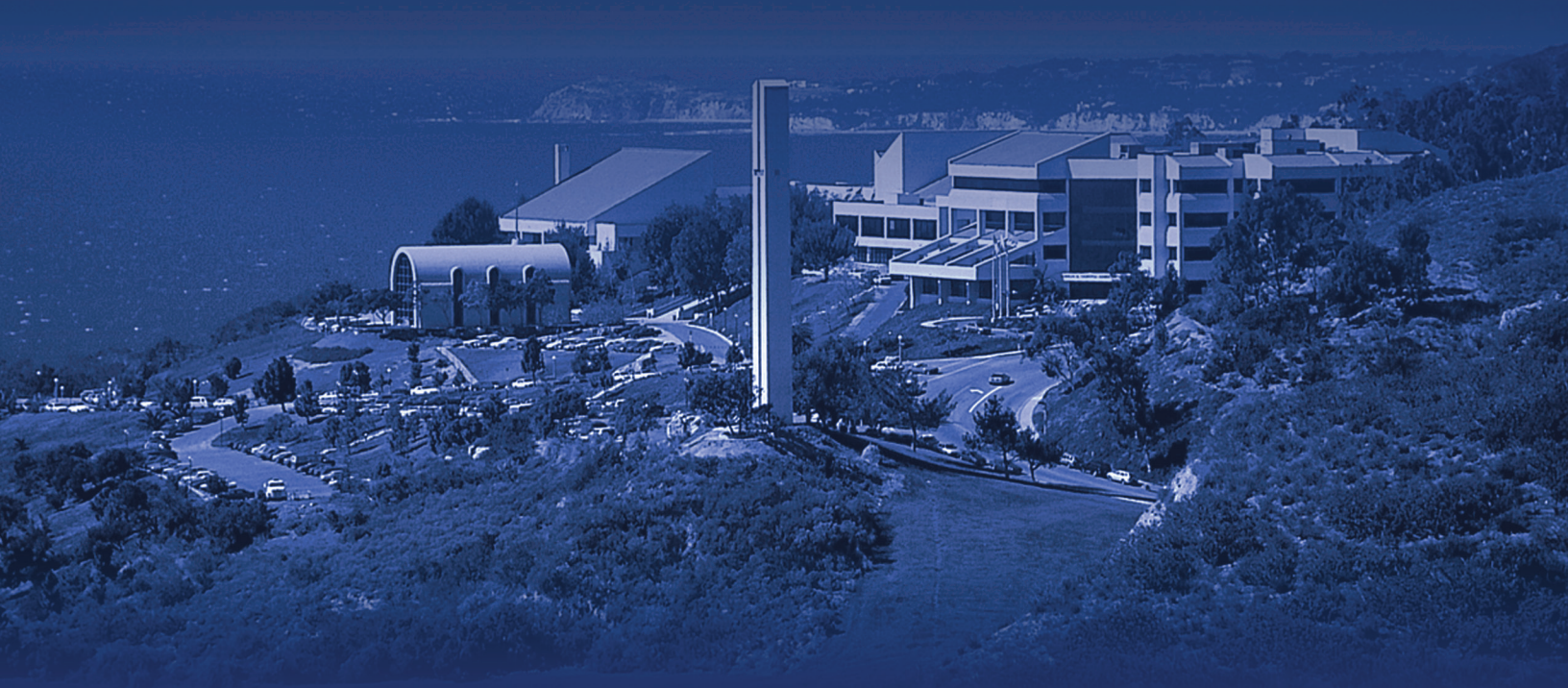
PEPPERDINE PRIVATE CAPITAL ACCESS INDEX



Quarterly Survey Report | Second Quarter 2014

PEPPERDINE PRIVATE CAPITAL MARKETS PROJECT
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Dun & Bradstreet Credibility Corp

Pepperdine Private Capital Index Survey Responses Second Quarter 2014

In an effort to gauge the demand of small and medium-sized businesses for financing needs, the level of accessibility of private capital, and the transparency and efficiency of private financing markets, Pepperdine University's Graziadio School of Business and Management and Dun & Bradstreet Credibility Corp. launched the Pepperdine Private Capital Access (PCA) and Private Capital Demand (PCD) Index. This index measures the demand for, activity and health of the privately-held businesses on a quarterly basis. This Index report was derived from survey results collected from May 9 to May 17, 2014 and contrasted with survey results collected from January 29 to February 28, 2014.

