

Ray Daffner:

Well, thank you all. We're going to get started now with our next panel, so feel free to bring your coffee over and get comfortable. We have a panel here of experienced fund managers who are going to identify and share emerging issues in the field of rural venture capital investing. And Kerwin, we want to thank you very much for that wonderful overview, the information about the types of investments and IRR and some recommendations to kick this discussion off. Thank you very much.

My name is Ray Daffner with the Appalachian Regional Commission, and I'm pleased to moderate this panel of three experienced fund managers: Lynn Gellermann from Adena Ventures, based in Ohio; Nat Henshaw from CEI Ventures in Maine; and Ray Moncrief from Kentucky Highlands in Kentucky. And we're going to have each of our three panelists talk a bit about their funds and about ways that they see this industry of rural development investing can move forward, ways to address some existing challenges and ways to expand and grow this whole industry.

As Kerwin mentioned, the purpose of our convening here today is to initiate discussion and to get some of the best ideas from not only the panelists here at the table from everyone in the room. So we encourage you, after our panelists provide their remarks, to actively participate in the conversation that we're gonna have. We're gonna split the time for this panel, about half the time will be remarks from panelists, and have the time will be discussions from all of you.

So it's my pleasure first to introduce Ray Moncrief as our first panelist, our first speaker. Ray is the president and chief executive officer of Mountain Ventures, an SBIC. He's also president and chief executive officer of the Southern Appalachian Fund Management Company and president of the general partner of Meritus Ventures, also a rural development venture capital fund. Ray has been appointed by President Bush to the Community Development Advisory Board of the CDFI fund, and Ray is also currently the chairman of the Community Development Venture Capital Alliance, the industry trade group. And it's my pleasure to introduce my friend, Ray Moncrief.

L. Ray Moncrief:

Thanks, Ray.

Well – microphoned up here – it's a pleasure being here. As I sat down at the table just this moment and looked at the audience, the first thing that struck me is the constituency of the people in the room. It would be interesting to take an amount of time that I

won't do and talk about the tapestry that has been woven by the input of the people in this room into the work that my partner Grady Vanderhoofven and I are doing.

I look here at the people that are on our advisory committee to people that are investors in two of our funds, the Southern Appalachian Fund, Meritus Ventures. I think about Steve Mercil and the times that I visited with him when he was Minnesota Technology. Now, he's the Rain Man. I think about all those sorts of things that we could talk about. Austin Belton sneaked in the back of the room just a minute ago, and I could give you hours and hours and hours of anecdotal material about Austin Belton and the New Markets Venture Capital Program.

So there is a rich constituency in this room that deals with rural, and I am delighted that we are gathered to indeed talk about rural. You might be surprised by the way I talk that I was born in rural and that I live in rural and that I work in rural. It's very important. I like where I live. I like where I work. And I think that, contrary to the belief of some, there is a very robust business activity in rural markets. At least, that's what we're finding out. People might say differently, but our portfolio of the Southern Appalachian Fund and our portfolio of Meritus Ventures tells us that there is robust activity in rural.

Let me tell you just a little bit about the organizations that I work with. I work with several. I am employed formally by a company named Kentucky Highlands Investment Corporation, which is a very old community development corporation founded over 39 years ago. We will be 40 years old next year, if we live that long, and we have been one of the first that adopted a venture capital strategy as a community development corporation.

I would like to take the credit for being an innovator of the community development venture capital movement, but I do believe that Kentucky Highland was there at the genesis, and I would give that credit to a guy named Tom Miller, who was a visionary guy that decided that we should use some of the moneys that were available to rural Appalachia and push that out the door as equity.

Kentucky Highlands has been very successful over the years, has aggregated a large amount of capital and manages many vertical programs, both debt and equity. And in its portfolio, in the eastern part of Kentucky, there are some 10,000 people that are employed in portfolio companies that was founded and/or expanded by

investments that Kentucky Highlands made.

As a result of that, a few years ago, Kentucky Highlands had the distinct pleasure of collaborating with a group in Oakridge, Tennessee by the name of Technology 20/20. We were sister-type companies, and it became apparent that we should do something to exploit a new program that had come onto the scene during the Bill Clinton administration called New Markets Venture Capital, which incidentally had a program that was akin to it called New Markets Tax Credit, which I'm going to comment on in just a minute.

We were successful in being one of six New Markets Venture Capital companies in the nation, and we have successfully invested that money in eight companies, and we are now managing that portfolio and are beginning to harvest that portfolio. As a matter of fact, Wednesday of this week, we made our third exit out of that portfolio, one that was very good to us, one that Kerwin mentioned a moment ago, which incidentally is yet another extrapolation of getting more involved in rural.

The Community Development Venture Capital Alliance, headquartered in New York City, co-invested with us in that deal, which brings more money as a segue into rural markets, and particular into Kentucky.

Right after the New Markets Venture Capital Program got launched, there were a group of rural senators that decided that we should do something similar to the New Markets Venture Capital. One of those was Tom Harkin of Iowa, who has been a champion of something called the Rural Business Investment Companies. The 2002 Farm Bill made a provision for the creation of something called a Rural Business Investment Program, under which was the creation of the investment companies.

That happened. We were successful in being conditionally approved as one of those, and there are a number of limited partners sitting in this room that invested in that particular fund.

Today, we are a \$36.5 million rural investment fund targeted exclusively at rural but have a key component that goes with that called operational assistance, which is an extraordinary tool to use in developing investment opportunities in rural markets or, in fact, in low-income census tracts as pertains to the New Markets Venture Capital Program.

The question is can you invest in rural. Yesterday, at the limited

partners meeting of Meritus Ventures, I was asked the question – we had a Q&A period after we got through with our presentations, and a number of questions arose from the limited partners. One asked, “Is there sufficient deal flow to invest all that we have?” Is it my opinion that the amount of money we have is just a pittance of what we could invest if we’d raised the fund. I know if I were to ask my partner, “What do you think that we could invest?”, he would without hesitation say, “We could invest \$100 million fund.” And the reason being is that is where we’re located. We’re located in rural.

I recall as we were writing the application for Meritus Ventures, one of the things that we really wanted to highlight and enunciate in our application is that there aren’t many of us in rural. There aren’t many of us doing this stuff where we’re doing it. So consequently, we ended up being, and are, the conduit for traditional venture capital into deals that we’re doing in rural central and southern Appalachia. So there is sufficient deal flow.

