



ICIC
Iowa Capital
Investment Corporation

2009 ANNUAL REPORT
OF ITS PROGRAMS INCLUDING THE
IOWA FUND OF FUNDS
TO
GOVERNOR CHET CULVER

March 19, 2010

Copies to: Bret Mills, Iowa Department of Economic Development
G. Richard Neumann, Iowa Capital Investment Board
David Casey, Iowa Department of Revenue
Legislative Leadership
Secretary of the Senate
Clerk of the House

PURPOSE

Iowa Capital Investment Corporation's ("ICIC") goal is to accomplish the purposes expressed in its enabling legislation in Iowa Code §§ 15E.61:

- *To mobilize private investment in a broad variety of venture capital partnerships in diversified industries and locales.*
- *To retain the private-sector culture of focusing on rate of return in the investing process.*
- *To secure the services of the best managers in the venture capital industry, regardless of location.*
- *To facilitate the organization of the Iowa fund of funds in which to seek such private investment and to create interest in such investments by offering state incentives for private persons to make investments in the Iowa fund of funds.*
- *To enhance the venture capital culture and infrastructure in the state of Iowa so as to increase venture capital investment within the state and to promote venture capital investing within Iowa.*
- *To accomplish these purposes in such a manner as to minimize any appropriations by the state of Iowa.*

SUMMARY

The Iowa Fund of Funds program, envisioned by the Legislature in 2002 and begun in 2005, continues to grow and have a positive effect on the Iowa economy. The first initiative of the ICIC, the Iowa Fund of Funds, Fund A, LLLP ("IFOF" or the "Fund of Funds") is designed to expand access to professionally managed seed and venture capital for Iowa entrepreneurs. At December 31, 2009 the Fund of Funds had closed on commitments of capital to seven venture funds that have specialties in the following areas:

- Early stage life sciences, medical services, nutrition, wellness and plant science
- Later stage manufacturing, services and distribution
- Seed and early stage in consumer media and retail, health care and financial services
- Middle market growth companies in healthcare, business and information services sectors
- Growth and expansion capital in the business services, consumer and health sectors
- Technology enabled business and consumer services, emphasizing financial and for-profit education sectors
- Later stage companies with solid potential for growth, introduction of new products and add-on acquisitions

Preliminary commitments were outstanding on two more funds as of December 31, 2009.

The program has a pipeline of high quality experienced funds interested in working within Iowa and helping our local entrepreneurs. These funds are actively seeking candidates for investment in new and growing companies across the state. As of this date, four companies have received capital from IFOF-supported venture funds, receiving nearly \$27.7 million in total capital -- \$12.4 million directly from IFOF venture funds with the balance of \$15.3 million leveraged from other sources.

The Fund of Funds was formed by ICIC which serves as its general partner. In 2005, ICIC engaged Cimarron Capital Associates I, L.L.C. (“Cimarron”) as its fund manager. Cimarron brings extensive experience managing fund of funds programs and developing entrepreneurial ecosystems for states and regions.

In addition to the Fund of Funds effort, in 2006 ICIC launched a \$45 million fund supported by New Markets Tax Credits, in partnership with Iowa’s banking industry. This fund is now fully invested with projects in Dubuque, Sioux City, Des Moines, Fairfield, and Davenport. In 2008 this fund gained a second commitment of \$50 million. ICIC supported the application with a commitment of \$5 million of contingent tax credits to encourage projects in rural communities.

These programs have been implemented without State appropriations or reductions of revenue. Contingent tax credits support the program, and are available to cover potential future losses. If investments perform reasonably well, the tax credits will not be used.

ICIC carefully coordinates its work to enhance the parallel efforts of the Iowa Department of Economic Development, the Iowa Capital Investment Board, the Regents universities, the local investing community, Iowa’s technology and industry associations, and local entrepreneurs. Over time, ICIC will help build a thriving Iowa entrepreneurial ecosystem in which a self-sustaining Iowa Fund of Funds and its partner venture funds play an empowering role.

