

STATE OF WISCONSIN

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Alberta Darling

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ASSEMBLY CHAIR
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JOINT COMMITTEE ON FINANCE

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Alberta Darling
Representative John Nygren

Date: March 1, 2018

Re: DOA Report to JFC

Attached is a report providing assessment of, and recommendations relating to, the fund of funds investment program being created under 2013 Wisconsin Act 41 (**Badger Fund of Funds I**) from the Department of Administration, pursuant to s. 16.295(8), Stats.

This report is being provided for your information only. No action by the Committee is required. Please feel free to contact us if you have any questions.

Attachments

AD:JN;jm



STATE OF WISCONSIN
DEPARTMENT OF ADMINISTRATION

Scott Walker, Governor
Scott A. Neitzel, Secretary
Waylon Hurlburt, Division Administrator

March 1, 2018

The Honorable Alberta Darling, Senate Chair
The Honorable John Nygren, Assembly Chair
Joint Committee on Finance
Madison, WI 53702

MAR 01 2018
St. Finance

Dear Senator Darling, Representative Nygren, and Members:

This report is provided pursuant to Section 16.295(8) of the Wisconsin Statutes and provides assessment of, and recommendations relating to, the fund of funds investment program being created under 2013 Wisconsin Act 41 (**Badger Fund of Funds I**). As required by Section 16.295(7) of the Wisconsin Statutes, annual and quarterly reports have been provided to the Legislature or made available on the Department of Administration's internet site.

The Department continues to be pleased with the progress of Sun Mountain Kegonsa, LLC (**Investment Manager**), including investment activity from the Badger Fund of Funds I and fulfilling other requirements of Act 41. At this time, five funds have received either commitments or contingent commitments from the Badger Fund of Funds I.

The three funds that have received commitments include two seed stage funds; the Idea Fund of La Crosse and the Winnebago Seed Fund, and one growth stage fund; Rock River Capital Partners. The two seed stage funds have also made investments in three separate Wisconsin-based startup companies. The Idea Fund of La Crosse invested in one company in Madison that is a data analytics company and founded by a UW-Madison alumnus. In addition, the Winnebago Seed Fund made two investments to date. The first investment was made to a Milwaukee-based medical data analytics company. The second investment was made into a Neenah-based digital sports training software company. The two funds that have received contingent commitments are also seed stage funds.

The two seed stage funds that had successful final closings raised more capital than their initial respective targets. In total, beyond the State's \$25 million appropriation, private capital raised in conjunction with the Badger Fund of Funds I and the portfolio funds will result in total investments exceeding \$75 million.

Now that the Badger Fund of Funds I is making investments, several items in the Limited Partnership Agreement (**LPA**) required amendment and clarification. Per Section 11(c) of the LPA, the proposed amendment received 90% approval by a Majority in Interest of the Limited Partners (including that of the State of Wisconsin Department of Administration), and a copy of this executed amendment to the LPA is attached to this letter.

The Honorable Alberta Darling, Senate Chair
The Honorable John Nygren, Assembly Chair
Joint Committee on Finance
March 1, 2018
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Finally, attached is a letter from the State of Wisconsin Investment Board (**SWIB**) that contains their recommendations to improve the investment program created under Section 16.295 of the Wisconsin Statutes. The Department generally concurs with the themes of SWIB's recommendations with the following additional comment on two such recommendations.

- The report filed in calendar year 2015 also identified concerns that 2013 Wisconsin Act 41 includes too many investment restrictions for the Badger Fund of Funds I. The Department still intends to use future reporting requirements to review investments and their results; based on this review the Department will then propose, if needed, changes or expansion of investment options.
- The Department's Capital Finance Office has the lead in providing administrative and monitoring resources for the Badger Fund of Funds I. The Capital Finance Office will discuss with both the Investment Manager and SWIB the specialized and dedicated tools and systems being used by other managers for monitoring and reporting purposes.