There is sufficient entrepreneurial activity. One of the questions that a limited partner asked yesterday is that, “Do you think that you’ll be able to invest in any technology deals in rural, central and southern Appalachia?” My answer is yes. We’ve done three deals in our new fund.

The first one is a company called Zip It! It is a slick little instant messaging device that’s targeted to teens and tweens. It is pure technology. It is a nifty little thing, and God willing, you’ll be able to buy one of those things in the first quarter of 2008. Actually, you can buy one on the Internet right now. Go to www.zipit, and you can buy one of those. We’ll be glad to sell you one.

Male: That’s the marketing help I was talking about.

L. Ray Moncrief: Absolutely. Absolutely. Gotta do that marketing help.

The second we did in a rural census tract in America is something called Aldis, which is retrofitting traffic lights with LED as opposed to incandescent bulbs. Well, that’s just a part of it. These guys have a technology, a proprietary technology called Guardian Eye, which is a camera that you fit up to the bottom of it that’s not just a camera. It manages the intersection. If there’s cars packed up one side and empty on the other side, it’s smart enough to say, “Okay, let’s let these other guys go so we don’t have to sit there.” It monitors biological situations. It monitors nuclear situations. That technology came out of rural. That was a technology transfer out of things like _____ National Laboratories.

The one that we're closing next week, or that we'll close in the next week, is a company called Single Pipe Communications, which is a Voice over Internet Protocol transaction that's about as rural as you can get. It'll be in rural Northern Kentucky, and it is a technology that's supplied to a rural market. It's not a big thing to get VoIP here in D.C. It is a thing to get VoIP in Harland, Kentucky. There aren't very many of those. There is a cable system in Harland, and their strategy is to build out the delivery of voice over Internet, not only to the residential users but the business users in rural markets.

So there are rural deals, a lot of rural deals.

We have had success in rural. We've found strong entrepreneurs. We have found strong investors, and we are, I think, what was referred to as a niche investor. Early on, when we started investing in rural, we found that a lot of the larger traditional VCs would want to do a modest valuation of a company and invest a large sum of money to end up with a large piece with the company. We invested a more modest sum, a smaller sum, on a more reasonable valuation to prepare the company for their Series B and Series C round of investing. We have found that there is a significant amount of opportunity investing with that strategy.

We're very hands on. Kerwin mentioned a moment ago that in our exit, we did a lot of the heavy lifting in the negotiation. We do a lot of heavy lifting on the going in and a lot of the going out. But the real value that we bring is the daily participation and the monthly participation at board meetings, insisting that these small entrepreneurial companies have board meetings and make them look at themselves to understand what their strong points are and what their weak points are.

As a matter of fact, every deal that we've done at Meritus Ventures has been via a syndication with traditional venture capital. That may not sound like a lot to you, but it is an extraordinarily sounding gong to those of us who are doing community development venture funds that are mission related or mission directed venture investing, otherwise referred to as double bottom line investing.

A lot of things that we do we kept mentioning over and over in our limited partnership meeting about double bottom line investing. Well, it just seems like we're there on the ground. You're finding the good deals, but the traditional larger VC funds don't want to go

to where the deals are, so consequently, we're there. We, in some cases, do the lead. In some cases, we participate in the syndication. But we are the conduit to get that done.

How do we create more opportunities in rural? It is a shame that our legislators created a program in the 2002 Farm Bill and only one RBIC emerged out of that. It is absolutely a crime that that took place. There was \$100 million authorized and appropriated in the '02 Farm Bill and because of various and sundry reasons, that amount got picked apart, pulled down until there was a paltry \$10 million left to run three programs. And for a lot of reasons, two of the programs weren't successful in putting their private equity together, and one did.

We're here talking about rural. On the table today is the 2007 Farm Bill, and I'm sure that we're going to be talking about that in various and sundry things. I notice there's a session that's going to be talking about the RBIC.

In my opinion, we should – if we're serious about rural, we should be serious about ensuring that the 2007 Farm Bill contains a reauthorization and re-appropriation, if you will, and mandatory spending requirements for the Rural Business Investment Company program because – and it needs to be one that is the new, enhanced version, one that creates an appetite for practitioners to say, "I think I would like to form one of those RBICs," not laden down with the fees that this current one is laden down with, but an incentive for practitioners to be rural practitioners as opposed to traditional practitioners.

One of the voids that we have, and one that I constantly talk about, is that there's deals, there's entrepreneurs, there's opportunities, but the lack of capacity is an impediment that we've got to address, and we've got to address it by making these programs somewhat more attractive.

An example of that would be Andy King with Co Bank, a \$30 billion Farm Credit System bank, would invest significant sum in this space. He's limited because the Farm Credit System can only invest 15 percent of the private equity of an RBIC. We want it to be 15 percent of the combined, which would give him more opportunity – there's a lot of pent up financing in the Farm Credit System. If you've never done an analysis of the Farm Credit System in rural markets, they have a lot of zeroes on their numbers. It's a big organization with money, and they are changing their strategy exclusively from a debt program to avail

themselves more to equity programs.

Another thing that we need to do policy-wise is that we need to address the New Markets Policy Tax Credit. Senator Grassley of Iowa insists in the reauthorization of an MTC, that a portion of it go to rural. A very small part of the New Markets Tax Credit allocations that's happened over the recent years – just a tiny fraction of that has gone to rural markets. We need to insist that more go to rural markets, and we need to harmonize the provisions of the New Markets Tax Credit regulations to make it friendlier to the creation of venture funds. You cannot use the New Markets Tax Credit efficiently to raise a venture capital fund for a couple of reasons. The 85 substantially all early exits, untimely exits as you mature in your fund. You've got to reinvest funds. If you're not quite to that six years and one day threshold – if you're there at 5 years and 300 days, you've gotta reinvest, or that triggers a recapture event all the way back to the first day. We have to address those kinds of things if we're going to use it to raise funds in rural markets.

Another thing that we have to do is that we have to invest in entrepreneurship. Entrepreneurs are profoundly important to rural. Dr. Jay Kayne, who is the Cintas Endowed Chair of Entrepreneurship at Miami University of Ohio, made a comment a couple of years ago in an entrepreneurial coaching clinic, and he said the following.

He said that government – that being local, state and federal – spend somewhere to the tune of \$18 to \$20 billion per year on economic development. That is \$18 to \$20 billion with a b on economic development. An extraordinary sum of just two percent goes to entrepreneurial development, whereas the most jobs that come out in this nation come from entrepreneurial businesses with just a few employees.

