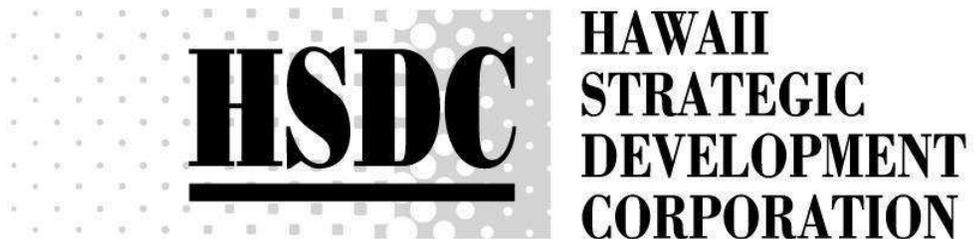


# 2010 Annual Report



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## Message from the Chairman

I would like to take this opportunity to thank the members of the Tech Caucus Group and others who spent considerable time and effort this past legislative session in an attempt to activate the State Private Investment Fund. Ultimately, this legislative initiative did not succeed, but the effort did help to educate policy makers and the community on the economic benefits of a well managed investment program. Current examples of these benefits are the contributions made by the Follow-on-Funding Program and the Hydrogen Special Capital Fund to Hawaii's economy over the past year.

Three members of HSDC's board had their terms expire this past year; our thanks to Glenn Yamada, Darren Kimura, and Jason Ikaika Hauanio, for their years of service.

Danton S. Wong  
Chairman of the Board

## Message from the President

This year's report highlights an increase in activity in our investment portfolio. Many of our fund investments are reaching the end of their terms and we are managing their exits. There may be opportunities to reinvest capital that is returned to HSDC and we are researching potential investments. However, to fulfill our mission as a catalyst for technology based economic development in Hawaii, HSDC will need to increase the financial resources we have to invest.

This past December, HSDC co-hosted a symposium on Best Practices in State Investment Programs. Representatives from Pennsylvania, New Mexico, Tennessee and Utah presented the positive impact their respective state's fund of funds investment programs have had on their economies. This coming December we plan on co-hosting a second Best Practices symposium, this time focused on Entrepreneurial Development. Again, representatives from several states will be invited to showcase their nationally recognized programs that have created a sustainable culture of entrepreneurial development in their communities.

Through these efforts and the tangible contributions our programs are producing we hope the technology sector stakeholders and policy makers will recognize the importance of well managed investment programs as part of the policy mix to drive entrepreneurial growth and capital formation here in Hawaii.

Karl Fooks  
President

## Report on the Follow-on-Funding Program

Act 267, SLH 2007 provided \$5 million for the Follow on Funding Program to be managed, under contract, by the Pacific International Center for High Technology Research (PICHTR). HSDC worked with PICHTR to establish a competitive process to select companies with promising technologies and to establish a set of metrics to evaluate the effectiveness of the program.

The purpose of the program was to provide funding for companies to commercialize the technologies they developed under research programs funded by the U.S. Department of Defense through the High Technology Development Venture and the Center of Excellence for Research in Ocean Sciences. These DOD funded programs support technology research and development, but not the commercial product development and marketing of the technology to generate revenues for the companies.

Through the Follow-on-Funding Program the state was able to provide funds to Hawaii's Dual Use sector companies, on a competitive basis, that allowed them to commercialize their innovations and build a sustainable business in Hawaii. The funds were disbursed in the first half of 2009 and 20 projects were funded with an average award of \$225,000. PICHTR has delivered a final report on the program that details the selection process and their program oversight. Their report is included as an appendix to this report.

The program was successful in achieving its objectives. The 20 projects that received funding represented a cross section of Hawaii's Dual Use sector companies and most of the participating companies were able to generate new revenues from their technologies, attract additional funding, and maintain or increase employment: the key metrics that were tracked under this program. These results were all achieved in a very difficult economic environment. The following table provides a summary of the projects funded and their performance.