As stated above, the Department is very pleased with the progress of the Badger Fund of Funds I, and looks forward to additional commitments to portfolio funds and many new investments in Wisconsin-based companies. Please contact David R. Erdman, Capital Finance Director, at (608) 267-0374 or david.erdman@wisconsin.gov with any questions on this report.

Sincerely,



Scott A. Neitzel
Secretary

Attachments



STATE OF WISCONSIN
INVESTMENT BOARD

February 16, 2018

The Honorable Alberta Darling
317 East State Capitol
P.O. Box 7882
Madison, Wisconsin 53707-7882

The Honorable John Nygren
309 East State Capitol
P.O. Box 8953
Madison, WI 53708

Dear Senator Darling and Senator Nygren:

The 2013 Wisconsin Act 41 ("Act 41") created and provided funding for a state venture capital investment program. Act 41 required the Secretary of Administration to form a committee to select an investment manager for the program. By statute, the committee consisted of three representatives of the State of Wisconsin Investment Board (SWIB) and two representatives, appointed by the secretary of the capital finance office in the Department of Administration (DOA). Sun Mountain Kegonsa was selected to manage the program, which is commonly referred to as the "Badger Fund".

Act 41 requires DOA to submit a report relating to the venture capital investment program to the Joint Committee on Finance by March 1, 2018. This report is required to include "any recommendations the investment board has for improvement of the investment program under this section and the specific actions the investment board proposes to be taken to implement those recommendations. This letter is SWIB's response to the reporting requirement. While we are optimistic about the prospects for the Badger Fund, the following are a few suggestions and comments to consider that may help improve the program.

Administrative and Monitoring Resources

Proper management, monitoring and reporting of venture capital investments requires administrative support. While we believe DOA is currently doing a good job of providing such oversight, resource needs will increase in the future. As the Badger Fund's underlying funds begin to invest in startup companies, the level of information and necessary oversight will increase. Providing an appropriate level of dedicated tools, systems and resources to monitor the program is important.

Limit Fund Restrictions

While certain investment restrictions are expected with these types of programs, we continue to believe that minimizing them, where appropriate, will lead to broader interest from fund managers and start-up companies. There are other early-stage programs where venture capital investors can generally invest in the best opportunities available with no restrictions. Allowing the market to pick

and choose the best sectors/companies is advantageous. A program with less restrictions provides greater fund and portfolio company diversity, which is a beneficial outcome.

Private Dollar Match and Fund Commitment

As the state venture program evolves, providing flexibility to the private dollar match requirement could potentially lead to bringing larger and more experienced fund managers into the state. Due to investor preferences, some Badger Fund investors elected to not commit to the underlying emerging managers. Addressing this issue may be something to consider in the future. It may be helpful to think of ways to provide incentives for investors to make commitments to both the fund of funds vehicle and underlying funds.

Venture Capital Risk/Return Profile and Investment Horizon

Start-up companies face many challenges and risks. In a typical venture capital portfolio, most of the returns will be generated by 20% of the investments. In addition, venture investments take time to appreciate and, after fees, returns will be negative in the early years of the fund's life. As investment values increase, fund returns will turn positive. In addition, given that investments are made at the earliest stages of a company's life it will take time for it to develop, have meaningful employment and ultimately create value for investors by being sold or going public. When investing in venture capital, patience is a virtue providing investors with a long-term mindset to not make quick decisions that could negatively impact the overall program. The Badger Fund is following through on the strategy proposed to DOA and needs the required time to execute that strategy. Any drastic changes could negatively impact the program's outcome and should be avoided.

SWIB appreciates the opportunity to work with various members of the Department of Administration on the support initiative and hope that our participation was valuable to the process. We also hope our comments are helpful to the Joint Committee on Finance. If we can be of any further help, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink, appearing to be 'CP', with a long horizontal flourish extending to the right.

Christopher P. Prestigiacomo
Portfolio Manager

AMENDMENT NO. 1
TO THE
LIMITED PARTNERSHIP AGREEMENT
OF
BADGER FUND OF FUNDS I, L.P.

