Iowa Agricultural Finance Corporation

An Iowa Agricultural Finance Corporation

September 28, 1998 Meeting Minutes

Board of Directors Meeting

Chairman Tom Urban called the meeting to order at approximately 12:00 noon on September 28, 1998. The meeting was conducted in Conference Room #3 within the Iowa Farm Bureau Federation Conference second floor Center in West Des Moines. Prior notice was provided to the Iowa Department of Economic Development under the terms of the loan agreement with the Department.

In attendance were the following Board Members elected pursuant to the process established in 1998 Senate File 2415:

- ❑ Duane Acker
- ❑ Jack May
- ❑ Leslie Miller
- ❑ Steve Morain
- Wayne Seaman
- ❑ Tom Urban

Board Member Jeff Plagge was unable to attend due to prior commitments. Also in attendance and participating in the meeting were the following individuals:

- ❑ Dan Winegarden, Interim President.
- ❑ Bob Helmick, Dorsey & Whitney law firm and corporate counsel.
- ❑ Sherri Peters, Dorsey & Whitney.

Melanie Johnson, IDED's general counsel, was unable to attend due to prior commitments but reviewed the meeting agenda in advance and received a briefing after the fact of the general scope of the meeting. (Under the terms of the loan agreement IDED, as a major lender, enjoys limited observer status. Melanie Johnson is IDED's designated contact and representative. The IDED representative is entitled to prior notice and to attend, but may be excluded from executive sessions of the Board or when certain topics are discussed in which IDED may have an adverse interest or the appearance of a conflict of interest.)

The Board approved the minutes of the prior meeting without comment or amendment.

The Board next took up review of the report of the Strategic Vision Subcommittee contained in Tab 6 of the briefing book. Members discussed the proposed redraft and accepted the changes with the addition of "value-added" as a descriptive modifier in several places. The Board approved adoption of the following:

"Vision
Iowa Agricultural Finance Corporation (we) will provide the financial and business leadership, expertise, and financial leverage to help Iowa agricultural producers, Iowa agricultural industry ventures, and Iowa biotechnology enterprises lead the world in responsibly produced, high-quality value-added agricultural products and services, profits, and growth in the twenty-first century."

"Mission
Iowa Agricultural Finance Corporation will:

- ❑ Make prudent investments in the business ventures and emerging technologies necessary for Iowa's leadership in responsibly produced value-added agricultural, food and biotechnology products and services.

- ❑ Help qualified Iowa agricultural producers obtain equity interests in Iowa value-added agricultural industry ventures.

- ❑ Help qualified Iowa value-added agricultural industry ventures obtain financing for growth.

- ❑ Help qualified biotechnology enterprises grow and foster Iowa's biotechnology industry in general.

- ❑ Deliver a competitive return to investors."

"Preamble to the Articles
It is the intent of the incorporators to establish a corporation to:

Qualify as an Iowa Agricultural Industry Finance Corporation under 1998 Senate File 2415 as enacted on July 1, 1998 (the "Act").

Pursue the public purposes enumerated in the Act, including fostering the growth of qualified Iowa agricultural industry ventures engaged in value-added activities and biotechnology enterprises.

Encourage the success of Iowa's value-added agriculture and biotechnology industries, emphasizing responsible production, high quality products and services, profitability, and growth.

Provide financing to qualified Iowa agricultural producers to obtain and expand their equity ownership interests in Iowa agricultural industry ventures.

Provide financing for qualified Iowa agricultural industry ventures to grow their businesses and to foster Iowa's value-added agricultural industry in general.

Provide financing for qualified Iowa biotechnology enterprises to grow their businesses and to foster Iowa's biotechnology industry in general.

Attract ~~public~~ private[1] investment, in the form of both debt and equity, to leverage the initial capitalization provided by the State of Iowa.

- ❑ Invest among various Iowa commodities and agricultural sectors through prudent business judgment and provide a structure of corporate ownership and control that precludes concentration of control by a particular commodity group, project or agribusiness."

After approving these revisions, the Board began discussion of the market role of IAFC, with reference to both the product matrix produced by the Product Development Subcommittee and a similar (but simplified chart) presented by Cybus Capital in a Finance Subcommittee meeting that preceded the Board meeting.