As a matter of fact, one of the members of the audience, Brian Dabson, gave a speech in Ashville, North Carolina talking about entrepreneurs, and he spent a significant amount of his time talking about how we need to invest in our communities to make them entrepreneurial friendly, which is very important. It's not easy for entrepreneurs to be entrepreneurs in some markets where there is little capital. They've got a great opportunity, but there's not an environment for them to thrive.

In conclusion, I think rural is a great place to be. I think that there are significant opportunities if we just tweak the model slightly.

We need to start celebrating the effort of entrepreneurs and celebrate the investing of entrepreneurs in rural markets. And we absolutely must stop the persecuting of failure. We persecute failure to the nth degree.

Will we continue doing this? Yes, we're gonna invest this, and as soon as Mike Tharp gives us the go ahead three years from now, we're gonna raise another fund, and we're gonna raise a large fund than the one that we have here. And we are going to continue to invest in rural markets in southern and central Appalachia.

Entrepreneurship is alive. The VC model is alive. Rural is very much alive. And it's a great opportunity, and I'm very happy to see the level of people in this room that have taken time out of your schedule to come here and talk about the rural agenda. Thank you very much.

[Applause]

Ray Daffner:

Ray, thank you very much for talking about rural venture funds and the market opportunities and providing some very specific opportunities to move this industry to the next step. I think what we're gonna do is hold the questions and discussion until all three of our panelists have a chance to speak, and then we'll have a broad discussion with everyone in the room.

Our next panelist is Nat Henshaw with CEI Ventures, and Nat began his career in the venture capital industry with Inner South Partners and Kitty Hawk Capital in North Carolina and then moved to the presidency of a chemical venture capital company in New York City. Nat founded CEI Ventures, an affiliate of coastal enterprises in 1994 and is based in Maine, and Nat is also one of the founders of the CDVCA, the Community Development Venture Capital Alliance. Nat Henshaw.

Nat Henshaw:

Thanks. Is it okay to walk around a little? Or do I need to be on this mic?

L. Ray Moncrief:

Nat's using technology to show that there is technology in rural markets. *(Laughter)*

[End of Part1Side2, Beginning of Part2SideA]

Ray Daffner:

Maybe.

Nat Henshaw:

Maybe. So, thank you all for coming today. Is this on? Great. I wasn't the president of Chemical Venture Capital. I was assistant

to the president, a minor distinction. (*Laughter*) Nor was I president of Chemical Bank, which at the time was then the sixth biggest thing.

We run two venture capital firms directly, two venture capital funds directly at CEI Ventures. We have a third new market fund which is also under the umbrella of coastal enterprises, which is a 30-year-old community development corporation. This is a for-profit, traditionally structured entity but managed by this management company which is a for-profit subsidiary of Coastal Enterprises.

Our first fund in '96 was \$5.5 million, and our second fund was formed in 2001 as a \$20-million company. Our niche is underserved markets in Maine and the northeast. Currently I've looked at deals in California and spent some time in Tennessee, among other places, but we have investments from an empowerment zone in Northtown, Pennsylvania to Whiting, Maine, which is the far east port way up the coast.

We're a socially responsible venture capital firm. Our core social value is jobs for people with low income, but we're also very interested in the environment, healthcare, education and other benefits found in the products and services, be it environmental cleanup, natural cleansers, natural food is a big area for us as well. So, quality jobs for people with low incomes, and health insurance is a primary quality determinate as well as wages.

Environmentally sustainable businesses, so we have an air pollution control company in Berlin, New Hampshire which we sold last summer and made money on. A little tiny company, million four in sales or so when we invested; 17.4 percent IRR on that investment.

We're diversified by industry in stage. So, we have a startup company that's a biotechnology company in South Portland called Chemigent which has developed a test for tuberculosis for use in the developing world, as well as we have a \$50-million software company in Nashville, new Hampshire. Although it wasn't there at the time, we've also got other mature businesses, recapitalization, management buyouts as well, often with an employee component to them.

These are – this is data on our funds. Of the 5.5 million we invested 4.6 million. In 20 companies we're fully invested. We've had six exits, one partial exit. We still have eight companies

including, we believe, some substantial, unrealized returns, some gains in terms of that \$60-million software firm I mentioned, which we started at I think 800,000 a million with them.

We've now returned 20 percent of capital to our investors from this fund, and there have been 551 jobs created. There's a total of about 1900 people employed at these companies. And investments currently in three states. I forget, there may have been an additional Vermont deal in this fund originally. Our second fund we've invested of the 20 million, 13 – over 13 million in 17 companies. We're fully committed, so we don't anticipate making a new company investment. We'll do follow-ons in this fund. We've had two full exits and one partial exit with 13 remaining companies, and we've returned 25 percent of capital to investors with additional capital that's escrowed to cash that's expected to go back.

So, this fund is doing quite well. It has a, as of last December, 20 percent IRR. It's created 397 jobs. It's got a total of somewhere just under 600 jobs at the companies. Companies with investments in six states including Maine, New Hampshire, Vermont, Massachusetts, New York and North Carolina. The North Carolina one happened to be a headquarters that moved from Portland, Maine to North Carolina. There's another one which we exited which was in Camden, Maine which is now located in San Francisco, a company called Freeboarders which makes software for apparel design and specification.

I think this is a piece of what we're trying to do is determine what would be some helpful policy descriptions or initiative for this industry. The bulk of our investors, perhaps 60 or 70 percent, are bank investors. That's been – CRA, the Community Reinvestment Act has been very helpful to us in this way. And it's varied from big banks who do this in the ordinary course and have done it for decades like Roz Ciulla from KeyBank is one of our investors, to some community banks who have never heard of venture capital, but they look at the investment test and they start looking at us and say, "Gee, this is an opportunity for us." And that's lead to significant capital for our funds.

There has been changes to remove the investment test from smaller banks. Those kinds of opportunities from some of the people who haven't heard of us and our industry go away when that kind of thing, when CRA is changed. That's not always the case, but it certainly is helpful regulation for our industry.

Secondly, we're a CDFI, as is our parent company. We're certified in Maine actually. As it turns out, the bulk of our bank investors are in Maine. This is how you get – one of the ways you get Community Reinvestment Act credit. We've talked with other funds that have done it more recently. There are various problems with getting certified. One, it's kind of designed for a firm that already has investments, so if you're certifying a new fund you have no investments, you're not certifiable from a CDFI standpoint. You might be otherwise certifiable.

