

## CURRENT MARKET CONDITIONS FUELING RENEWED INTEREST IN SBICs

SBICs Are So Popular That Even Traditional Private Equity Funds Are Getting in the Game

**F**rozen credit markets, recessionary pressures, a limited partner capital crunch, and access to low-cost capital and leverage—along with some help from Congress—have resulted in the new-found popularity of the U.S. Small Business Investment Company (SBIC) program.

### What is the SBIC Program?

SBICs are privately owned and managed private equity firms licensed and regulated by the Small Business Administration (SBA). The SBIC program is a unique partnership between the public and private sector. The SBA does not invest directly into small businesses through the SBIC program, but rather provides funding to qualified investment management firms. The SBIC program was created by Congress in 1958 to bridge the gap between entrepreneurs' need for capital in the critical \$250,000 to \$5 million range in the form of subordinated loans generally not available through traditional financing sources. The minimum private capital required to establish an SBIC is \$5 million.

Additional capital, up to three times the private capital, is potentially available through the SBA by the sale of SBA guaranteed securities. The private capital is at risk in its entirety before any taxpayer money is at risk. The SBIC program is governed and closely regulated by the SBA. Many well-known companies, such as Whole Foods, Intel, Apple, Federal Express, and Outback Steakhouse received early-stage financing from the SBIC program. Today, there are

approximately 340 SBICs with over \$17.4 billion in capital under management.

### Why Has There Been a Renewed Interest in the Program?

Fundraising conditions are extremely challenging today, with many investors

It is reviewed by the SBA, and if the applicant appears to be qualified, it is invited to meet with the SBA. After this meeting, the applicant is either turned down or is issued a "green light" letter inviting the applicant to the second stage of the application process, the preparation

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holding back commitments. The SBIC program is appealing today because it provides access to fund level leverage at very attractive rates. For example, a fund with \$75 million of private commitments can receive additional SBA Debenture Leverage of up to \$150 million. The Debenture Leverage can be accessed over a five-year period and must be repaid in ten years. The cost of the Debenture Leverage is fixed at the time the SBIC draws the leverage, and generally approximates the 10-Year U.S. Treasury Note (currently 3.5 percent – 4 percent), plus 200 – 225 basis points, which in today's market is very attractive.

### What Is the Application Process and How Long Does It Take to Become a Licensed SBIC?

The first step in the application process is submission of the Management Assessment Questionnaire (MAQ) to the SBA. The MAQ solicits information about the business plan and management's qualifications.

of the formal license application. During the formal application process, the SBA further qualifies the management team and business plan. The entire process can take between 6 – 12 months for first-time applicants, but may be shorter for second-time SBIC funds.

### Are There Any Restrictions as to What an SBIC Can Invest In?

In general, funds provided to an SBIC must be invested in small businesses, which the SBA defines as companies with no more than \$18 million in net worth or \$6 million in after-tax income in the prior two years. SBIC regulations also preclude certain types of investments, such as real estate projects, banks, and passive businesses.

### Have There Been Any Recent Changes to the Program?

The American Recovery and Reinvestment Act created some very positive changes to the SBIC program. For example, the

formula for calculating the maximum amount of available leverage made available to a single SBIC was increased, as was the amount SBIC may invest in any single small business. In addition, the Recovery Act requires SBICs to invest 25 percent of their investment dollars into “smaller” businesses. The SBA has also indicated that it plans to streamline the application and licensing process, in particular, for those that have already gone through the process.

### **SBICs and Traditional Private Equity Funds: A Good Match for Today’s Market**

Historically, traditional private equity funds and SBICs have typically lived separate lives. However, the perfect storm facilitated by the current economic and political situations has created an environment where non-SBICs are looking to get into the SBIC game. The ability to obtain government-secured leverage, and the stated support of small businesses by the Obama administration, combined with the tight bank lending markets, make SBICs an attractive option.

