Private Equity/Venture Capital
Cohnnection

August 2012

Early Stage SBIC Regulations Issued

by Guergana Rangatcheva, CPA, Manager

The Small Business Administration ("SBA") issued final regulations for the Early Stage Small Business Investment Companies (SBICs) initiative on April 27, 2012, nearly a year after President Obama's "Start-up America" legislation was passed creating the $1 billion, five-year program. This initiative is intended to promote American innovation and job-creating by encouraging private sector investments in job-creating early stage small businesses. Under the initiative, the SBA will provide leverage in the form of 10-year debentures as a one-to-one match to private sector investments in promising high-growth companies. The leverage will be deployed up to $150 million in 2012, followed by up to $200 million per year from 2013 to 2015 and up to $250 million in 2016.

Highlighted below are the major provisions of the new regulations and their impact on fund managers who would consider participating in the Early Stage SBIC program. The SBA created the Early Stage SBIC program with three major differences from the traditional SBIC program:

- Applications for the Early Stage SBIC program can only be made annually at specified periods of time.
- There are two application tracks in order to speed up the licensing process. Track 1 was created for applicants with capital and Track 2 was created for all others.
- At least 50 percent of the fund's capital must be deployed in early stage companies, which are defined by the regulations as companies that never achieved positive cash flow from operations prior to the SBIC investment. Those managers interested in applying for a subsequent Early Stage SBIC license will have to pay close attention to their cash management, especially if they have a lot of leverage outstanding in their previous fund as it may deter them from obtaining a second license.

Our View of the News

The new SBA regulations make the Early Stage SBIC debenture program more compatible with the unique characteristics of early stage funds, which typically cannot support regular interest payments in their earlier years. The SBA addressed this issue by easing the regulations for the first five years during which Early Stage SBICs will have the option to either maintain a five-year interest reserve, which may be held as unfunded capital commitments, or structure the interest due as an original issue discount.

On May 1, 2012, the SBA made its first annual call under the Early Stage SBIC program and announced the deadlines for the 2012 application process. For Track 1 applicants, the management assessment questionnaire ("MAQ") must be submitted by May 25, 2012 followed by a formal license application no later than July 30, 2012. For Track 2, the deadline to submit the MAQ is May 19, 2012 and for the formal license application is May 15, 2013. The anticipated licensing dates are September 28, 2012 for Track 1 and September 30, 2013 for Track 2. Those funds that intend to file a license application must achieve at least $20 million in regulatory capital by the time they submit their formal applications.

The SBA did not relax its licensing standards in connection with the Early Stage SBIC program. Early Stage SBIC applicants will still have to demonstrate top quality manager qualifications, track record, proposed investment strategy, and proposed organizational structure and fund economics. In addition, the SBA announced that it has reserved the right to diversify the licensing geographically and across vintage years in order to mitigate some of the program risks. The SBA also reserved the right not to license any SBIC if no applicant meets the qualifications. ■

For more information on the SBIC program, please contact Guergana Rangatcheva, CPA, manager, at grangatcheva@jhcohn.com or 860-368-5275.

CALIFORNIA

Los Angeles
11755 Wilshire Boulevard
17th Floor
Los Angeles, CA 90025
310-477-3722

San Diego
9255 Towne Centre Drive
Suite 250
San Diego, CA 92121-3060
858-535-2000

Warner Center
21700 Oxnard Street
7th Floor
Woodland Hills, CA 91367
818-205-2600

CAYMAN ISLANDS

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

CONNECTICUT

Farmington
76 Batterson Park Road
Farmington, CT 06032
860-678-6000

Glastonbury
180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

New London
125 Eugene O'Neill Drive
Suite 120
New London, CT 06320
860-442-4373

Stamford
1177 Summer Street
Stamford, CT 06905
203-399-1900

MASSACHUSETTS

Springfield
One Monarch Place
Suite 2020
Springfield, MA 01144
413-233-2300

NEW JERSEY

Roseland
4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

Eatontown
27 Christopher Way
Eatontown, NJ 07724
732-578-0700

Metro Park
333 Thornall Street
Edison, NJ 08837
732-549-0700

Princeton
103 Carnegie Center
Suite 311
Princeton, NJ 08540
609-896-1221

NEW YORK

Manhattan
1212 Avenue of the Americas
New York, NY 10036
212-297-0400

Long Island
100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

White Plains
1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700

J.H. COHN LLP
ACCOUNTANTS & CONSULTANTS

877-704-3500
www.jhcohn.com