**Follow-on-Funding Program Metrics**  
**June 30, 2010**

Project	Award Amount	Revenue or Anticipated Product Sales	Additional Capital Raised	Additional Capital Anticipated	Total Additional Capital	Hired New Employees	Transfer to Acquisition Cycle	Develop Commercial Product
Cellular Bioengineering, Inc. <sup>2</sup>	\$285,238	not reported			\$0	YES	YES	YES
Concentris Systems, LLC	\$300,000	\$1,380,000	\$780,000	\$1,500,000	\$2,280,000	NO	YES	YES
Fatigue Science <sup>1</sup>	\$300,000	\$587,845	\$775,000	\$500,000	\$1,275,000	YES	YES	YES
Makai Ocean Engineering	\$300,000	\$1,900,000			\$0	YES	NO	YES
Oceanit Laboratories, Inc. - LiquidWeb	\$225,000	\$3,250,000			\$0	YES	PENDING	YES
SEE/RESCUE - DeSalinator	\$44,660	not reported			\$0	YES	YES	YES
SEE/RESCUE - PocketFloat	\$49,660	not reported			\$0	YES	YES	YES
Innovative Technical Solutions - EOD	\$299,956	\$680,000		\$1,500,000	\$1,500,000	YES	NO	NO
Innovative Technical Solutions - Mini	\$250,237	\$370,000			\$0	YES	NO	NO
Nanopoint, Inc.	\$300,000	\$125,000	\$573,000		\$573,000	NO	NO	YES
Oceanit Laboratories, Inc. - Inspecta	\$275,000	\$16,000,000			\$0	NO	YES	YES
Oceanit Laboratories, Inc. - WIND	\$300,000	\$2,100,000			\$0	YES	YES	YES
Referentia Systems, Inc.	\$299,996	\$200,000	\$893,000		\$893,000	YES	YES	YES
SEE/RESCUE Corporation - LifeFloat	\$201,500	not reported			\$0	YES	PENDING	YES
TeraSys Technologies, LLC	\$198,496	\$1,255,000			\$0	YES	IN PROGRESS	YES
Archinoetics	\$189,943	\$0		\$3,000,000	\$3,000,000	NO	NO	YES
Hawaii Hydrogen Carriers	\$95,100	\$100,000	\$100,000	\$1,000,000	\$1,100,000	YES	YES	YES
Kuehnle Agrosystems	\$200,000	\$36,000		\$0	\$0	YES	YES	YES
Pipeline Micro, Inc.	\$200,190	\$0			\$0	YES	NO	NO
Williams Aerospace	\$185,000	\$672,219	\$120,000	\$3,500,000	\$3,620,000	YES	YES	YES
<b>TOTAL</b>	<b>\$4,499,976</b>	<b>\$28,656,064</b>	<b>\$3,241,000</b>	<b>\$11,000,000</b>	<b>\$14,241,000</b>			
<b>Program Commitments (number of projects)</b>		<b>12</b>			<b>5</b>	<b>15</b>	<b>5</b>	<b>5</b>
Number of projects achieving program commitments		<b>12</b>			<b>8</b>	<b>16</b>	<b>11</b>	<b>17</b>
PERCENTAGE OF COMMITMENT		100%			160%	107%	220%	340%

