

Questions for Iowa Agricultural Finance Corporation Hearings

1. How was the investment strategy or investment portfolio standards for the fund determined?
2. How were potential investors targeted?
3. The legislation provided that the fund was to make a market rate of return and a draft of the 1998 annual report talks about producing competitive returns for the investors. What is the fund's targeted rate of return and why do you believe this is consistent with Legislative intent?
4. A draft of the corporation's 1998 annual report talks about the creation of a Strategic Vision Subcommittee that will evaluate the success of the corporation in fulfilling the public purpose of the legislation. Has this subcommittee been formed? If so, who is on the committee and what are its findings?
5. Have the 1998 and 1999 annual reports been submitted to IDED, the Governor and Legislature as required by law?
6. How was Cybus Capital Markets chosen as the investment fund manager?
7. When they were chosen did the board and/or management know that Cybus had no experience as an investment fund manager? Was Cybus inexperience taken into account when a fee was negotiated?
8. What steps were taken to make sure that Cybus as the fund manager does not have a conflict of interest with current or future clients that Cybus is involved with?
9. What is the maximum that the fund will invest in any one venture? How was the maximum established? How is the maximum consistent with the legislation's intent?
10. How many applications have been submitted? How many are actively being pursued? What percentage of time is spent by Cybus in assisting applicants in structuring their business, what percentage in reviewing applications, and what percentage in soliciting potential investors?
11. What is Piper Jaffray's purpose as the funds investment banker? What is their fee?
12. What is the total amount of administrative and other costs to raise and manage the fund? What percentage is this of the total fund? If you disregard the State's loan, what percentage does administrative costs make up of the remaining funds?
13. This fund was started with the idea of encouraging a beef packing plant; What have you done to help finance such a plant?
14. Since you were established with public funds, what accountability do you have to the public?
15. Please provide a copy of the prospectus or any similar document for tecTerra Food Capital Fund I, L.C.

ANSWERS TO FINANCE COMMITTEE INQUIRY

Stephen M. Morain – 1-6-2000

1. What steps did you take to assure compliance with legislative intent?

The corporation has taken the following steps to assure compliance with legislative intent:

- The loan agreement was developed in accordance with the Attorney General's interpretation of the intent of the Act. It provides additional procedures and requirements to assure compliance with the intent of the Act. The Board retained as corporate counsel Dorsey & Whitney, an adviser involved in the development of the Act and its intent, to confer with the Attorney General to draft the loan agreement.
- DED's General Counsel is an ex-officio member of the Board and is free to participate and comment on matters to insure legislative compliance.
- DED's Director and General Counsel reviewed and approved the concept of involvement of private capital through the limited partnership agreement.
- The DED's General Counsel issued an opinion dated June 25, 1999 approving the plan of implementation of the Act and its legislative intent through the financing vehicle and plan set out in the Private Placement Memorandum of the fund.
- DED, as our State contact, continues to receive regular briefings and is involved with planning for individual investment opportunities.
- All investments are subject to review by corporate legal counsel for statutory compliance with an appropriate legal opinion supporting each investment.
- The provisions of the Act set the basis of the investment strategies.

The loan agreement with the DED and the establishment of the limited partnership, which forms the basis of the additional private capital available for financing under the Act, are based upon those statutory requirements.

Specifically, the Articles of Incorporation require compliance with those standards (See Section 7 of the Articles) including:

- The corporation shall only provide financing to persons and ventures eligible for financing in accordance with the Act.
- The corporation's Bylaws incorporate the guiding principles of the Act (See Section 8 of the Bylaws). These include the statutory requirement that the corporation must apply customary and acceptable business and lending standards and practices in selecting persons and projects designated for financing.

- The corporation is required to adopt policies and procedures, which maximize public oversight and provide forums for public comment and ensure accountability, which has been done.
- The corporation will comply with requirements established by DED.
- The corporation will submit a report to the Governor, the General Assembly and DED no later than January 10th of each year as required by the Act.
- An audit will be carried out in accordance with the Act. In addition, the State Auditor may audit the books and accounts of the corporation at any time.
- To the extent feasible and fiscally prudent the corporation will maintain a portfolio which is diversified among the various types of agricultural commodities and agribusinesses.
- These statutory requirements have been imposed upon the fund by IAFC as a condition of its participation in the tecTERRA Food Capital Fund.

