

2013 ANNUAL REPORT

INVESTSC, INC.

TO

SOUTH CAROLINA

VENTURE CAPITAL AUTHORITY

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InvestSC, Inc. to the South Carolina Venture Capital Authority

BACKGROUND

The Venture Capital Investment Act was created by the state legislature in 2005 in order to promote the availability of capital for creating and building business ventures in South Carolina. The Venture Capital Authority (VCA) was established as an agency within the Department of Commerce to identify and select qualified professional investors who will invest in South Carolina companies. The authority is a seven member board selected by the governor and state lawmakers. In 2007 the authority received financing by a private institutional lender secured by state tax credits. Four venture capital firms were then selected to make investments within the state.

InvestSC, Inc. was formed by the South Carolina Jobs-Economic Development Authority at the specific request of the VCA. The authority selected InvestSC to serve as a “Designated Investor Group” for the purpose of assisting the authority in meeting the goals and objectives of the Venture Capital Investment Act. InvestSC was organized in 2007 as a nonprofit corporation and received 501(c)(3) tax-exempt status approval from the Internal Revenue Service.

INVESTMENT PORTFOLIO

The South Carolina Venture Capital Authority solicited and received proposals from fifteen private equity firms. The VCA Board performed its due diligence by conducting research into the background, financial capacity and business operations of the interested firms. The strategy was to maximize investment return and minimize portfolio risk by creating a balanced investment stage portfolio. The funds selected target specific sectors that currently exist in South Carolina and can take advantage of clusters that represent state strengths. Each of the funds is made up of successful investment professionals who have previously invested in South Carolina and have established a presence here.

Noro Moseley: Founded in 1983, Atlanta-based Noro-Moseley Partners (“NMP”) is one of the largest and most experienced venture capital firms in the southeast. Since its inception, NMP has invested in about 160 companies through funds totaling \$580 million in capital. In 2000, NMP announced the closing of NMP V, their fifth fund totaling \$320 million, the largest ever in the Southeast.

NMP invests primarily in Southeastern-based, early and established growth stage companies. This includes companies in various stages of maturity from first round financings to established companies looking for capital. Their focus industries include technology, healthcare

and business services. Prior sample investments include SecureWorks, NovaVision, OpenSite, and PGA Golf and Superstore.

Nexus Medical Partners: Nexus Medical Partners is a private equity firm, headquartered in Boston, MA, with an office in Charleston that specializes in various stages of development. Specific companies include those in medical devices, diagnostics, biotechnology, specialty pharmaceutical and drug discovery tools. They prefer to lead their investments and to work in a hands-on manner with portfolio companies, committing multiple partners to each investment.

Each of the Nexus Principals averages twenty years in the business and has had successful careers in the medical device and pharmaceutical industry. They have helped to launch some of the top companies in medical technology and life sciences. Prior sample investments include Genentech, Biogen, Cyberonics, and Regeneron Pharmaceuticals.

Frontier Capital: Frontier Capital is a Charlotte-based private equity investment firm that provides expansion capital to high growth business services companies. These companies typically utilize technology, an innovative business process, or a unique expertise to deliver a differentiated service to their customers and would include specialties such as IT, software, marketing, healthcare services, outsourcing and communications. They have a proven solution in the marketplace and need capital to accelerate growth.

Frontier has a team of professionals with both extensive investment experience and a broad network of established business relationships. This team is complemented by a small group of former CEO's (such as from First Union CEO Ed Crutchfield) and Senior Executives who serve as Operating Partners. Prior sample investments in South Carolina include LURQH in Myrtle Beach and RJM in Easley.

Azalea Fund: Azalea Capital, headquartered in Greenville, SC, is a merchant banking firm providing strategic equity capital to privately owned, middle-market firms in the Southeast. Partnering with management teams in scalable, operating companies with established revenues and cash flows, Azalea provides both financial and human capital to significantly enhance the long-term equity value of the underlying business.

