

# MINUTES OF THE UTAH CAPITAL INVESTMENT BOARD MEETING

**\*\*APPROVED\*\***

May 11, 2016 | 3:00-4:30

Governor's Office of Economic Development – Canyonlands Conference Room  
60 East South Temple, Third Floor, Salt Lake City, UT 84111

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**Board Members Present:** Sam Straight, Val Hale, Pam McComas, David Damschen, Derek Miller

**Guests Present:** Susan Eisenman, Bret Jepsen, Richard Pugmire, Scott Peterson, Theresa Foxley

**Staff:** Kathy Whitehead

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## AGENDA

- I. Welcome
- II. Quorum
- III. Review and Approval of Minutes
- IV. Administrative Rules Update
- V. UCIC Report
- VI. Other Business
- VII. Motion to Adjourn Public Meeting

### I. Welcome

Samuel Straight welcomed the board.

### II. Quorum

Sam confirmed there was a quorum present.

### III. Review and Approval of Minutes

There were two sets of minutes to approve, one from December 11, another from March 2, which was an electronic meeting.

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### MOTION

Derek Miller moved to approve both sets of minutes and Pam McComas seconded the motion. The motion passed unanimously.

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Since Susan was not present at this stage of the meeting, Sam moved the discussion to the UCIC report.

### V. UCIC Report

Prior to discussing UCIC fund performance, Bret Jepsen first thanked the board members for their time spent on behalf of UCIC. He then mentioned the strong performance of the fund, noting the last couple of years have had some strong distributions and liquidity from the portfolio. However, the biggest challenge UCIC faces is the fund's debt-based structure. It is unusual and UCIC is in the process of refinancing in a more favorable way. Bret expressed

thanks for the two existing investors offering very friendly terms. UCIC is concerned with making sure the portfolio is regular so there is never any danger of default.

Richard Pugmire continued the update referring to the handout of UCIC's performance. He noted that 2015 was an exceptional year for the portfolio. Distributions exceeded contributions by \$16 million and much of that capital went to paying down debt. The balance is down to \$90 million. Pacing in 2016 is slower than last year. One of the reasons for that is market volatility especially in January and February. The market has since stabilized. If it remains stable, we could see an increase on distributions the latter part of the year. If it destabilizes again, it could be a low year.

The overall performance of the 28 funds generated a 12.6% net IRR. Comparing the net asset value to the debt balance, we still have a nice gain there. As companies in the portfolio mature, many go public. This is good from a 1-2 year perspective, but it creates more volatility in the net asset value, and we do expect to see a decline as of March 31. Bret remarked that although it is unusual to have a debt based structure, they've never had a better net asset value to debt ratio in the history of the program. He stressed the importance of getting distributions out in a meaningful way.

Richard also reported that 77 Utah based companies have received investments and will increase to 78 in quarter one. This will push the funds in the portfolio of investments in Utah companies over \$1 billion. The actual dollars that are attributed back to Utah Capital are just under \$18 million. Scott Peterson interjected that while getting distributions out is a key issue, UCIC has no control over distributions. Since they are a debt based fund, they're bound into the cash flow structure of debt, and it is important to match the duration of cash flow to pay down the debt. Richard agreed that although almost all managers are optimistic about the upside in the portfolio, the distribution timing is uncertain given the financial markets, particularly the weak IPO market.

Sam asked if UCIC will be able to meet its current debt obligations in the next 3-6 months. Richard said that it looks fine for the next 3 months, but that if they don't get dollar distribution, it becomes more difficult in 6 months. Bret added that according to the debt structure put in place in 2012, at this point in time they need to start repaying the principle in addition to the interest, which increases quarterly payments significantly, which is why they're focused on refinancing. Sam asked the UCIC to give a brief history of the financing structure before 2012 and how things changed for the benefit of new board members.

## **History of Fund 1**

Richard explained that the fund started investing in 2006 and got financing from a large bank for \$100 million. The financing was debt based because they couldn't find financing anywhere else. Scott stressed that typical venture funds are equity based. He reasoned that the government must have felt very strongly about the program if they were willing to utilize a debt based fund. Richard said that the interest rate in 2006 was 6.8% and there was a steep prepayment penalty. Payment requirements for the principle wouldn't have been required until 2017. In 2012 the debt was refinanced into a more flexible structure with a much lower prepayment penalty. A sizeable

portion was a floating rate, but that was allowed to be prepaid at any time. The overall interest rate went down from 6.8% to below 4%, which has resulted in millions of dollars of savings since 2012.

Scott reiterated that with the refinancing and bringing Bret Jepsen and Richard Pugmire on board, the investment profile and the relationship with venture investees has improved dramatically. Scott himself didn't come on board until 2014, operating with the idea that the program would continue. The 2015 legislation signed by the governor also seemed to indicate that the state is interested in continuing the program. UCIC is looking for equity investors and trying diligently to find ways to eliminate the debt. Doing so gives UCIC a better way to match up the time and duration of cash flows. It would also dramatically reduce the risk of tax credits. Some UCIC board members have been operating under the assumption we would continue through equity financing. Other board members have expressed concerns about exposing the state to additional tax credits, prompting a debate about where the program is heading. Some want to declare victory and wind down the program. Others feel that the legislation indicates that the program should continue. Meanwhile the debt still needs to be refinanced so there's no risk of default.