In addition the Corporation has taken action to assure ultimate ownership of IAFC by Iowa agricultural producers. The Corporation is following the Act's mandate that Iowa producers will become shareholders in the corporation as each venture is financed. As an example, upon closing our first transaction in the near future, the first Iowa producers will become shareholders in both the portfolio company and IAFC. With subsequent financings the corporation and its control will pass to Iowa producers in accordance with the provisions of the Act and the articles, as approved by the Attorney General.

2. How were the investment strategy or investment portfolio standards for the fund determined?

A successful investment strategy cannot be developed separate from the mission of an organization. Our investment strategy is grounded in the Act, which allows debt and equity investments into companies processing primarily agricultural products grown in Iowa and ag-related biotech companies with a substantial Iowa presence.

We believe our mission encompasses four elements. First, we must generate sufficient investment returns to repay the \$25 million loan to the state. Second, we are to invest in those biotech and ag value added companies specified by the Act, in order to increase the percentage of Iowa's ag products which are processed within the state's borders. Third, we should structure those investments such that farmers have an increased profitable ownership in those processing facilities. And, finally, we should generate sufficient profitability from those investments, after repaying the state loan, to have operating capital to continue carrying out the mission in perpetuity.

Concerning specific investment tactics and parameters, we will follow both the positive (invest in and loan to Iowa ag value added and biotech companies) and negative (don't deploy capital to companies guilty of commission of acts specified in the Act) dictates of the enabling legislation.

The Act calls for use of prudent investment judgment, which includes diversification of risk, both in the number of separate investments and the types of agricultural

products being processed. We believe this dictates a target size of investment for ag processors in the \$1-5 million range, although we believe a maximum investment of up to \$11 million could be justified for a single particular project.

We intend to utilize Cybus's experience and contacts within the food and fiber processing industry to generate deal flow, not just wait for deals to be presented to us. Cybus has demonstrated capability as an investment and merchant banker to find and create deals with well above average return for lower than average risks. We intend to use their expertise to analyze, structure and negotiate those deals and to include farmer ownership through a number of different means – each appropriate to its own unique circumstances.

Because we intend to encourage farmer ownership in individual deals - - and because we need superior investment results to meet our mission - - we believe we must invest in deals with a high expectation of profit and a lower than average risk profile. It violates the spirit of the Act, prudent investment philosophy, and common sense to invite our farmer partners to invest in businesses that lack a high potential rate of return. We also believe that, given the material facts, farmers would recognize inferior investments and decline the opportunity, so such an exercise to include them into bad deals would be futile in any event.

The statute also dictates we generate a market rate of return. We believe, given the risks inherent in loaning to and investing in portfolio companies of the type contemplated by the Act requires a target return rate in the 20-25% range to be competitive with returns available from similar risk profile portfolios. We believe the strong tendency of Iowa farmers has long been to reinvest any available capital back into their farming operations. It will take a projected rate of return well in excess of that available on-farm to induce them to divert their available capital to an off-farm company in which they are a passive investor.

Nevertheless, we believe that niche market companies with superior technology or intellectual property, patents or higher perceived value products not easily replicated by their competitors, can be found or created by Cybus from its extensive knowledge of the ag processing and distribution markets. We believe that an acceptable percentage of them can be found in Iowa or induced to locate here to insure success of the mission established by the Act and described herein. We intend to conclude deals with a sufficient number of them to successfully invest the funds available from the state of Iowa and private investors.

We also intend to maintain an approach with the broadest possible initial funnel for deal flow. We will consider any proposal, except one specifically prohibited by the Act. If it does not initially fit the investment parameter screen, we will encourage Cybus to offer suggestions, advice and access to resources which could qualify the proposal. The best deals do not generally come camera ready. They are the product of thorough analysis, hard work, creativity and experience gained from prior successes and failures.

3. How were potential investors targeted?

Entities that are willing and capable to invest in venture capital financings as required by the Act are targeted as potential investors.

