 8 & 15
 - Regulatory Compliance for Biologics and Drugs: Nov. 14-16
- Info: <http://bioscience.ucsd.edu>, 858-451-7696 or ehickman@ucsd.edu. Enroll: 858-534-3400.

UCSD Extension Upcoming Clinical Research/Clinical Trial Courses:

- Site and Investigator Recruitment: Nov. 3
 - Pharmaco-Economics and Effectiveness Trials: Nov. 10 & 17
- Info: <http://www.extension.ucsd.edu/healthcare> or dmstern@home.com. Enroll: 858-534-3400.

**** "UCSD Neurosciences Graduate Seminar Series 2001-2002" upcoming schedule:

- The role of attention in sensory processing in monkey visual cortex: Oct. 30
- Signal transduction pathways that regulate nervous system development: Nov. 6
- The evolution of feeding behavior in nematodes: Nov. 20
- Computations in the owl's auditory system: Nov. 27

Info & Locations: 858-534-7875. Open to general public.

AROUND TOWN

**** "State of the Telecom Industry" is presented by the San Diego Telecom Council. Goldman Sachs will present research uncovered by in-house analysts. A panel of experts will discuss their perspectives of what these things mean, and their outlook going forward. Panelists include Mike Goguen, General Partner, Sequoia Capital; George Abe, Partner, Palomar Ventures; and David Nagel, President & CEO, Palm, Inc. Thursday, November 1, 5:00 p.m.; Hilton Torrey Pines, La Jolla; Cost: \$45 at the door; Register & Info: <http://www.sdtelecom.org/events/index.cfm>.

**** "Comfort Zone – A scientifically advanced product for personal pain management" is presented by UCR CONNECT. Donald K. Dougherty, President & CEO of BotanaMedica will discuss his company and its pain management technology and product. Friday, November 2, 11:30 a.m. to 1:00 p.m.; Temecula City Council Chambers, 43200 Business Park Drive, Temecula; Cost: \$8.00/members, \$10.00/non-members (cash or check only). Register & Info: 909-699-3560 or esternagle@ucx.ucr.edu.

**** "Making the Most of Trade Shows" is presented by the San Diego High Tech Marketing Alliance (SDHTMA). The event features Beth Walsh of McQuarter Group and Mark Fisher of Concepts Worldwide. Wednesday, November 7, 11:30 a.m. to 1:30 p.m.; La Jolla Radisson Hotel; Cost and general info: 760-630-2089 or prarus@home.com.

**** "Entrepreneur Exchange: San Diego" is presented by the Foundation for Enterprise Development and Ernst & Young. The focus of this interactive program will be "Managing Growth During Turbulent Times." Features Entrepreneur of the Year Award recipients from San Diego who have worked through challenging times and grown their organizations – David Rickey of AMCC, Lisa Richards of Hospitality, and Peter Farrell of ResMed. Thursday, November 8, 5:00 to 7:15 p.m.; Hilton La Jolla Torrey Pines; Register & Info: <http://www.fed.org/events/ee.htm>; Cost: \$45.

**** "Globalization" is presented by the San Diego World Trade Center. Martin Coles, Senior Vice President, Gateway International, will discuss the computer industry and how it relates to international trade. Thursday, November 8, 7:30 to 9:00 a.m.; University Club; Cost:

\$30/members, \$45/non-members; Register & Info: 619-615-0868 x109, achat@sdwtc.org or <http://www.sdwtc.org/event>.

**** "IT Engineering and Investment Opportunities in Poland" is hosted by the San Diego World Trade Center and presented by the Polish Agency For Foreign Investment (PAIZ) in cooperation with Consulate General of the Republic of Poland. Learn about high-tech opportunities with Poland at the first High-Tech Investment and Trade Mission from Poland visiting the U.S.A. Friday, November 9, 7:30 a.m. to 3:00 p.m.; University of San Diego, Manchester Executive Conference Center, 5998 Alcalá Park; Cost: Free, RSVP required; RSVP: 619-615-0868 x109 or achat@sdwtc.org. Info: <http://www.sdwtc.org/event> and <http://www.pan.net/tradeconsul>.

**** "Current Trends in Manufacturing Facilities Requirements from the FDA Perspective" is presented by BIOCOSAN/san diego. Gain insight into what the FDA is looking for on facility audits including common mistakes, timelines for the approval process, approval elements for both biologics and medical device companies and how R&D can assist in the approval process. Panelists include Brenda Holman of the FDA, Brent Jacobs of Burnham Real Estate Services and Ken Baldwin of McGraw/Baldwin Architects. Thursday, November 15, 7:30 to 9:00 a.m.; Marriott La Jolla, 4240 La Jolla Village Drive; Cost: \$35 BIOCOSAN/san diego members, \$55 Non-members; Register & Info: <http://www.biocom.org>.

For a comprehensive listing of current events in the technology industry, visit the Southern California Technology Calendar at <http://www.socaltechcalendar.com>.

8. Send Us Your News By Friday

Editor: Brian Blazevic
Editor-At-Large: T George Harris

The CONNECT Newsletter is published weekly on Tuesdays by UCSD CONNECT. The deadline for submissions is 5:00 p.m. on Friday prior to Tuesday publication. CONNECT welcomes company information and program announcements; however, all information is printed at the discretion of UCSD CONNECT and only on a space available basis. The Newsletter does not print company earnings reports or job listings. Event announcements must include date, time, sponsoring organization, a brief description and a contact phone number.

SEND COMPANY NEWS AND ANNOUNCEMENTS to connect5@ucsd.edu.

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REPORT YOUR SUBSCRIPTION PROBLEMS to connectnews@ucsd.edu.

END