BACKGROUND

Creating a Venture Capital Network in Iowa. The economic well-being of Iowa depends on the creation and growth of competitive, knowledge-intensive companies capable of success in high-growth domestic and international markets. These companies depend on Iowa’s access to sophisticated risk capital and investment skills, employee talent, and a network of connections to entrepreneurial resources. These are all essential ingredients for a vigorous entrepreneurial Iowa. The Governor and Legislature have recognized that it is imperative these resources are made more broadly accessible to our local entrepreneurs. One important source of such money, talent and connections is found in the people making up America’s 1000+ professional venture capital firms. Most of these firms have traditionally focused their efforts on the east and west coasts, leaving the rest of the country, including Iowa, with little access to the necessary resources of the national venture capital network. In recent years, leading states (including Iowa) have forged creative ways to connect themselves to this network, seeking to ensure that their most promising entrepreneurs have a chance to compete on a level playing field with their peers in the venture capital-rich areas of the country.

In the venture capital world, many companies seeking funding from experienced venture capitalists do not meet minimum investment standards and are not funded. The same will be true of companies in Iowa, and perhaps to a larger extent because the venture capital environment in Iowa is immature. For that reason, success of the Fund of Funds is substantially more than just the number of Iowa companies that receive funding from professional venture capitalists.

Among other benefits are the positive effects on those companies that do not receive funding. Aspiring entrepreneurs are provided the opportunity to gain an understanding of the standards required by high quality, professional venture firms; to address deficiencies, and to meet those standards. Companies that achieve these national standards of quality will be more likely to find the capital they need to grow and prosper. The ultimate success of Fund of Funds investments will help build overall economic momentum, and catalyze cultural change and a more robust entrepreneurial ecosystem in Iowa in the years and decades to come.

Iowa Fund of Funds. Through legislative action in 2002, the Iowa Legislature created the Iowa Fund of Funds program. The program is designed to help level the national venture capital playing field and bring venture funds, expertise, and networked resources to assist Iowa entrepreneurs. The Legislature also directed that resources to be allocated to support loan guarantees and other related credit enhancements for rural and small business borrowers within the state. Codified in Iowa Code §§ 15E.61 et. seq., the legislation provides \$100 million of transferable Iowa tax credits to be used to support the capitalization of the Fund of Funds and its investments in venture capital funds along with other programs specified. The tax credits, which are applicable against State income, franchise, and premium taxes, are contingent and have value to the holder only to the extent of future losses in the program, if any.

ICIB and ICIC. In order to facilitate the goals set forth in the Act, the Legislature authorized the formation of the Iowa Capital Investment Board (“ICIB”) and the ICIC. ICIB is a state agency that authorizes the commitment of tax credits, while ICIC directs the program. The members of the ICIB Board of Directors are Rick Neumann (Chair), Gene Blanshan (Vice-Chair), Suzanna de Baca, Carol Garrett, Daniel S. Rogers, Senator Pat Ward, Representative Roger Thomas, and Senator Roger Stewart.

ICIC is a private, 501(c)(3) not-for-profit corporation organized under Iowa Code Chapter 504A on May 7, 2002. The members of the ICIC Board of Directors are Dennis Murdock (President), John Rigler (Vice President), Bruce Tamisiea (Treasurer), and Tim Urban. Serving as general counsel is the firm of Davis, Brown, Koehn, Shors & Roberts, P.C. KPMG serves as the current auditor for the ICIC’s annual financial audit. Upon its termination, ICIC is scheduled to turn its assets and accumulated profits over to the State.

Formation. In 2005, technical amendments to the original legislation removed impediments to securing low-cost investment capital. With this resolved, the IFOF, an Iowa private, for-profit limited liability limited partnership, was capitalized on June 28, 2005. ICIC is the general partner of the Fund of Funds. In accordance with the statute, the investments of the Iowa Fund of Funds have focused on partnership interests in private venture capital funds rather than direct investments in individual enterprises. The State Auditor is responsible for the annual financial audit of IFOF. KPMG currently provides that service to the State Auditor’s office.

