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 Performance

November 2012

Table of Contents

Program Overview:

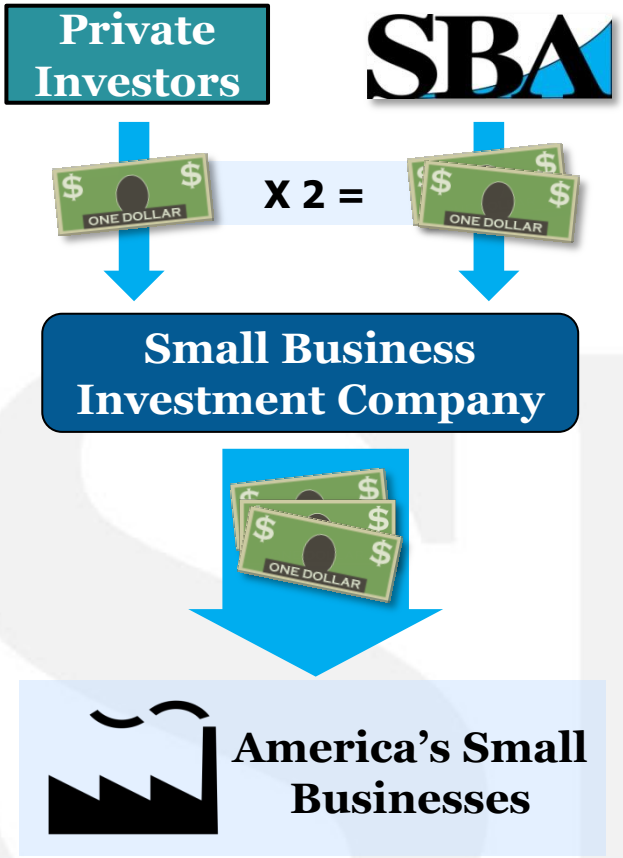
- *The SBIC Program in Brief*
- *Our Results in FY 2012*
- *Success Stories*

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 2012

The SBA issued **$1.92 billion** in new commitments to SBICs

$3.13 billion in financing dollars were invested in small businesses

937 small businesses were financed, 29% of which were in low-to-moderate income areas or in minority or women-owned businesses

...financed 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

Table of Contents

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, low income areas or rural areas.

Application Process:
- *Rolling*

Processing Time:
- *Expedited*

Leverage Available:
- *Two Tiers*
- *Cap of $150 million*

Early Stage License

Investment Strategy:
Applicants committed to deploying at least 50% of their capital in early-stage companies.

Application Process:
- *Single Deadline*

Processing Time:
- *Normal*

Leverage Available:
- *One Tier*
- *Cap of $50 million*

SBIC Leverage Products

Standard Debenture

Discounted Debenture

Amount:	Typically 2x (but up to a maximum of 3x) the capital raised from private investors
Term:	10 years with principal payment due at maturity NO prepayment penalty
Interest:	Semi-annual payment based on a spread above the 10-year Treasury note
Fees:	1% commitment fee; 2% drawdown fee Annual fee due semi-annually
Uses:	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

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

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

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.

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

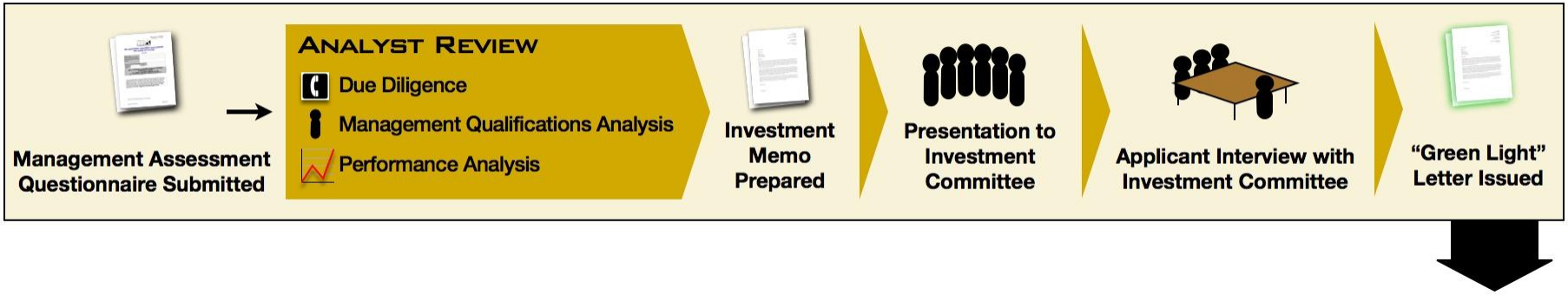
Use of Proceeds

SBICs may *not* invest in:
- Project Finance
- Real Estate
- Financial Intermediaries