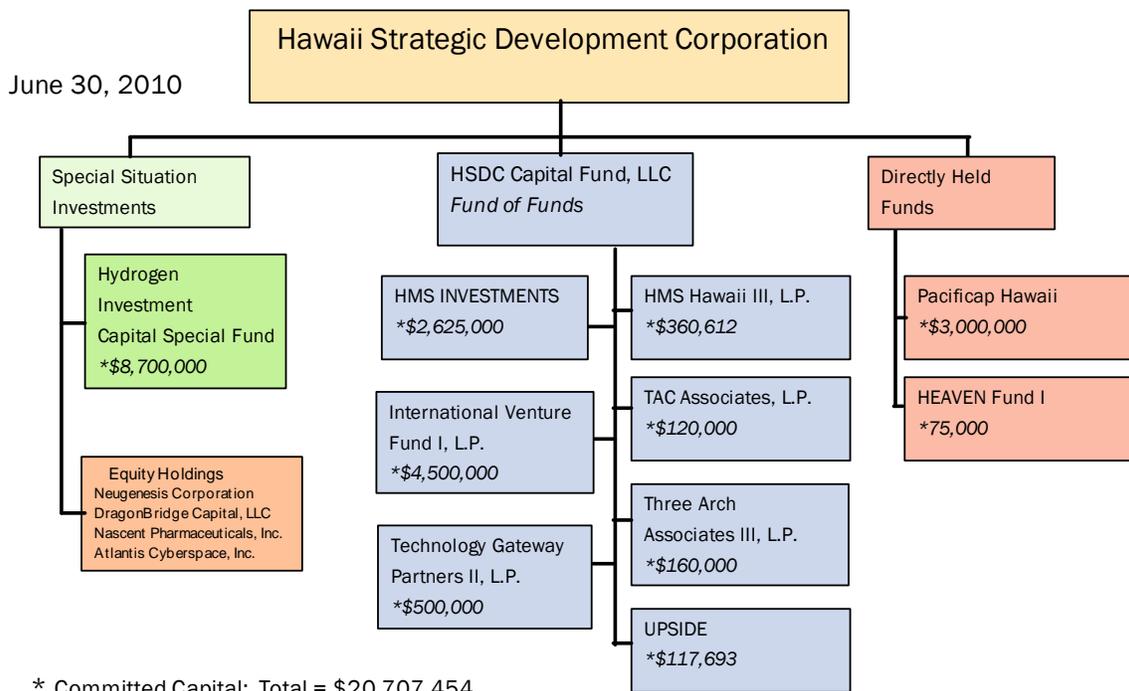
*1/ Figures for Fatigue Science were updated in May 2010, after the submission of their final report in February 2010.*

*2/ Cellular Bioengineering, Inc. did not report revenue or sales, but has sold product.*

Programs like the Follow-on-Funding Program help to leverage the significant amount of Federal funding of research programs in Hawaii because they provide the required matching funds for Federal programs, allow companies to focus on developing a business and not just a technology, and help an emerging technology sector develop into an innovation cluster. In the future, these programs could be structured to return capital to provide resources for the next round of funding.

## HSDC's Investment Portfolio

As of June 30, 2010, HSDC's investment portfolio totaled \$11.7 million in invested capital. The portfolio has returned \$4.0 million to date and the current carrying value of the investments is \$4.1 million, including \$817 thousand of cash awaiting investments held at HSDC Capital Fund, LLC, a fund of funds that is the legal entity through which HSDC holds most of its investments in venture partnerships. HSDC also administered the Follow-on Funding Program, a \$5 million grant program that ended this year, and is the administrative agent for DBEDT's \$8.7 million Hydrogen Fund program.



