



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

**DATE:** January 03, 2011

**TO:** All SBICs With Outstanding Participating Securities Leverage

**SUBJECT:** Policy Change Regarding “Buyouts” of Small Business Investment Companies (“SBIC”) with Outstanding Participating Securities (“PS”) Leverage in the Office of SBIC Operations

1. **Policy Change.** The SBA will consider requests for SBA approval of “buyouts” of the portfolio of active SBICs with outstanding PS leverage (“PS SBICs”) under the terms and conditions outlined in this Memorandum. Any proposed “buyout” must include a market value purchase price offer at or above the “floor” of repaying the SBA leverage and any other obligations due SBA as described in paragraph 4(c)(iii) below. Previously, SBA only considered requests for approval of buyouts that would fully repay SBA’s leverage, earned and unearned accrued prioritized payments, and any SBA profit participation calculated on the basis of a current valuation, acceptable to SBA, of the portfolio.

2. **“Buyout” Definition.** A “buyout” is characterized as a transaction in which the SBIC sells all or substantially all of its assets to another entity and uses the sale proceeds to repay SBA leverage, earned prioritized payments, charges, adjustments, and any allocable SBA profit participation. In many buyout situations, regulatory conflicts of interest exist, such as continued management of assets by the SBIC managers or sale to a party which includes Associates (as defined in 13 CFR 107.50). When a conflict of interest exists, SBA’s prior written approval is required for the buyout. If no conflict of interest exists, SBA approval of a buyout may not be required.

3. **Buyout Offer Considerations.** SBA will examine the economics of the offer and whether it would be in the SBA’s best interest to hold its position in the SBIC based on valuations, expected wind-down time, anticipated future cash flows and impact on the small businesses comprising the SBIC’s portfolio. SBA will neither provide a counter offer nor negotiate with the SBIC; it will either accept or reject the presented offer.

4. **Procedures.** SBICs seeking SBA approval of a buyout when a conflict of interest exists should follow the procedures outlined below:

- a. A PS SBIC may present only one request for approval of a buyout transaction for SBA’s consideration in any twelve month period. The offer should represent the SBIC’s best offer because SBA will either approve or reject the request as submitted and will not negotiate the terms.
- b. The PS SBIC must submit a written request to SBA to approve the buyout, which must include the following:

- i. Copy of the buyer's offer, including all terms and conditions (Note: only offers meeting the requirements identified in paragraph 4(c) below will be considered).
  - ii. Purchase price offered and associated distribution of proceeds to SBA, limited partners, and any other parties. If the proposed transaction provides for full repayment of capital (including to both the SBA and limited partners) or otherwise provides realized earnings, the SBIC should also provide a completed PS distribution worksheet. (If an offer would provide for total repayment of Leverage and Private Capital, SBA may require any additional proceeds from the sale to be used for repayment of prioritized payments, charges and adjustments as consideration for approval, even if the PS distribution worksheet does not characterize these amounts as "earned".)
  - iii. Name and ownership of buyer(s) and evidence of the buyer's ability to close the transaction (such as source of funds) satisfactory to both the SBIC and SBA.
  - iv. Discussion of the general partner's authority to sell the SBIC's assets, including a discussion of any provisions of the SBIC's limited partnership agreement that require approval by the limited partners ("LPs") and, if so, what LP ownership percentage is required.
  - v. Form 468 updated as of the date of the request.
  - vi. SBIC's wind-up plan, and any forecasts and other materials provided to the offeror regarding the valuation, timing and expected cashflows with respect to the SBIC's portfolio.
  - vii. Any other offers received by the SBIC for the sale of its portfolio assets and/or SBA's position.
  - viii. Discussion and evidence of any marketing efforts undertaken for the sale of the SBIC's portfolio assets.
  - ix. Statement either identifying any unresolved regulatory issues or violations or certifying that no such issues exist. SBA may require regulatory issues or violations to be resolved prior to approving the transaction.
- c. The proposed offer must meet the following requirements:
- i. The offer must be in writing, clearly indicating the purchase price and all terms and conditions of the transaction.
  - ii. The proposed transaction must be structured as a sale of all or substantially all of the SBIC's portfolio assets to another entity.
  - iii. At a minimum, the offer must result in payment to SBA of cash sufficient to repay all of the SBIC's outstanding leverage (Participating Securities and Debentures); Debenture interest accrued to the next payment date; and any *earned* prioritized payments, charges, adjustments and allocable SBA profit participation.

