



The SBIC Program

U.S. Small Business Administration

- What is the SBIC Program?
- Why partner with the SBA?
- Who is an ideal candidate for the SBIC Program?
- How does the program work?



What is the SBIC Program?



What is the SBIC Program?

- In 1958, Congress passed the Small Business Investment Company Act creating the SBIC Program
 - Multi billion \$ fund of funds
 - Invests long term capital in privately owned and managed investment firms (licensees)
 - Invests across the spectrum of private equity, including venture, buyout and mezzanine funds
 - Public-private partnership
 - Self-funding
 - Administered by the Investment Division, US Small Business Administration
- to bridge the gap between entrepreneurs' need for capital and traditional financing sources.

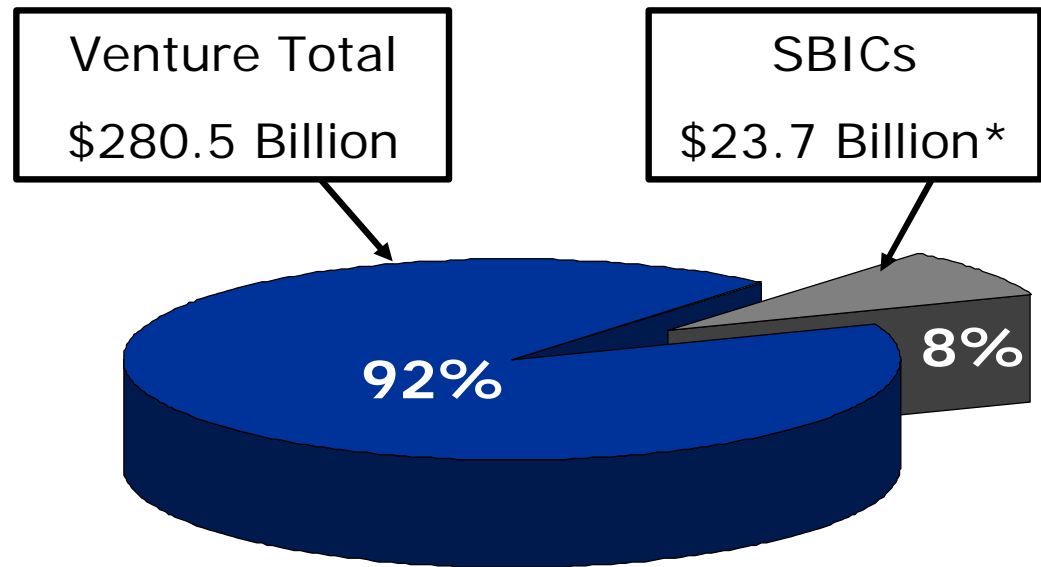
What is the SBIC Program?

A Vital Part of Venture Capital Industry

SBICs currently provide:

- 8% of all venture financing dollars*
- 64% of all seed financing dollars
- Over 62% of all venture financings by actual number

FYs 1994 through 2002



* Includes only SBIC financings with equity features. Total SBIC investments include substantial portion of debt investments.



What is the SBIC Program?

America's small businesses are the engines for growth in our economy – and SBICs provide the fuel

- \$2.7 billion in SBIC financings in FY 2002
- Companies with current SBIC financing employed 1.1 million in FY 2002
- Over 27% of SBIC financing dollars went to low and moderate income areas in FY 2002
- Broader geographic distribution across nation than private equity as a whole – 71% of portfolio outside California and Massachusetts
- SBICs tend to invest across a wider range of industries, than private equity as a whole – 25% in manufacturing



What is the SBIC Program?

SBICs: Investing in some of the nation's most successful companies

A&W Brands Holding Co.
Actel Corporation
Adaptec
Airport Systems Int'l, Inc.
America Online
Amgen Inc.
Apple Computer
Assembly Solutions, Inc.
BeautiControl
CTC Distribution Services
Callaway Golf Company
Cardio Logic, Inc.
Cerner
Chesapeake Biological Labs, Inc.
Citation Computer Systems, Inc.
Cognex Corporation
Compaq, Inc.
Comptek Research, Inc.
Connecticut Culinary Institute
Cooper Natural Resources, Inc.
Costco Wholesale Corporation
Cray, Inc.
Cutter & Buck
Datastream
Devon Group, Inc.
Digimark, Inc.
Domain Furniture, Inc.
DoubleClick.com