Second quarter survey results revealed that private capital access increased 2.3% compared to access three months ago. On the other hand, private capital demand decreased 3.7% compared to Q1 2014. 48% of respondents report the current business environment restricting their growth opportunities for business and 41% of respondents report the current business environment restricting their ability to hire new employees. 38% of business owners said they transferred personal assets to their business over the last 3 months. 43% of respondents have financing coming from outside sources.

The results also showed that about 58.4% of private businesses (who attempted to get financing) attempted to get a bank loan in the last three months and 54% of them were successful. 24.9% of those who attempted to get financing applied for asset-based loan and only 30% of them were successful.

About Pepperdine Private Capital Access and Private Capital Demand Index

The Q2, 2014 Private Capital Access and Private Capital Demand Index survey results were generated from responses by 1,251 business owners. Index weights were derived using factor analysis and then the resulting raw index values were scaled from zero to 100. The higher the value of the PCA Index or the PCD Index, the greater the access to capital or demand for capital, respectively. A value of less than 50 for an index represents a low level of access or demand, while a value greater than 50 can be interpreted as relatively high capital access or demand.

Businesses involved in services accounted for 36% of respondents followed by construction (9%), retail trade (9%) and finance & real estate (8%). Approximately 63% of respondents have less than or equal to $1 million in revenues, followed by 22% reporting between $1 million and $5 million. 43% of respondents have businesses that are older than 20 years, 22% of respondents have firms with age between 10 and 20 years, and 15% of respondents reporting their firm age between five and 10 years. Approximately 65% of respondents have less than or equal to five employees.

Q2-2014: Key Trends in the Private Capital Markets

In the past 3 months:

Private capital access increased 2.3%

Private capital demand decreased 3.7%

48% of respondents report the current business environment restricting their growth opportunities for business

41% of respondents report the current business environment restricting their ability to hire new employees

58.4% of private businesses who attempted to get financing tried to get a bank loan; 54% were successful

PCA and PCD Index Results – Whole Sample

Whole Sample	PCA Index	PCD INDEX
2012-Q2	27.8	37.0
2012-Q3	27.0	36.5
2012-Q4	27.3	35.1
2013-Q1	25.6	32.7
2013-Q2	26.8	33.4
2013-Q3	27.5	31.7
2013-Q4	27.8	32.8
2014-Q1	28.3	32.3
2014-Q2	28.9	31.1
Change	0.6	-1.2
Pct. Change	2.3%	-3.7%

The Q2, 2014 PCD Index number for the entire sample is 31.1, reflecting weakness in demand for external loans and other financing. This number represents a 3.7% decrease from the Q1, 2014 demand indication of 32.3. The Q2, 2014 PCA Index is 28.9, which is a 2.3% increase from the Q1, 2014 index value of 28.3. The PCA numbers reflect decreased difficulty securing loans and other business financing sources compare to PCA numbers in second quarter.

Small Business PCA and PCD Index Results (< $5M in Revenues)

The Q2, 2014 PCD Index number for small businesses is 32.1, reflecting weakness in demand for external loans and other financing. This number represents a 3.9% decrease from the Q1, 2014 demand indication of 33.4. The Q2, 2014 PCA Index for small businesses is 27.7, which is a 2.2% increase from the Q1, 2014 index value of 27.1.

Small Business PCA and PCD Index Results (< $5M in Revenues) Continued

<$ 5M Revs	PCA Index	PCD INDEX
2012-Q2	26.6	38.8
2012-Q3	26.0	38.0
2012-Q4	26.3	36.5
2013-Q1	24.6	33.2
2013-Q2	26.3	34.3
2013-Q3	26.8	32.3
2013-Q4	26.6	33.9
2014-Q1	27.1	33.4
2014-Q2	27.7	32.1
Change	0.6	-1.3
Pct. Change	2.2%	-3.9%

Lower Middle Market PCA and PCD Index Results ($5M – $100M in Revenues)

$5M-$100M	PCA Index	PCD INDEX
2012-Q2	34.7	32.3
2012-Q3	33.5	33.1
2012-Q4	32.7	31.5
2013-Q1	31.9	30.6
2013-Q2	34.3	28.7
2013-Q3	34.7	27.6
2013-Q4	33.7	26.3
2014-Q1	36.7	24.8
2014-Q2	37.0	24.9
Change	0.3	0.1
Pct. Change	0.8%	0.3%