Because of the risk involved in financing new ventures that comply with the narrow focus of the Act (Iowa processing facilities located in Iowa for Iowa commodities with ownership opportunities for Iowa producers), qualified investors were sought through a private placement process in compliance with federal and state security law requirements.

Although there is additional risk in investing in such ventures, it is a manageable risk in the hands of experienced investors. There is an established private market for investments by such investors who understand the risks and the management that is required to make those investments productive.

This narrow market of investors was targeted by retaining an experienced investment banker, U.S. Bancorp, Piper Jaffray which is highly experienced in identifying this type of investor in this geographic region as well as being highly experienced in investments in agricultural ventures.

4. The legislation provided that the fund was to make a market rate of return and a draft of the 1998 annual report talks about producing competitive returns for the investors. What is the fund's targeted rate of return and why do you believe this is consistent with Legislative intent?

The targeted rate of return (being the optimistic upside potential) is 23% on outside private investor's funds.

This return is consistent with the legislative intent for the following reasons:

- The return was established after nearly six months of investigation into the markets competing for these types of private capital willing to take the risk inherent in the limited ventures identified in the Act.
- This rate is consistent with other opportunities in the market but which do not have the narrow limitations imposed upon it by the Act.
- The return also takes into account the unusual requirement that the private investors are required to provide a 2% guaranteed return to the corporation on the \$25,000,000 regardless of the outcome of the investments. In effect, by becoming private investors, they are guarantors of this return. This, in connection with other preferential returns to the corporation, gives assurance of the corporation's ability to pay back the State the annual principal of payments of \$1,000,000 due annually commencing September 1, 2004.
- There was some tradeoff of providing a high potential return to the private investors in exchange for a better assurance of return to the corporation sufficient to pay the State loan.
- Although the "targeted" rate of return is 23% it should be kept in mind that the entire amount of private investment is at risk. Not only would there be no return, but there would be a 100% negative return, or complete loss, for any failed venture. Any prudent investor will take into consideration the possibility, and

indeed probability, of certain failed ventures among a total portfolio offset, hopefully, by successful ventures.

These rates of return are consistent with the legislative intent and are required to implement that intent of providing financing for these types of Iowa Agricultural processing ventures.

- 5. A draft of the corporation's 1998 annual report talks about the creation of a Strategic Vision Subcommittee that will evaluate the success of the corporation in fulfilling the public purpose of the legislation. Has this subcommittee been formed? If so, who is on the committee and what are its findings?**

The members of the Committee are: Wayne Seaman, Bill Horan and Paul Hill.

The subcommittee has been formed. Its function is to evaluate proposals with a particular focus on the issue of producer involvement. It evaluates proposals and the means by which the proposal will assist producers in acquiring an ownership interest in the processing facilities.

- 6. Have the 1998 and 1999 annual reports been submitted to IDED, the Governor and Legislature as required by law?**

Yes. The 1998 annual report was provided to all legislators, IDED and the Governor's Office. The 1999 report will be available at the January 12, 2000 Public Forum to be held at the Iowa State Historical Building Auditorium. Invitations have been issued to all legislators among others. The meeting is scheduled from 5:00 p.m. until 6:30 p.m.

- 7. How was Cybus Capital Markets chosen as the investment fund manager?**

Cybus Capital Markets was chosen pursuant to an open competitive process.

The invitation to discuss management of the fund was drafted by the Finance Committee composed of directors Steve Morain and Duane Acker and conveyed to more than ten fund managers and investment bankers who are active in Iowa and the upper Midwest in the food and biotech agricultural industries.

In-person interviews were then conducted.

Final interviews were focused on three Iowa-based companies.

The board considered three factors to be critical in selecting the manager. First, the analytical and intellectual skills, management capabilities and judgment of the senior management of each candidate. Second, specific experience in and knowledge of the agriculture, food and fiber processing sectors. Finally, Iowa based or at least a strong Iowa presence.

Cybus's major strengths were its demonstrated extensive experience in food, fiber and agribusiness concerns and a strong Iowa presence with additional locations throughout the nation focused on the food industry and potential processing ventures to be brought to Iowa. They also have eight highly skilled professional principals, six located in Iowa, who will devote a substantial portion of their time to the fund.