Collectively, Azalea Principals have over 100 years combined experience in business and finance. Their Principals, Advisory Board, and investor base, consisting predominantly of CEOs and former CEOs, bring a wealth of knowledge and experience in a diverse spectrum of industries including manufacturing, distribution, business services, consumer products, and healthcare. Prior sample investments in South Carolina include Horizon CNC Products, Spartan Foods, Power Equipment Maintenance, ISO Poly Films and Tekgraf Corporation.

FINANCING

The VCA Board approved DBAH Capital, LLC (Deutsche Bank) as a lender under the Act and received approval from the State Budget and Control Board. On June 22, 2007, InvestSC and DBAH signed a Securities Purchase Agreement for \$50 million in notes. The notes are secured by all of the investments and tax credit certificates issued by the authority. At closing, the first draw of \$15 million was made on the notes. This was followed by a required draw of \$10 million in June 2008 and an additional \$19,800,000 during 2009. The final required draw of \$5,200,000 was made on June 22, 2010. The outstanding balance of the notes payable to Deutsche Bank on December 31, 2013 was \$50,000,000. Each draw requires a contribution to the premium reserve fund (described below) equal to 7.5% of the amount drawn.

Interest is payable semi-annually at a fixed rate of 7.247%. Required interest payments were made in June and December of 2013 in the amount of \$1,831,880 and \$1,841,946, respectively. Semi-annual interest payments of approximately \$1,840,000 are required each June and December. Annual principal payments of \$12,500,000 will begin in 2019 until the notes are paid off on June 22, 2022.

The notes require the establishment of three reserve funds as follows: interest reserve, tax reserve and premium reserve funds. The required interest reserve is equal to the semi-annual interest payment that would be due assuming the maximum aggregate principal amount of notes was outstanding. The tax reserve was released in October 2007, since InvestSC received notification from the Internal Revenue Service that it is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The premium reserve is a computed amount as required by the "Premium Account Control Agreement". On December 31, 2013, the interest reserve and premium reserve totaled \$1,875,579 and \$3,751,157 respectively. The funds in these reserve accounts are held in trust and are not available to meet future capital calls by the Funds.

In the Report on Financial Statements issued by Elliott Davis on May 4, 2010 and June 20, 2011, the risk of default to the venture capital funds was disclosed. The AUDIT REPORT COMMENTS section below further discusses this risk. Upon the recommendation of Deutsche Bank, the Securities Purchase Agreement was amended on December 21, 2010, whereby, the Capital Contribution Account was established to receive all distributions from the funds and other amounts as necessary to meet the unfunded obligations to the venture capital funds. Prior fund distributions held in escrow by the funds of \$653,783 and \$2,900,000 from the Operating Account were transferred to the Capital Contribution Account on December 22, 2010. As of December 31, 2013, the Capital Contribution Account balance was \$1,749,770 and the unfunded capital commitments were \$1,748,175.

The creation of the Capital Contribution Account lessens the near term risk of default to the venture capital funds, but created the need to sell tax credits to fund the semi-annual interest payment of \$1,841,946 in December 2010. InvestSC had discussions with various brokers of tax

credits, individual companies and Deutsche Bank to determine the best method of monetizing the tax credits. On December 21, 2010, tax credits in the amount of \$2,300,000 were sold for \$1,840,000 (\$0.80 for each dollar of tax credits) by RBC Tax Credit Equity, LLC in Charlotte, NC. This was followed by the sale of tax credits in the same amount in June and December of 2011 and 2012. No tax credits were sold in 2013. As of December 31, 2013, the total amount of tax credits sold were \$11,500,000 for a net of \$9,200,000. All proceeds were used for the payment of interest to Deutsche Bank.