- iv. The offer cannot provide a better compensation package, going forward, to the General Partner (“GP”) and/or any principals than is currently in place.
  - v. The offer cannot require any representations, covenants, acknowledgments or other agreements of SBA, nor will SBA be a party to the transaction.
  - vi. The offer must include a provision that no further leverage will be drawn to support any additional follow-on financings or expenses prior to closing.
  - vii. The offer must allow at least 21 business days for SBA review after receipt of all valuations and intermediary efforts identified below.
  - viii. The offer must provide for closing and payment in cash within 45 business days of SBA approval.
- d. Within 2 weeks of receiving the SBIC’s written request for buyout approval in accordance with this paragraph 4, the SBIC’s Operations Analyst will review the request and set up a meeting with the SBIC’s management team to review the SBIC’s portfolio and wind-up plan. In addition, SBA may request additional information or identify follow-up actions to be taken by the SBIC.
- e. The SBIC must retain and pay for an independent valuation contractor from SBA’s valuation contractor list to value all portfolio companies identified by the SBA at the portfolio meeting. (SBA maintains a list of valuation contractors that may be used for this purpose<sup>1</sup> which SBA will provide to SBICs after submitting their buyout request.) In general, SBA will seek valuations on at least 80% of the projected value of the portfolio but reserves the right to require valuations on all assets. The consultant must value the portfolio and assess SBIC exit projections in terms of timing, expected proceeds, and risk. SBA may additionally require second valuations on key drivers in the portfolio, which may require visits to the portfolio companies. In those situations, the SBA may require the SBIC to retain and pay for the valuation contractor selected by SBA from SBA’s list of valuation contractors. SBA must be provided with a copy of the consultant’s valuation report and have direct access to all valuation consultant(s), whether engaged by the SBIC or by SBA. The SBIC will aid the consultant(s) in obtaining any information and providing access to any portfolio companies and individuals needed to appropriately assess the valuation and exit projections. The resulting valuations and/or results are for the exclusive use of the SBIC and SBA and cannot be distributed or otherwise made available to others, including, without limitation, any prospective buyers.
- f. If the proposed buyer is an Associate of the SBIC, the SBIC must retain a secondary private equity market intermediary acceptable to SBA to conduct a marketing process to ensure a fair price is obtained. (If the proposed buyer is not an Associate, the SBA will not require this marketing process; however, SBICs may wish to undertake such a process as it would provide additional support for the offer.) SBA will not accept

---

<sup>1</sup> Valuation contractors who wish to be on this list should contact the Director of SBIC Operations at [Marja.Maddrie@sba.gov](mailto:Marja.Maddrie@sba.gov) with “Valuation Contractor List” in the subject header.

any marketing process that provides for an intermediary receiving compensation or a success fee in excess of 2% of the purchase price. All fees and expenses of the intermediary shall be paid by the SBIC.

- g. After receiving all information identified in this paragraph 4, SBIC's analyst will evaluate the proposal and present his/her analysis and recommendation to a committee composed of the Deputy Associate Administrator for Investment, Director of the Office of SBIC Operations, Director of the Office of Liquidation, and the Senior Policy Analyst. The committee will make a recommendation on whether to approve or reject the buyout request and will forward their recommendation to the Associate Administrator for Investment ("AAI"), who will make the final decision. In making this determination, SBA will examine the economics of the offer and whether it would be in the SBA's best interest to hold its position in the SBIC based on valuations, expected wind-down time, anticipated future cash flows and impact on the small businesses comprising the SBIC's portfolio. SBA will neither provide a counter offer nor negotiate with the SBIC; it will either accept or reject the presented offer.
- h. Any request for approval granted by SBA is conditional upon SBA's receipt of an acceptable opinion of counsel to the effect that the contemplated transaction is in compliance with all applicable laws, the SBIC's partnership agreement and/or other governing document, including any necessary approvals and authorizations by its limited partners as required by its limited partnership agreement.
- i. SBA may also require SBICs to resolve regulatory issues prior to the transaction, particularly if an issue negatively impacts small businesses in their portfolio. Separate from the proceeds SBA receives as a result of this transaction, SBICs must pay any exam fees owed SBA prior to the transaction.
- j. Upon SBA's receipt of all proceeds due SBA, the SBIC will tender surrender of its license for SBA approval.

5. **Policy Review.** SBA will review both the policy and procedures associated with this letter before the end of the fiscal year and, if needed, issue new guidance. If you have any specific concerns regarding this policy, please contact your analyst.

Respectfully,

Sean J. Greene  
Associate Administrator for Investment