Control

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

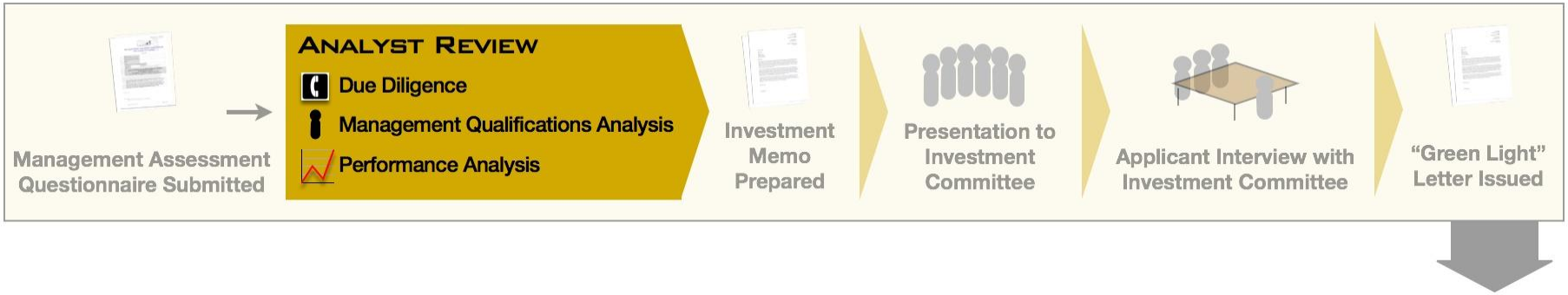
Phase I: The Application Process



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

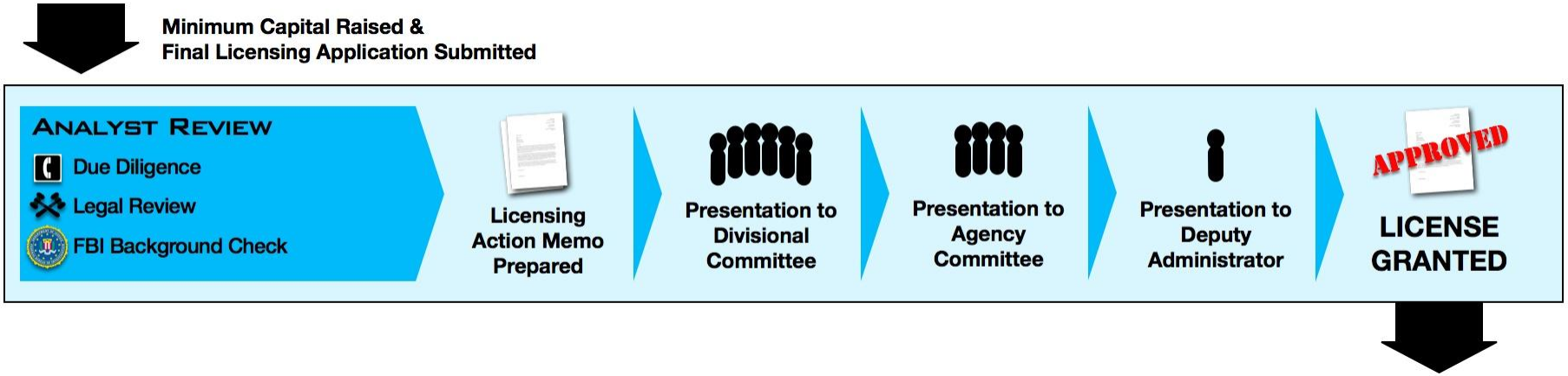
Strategy Evaluation

- 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

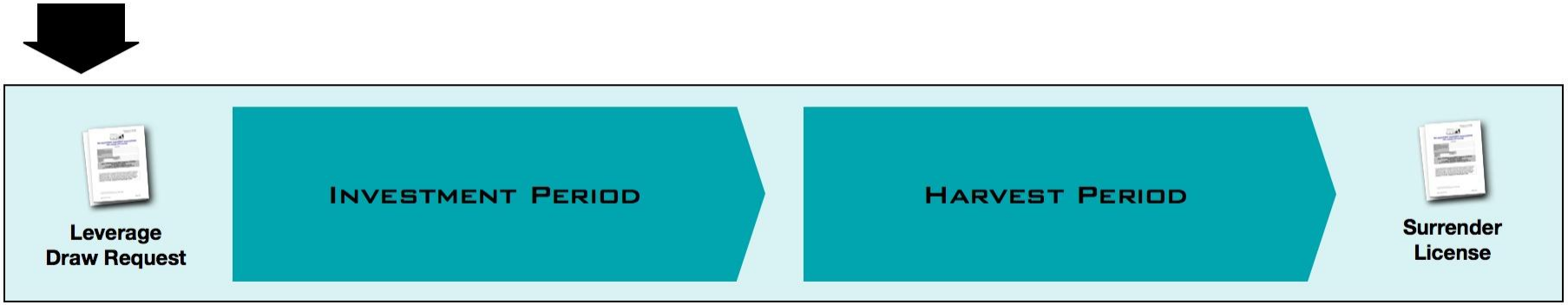
Phase II: The Licensing Process



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

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)