But at any rate, we – on our first fund we needed to close an investment of getting our letter, and we actually had one teed up, and it fell into place very nicely. If you have market area, which a lot of firms do, including ourselves, which includes nine states, you can imagine the difficulty getting certified so your bank investors get credit for that over time. So, we haven't done it recently. These are just voicing of my fears and dreams for this program and how we can be certified. It's also, of course, helpful to have the investment capital from a CDFI fund, and we have had that capital in the past, and it's been very helpful to us.

I personally feel this third item: restore participating preferred securities at SBA – we had a bubble in this country, which everyone is fully aware of, an internet bubble where a lot of private investors lost a lot of money and some public investors did too, the SBA. Just because that happened does not mean that was a bad program, and maybe Austin can help us with this more at the right moment, but I think this is an excellent program that was ditched as the result of a market cycle. It was well designed. It allows the federal government to become an investor in a venture capital fund on roughly the same or similar basis to that of a private investor. That's gone away. You can only borrow money now. There's a matching problem trying to do equity investments which have an uncertain and very long life and a debt security which requires current payments on debt. It's a little analogous to if you're an entrepreneur and you're starting a company that won't have any profits for five years and you – but you have to borrow against your home and make payments each month. That's a potential mismatch which can lead to bankruptcy. That can happen too with equity funds funded by debt.

I think we, as Ray mentioned we should, reauthorize two programs, the first being the rural business investment program, which was perhaps authorized but not funded. I don't know the details, but this was a good program. It is useful for rural areas. It has technical assistance money, which is good, which is

unmatched. Doesn't have to be matched, which is a problem if you're trying to raise capital it's certainly better to be spending your time raising investment capital than trying to get grants, which are a lot harder and not really what we do here to give us money. We're trying to make money for you. Not necessarily the same thing that venture capital people do.

And it's hard to get it. It also takes away from things like our parent company that are trying to get grants for all sorts of activities from child care to affordable housing and other things. So, that's a very useful program. Getting more of those companies authorized and up and running would be good, having more money for that program, it's a good thing.

Similarly, with the new market venture capital fund that's – program, that's a similar deal, but low income tends to subtract everywhere, also in rural areas. Another excellent thing to do. Be nice if it had various improvements, including not needing to match, etcetera. If it became an equity program instead of debt, that'd be a great thing.

Rationalize the new market tax credit for venture capital investing. Ray alluded to some of the issues, the substantially all program, we have management fees. You have a \$10 million fund. You charge, say, 2.5 percent on that each year. You're not allowed to use that to pay your management fees the standard way that venture funds would work. You can do it with a new market tax credit. You have to invest all of your money. You saw ahead a \$5.5 million fund that had \$4.6 million investment, can't do that. You need to have 5.5 million. I may not totally be up to speed on all the regulations, so don't ding me too hard if I don't have everything exactly right. For example, I heard reference to 85 percent.

The substantially all, the holding period you have to hold the investments for seven years. Well, we just made an investment in a company in 2004, Innov-X Systems, happened to be in Woodbourne, Massachusetts, a scientific instrument company, clean technology. It's used to clean up – to detect hazardous metals in soil. It's used to get lead out of toys, for example. It's used to detect lead paint in apartment buildings. Worldwide it's used to sort scrap metal, hazardous cleanup recycling. Very interesting company. We invested in 2004. Last December, which was December 2006, two years later, we had a partial exit. We still own 8.5 percent of that company, but we got \$3 million back on our \$600,000.00 investment. You can't do that. You have

recapture.

If Roz Ciulla, if you invested for a new market tax credit we'd have recapture. Your tax department would be all over us. I wouldn't be here. I'd be out with a tax attorney. I'd be writing checks. I'd be being beaten up. It would be all sort of fun stuff, so that's not a good thing. We need to rationalize the new market tax credit so that it can be used for venture capital investing to create jobs, not just to create buildings in rural areas, sometimes buildings that often exist already.

Maintain capital gains treatment for carried interests. Guys, gals, while we're doing this all your government is about to tax the entrepreneurial engine that gets all this stuff going. After you've done this for ten years and maybe you've been successful, and maybe you haven't lost the money, at the end of the day you hope that your profit participation in that fund will be taxed at 15 or 20 percent as opposed to 46 percent plus your state rate, which in Maine is about 11 percent. You're talking about doubling or more – well more – three times the rate of taxation. I'm not saying that it's wrong to go after plutocrats who may have a lot of other stuff going on too, but we're about to torpedo this engine that creates all of this while we're doing all these tweakings of all these programs because people will choose to go to a common investment banker and get paid a bonus each year as opposed to be waiting ten years to have your carried interest payoff.

That's – that overshadows everything else we're doing here today, and it's about to happen. It's very likely to happen. The result may be some financial engineering which will keep a lot of lawyers and accountants busy for a long time that it's like a Shari Allah. You can't have interest, so you own it and lease it to someone. We'll have to do something like that, but it's going to be a lot of wasted time, effort, expense, and it's also going to catch a lot of people that might have been doing it for a long time. Thanks.

[Applause]

Ray Daffner:

Thanks you, Nat, and thank you for those clear recommendations regarding CRA and FDIC programs, tax treatment issues and other matters as well. Lynn Gellermann is our next panelist – excuse me, Lynn – Lynn is a founding partner of Adena Ventures and also partner in Woodland Venture Management, and Lynn brings 20 years of banking, venture capital and economic development experience to the funds. Lynn also serves on the boards of several portfolio companies of Adena Ventures and serves as an advisor to

several research and economic development entities in Ohio. Lynn Gellermann.

Lynn Gellermann: Thanks, Ray. Good morning. Batting cleanup with these two guys is somewhat challenging, so this will be fairly short. I wanted to first recognize a couple of investors in Adena Ventures that have stayed with us since the beginning. Roz Ciulla from KeyBank EBC and also Chris Perez from the Heron Foundation. They've been outstanding supporters. I'd like to thank ARC, Anne Pope and Tom Miller, Tom Hunter back there. They made a small but vital grant to Ohio University that helped us get started five or six years ago. I'd like to recognize too the importance of cheerleading and moral support when you're doing the tough work that the three of us have been doing, and Kerwin and CDVCA have been very supportive, and also Ruth Clevenger from the Federal Reserve Bank of Cleveland helped us get started, and lastly the SBA as a New Markets fund has been critical to us getting to scale so we could actually have a chance of running a successful venture capital fund. So, some great people in this room. Some of us – many of us have been fighting this fight for a long time, and I wanted to say thank you.