- 8. When they were chosen did the board and/or management know that Cybus had no experience as an investment fund manager? Was Cybus inexperience taken into account when a fee was negotiated?**

Yes, the fact was well known and extensively discussed that Cybus as an entity has not previously managed a fund. Individual members of Cybus, however, have been successful portfolio managers within major financial institutions. Cybus principals have also been investment bankers, bank and commercial lenders, insurance company investment officers and financial analysts. They also have closed, collectively, approximately \$2 billion of deals similar to what we anticipate will be financed through the fund. The IAFC Board feels the proven success of Cybus in closing those deals for clients requires, perhaps, more finely-honed skills than simply managing a fund, because Cybus had to convince independent investors and lenders to commit to those projects, as well as analyzing, due diligence, structuring, and negotiating the conflicting interests of the sources and users of capital. The IAF Board has full confidence in Cybus's capability to manage the fund.

- 9. What steps were taken to make sure that Cybus as the fund manager does not have a conflict of interest with current or future clients that Cybus is involved with?**

Our agreement with Cybus provides for disclosure of any prior dealings with a client or prospective client whether or not there is a conflict of interest or a potential conflict. Prior to approving any transaction disclosure audits are conducted by independent law firms or auditors. These audits would disclose any involvement by Cybus or its principals. Cybus must also disclose any fees received by it from Fund portfolio companies or prospective clients.

A strength of Cybus is their extensive experience in the food and agricultural business. As a result there will undoubtedly be certain businesses that we may target with which one of Cybus' officers has had prior contacts. Knowing of this potential, our agreements provide safeguards and procedures for proper disclosure in dealing with any potential conflicts.

- 10. What is the maximum that the fund will invest in any one venture? How was the maximum established? How is the maximum consistent with the legislation's intent?**

In order to comply with the investment strategies set out in the Act and the contract with IDEED, the fund seeks to make investments of between \$1,000,000 and \$5,000,000 in any single venture with an objective of a maximum allowed of 20% of the fund, or \$11,000,000 assuming full private investor participation.

This guideline is consistent with the legislative intent of "maintaining a portfolio which is diversified among the various types of agricultural commodities and agribusinesses."

- 11. How many applications have been submitted? How many are actively being pursued? What percentage of time is spent by Cybus in assisting applicants in structuring their business, what percentage in reviewing applications, and what percentage in soliciting potential investors?**

The fund has received over 40 applications (formal receipt of a business plan). However, we have had contact with over 2,000 companies or prospects through direct mailings, follow up phone calls and various small and large group meetings. Total expressions of interest in financing total more than \$250 million.

The vast majority of applications do not currently meet the threshold tests required by the Act of producer ownership or involvement, but with refinement or restructuring, it is possible that some of those proposals might become eligible.

Approximately 15 proposals are in active negotiation. Most of those require counseling and restructuring to include producer ownership.

Cybus informs us that their time is split between various functions as follows:

- assisting applicants and structuring their business - 25%;
- reviewing applications - 30%;
- soliciting potential investors - 10%; and
- soliciting potential investments 35%.

12. What is Piper Jaffray's purpose as the fund's investment banker? What is their fee?

U.S. Bancorp Piper Jaffray is the corporation's investment banker. It receives no fee from the corporation for this service except reimbursement of expenses. To-date they have not billed any expenses beyond that connected with the placement. Their fee is only in connection with an investment fund from the private investments in the fund.

Pursuant to the corporation's investment banking agreement, Piper Jaffray has been retained as the placement agent for the limited partnership at a fee of 2.85% of private funds raised. (The investment banker contract contemplated a fee of up to 3.85% which is customary in the market; the fund's private placement agreement reduced it to 2.85% in view of the major commitments from local agricultural related investors.)

Piper is not paid anything with respect to the investment of the \$25,000,000 from the State. It is paid only for the private funds actually invested. They are not paid a fee based upon commitments, but a fee based upon actual dollar investments in ventures when and if the funds are invested in qualified ventures.