Table of Contents

The Application & Investment Processes

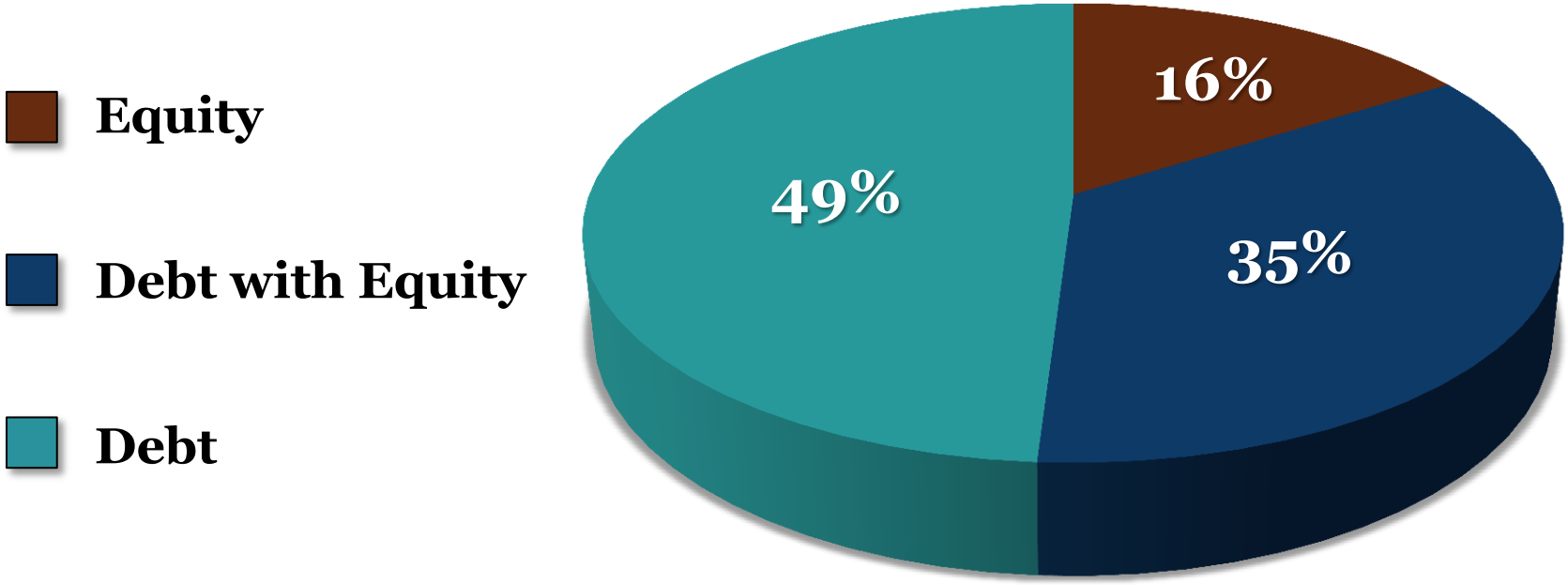
The SBIC Life Cycle

The SBA's SBIC Portfolio

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

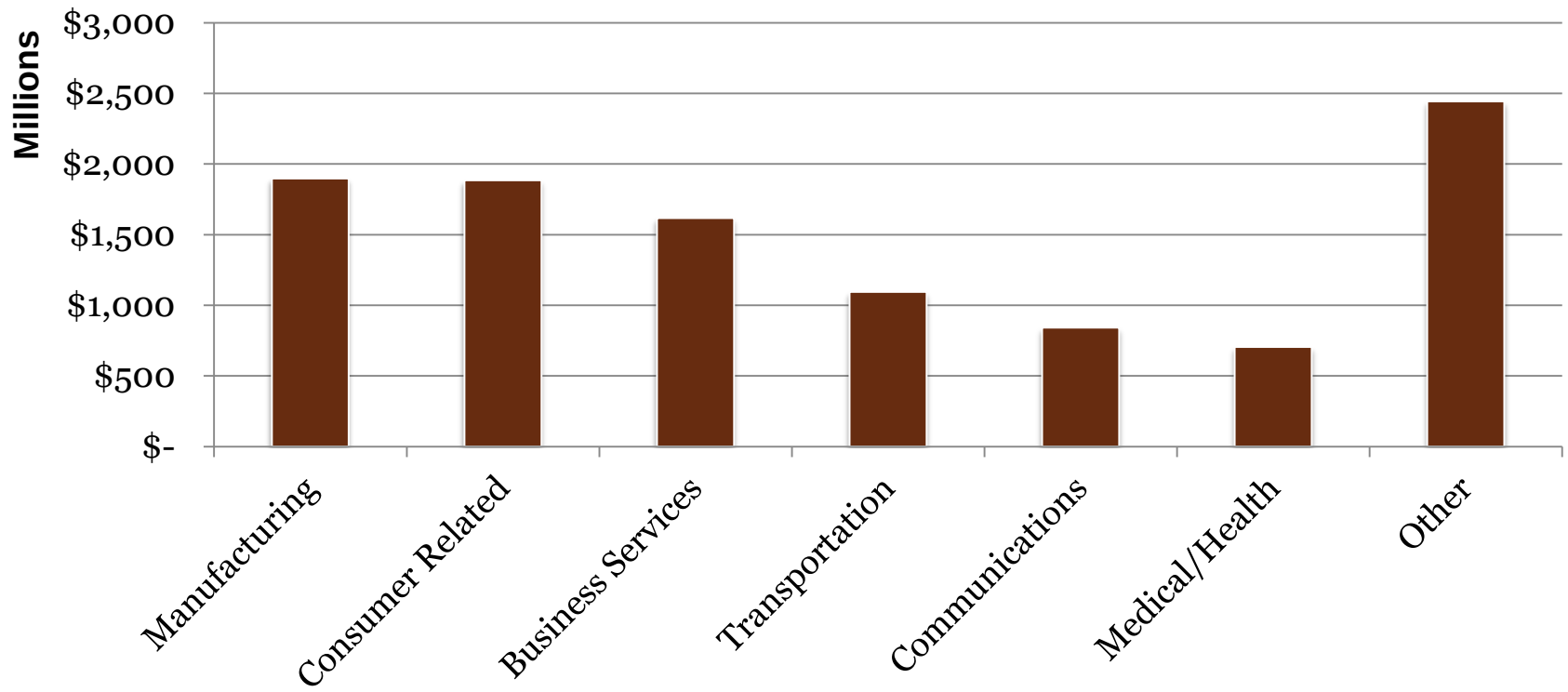