Adena Ventures is the first new market venture capital fund in the nation. We're based in Athens, Ohio, a rural university town. We're five years old, which as you can tell from the prior discussions, that's relatively young in this industry. We have invested \$16 million roughly in 10 companies, 90 percent of which are located in low-income communities and about 40 percent of which are based in or have significant operations in rural communities.

We primarily invest in tech companies, for example, video game middleware, digital video and interactive digital video technologies. We invest in technology and able-serviced companies, and then we've balanced our portfolio with some more traditional investments. We do, in fact, own a significant portion of a furniture company, so it keeps it interesting.

And we do live and work in a rural community. I moved to Athens five or six years ago, but as our portfolio has grown and as we have worked with co-investors, which I'll get to in a second, we're really working coast to coast. We work in cities. We do put in windshield time. We do drive to rural communities, but we put our time in in New York and Silicon Valley and Boston, in Chicago. Those places are important to the work we do. I'll get to more of that in a second.

One of the unique things about Adena Ventures and the New Markets program is we raised a significant amount of operational assistance funding, and to date we have provided \$4.5 million of operational assistance to 70 companies, so we've been able to touch a lot more companies, many of which are in rural communities, than we normally would have been as just a traditional vanilla venture fund. You can tell we've helped 70 companies with operational assistance. We've only invested in ten of those, and we provide operational assistance before, during and after investment. And I think at the end of this one of the recommendations that I would make is that it works. Operational assistance works. It should continue on in various forms. It should probably continue to get very innovatively used, and we've seen it make a big difference in companies whether or not we invested. So, we're proponents of that.

Ray Daffner: You might just explain what operational – we keep using that term. I don't know if we've ever really defined it.

Lynn Gellermann: Okay. For the benefit of those of you who haven't heard that before. That includes service – professional services that we provide to our portfolio companies, and we do that through blue chip, third-party vendors, for-profit, private companies and universities. The types of services are business planning, financial forecasting and modeling, executive recruiting. What we're trying to retain and attract executive talent to help our companies grow, marketing, website development, those types of things to help companies get started and hit growth inflection points.

Ray Daffner: And it's specifically for New Markets Venture Capital and rural business investment companies? It's not otherwise _____ --

Lynn Gellermann: I would say in rural communities, particularly in Appalachia, where we do most of our work, we have had to go to cities, nearby cities, and we have sort of had to bed, borrow and buy those services because they typically don't exist where we run our fund. There is not an executive recruiting firm in Athens, Ohio. There is not a top shelf marketing and PR firm in Nelsonville, Ohio, so we go to Columbus and Pittsburg and Cleveland and Charleston, West Virginia, and we have built a menu of companies that want to help and invest their time and services in Appalachia, and that's really been rewarding. It kind of has created a network unto itself. It's been very helpful.

So, a couple of our goals were to establish some financial leverage. We thought it's kind of neat to bring a dollar of venture capital to Appalachia, but really we want to accomplish more than that. So,

over time we've done some pretty heavy syndication of our companies. To date I believe we've worked with about 18 other venture firms, co-investors that hail from 11 states and 3 different countries. We've put about \$20 million to work in central Appalachia. They've put \$60 million to work. So, that's about a 3:1 financial leverage factor. That's probably going to increase a little bit here as the fund matures a little bit.

Also, we've helped maintain or create 750 jobs, and a lot of that has been really with our operational assistance programming, and that's vital to that figure. It's not just our ten portfolio companies. So, those are two indicators that we've worked with.

I would like to mention that SJF Ventures, Bonny Moellenbrock is here. They are one of our co-investors in a company in Nelsonville, Ohio, rural, and also Mountaineer Capital is here, Pat Bond, and they've invested with us several times in Appalachia.

So, here's what I see in the market, and I think a lot of public policy has been covered by my colleagues here, and they've done a great job with that. One of the things we're seeing, a positive trend, state government and universities are stepping up to the plate, and we're seeing more seed and more angel fund organization as a result of that. So, I think there has been, as certain things have shifted away from federal government or have been shut down, states particularly states that are at the back of the bus economically or need to turnaround their economies like Ohio, have stepped up aggressively, innovatively and are doing a lot of different things in and around the venture capital space. So, we're really thrilled to see that, Pennsylvania, Ohio, many, many states are getting involved in that.

Universities are starting to get increasingly involved. It's not just an entrepreneurship center anymore. They want to work with a venture fund. They want to be hands on with portfolio companies. They want to give their MBA students real life experience, and so we work with the University of Charleston and Ohio University, but just in general we're starting to see universities step up in many different ways. So, I think that's all good.

Adena, for example, comes to the market, and we didn't solve everybody's problem. There was still some very early seed, pre-seed and angel funding needs that existed. So, people are starting to address that into the capital gap.

Additionally, pension funds and other large institutional investors

have woken up, and they are hiring people like Credit Suisse to manage portfolio allocations for emerging managers, and I think many of us practitioners in the room would qualify or be seen as emerging managers.

So, those are pretty large pools of money that might help us raise second and third and fourth funds. Again, I think that's positive, and when you start working with Credit Suisse, they're really engaged. They're in the market. They know what they're doing, and they're also helping to create new networks, whether that's Ohio or North Carolina. So, that's positive.

I mentioned operational assistance works, and we're starting to see that come about in different forms. I think some of the challenges we see there's a tremendous lack of corporate presence and involvement in activity in rural America, at least the part sort of it that we work in, and that really has an impact on networks and exits and corporate leadership. And so those corporations aren't there. Can we get them engaged and interested without necessarily having to build a plant? How can we get them engaged I think is a challenge.

While early stage and seed – really early money is starting to come around, in part through public policy, and buyout money has been very prevalent the last couple of years, we're seeing recently growth capital, subsequent funding for companies that we've started. When you need to go do a 5 or 7 or \$12 million round that's no so easy buy in in general, and particularly hard in rural America. So, what are we going to do about growth capital, and that really speaks to scale: \$20 million fund, we're \$34 million fund; where's the \$100 million fund to come and co-invest with us and help us get our companies to the next skill?

