

June 27, 2018

Attn: Barbara Brown

For Reporting Purposes To:

Senator Ronald Caldwell
Chair Senate Committee on Agriculture, Forestry and Economic Development

Rep. Dan M. Douglas
Chair House Committee on Agriculture, Forestry and Economic Development

Room 315, State Capitol
Little Rock, AR 72201

Senator Caldwell and Representative Douglas:

Attached for disbursement as required by A.C.A. §15-5-1408 is the Arkansas Institutional Fund ("AIF") Annual Report for year 2017. Please feel free to contact me directly at 682-5905 if you have any questions or would like to learn more about any of our investment programs or ADFA.

Sincerely,



Brad Henry
Vice President, Development Finance

Arkansas Institutional Fund

Annual Report

January 1, 2017, Through December 31, 2017

Table of Contents

Cover Letter.....	3
Executive Summary.....	4
Operating Principles	5
Investment Objectives	5
Funding Mechanism	5
2017 Activities Audit.....	6
Investment Plan Implementation	6
Organization	7
Professionals and Advisors.....	7

Cover Letter

To: Governor Asa Hutchinson
House Committee on Agriculture, Forestry and Economic Development
Senate Committee on Agriculture, Forestry and Economic Development
Arkansas Development Finance Authority

From: Arkansas Institutional Fund, LLC

Date: June 30, 2018

Re: Annual Report per A.C.A. §15-5-1408 of the Venture Capital Act of 2001

We are pleased to provide this annual report on the activities of the Arkansas Institutional Fund (the "AIF") which serves as the designated investor group chosen by the Arkansas Development Finance Authority (the "ADFA") to implement the provisions of the Venture Capital Act of 2001.

There has been no use of funds from the ADFA Bond Guaranty Fund. Further, there has been no redemption or transfer of tax credits allowed under subchapter §§15-5-1401 other than the original transfer by the State Board of Finance to the ADFA (see Organization page 6).

On March 31, 2017, AIF entered into a loan agreement with ADFA. The proceeds from this loan were used to repay AIF's outstanding loan to Bank of the Ozarks. The current outstanding balance owed to ADFA is approximately \$18 million. The loan is current and compliant with all covenants of the loan agreements.

The Arkansas Venture Capital Investment Trust compiled the statistical information and data supporting this report. The ADFA Board of Directors appointed the Arkansas Venture Capital Investment Trust as the Replacement Fund Manager effective January 1, 2016. ADFA is in the process of finalizing a contract with the Replacement Fund Manager to provide administrative services. The Arkansas Venture Capital Investment Trust, in its capacity as Replacement Fund Manager, is responsible for submitting this annual report.

Executive Summary

The mission of the AIF is to increase the availability of equity and near-equity capital for emerging, expanding, relocating and restructuring enterprises in the state. Such investments will help strengthen the state's economic base and create jobs. The method by which AIF addresses this task is to encourage and support the growth of a local capital industry capable of financing companies throughout the risk spectrum, from early stage start-ups to later stage expansions.

AIF is structured as a "fund of funds" venture capital investment program and is capitalized utilizing a guaranty backed first by a \$10 million pledge from ADFA's Bond Guaranty Program and second by \$60 million in Arkansas state income tax credits. The AIF invested in proven, professionally managed private equity, seed and venture capital funds that commit to include Arkansas in active, aggressive, visible deal prospecting.

AIF makes commitments to private equity and venture capital funds over a period of time based on agreed upon staging and performance requirements. AIF committed to two rounds of investment. The first round, launched in 2003, is comprised of 10 commitments, \$33.2 million in aggregate plus one conditional commitment of \$1.0 million for a total of \$34.2 million. Commitments have generally ranged from \$2.0 - \$5.0 million in size and have been subject to ADFA approval. The second round was launched in 2014 and has made one investment commitment totaling \$4 million. The original plan was to commit approximately \$30 million to eight to ten private equity, seed and venture capital funds. However, the termination of Cimarron Capital Associates, I LLC mandates that the AIF shall make no new investment commitments. AIF will honor existing investment commitments. At fiscal yearend 2016, AIF has issued or closed on 11 commitments totaling \$37.2 million.