IMPLEMENTATION OF INVESTMENT PLAN

The InvestSC Board has approved the Funds selected by the South Carolina VCA and verified that each Fund’s investment plan provides for the investment in “South Carolina based companies” as provided in the Act. The VCA has authorized investments in the following funds:

- Noro-Moseley Partners VI, LP - \$10 Million commitment
- Nexus Medical Partners II, LP - \$20 Million commitment
- Frontier Fund II, LP - \$8 Million commitment
- Azalea SC Fund, LP - \$1.5 Million commitment
- Azalea III Fund, LP - \$8.5 Million commitment

Noro-Moseley Partners VI, LP: The limited partnership subscription agreement was executed by InvestSC on June 8, 2007. The final closing for the Fund was April 2008 in the total amount of approximately \$119 million. The initial capital draw of \$1,000,000 (ten percent of commitment) was funded by InvestSC on September 28, 2007. A schedule of all capital calls is as follows:

Date	Capital Call	Total Drawn	Remaining Commitment
			10,000,000
9/28/2007	1,000,000	1,000,000	9,000,000
6/4/2008	1,000,000	2,000,000	8,000,000
3/3/2009	997,993	2,997,993	7,002,007
10/22/2009	1,000,000	3,997,993	6,002,007
3/9/2010	1,000,000	4,997,993	5,002,007
12/14/2010	1,000,000	5,997,993	4,002,007
5/10/2011	1,000,000	6,997,993	3,002,007
4/2/2012	1,000,000	7,997,993	2,002,007
9/10/2012	1,000,000	8,997,993	1,002,007

Noro-Moseley has investments in the following 17 companies as of December 31, 2013: Adaptivity, Appia, Change Healthcare, Clearleap, Diabetes Care Group, FrontStream Payments, Half Off Depot, Navitas, Network Medical, PeopleMatter, 2080 Media, RemitDATA, Streamline Health Solutions, Tower Cloud, Virtustream, Vocalocity, and WellCentive. Noro-Moseley investments are focused in three sectors: Healthcare (32%), Technology (59%), and Finance (7%). The partnership agrees to make investments in South Carolina based companies as required by the South Carolina Venture Capital Investment Act at least equal to the amount invested in the Fund.

Noro-Moseley made its first South Carolina investment in May 2011 in PeopleMatter, a Charleston based company that provides workforce management software for service based industries. PeopleMatter’s solutions are specifically designed to help companies manage high-volume, high-churn workforces such as those in the restaurant, convenience store, hospitality and retail sectors. The founder of the company, Nate DaPore was congratulated in a resolution by the SC Legislature for being recognized as the 2011 “Top Up-and-Coming Entrepreneur” by the Southeast Chapter of TiE. The company has grown to over 140 employees in South Carolina. Noro-Moseley has led several rounds of funding and attracted other investors for over \$50 million into the company.

InvestSC carries the investment in Noro-Moseley at their audited book value of \$11,525,645 compared to a cost of \$6,298,055. As of December 31, 2013, InvestSC has invested \$8,997,993 and received cumulative distributions of \$4,134,065 from the fund. The fund is performing very well overall, with a multiple of 2.1x of fair value to cost. Noro-Moseley expects to make its final capital call and be fully invested by the end of 2014. According to the Noro-Moseley audited financial statements, the internal rate of return (IRR) for the Partnership is 16.6%, 16.8%, 10.7%, -2.6% and -1.8% as of December 31, 2013, 2012, 2011, 2010 and 2009, respectively.

Nexus Medical Partners II, LP: The limited partnership agreement was executed by InvestSC on July 5, 2007. The initial capital draw of \$5,000,000 (twenty-five percent of commitment) was funded by InvestSC on July 6, 2007. A schedule of all capital calls is as follows:

Date	Capital Call	Total Drawn	Remaining Commitment
			\$20,000,000
7/6/2007	5,000,000	5,000,000	15,000,000
6/24/2008	5,000,000	10,000,000	10,000,000
1/28/2009	5,000,000	15,000,000	5,000,000
10/16/2009	5,000,000	20,000,000	0

InvestSC is the only investor in this Fund and all investments will be in South Carolina based companies. Nexus expects to bring in additional partners on all of its South Carolina investments, creating a multiplier of three to four times the InvestSC investment.

Nexus has made investments in 14 companies through December 2013 that are either South Carolina based or will have significant operations in the State. Their first investment, Sabal Medical, located in Charleston, was acquired by Swisslog in January 2011. They also closed their positions in Mini-Lap and Myconostica, and sold a major portion of their investment in Deltex Medical. Spectra Analysis is a Massachusetts based company looking to relocate to Greenville, SC. Sultan Scientific, a publicly listed company in the UK, has built a portfolio of healthcare businesses which need to expand to the US. This should create multiple opportunities for launching South Carolina based companies.

