

# The Small Business Investment Company Program

*Meeting the Capital Needs of American Small Business*



Program Overview



The SBIC  
Life Cycle



The SBA's SBIC  
Portfolio



Program  
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## Program Overview:

- *The SBIC Program in Brief*
- *Our Results in FY 2010*
- *Success Stories*



The SBIC Life Cycle

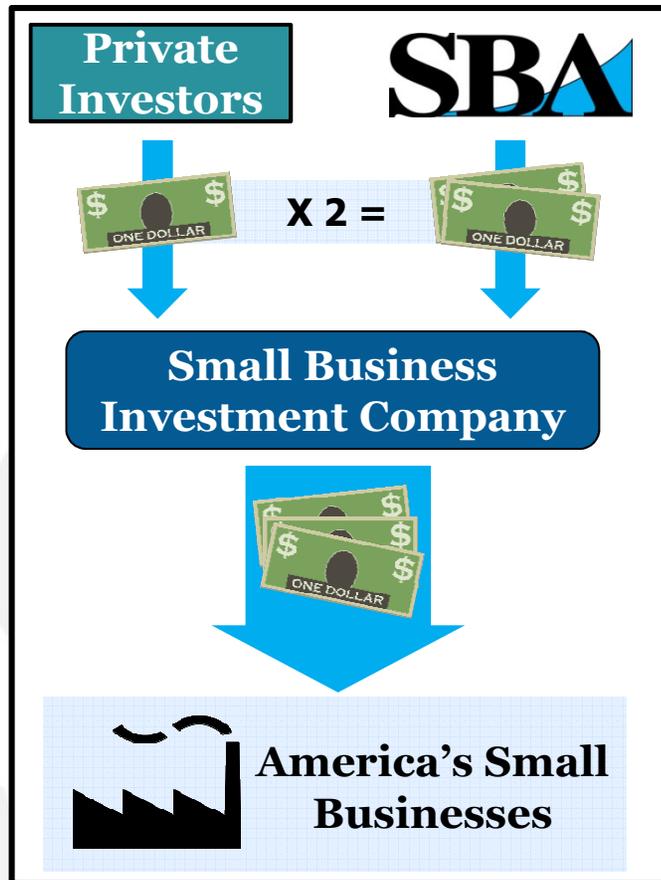


The SBA's SBIC Portfolio



Program Performance

## *The SBIC Program in Brief*



The SBIC Program is a multi-billion dollar, government-sponsored investment fund created in 1958 to bridge the gap between entrepreneurs' need for capital and traditional sources of financing:

- The program invests long-term capital in privately-owned and managed investment firms licensed as Small Business Investment Companies (SBICs)
- For every \$1 an SBIC raises from a private investor, the SBA will provide \$2 of debt capital, subject to a cap of \$150 million
- Once capitalized, SBICs make debt and equity investments in some of America's most promising small businesses, helping them grow

## *Our Results in Fiscal Year 2011*



The SBA issued **\$1.83 billion** in new commitments to SBICs



**\$2.83 billion** in financing dollars were invested in small businesses



**1,339** small businesses were financed, 34% of which were in low-to-moderate income areas or in minority or women-owned businesses



An estimated **61,527** jobs were created or retained

**...all at *ZERO* cost to taxpayers...**

## *SBIC Success Stories*

Since its inception, the SBIC program has helped finance thousands of small businesses. The following is a small sample of SBIC success stories.

Costco

Callaway

Cutter & Buck

Amgen

Adaptec

Intel

Staples

AOL

FedEx

Apple

HP

Jenny Craig

Quiznos

Outback  
Steakhouse

Build-a-Bear  
Workshop

Sun

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Program Overview



## The SBIC Life Cycle

- *Types of SBIC Licenses*
- *Leverage Products Available*
- *The Application Process & Investment Criteria*



The SBA's SBIC Portfolio



Program Performance

## *Types of SBICs*

In January of 2011, the White House and the SBA announced the availability of two, new SBIC Licenses, each building on the success of the Standard Debenture License

### **Standard License**

**Investment Strategy:**

For applicants seeking the broadest investment mandate, with few restrictions on their strategy or capital allocation.

**Application Process:**

- *Rolling*

**Processing Time:**

- *Normal*

**Leverage Available:**

- *Two Tiers*  
- *Cap of \$150 million*

### **Impact Investment License**

**Investment Strategy:**

Applicants commit to investing 50% of their capital in clean energy, education, or economically-distressed zones.

**Application Process:**

- *Rolling*

**Processing Time:**

- *Expedited*

**Leverage Available:**

- *Two Tiers*  
- *Cap of \$80 million*

### **Innovation License (2012)**

**Investment Strategy:**

For early-stage investors who will be permitted to draw LP capital to cover the interest due on their debentures.

**Application Process:**

- *Single Deadline (Opens 2012)*

**Processing Time:**

- *Normal*

**Leverage Available:**

- *One Tier*  
- *Cap of \$50 million*

## *SBIC Leverage Products*

<b>Standard Debenture</b>	<b>Amount:</b>	Typically 2x (but up to a maximum of 3x) the capital raised from private investors
<b>Discounted Debenture</b>	<b>Term:</b>	10 years with principal payment due at maturity NO prepayment penalty
	<b>Interest:</b>	Semi-annual payment based on a spread above the 10-year Treasury note
<b>Energy Savings Debenture</b>	<b>Fees:</b>	1% commitment fee; 2% drawdown fee Annual fee due semi-annually
	<b>Uses:</b>	Investments in “small businesses” as defined by the SBA Office of Size Standards and federal regulations, generally in later stage and “buyout” transactions. Real estate and project finance generally prohibited.

## *SBIC Leverage Products*

<b>Regular Debenture</b>	<b>Amount:</b>	Typically 2x (but up to a maximum of 3x) the capital raised from private investors
<b>Discounted Debenture</b>	<b>Term:</b>	5 or 10 years with principal payment due at maturity NO prepayment penalty
	<b>Interest:</b>	Semi-annual payment for last five years of 10 year note only; based on spread above 10 year Treasury note
<b>Energy Savings Debenture</b>	<b>Fees:</b>	1% commitment fee; 2% drawdown fee Annual fee due semi-annually for 10 year bond only
	<b>Uses:</b>	The discounted debenture is appropriate for debt and equity investments in “small businesses” located in low-to-moderate income areas.