This fiscal year continued the trend of returns with an additional \$947,020 in distributions to AIF from its investee funds. Distributions were used to pay down the financing line balance. The first round of investments has recorded two partial unrealized write-downs in the portfolio.

The primary objectives of AIF during 2018 were to enhance relationships with the AIF portfolio funds and manage the existing portfolio.

Operating Principles

Effective January 1, 2016, the AVCIT became the replacement fund manager. The change in fund manager necessitated a review of the existing operating principles.

The following are principles pursued by AIF:

- Risk capital is necessary to generate and support the growth of entrepreneurial firms, which in turn create jobs and provide economic growth.
- A responsive state program can demonstrate to potential investors the high level of commitment Arkansas has for entrepreneurial ventures. The program shall be managed in a way that limits operating costs and maximizes investment in Arkansas companies.
- The pursuit of a market rate of return provides the best discipline for using limited resources to generate the greatest economic impact.
- The risks of making venture capital investments in Arkansas can best be managed by diversification through a number of investments in separate venture capital funds with proven track records.
- The risks of making venture capital investments in Arkansas require stringent review of the portfolio in order to protect the underlying collateral.

Investment Objectives

Effective January 1, 2016, the AVCIT became replacement fund manager. The change in fund manager mandates that no new investment commitments shall be made by the AIF. The replacement fund manager is required to honor all existing investment commitments. Thus, the new investment objectives are to manage the existing portfolio in a manner that maximizes investment activity in Arkansas, while also taking all necessary steps to protect the underlying collateral.

Funding Mechanism

AIF is capitalized through the use of an ADFA guaranty backed first by \$10 million from its Bond Guaranty Reserve Account and second by an Arkansas income tax credit allocation of \$60 million on a contingent basis. The most recent review by the Standard and Poor's rating agency of the ADFA Bond Guaranty Program indicated that the \$10 million first loss pledge has not negatively affected the current "A+" rating of the program. The financing facility is rebid on a periodic basis. Bank of the Ozarks is the most recent successful bidder and held the loan during 2016. On March 31, 2017, AIF entered into a loan agreement with ADFA. The proceeds from this loan were used to repay AIF's outstanding loan to Bank of the Ozarks. The current

outstanding balance owed to ADFA is approximately \$18 million. The loan is current and compliant with all covenants of the loan agreements.

If the tax credits are ever needed by the ADFA to meet a call on a guaranty after the use of the Bond Guaranty Reserve Account, the credits may be utilized by the lender or sold to raise cash to meet the further guaranty obligations. AIF has established tax credit purchase contracts at par with six major Arkansas income tax payers for that purpose, or may competitively market tax credits to the statewide pool of all income tax payers. Distributions from AIF portfolio funds are used to pay down the line balance. This fiscal year showed an additional \$947,020 in distributions to AIF from its investee funds.

2017 Activities Audit

- On March 31, 2017, AIF entered into a loan agreement with ADFA. The proceeds from this loan were used to repay AIF's outstanding loan to Bank of the Ozarks. The current outstanding balance owed to ADFA is approximately \$18 million. The loan is current and meets all current needs to cover existing commitments. AIF will continually evaluate, and implement as warranted, potential improvements in funding structure efficiencies particularly given the changing economic factors.
- AIF reviewed all quarterly and annual portfolio reports, attended all annual meetings of the investment portfolio and routinely discusses potential investment opportunities with the investment portfolio.

Investment Plan Implementation

During 2015 AIF closed on a \$4.0 million commitment to Technology Operators Fund II, a \$57 million risk capital fund, the first in investment round two.

Prior years' closed commitments include: a \$100 thousand commitment to Fund for Arkansas' Future II; a \$5 million commitment to Noro-Mosely Partners VII; a \$4.0 million commitment to Fulcrum II Growth Fund; a \$4.0 million commitment to Memphis BioMed Ventures II; a \$2.0 million commitment to Meritus Ventures; a \$5.0 million to Noro-Moseley Partners VI; a \$4.5 million to Petra Growth Fund II; a \$4.5 million commitment to Prolog Ventures II; a \$100,000 commitment to the Fund for Arkansas' Future; and, a \$4 million commitment to SSM Venture Partners III.