An investment was made in American Titanium works in July 2010. They are developing the first titanium mini-mill in the world in Laurens, SC. The investment is to assist the company in attracting an equity investment which could result in a total project of over \$350 million.

Nexus made an investment in Zipit in November 2010. This is a Greenville, SC company that provides device and software network services. They are working with Verizon Wireless to market a pager replacement solution for hospitals.

In December 2009, Lab 21 acquired Selah Technologies, a South Carolina based company whose technology originated from a Clemson University researcher. The InnoVenture conference in Greenville brought together a local entrepreneur and the Clemson University Research Foundation to form Selah several years ago. Selah was purchased in May 2014 by EKF Diagnostics, a publicly traded company in the UK, making it one of the major exits in the Upstate's biotech industry.

The most recent investment (2012) is Proterra, a manufacturer of an all-electric bus which has a manufacturing plant located in Greenville, SC. This was part of a \$23M financing Series B round involving other prominent private equity funds. The management of the company has significant experience in the automotive and electronics industry. The company is projecting significant growth in the next few years.

InvestSC carries the investment in Nexus Medical Partners at their audited book value of \$18,747,471 compared to a cost of \$18,307,146. This recognizes the realized and unrealized gains and losses in value, and the management fees and expenses paid to the general partner. As of December 31, 2013, InvestSC has invested \$20,000,000 in Nexus and received cumulative distributions of \$1,725,000. According to the Nexus Medical Partners audited financial statements, the internal rate of return since inception (IRR) of the fund is 0.68%, (2.03%),

0.04%, 2.60%, 6.0% and 16.95% through December 31, 2013, 2012, 2011, 2010, 2009 and 2008, respectively.

Frontier Fund II, LP: The limited partnership agreement was executed by InvestSC on September 21, 2007. The Fund was closed that day with total subscriptions of \$115 million. The initial capital draw of \$1,200,000 (fifteen percent of commitment) was made by InvestSC on September 24, 2007. In addition, InvestSC paid “catch-up interest” of \$122,663 at closing. A schedule of all capital calls is as follows:

Date	Capital Call	Total Drawn	Remaining Commitment
			\$8,000,000
9/24/2007	1,200,000	1,200,000	6,800,000
12/6/2007	800,000	2,000,000	6,000,000
6/19/2008	800,000	2,800,000	5,200,000
8/5/2008	960,000	3,760,000	4,240,000
1/28/2009	800,000	4,560,000	3,440,000
6/24/2009	280,000	4,840,000	3,160,000
8/27/2009	280,000	5,120,000	2,880,000
1/4/2010	720,000	5,840,000	2,160,000
4/28/2010	360,000	6,200,000	1,800,000
10/5/2010	520,000	6,720,000	1,280,000
3/29/2011	600,000	7,320,000	680,000
9/9/2011	200,000	7,520,000	480,000
3/26/2012	262,832	7,782,832	217,168
7/12/2012	217,168	8,000,000	0

The capital commitment of \$8,000,000 to Frontier has been 100% funded.

The Fund has invested \$100.4 million in eleven companies and is fully allocated including reserves. The Fund will no longer be investing in new companies as its investment period ended in 2012.

Frontier is pleased with the overall portfolio performance and continues to see increased valuations for individual portfolio companies. Frontier II completed its first exit in April 2010 with the sale of Ryla, Inc. The next two exits were in December 2012 of Lanyon and Azaleos and resulted in a distribution of \$3,575,450 to InvestSC in January 2013. These three exits were at a multiple of 2.75x invested capital. The fund had eight remaining active companies as of December 31, 2013. The portfolio is performing very well. The fund is performing very well overall, with a multiple of 2.1x of fair value to cost.

Frontier agrees to make investments in South Carolina based companies as required by the South Carolina Venture Capital Investment Act at least equal to the amount invested in the fund. Perceptis, a leading provider of outsourced help desk and information technology services

for educational institutions was located in Cleveland, OH. In May 2011 the company moved to Greenville, SC and employs approximately 200 people. Frontier sold its investment in Perceptis in May 2014.

