2010 ANNUAL REPORT

INVESTSC, INC.

TO

SOUTH CAROLINA

VENTURE CAPITAL AUTHORITY

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BACKGROUND

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

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

INVESTMENT PORTFOLIO

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

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

NMP invests primarily in Southeastern-based, early and established growth stage companies. This includes companies in various stages of maturity from first round financings to established companies looking for capital. Their focus industries include technology, healthcare and business services. Prior sample investments include SecureWorks, NovaVision, OpenSite, and PGA Golf and Superstore.

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

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

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

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

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

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

FINANCING

The Venture Capital Authority Board approved DBAH Capital, LLC (Deutsche Bank) as a lender under the Act and received approval from the State Budget and Control Board. On June 22, 2007, InvestSC and DBAH signed a Securities Purchase Agreement for $50 million in notes. The notes are secured by all of the investments and tax credit certificates issued by the authority. At closing, the first draw of $15 million was made on the notes. This was followed by a required draw of $10 million in June 2008 and an additional $19,800,000 during 2009. The outstanding balance of the notes on December 31, 2009 was $44,800,000.

The final and required draw of $5,200,000 was made on June 22, 2010. The outstanding balance of the notes payable to Deutsche Bank on December 31, 2010 was $50,000,000. Each draw requires a contribution to the premium reserve fund (described below) equal to 7.5% of the amount drawn.

Interest is payable semi-annually at a fixed rate of 7.247%. Required payments of interest and commitment fees were made in June and December of 2010 in the amount of $1,641,365 and $1,841,946 respectively. Semi-annual interest payments of approximately $1,840,000 are required each June and December. Annual principal payments of $12,500,000 will begin in 2019 until the notes are paid off on June 22, 2022.

The notes require the establishment of three reserve funds as follows: interest reserve, tax reserve and premium reserve funds. The required interest reserve is equal to the semi-annual interest payment that would be due assuming the maximum aggregate principal amount of notes was outstanding. The tax reserve was released during October 2007, since InvestSC received notification from the Internal Revenue Service that it is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The premium reserve is a computed amount as required by the “Premium Account Control Agreement”. On December 31, 2010, the interest reserve and premium reserve totaled $1,875,015 and $3,750,031 respectively. The funds in these reserve accounts are held in trust and are not available to meet future capital calls by the Funds.

In the Report on Financial Statements issued by Elliott Davis on May 4, 2010 and June 20, 2011, the risk of default to the venture capital funds was disclosed. The AUDIT REPORT COMMENTS section below further discusses this risk. Upon the recommendation of Deutsche Bank, the Securities Purchase Agreement was amended on December 21, 2010, whereby, the Capital Contribution Account was established to receive all distributions from the funds and other amounts as necessary to meet the unfunded obligations to the venture capital funds. Prior fund distributions held in escrow by the funds of $653,783 and $2,900,000 from the Operating Account were transferred to the Capital Contribution Account on December 22, 2010. As of December 31, 2010, the Capital Contribution Account balance was $3,553,783 and the unfunded capital commitments were $11,575,070.

The creation of the Capital Contribution Account lessens the near term risk of default to the venture capital funds, but created the need to sell tax credits to fund the semi-annual interest payment of $1,841,946 in December 2010. InvestSC had discussions with various brokers of tax credits, individual companies and Deutsche Bank to determine the best method of monetizing the tax credits. On December 21, 2010, tax credits in the amount of $2,300,000 were sold for $1,840,000 ($0.80 for each dollar of tax credits) by RBC Tax Credit Equity, LLC in Charlotte, NC.

IMPLEMENTATION OF INVESTMENT PLAN

The InvestSC Board has approved the Funds selected by the South Carolina Venture Capital Authority and verified that each Fund's investment plan provides for the investment in "South Carolina based companies" as provided in the Act. The Venture Capital Authority has authorized investments in the following funds:

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

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

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

Investments have been made in the following sixteen companies as of December 31, 2010: Acumen Brands, Adaptivity, Navitas, Virtustream, FrontStream Payments, Gateway One Lending and Finance, Vocalocity, 2080 Media, Renal CarePartners, Clearleap, Lanx, RemitDATA, Appia, Diabetes Care Group, Dormir, and Tower Cloud. Noro-Moseley investments are focused in three sectors: Healthcare (41%), Technology (45%), and Finance (14%). The partnership agrees to make investments in South Carolina based companies as required by the South Carolina Venture Capital Investment Act at least equal to the amount invested in the Fund.