Effective January 1, 2016, the AVCIT became replacement fund manager. The change in fund manager mandates that no new investment commitments shall be made by the AIF. The replacement fund manager is required to honor all existing investment commitments.

Organization

ADFA was given the authority to implement a Venture Capital Investment Program during the Eighty Third General Assembly.

ADFA utilized a national RFP process to employ the program's Designated Investor Group (DIG). The Arkansas Legislative Counsel approved this professional services contract. The fund management portion of the contract was rebid in March of 2009 and Cimarron Capital Associates I, LLC, a successor to the original successful bidder, was selected as AIF fund manager. Based on past and current performance, the contract was reviewed and extended in December of 2013 and revised in January of 2015.

AIF is structured as an Arkansas limited liability company with two members, Cimarron and the Arkansas Venture Capital Investment Trust (an Arkansas public trust). In 2003 Governor Mike Huckabee authorized the establishment of the Trust to hold ADFA's equity interest in the AIF. The President of ADFA, the President of the Arkansas Science and Technology Authority and the Director of the Department of Finance and Administration serve as trustees for this public trust.

The ADFA Asset Commitment Committee, a committee of the ADFA Board of Directors provides oversight to the AIF program. The ADFA Board of Directors and the Department of Finance and Administration developed and put into place the permanent rules regarding the program. In 2003 the State Board of Finance approved the issuance of \$60 million in Arkansas state income tax credits, which have been transferred to the ADFA. A listing of the ADFA board members can be found at www.arkansas.gov/adfa/board.

The Arkansas Venture Capital Investment Trust compiled the statistical information and data supporting this report. The ADFA Board of Directors appointed the Arkansas Venture Capital Investment Trust as the Replacement Fund Manager effective January 1, 2016. ADFA is in the process of finalizing a contract with the Replacement Fund Manager to provide administrative services. The Arkansas Venture Capital Investment Trust, in its capacity as Replacement Fund Manager, is responsible for submitting this annual report.

Professionals and Advisors

The managing directors of Cimarron Capital Associates I, LLC are Michael A. Tharp, CFA and Robert G. Heard.

Gary L. Betow of the firm Conner & Winters provides general counsel legal services to AIF. Robert Smith of the firm Friday, Eldredge and Clark provides AIF with Arkansas tax and corporate counsel legal services. Robin Painter and Arnold May, both of the firm Proskauer

Rose, and Robert Curry of the firm Conner & Winters, provide private equity, seed and venture capital legal advice to AIF.

Thomas & Thomas, LLP performs the annual financial audit as required by the ADFA.

Appendix A -- Summary AIF Financial Audit, Balance Sheet and Income Statement

BALANCE SHEET	12/31/2017
Assets	
Cash	205
Investments	<u>16,288,612</u>
Total Assets	16,288,817
Liabilities and Memembers' Deficit	
Liabilities	
Accounts Payable	11,670
Payable to Fund Manager	102,547
Distributions payable to member	3,900
Accrued interest payable	218,993
Line of Credit	<u>23,805,496</u>
Total Liabilities	24,142,606
Members' Deficit	(7,853,789)
Total Liabilities and Members' Deficit	16,288,817
INCOME STATEMENT	
	1/1/17 THRU 12/31/2017
Income	
Investment Income (Loss), Net	947,020
Impairment loss	<u>(835,247)</u>
Total Income (Loss), Net	111,773
Expenses	
Fund Manager fees	85,000
Guaranty fee	50,000
Interest expense	796,970
Professional fees and investment expenses	118,201
Other	<u>6,037</u>
Total Expenses	1,056,208
NET INCOME (LOSS)	(944,435)
MEMBERS' DEFICIT, BEGINNING OF YEAR	(6,848,907)
Distributions to member	(60,447)
MEMBERS' DEFICIT, END OF YEAR	(7,853,789)