## SBIC Leverage Products

<b>Regular Debenture</b>	<b>Amount:</b>	Typically 2x (but up to a maximum of 3x) the capital raised from private investors
	<b>Term:</b>	5 or 10 years with principal payment due at maturity NO prepayment penalty
<b>Discounted Debenture</b>	<b>Interest:</b>	Semi-annual payment for last five years of 10 year note only; based on spread above 10 year Treasury note
	<b>Fees:</b>	1% commitment fee; 2% drawdown fee Annual fee due semi-annually for 10 year bond only
<b>Energy Savings Debenture</b>	<b>Uses:</b>	The energy-savings debenture is available to SBICs making “qualified energy-savings investments,” such as manufacturers of products that improve energy efficiency

## Some Major SBIC Investment Requirements

### Instruments

**SBICs may invest using:**

- Loans
- Debt with Equity features
- Equity

**SBICs may not invest:**

- More than 10% of the proposed total fund size in a single company without SBA approval

### Use of Proceeds

**SBICs may not invest in:**

- Project Finance
- Real Estate
- Financial Intermediaries

### Geography

**SBICs may invest:**

- In businesses located anywhere in the U.S. or its territories

**SBICs may not invest:**

- In businesses with over 49% of their employees located outside the U.S.

### Control

**SBICs may:**

- Control small businesses for up to seven years, a limit that may be extended with SBA approval

### Size

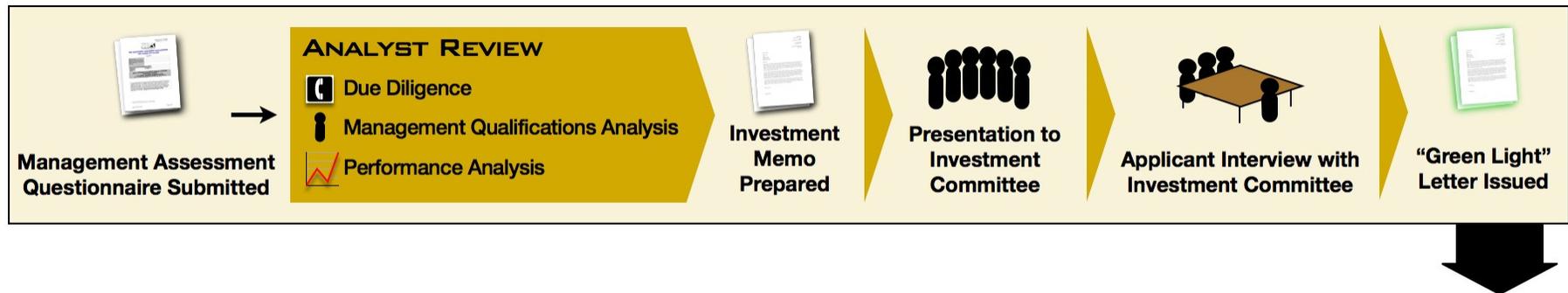
**SBICs must invest in Small Businesses, defined as:**

- Businesses with a tangible net worth < \$18 million **AND** average after-tax income for prior two years of < \$6 million
- **OR** Businesses qualifying as “small” under SBA’s N.A.I.C.S. Industry Code standards

**SBICs must make 25% of their financings in “Smaller Businesses”, defined as:**

- Businesses with a tangible net worth < \$6 million **AND** average after-tax income for prior two years < \$2 million

## Phase I: The Application Process



### Phase I – Office of Program Development:

- Applicants submit a “Management Assessment Questionnaire”, which includes:
  - Description of proposed fund strategy
  - Detailed investment track records of fund management
  - List of references to guide due diligence
  - Due diligence documents, term sheets and other fund documentation
- Analysts review track record and conduct extensive due diligence
- Investment Committee approval required to move forward
- Target Time Frame: 8 weeks

## Phase I: The Application Process



### Phase I – Key Evaluation Criteria for Analyst Review:

#### ***Manager Assessment***

- Proven investment experience
- Balanced track record among principals
- Evidence indicating a cohesive and effective team
- Principals with strong, positive reputations
- Robust investment and due diligence process

#### ***Performance Analysis***

- High quality track record with transactions analogous to those proposed for the SBIC strategy
- Evidence past returns could have supported SBIC cost of leverage and met or exceeded targets
- Analysis of fund performance measured against peer funds

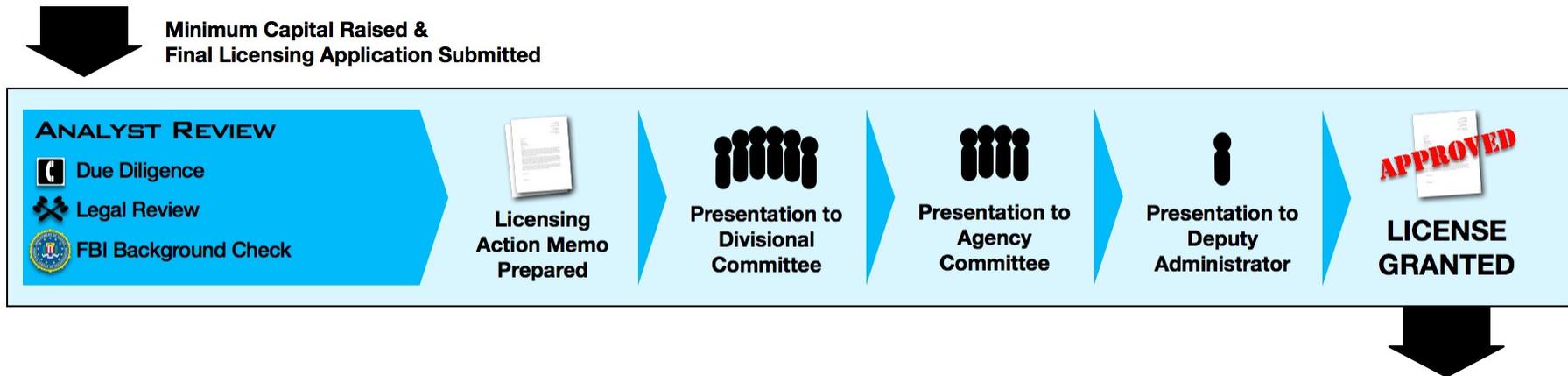
#### ***Strategy Evaluation***

- Clearly articulated focus and investment thesis
- Evaluation of targeted transaction size, investment themes and type instruments to be used
- Clear indications proposed investments will fund eligible “small businesses”