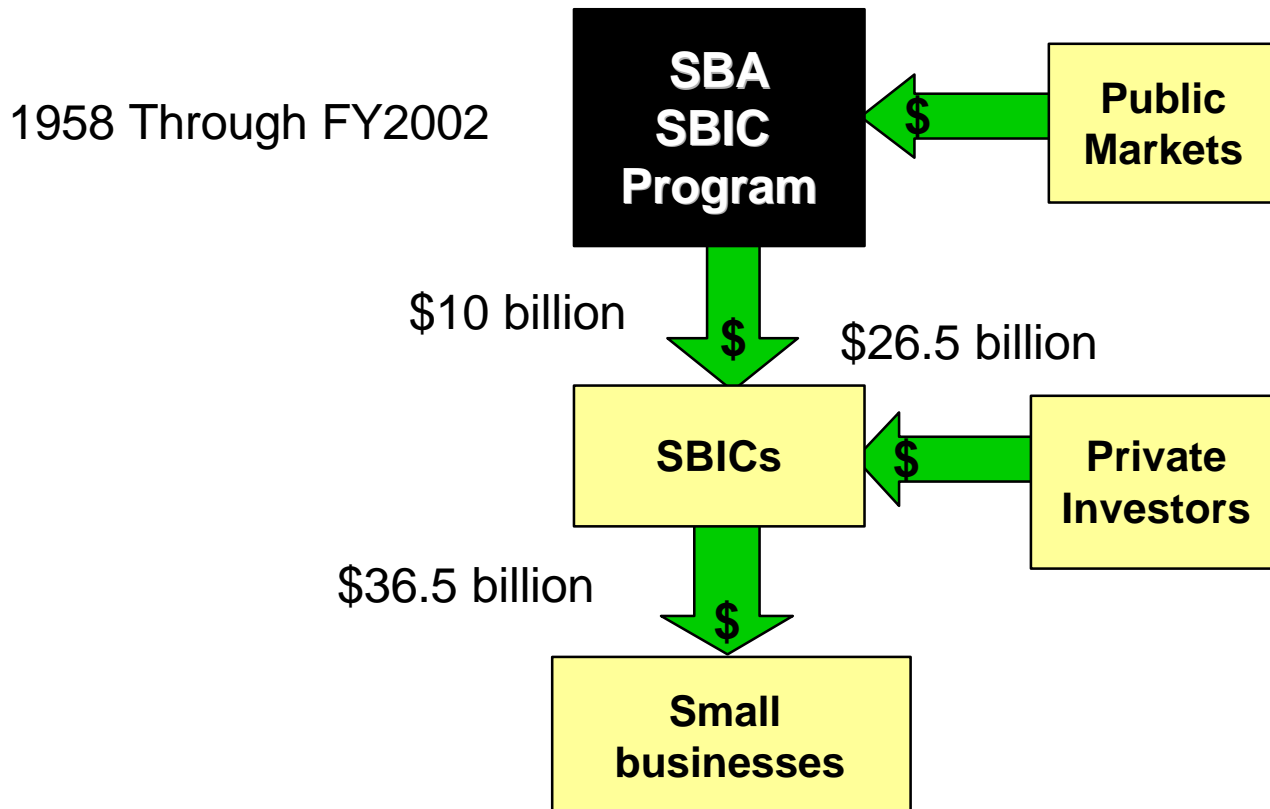
Douglas Machine Inc.
Duracraft Corporation
Etak, Inc.
Educational Development
Encore Wire Corp.
Envoy Corporation
Evergreen Solar, Inc.
FedEx
Fiserv
Fusion UV Systems, Inc.
Gendex
General Sciences Corp.
Genicom Corp.
Geotek Communications, Inc.
Global Village Communications
Gymboree Corporation
Hanger Orthopedic Group, Inc.
Harman International
HS Resources, Inc.
Healthcare Compare Corp.
Healthcare Services of America
HealthSouth Rehabilitation
Industrial Training Corp.
Information Analysis Inc.
Infotec Commercial Services
Intel Corp.
Jenny Craig, Inc.
Kent-electronics
Kentucky Kingdom, Inc.