SBIC-funded companies rarely go public and seldom are bought. They tend to have somewhat dependable revenue streams and the investment philosophy is generally “longer” term than the traditional private equity fund, which is why many believe the SBIC program to be complementary. J.H. Cohn professionals knowledgeable in SBICs are currently working with traditional private equity funds to help them determine if an SBIC is right for them. ■

*If we can help you in this area, or if you have additional questions, please contact Chris Aroh, CPA, partner, at [caroh@jhcohn.com](mailto:caroh@jhcohn.com) or 860-633-3000.*

## **WHAT YOUR PORTFOLIO COMPANIES NEED TO KNOW ABOUT HEALTH BENEFITS**

### **2009 Health Benefits Survey Reveals Smaller Employers Using Fewer Cost Control Methods**

**W**ith the new deal market experiencing a slowdown, many private equity funds are focusing more time on finding ways to further improve the operations of their existing portfolio companies. With the cost of benefits accounting for a large portion of their overall expense, now is a good time to take stock in the overall performance and efficiency of your portfolio company’s health benefit related activities.

At the close of last year, together with Cohn Benefits Consultants (CBC), a J.H. Cohn Affiliated Company, the Firm sponsored the 2009 J.H. Cohn Health Benefits Survey. Conducted online, 2,000 CFOs and financial executives from small to large companies in New Jersey were invited to participate. The 2009 survey, a follow-up to our 2007 survey, was designed to provide updated information that can be used to identify opportunities to control costs while optimizing benefits and employee satisfaction.

#### **Survey: Companies Can Do More to Contain Costs**

A principal finding was that smaller companies implemented fewer cost control measures and generally paid significantly more for health insurance than larger companies. On average, companies with less than 200 employees paid approximately 25 percent more than companies with 200 or more employees. Additional key findings were:

- Healthcare costs continue to rise at an alarming rate on a year-to-year basis. Thirty-six percent of respondents reported double-digit increases.
- Thirty-seven percent of respondents now offer a High Deductible Health Plan, up from only 11 percent in our 2007 survey.
- A disproportionate number of small employers continue to offer employees only one health plan option. Approximately 80 percent of companies with greater than 200 employees offer a choice of plans while only about half of the companies with 200 or fewer employees do.

- Only 37 percent of respondents require generic substitutions for prescription drugs, and only 35 percent require the use of mail order prescription drug services for maintenance drugs.

The survey results confirm that there is much employers can still do to contain healthcare costs, and that these efforts pay off in the form of reduced premiums. CBC works with a wide range of companies to review their current plans and identify opportunities to control or reduce costs while optimizing benefits. CBC has the expertise to assist in the transaction and due diligence process by reconciling the financial components of employee benefits and pension plans, and can evaluate benefit structures to determine suitability, identify potential problems and resolutions, and recognize opportunities that will yield better economic results. ■

*To set up a meeting with Cohn Benefits Consultants, please contact George Szabo, CPA, partner, and co-director of the Firm’s Mergers & Acquisition Services Practice, at [gkszabo@jhcohn.com](mailto:gkszabo@jhcohn.com) or 877-704-3500.*

For a copy of the survey report, [click here](#).

# GEORGE T. SZABO JOINS J.H. COHN

George T. Szabo, CPA, has joined J.H. Cohn LLP as a partner and co-practice director of the Firm's Mergers & Acquisition Services Practice. George joins J.H. Cohn from a Big Four accounting firm where, as a partner and member of that firm's Transaction Advisory Services practice, he was actively involved in developing, executing, and managing a book of transactions-focused business serving private equity and corporate clients.

George, through his leadership qualities and depth of experience, is a valuable addition to our already-strong transactions-focused brand."

J.H. Cohn's Mergers & Acquisition Services Practice provides the Firm's private equity and corporate clients with value-added due diligence; financial modeling and valuation; post-acquisition integration; M&A consultation; and tax diligence,



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"In these challenging economic conditions, it is especially important for private equity and corporate acquirers to combine a clearly defined M&A strategy with the invaluable benefits of a trusted advisor," said Thomas J. Marino, CPA, J. H. Cohn's chief executive officer. "We work with our clients through each phase of the investment life cycle, and believe that

structuring, and optimization advisory services. The Firm aims to effectively position its clients for successful investments by providing best-in-class services that place strong emphasis on the financial, tax, risk management, human capital, IT, and operational critical success factors during the acquisition and integration processes as well as the investment holding period.

George received a Master of Business Administration degree in finance from Columbia University and a Bachelor of Science degree from Rutgers University. He is a member of the American Institute of Certified Public Accountants, the New York State Society of Certified Public Accountants, and the New Jersey Society of Certified Public Accountants. George also served on the board of directors of the New Jersey Association for Corporate Growth. ■

For more information on J.H. Cohn's Private Equity Practice, [click here](#).

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