The Board considered the intended scope of "value-added" agricultural investments against the backdrop of available financing sources in the current market. Generally, the Board concluded that asset secured debt financing is generally available for traditional or conventional production agriculture. The Act generally directs the corporation to not fund businesses that would eliminate existing, Iowa competitors. The Act also encourages maximum leverage of the funds loaned to IAFC in pursuit of the public purpose. The Board concluded that it did not intend to make investments through asset secured loans with fixed terms, generally concluding that banks and the Farm Credit System have this market need covered. The Board expressed no desire to compete with banks but instead expressed the desire to leverage the debt financing available through

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[1] In this context, "private" better distinguishes the intended source of additional capital as "public" can mean either governmental sources or the broader public of the citizenry as a whole.

traditional ag lenders with more creative financial devices. With reference to the Cybus chart, the Board determined to focus on the four right hand boxes, respectively: secured loans with equity kickers, subordinated loans, subordinated loans with equity kickers, and equity investments. Market feedback is that few if any alternative sources are serving the market need for this category of capital access.

The Board also discussed the type of business it wanted to focus investments upon. In particular, the Board considered investments in traditional production agriculture -- that is ag activities "within the farm gate". The consensus was that investments would generally focus on activities between the farm gate and the consumer, such as processing. The Board did not preclude consideration of production agriculture if a business plan offered some qualitative advantage or uniqueness over conventional practices. The Board reserved the right to consider on-farm or production agricultural proposals that feature unique or innovative technology, processes, results or business models. This means that adding production capacity is not a major objective of IAFC, rather IAFC is looking to increase demand for Iowa agricultural inputs by fostering breakthrough technologies or businesses. The intended focus is value-added processing beyond the farm gate.

The discussion featured consideration of the necessary return on investment to service the IDED loan and to meet private investors' expectations. The necessity of an "exit strategy" was a consensus point, ideally more than one option to liquidate IAFC's position within a reasonable period of time. The Act's requirement of prepayment on a strict annual schedule and the Market's demand for return on investment both drive the need for an exit strategy. The Board concluded that the necessity of an exit strategy might limit IAFC's ability to consider some business plans and investment models. It follows from the Act's purposes that IAFC's equity should ideally be replaced with agricultural producers' equity in a venture.

The Board generally agreed that potential reward must offset the risk, so that the price of capital will vary based upon the risk presented. The demands of the Act mean that the Board cannot pursue high risk, low return investments. Members recognized that this may lead to some disappointed applicants who may assume that government involvement (the IDED loan) means low cost money, in the form of grants, forgivable loans or low interest. The Board concluded that applicants should be forewarned that IAFC is not necessarily a cheaper source of capital than banks. The decision to focus on options like loan guarantees with equity kickers, loans with both interest and equity kickers, and equity investments reflects the need for IAFC to receive the potential upside of success when making riskier investments that cannot work with traditional asset secured bank lending. For instance, by way of example, an early stage venture capital investment might demand a significantly higher percentage ownership in a company than a later stage mezzanine financing of the exact same amount. Why? The early stage investment is riskier and must be paid a higher reward for ultimate success since a total loss is also a possibility. The later stage investment is less risky and requires lower upside rewards to compensate the capital invested for the less risky downside potential.

The Board agreed that it would not discourage investors from outside the state, under the general philosophy that "green is green" and the objective is to leverage the moneys loaned by the State to maximum effect.

The Board instructed Dan Winegarden to begin preparing a proposed pipeline summary report for each applicant and relative scoring system. The report should allow quick presentation of the key aspects of a proposed investment and its suitability under the Act's criteria and the Board's priorities. For instance, does the applicant have all the required pieces of its business plan fully developed? IAFC might direct an applicant to improve its chances by recognizing the criteria in advance of application and by directing applicants to appropriate resources for help. The Board specifically considered the desirability of including in any rejection of financing a brief summary of the basis for denial. The purpose of an explanation is at least two fold. First, it allows the applicant to learn, possibly revise and improve the proposal for resubmission or better success with other financing sources. One goal of IAFC and the Act is to foster entrepreneurial development and risk-taking. This requires that deal makers learn how deals are done and the demands of the market. Second, an explanation assures others that may learn of the rejection that consideration involved reasonable business judgment. This may be particularly important to reassure Legislators or public officials that the moneys are being well spent within the confines of the Act. Factors mentioned that might be included in a scoring or summary system included: unique/not unique, management qualifications and experience, analysis of marketing plan, analysis of financials. A proposed timeline of three (3) months for response back to applicants was discussed, recognizing that an answer is important in business planning, even if the answer is, "No."

Members were asked to offer additional suggestions on the checklist and to submit them to Dan for coordination.

The Board next considered potential organizational structures to find appropriate deals. Three basic options were considered:

1. Wait for deals to come to us.
2. Associate formally or informally with those who already to deals to find deals for us (e.g., a Cybus, MABSCO, Everen or similar).
3. Hire staff to find deals.