**HSDC Investment Portfolio**  
June 30, 2010

<b>Active Funds</b>	<b>Pro Rata Interest</b>	<b>Mgt. Fee</b>	<b>Vintage Year</b>	<b>Capital Commitment</b>	<b>Capital Contributed</b>	<b>Cash and Securities Distributed</b>	<b>Reported Value<sup>1</sup></b>	<b>Distributions + Reported Value</b>	<b>Date of Latest Report</b>
Heaven Fund I Series B & C	100.00%	3.00%	2007	\$ 75,000	\$ 75,000	\$ -	\$ 71,750	\$ 71,750	12/31/2009
HMS Investments	80.00%	3.50%	2003	\$ 2,625,000	\$ 2,662,968	\$ 3,242,685	\$ 501,804	\$ 3,744,489	6/30/2010
HMS Hawaii III, L.P.	12.10%	2.50%	2004	\$ 360,612	\$ 349,794	\$ 158,914	\$ 161,370	\$ 320,284	6/30/2010
International Venture Fund I, L.P.	27.01%	2.50%	2000	\$ 4,500,000	\$ 4,500,000	\$ -	\$ 1,257,421	\$ 1,257,421	6/30/2010
PacificCap Hawaii, L. P.	99.00%	2.50%	2000	\$ 3,000,000	\$ 3,000,000	\$ 347,113	\$ 868,992	\$ 1,216,105	6/30/2010
TAC Associates, L.P.	1.50%	1.50%	2001	\$ 120,000	\$ 76,107	\$ 7,548	\$ 79,339	\$ 86,887	6/30/2010
Technology Gateway Partners II, L.P. <sup>3</sup>	3.24%	2.25%	2004	\$ 500,000	\$ 500,000	\$ 175,924	\$ 94,949	\$ 270,873	6/30/2010
Three Arch Associates III, L.P. <sup>3</sup>	1.50%	0.38%	2000	\$ 160,000	\$ 111,223	\$ 110,314	\$ 69,342	\$ 179,657	6/30/2010
UPSIDE & UPSIDE I	18.75%								
	23.84%	1.50%	2004	\$ 117,693	\$ 117,693	\$ -	\$ 96,332	\$ 96,332	6/30/2010
<b>TOTAL ACTIVE FUNDS</b>				<b>\$ 11,458,305</b>	<b>\$ 11,392,786</b>	<b>\$ 4,042,499</b>	<b>\$ 3,201,299</b>	<b>\$ 7,243,798</b>	

<b>Active Equity Holdings</b>	<b>Pro Rata Interest</b>	<b>Mng. Fee</b>	<b>Vintage Year</b>	<b>Capital Commitment</b>	<b>Capital Contributed</b>	<b>Cash and Securities Distributed</b>	<b>Reported Value<sup>2</sup></b>	<b>Distributions + Reported Value</b>	<b>Date of Latest Report</b>
DragonBridge CapitaL LLC	1.67%	N/A	N/A	\$ 50,000	\$ 50,000	\$ -	\$ -	\$ -	11/17/2009
Nascent Pharmaceuticals, Inc. <sup>4</sup>	0.19%	N/A	N/A			\$ -	\$ -	\$ -	3/15/2010
Neugenes Corporation <sup>2</sup>	0.25%	N/A	N/A	\$ 128,401	\$ 128,401	\$ -	\$ -	\$ -	3/22/2010
Atlantis Cyberspace, Inc. <sup>2</sup>	0.98%	N/A	N/A	\$ 115,560	\$ 115,560	\$ -	\$ -	\$ -	4/30/2009
Nellix, Inc. <sup>3</sup>								\$ -	
Series B Preferred Stock	0.23%			\$ 40,000	\$ 40,000		\$ 42,424	\$ 42,424	3/31/2010
Secured Convertible Promissory Note				\$ 6,417	\$ 6,417		\$ 6,417	\$ 6,417	3/31/2010
<b>TOTAL ACTIVE EQUITY</b>				<b>\$ 340,378</b>	<b>\$ 340,378</b>	<b>\$ -</b>	<b>\$ 48,841</b>	<b>\$ 48,841</b>	
<b>TOTAL ACTIVE PORTFOLIO</b>				<b>\$11,798,683</b>	<b>\$11,733,163</b>	<b>\$ 4,042,499</b>	<b>\$ 3,250,140</b>	<b>\$ 7,292,639</b>	

1/ Valuations are as of the most recent data available from General Partners.

2/ Received as a distribution from the dissolution of Keo Kea Hawaii, LP

3/ Received as a distribution from the dissolution of Lava Ventures IV

4/ Received as a distribution from the dissolution of Hawaii Venture Fund

Below are descriptions of HSDC's active investment portfolio with the amount of capital invested in each fund as of June 30, 2010:

## Hawaii-based Venture Capital Funds

**HMS Investments; \$2.66 million:** Initial investment in September 1995. HSDC holds an 80% limited partner interest in this Hawaii based venture capital investment partnership. The investment portfolio consists of private equity investments in Firetide and Hawaii Biotech.

