



Investing in SBIC's: A Bank LP's Perspective

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History with SBIC Program

- TD Bank has been investing in the SBIC asset class for more than a decade.
- TD Bank has investments in all asset strategies – mezzanine, equity and debt funds within the Bank's footprint from Maine to Florida.
- 35 investments in the New England market – MA, ME, NH, RI, CT and VT.

Bank Investment Considerations

- Permissible Bank investment under Dodd-Frank/ Volcker Rule – carve out for SBICs
- Evaluate strong investment managers with a dependable track record of delivering solid results in order to deliver solid economic returns for the Bank's shareholders.
- Potential for banking relationships to develop with the Fund, the Fund Manager, the General Partners and the Funds' portfolio companies.
- Investment asset diversification.
- Qualifies for CRA investment test.

Due Diligence – Checklist

- Track Record
- Management
- Fund Investment Process
- Fund Partnership Terms
- References
- Document Checklist
- Portfolio Monitoring

Due Diligence – Track Record

- Evaluate investment track record of Fund managers
 - Assess prior returns – IRR, DPI (distributions to paid in capital), RVPI (residual value to paid in capital), TVPI
 - Contrast the team’s deal underwriting to its stated strategy
 - are they consistent or does the team deviate from their stated underwriting approach e.g. investing in equity securities when their skill set is mezzanine lending?

Due Diligence – Management

- Team cohesiveness
 - How long has the team worked together and in what capacity
- Team departures
 - Understand why there are changes
- Conduct face-to-face meeting with team
- Perform Lexis-Nexis and OFAC background checks on senior professionals
- Understand how management communicates with its Limited Partners – e.g. do they provide quarterly LP updates

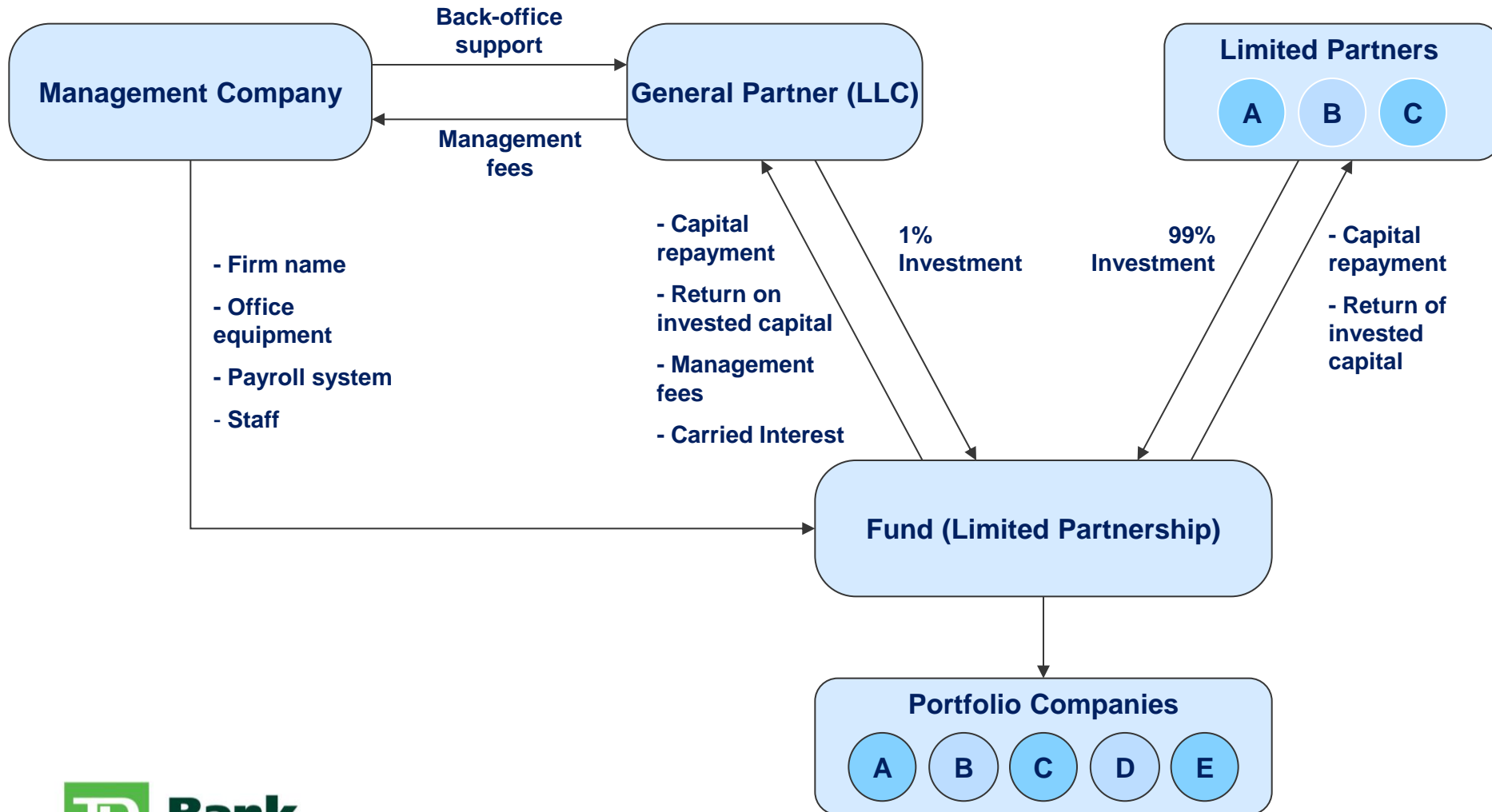
Due Diligence – Fund Investment Process

- What are the Fund's key competitive differentiators
- Decision making process
- For all investments
 - What is the exit strategy thought process on the front end?
- Formal procedures for managing portfolio risk
- Valuation process & policies
- Lessons learned & measures taken to avoid future risks

