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EMPLOYEES' RETIREMENT SYSTEM
HAWAII' EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

STATE OF HAWAII'
DEPARTMENT OF BUDGET AND FINANCE
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ADMINISTRATIVE AND RESEARCH OFFICE
BUDGET, PROGRAM PLANNING AND
MANAGEMENT DIVISION
FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

December 26, 2019

The Honorable Ronald D. Kouchi
President and Members
of the Senate
Thirtieth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Scott K. Saiki
Speaker and Members of the
House of Representatives
Thirtieth State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Kouchi, Speaker Saiki and Members of the Legislature:

For your information and consideration, I am transmitting a copy of the Innovation Economy 2019 report, as required by Act 260, Session Laws of Hawaii 2007. In accordance with Section 93-16, Hawaii Revised Statutes, a copy of this report has been transmitted to the Legislative Reference Bureau and the report may be viewed electronically at <http://ers.ehawaii.gov/resources/reports-to-legislature>.

Sincerely,

CRAIG K. HIRAI
Director of Finance

Enclosure

c: Legislative Reference Bureau

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EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

ACT 260, SESSION LAWS OF HAWAII 2007
RELATING TO THE INNOVATION ECONOMY

HAWAII VENTURE CAPITAL INVESTMENT
2019

Act 260, Session Laws of Hawaii 2007, expresses the State's desire to increase economic growth through the development of the State's human resources, and employing these highly skilled resources to leverage increases in innovation across the State's economy.

The Board of Trustees of the Employees' Retirement System (ERS) acknowledges the intent of Act 260. Accordingly, the ERS, through its investment policies and an appropriate-sized funding allocation, has demonstrated a commitment to supporting an innovation economy while at the same time pursuing its objectives of achieving attractive venture capital investment return for the benefit of its beneficiaries.

The ERS Board approved the creation of a Hawaii Targeted Investment Program (HiTIP) Policies and Procedures on March 10, 2008, which included the adoption of funding criteria, as required by Act 260. A \$25 million program funding allocation and a comprehensive HiTIP operating structure were approved on November 10, 2008 and December 8, 2008, respectively. A \$35 million program for HiTIP II was approved on September 12, 2016 and closed in the first quarter of 2017. The purpose of the HiTIP is to invest venture capital in locally-based early-stage technology companies through a portfolio of local, regional, and national venture capital funds within an institutional investment program structure. Under a competitive search process, the ERS selected a discretionary investment manager to operate and manage the HiTIP, which is projected to have a program lifespan of up to 15 years per fund.

The ERS is required to annually report any Hawaii venture capital investment. For calendar-year 2019, the ERS has supported Act 260 through the following investment measures:

- Since inception, HiTIP has committed \$57.25 million into seventeen private equity funds and one Hawaii-based co-investment. HiTIP I, at \$25.25 million of total capital, is fully committed to seven private equity funds and one co-investment. HiTIP II, a \$35.25 million pool, began investing in 2017 and has committed \$32 million to ten private equity funds.
- HiTIP seeks to invest in the major industry sectors of the Hawaiian entrepreneurial ecosystem. The sector exposure of HiTIP I, as a percent of remaining value as of June 30 2019, is 48% Healthcare/Life Sciences, 14% Enterprise Products and Services, 12% Commerce/Logistics/Transportation, 10% Tech – Cloud/SaaS/Software, 8% Consumer Products and Services, and 8% Other. For HiTIP II the sector exposure, as a percent of remaining value as of June 30 2019, is 38% Tech – Cloud/SaaS/Software, 24% Healthcare/Life Sciences, 13% Enterprise Products and Services, 10% Consumer Products and Services, 6% Commerce/Logistics/Transportation, and 10% Other.

- Since inception, HiTIP funds have looked at 1,218 investment opportunities with 674 Hawaii-based companies. Of these companies, 180 are currently being tracked for a potential future investment.
- HiTIP I funds have invested into five companies operating in or that were started in Hawaii. Total direct investment by HiTIP I funds into Hawaiian companies is \$35.8 million, 143% of ERS's HiTIP I commitment. Including capital from co-investors, \$229 million has been invested into Hawaiian companies, 917% of ERS's HiTIP I commitment. HiTIP II funds, which in aggregate are still early in their investment periods, have invested into four companies operating in or that were started in Hawaii. Total direct investment by HiTIP II funds into Hawaiian companies is \$0.2 million, 0.5% of ERS' HiTIP II commitment. Including capital from co-investors, \$1.0 million, 2.8% of ERS' HiTIP II commitment. Multiple Hawaii based companies are in discussions with HiTIP funds for potential investment.
- As of September 2019, the HiTIP I portfolio has distributed 67% of invested capital. A major source of liquidity in the portfolio has come from twelve Initial Public Offerings (IPOs). Polaris Venture Partners VI portfolio companies Alector (ALEC) and Covetrus (CVET) went public in February 2019. Polaris Venture Partners VI portfolio company Scholar Rock (SRRK) went public in 2018. MPM BioVentures V portfolio company Rhythm Pharmaceuticals (RYTM) completed its initial public offering in 2017. Epic Venture Partners IV portfolio company Everspin Technologies (MRAM) and Polaris Venture Partners VI portfolio company Editas Medicine (EDIT) went public in 2016. Another Epic portfolio company, Instructure (INST) and Pantentes Talgo (TGO) from Vantera Transformative Energy and Materials Fund went public in 2015. Conatus Pharmaceuticals (CNAT) and Aratana Therapeutics (PETX) from MPM BioVentures V and Receptos (RCPT) from Polaris Venture Partners VI went public in 2013. Verastem (VSTM) from MPM BioVentures V went public in 2012.
- As of September 30, 2019, the gross Internal Rate of Return (IRR) of the HiTIP I fund is 11.0% with a Distributed to Paid-In Ratio (DPI) of 0.67x and a Total Value to Paid-In Ratio (TVPI) of 1.61x. HiTIP II is too early for meaningful performance data.