#### ***Fund Structure & Economics***

- Structure of LP preferred return
- GP carry, management fees and vesting schedules in line with industry norms
- Alignment of carry distribution with time dedication and level of responsibility
- Adequate fund infrastructure

## Phase II: The Licensing Process

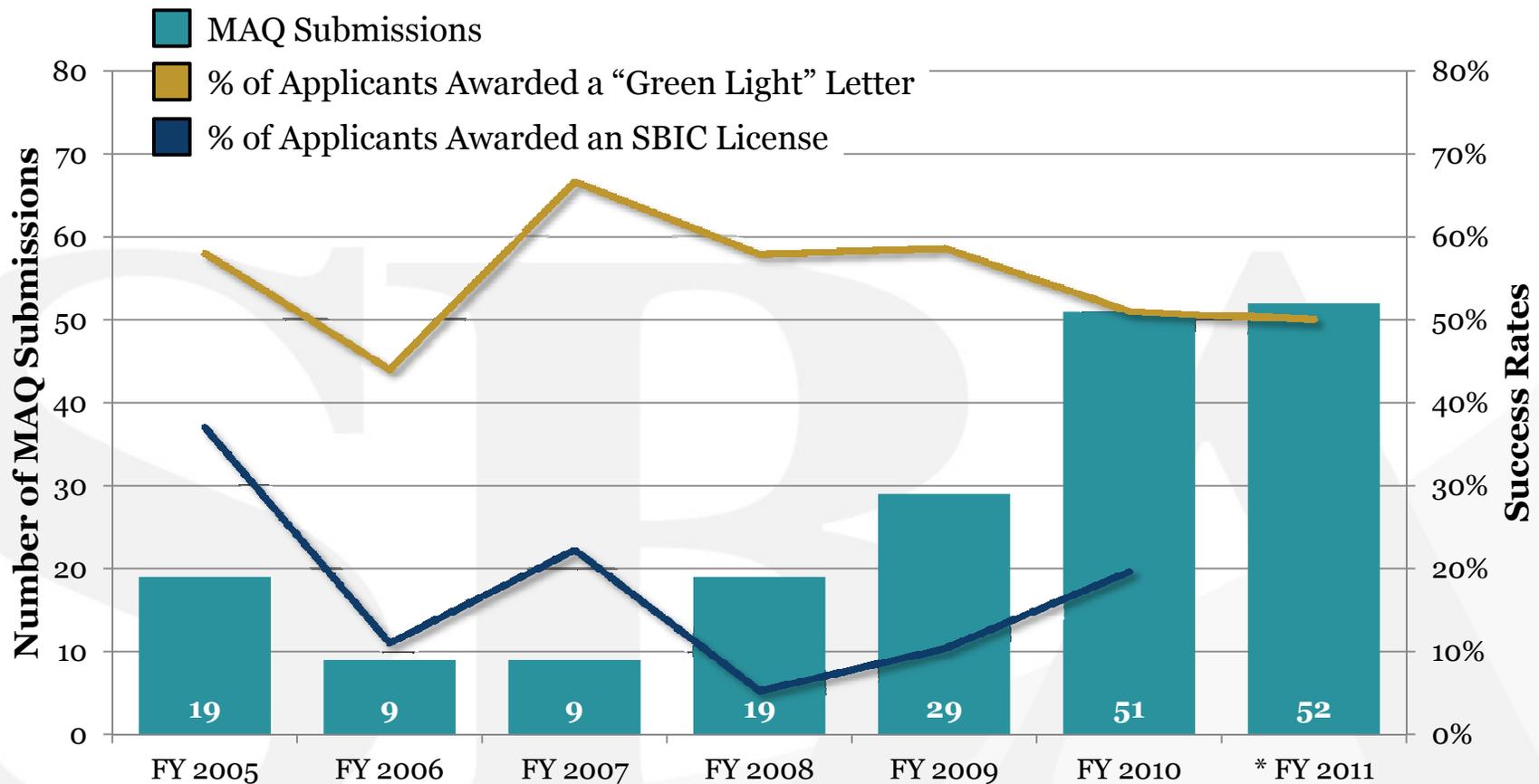


### Phase II – Office of Licensing:

- Prior to the submission of the Licensing Application, applicants must have secured private capital commitments in an amount sufficient to ensure the fund's financial viability
- Analysts review the application, business plan, financial projections, ownership diversity and coordinate a legal review with SBA's Office of General Counsel
- Licensing is contingent on the approval of the SBA's Divisional Committee, Agency Committee and the Deputy Administrator
- Target Time Frame: 6 months

## Success Rates for 1<sup>st</sup> Time Applicants

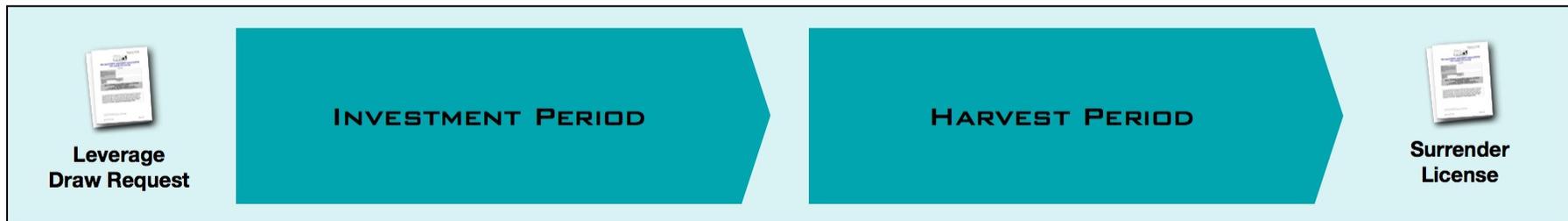
The substantial increase in MAQs submitted to the SBA over the past four fiscal years indicates growing interest in the SBIC program.