The Board expressed reluctance to build a large staff and felt that as IAFC became known to major financing sources in the State, that deals would come to IAFC. The Finance Subcommittee (Steve Morain and Duane Acker) was instructed to arrange presentations for the next Board meeting by various investment bankers and investment managers, such as Cybus, Equity Dynamics, Berthel Fisher, MABSCO, Everen and others as appropriate. Their presentations should include consideration of two basic issues: Suggestions on how they might help IAFC find private investors (firm leverage), and suggestions on how they might help IAFC find investment opportunities (deal leverage). Other issues mentioned included, how IAFC can reach outside of Iowa to find relocation or expansion opportunities within the food and technology sector. Trends mentioned included, brand owners' desire to get out of production and focus efforts on brand management, marketing and distribution. (By necessity this strategic trend requires adherents to purchase product produced by others.)

Dan Winegarden was assigned the task to organize internal processes to coordinate with key partners like the rural electric cooperatives (RECs), Iowa Department of Economic Development (IDED), the John Pappajohn Entrepreneurial Centers (JPECs); Iowa Area Development Group (IADG), Iowa State University Extension Service (ISUE), and others. The general goal is to avoid replicating resources or expertise available elsewhere.

Mr. Winegarden provided an update on recent and planned management decisions. A reimbursement agreement was executed with the Iowa Department of Economic Development on September 21, 1998. The agreement reduces to writing the verbal commitment of IDED's Director, David Lyons to assist with cash flow pending the loan by providing a source of funds to be reimbursed after concluding IAFC's permanent financing. It also allows IAFC to access non-managerial support services and purchasing through IDED. See Tab 8 of the Board Briefing Book.

The Board authorized Dan to lease space within 200 East Grand Avenue for approximately $15-$17 per square foot and to expend up to $15,000 to furnish and equip the space. The Merit Resources professional employer organization (PEO) contract will become effective beginning October 4, 1998. The Board asked that reimbursements paid by IDED be itemized when submitted for payment. Mr. Winegarden reported that consideration of insurance, including Directors and Officers (D&O) was being coordinated with counsel and a decision would be made after planned meetings with potential brokers, including Mark Lyons, of LaMair Mulock Condon.

The Board approved retention of KPMG Peat Marwick as corporate auditor and tax advisor. Mr. Winegarden will negotiate terms and prepare a retainer letter after discussions with Suku Radia and Mike Wiskirchen.

The Board decided to perform market research and public relations in house, considering the previously submitted Meyocks and Priebe proposal to be more than IAFC was willing to pay given the nature of business it is proposing to undertake.

The Board discussed whether to provide for a per diem payment to Directors. The Board generally concluded that none of the current members personally required a per diem payment; however, members warned that capital markets often look to a personal stake by board members in a corporation when deciding whether to invest. From the viewpoint of potential investors a volunteer board is not desirable. Members recognized that director compensation is a politically sensitive issue when public moneys are involved. Various options were discussed, including establishing a per diem with objective criteria, but personally waiving receipt until after private investors enter the pool. Other options included granting the per diem in the form of stock options to create a vested interest that would encourage confidence by private investors that Directors would dedicate adequate effort and would not walk away. No decision was made and the issue was deferred for later consideration. Dan was instructed to keep track of Director's time expended on IAFC business (Director's are to report time to and coordinate with Mr. Winegarden).

Mr. Winegarden was instructed to prepare a simple form for submitting travel expenses incurred by Directors in connection with IAFC business, such as attending Board meetings.

The Board then conducted an executive session to discuss CEO search issues. After reopening the meeting Chairman Urban relayed the Board's satisfaction with the excellent work to date by Dan Winegarden and instructed him to plan on at least six (6) more months of work. A performance review or reconsideration of the time frame will be conducted in approximately four (4) months.

The Board then returned to discussions of product and market positioning with reference to the Product Development Matrix presented by the Product Development Subcommittee, represented today by Leslie Miller. Members proceeded to discuss the risk/reward balance with several examples including a simple explanation of current interest rates relative to risk. Current U.S. Treasury securities offer returns of about 5.11%, bank prime lending rates for the safest and best customers cluster around 8.00-8.5%, the current junk bond rate (non-investment grade securities, generally reflecting a significant chance of loss of principal) are about 12.5%. Many potential applicants will not even qualify as "b" grade junk bonds, so the market will demand even higher interest, say 15-16% minimum, if interest is the only compensation for risk.

The Board must also consider a built-in loss factor, since not every investment will pay as intended and some principal or interest may be foregone. One aid in this regard is the provision that every borrower has to buy stock in IAFC equal to 5% of the financing. This can in essence form the first stage of loan reserves.