Kronos, Inc.
Labor Ready, Inc.
Lam Research Corporation
Leap Into Learning, Inc.
Lifeline Systems, Inc.
Maxim Integrated Products
Medical Staffing Network, Inc.
Metrolina Outreach Mammography
Microcom Corporation
Micromodule Systems
Microtouch Systems, Inc.
Mothers Work, Inc.
Mellcor, Inc.
Neoterik Health Technologies, Inc.
NetFrame Systems, Inc.
Network Systems
Newcomb Communications, Inc.
New England Critical Care
NuCo2, Inc.
Octel Communications Corp.
Optical Data Systems
Orbital Sciences Corp.
Outback Steakhouse, Inc.
PeopleSoft, Inc.
Performance Polymers, Inc.
Petstuff, Inc.
Potomac Group, Inc. (MediFAX)
Protocol Systems
RF Power Products

Radio One, Inc.
Read-Rite
Restoration Hardware, Inc.
Rock Bottom Restaurants, Inc.
Sage Software, Inc.
Seasafe, Inc.
Security Dynamics Technology
Staples, Inc.
Steelweld Equipment Co.
Sun Microsystems
Symbol Technologies
Synoptics Communications, Inc.
TECHNE Corporation
Teradata Corporation
The Computer Group (TCG)
The Merchandising Group (TMG)
The Systems Center
Tricord Systems, Inc.
Universal Health Services
Vertex Communications Co.
Vivid Technologies, Inc.
webMethods, Inc.
Wellfleet Communications
Wild Oats Markets, Inc.
Wire Networks, Inc.
Xtreme Networks, Inc.
Zydacron, Inc.

What is the SBIC Program?

A public-private partnership that harnesses private capital alongside SBA-guaranteed funds, providing a much larger base of capital for entrepreneurs





Why partner with the SBA?



Why partner with the SBA?



Available & Predictable LP Capital

- At a time when raising institutional private capital is extremely challenging, SBA
 - is on track to fund in excess of \$1 billion in leverage in 2003
 - set an objective to maintain a stable flow of new licensees
 - is steadily increasing commitments relative to past years

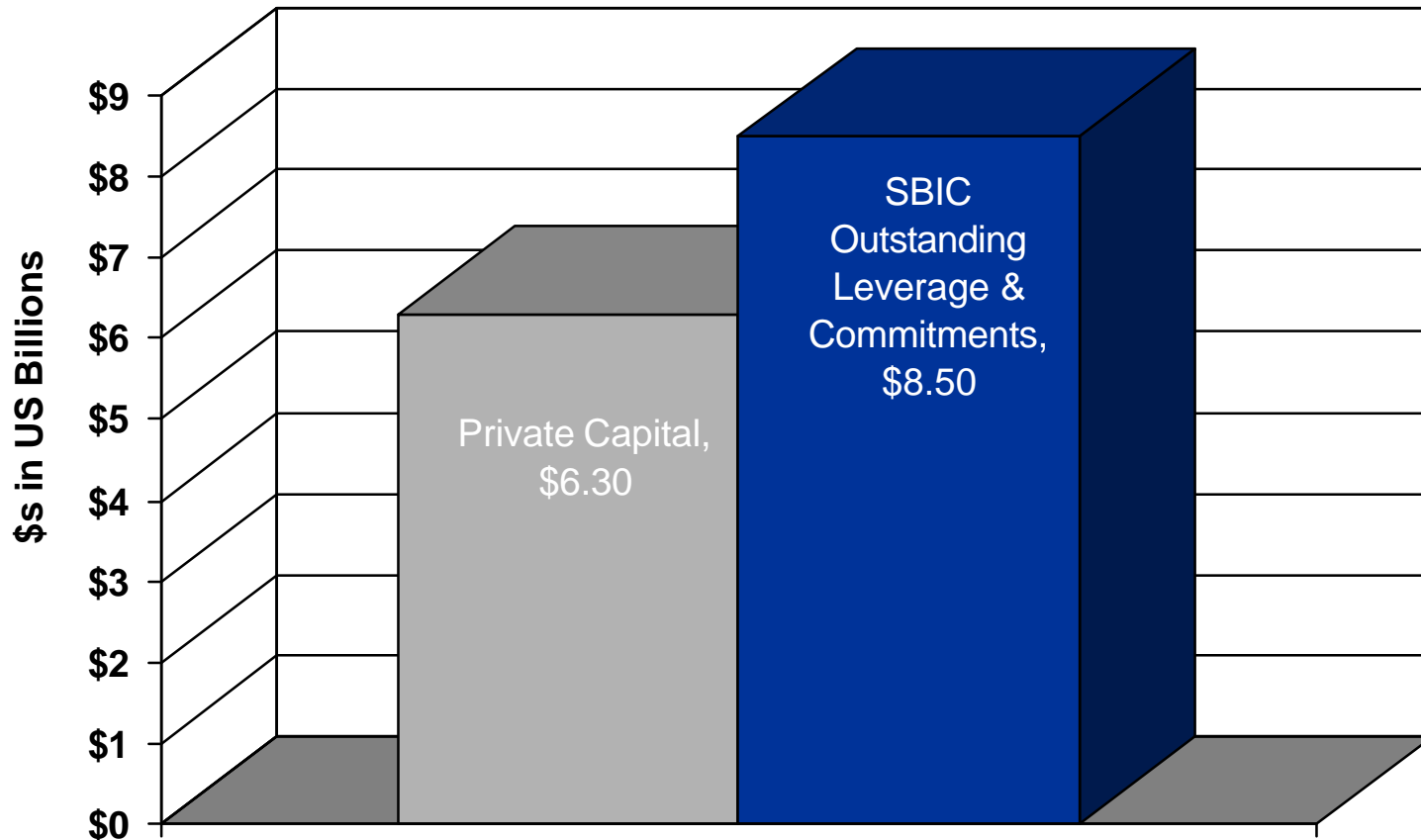
- SBA's process is a "known quantity" – the process is clearly defined with early milestones

