

**Arkansas Institutional Fund**

**Annual Report**

**January 1, 2018, Through December 31, 2018**

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## **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 28, 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).**

**In October 2018, AIF entered into a line of credit loan agreement with the Arkansas Venture Development Fund ("AVDF"). The proceeds from this loan are used to fund investments and operating expenses of the AVDF. The current outstanding balance owed to AIF is approximately \$3.8 million. The loan is current and compliant with all covenants of the loan agreements.**

**The ADFA Board of Directors appointed the Arkansas Venture Capital Investment Trust as the Replacement Fund Manager effective January 1, 2016. ADFA is under contract with the Replacement Fund Manager to provide administrative services, including the production and submission of 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. To date, AIF has issued or closed on 11 commitments totaling \$37.2 million.

In October 2018, AIF agreed to a line of credit loan to the Arkansas Venture Development Fund ("AVDF"), with proceeds of the loan being used to fund investments and operating expenses of AVDF. The current outstanding balance owed to AIF is approximately \$4.2 million.

This fiscal year continued the trend of returns with an exceptional \$8,656,069 in distributions to AIF from its investee funds that included \$1,340,948 in returns of principal and \$7,315,121 in investment income. 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 \$22.5 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. This fiscal year continued the trend of returns with an exceptional \$8,656,069 in distributions to AIF from its investee funds that included \$1,340,948 in returns of principal and \$7,315,121 in investment income. Distributions were used to pay down the financing line.

## **2018 Activities Audit**

- In October 2018, AIF entered into a line of credit loan agreement with the AVDF. The proceeds of the loan are being used to fund investments and operating expenses of AVDF; the current outstanding balance owed to AIF is approximately \$4.2 million.
- AIF reviewed all quarterly and annual portfolio reports, attended all annual meetings of the investment portfolio and routinely discusses potential investment opportunities within the investment portfolio.

## **Investment Plan Implementation**

Prior years' closed commitments include: a \$100 thousand commitment to Fund for Arkansas' Future II; a \$5 million commitment to Noro-Moseley 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; a \$4 million commitment to SSM Venture Partners III and a \$4.0 million commitment to Technology Operators Fund II.

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 Executive Director of the Arkansas Economic Development Commission 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](http://www.arkansas.gov/adfa/board).

The ADFA Board of Directors appointed the Arkansas Venture Capital Investment Trust as the Replacement Fund Manager effective January 1, 2016. ADFA is under contract with the Replacement Fund Manager to provide administrative services, including the production and submission 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.

Landmark, CPA's performs the annual financial audit as required by the ADFA.

**Appendix A – Summary AIF Financial Audit, Balance Sheet and Income Statement**  
**DRAFT**

<b>BALANCE SHEET</b>	<b>12/31/2018</b>
<b>Assets</b>	
Cash	245
Accrued Interest Receivable	26,796
Loan Receivable	3,778,471
Investments	<u>15,644,689</u>
<b>Total Assets</b>	<b>19,450,201</b>
<b>Liabilities and Members' Deficit</b>	
<b>Liabilities</b>	
Accounts Payable	0
Payable to Fund Manager	0
Distributions payable to member	5,932
Accrued interest payable	97,358
Line of Credit	<u>21,799,262</u>
<b>Total Liabilities</b>	<b>21,902,552</b>
<b>Members' Deficit</b>	<b>(2,452,351)</b>
<b>Total Liabilities and Members' Deficit</b>	<b>19,450,201</b>

# DRAFT

<b>INCOME STATEMENT</b>	<b>1/1/18 THRU 12/31/2018</b>
<b>Income</b>	
Investment Income (Loss), Net	7,315,121
Interest Income	26,796
Impairment loss	(875,658)
<b>Total Income (Loss), Net</b>	<b>6,466,259</b>
<b>Expenses</b>	
Fund Manager fees	85,000
Guaranty fee	50,000
Interest expense	688,362
Professional fees and investment expenses	51,235
Other	457
<b>Total Expenses</b>	<b>875,054</b>
<b>NET INCOME (LOSS)</b>	<b>5,591,205</b>
<b>MEMBERS' DEFICIT, BEGINNING OF YEAR</b>	<b>(7,853,789)</b>
Distributions to member	(189,767)
<b>MEMBERS' DEFICIT, END OF YEAR</b>	<b>(2,452,351)</b>