Program Performance

SBIC Program Debenture Portfolio: FY '08-'12



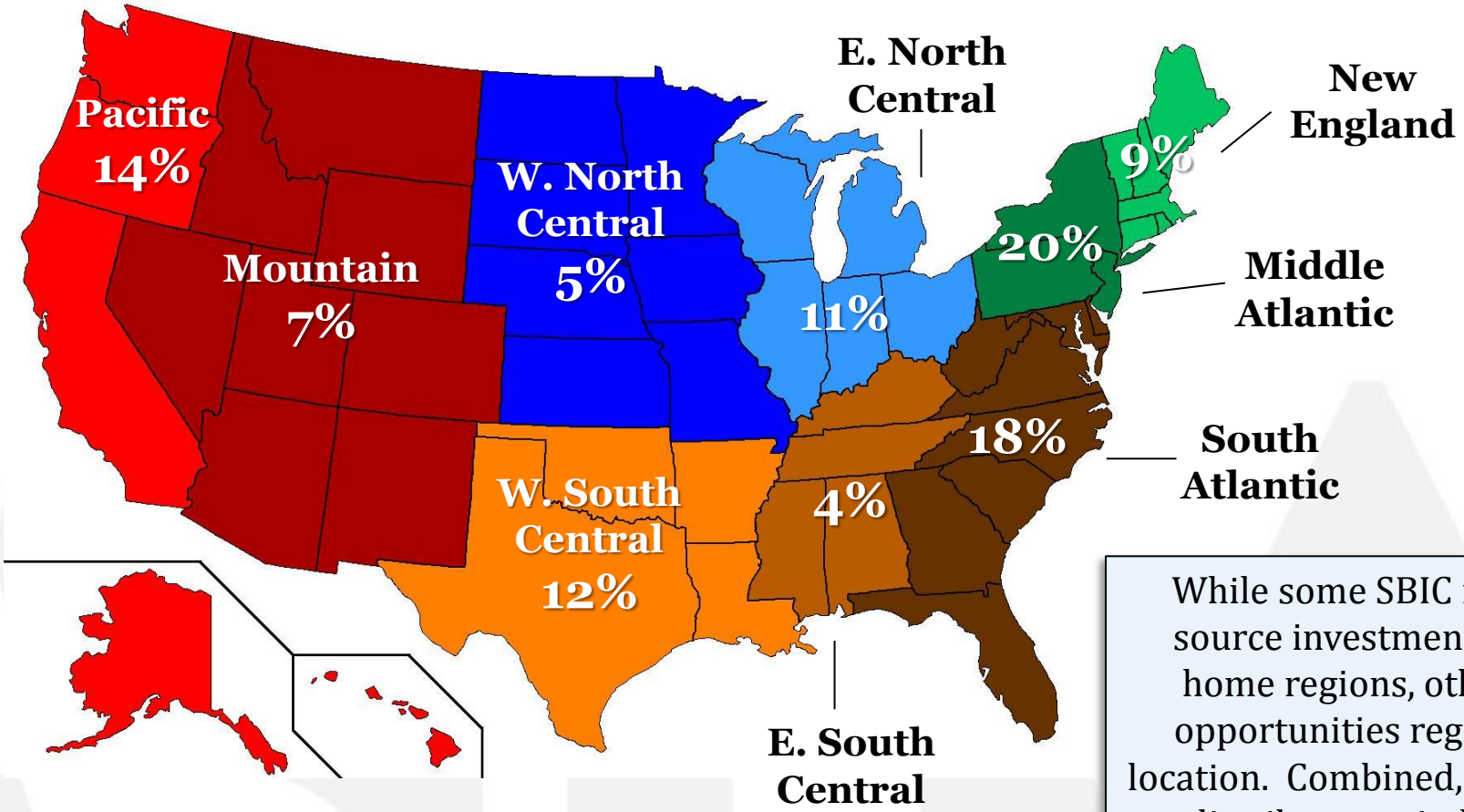
Given the structure of the SBA's lending, debt dominates most debenture SBICs portfolios, but managers will often structure deals to include equity positions or will attach equity "kickers" to enhance returns.

SBIC Program Debenture Portfolio: FY '08-'12



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 '08-'12



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.