**HMS Hawaii III; \$0.35 million:** Initial investment in March 2004. HSDC holds a 12.1% limited partner interest in this Hawaii based venture capital partnership. The investment portfolio consists of private equity investments in AGIS Network, Sprout, and Firetide. It also holds publicly traded shares of Hoku Scientific.

**PacifiCap Hawaii, L.P.; \$3.0 million:** Initial investment in June 2000. HSDC holds a 99% limited partner interest in this Hawaii based venture capital partnership. The investment portfolio consists of private equity investments in Fresh Direct Holdings Inc., 4Charity.com, Iris Wireless, Bivision Systems and Trex-Cross Fiber VIPP Note.

### **Regional Venture Capital Funds**

**International Venture Fund I; \$4.5 million:** Initial investment in April 2000. HSDC holds a 27.01% limited partner interest in this California based venture capital partnership. The investment portfolio consists of private equity investments in Lumidigm, Napo Pharma, AssistGuide, Hawaii Biotech, and Cardax Pharmaceuticals.

**TAC Associates; \$ 0.076 million:** Received a 0.87% limited partner interest in this California based venture capital partnership as a distribution from the dissolution of Lava Ventures IV.

**Three Arch Associates III; \$ 0.111 million:** Received a 1.58% limited partner interest in this California based venture capital partnership as a distribution from the dissolution of Lava Ventures IV.

**Technology Gateway Partners II; \$0.5 million:** Initial investment in April 2004. HSDC holds a 3.24% limited partner interest in this California based venture capital partnership. The investment portfolio consists of Perlan Therapeutics and Neophotonics.

### **Fund to Support Hawaii Angels**

**Heaven Fund I; \$0.075 million:** Initial investment in November 2007. HSDC holds a 3.0% limited partner interest in the Series B and Series C of this Hawaii based venture capital partnership. This investment partnership supports investments made by the Hawaii Angels, a Hawaii based Angel investing network and currently holds private equity investments in 19 companies in its investment portfolio.

### **Fund to Support Technology Transfer from the University of Hawaii**

**UPSIDE I; \$0.118 million:** Initial investment June 2003. HSDC holds a 23.84% interest in this pooled capital fund. The balance is held

by the Research Corporation of the University of Hawaii. The capital fund is tasked with investing in promising start-up companies using UH developed intellectual property. HSDC holds an 18.75% interest in the original UPSIDE investment portfolio which consists of private equity investments in Pipeline Micro and Kuehnle Agrosystems.

### **Direct Equity Holdings**

HSDC directly holds share certificates, due largely to the liquidation of previous investment partnerships, in the following companies: Neugenesis, Atlantis Cyberspace, DragonBridge Capital LLC, Nascent Pharmaceuticals, and Nellix. DragonBridge Capital LLC was a direct investment by HSDC. As these are non-traded shares, it is difficult to accurately value these interests.

HSDC is also the administrative agent on two important programs, listed below, promoting the development of technology based companies in Hawaii:

**Follow-on Funding Program; \$5 million:** The State awarded this grant program to the Pacific International Center for High Technology Research in June 2008. HSDC executed and administers the contract implementing this program with the Pacific International Center for High Technology Research. This is a multi-year grant program to support Hawaii technology companies' efforts to commercialize for the civilian market, technology originally developed for the military market. \$4.5 million has been provided to 20 projects in Hawaii through a competitive solicitation process. This program was successfully completed this fiscal year.