- SBA as a single large LP can reduce the fundraising timeline / burden on a fund and consolidate investor / LP relations efforts



Why partner with the SBA?

Strong Commitment to the Sector



As of 05/2003

Source: Data Management Branch,
Investment Division, US Small
Business Administration

Note: Amounts exclude Bank SBICs and
Specialized SBICs.

Why partner with the SBA?



Beneficial Effects of Leverage

Impact of SBIC Leverage

(Source: National Association of Small Business Investment Companies)

Gross Portfolio Return	Return to Investors without SBIC Leverage	Return to Investors with SBIC Leverage	% Yield Enhancement
10.0%	4.4%	0.0%	NA
15.0%	8.4%	12.7%	51.2%
20.0%	12.5%	19.5%	56.0%
25.0%	16.7%	27.3%	63.5%
30.0%	20.9%	35.2%	68.4%
35.0%	25.2%	42.5%	68.7%
40.0%	29.4%	49.6%	68.7%
45.0%	33.8%	56.2%	66.3%
50.0%	38.1%	63.7%	67.2%

Notes:

- 1) All returns refer to compound annual returns, i.e. IRR
- 2) Assumes returns are net of 2.5% annual expenses, 20% management carried interest, 15% uninvested capital, 4-year investment and 4-year holding period
- 3) Assumed leverage: Participating securities (2X Private Capital), 7.75% Prioritized Payments and 9% Profit Participation Rate



Why partner with the SBA?

- The Community Reinvestment Act (“CRA”) makes available to SBICs, an entirely new category of potential private LP investment that would be inaccessible otherwise
 - CRA encourages depository institutions to meet the credit needs of their communities
 - Investment in a SBIC is defined as a “qualified CRA investment” by bank regulators
- Enhanced deal sourcing through network of SBIC Program’s 400+ fund universe
- SBA’s financial reporting criteria help SBICs develop standardized and comprehensive investor relations processes



Why partner with the SBA?

Constantly working to improve the SBIC Program

- Streamlining application and license process:
Goal- 6 to 9 months from MAQ submission to License*
- Working to simplify and improve handling of processes such as cash distributions
- Just-in-time capital call capabilities
- Better use of data to demonstrate program results
- Developing industry focus groups to enhance the SBIC Program and collaborate with industry

* *Dependent on time required by applicant to submit application following receipt of "Go Forth" letter.*



Who is an ideal candidate for the SBIC Program?



Who is an ideal candidate for the SBIC Program?



- Private equity experience relevant to proposed fund
- Investment experience as a principal rather than an agent
- Realized track record of superior returns relative to funds of same vintage year and style
- Hands-on experience adding value at the portfolio company level
- Cohesive team, with diverse experience, complementary skills, history and strong chemistry



How does the program work?





How does the program work?

Customized structures to fit managers' needs

**Existing or
Emerging Fund**

**Standard
Structure**

**Drop-down
Fund**

**Side-by-
side Fund**

**Side-by-side
with drop-down
feature**

**Participating
Securities**

**Debenture
Securities**



How does the program work?