Table of Contents

The Application & Investment Processes

The SBIC Life Cycle

The SBA's SBIC Portfolio

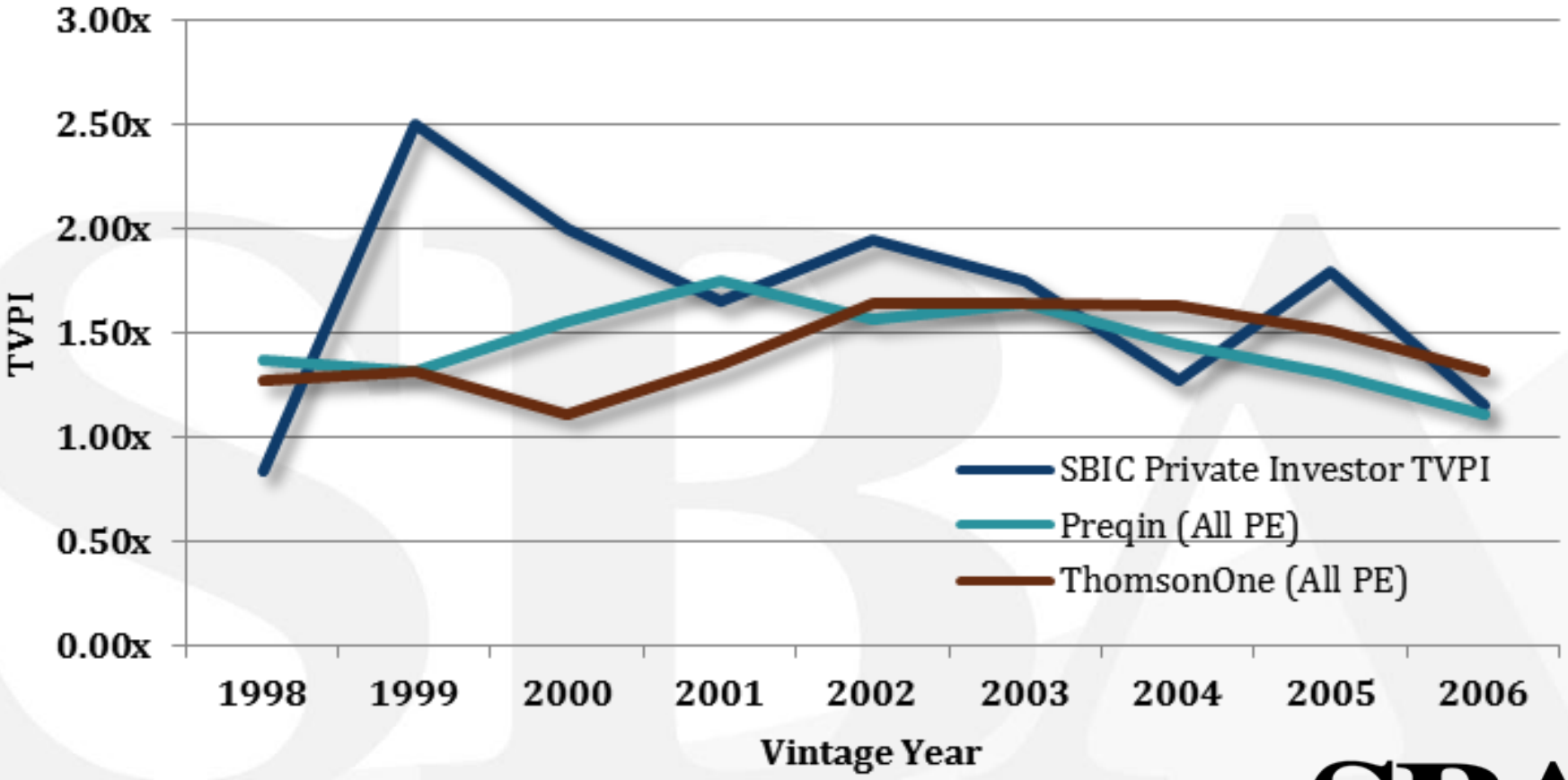
Program Performance

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

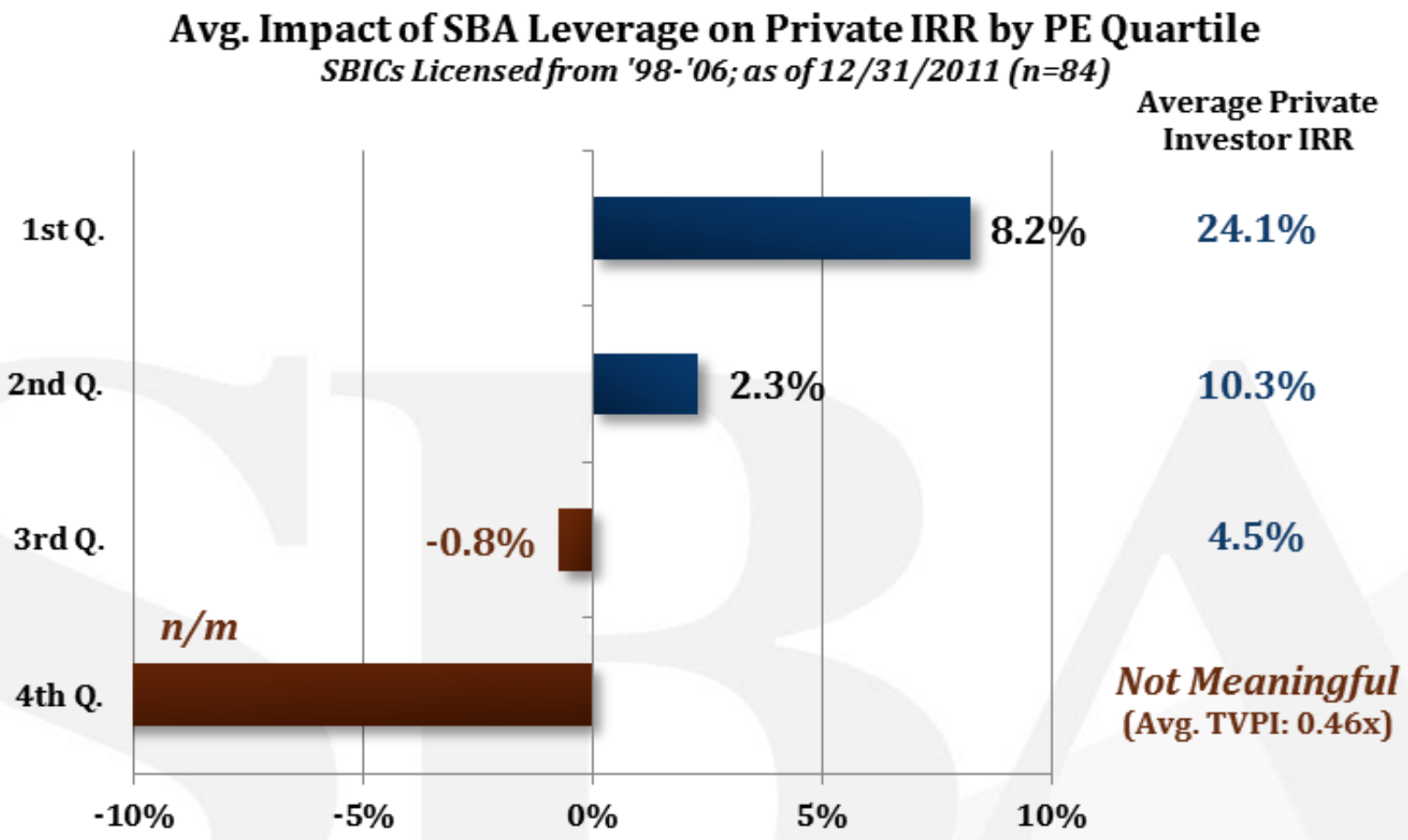
Strong Historical Returns

SBIC Private Investor Returns v. Benchmarks

Total Value to Paid-In Capital (TVPI) – Pooled Basis as of 12/31/2011

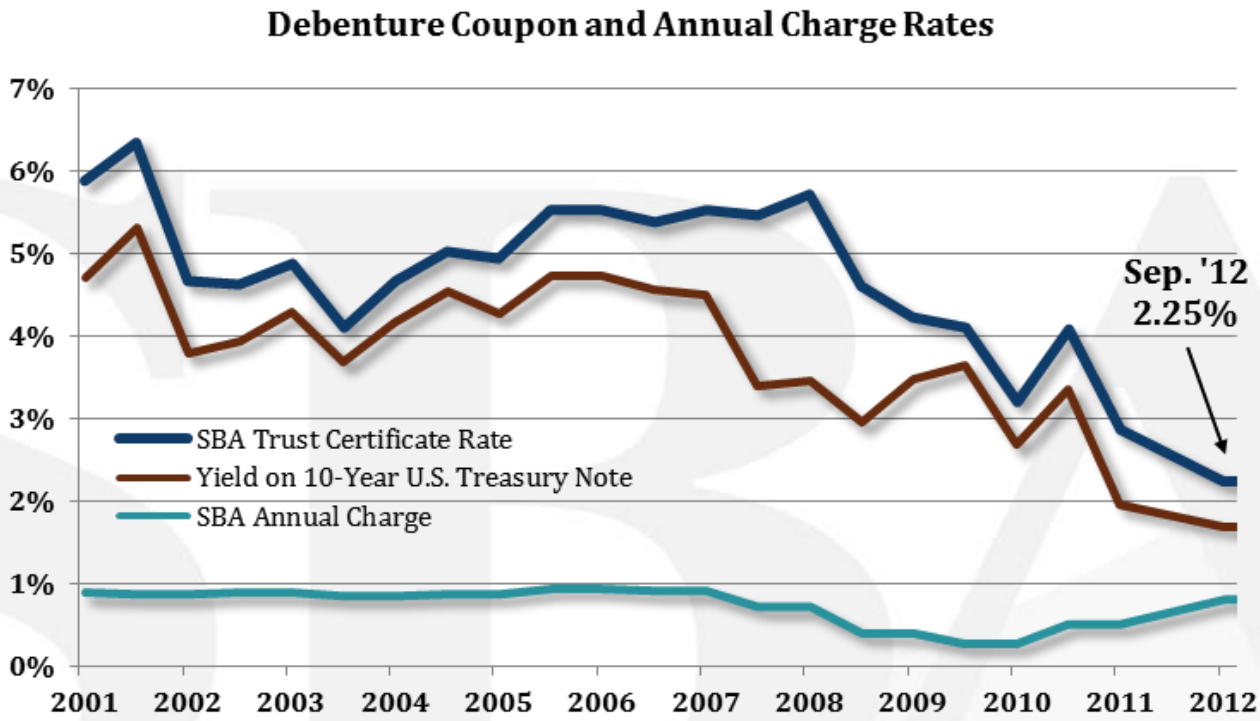


Historical Impact of SBA Leverage



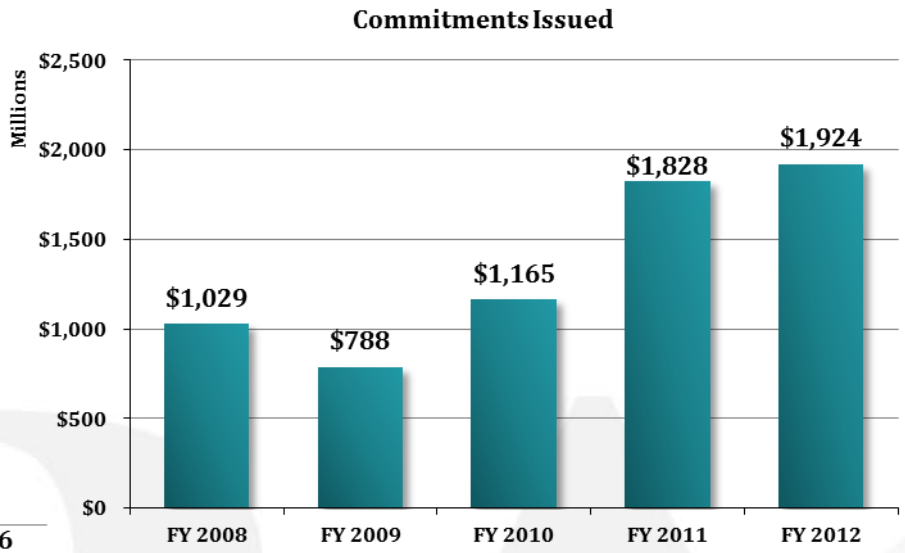