13. What is the total amount of administrative and other costs to raise and manage the fund? What percentage is this of the total fund? If you disregard the State's loan, what percentage does administrative costs make up of the remaining funds?

The total cost to manage the fund is provided contractually in the Private Placement Memorandum. During the commitment period the Fund Manager receives an annual management fee of 2.25%. After placing all committed capital or five years, whichever comes first, the Fund Manager receives an annual fee to manage investments, including arranging appropriate exit strategies, equal to 1.75% of the declining balance of investment funds. The fee is for the management of the investments regardless of the source: private or state loan.

Cybus as a general partner also receives 12% of profits (if any) above the priority payments to IAFC and to private limited partners. (This compares to the industry's 20% norm for fund managers.)

14. This fund was started with the idea of encouraging a beef packing plant; what have you done to help finance such a plant?

The Act provides for the encouragement of the development of Iowa processing facilities owned by Iowa producers and requires that it maintain a portfolio "which is diversified among the various types of agricultural commodities and agribusinesses." It also provides that not more than 75% of monies originating from the State may be used to finance any one Iowa Agriculture Industry venture.

The fund was established to encourage the development of this broader spectrum of processing facilities and not for just one industry. A beef packing plant with cattle producer ownership is within this scope, and is presently under negotiation.

Certain proposals have been suggested and information exchanged. The sponsors of the processing facility have requested that the details of the contemplated transaction be maintained confidential in order to maintain their competitive advantage and not to compromise the transaction with other parties.

15. Since you were established with public funds, what accountability do you have to the public?

We are fully accountable to the public for the state funds as mandated by the Act and the Loan Agreement.

The Act provides for certain accountability including adoption of policies and procedures for public oversight and reporting. These requirements have been incorporated in the Articles of Incorporation and Bylaws of the corporation. In addition, in conferences and negotiations with the attorney general, we have expanded upon those requirements and have included more detailed requirements and procedures to ensure compliance.

Pursuant to those objectives and requirements, we have held public forums, have made reports, and subjected ourselves to audits to fulfill our accountability to the public.

In addition, the Board recognizes its responsibility to be accountable for the public funds and has requested that its members be allowed to appear before the legislative Fiscal Committee. It is open to any other suggestions by which it can fulfill its responsibilities of accountability while pursuing the mandates of the Act and remaining a private entity to attract and encourage producer owned processing facilities in the State of Iowa.

16. Amount of dollars currently held by IAFC?

Approximately \$23,000,000 of cash deposits or trust assets held in government or high-grade corporate bonds. Almost all is contractually committed and subject to call under the limited partnership agreement approved by IDEED.

17. Interest earned on account from inception?

\$941,233.29 This does not include any accrued income not yet paid. Investment returns on bankable funds are approximately a 5.25% effective rate of return.

18. Payments made for IAFC expenses to attorneys, consulting firms and administrative expenses?

Our financial reports are attached. The specific amounts requested are as follows:

Category	Net Dollar Amount ¹
Legal	\$97,376.86
Accounting	\$12,527.50
Marketing	\$17,416.17
Administrative Support	\$6,061.09
Other Consulting ²	\$137,053.20
Employee compensation (including benefits)	\$98,085.58
IDED (Office rent and reimbursement for start-up costs)	\$9,716.26
Office Equipment (e.g. computers etc.)	\$5,588.44
Office Supplies & Operations (e.g., phone, paper and mailing)	\$7,686.56
Board Support (e.g., travel reimbursement)	\$2,056.83
Taxes ³	\$103,000.00
Total expenses	\$496,568.49
tecTERRA partnership units ⁴	\$2,409,117.35

The loan agreement with IDED negotiated by the Attorney General allows up to \$100,000 of the state loan to be used for start-up costs including administrative costs, overhead costs, or salaries. No principal was consumed and the principle is still intact to be fully deployed as investments.

19. Loans made to date?

On December 16, 1999 the IAFC Board approved a \$2,200,000 convertible debt investment for a 40% ownership interest in a specialty organic food firm. The loan is

¹ Numbers are approximate, allocation to categories consistent based upon payee, but assignment to each category reflects some judgment. For instance some mailing expenses could arguably be marketing expenses, yet are included in office supplies and operations.

