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## Utah Fund of Funds

By Steve Osborne, 11/20/2007 7:56:34 AM MST

To say that the Utah Fund of Funds is a perpetual money-making machine that gives Utah something — a whole lot of something — for nothing, might be an overstatement. But not much of one.

The fact is, the fund is one of those rare government-sponsored projects that everyone seems to be excited about — a program that has spawned no serious critics because it's working flawlessly, doing what it was mandated to do, and delivering plenty of upside with apparently no downside.



The Utah Fund of Funds (UtahFoF.com) was created by the Utah Legislature through the passage in 2003 of House Bill 240, the Venture Capital Enhancement Act. Though chartered in 2003, the fund did not begin breathing until January, 2006, after a series of regulatory and legal issues were handled. The fund's stated mission is to "increase the amount and diversity of capital funding available to help the state's early-stage and growth companies to grow, prosper and mature in Utah."

In short, the Utah Fund of Funds was born to boost entrepreneurial opportunity in Utah. But another objective was implicit: frustration reduction.

"In the past, due to their location, Utah companies have been disadvantaged," explains Jeremy Neilson, managing director of the fund. "They had a hard time finding venture capitalists who were interested in investing in Utah companies and keeping those companies in our state. They would get term sheets from investors, but the terms would say they had to move. Utah entrepreneurs who wanted to build great companies and keep them here were frustrated.

"The Utah Fund of Funds' purpose is to give Utah's already great companies and entrepreneurs increased access to capital. This is not an entitlement program. It's not about funding companies just because they are in Utah. It's about funding Utah's great companies and keeping them in Utah."

Mark Solon, founder and managing director of Highway 12 Ventures, a venture capital fund, agrees. "What is exciting about the Fund of Funds is that it's opening many doors for co-investment and long-term relationship building in Utah," he points out. "It's not easy to get a lot of these outside firms excited to look at deals here. Now they have an incentive to put their capital to work in Utah."

### How the Fund Works

1. The state-sponsored Utah Fund of Funds borrowed money from a third-party lender (in this case, \$100 million USD from Deutsche Bank), agreeing to repay that money, together with a low interest rate that is well below prime. As collateral, the state of Utah pledged collateral in the form of cash from its corporate tax coffers. This collateral can only be claimed by the third-party lender in the event that the state cannot meet its debt obligation, and only to the extent of the shortfall.

2. The Utah Fund of Funds invests the \$100 million in select venture capital and private equity funds located both in Utah and outside Utah. The managers of these funds must commit to establish a working relationship with the Utah Fund of Funds and the state's start-up and business community. Because the state is not in the business of investing directly in home-grown companies, the Utah Fund of Funds does not give any company or individual money. Rather, it invests in venture capital and private equity funds that in turn invest in specific enterprises.

3. Utah entrepreneurs seek money from the venture capital and private equity funds in which the Utah Fund of Funds invests. This places them in a position similar to the coach's son during high school

football try-outs. They will be carefully considered, but if they don't show promise of being able to perform, they won't be selected.

4. The Utah Fund of Funds uses returns from its investments it makes in the venture capital and private equity funds to repay the original loan to the third-party lender. If the debt obligation cannot be met, the Utah corporate tax assets pledged as collateral will be used to do so. It is unlikely that this will ever happen. (Oklahoma has been doing this program since 1993, and hasn't had to repay a dime.) But even if worse comes to worse and Deutsche Bank takes all the collateral several years down the road, the state will already have reaped an equal or greater financial benefit than the amount of unpaid debt it would have to cover.

5. The process recycles as loans are repaid.

#### **A Valid Question**

Because the Utah Fund of Funds invests in venture capital and private equity funds, and those funds invest in portfolios of individual ventures, some of the money ends up capitalizing businesses that have nothing to do with Utah. Why doesn't the state require the portfolio funds it invests in to give money only to Utah-based enterprises? Why should Utah help some company in New Jersey become a success?

"In the venture capital world," Neilson explains, "it's impossible for me to restrict the Utah Fund of Fund's money to go only into Utah. The venture capitalists have a lot of investors in their funds, and the other investors feel that if the managers of the funds they are investing in are restricted from making the best decisions possible for those funds, they will pull their money out. The funds' managers will kick Utah Fund of Funds out long before they let everyone else run away because we're making demands that they only invest in Utah companies.

"You can say that we're giving money to companies in other states," he adds. "But while a portion of our money goes into every single deal in the various portfolios, a portion of everyone else's money comes into all the Utah deals in the portfolios. So in reality, the fund has helped Utah companies get money from outside the state. The 23 Utah companies that have received startup or expansion capital from the portfolio funds we invest in have raised \$293 million from all their investors. Only \$50 million of that comes indirectly from the Utah Fund of Funds."

#### **Is It Working?**

The proof of the effectiveness of any program, of course, is in the pudding. What does Utah's entrepreneurial community think of the Utah Fund of Funds?

Dave Hubbard, founder and CEO of MatchBin.com, the Salt Lake City-based online trading platform that specializes in product and service matching, is openly enthusiastic. He claims that without the Fund of Funds, "many great Utah ideas would go unfunded, companies would wither for lack of capital for growth and expansion, and more jobs and ideas would move out of state."

"Capital is the life-blood of the biomedical industry," adds David Clark, president and CEO of Prolexys Pharmaceuticals, a Utah biopharmaceutical company. "The Utah Fund of Funds will do more to attract capital to innovative life science companies in the state than any other single industry or government effort."

David Bailey, CEO of IntelliSum Inc. (Utah-based developer of the 3-D IntelliCamera technology) and former co-founder and CEO of Iomega joins the chorus. "The Utah Fund of Funds has been very helpful introducing us to potential investors," he says. "One such introduction resulted in the venture capital firm, Flywheel Ventures, making a significant investment in our company."

#### **What Next?**

By the end of 2007, all the Utah Fund of Fund's \$100 million will have been invested in portfolio funds.

End of story?

"In order to keep the program alive and keep all the benefits coming to Utah, we need to have additional money to invest in our fund," states Neilson. "Venture capitalists come here because we invest in our

fund, but if we've run out money when they raise another fund, they'll stop coming and the benefits go away. So we're asking the state legislature to increase the tax credits for the fund from \$100 million to \$300 million in 2008, giving us an additional \$200 million to keep the program moving forward.

Will the legislature approve this request?

Neilson thinks the likelihood is high for three reasons. First, the fund has already produced solid financial results. Twenty-three Utah companies have been funded from the program so far through 15 portfolio funds. This has created 974 Utah jobs with an average salary of \$62,000, generating returns to the state in the form of tax revenues and general economic development benefits.

Second, the state is putting no money into the program, with a very low risk that it will ever have to. True, the risk exists, but even in the worst-case scenario — if all the tax credits were forfeited as collateral in 10 to 12 years — the fact that those credits would have already generated \$100 million or more in tax revenue, makes the risk a paper tiger.

The third reason? "If we don't increase the funding," Neilson argues, "the program will come to a halt, harming Utah's entrepreneurs and Utah's reputation. Right now there's a lot of buzz and excitement being generated by the fund. Venture capital firms are coming and shopping Utah. A lot of money is looking toward Utah for potential deals. If that stops, all the momentum, interest, excitement and funds that have been swirling around and benefiting Utah and Utah's entrepreneurs will go away."

Neilson has talked to 66 state legislators about increasing the funding in 2008. He reports that they are very supportive of the idea.

And why shouldn't they be?

"We've been successful so far," he points out. "A number of Utah companies are benefiting from the program. The state is not putting money into this and is getting great benefits with almost no risk."