InvestSC carries the investment in Frontier Fund at their audited book value of \$8,779,029 compared to a cost of \$5,374,764 (includes \$122,663 interest). This recognizes the unrealized gains and losses in the portfolio companies and the management fees and expenses paid to the general partner. As of December 31, 2013, InvestSC has invested \$8,000,000 in Frontier and received cumulative distributions of \$4,404,284 from the fund. According to the Frontier II audited financial statements, the internal rate of return since inception of the partnership is 15.6%, 16.3%, 20.5%, 16.4%, 7.9% and (21.3%) through December 31, 2013, 2012, 2011, 2010, 2009 and 2008, respectively.

Azalea SC Fund, LP: The limited partnership agreement was executed by InvestSC on September 28, 2007. An important development relating to the Azalea SC Fund during 2008 was to reduce the commitment from \$10,000,000 to \$1,500,000 and allocate the balance of \$8,500,000 to their new fund, Azalea III. Azalea Capital requested that this change be made in order to ensure that the funds could be deployed in a timely manner. Azalea continues to seek and invest in South Carolina based companies, but many of their investments also occur in other states. The VCA Board approved of this change at its meeting on October 28, 2008. A schedule of all Azalea SC capital calls is as follows:

Date	Capital Call	Total Drawn	Remaining Commitment
			\$1,500,000
9/28/2007	1,000,000	1,000,000	500,000
1/16/2009	50,000	1,050,000	450,000
7/22/2011	Fund Dissolved		-0-

InvestSC is the sole investor in the Azalea SC Fund, which is a side fund to the Azalea II Fund. Azalea SC Fund is a one third participant in all South Carolina investments made by the Azalea II Fund. Investments were made in Spartan Foods of America (Spartanburg) and Horizon CNC Products (Travelers Rest). Both of these were add-on investments in their Azalea II Fund portfolio in which the Azalea SC Fund participated.

Spartan Foods was sold in December 2009 to another private equity firm. Azalea's original investment in Spartan Foods was made in March 2005 and the Azalea Fund II realized a return of 6.25 times its invested capital on this investment. Azalea SC Fund's return was approximately 3.0 times its invested capital. In January 2010 InvestSC received a cash distribution of \$1,637,819, followed by another distribution of \$28,740 in April 2010. A gain of

\$678,137 was realized by InvestSC. The investment in Horizon CNC Products was written off in December 2008 as the General Partner found it necessary to discontinue the business operations.

The Azalea SC fund was dissolved in 2011 and \$100,323 was distributed to InvestSC on July 22. To summarize the Azalea SC Fund, \$1,050,000 was invested and a total of \$1,766,882 was returned. Most of the activity occurred within a 27 month period.

Azalea III Fund, LP: The limited partnership agreement was executed by InvestSC on October 31, 2008. A schedule of all Azalea III capital calls is as follows:

Date	Capital Call	Total Drawn	Remaining Commitment
			\$8,500,000
10/31/2008	850,000	850,000	7,650,000
8/30/2009	1,700,000	2,550,000	5,950,000
6/1/2020	(1,402,500)	1,147,500	7,352,500
12/7/2010	1,059,437	2,206,937	6,293,063
6/17/2011	926,711	3,133,648	5,366,352
2/23/2012	720,775	3,854,423	4,645,577
7/12/2012	648,698	4,503,121	3,996,879
9/4/2012	212,129	4,715,250	3,784,750
11/2/2012	906,118	5,621,368	2,878,632
1/30/2013	459,237	6,080,605	2,419,395
11/8/2013	628,104	6,708,709	1,791,291
12/20/2013	1,045,124	7,753,833	746,167

Azalea III had its final closing on April 30, 2010 and raised a total of \$82.5 million. Grove Street Partners (Boston) and the SC Retirement Fund were among the institutional investors making commitments. The agreement with Azalea III is similar to those with Frontier and Noro-Moseley, in that the Fund agrees to make investments in South Carolina based companies as required by the South Carolina Venture Capital Investment Act at least equal to the amount invested in the Fund.