Derek Miller asked about the role and responsibility of the UCIB in regard to tax credits. Susan explained that the quasi-governmental entity UCIC does the venture capital and a governmental entity administers the tax credits. The role of the UCIB is as a check and balance in the system to set forth in rule the contingencies to exercise the tax credits. The rule should have been final May 1<sup>st</sup> unless there were comments, but so far she hasn't heard that there were any. The board also is meant to partner with the UCIC and keep an eye on the fund structure, but largely the UCIB keeps tax credits in the treasurer's vault until they are retired or exercised.

Scott added that the first tranche was issued in the vault with the treasury related to debt outstanding for about \$100 million. Since the fund is debt structured, that's principal plus interest. Now they're at a net balance of \$90 million, which means potential exposure for \$90 million in tax credits. Susan said that those tax credits are already issued, but they are contingent.

Derek clarified that tax credits haven't been issued for a second round, but the board has promulgated the rules by which that could happen. Susan agreed, saying that the tax credits are like a contract with investors. If contingencies aren't met, they can return and receive a tax credit. The tax credit contract with those involved in Fund 1 can't change because it's already seven years in and the rules are set. The worst case scenario would be that some or all of the \$90 million of tax credits comes due and the board would have to determine what investors are entitled to what amount. The board would certify that to the tax commission, who would issue the refund.

Derek asked if there is another checkpoint that happens with the UCIB prior to putting tax credits into play with a Fund 2. Or is that all in the UCIC's hands now that the rules have been promulgated? Susan explained that issuance of tax credits and redemption are two different processes. The board has not redeemed for Fund 1 nor issued or redeemed for a Fund 2. Derek questioned whether the UCIC is determined to refinance Fund 1 whether or not the board moves forward with a Fund 2.

## **Refinancing: Equity vs. Debt**

Scott restated that he does not want the fund to run the risk of being exposed to a default and that the UCIC does not have management of the distribution payment stream. That's controlled by the venture funds that they've invested in. The way the debt was refinanced in 2012, there's a requirement to pay down principal and interest. They're concerned because those payments have increased and there's a balloon due in October 2017. The UCIC is unanimous about refinancing. They are discussing very good terms offered by the two remaining lenders. Derek asked when this refinance would be finalized. Scott said that they are within a week of finalizing terms and that there will be another board meeting scheduled in about a month.

Sam explained that if UCIC reached an agreement on new terms, the UCIB would have to review those terms with the help of outside counsel at Parr Brown as well as Susan Eisenman. If UCIB is comfortable with the refinancing terms, UCIC would finalize the refinance, the existing tax credits would be retired and new tax credits would be issued.

Bret included that although this refinance would be more favorable than the current terms, it would still not be as optimal as an equity structure. Sam asked if the current refinancing would interfere with refinancing the fund with equity in the future. Bret said that a portion could be refinanced with equity without a prepayment penalty.

David Damschen asked if consideration had been given to bidding and looking at other sources for the refinance. Bret explained that his background is in equity and he had similar questions a year ago. He was put in contact with several banks and they were first of all intrigued that a bank could even do what they were asking. He also spoke recently with a large secondary advisor in the private equity market who had mentioned they were seeing more debt structures at the company level, with more flexible terms. Bret was transparent about the terms with their lenders and the advisors agreed that those terms were very good. Scott also related that he had informally spoken with the chairman of a bank about hypothetical terms and the chairman was not interested. The terms others would be interested in are not even close to what UCIC has been offered.

Bret spoke to the commitment Zion's Bank has to the state of Utah saying they are working very close to the cost of their capital. He said they want to be helpful and don't want to cash tax credits. That's UCIC's goal as well.

## **Possibility of Fund 2 and Legislative Intent**

Sam asked if there were any more questions. Scott said that in the last 18-24 months the UCIC has been working to find equity holders because, as was discussed, it would be more favorable than a debt structure. The most recent thing they've looked at is doing a combination of refinancing Fund 1 with a combination Fund 2, but they've hit a block with UCIC board members who feel that the program has served its purpose and should wind down. However, there is some concern this might violate in some way the intent of the recently passed legislation.

Val Hale commented that the program was created a decade ago because there wasn't a lot of capital investment coming into the state. The question the board should consider is whether venture capital in Utah still needs stimulation. The legislative intent in 2006 may be different from how legislators view the situation today.