Due Diligence – Partnership Terms

- Limited Partnership Terms
 - Investment period
 - Recycling of returned capital
 - Diversification
- Fund capitalization – private LP capital vs. SBA match
- How much are the general partners contributing to the Fund?
- Any preferred return to the limited partners?
- How are losses/ gains distributed?
- Investment Committee/ Advisory Board roles

Limited Partnership Structure



Due Diligence – Background References

- Co-investors
- Other limited partners- talk with LPs who are not returning LPs
- Former partners
- Former employers
- Portfolio Company CEOs
- Senior lenders

Due Diligence – Document Checklist

- Limited Partnership Agreement
- Subscription Agreement
- Private Placement Memo
- Management Assessment Questionnaire (MAQ)
- Most Recent PowerPoint Presentation
- Audited Financial Statements, if available

Portfolio Monitoring – Best Practices

- Conduct annual in-person meeting and more frequent telephonic meetings with the investment team
- Review fund communications – quarterly & audited annual financial statements, K-1s, etc
- Obtain quarterly capital account statement

Risks

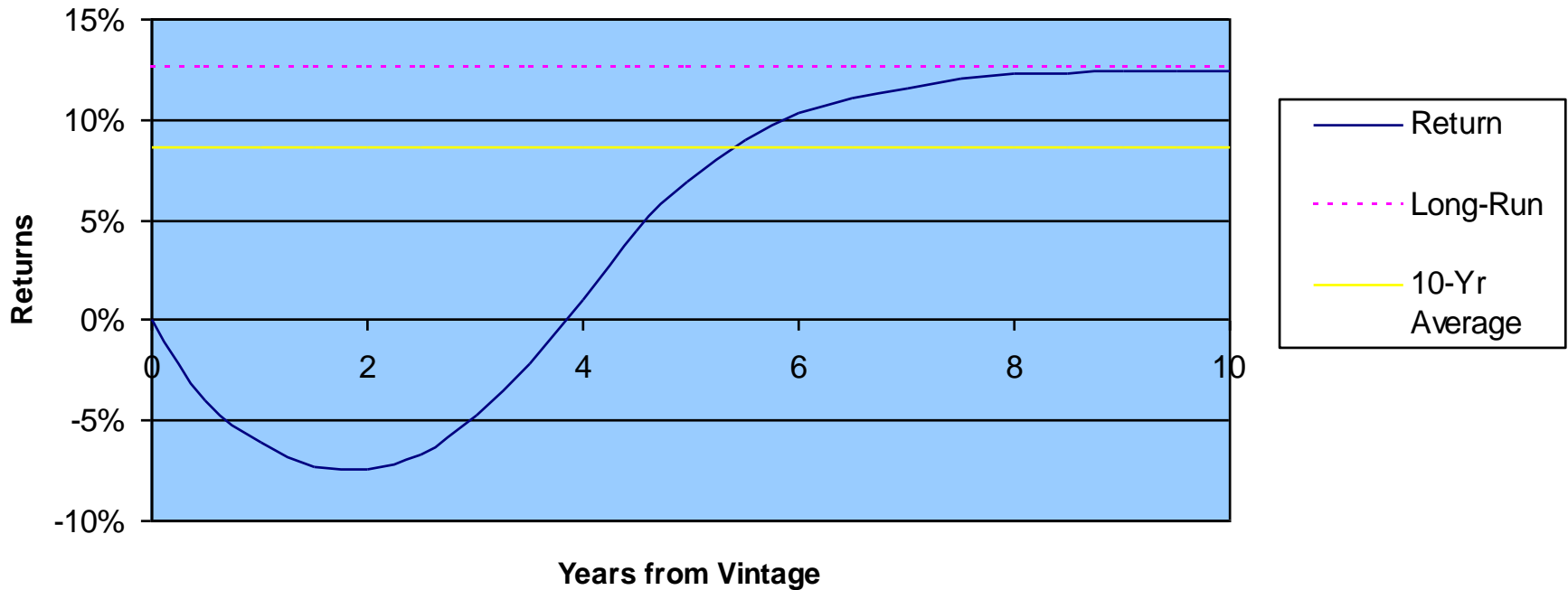
- Loss of capital – By far the greatest risk
- Fund Impairment
 - Fund is required to provide SBA with quarterly Capital Impairment Worksheet
- Timing of the “return of capital”
 - Understanding of when the SBA allows distributions of retained earnings available for distribution or “READ” as it is referred to commonly

Risk Mitigants

- Mitigants:
 - Meticulous due diligence process
 - Underwriting experienced managers who have previously executed upon consistent strategy
 - Shallower J Curve for mezzanine funds

Return on Investor Capital

Mezzanine Fund J-Curve



Conclusion

- SBA, OCC and FRB have a tremendous opportunity to educate the banking sector with this investment class
- Understand the SBIC program – talk with the SBA
- CRA credit for Fund investment – talk with your OCC examiner
- Perform your own due diligence – do not rely on others
- Comfort with Fund Management team & their past performance
- Patient capital