And the last couple of things I think human capital has been and will continue to be a challenge for rural America and early-stage investing, and I think we have all found innovative ways to try to attract and maintain that talent, but it is a challenge. Not everybody wants to live in Athens, Ohio. So, you really have to come up with some interesting and unique approaches how to solve a human capital issue.

Lastly, we do put a lot of windshield time in, and that includes driving to airports. Rural America could really use a little help on transportation. It's beautiful out there, but it takes some doing. So, I'm all for innovative, commercial air programs that might, for example, leverage university airports, which we're working on in

Athens, light rail, highway bypasses, all that helps us get to where we need to be, and it's very challenging. So, I thank you for your time, and I hope those thoughts are of some help to our discussion today.

Ray Daffner:

Thank you, Lynn. And thanks to all our panelists for their comments and for what they do every day to help create jobs and businesses in our rural communities. We've heard some wonderful ideas here, wonderful thoughts and recommendations. They focused on a range of activities. Some are programmatic such as support for expansion and continuation of programs like the RBIC program or new market tax credit program, our related items to help ensure that it's continued availability and usefulness for venture capital investing. Some comments related to the SBIC program, participating securities.

Some of our speakers comments related to regulatory matters such as CRA programs and to ensure their continued encouragement of private investors to continue to invest in this field. Other comments related to tax matters such as capital gains treatment, carried interest, and some comments also evolved around the growing role of state government and university involvement both in seed and angel fund investment, the involvement of new types of private investors such as institutional investors helping expand capital available for this industry and the importance of corporate involvement, non-financial corporate involvement. And some general comments about challenges that rural communities face, the importance of ensuring that our rural infrastructure be that human capital or transportation infrastructure exists so that our entrepreneurs can flourish.

So, really a broad range of comments and insights provided by our panel here, and I think now is an opportunity to hear – to have a discussion with all of those in the audience. We have a microphone here from John Olson and another one over from Dave Erickson, so please feel free to raise your hand. And we're very interested to hear, not only your reactions, but your recommendations as well.

William Buster:

Good morning. My name is William Buster with the W.K. Kellogg Foundation, and this may be a result of who and how the meeting was planned, but I have a question about geography. Are there not the opportunities in places like Indian country, the lower Mississippi Delta, the black belt counties of Alabama, Georgia and South Carolina to do these kinds of funds? I've looked at this, and I don't see a lot of those opportunities, but from the professional – you guys are the professionals. Do you see these opportunities, or

are they out there and we just don't see them from the foundation side?

Lynn Gellermann: We're working on one of those right now, so I'd like to speak with you afterwards about that. I think there are opportunities. I think people are trying to replicate and improve upon the different venture models that the three of us and others have put together, and I think that is gradually – there are conversations and needs that are spreading to places like Alabama and the black belt and the Mississippi Delta. So, I think over time you're going to see more of that.

You're going to have to probably see first-time funds, and we know how hard that is to raise that money, so if you're interested in those types of efforts I think the Kellogg Foundation and others can be vital to getting new funds started down there. We certainly are trying to bring some of our experience down to the black belt region, and I know others are working in other geographies that you mentioned. So, I think there are things afoot in those areas.

Nat Henshaw: I looked at a business plan actually for a – I was on the selection committee for a venture capital fare, and I looked at a fund that was targeting Indian country, and I think those types of efforts are interesting. I wouldn't make it solely – I wouldn't tie one's hands too much that I think that it's good to be able to invest in those geographies and also to invest elsewhere as well, but the diversity to bring people back to invest in your deals is helpful, and to have other deals in your portfolio that aren't solely concentrated in a specific geography. That's how we designed our fund.

So, I think there are those opportunities. We've had members of CDVCA that have been from those areas at various times and currently too. These are long funds thinking about equity and existing members. So, I think there is opportunity. I think the question is kind of about diversifying, whether there's enough deal flow for a specific area, and I'd encourage broader areas for development.

L Ray Moncrief: Just sort of to tack onto what Nat said, you sort of hit the nerve of a comment that I made earlier, and that is the creation of capacity. It's a fact that every business needs a form of equity. A lot of people camouflage equity with debt, but it's borrowing money on credit cards and friends and family and those things to put in a company, but every business needs a layer of equity to leverage with bank debt and those sorts of things.

And equity investing is not sort of the easiest investing to do. It's

very intensive and it's sort of – not underwriting alone and taking the collateral on it and moving on. It's very hands on and requires a lot of work. And in order for a fund to develop there has to be a sufficient reason for it to, and we've got to create – and I'm going to come back to the word capacity because I do think that we have to develop young practitioners that want to do this type of work and have to be incentives to woo them away from the Bostons the Californias, the Austins, Texas and places like that that make them see a reason to invest in areas like you're discussing. There are opportunities in the Mississippi Delta. I'm a product of the Mississippi Delta. Indeed, there are opportunities there if one were to be indigenous of the area.

I tell you what you can't do. You can't live in urban America and invest effectively in rural America. You can't do that. I was on a panel a number of years ago in Denver, and a guy that was an investment banker – I won't name the firm – said that "all that it takes to get to rural deals is a little smaller airport in a little smaller plane," and I sat at the table. I had a set of comments written, and I completely rewrote my comments to address that issue because that's just not true. You've got to live there and live with the people you're investing in to see the opportunities to do all the things that Kerwin talked about to go to every single meeting that's out there to do the stumping and the networking to make deals go. So, it's capacity building. If you want to see deals in the lower Mississippi and places like that you're going to have to create capacity for people out there doing it.

Rebecca Seib: Ray, can you hear me?

L Ray Moncrief: Yes.

Rebecca Seib: Ray. You touched on some of the items that I was going to address, but basically this is sort of a reverse kind of question that I have because I've worked on the emerging technology fund and the Texas enterprise fund in Texas, and we don't have rural opportunities. And with the fund that I work on now, it's more or less a debt instrument, we're so focused on the infrastructure and the essential community needs that make those rural areas attractive. It's not the fact that there's funds available. It's those entrepreneurs out there, and maybe Lynn touched on a piece that – because I network with the Delta Council, I might add, and a lot of others in our district that maybe we would find these in the universities. But we're not seeing – we're seeing entrepreneurs, but we're not seeing the advanced technology that you might see or from what you all have been fortunate enough to see.

I was wondering are there other sources where we might find that development because rural communities desperately need more access to communications and these kinds of services and businesses?