Azalea III made its first investment in September 2009 with the acquisition of the auto textile division of Milliken. The new company is called Sage Automotive Interiors. It is the largest seat fabric producer in North America with a 40% market share. Three manufacturing

locations are in South Carolina (Abbeville, Spartanburg and Greenville) and one in Georgia. This acquisition marks the first time that Milliken has ever sold a division and saved over 600 jobs in South Carolina.

Azalea sold Sage in May 2011 to The Gores Group, a private equity firm headquartered in Los Angeles, CA. Sage has grown to over 1000 employees and will continue to operate its three plants in South Carolina. The holding period of the investment was only 20 months and realized a significant gain. InvestSC received a distribution of \$5,156,000 from the sale and the funds were deposited in the Capital Contributions Account.

Azalea III made two additional investments in 2010. KLMK in Richmond, Virginia is a leading provider of healthcare facility consulting services to hospitals in the United States. Ivize in Atlanta, Georgia is a provider of litigation document support services to law firms and corporations in the Midwest and Southeast United States. In 2011, Azalea III made an investment in Star Packaging, a producer of flexible plastic packaging primarily for the food industry.

In 2012, Azalea III made investments in two companies in the power generation industry. Orbital Tool Technologies in Belvidere, Illinois performs on-site machining and fabrication throughout the United States. Power Services Group in Savannah, Georgia provides specialty staffing services to power generation plants and industrial customers.

The fourth quarter of 2013 was very active for Azalea. Azalea sold its investments in KLMK and Star Packaging in the Q4 2013. InvestSC received distributions of \$1,950,396. The fund made two acquisitions in Q4 2013: an add-on for Orbital Tool (Century Turbine) and the acquisition of Turbine Generator Maintenance. These are the last investments for Fund III. Remaining uncalled capital in Fund III will be used to support the growth of the existing portfolio and for partnership expenses.

InvestSC carries the investment in Azalea Fund III at their audited book value of \$4,479,683 compared to a cost of \$3,711,188. As of December 31, 2013, InvestSC has invested \$7,753,833 in Azalea III and received cumulative distributions of \$8,449,963 from the fund. According to the Azalea III audited financial statements, the internal rate of return since inception of the fund is 95%, 109%, 123%, 140.3%, (8.9%) and (67.1%) through December 31, 2013, 2012, 2011, 2010, 2009 and 2008, respectively.

SUMMARY OF INVESTMENTS AND FAIR VALUES

Investment	2013		2012	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Noro-Moseley Partners VI, LP	6,298,055	11,525,645	7,542,816	11,932,907
Nexus Medical Partners II, LP	18,307,146	18,747,471	18,307,146	16,638,308
Frontier Fund II, LP	5,374,764	8,779,029	7,563,753	11,654,944
Azalea Fund SC, LP	-	-	-	-
Azalea Fund III, LP	3,711,188	4,479,683	3,194,527	3,959,557
Totals	<u>33,691,153</u>	<u>43,531,828</u>	<u>36,608,242</u>	<u>44,185,716</u>

TAX CREDIT CERTIFICATES

The South Carolina VCA Board has issued its initial tax credit certificates and its blank tax credit certificates, as contemplated by the Venture Capital Investment Act, to serve as a source of security for the payment of principal and interest under the terms of the Securities Purchase Agreement with DBAH Capital, LLC. It is anticipated that these tax credits will be sold to companies with South Carolina tax liabilities. The tax credit certificates can be used to pay state income taxes, bank fees, insurance premium taxes or other tax liabilities. These certificates are held in trust by a custodial bank until such time that they must be exercised.

As mentioned in the FINANCING section above, Elliott Davis disclosed a risk of default to the venture capital funds due to the timing and amount of capital call and distributions by the venture capital funds. Tax credits can only be used to fund required payments to the bank and cannot be used to fund capital calls. The AUDIT REPORT COMMENTS section below further discusses this.