This Amendment No. 1 (this "Amendment No. 1") to the Limited Partnership Agreement of Badger Fund of Funds I, L.P. (the "Partnership"), dated as of June 3, 2015 (the "Partnership Agreement"), is made this 2nd day of January, 2018, by and among Sun Mountain Kegonsa, LLC as general partner (the "General Partner") and the Limited Partners.

WITNESSETH

WHEREAS, the General Partner and the Limited Partners are parties to the Partnership Agreement; and

WHEREAS, the General Partner and a 90% Majority in Interest of the Limited Partners, excluding any interest of the General Partner or its Affiliates (as required by Section 11(c) of the Partnership Agreement) have agreed to amend the Partnership Agreement in the manner set forth herein.

NOW, THEREFORE, in consideration of the premises herein contained the parties hereto agree as follows:

1. Defined Terms. Capitalized terms used but not defined herein shall have the meaning given to such terms in the Partnership Agreement.

2. Amendments.

(a) The opening paragraph of Section 4(b) of the Partnership Agreement is hereby amended by inserting the words "and 'partnership representative'" after the words "and is specifically authorized to act as, the 'tax matters partner'" in the penultimate sentence thereof.

(b) The first sentence of Section 5(d)(vi) of the Partnership Agreement is hereby amended and restated to read as follows:

"(vi) No member of the Advisory Committee (including the Limited Partner who designated such member) shall owe any fiduciary or other duties to any other Partner or the Partnership, nor will any member of the Advisory Committee (including the Limited Partner who designated such member) be liable to any other Partner or the Partnership for any reason related to such member's participation on the Advisory Committee (other than fraud or willful misconduct on the part of such member) including without limitation, for any mistake in judgment, any action or inaction taken or omitted to be taken, or for any loss due to any mistake, action or inaction."

(c) Section 4(c)(i) of the Partnership Agreement is hereby amended and restated to read as follows:

“(i) for the purpose of covering Capital Contributions to Collective Investment Vehicles, Partnership Expenses, the Management Fee or the Monitoring Charge. Once a quarter, the General Partner will utilize its best efforts to bring the balance of the credit facility to \$0, or”

(d) Section 6(c)(i)(2) of the Partnership Agreement is hereby amended and restated in its entirety to read as follows:

“(A) All out-of-pocket fees, costs and expenses, if any, incurred in developing, negotiating, structuring, and disposing of actual Portfolio Investments, including without limitation any financing, legal, accounting, advisory, travel and consulting expenses in connection therewith (to the extent not subject to any reimbursement of such costs and expenses by entities in which the Partnership invests or other third parties) and the fees and expenses of the General Partner’s investment committee, and (B) Broken Deal Expenses, to the extent not reimbursed by an entity in which the Partnership has invested or proposes to invest or by other third parties or capitalized as part of the acquisition of a transaction;”.

(e) Section 6(c)(i) of the Partnership Agreement is hereby amended by deleting the word “and” at the end of Section 6(c)(i)(10), replacing the period at the end of Section 6(c)(i)(11) with a semi-colon, and inserting a new Section 6(c)(i)(12) and a new Section 6(c)(i)(13), each to read as follows:

“(12) the expenses of any Partnership Meetings held pursuant to Section 7(d);
and

“(13) The costs of registration and compliance program expenses of the Partnership, the General Partner, the Manager and its Affiliates (including, but not limited to, costs and expenses related to U.S. registration, regulatory and self-regulatory filings such as Forms 13D, 13F, 13G, 13H, PF, ADV, and other filings and reports the preparation of which may be required of the Partnership, the General Partner, the Manager and its Affiliates, as well as all compliance consulting fees related to operations).”

(f) Section 6(c)(ii) of the Partnership Agreement is hereby amended and restated in its entirety to read as follows:

“(ii) Notwithstanding Section 6(c)(i), and ignoring for purposes of this Section 6(c)(ii) any costs and expenses of the Partnership identified in Section 6(c)(i)(4) and Section 6(c)(i)(8) (and specific solely to Section 6(c)(i)(8) to the extent that

such costs are incurred prior to July 1, 2017), Partnership Expenses shall not exceed 2% of the Partners' aggregate Capital Commitments."