² The primary source is a monthly retainer paid Cybus while planning the Fund from November until August.

³ This does not yet reflect an accrued liability for taxes in the last quarter of 1999.

⁴ tecTERRA partnership units reflects amounts paid into tecTERRA Food Capital Fund in cash or in kind for which IAFC received either general partner units or limited partner units that are assets. On the balance sheet, cash is converted to a long-term asset, but no immediate change in net worth results from the conversion. Some units remain unissued and therefore not counted until the next investor closing.

conditioned upon the company building a new plant in a small Iowa town. The company will employ approximately 100 employees at above average wages. The new plant is three to four times the size of the firm's existing facility and is better located to the firm's emerging markets in the East and Southeast. Simultaneously the Board approved a parallel loan from IAFC to the Iowa Organic Supply Network, a qualified networking farmers entity for \$275,000 to purchase one-eighth of tecTerra's stake in the firm – or 5% of portfolio firm. The loan to the Network is conditioned upon the Network purchasing an equity stake in IAFC equal to at least 5% of the loan. Firm management is excited to have farmer ownership and expects to enter procurement contracts with those farmer-owners for higher margin specialty crops to be used in their Iowa plant.

20. Types of firms targeted for loans?

The types of facilities targeted for loans are those set out in the Act and more fully described in the Private Placement Memorandum. These include biotechnology, food, fiber and other high value-added agricultural processing, marketing and distribution companies offering opportunities to involve Iowa agricultural producers in ownership.

21. Whether attempts have been made to structure so farmers will share in equity generated by projects?

Yes. As required by the Act, our corporate documents and our representations to private investors we have worked diligently to structure proposed ventures so that farmers and Iowa agricultural producers will have an opportunity to share in equity generated by the projects.

It is has been our experience that there have been few if any proposals brought by producers desiring direct loans to invest in a processing facility. More frequently, an entity proposes a processing facility seeking financing and we counsel with them and restructure the plan to involve producer ownership opportunities.