The Board considered the range of options reflected in the matrix, including: direct loans; secondary market loans; loan participations on a last-in-first-out basis; loan participations on a last-in-and-last out basis; loan guarantees, both with and without equity kickers or maintenance fees; interest rate subsidies; Agricultural Credit Corporation (ACC) status; revolving loan fund; and equity financing or venture capitalist model.

The Board determined that IAFC is looking for companies in which it wants to own an interest. Most deals should offer IAFC an equity interest to take a position in the deal.

This means IAFC will earn income on a delayed basis, requiring careful cash flow management of IAFC's funds within a budget, and the management of IAFC's own risk profile. The Board considered allocating a portion of funds available to various categories of financing activities or levels of risk. A simple division was proposed as a starting point, contemplating: one-third (1/3) in loan guarantees, one-third (1/3) in subordinated debt of some form, and one-third (1/3) in equity. General consensus appeared to be that with equity kickers as much as eighty percent (80%) of financings (by dollar total) would likely involve equity in one form or another. No formal action was taken to allocate funds.

Product conclusions included:

- There are direct loan sources available; no need to drive existing funds out of the market. This will not lead to the increase in economic activity sought by the Act. Goal is to do deals not getting done today, not to drive private capital out with subsidized loans.

- Secondary market option should be remembered for future consideration, but because of the minimum scale, it is not the place to start. Planning for future ability may influence timing of scheduled payments.

- We need to pursue 18-20% minimum target rate for internal rate of return (IRR) on equity investments to be competitive with other equity investment alternatives.

- Banks are potential process partners on debt, but not on the equity side.

The impact of being fully invested was also discussed. The Board concluded it was not in business to turn down opportunities to make good investments. If IAFC gets good investments, it will get more private capital.

The Board concurred on a goal to maximize leverage, including both deal leverage (more money into our deals enabled by IAFC's participation) and entity leverage (more money into IAFC). Informally the Board

determined to seek to leverage the initial $25 million into $100 million. This was seen as essentially the smallest the fund could be to succeed in becoming self-sustaining and to make the magnitude of economic impact called for by the Act.

The Finance Subcommittee (Steve and Duane) was instructed to map out what the process would look like to move from $25 million to $100 million -- a template for fund raising. One possible model might include $25 million in private equity from institutional investors and $50 million of debt in a public debt offering at a reasonable coupon rate.

The Strategic Vision Subcommittee (Jack May and Wayne Seaman) was instructed to consider and recommend strategies to move farmers (ag producers) up the value-added food chain.

The Board considered dates for future meetings. A December meeting was ruled out due to the holidays and travel schedules and the late November meeting already scheduled. No January date was found that worked well for everyone. The Board decided to defer scheduling a January meeting to see how work progresses. A conference call may be used to consider issues that cannot be delegated to a subcommittee. A report to the Legislature, Governor and IDED will be required in January.

The agenda for the next meeting will be the reports of the three subcommittees and especially the presentations by investment bankers and fund managers.

A public comment forum will be scheduled in conjunction with the next meeting.

Chairman Urban adjourned the meeting at approximately 3:15 p.m.

Summary of Assignments

- ❑ Finance Subcommittee.
  - ✓ Template for raising capital to reach the $100 million goal over the next six (6) months.
  - ✓ Presentations by appropriate investment bankers or fund managers for the next Board meeting, on Thursday, October 29, 1998.
- ❑ Strategic Vision Subcommittee.
  - ✓ Consider and recommend strategies to move farmers (ag producers) up the value-added food chain.
- ❑ Product Development Subcommittee.
  - ✓ Meet with appropriate interest groups and potential service partners to refine potential product offerings consistent with the Board's discussions.
  - ✓ Return recommendations based upon feedback and further research.
- ❑ Management.
  - ✓ Lease and equip office space.
  - ✓ Prepare reimbursement form for expenses.
  - ✓ Retain KPMG Peat Marwick.
  - ✓ Obtain appropriate property and casualty insurance, including D&O coverage.
  - ✓ Keep track of Board members hours expended on IAFC business (members to report hours to Dan).
  - ✓ Prepare letter or application to applicants explaining requested information and standards.
  - ✓ Prepare pipeline report in summary format with appropriate scoring or relative ranking system to evaluate applicant submissions and present conclusions to the Board.
  - ✓ Begin development of budget and business plan to support solicitation of additional capital.
  - ✓ Provide support and assistance as requested by Subcommittees.
  - ✓ Continue contacts with politicians and interested groups.
  - ✓ Begin planning for and preparation of annual report for submission to the State in January.