(g) The introductory paragraph of Section 7(c)(i)(1) of the Partnership Agreement is hereby amended and restated in its entirety to read as follows:

"(1) the following financial statements for the Partnership prepared following United States generally accepted accounting principles:"

(h) The introductory paragraph of Section 7(d) of the Partnership Agreement is hereby amended and restated in its entirety to read as follows:

"(d) Partnership Meetings. The General Partner may, and upon the written request of at least 33% in Interest of the Limited Partners will, call a meeting of the Partnership by giving at least 21 days' notice of the time and place of such meeting to each Limited Partner, which notice will set out the agenda for such meeting. The Limited Partners may participate in such meetings by means of conference telephone or similar communications by means of which all persons participating the meeting can hear and be heard."

3. Expenses of this Amendment No. 1. For the avoidance of doubt, the Partnership shall bear all expenses associated with this Amendment No. 1 as Partnership Expenses in accordance with the Partnership Agreement.

4. Ratification and Confirmation of the Partnership Agreement. Except as expressly modified by this Amendment No. 1, the Partnership Agreement is hereby ratified and confirmed in all respects, and shall remain in full force and effect.

5. Governing Law. This Amendment No. 1 shall be governed and construed in accordance with the laws of the State of Delaware.

6. Effectiveness. This Amendment No. 1 shall be effective on the date hereof.

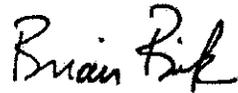
7. Counterparts. This Amendment No. 1 may be signed in any number of counterparts, each of which when signed by the General Partner shall be an original, but all of which taken together shall constitute one amendment. Any signature to this Amendment No. 1 transmitted by facsimile or electronically in .pdf format is binding upon the parties with the same force and effect as an original signature on a final document.

[Signature Page to Follow]

IN WITNESS WHEREOF, the parties hereto have executed this Amendment No. 1 on the date first above written.

GENERAL PARTNER:

Sun Mountain Kegonsa, LLC

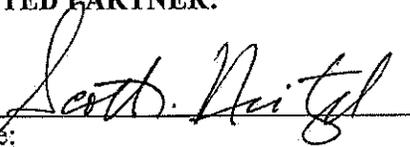


By: _____

Name: Brian Birk

Title: President

LIMITED PARTNER:



By: _____

Name:

Title:



To: State of Wisconsin DOA Capital Finance Office
Date: January 26, 2018
Re: Amendment to Limited Partnership Agreement ("LPA")

Dear Limited Partner,

As discussed at the annual meeting, the Badger Fund of Fund I, L.P. ("BFF") has identified several items in the LPA that require either a language clarification and / or a different categorization. The attached proposed amendment seeks to address these items. Please note that your overall capital commitment to the BFF will not be impacted by this proposed amendment.

For your review, what follows is a high-level summary of the amendment.

Clarifies the following items within the LPA	Rationale
All quarterly financial statements, in addition to those prepared each fiscal year-end, will be prepared under U.S. GAAP.	<i>As a Registered Investment Adviser ("RIA"), we are required to provide quarterly GAAP basis financial statements to investors. This would also be consistent with what has been done since inception and currently required in the LPA on an annual basis.</i>
Limited partners have the option to participate in meetings via conference call in the event they cannot attend in person.	<i>The fund does not explicitly address this item, but it's a typical LPA disclosure. This item provides another option for limited partners to participate in annual meetings.</i>
Members of the Limited Partner Advisory Committee do not owe any fiduciary or other duty to any other Partner, or the Fund.	<i>The fund does not explicitly address this item, but it's a typical LPA disclosure. Such language was recommended by the BFF's external counsel as a result of potential Advisory Committee members asking about their liability via participating on such committee. External counsel recommended that it is reasonable that Advisory Committee members do not owe any duty to any other partner, or the fund, other than the duty to act in good faith (of course, absent fraud or willful misconduct).</i>
In accordance with new guidance issued by the IRS, the General Partner is designated as the Fund's "partnership representative", as well as its "tax matters partner", for purposes of tax audits.	<i>The fund does not explicitly address this item, but it's a typical LPA disclosure. This item was recommended by the BFF's external counsel to be compliant with recent IRS pronouncements.</i>