Low Cost Capital

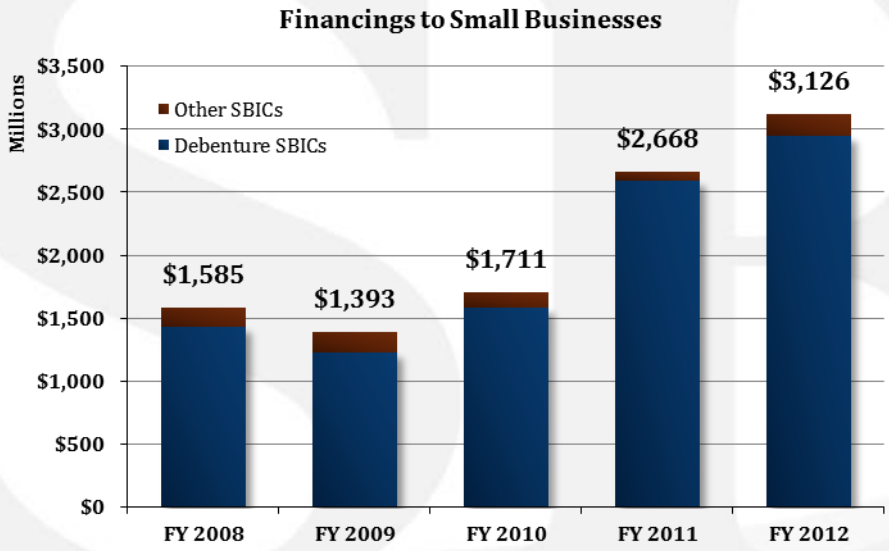
The SBA's leverage commitments to licensed SBICs are funded through the sale of government-backed securities called "trust certificates." Every March and September, these commitments are pooled and sold on the open market at a premium over 10-year Treasury Notes.



Record Growth of Debenture Program

Debenture and Other SBIC financings to small businesses, as well as SBA commitments to SBICs…





…both reached record levels in FY 2010, FY 2011 *and* FY 2012.

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 presumed qualified for the purposes of the Community Reinvestment Act.

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 3rd St., SW
Suite 6300
Washington, DC 20416

Samuel J. Boyd, Jr.
Director of Program Development
SBIC Program
sam.boyd@sba.gov
p: 202-205-7546

Scott Schaefer
Sr. Investment Officer
SBIC Program
scott.schaefer@sba.gov
p: 202-205-6514

Jeff Finkelman
Investment Officer
SBIC Program
jeff.finkelman@sba.gov
p: 202-205-2414