\* The licensing rate for FY 2011 is unavailable as many funds have only recently begun the fundraising process  
 NOTE: The U.S. Government's fiscal year runs from October 1<sup>st</sup> through September 30<sup>th</sup>



## *Phase III: Portfolio Monitoring*

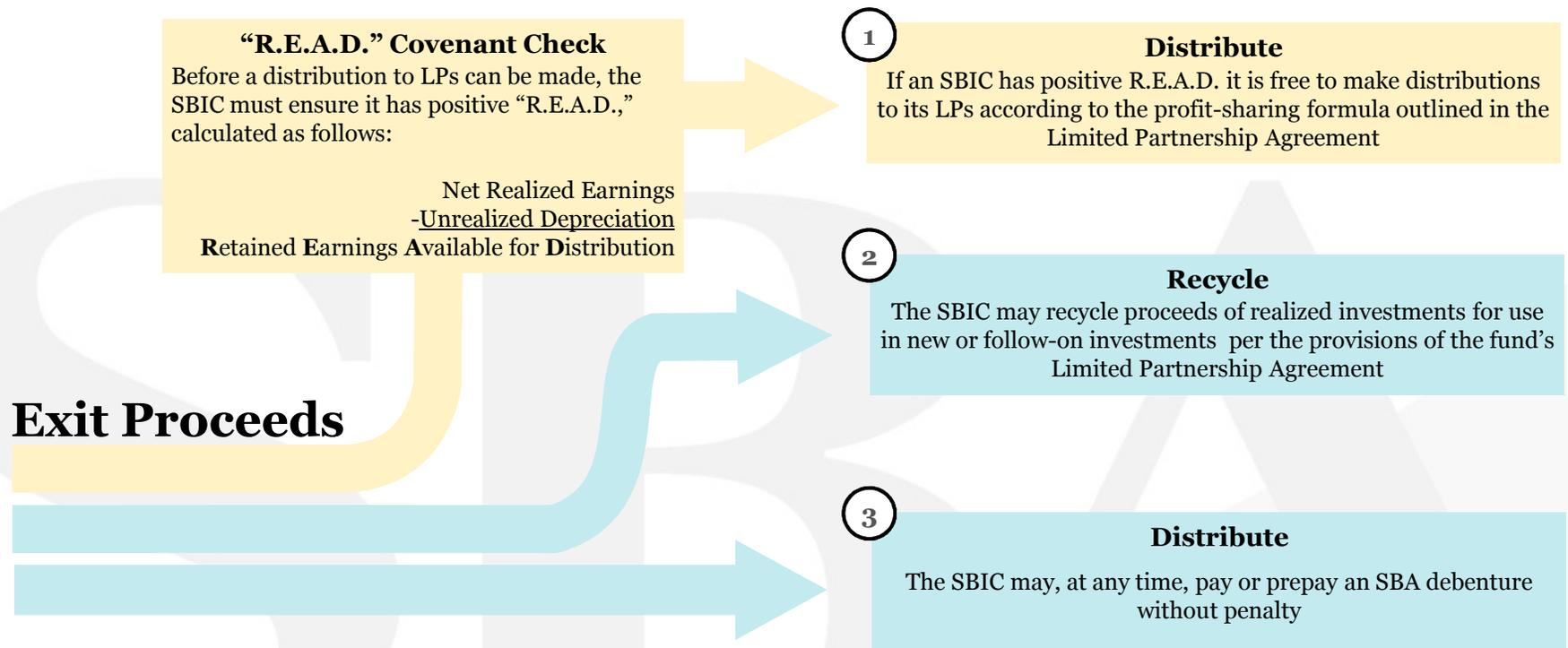


### **Phase III – Office of Operations:**

- After an investment fund obtains an SBIC license it moves into the Investment Division's Office of Operations, where the SBA monitors its performance
- Analysts in the Office of Operations perform a variety of tasks:
  - Assist SBICs with the draw down of SBA-guaranteed leverage
  - Review and seek authorization for potential conflicts-of-interest
  - Process requests for the transfer of LP interests
  - Monitor financial health of SBICs
- Target Time Frame: Life of the Fund (~10 years)

## Distributions to LPs and the SBA

Like other private equity funds, SBIC G.P.s have discretion regarding the use of proceeds when investments are exited. The graphic below illustrates the three options available to SBICs and the minimal role the SBA plays in the process.



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The Application & Investment Processes



The SBIC Life Cycle



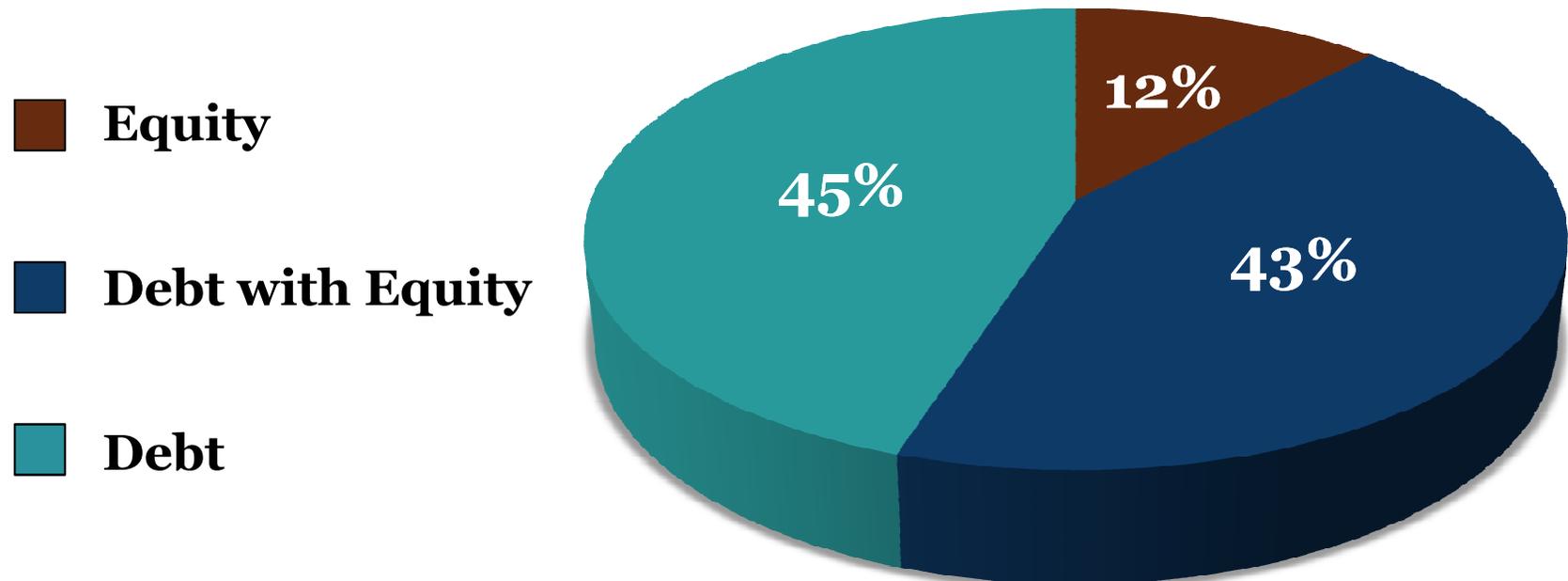
## The SBA's SBIC Portfolio

- *Debenture Portfolio by Instrument*
- *Debenture Portfolio by Sector*
- *Debenture Portfolio by Geography*