Scott argued that the 2015 legislature still saw a need to continue the program. Utah is doing well, but it still has a ways to go. Venture capital historically goes to California. Utah is competing with top states, but only because of a handful of big deals. If the government and legislature is fine with relying on big deals, that's okay. However, if Utah wants to continue to grow its infrastructure and bring additional funding for opening stage and developing companies, then this program is still needed to bring that money in. He noted that big companies are doing well in Utah, but venture investment in startups isn't strong. Val responded that he has seen regular interest from investors looking for the next big thing in Utah. It's no longer a secret, they want to find the next Omniture.

Scott maintained that the 2015 legislature was a good indication that the government wants this program to continue. David pointed out that at the time the legislature was told that a Fund 2 would be a way to mitigate risk and exposure to Fund 1. The UCIC meeting discussed other options for mitigating the risk of tax credits on Fund 1. The legislature didn't have information about such options. It would be worthwhile to share that new information with legislators before deciding how to proceed. Scott agreed that as chairman of UCIC he wants to mitigate tax credit risks as much as possible. He's also committed to enhancing venture capital in the state of Utah. With that in mind, he is open to continuing questions about whether the program is still beneficial to taxpayers.

Bret shared his point of view saying that the predecessors of this program were more or less given a blank check and asked to do their best. Now we know that the state of Utah spends money to improve the economy in various ways and everyone wants to be sure the money is spent efficiently. Legislators have seen this program and that there's a low probability of it ever costing any money and they trust Bret and Richard to invest that money profitably. If the right structure and people are involved, it's a great way to stimulate certain pockets of the economy. Scott agreed saying that the fund is in better shape than ever with Bret and Richard on board. Their work refinancing has lowered risk of exposure to the state considerably. He reiterated that as chairman of UCIC it's beyond his role or the role of his board whether the program continues.

Derek was concerned that considering the 2015 legislation as a green light to move forward was the right way to see it. Scott clarified that he didn't want the UCIC board to presume the program will continue or not because it is not up to that group. It's something that needs to be brought up to other powers.

Derek stated that he didn't personally feel that the UCIB promulgating rules for a Fund 2 was necessarily an agreement that a Fund 2 would go forward. Sam commented that the rules had to

be promulgated according to the statute and doesn't determine what happens next. More information is needed before anyone knows if there will be a Fund 2. The board looks at proposals presented and speaking in hypotheticals is difficult. He felt that based on what was said, refinancing is important and he's appreciative of the work that's been done renegotiating terms. Bret and Richard have done a great job of getting the fund in a healthier position than where it was before. He voiced his hope that UCIB would soon see a term sheet that had the approval of all parties, and could be voted on. Until then, some of the questions raised were perhaps bigger than what could be resolved at that time.

David asked for clarification about a hypothetical Fund 2. It wouldn't be funded with debt, would it? Everyone confirmed that it would be funded with equity, and Susan further clarified that the statute would not even allow for debt funding.

#### **IV. Administrative Rules Update**

Sam asked if there were any other matters of business before the meeting closed to discuss the specifics of financing. He checked the agenda to be sure nothing was missed, asking Susan if there were any other updates for the administrative rules. She said there were not.

#### **VI. Other Business**

Scott pointed out the amount of work that goes into putting together the terms for refinancing with a Fund 2 in mind. He once more asked if the UCIB anticipated a Fund 2 because preparing that sort of change would require a lot of hours and it's not a path they want to go down if there will be no Fund 2. Although the UCIB isn't the final word in how the program operates, they do have a controlling interest. Sam said that his position as chair of the UCIB includes eliciting the opinions and consensus of the board and that has not yet been done. He doesn't know how the board feels about the questions asked. Sam also expressed a need for some legal advice about what the statute means. As Derek pointed out, there's new information since the time legislation was passed. The board is willing to figure things out, but that will take time. Sam felt the board was not prepared to give an immediate answer.

Scott agreed that this is a big question and as chair of UCIB he wishes to execute the desires of the state of Utah and appropriate bodies whether that means the legislature, governor, or others. In order to do that, he needs to know what those desires are. Sam said that doing the right thing according to statute is the UCIB's goal as well.

#### **VII. Motion to Adjourn**

Before moving to a closed meeting, Susan explained that the UCIB is a government board and is governed by the public meetings act. The purposes for which a meeting can be closed are extremely limited. However, the board has statutory authority to close meetings to discuss fund performance, venture firms, and private equity firms if necessary to protect the information from

disclosure. She asked Bret if closing the meeting would be necessary for the next discussion. He confirmed. Sam asked if the board was interested in adjourning the meeting.

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**MOTION**

David Damschen moved to adjourn the public portion of the meeting and Val Hale seconded the motion. The motion passed unanimously.

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Sam noted the board would now move to a closed meeting based on Utah annotated code [Utah Code §63M-1-1205(8), Utah Code §63M-1-1224(3)] in order to discuss fund performance, venture firms, and private equity firms with Bret and Richard from the UCIC. Susan submitted completed copies of the appropriate documents for closing a meeting including a full quorum unanimous vote in the affirmative. A complete and unedited recording of the closed meeting will be made and protected by statute.