Customized structures to fit managers' needs

- **Standard structure**
 - At fund inception, private LPs participate alongside SBA
- **Drop-down fund**
 - All private LPs desire full or blended participation in SBIC structure
 - Best suited for existing funds, looking to expand capital under management without full fundraising cycle
- **Side-by-side fund**
 - Only a portion of private LPs desire participation in SBIC structure
 - Extract portion of LPs from traditional structure to organize SBIC structure
 - Best suited for funds when only a portion of LPs desire SBIC leverage
- **Side-by-side fund with drop-down feature**
 - Same as side by side but with blended participation
 - Best suited for funds when only a portion of LPs desire blend of leveraged and unleveraged investment.

*****Additional costs and time required depend on complexity of the structure and private LP's cooperation***



How does the program work?

Participating Securities

- Well suited for pure equity investors
- Preferred Limited Partnership interests, redeemable after 10 years
- Preferred interest accrues, payment of which is contingent upon SBIC profits
- SBA receives current return, once SBIC is profitable, plus small profit participation
- SBA trades pro-rata distribution of profits for liquidity preference
- Leverage available up to 2x private capital paid-in
- Leverage ceiling is \$113 million
- 3% origination / commitment fee plus 1.3% annual fee on leverage drawn*

** The annual fee is a contingent payment, fixed at time of leverage commitment. The current rate floats according to the SBIC Program's required subsidy rate.*



How does the program work?

SBA's profit participation

Profit Participation Rates depend on the 10 Year Treasury Bond Rate and the Ratio of Participating Securities to Private Capital

Participating / Private Capital	<u>10 Year Treasury Bond Rate</u>						
	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%
0.5	2.25%	2.81%	3.38%	3.94%	4.50%	5.06%	5.63%
1.0	4.50%	5.63%	6.75%	7.88%	9.00%	10.13%	11.25%
1.5	5.25%	6.57%	7.88%	9.19%	10.50%	11.81%	13.13%
2.0	6.00%	7.50%	9.00%	10.50%	12.00%	13.50%	15.00%



How does the program work?

Debenture Securities

- Best suited for mezzanine / later stage investors focused primarily on debt and debt with equity features
- Interest only, bullet with 10 year maturity
- Interest payments are semi-annual
- Unsecured, non-recourse to General Partners
- Leverage available up to 3x private capital paid-in
- Leverage ceiling is \$113 million
- Diminishing prepayment penalty in first five years (5.4.3.2.1%)
- 3% origination / commitment fee plus .87% annual fee on leverage drawn*

** The annual fee is a contingent payment, fixed at time of leverage commitment. The current rate floats according to the SBIC Program's required subsidy rate.*



How does the program work?

What can SBICs invest in?

- Loans, debt with equity features or equity
- 100% "Small Business"
 - Net worth < \$18M and average after-tax income for prior two years < \$6M
- Of which, 20% must be "Smaller Enterprise"
 - Net worth < \$6M and average after-tax income for prior two years < \$2M
- Not more than 20% of the private, committed capital can be invested in a single company without prior SBA approval
- Project financing is prohibited (real estate, single purpose projects)
- SBICs may control small businesses for up to seven years which may be extended with SBA approval



How does the program work?

Low/Moderate Income ("LMI") Debenture Securities

- Debenture licensees are eligible to use LMI Debentures
- Deferred interest, debentures issued at a discount and require no interest payments or SBA annual charge for first 5 years
- Available in 5 and 10 year maturities
- Restricted to LMI qualified investments:
 - 50% of employees or assets in LMI Zone, as defined by applicable government agencies
 - 35% of full-time employees have primary residences in LMI Zones



How does the program work?

The Licensing Process

Step 1: Office of Program Development "Gatekeeper"

- Management Assessment Questionnaire ("MAQ")
- Analyst review & preliminary due diligence
- Investment Committee
- "Go Forth" Letter

Step 2: Office of Licensing

- In order to apply, applicant must have a minimum of \$5 million committed private capital for Debenture applicants and \$10 million committed for Participating
- Analyst in-depth review of application, business plan, financial projections, legal documentation, ownership diversity and final due diligence on management team
- Divisional and Agency Licensing Committee
- Final approval



How does the program work?

The Licensing Process (cont'd.)

Step 3: Office of SBIC Operations (Post-License)

Responsible for monitoring the operations, financial condition and regulatory compliance of licensed SBICs

- Approval of leverage and draw requests
- Review of annual examination reports
- Provision of pre-approval for over-line investments, conflicts of interest, GP change of ownership, etc.
- Portfolio valuation analysis
- Maintenance of good working relationship
- Attendance of annual fund meetings and visits to small business concerns



Conclusion

The SBA is strongly committed to promoting private equity through its SBIC Program, a successful, self-funding and stable source of capital.

www.sba.gov/INV