Clarifies the following items within the LPA (continued)	Rationale (continued)
Enable the General Partner to utilize the fund's line of credit for investment purposes in addition to Partnership Expenses, the Management Fee or Monitoring Charge in order to manage short term working capital needs.	<i>We've been utilizing a line of credit with Capitol Bank to cover Partnership Expenses and Management Fees. However, the LPA is silent on using the line of credit for investment purposes. Now that the BFF is making investments, we would like to amend the LPA to explicitly allow us to utilize a line of credit to fund investments. This will allow us to limit the number of capital calls to one per quarter. The facility will be zero balanced each quarter.</i>
The language for the following expense items will be modified to make it clear that they are included in Partnership Expenses:	
Travel expenses incurred in developing, negotiating, structuring, and disposing of actual Portfolio Investments.	<i>The LPA does not explicitly address this. It is typical that travel costs related to performing due diligence on underlying funds would be included within Partnership Expenses.</i>
Costs of limited partner meetings.	<i>The LPA does not explicitly address this. It is typical that costs associated with holding annual meetings would be included within Partnership Expenses.</i>
Registration and SEC compliance program expenses, as well as compliance consulting fees, related to the Badger Fund, whether incurred by the Partnership, General Partner, Manager or any of its Affiliates.	<i>The LPA does not explicitly address this. It is typical that expenses incurred related to being a RIA and ensure compliance with the SEC regulations would be included within Partnership Expenses. The expenses associated with hiring external compliance consultants would be charged to the BFF based on its pro-rata portion of such expenses.</i>

In addition to the above, the below two re-categorizations will cause such expenses to be excluded from the life-to-date cap of partnership expenses, which is currently set at 2% of Limited Partner committed capital, (and the amendment adds the General Partner's commitment to the 2% cap). These items would be re-categorized from ongoing fund costs to initial set-up costs as we believe the 2% was intended to cover just ongoing operating costs related to running the BFF.

Items to be re-categorized from ongoing fund costs to initial set-up costs	Rationale
Initial Organizational expenses incurred when setting up the Badger Fund (to the extent such costs were incurred prior to July 1, 2017).	<i>Because of complexities related to Act 41, the drafting of the BFF LPA and PPM required significantly more legal work than typical for a fund, as external counsel could not utilize standard 'fund-of-fund' templates when creating formation documents.</i>



Interest, fees and expenses related to lines of credit.	<i>We leveraged lines of credits to minimize capital calls to limited partners until the BFF's underlying investments started calling capital. Going forward, we intend to issue capital calls quarterly, or as needed, and expect the line of credit and interest costs to significantly decrease.</i>
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Please note, existing partnership expenses have also been higher than originally anticipated as the BFF incurred notable legal fees related to creating template documents (LPA, subscription docs, PPM's, etc.) for underlying funds to help keep their initial costs down. Developing these templates benefitted BFF investors since they significantly lowered legal costs for our underlying funds. Further, the BFF has also incurred greater than expected costs related to training sessions for underlying fund managers.

Should you have questions on any of the above, please feel free to reach out to Brian or Ken, or our CFO, Eddie Markman, at 505-395-7728 or eddie.markman@sunmountaincapital.com.

Best Regards,

A handwritten signature in cursive script that reads "Brian Birk".

Brian Birk
President
Sun Mountain Kegonsa, LLC
Investment Manager for the Badger Fund of Funds

A handwritten signature in cursive script that reads "Kenneth U. Johnson".

Kenneth U. Johnson
Partner
Sun Mountain Kegonsa, LLC
Investment Manager for the Badger Fund of Funds