In order to maintain the required liquidity to meet both required interest payments and capital calls as they come due, the InvestSC Board of Directors approved a resolution in December 2010 to sell tax credits as needed to meet the required interest payment of \$1,841,946 on December 22, 2010. On December 21, 2010, tax credits in the amount of \$2,300,000 were sold for \$1,840,000 (\$0.80 for each dollar of tax credits) by RBC Tax Credit Equity, LLC in Charlotte, NC.

There were additional tax credit sales in June and December of 2011 and 2012 in the amount of \$2,300,000 each, which were sold for \$1,840,000 each (\$0.80 for each dollar of tax

credits) by RBC Tax Credit Equity. All of the tax credits were sold to insurance companies and used to pay insurance premium taxes.

Through December 31, 2013, there have been five tax credit sales for a total of \$11,500,000 and a net of \$9,200,000. Distributions totaling \$7,803,800 were received from Frontier, Noro-Moseley and Azalea in 2013 which provided sufficient liquidity so that no tax credit sales were required in 2013.

EXPENSES

InvestSC, Inc. was organized on March 1, 2007 and began operations on June 22, 2007 upon execution of the Securities Purchase Agreement as mentioned above in the Financing section. There were significant costs associated with the note issuance, structuring of the transaction, and legal fees. InvestSC paid all the fees for itself, the VCA and the lender from the initial proceeds of the loan. These fees totaled \$1,103,500 and are to be amortized over the 15 year term of the notes.

For the period ending December 31, 2013, interest expense on the notes was \$3,673,826 and interest earned on all deposits was \$1,298 for a net investment expense of \$3,672,528. General administrative expenses for the period were \$105,833. In addition, the amortized portion of the note issuance costs was \$73,600. A schedule of the expenses expressed as a percentage of the fair value of assets on December 31, 2009 through 2013 is shown below:

	Year Ended Dec 31, 2013	Year Ended Dec 31, 2012	Year Ended Dec 31, 2011	Year Ended Dec 31, 2010	June 22 to Dec 31, 2009
Total Assets	57,092,375	55,904,662	53,354,837	53,086,896	43,941,532
Less, Note Issuance Cost (net)	-625,283	-698,883	-772,450	-846,017	-919,583
Fair Value of Assets	56,467,092	55,205,779	52,582,387	52,240,879	43,021,949
Notes Payable to DBAH	50,000,000	50,000,000	50,000,000	50,000,000	44,800,000
Investment Expense for period	3,672,528	3,682,499	3,672,721	3,444,696	2,478,037
As a percentage of fair value of assets	6.50%	6.67%	6.98%	6.54%	5.76%
General Administrative Expense for period	105,833	120,316	119,285	150,532	125,940
As a percentage of fair value of assets	0.19%	0.22%	0.23%	0.29%	0.29%

AUDIT REPORT COMMENTS

Elliott Davis, LLC has audited the financial statements of InvestSC since its inception and issued their opinion that they are in conformance with accounting principles generally accepted in the United States. In the audited Report on Financial Statements for the years ended

December 31, 2010 and 2009, they did, however, include a note to the statements that reads as follows:

NOTE 9 – INVESTMENT COMMITMENTS

The Organization has committed to invest an additional \$11,575,070, with four venture capital funds. The timing and amount of the capital calls by the venture capital funds for these additional investments is uncertain. The Organization will use the distributions from existing investments with the venture capital funds to fund these future capital calls. Those distributions will be deposited into the capital contribution account and capital call will be funded by disbursing funds from this account. At December 31, 2010, the capital contribution account had a balance of \$3,553,783. The timing and amount of distributions from the venture capital funds is also uncertain. If the Organization is unable to make the required capital contributions upon receiving a capital call, the Organization would be in default in accordance with its agreements with the individual venture capital funds. Upon default, the Organization may be subject to a default fee and possible liquidation of portfolio investments if capital contributions are not paid within certain time frames as noted within its agreements with the individual venture capital funds.