Management. The statute requires ICIC to employ a professional fund allocation manager. In 2005 Cimarron was engaged in this capacity. Cimarron, a national leader in regional private equity, has operations in Des Moines, Little Rock, Phoenix, Chicago, and Oklahoma City.

Investment Allocation and Strategic Objectives of the Fund of Funds. Working with its fund manager, ICIC has developed a formal policy to guide the allocation of venture fund investments and achieve the strategic objectives of the Fund of Funds. The Fund of Funds is investing in a diverse set of private venture capital funds so as to connect Iowa's most promising entrepreneurs with the full resources of the national venture capital network.

Each fund management team agrees to establish an appropriate presence within the state and work with entrepreneurs. They may interface with angel investors, other venture funds, university tech transfer and development staff, economic developers, and corporate business development groups to identify promising Iowa opportunities.

To minimize the use of Iowa contingent tax credits, the Fund of Funds invests only in carefully selected and diversified private equity and venture capital funds with capable management teams and a demonstrated history of earning market rates of return. In the aggregate, the portfolio is being constructed to be broadly diversified across industries, time and geography, and across stage of investment within the following general guidelines:

| | |
|-------------------------------------------------------|-----------|
| Early Stage (includes seed and start-up) | 10% - 20% |
| Traditional Venture Capital | 30% - 40% |
| Later Stage (includes expansion & mezzanine) | 40% - 50% |
| Special Situations (turnarounds, restructuring, etc.) | 3% - 7% |

To meet the needs of the Iowa economy, fund commitments are focused in several strategically important industries:

Life Sciences (including agricultural technology, animal sciences and cleantech)
Information Technologies
Financial Services
Advanced Manufacturing
Other emerging sectors

SUMMARY OF ACTIVITIES THROUGH 2009

Since 2002, ICIC has worked to create the Fund of Funds and build it into the active investing program it is today. With the Legislature's timely assistance in 2005 and continued support, IFOF has made significant progress.

Commitments to Venture Funds

The Fund of Funds has selected nine venture capital funds for investment. As of December 31, 2009, seven investment commitments have closed and two commitments are pending. The closed commitments are to:

- **Prolog Ventures Fund II**, a \$5 million commitment to this \$66 million early stage life sciences fund focused on deals in the central Midwest. Based in St. Louis, the managers of Prolog Ventures engaged a local representative in Iowa and formed an

investment advisory board consisting of key members of the life sciences and entrepreneurial communities from Iowa State and the University of Iowa.

- **Bayview Capital Partners Fund II**, a \$2.7 million commitment to this \$125 million fund focused on late-stage manufacturing, services, and distribution companies in the Midwest. Based in Minneapolis, the fund is a licensed Small Business Investment Company. The managers of Bayview Capital Partners are engaged in extensive marketing, development, and educational efforts within Iowa in partnership with Iowa banks, attorneys, and CPAs.
- **Village Ventures Fund II**, a \$5 million commitment to this \$104 million fund launched in February of 2007. Village Ventures, based in Boston, is a seed and early stage venture capital firm. They focus their efforts on consumer media and retail, health care and financial services in emerging US technology centers which possess world class innovation but generally lack local sources of institutional early stage capital. The managers of Village Ventures have engaged a local representative in Iowa and have a vigorous program to identify prospective companies.

In 2009, IFOF committed an additional \$1.2 million to a supplemental funding for the Village Ventures Fund II. The \$30.6 million in supplemental funding was raised by Village Ventures from its limited partner group.