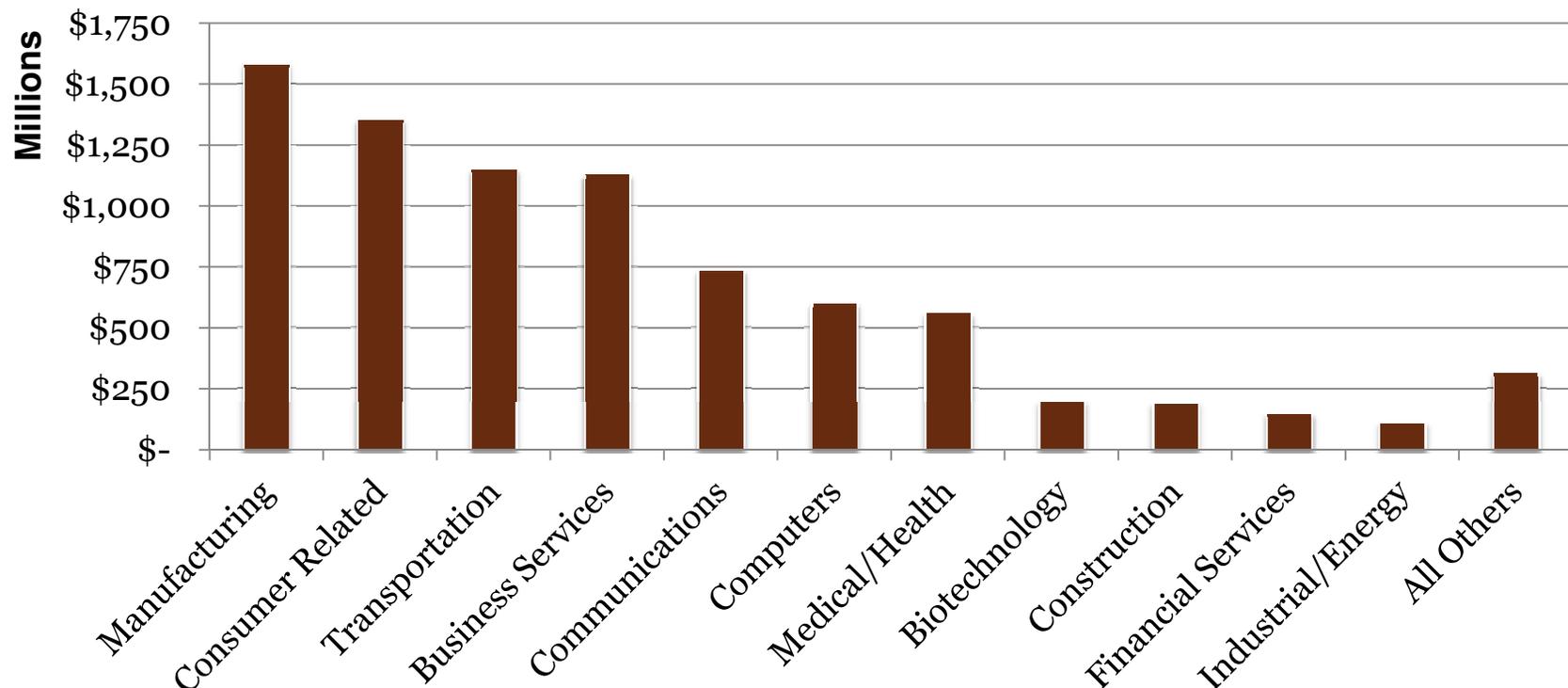
Program Performance

*SBIC Program Debenture Portfolio: FY '07-'11*



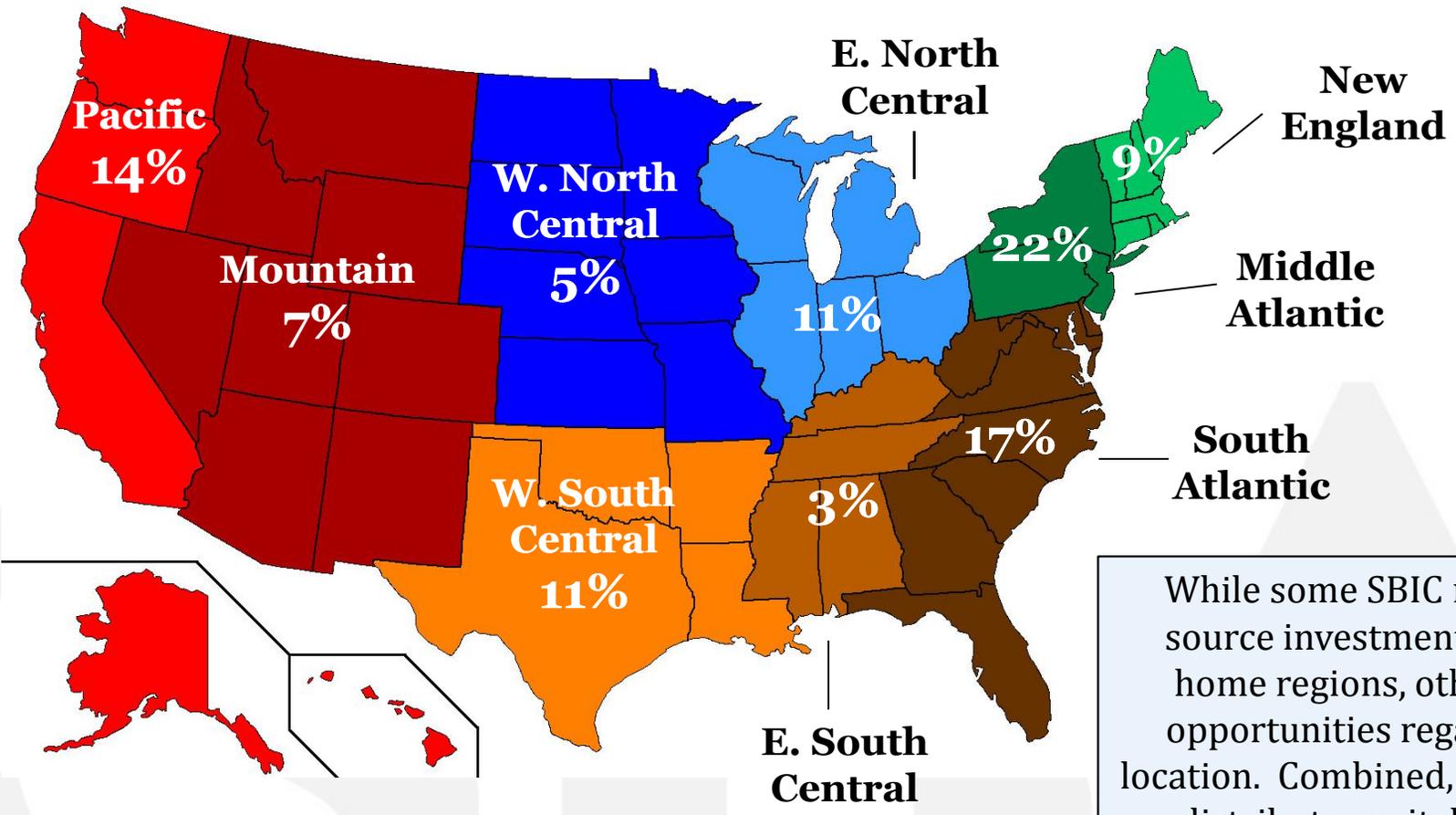
Given the structure of the SBA's lending, debt dominates most debenture SBICs portfolios, but managers will often structure deals to include equity positions or will attach equity "kickers" to enhance returns.

## SBIC Program Debenture Portfolio: FY '07-'11



The need for capital among small businesses is not limited to one, or even a few sectors of the economy. In fact, small businesses across the spectrum of American industry are connecting with debenture SBICs to access the capital they need to expand and grow.

SBIC Program Debenture Portfolio: FY '07-'11