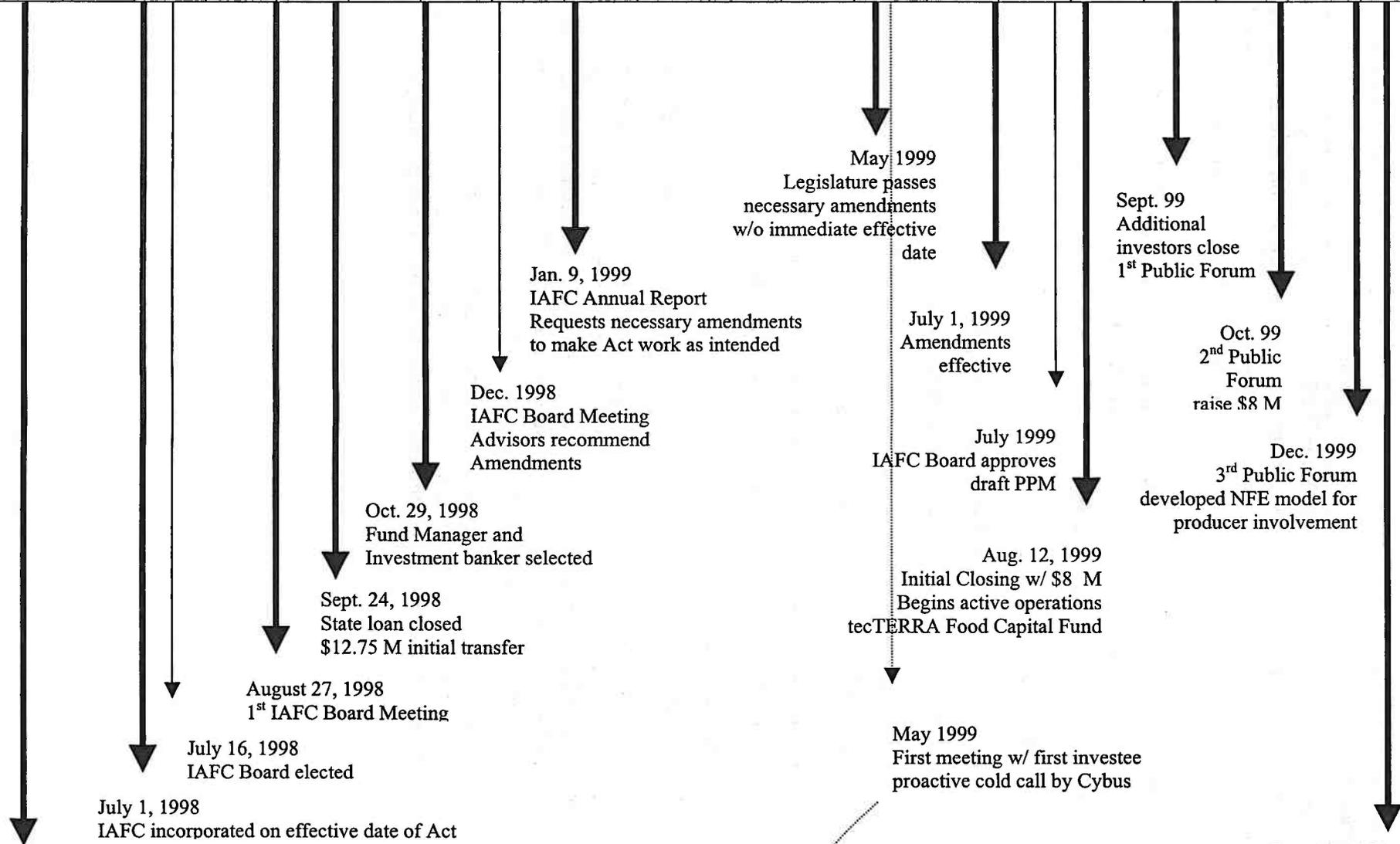
Early deals are intended to create templates for producer involvement that can be reused in later transactions, but these are not necessarily the only models for involving agricultural producers in equity ownership or other benefits of growth. Creative development of producer involvement opportunities will be necessary to meet both the profit and public purchase objectives of the Act.

22. Please provide a copy of the prospectus or any similar document for tecTerra Food Capital Fund I, L.C.

The prospectus has been previously provided and is available with this document.

40+ road shows

May 98	June 98	July 98	Aug 98	Sept 98	Oct 98	Nov 98	Dec 98	Jan 99	Feb 99	Mar 99	April 99	May 99	June 99	July 99	Aug 99	Sept 99	Oct 99	Nov 99	Dec 99
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1998 S.F. 2415
Iowa Agricultural Industry
Finance Act (the "Act")

Dec. 16, 1999
IAFC Board approves first tecTERRA investment in specialty organic processor, creating 100+ jobs and Equity ownership opportunity for Iowa ag producers

Marketing

Marketing the availability of IAFC's tecTERRA Food Capital Fund is a critical part of success. Deal origination will be the difference between success and failure. Finding good opportunities and shaping them into successful deals is the pattern of successful fund managers. Cybus is aggressively promoting the Fund both within Iowa and outside of the State.

- Number of professionals representing Iowa and tecTERRA Food Capital Fund in marketing through IAFC and Cybus = 22
- Number of mailings = 1927
- Number of phone contacts = 600
- Number of marketing / business meetings = 99
- Number of public speaking engagements = 13
- Number of public forums = 3
- Number of attendees at public forums = 121
- Number of applications (business plans) received = 40
- Amount of money requested to date = **\$234 Million**
Assuming funding at levels of expressed interest.
- Current funds under management to meet demand = **\$43 Million**

Marketing is an ongoing process to fill the pipeline with future investment opportunities. Often timing is important. A deal that is not mature today may get there next year. Staying in front of decision-makers on a regular basis is important. A firm may not be considering expansion today, but again tomorrow is another question. The marketing contact has to come at the right time. This means taking more than one shot.

Cybus is demonstrating their capacity for proactive marketing. We are not sitting on our hands waiting for deals to come to us all tied-up with neat little bows. This is definitely some a "some assembly required" business. Cybus is putting the pieces together.