**The Hydrogen Investment Capital Special Fund; \$4.4 million:** Despite its authorization in 2006, the investment program did not begin until December 2008. HSDC is the administrative agent for this DBEDT managed \$8.7 million program, which is divided equally between an investment program and a cost match grant program, both contracted out to Kolohala Ventures to implement. To date, \$2.4 million of the \$4.2 million investment program has been invested in a portfolio of Hawaii based clean energy companies consisting of: Clearfuels Technology, Kuehnle Agrosystems, Big Island Biodiesel, and Real Green Power. These investments have been instrumental in mobilizing resources for these companies to export their

clean energy technologies and leverage Hawaii's commitment to a clean energy future.

The \$4.2 million subprogram to provide cost-matching grants to entities in Hawaii pursuing grants for their Hydrogen related projects has disbursed \$1.3 million to date.

### **Lava Ventures IV, LLC**

Lava Ventures IV was liquidated in March 2010. This investment fund was managed by Gwen Watanabe and generated a 34.5% IRR on HSDC's \$500,000 investment. The fund's major success was its investment in Hoku Scientific, Inc. which successfully IPO'd in 2005. The remaining assets in the fund were principally two limited partner interests in Three Arch Associates III, L.P. and TAC Associates L.P., two funds that are part of the family of funds managed by Three Arch Partners. These limited partner interests were distributed to HSDC.

## Financial Report

### Revolving Fund (\$000)

HSDC funds its operations and investments through the HSDC Revolving Fund and from returns on investment generated through the HSDC Capital Fund, LLC.

FY Ending	6/30/2008	6/30/2009	6/30/2010
Interest Income/Partnership Distributions	\$348	\$89	\$8
Investments	\$75	\$0	\$0
Operating expenditures	\$229	\$101	\$161
HSDC Revolving Fund Balance	\$479	\$466	\$313
HSDC Capital Fund, LLC			
Uncommitted cash awaiting investment	\$862	\$790	\$817

### Special Funds (\$000)

Act 240, SLH 2006 established the Hydrogen Investment Capital Special Fund within HSDC, with expenditures to be overseen by the Department of Business, Economic Development and Tourism. The fund was capitalized with \$10,000,000 in October 2006. In June 2009, Act 79, SLH 2009, Sect. 12, transferred \$2,000,000 out of the fund and back to the general fund.

Act 267, SLH 2007 provided \$5 million for the Follow on Funding Program within HSDC.

FY Ending	6/30/2008	6/30/2009	6/30/2010
Hydrogen Investment Capital Special Fund	\$10,493	\$4,839	\$4,379
R&D Follow on Funding Program	\$5,000	\$350	\$100

HSDC's Board of Directors  
Fiscal Year 2010

Danton S. Wong, Chairman  
Attorney/Partner  
Chun Kerr Dodd Beaman & Wong

Eric B. Yee, Vice Chairman  
Vice President, Private Banking  
First Hawaiian Bank

Jason I. Hauanio  
Asst. Vice President, Sr. Financial Advisor  
Merrill Lynch

H. Brian Moore  
Senior Vice President  
Pacific Guardian Life Insurance Co.

Theodore Liu  
Director  
Department of Business, Economic  
Development & Tourism

Roland Resurreccion, AIA LEED  
Project Manager  
Hawaii Pacific Health  
Design and Construction

Darren T. Kimura  
President / CEO  
Sopogy, Inc.

Glenn S. Yamada  
Pearlridge Market Manager  
American Savings Bank

Blenn Fujimoto  
President and CEO  
Central Pacific HomeLoans Inc.

Edward H. W. Young  
TEYC Hawaii

Assumpta Siu Rapoza  
Director, Enterprise Risk Mgt.  
Hawaii Medical Service Association

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APPENDIX

# **FINAL REPORT**

**SUBMITTED TO**

**HAWAII STRATEGIC DEVELOPMENT CORPORATION**

**FOR THE**

**STATE OF HAWAII FOLLOW-ON-FUNDING PROGRAM**

**HAWAII TECHNOLOGY DEVELOPMENT VENTURE (HTDV)**

**JUNE 2010**

State of Hawaii, Hawaii Strategic Development Corporation #57257