While some SBIC managers source investments in their home regions, others seek opportunities regardless of location. Combined, their efforts distribute capital to small businesses across the country.

Note: Percentage total does not sum to 100% due to rounding



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The SBA's SBIC Portfolio

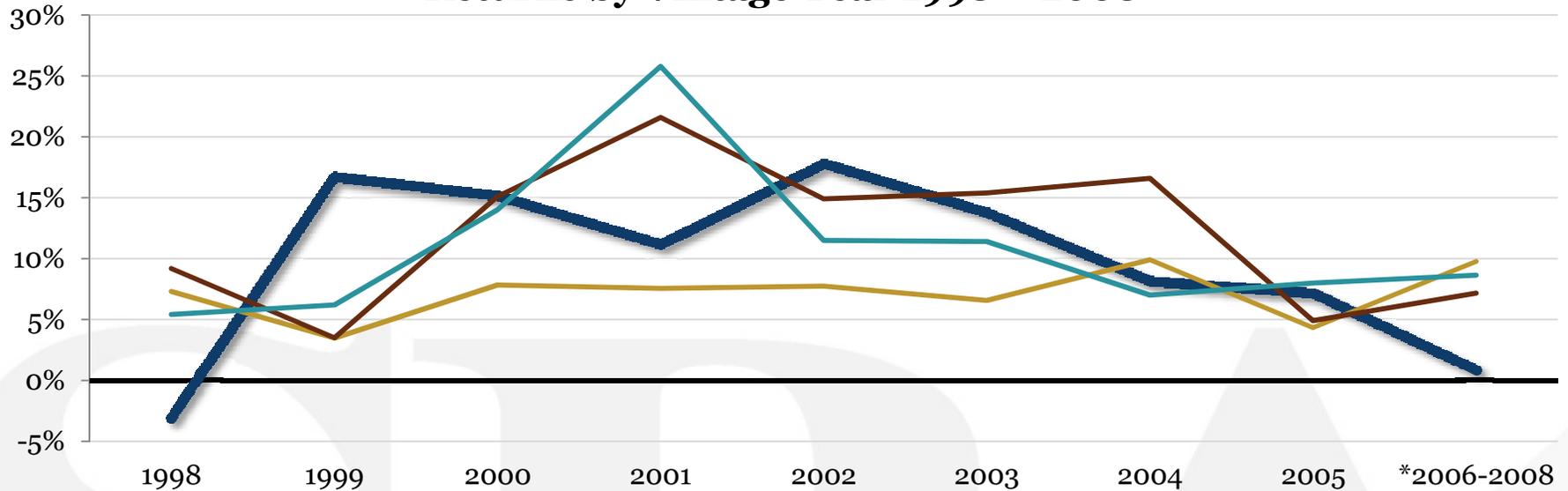


## Program Performance

- *Historical Returns*
- *Leverage and the Cost of Capital*
- *Record Growth of the Debenture Program*
- *The Advantages of an SBIC*

# Strong Historical Returns

Returns by Vintage Year 1998 – 2008



■ SBIC Debenture Funds Pooled IRR (1)

■ Preqin US Mezzanine Pooled IRR (2)

■ Thomson Sm. & Med. Buyout & Mezzanine Pooled (3)

■ Preqin US Sm. Buyout Pooled IRR (2)

\* 2006 – 2008 data is presented as an arithmetic mean of the pooled IRRs for those years