L Ray Moncrief:

To address that directly, sometimes businesses and ideas don't just state in rural markets. Sometimes you have to help the people that you're investing in, identify where they really want to establish their business, quite frankly, and sometimes you have to encourage them that we'd love to invest in you, but you need to establish your business in this geography, and you need to hire people that are indigenous to this area, the cross section of those people that are there.

Encouraging business – where I live in eastern Kentucky. I have for close to 25 years encouraged businesses in urban areas to attract investment to move to rural areas. As a matter of fact, week before last I attended the 35th anniversary dinner of a company that was headquartered – that was started in an urban area and was looking for risk money. Thirty-five years ago they moved to rural Kentucky, and I'm telling you severe rural Kentucky to establish their business. Today they're a \$50 million revenue business earning a significant bottom line. We have invested in them, exited. I've invested as an entrepreneur now three times and pray that I live long enough to invest in him again, but we have to encourage people to move out of urban markets into rural markets. It's not a natural sort of thing, which means that we've got to start elevating and creating entrepreneurial environments helping people recognize that they indeed are entrepreneurs.

We're investing in something called the Center for Entrepreneurial Growth, which is something that we got from Technology 20/20 down in Oakridge, and that's training entrepreneurs that here's what it means to be an entrepreneurs. I don't believe you can train entrepreneurs. I believe you can train people that have entrepreneurial tendencies on how to bring the best out of their tendencies out and capitalize on that to make businesses grow.

So, that's how you move urban businesses that have started into rural markets, and I think it's an on-purpose push to in fact do that.

Chris Perez:

Hi. This is Chris Perez from the F.B. Heron Foundation. I guess this is almost a segue question, and I'm segueing to myself, so I apologize for that as I'm going to be up there in a second, but one of the things I note that has not been listed or you all have not sort of talked about as a challenge is sort of self-identification and what we call ourselves or what you call yourselves. And that might be

an interesting place to start considering that we all gathered here under the _____ of a rural community development venture capital discussion. But it seems to me, and Kerwin, this was in your slide. You had mentioned that there's a significant amount of community development venture capital funds in rural America where they seem to congregate there. And to me that's a little problematic, so I'm trying to understand really what makes you a community development venture capitalist. I don't want to put anyone on the spot, but in our materials here, and I think Julie is here. Is she her? There you are, right in front of me. I know I saw you a second ago. You talked a little bit about how to think about defining the space, and it seems that there was a general definitional approach to limited deal flow and commitment to the double bottom line.

So, I want to ask sort of based on that, Lynn, does your sort of commitment to the double bottom line make you a community development venture capitalist? How do you distinguish yourself between a community development venture capitalist and a traditional venture capitalist and how you think self-identification plays into some of these challenges around fundraising and deployment?

Lynn Gellermann:

I think we're for-profit, and we are committed to the first bottom line first and foremost. We're here to make money. We think you can do well financially and do good along the way as a result of your investment activity. So, we don't make investments to get a social return, but we do think good investments can often result in social benefits, whether that be jobs, income, payroll taxes, benefits for people, profit sharing. We particularly for Adena have also looked at geography where 90 percent of our investments are in low-income communities. That doesn't mean everybody involved with that company is low income. In fact, we hope it's the opposite, that over time they are not low income or we haven't done very well.

Then I think the provision of operational assistance is sort of fundamental to going above and beyond as an investor what capacity we have, what help we can provide. Again, 80 percent of those funds the companies we've helped with those funds have been lower income areas that haven't in the past had access to those services. So, this is very much about business, but I think along the way good things can happen.

As you know, we have a company in Nelsonville, Ohio that started with seven people and a million and a half revenue. Today they employ 75 people and they're going to hit about 35 million in revenue. Those people have benefits. They have jobs. They have

employee stock options. That's a major employer in Nelsonville. We also think it's a good investment and that we're going to successfully exit that. In fact, we've already had a liquidity event with that.

So, those are the ways I would answer that, but I don't know that you can run a venture fund without a real clear eye on the first bottom line.

Nat Henshaw:

I – we speak of ourselves as socially responsible venture capital. And we do have urban investments as well. I know that may be sacrilege here, but it's a fact. *(Laughter)* Our – I'd say one of our core ways in which we identify ourselves as a community development venture capital firm is that we sign agreements with each company to target the creation and hiring of people with low incomes as a result of our financing.

So, that's not something that standard venture capital firms do or probably contemplate on any basis. Although I think some SBICs probably track excess labor areas and look at some of those employment impacts.

[End of Part2SideA, Beginning of Part2SideB]

Nat Henshaw:

-- answer that question. Thanks.

L Ray Moncrief:

Don't leave me out here. I think that we are committed to the development of venture capitalists by virtue of the mission, by virtue of the fact that we were new markets tax credit or new markets venture capital, which has as its mission investing in low income census tracts.

Secondly, by being a rural business investment company required to invest in populations of 50,000 and below rural. I believe that makes us exactly that. Whenever there's a restriction and an own purpose mission-driven of where you invest that makes you community development. Of course, we have double bottom line because we're trying to hire rural people and RBICs. We're trying to hire low-income people in NMVCs. Does the model work? It absolutely works, so that what makes us community development. And Kentucky Highlands is a committed to development corporation that does community sorts of work.

Rebecca Seib:

Hello. My name is Rebecca Seib, and I'm with NeighborWorks America. And we represent a network of organizations across the United States. We have approximately 240 chartered organizations. Of those 240 chartered organizations we have 52 of

those organizations or 22 percent that are actually doing commercial lending within their communities. Their footprints are quite large. They do everything from business development to commercial property development to providing affordable loans to community facility development such as hospitals and other community facilities. You talked about the issue of capacity in hard-to-reach areas or where your footprint is not there. Can you please talk about or just do some visioning on how, for example, a network of nonprofit intermediaries could actually help you identify business opportunities as well as manage some aspects of your fund in order to earn some revenue for their own organization as well as to create quality jobs or at least jobs for – maybe they're low-skilled employment opportunities that are in many of the colonials or in Indian country or the Delta. Thank you.