Lower Middle Market PCA and PCD Index Results ($5M – $100M in Revenues) Continued

The Q2, 2014 PCD Index number for lower middle market companies is 24.9, reflecting continued weakness in demand for external loans and other financing. This number represents a 0.3% increase from the Q1 demand indication of 24.8. This is not a good sign for future growth. The Q2, 2014 PCA Index for lower middle market companies is 37.0, which is a 0.8% increase from the Q1 index value of 36.7. The PCA numbers reflect continued difficulty securing loans and other business financing sources. When compared to the small business indicators, lower middle market companies demonstrate lower demand (27.7 vs. 37.0) and higher access (32.1 vs. 24.9).

Current demand for external financing

Twenty-nine percent (29%) of respondents attempted to raise external financing in the last three months. Forty-three percent (43%) of respondents have financing coming from outside source, and seventy percent (70%) out of those respondents have business loans which required personal guarantee. Half of respondents (50.3%) indicated the need for external financing due to planned growth or expansion including acquisitions (not yet realized), 52.2% of respondents indicated need for external financing due to working capital fluctuations, and 41.4% of respondents indicated need for external financing due to increased demand already realized. Nearly forty-one percent (40.7%) of those who indicated need for external financing reporting high or extremely high need due to planned growth. Forty-eight percent (48%) of respondents believe the current business financing environment is restricting growth opportunities while 41% of respondents believe it restricting their ability to hire new employees.

Accessibility rate

Nearly sixty-six percent (66.1%) of respondents characterize the current business environment as difficult to raise new business financing and only 15% of respondents characterize the current environment in regards to raising new financing as easy. 54% of those who applied for bank business loan were successful. Thirty percent (30%) of respondents were successful obtaining asset based loans while 30% were able to raise private equity. Approximately five percent (5%) of respondents had community development financial institution as a source of financing in the last three months. Nearly forty-two percent (42.1%) of respondents indicated growth or expansion including acquisitions as their main purpose to raise external financing. Thirty-eight percent (38%) of business owners transferred personal assets to their business over the last 3 months.

Satisfaction rates

Respondents who raised financing from crowd funding, friends or family, grants, banks, leasing companies or trade credit are the most satisfied with pricing and contract terms, whereas respondents who raised financing through factor companies, private equity groups, mezzanine lenders and hedge funds are the least satisfied with pricing and contract terms. Respondents also indicated that raising financing from grants, friends and family, trade credit, banks, credit cards, crowd funding and leasing companies have easier general financing process. Fifty-six percent (56%) of those respondents who were unsuccessful in raising capital feel their general category of financing is still a good fit for their business.

Expected demand for external financing

Twenty-eight percent (28%) of respondents are planning to raise new financing in the next six months, 58% of respondents are not planning to raise financing in the next six months and 14% of respondents are unsure. The most popular reasons for not planning to raise financing are enough cash flow (67%), sufficient financing in place (36%), business would be rejected (12%) and weak economy (13%). Fifty-two percent (52%) of respondents indicated need for external financing due to planned future growth or expansion, 50% of respondents indicated need for external financing due to expected working capital fluctuations and 45% of respondents indicated need for external financing due to expected increase in demand.

Expected access rates

Nearly fifty-nine percent (59.2%) of respondents expect it would be a difficult business environment in which to raise new financing in the next six months, 23.8% of respondents expect it would be the same, and only 16.9% of respondents expect it would be easy. Sixty-six percent (66%) of respondents are planning to obtain a bank business loan, 31% of respondents are planning to apply for asset-based loan and 36% are planning to raise financing through business credit cards. Sixty percent (60%) of respondents indicated growth or expansion (including acquisition) as a main purpose to raise financing and 15% of respondents said the main purpose is working capital fluctuations. Respondents indicated higher confidence for successful financing from family and friends, credit cards, crowd funding, leasing companies and personal loans.

Hiring/growth outlooks and financing failure impacts

Forty-three percent (43%) of respondents are not planning to hire any additional employees in the next six months. Forty-six percent (46%) of respondents are planning to hire from one to five employees, and 6% of respondents are planning to hire from six to ten employees. 67% of respondents expect slower business growth if their business is unable to raise new external financing in the next six months, 52% of respondents will reduce number of employees, and 24% of respondents will sell the business or shut down. The average revenue change expectation in the next 12 months is 8.4%, although the average last 12 months revenue change was 2.9%.

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