- **LFE Growth Fund II**, a \$5 million commitment to a \$30 million fund that invests growth and expansion capital in smaller middle-market growth-stage companies in the business services, consumer and health sectors. Based in Minneapolis with an office Ankeny, LFE has a special emphasis on businesses that are owned or led by female entrepreneurs or that serve markets of interest to women.
- **OCA Ventures II**, a \$5 million commitment to a \$50 million seed and early stage venture fund. Based in Chicago, OCA focuses on core technologies, financial services, for-profit education and technology-enabled services.
- **Petra Growth Fund II**, a \$5.5 million commitment to a \$160 million private equity fund focused on debt and equity investments in high growth small businesses. The managers of Petra are engaged in extensive marketing, development, and educational efforts within Iowa, and have engaged the Des Moines firm LWBJ Financial to extend their marketing reach.
- **Stone Arch Capital II**, a \$6 million commitment to a \$172 million private equity fund that focuses on investing in later stage companies that offer solid potential for growth, introduction of new products and add-on acquisitions. Stone Arch has special expertise in manufacturing of agricultural equipment.

The two pending commitments include:

- \$7.5 million to a \$125 million fund that will focus on early-stage firms offering technology-enabled or business information services with an emphasis on information technologies, life science (medical devices, healthcare IT, and animal/plant sciences), and wireless technologies.
- \$7 million to a \$100 million fund that will focus on expansion and late-stage financings in small companies.

Expanded Our Funds' In-State Iowa Presence and Capital Leverage

In-State Development Efforts. The managers of all of the selected venture funds have agreed to participate in a wide variety of Iowa venture activities, including the annual Venture Capital and Entrepreneur Conference and the Iowa Venture Forum in Des Moines sponsored by the Iowa Department of Economic Development. ICIC co-sponsored the Iowa Venture Forum with the Iowa Department of Economic Development, with ICIC taking a lead role in the organization of the venture forum.

Each fund has committed to conduct aggressive deal prospecting in the state. Their presence in Iowa gives Iowa entrepreneurs an avenue to directly interface with potential funders and help build business plans and financial strategies that will meet the market test. The presence of venture capital firms in Iowa expands the likelihood that Iowa entrepreneurs will obtain the capital they need to grow and prosper.

Invested in Iowa Companies

As of this date, Iowa companies have received nearly \$27.7 million of equity and debt financing as a result of the work of IFOF portfolio funds -- \$12.4 million directly from the IFOF venture funds, and the balance of \$15.3 million leveraged from other sources.

- Bayview II invested in Accu-Mold, Inc. of Ankeny, a precision maker of small, high technology molded plastic parts with exciting prospects in medical devices and advanced manufacturing markets.
- LFE Growth Fund II invested in Global ID Group, of Fairfield, a leading provider of testing and certification for food and agricultural products.
- Prolog Venture Fund II invested in Asoyia, of Iowa City, a developer of soybean oil with zero trans fats.
- Bayview II invested in Applewhite Dental Partners, of Dubuque, a dental practice management company with facilities in Cedar Rapids, Ft. Dodge and Manchester.

With these investments, the Fund of Funds has attracted to the Iowa economy more than one and one half times the \$17.2 million drawn from IFOF by its portfolio funds through 2009. This illustrates the economic multiplier potential of the Fund of Funds' program.

- *Capital Leverage.* Part of this leverage represents the ability of the Fund of Funds to make large capital resources available to Iowa enterprises by making carefully

selected, smaller capital commitments to venture funds that raise the vast majority of their capital competitively from other institutional investors. The seven portfolio funds have raised nearly \$738 million in commitments, and have met the test of the private market -- they compete worldwide for capital.

- *Co-Investment Networks.* The managers of IFOF portfolio venture funds also bring extensive networks of venture and private equity co-investors able to multiply their own direct investments. Over time and in aggregate, every dollar invested by IFOF portfolio funds in Iowa companies is expected to attract two to three matching dollars from co-investors.
- *Investing Culture and Expertise.* Finally, the managers of IFOF portfolio venture funds bring investing expertise into the state. Iowa has historically lagged other states in the breadth and vigor of its entrepreneurial economy in high-knowledge and high-growth industries. By importing expertise and culture, we transmit the “intellectual DNA” of entrepreneurship and venture investing into our Iowa ecosystem and help jump-start a more dynamic economy better able to compete in global technology markets.