Noro-Moseley made its first South Carolina investment in May 2011 in PeopleMatter, a Charleston based software company that manages the needs of the food service industry. The founder of the company, Nate DaPore was congratulated in a resolution by the SC Legislature for being recognized as the 2011 "Top Up-and-Coming Entrepreneur" by the Southeast Chapter of TiE. The company has approximately 50 employees.

InvestSC carries the investment in Noro-Moseley at their audited book value of $6,259,924 compared to a cost of $5,997,993. This recognizes the unrealized gain in value of six of its portfolio companies and unrealized loss in value of three, and the management fees and expenses paid to the general partner. Noro-Moseley expects to be fully invested by the end of 2012, with 22 to 24 portfolio companies. According to the Noro-Moseley audited financial statements, the internal rate of return (IRR) since inception of the Partnership to the Limited Partners is (2.6%) through December 31, 2010.

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

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

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

Nexus has made investments in 10 companies through December 2010 that are either South Carolina based or will have significant operations in the State. They expect to make one additional investment from this fund. Their first investment, Sabal Medical, located in Charleston, was acquired by Swisslog in January 2011. The sale recognized a gain and a distribution of $1,100,000 was made to InvestSC in January. Four companies, Deltex Medical, Lab 21, Myconostica and Vital Sensors are establishing their United States headquarters in South Carolina. Spectra Analysis is a Massachusetts based company looking to relocate to Greenville, SC. Sultan Scientific, a publicly listed company in the UK that has built a portfolio of healthcare businesses which need to expand to the US should create multiple opportunities for launching South Carolina based companies.

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

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

In December 2009, Lab 21 acquired Selah Technologies, a South Carolina based company whose technology originated from a Clemson University researcher. The InnoVenture conference in Greenville brought together a local entrepreneur and the Clemson University Research Foundation to form Selah several years ago. This acquisition will provide a strong basis from which to launch Lab 21's US business.

Mini-Lap Technologies entered into a licensing agreement which will prevent them from moving to South Carolina. This violated Nexus' investment requirement so they demanded payment of their $500,000 investment plus a 25% premium. InvestSC received $200,000 in February 2010 and received the balance of $425,000 in June 2010.

InvestSC carries the investment in Nexus Medical Partners at their audited book value of $20,543,866 compared to a cost of $19,498,750. This recognizes the write-up in value for unrealized gains for Lab 21 and Sabal Medical, and the management fees and expenses paid to the general partner. All other investments are carried at or near cost. According to the Nexus Medical Partners audited financial statements, the internal rate of return since inception (IRR) of the fund is 2.60%, 6.0% and 16.95% through December 31, 2010, 2009 and 2008, respectively.

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

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

Frontier invested $13.6 million in 2010, adding Perceptis as a new investment and providing follow-on financings for four portfolio companies. In March 2011, Frontier made its final investment in Celergo. The Fund has invested $88 million in eleven companies and is fully allocated including reserves.

Frontier is pleased with the overall portfolio performance and continues to see increased valuations for individual portfolio companies. Frontier II completed its first exit in April 2010 with the sale of Ryla, Inc. The transaction generated a 2.9x return on invested capital and a 41% IRR. Over the course of Frontier's three year investment period, Ryla grew annual revenue from $15 million to over $100 million. A distribution of $828,834 was made in May 2010.

Frontier agrees to make investments in South Carolina based companies as required by the South Carolina Venture Capital Investment Act at least equal to the amount invested in the fund. Perceptis, a leading provider of outsourced help desk and information technology services for educational institutions was located in Cleveland, OH. In May 2011 the company moved to Greenville, SC and employs over 200 people.

InvestSC carries the investment in Frontier Fund at their audited book value of $8,545,753 compared to a cost of $6,391,293 (includes $122,663 interest). This recognizes the unrealized gains and losses in the portfolio companies and the management fees and expenses paid to the general partner. According to the Frontier II audited financial statements, the internal rate of return since inception of the partnership is 16.4%, 7.9% and (21.3%) through December 31, 2010, 2009 and 2008, respectively.