L Ray Moncrief:

I'll take a shot at that first. I think it's an outstanding question, quite frankly. Right now we are designing an entrepreneurial boot camp for Arkansas. My partner and I had a conversation on the airplane, and my partner put some meat on the bones of the outline we wrote, and we presented that to our partners in Arkansas. And we just had that conversation for about an hour and a half yesterday about how can we go to hard to reach areas to let people know that we're there to do investing? It goes something like this. We're talking about a one-day boot camp where in the morning time we would have presenters that would include intellectual property attorneys. It would have bankers and investment – or economic development professionals, those sort of things in areas throughout the state of Arkansas. I'm just saying Arkansas because we're designing that for Arkansas. It can be replicated anywhere.

And then what we're doing somewhere in that morning session we'll talk about the venture capital model. We'll talk about a rural business investment company and what risk money is, which is a huge training thing for entrepreneurs in hard to reach areas because when you sit down with a would-be investee and say, "Well we invest in a participating convertible preferred stock," that's just a mouthful that they can't digest. So, there needs to be time to train them how to do that. The whole afternoon will be dedicated to building a pyramid where the base is, this is what a business looks like. How do you prepare businesses in multiple iterations to – you get to the top of that pyramid that says, "You are now ready to do some type of investing."

I think that if you want to help us do those sorts of things network with us in hard-to-reach places like what William was talking about in the Mississippi delta, in rural Arkansas, in rural Tennessee, rural Kentucky, southeast Ohio where Lynn works, in

Wilton, Maine where Nat works in the western part of the state. It's those kinds of things that we need to help segue us into investment opportunities. There are deals out there that sometimes they don't even know what the word venture capital is and how to get to us, much less us get to them. So, that's a great question. I thank you for asking that.

Nat Henshaw:

We're always interested in forming partnerships with other groups. It's critical for us to generate deal flow. That's one very important thing. Another thing that we work with other local groups about – and these are a very wide variety of different sources – is job training providers and technical colleges to train the people for the jobs that we hope to be creating when we invest in a company.

If we invest in a software company but we can't find anyone that has any programming skills and they have to go outside of the area, either move the company or bring people in as opposed to local people, that's a problem. We do finance and gross seminars where we'll go around to areas and talk about what's necessary to be venture ready, what kind of goals you might have, what it's like to work with venture firms. And we'll get a group of local people from the area that make investments. We might have an angel investor and a couple three venture capital firms and some other groups and have a session like this and then lunch and try to generate some deals among other things.

So, we do a range of things, and it's critical for deal flow development to have a network as well as to help the companies. Beyond that, operational assistance can often be a source of hiring groups maybe like your network to do things for the company, which would be helpful. It might be in the job development area.

William Buster:

I just want to make a quick little comment back to a word that you used, Ray, tapestry. I think when I think of community development venture capital I think there's the tendency maybe to misunderstand the word venture capital. I think we're talking about policy that encourages risk and equity capital at different scales and different levels because the – what you might need in one area might be a small angel fund to start developing entrepreneurs so at some point in time they can bring them to a fund like Ray's. So, you need different shapes and sizes and an ecosystem both of this talent and capital, and I think the challenge for all of these programs is just to figure out how to put these things in place so that it allows for some of this flexibility that we're talking about.

I think the comments made by the panelists about tweaking some

of these programs is key to building in some flexibility so we can build capacity at these different levels.

Lynn Gellermann: I would agree with that. I think it's going to become increasingly important for things like the federal government to – agencies to either learn or learn anew how to work with state governments. For example, can ARC work with the state of Ohio on its new capital fund? That interaction and then there are some parameters within both state and federal governments and agencies which sometimes prohibit their participation in an at-risk, for-profit environment. So, there's a lot to talk about, not only regulatorily, but within agencies and within governments. And I think for state and federal government to be able to work together innovatively, efficiently, if that's possible, to address venture capital I think that'd be very helpful all right. Surprising to me how far apart those entities often are. Was that PC enough? *(Laughter)*

Ray Daffner: I think we have time for one more question, and I think Pat Bond has it. Then after this question we're going to move on to the next panel.

Pat Bond: Okay, Lynn, this will fit into exactly what you said of a question. Has anyone thought about – we talked about tax credits. Kerwin mentioned tax credit programs, and there's been a lot written and a lot done, but policy and research or development of a model program that could be implemented by the states for incentives for equity capital. So, it seems to me that so many people are spending so much time running around, trying to figure out what is the best deal. Kentucky has a program. West Virginia has a program. Ohio has a program. Tennessee has a program. But a way to develop something that is more consistent in rural American.

Lynn Gellermann: I know Julia Rubin and Kerwin and CDVCA I think we'll hear from them later, but there's been a lot of study that's ongoing. I think a lot of these state programs are pretty new or have different versions of themselves, and I think to the extent that hasn't been studied it would – we need to keep an eye on that. The West Virginia venture program did that work better than what Kentucky's doing? Those are valid questions. A lot of that I don't know if we know the answer yet, but I agree.

Pat Bond: There was a study put out last year by the National Association of State Venture Funds, NASVF, and that's a great starting place to look at the range of structures of state programs or regional programs like the folks down in Arkansas and Oklahoma are doing. And I think there's some impact analysis as well.

Nat Henshaw: I actually met with someone yesterday afternoon from the Maine State Department of Economic and Community Development that's looking at \$100 million venture fund pattern on some of the other – sort of fund-to-funds managed by an investment bank that would invest in funds that would commit to seek deals in Maine.

There are, as you know, all these groups that have tried in other states in various different levels of incentive and that sort of thing. One thing I think about states is they actually want to have a different as opposed to consistent way of doing it because they want to make their place more attractive. So, you may be working a little bit across purposes if the standard is a 80-percent tax credit someone's going to want an 85. I'll just point that out about states.

L Ray Moncrief: And I'll point out to you in our footprint where we're working I point to the state of Arkansas what they're doing in Arkansas. I am extraordinarily impressed with their commitment to creating risk money for venture investing within the state of Arkansas. Mike Tharp and his partner manage something called the Arkansas Institutional Fund, and there's just been a recent commitment for something in excess of \$100 million to push this type money to finds that indeed would identify and invest in this type of space in Arkansas. They've got an outstanding model. I wish Kentucky would copy their model, quite frankly. So, you might speak to Mike during the process.

Ray Daffner: Well, it's time to wrap up this particular panel. Again, let's thank our panelists for their comments.

[Applause]

Ray Daffner: And for all of you in the audience this afternoon we're going to have an hour and a half facilitated conversation, so if there are additional comments that you would like to make that'd be a great time to do that. So, please, don't lose your thoughts, and we'll move on to our next panel.