Developed Additional Funding Sources to Lower Capital Costs

The Fund of Funds is capitalized by private investments with the support of contingent tax credit certificates issued by the ICIB. Iowa Designated Investor, Inc. (“IDI”), a single purpose entity, is to date the only investor in the Fund of Funds. Funding was first provided in 2005, supported by a \$10 million line of credit from West Bank in West Des Moines. Funding was expanded in February 2008, supported at that time by a \$30 million line of credit from West Bank and the Bank of Oklahoma. IDI expects to secure additional funding on an as-needed basis.

The tax credits have value only to the extent the investment results are insufficient to cover the State-approved scheduled return for the IFOF investors. The credits are limited to \$100 million in the aggregate and \$20 million in any fiscal year.

A team of Iowa corporations stand ready to purchase these tax credits, without a discount, should the need arise. Their pledge to make these purchases at par is a significant commitment to minimize the cost of the program to the State of Iowa, if tax credits are ever needed. These commitments, obtained with the help of the Iowa Association of Business and Industry, have been essential to enabling IDI to raise capital at a low cost. The members of this team include Alliant Energy, Iowa Network Services, First National Bank of Muscatine, Dubuque Bank & Trust, Quad City Bank & Trust, Ames National Corporation, and others.

Demonstrated Good Financial Stewardship

During the turbulent financial markets of 2009, ICIC has successfully demonstrated good financial stewardship. IDI maintained its financing relationships with West Bank and Bank of Oklahoma to support the Fund of Funds. Additional potential funding options were

explored to add investment capacity and address an anticipated rising interest rate environment. The mechanisms, already in place, for monetizing tax credit certificates if and as needed, were strengthened to help ensure that tax credits, if every used, would receive dollar for dollar value.

Developed Iowa Business and Venture Industry Relationships

During 2009, ICIC was active in expanding relationships and resources both within Iowa's entrepreneurial community and into the national venture capital community:

- Added Mark Huston to its in-state team to provide an increased presence in Iowa to actively market the program and make connections between Iowa entrepreneurs and the venture capital and private equity community. Mark resides in Des Moines.
- Co-sponsored the October, 2009 Entrepreneur and Venture Capital Conference in Des Moines, served on the Planning Committee, assisted in promotion of the event, and brought venture capitalists to speak at the conference sessions.
- Helped organize the October 2009 Iowa Venture Forum. Thirty four Iowa entrepreneurs applied to present at the Forum, and 12 companies were selected. They presented to 16 venture capitalists and a number of angel investors during the event. All the companies that applied were a part of the event.
- Marketed IFOF at the World's Best Technologies Showcase and numerous venture forums across the country.
- Contributed to www.IowaEntrepreneur.com, an educational site for Iowa entrepreneurs and investors.
- Participated as a member in a number of Iowa business and trade associations and actively represented the interests of Iowa's angel and private equity investors and entrepreneurs.
- Helped form an association of Iowa angel capital groups to promote education and deal sharing within the angel capital, private equity and investment community in Iowa. ICIC hosts quarterly meetings, in cooperation with the Iowa Department of Economic Development, to encourage and facilitate communications among angel investors and venture investors to increase local capacity to invest in attractive deals.
- Enhanced our relationships with all three Regent universities, Pappajohn Centers, and small business accelerators to spread knowledge of private equity capital and investing throughout the state.


Provided Advice to the Legislature and Executive Branch

ICIC has been and continues to be available to serve as a resource of expertise to provide information to legislative committees and the Executive Branch on the advantages and

disadvantages of a variety of investment programs in early to late stage capital. We stand ready to assist the Legislature and Governor in developing sound economic development programs for Iowa.

We appreciate the help of our Legislature and Governor, whose continuing support of our program and patient understanding of our goals and timelines are so important to our success.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dennis L. Murdock". The signature is written in a cursive style with a large initial 'D' and 'M'.

Dennis Murdock
President