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

Date	Capital Call	Total Drawn	Remaining Commitment
			$1,500,000
9/28/2007	1,000,000	1,000,000	500,000
1/16/2009	50,000	1,050,000	450,000

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

Spartan Foods was sold in December 2009 to another private equity firm. Azalea's original investment in Spartan Foods was made in March 2005 and the Azalea Fund II realized a return of 6.25 times its invested capital on this investment. Azalea SC Fund's return was approximately 3.0 times its invested capital. In January 2010 InvestSC received a cash distribution of $1,637,819, followed by another distribution of $28,740 in April 2010. A gain of $678,137 was realized by InvestSC. The investment in Horizon CNC Products was written off in December 2008 as the General Partner found it necessary to discontinue the business operations.

InvestSC carries the remaining investment in Azalea SC at $102,990 which is the approximate amount that will be distributed upon the dissolution of the fund in 2011. There will be no additional investments made by Azalea SC and there are no plans by the general partner to draw the remaining $450,000 in committed capital. According to the Azalea SC audited financial statements, the internal rate of return since inception of the fund, net of profit allocations (carried interest) to the General Partner, is 32.8% and 11.3% through December 31, 2009 and 2008, respectively.

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

Date	Capital Call	Total Drawn	Remaining Commitment
			$8,500,000
10/31/2008	850,000	850,000	7,650,000
8/30/2009	1,700,000	2,550,000	5,950,000
12/7/2010	1,059,437	3,609,437	4,890,563
6/17/2010	926,711	4,536,148	3,963,852

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

Azalea III made its first investment in September 2009 with the acquisition of the auto textile division of Milliken. The new company is called Sage Automotive Interiors. It is the largest seat fabric producer in North America with a 40% market share. Three manufacturing locations are in South Carolina (Abbeville, Spartanburg and Greenville) and one in Georgia. This acquisition marks the first time that Milliken has ever sold a division and saved over 600 jobs in South Carolina.

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

Azalea III made two additional investments in 2010. KLMK in Richmond, Virginia is a leading provider of healthcare facility consulting services to hospitals in the United States. Ivize in Atlanta, Georgia is a provider of litigation document support services to law firms and corporations in the Midwest and Southeast United States. Multiple investments are expected in 2011.

InvestSC carries the investment in Azalea Fund III at their audited book value of $7,297,926 compared to a cost of $2,206,938. This recognizes the mark up in value of Sage, management fees and expenses paid to the general partner as well as a portion of the organizational costs. According to the Azalea III audited financial statements, the internal rate of return since inception of the fund is 140.3%, (8.9%) and (67.1%) through December 31, 2010, 2009 and 2008, respectively.

SUMMARY OF INVESTMENTS AND FAIR VALUES

Investment	2010 Cost	2010 Estimated Fair Value	2009 Cost	2009 Estimated Fair Value
Noro-Moseley Partners VI, LP	5,997,993	6,259,924	3,997,993	3,914,658
Nexus Medical Partners II, LP	19,498,750	20,543,866	20,000,000	21,524,083
Frontier Fund II, LP	6,391,293	8,545,753	5,242,663	5,922,527
Azalea Fund SC, LP	71,118	102,990	90,318	154,139
Azalea Fund III, LP	2,206,938	7,297,926	2,550,000	2,419,076
Totals	$ 34,166,092	$ 42,750,459	$ 31,880,974	$ 33,934,483

TAX CREDIT CERTIFICATES

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

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

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

EXPENSES

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

For the period ending December 31, 2010, interest expense on the notes was $3,492,732 and interest earned on all deposits was $48,036 for a net investment expense of $3,444,696. General administrative expenses for the period were $150,532. In addition, the amortized portion of the note issuance costs was $73,567. A schedule of the expenses expressed as a percentage of the fair value of assets on December 31, 2010, 2009 and 2008 is shown below:

	Year Ended December 31, 2010	Year Ended December 31, 2009	June 22 to December 31, 2008
Total Assets	53,086,896	43,941,532	23,501,557
Less, Note Issuance Cost (net)	(846,017)	(919,583)	(993,150)
Fair Value of Assets	52,240,879	43,021,949	22,508,407
Notes Payable to DBAH	50,000,000	44,800,000	25,000,000
Investment Expense for period	3,444,696	2,478,037	1,494,813
As a percentage of fair value of assets	6.89%	5.76%	6.64%
General Administrative Expense for period	150,532	125,940	143,376
As a percentage of fair value of assets	0.30%	0.29%	0.64%

AUDIT REPORT COMMENTS

Elliott Davis, LLC audited the financial statements of InvestSC as of December 31, 2010 and 2009 and issued their opinion that they are in conformance with accounting principles generally accepted in the United States. They did, however, include a note to the statements that reads as follows:

NOTE 9 – INVESTMENT COMMITMENTS

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

As of June 17, 2011, the unfunded commitments to the individual funds are as follows:

Noro-Moseley Partners VI	$3,002,007
Frontier Fund II	680,000
Azalea Fund III	3,963,852
Total Unfunded Commitments	$7,645,859

The balance in the Capital Contribution Account as of that date was $7,283,458.

RATES OF RETURN

InvestSC has received distributions from Azalea SC, Azalea III, Frontier and Nexus. All of the funds expect a ten year life with additional time as necessary for timely exits from investments. Nexus has drawn its entire commitment of $20 million. Azalea SC does not plan to draw its remaining $450,000 and the partnership will be unwound during 2011.

Internal Rate of Return (IRR)
by Venture Capital Fund

	2010	**2009**	**2008**
Noro-Moseley Partners VI	-2.6%	-1.8%	n/a
Nexus Medical Partners II	2.6%	6.0%	17.0%
Frontier Fund II	16.4%	7.9%	-21.3%
Azalea SC Fund	n/a	32.8%	11.3%
Azalea III Fund	140.3%	-8.9%	-67.1%

(IRR's as reported by Funds)

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

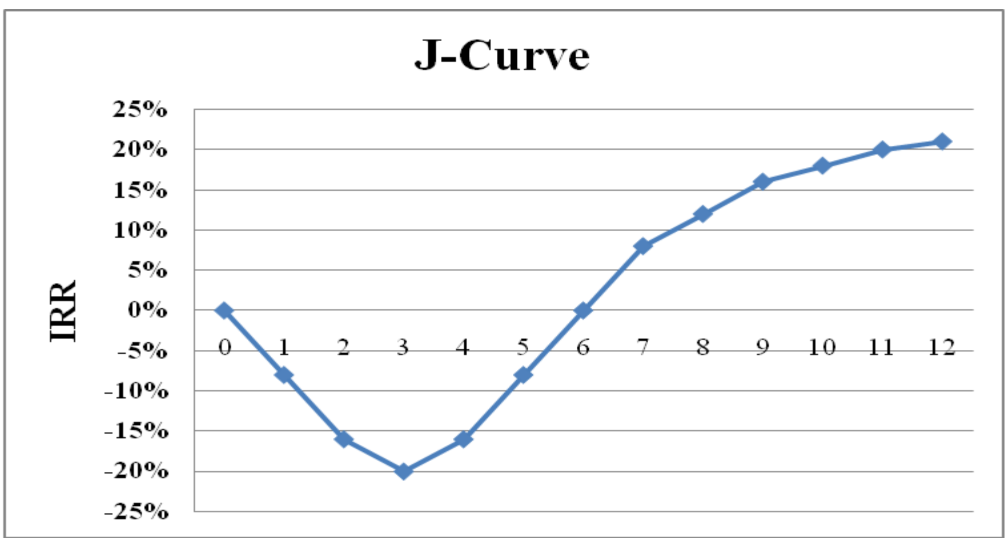
The “J”curve shows a fund’s internal rate of return (IRR, or simply the compound annual return to date) charted against the financial years of a venture fund. Venture capitalists typically commit their funds over the first few years and draw down monies to the underlying companies against these commitments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

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

• The first few years or so give little, if any, indication of final returns

• The annual return over any single year is relatively meaningless

• The IRR over the life of the fund is the real measure of a fund’s success



Source: Mowbray Capital