



June 26, 2020

Attn: Barbara Brown

For Reporting Purposes To:

Senator John Cooper,
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 2019. The Summary of Financial Audit is presented in DRAFT form with no values presented expected to change. In the unlikely event that a value should have a material change, an amended report will be filed. Please feel free to contact me directly at 682-5906 if you have any questions regarding the information provided or would like to learn more about any of our investment programs or the ADFA.

Sincerely,

Charles Cathey
Development Finance Officer
and Bond Guaranty Manager



Funding Mechanism	3
2019 Activities Aids	3
Investment Plan Implementation	4
Effective January 1, 2016, the AVCIT became replacement fund manager. The change in fund manager mandates that all new investment commitments shall be made by the AIF. The replacement fund manager is required to honor all existing investment commitments.	4
Organization	6
Professional and Advisors	7

Arkansas Institutional Fund

Annual Report

January 1, 2019, Through December 31, 2019

Table of Contents

Cover Letter	3
Executive Summary	4
Operating Principles.....	4
Investment Objectives.....	5

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 26, 2020

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 7).

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.

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 \$4.4 million. The loan is current and compliant with all covenants of the loan agreements.

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 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 \$4.4 million.

This fiscal year continued the trend of positive returns with \$2,063,886 in distributions to AIF from its investee funds that included \$1,121,585 in returns of principal and \$942,301 in investment income. Distributions were used to pay down the financing line balance. Since inception round only two partial unrealized write-downs have been recorded in the portfolio.

The primary objectives of AIF during 2019 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 various 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 to protect the underlying collateral.

Investment Objectives

The change in fund manager mandates that no new investment commitments shall be made by the AIF and the replacement fund manager is required to honor all existing investment commitments. Thus, the 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 by 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. 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 \$22.2 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 taxpayers for that purpose or may competitively market tax credits to the statewide pool of all income taxpayers.

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 \$4.4 million.

2019 Activities Audit

- The trend of positive returns continued in 2019 with \$2,063,886 in distributions to AIF from its investee funds that included \$1,121,585 in returns of principal and \$942,301 in investment income. Distributions were used to pay down the financing line.
- Capital Calls totaled \$900,000 with \$500,000 to Noro-Moseley Partners VII and \$400,000 to Technology Operators Fund II.

- 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-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; 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.

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

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 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

BALANCE SHEET	12/31/2019
Assets	
Cash	311
Accrued Interest Receivable	43,987
Other Asset	109,863
Loan Receivable	4,135,130
Investments	<u>15,423,103</u>
Total Assets	19,712,394
Liabilities and Members' Deficit	
Liabilities	
Accounts Payable	0
Payable to Fund Manager	0
Distributions payable to member	5,633
Accrued interest payable	105,388
Line of Credit	<u>21,932,631</u>
Total Liabilities	22,043,652
Members' Deficit	(2,331,258)
Total Liabilities and Members' Deficit	19,712,394

INCOME STATEMENT	1/1/19 THRU 12/31/2019
Income	
Investment Income (Loss), Net	942,301
Interest Income	140,088
Impairment loss	0
Total Income (Loss), Net	1,082,389
Expenses	
Fund Manager fees	85,000
Guaranty fee	50,000
Interest expense	763,516
Professional fees and investment expenses	31,402
Other	404
Total Expenses	930,322
NET INCOME (LOSS)	152,067
MEMBERS' DEFICIT, BEGINNING OF YEAR	(2,452,351)
Distributions to member	(30,974)
MEMBERS' DEFICIT, END OF YEAR	(2,331,258)