Since establishing the Capital Contribution Account, InvestSC has eliminated the risk of default to the funds. The corresponding note in the audited financial statements has been revised to reflect that. The unfunded commitments to the individual funds and the Capital Contribution Account balances are as follows:

	<u>12/31/2013</u>
Noro-Moseley Partners VI	\$1,002,007
Frontier Fund II	-0-
Azalea Fund III	<u>746,167</u>
Total Unfunded Commitments	\$1,748,174
Capital Contribution Account	\$1,749,770

**Internal Rate of Return (IRR)
by Venture Capital Fund**

	2013	2012	2011	2010	2009	2008
Noro-Moseley Partners VI	16.6%	16.8%	10.7%	-2.6%	-1.8%	n/a
Nexus Medical Partners II	0.7%	-2.3%	0.0%	2.6%	6.0%	17.0%
Frontier Fund II	15.6%	16.3%	20.5%	16.4%	7.9%	-21.3%
Azalea SC Fund	n/a	n/a	n/a	n/a	32.8%	11.3%
Azalea III Fund	95.0%	109.0%	123.0%	140.3%	-8.9%	-67.1%

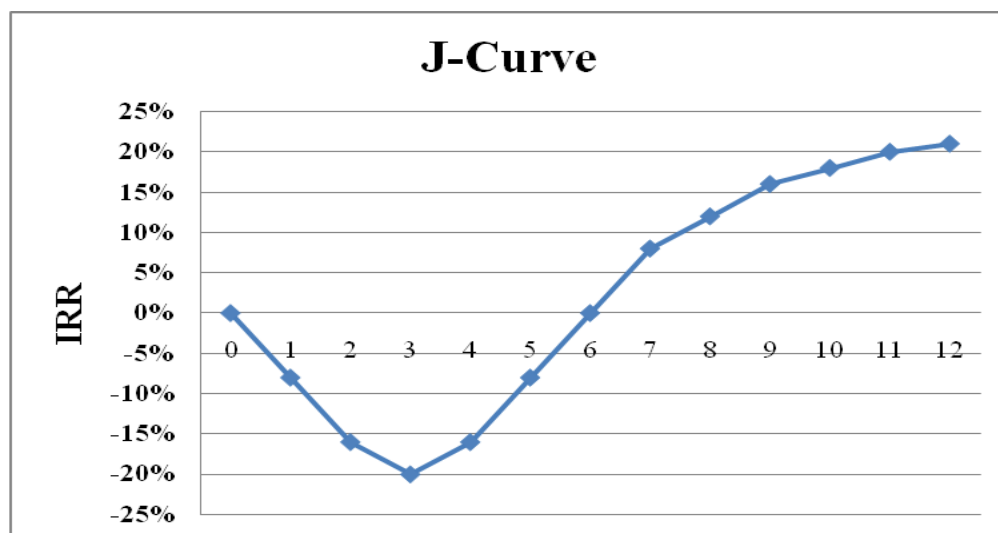
(IRR's as reported by Funds)

Reviewing the performance of a venture capital fund on a year to year basis provides no meaningful insight into total fund performance, because venture funds typically show a negative return for the first few years of their life. This is entirely natural and will be true even of the very best venture funds, since the pattern of cash flows (negative in the early years, positive in the later years) produces a “J” curve.

The “J” curve shows a fund’s internal rate of return (IRR, or simply the compound annual return to date) charted against the financial years of a venture fund. Venture capitalists typically commit their funds over the first few years and draw down monies to the underlying companies against these commitments over several more years. It may take several years for VCs to realize their investment in a typical start-up company, based largely on the time needed for these companies to prove their products in the market, and on the availability of suitable exit opportunities (trade sale, IPO, etc.). The above two factors inevitably result in a negative IRR for the first several years of a fund as cash goes out as investments, but has yet to come back by way of realizations. See the “J” curve illustration below.

By the second half of a fund’s life, investments are being realized and annual returns are generally high, compensating for the negative early years and hopefully resulting in a good overall performance compounded annually over the life of the fund. When looking at venture returns, it is therefore important to note the following:

- The first few years or so give little, if any, indication of final returns
- The annual return over any single year is relatively meaningless
- The IRR over the life of the fund is the real measure of a fund’s success



Source: Mowbray Capital