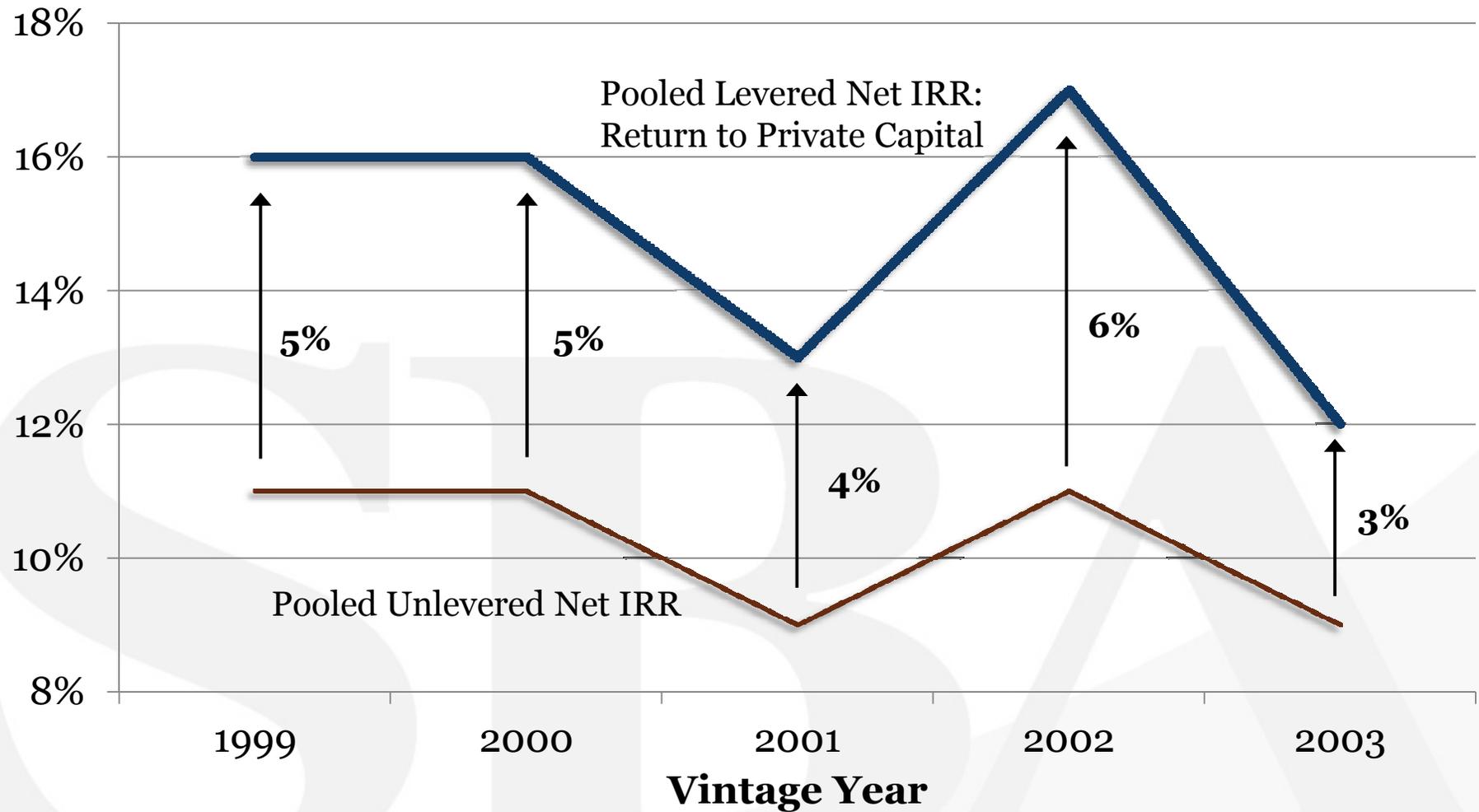
(1) SBIC Vintage Year determined by date of license. Data as of 12/31/10 ; Returns calculated based on information collected as part of annual financial statement submissions to SBA; Returns include an assumed 20% carried interest payment to the GP after LPs have received distributions equal to paid-in capital.

(2) Source: Preqin Ltd. [www.preqin.com](http://www.preqin.com). Data includes "Most up-to-date" figures and was accessed 12/12/11; Benchmark may include some funds licensed as SBICs

(3) Source: Thomson Reuters. [www.thomsonone.com](http://www.thomsonone.com). Data as of 12/31/10. Data includes US funds from \$5M to \$500M categorized as Small Buyout, Medium Buyout, or Mezzanine.

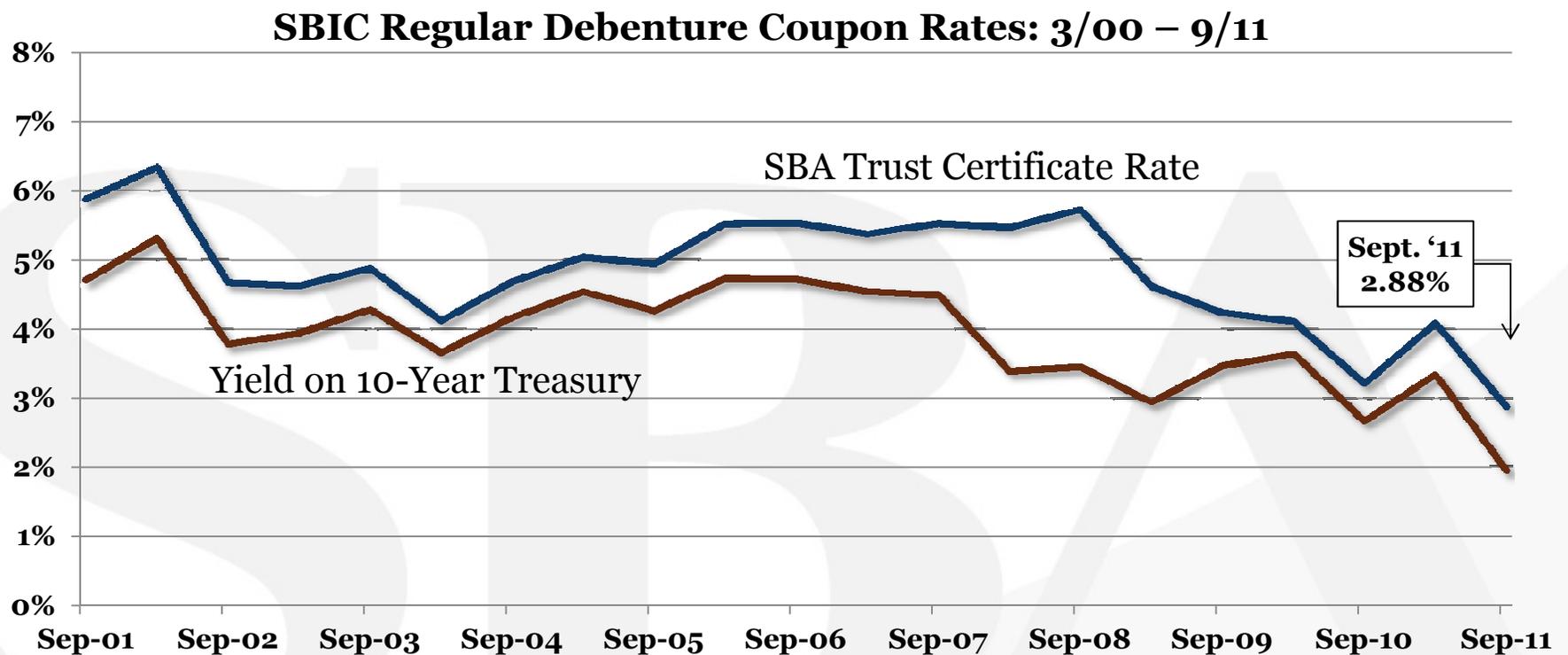


# Historical Impact of SBA Leverage



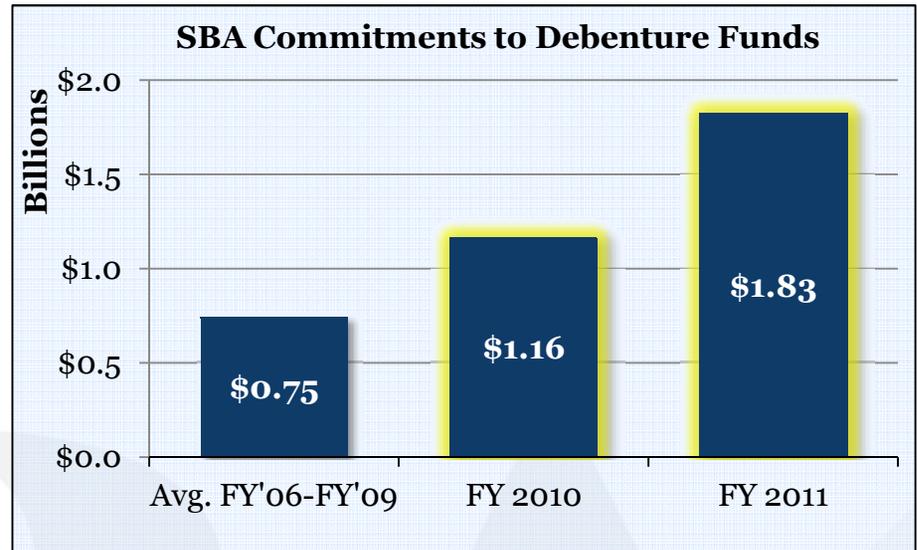
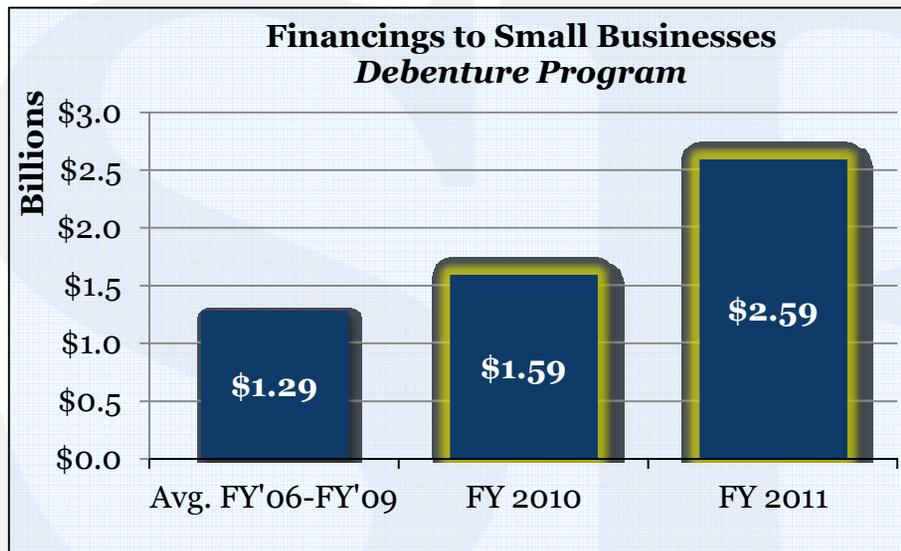
## Low Cost Capital

The SBA's leverage commitments to licensed SBICs are funded through the sale of government-backed securities called "trust certificates." Every March and September, these commitments are pooled and sold on the open market at a premium over 10-year Treasury Notes.



# Record Growth of Debenture Program

Debenture fund financings to small businesses and SBA commitments to debenture funds...



...both reached record levels in FY 2010 and FY 2011.

## *The Advantages of an SBIC*

### **Strong, stable returns**

*Very low cost of capital provides SBICs pricing flexibility across cycles and 10 year debenture term avoids problem of duration mismatch.*

### **Flexible Fund Structure**

*The SBA licenses a variety of fund structures, including SBICs established as “drop-down” or “side-car” funds attached to an existing investment fund.*

### **Regulatory Benefits**

*SBICs are exempt from SEC registration requirements. Yet, LPs benefit from the careful monitoring done by the SBA, greatly reducing the risk for fraud and abuse.*

### **Rapid Deployment of Funds**

*The SBA generally provides leverage up to 2x the private capital commitments an SBIC has raised, but selectively awards leverage at 3x. Fund managers are thus able to minimize the time they spend fundraising and focus their efforts on investing.*

### **Community Reinvestment Act**

*Investments in Small Business Investment Companies are eligible as Community Reinvestment Act credits.*

### **The Opportunity of “Small Business”**

*Despite being the bedrock of the American economy, the small business community is underserved and represents a value opportunity for investors.*

# Contact Us

**U.S. Small Business Administration**  
Investment Division  
409 3<sup>rd</sup> St., SW  
Suite 6300  
Washington, DC 20416

**Scott Schaefer**  
Investment Officer  
SBIC Program  
[scott.schaefer@sba.gov](mailto:scott.schaefer@sba.gov)  
p: 202-205-6514