PEPPERDINE PRIVATE CAPITAL ACCESS INDEX

Quarterly Survey Report | Fourth Quarter 2014

PEPPERDINE PRIVATE CAPITAL MARKETS PROJECT
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Q4-2014: Key Trends in the Private Capital Markets

Private capital access increased by 3.2%. This is up from Q3 and up from 2013.

Private capital demand increased 3.8% compared to Q3, but is still down from Q4, 2013.

42% of respondents report that the current business environment **restricts their ability to hire new employees,** unchanged from Q3.

33% of business owners said they **transferred personal assets** to their business, an increase from Q3.

44% of respondents have secured **financing from outside sources,** unchanged from Q3.

57.9% of those who attempted to get financing applied for a bank loan and of these, only 49% were successful. This is down from Q3 but up from 2013.

Pepperdine Private Capital Index Survey Responses Fourth Quarter 2014

In an effort to gauge small and medium-sized businesses' demand for financing and access to private capital, as well as 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. The Index measures the demand for capital, activity, and health of privately-held businesses on a quarterly basis. This Index report was derived from survey results collected from October 15 to November 7, 2014 and contrasted with survey results collected from July 22 to August 15, 2014.

Fourth quarter survey results revealed that private capital access increased by three percent (3.2%) compared to three months ago. Private capital demand increased almost four percent (3.8%). Fifty percent (50%) of respondents report the current business environment is restricting their growth opportunities and forty-two percent (42%) of respondents report the current business environment is restricting their ability to hire new employees. Thirty-three percent (33%) of business owners said they transferred personal assets to their business over the last three months. Forty-four percent (44%) of respondents have secured financing from outside sources.

The results also showed that almost fifty-eight percent (57.9%) of the private businesses that attempted to get financing sought a bank loan, and forty-nine percent (49%) of them were successful. About one third (27.8%) of those who attempted to get financing applied for asset-based loan and only thirty-three percent (33%) were successful.

About Pepperdine Private Capital Access and Private Capital Demand Index

The Q4, 2014 Private Capital Access and Private Capital Demand Index survey results were generated from responses by 2,131 business owners. Businesses involved in services accounted for thirty-two percent (32% of respondents, followed by construction (12%), retail trade (9%), and manufacturing (9%). Approximately sixty-four percent (64%) of respondents have less than or equal to $1 million in revenues, followed by twenty-three percent (23%) reporting between $1 million and $5 million. Forty-two percent (42%) of respondents have businesses that are older than 20 years. Fifty-eight percent (58%) of respondents have less than or equal to five employees.

Index weights were derived using factor analysis and the resulting raw index values were scaled from 0 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.

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
2014-Q3	28.7	29.2
2014-Q4	29.6	31.1
Change	0.9	1.1
Pct. Change	3.2%	3.8%

The Q4, 2014 PCD Index number for the entire sample is 31.1, reflecting weakness in demand for external loans and other financing. This number represents almost a four percent (3.8%) increase from the Q3, 2014 demand indication of 29.9. The Q4, 2014 PCA Index is 29.6, which is an increase of over three percent (3.2%) from the Q3, 2014 index value of 28.7. The PCA numbers reflect increased access to securing loans and other business financing sources compare to PCA numbers in third quarter.

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

The Q4, 2014 PCD Index number for small businesses is 31.9, reflecting weakness in demand for external loans and other financing. This number represents nearly a four percent (3.5%) increase from the Q3, 2014 demand indication of 30.8. The Q4, 2014 PCA Index for small businesses is 28.5, which is nearly a four percent (3.5%) increase from the Q3, 2014 index value of 27.5.

<$ 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
2014-Q3	27.5	30.8
2014-Q4	28.5	31.9
Change	1.0	1.1
Pct. Change	3.5%	3.5%

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

The Q4, 2014 PCD Index number for lower middle market companies is 25.5, reflecting continued weakness in demand for external loans and other financing. This number represents an increase of less than one percent (0.7%) from the Q3 demand indication of 25.3. The Q4, 2014 PCA Index for lower middle market companies is 37.5, which is an increase of less than six percent (5.4%) from the Q3 index value of 35.5. 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 (25.5 vs. 31.9) and higher access (37.5 vs. 28.5).

$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
2014-Q3	35.5	25.3
2014-Q4	37.5	25.5
Change	1.9	0.2
Pct. Change	5.4%	0.7%

Current demand for external financing

Twenty-eight percent (28%) of respondents attempted to raise external financing in the last three months. Forty-four percent (44%) of respondents have financing coming from an outside source. About fifty-two percent (51.6%) of respondents indicated a need for external financing due to working capital fluctuations, about fifty percent (50.3%) of respondents indicated need for external financing due to planned growth or expansion including acquisitions (not yet realized), and nearly forty-three percent (42.7%) of respondents indicated need for external financing due to increased demand already realized. Around forty-one percent (41.1%) of those who indicated a need for external financing reported high or extremely high need due to planned growth.

Accessibility rate

Sixty-two percent (62.2%) of respondents characterize the current business environment as difficult to raise new business financing and only about twenty percent (20.3%) of respondents characterize the current environment in regards to raise new financing as easy. Forty-nine percent (49%) of those who applied for a bank business loan were successful. Thirty-three percent (33%) of respondents were successful obtaining asset based loans while twenty-six percent (26%) were able to raise private equity. Approximately five percent (5%) of respondents used a community development financial institution as a source of financing in the last three months. Forty-three percent (43%) of respondents indicated growth or expansion including acquisitions as their main purpose in raising external financing. Thirty-three percent (33%) of business owners transferred personal assets to their business over the last three months.

Satisfaction rates

Respondents who raised financing from friends or family, grants, banks, trade credit, angels, or private equity groups are the most satisfied with pricing and contract terms, whereas respondents who raised financing through factor companies, venture capital firms, mezzanine lenders, and hedge funds are the least satisfied with pricing and contract terms. Respondents also indicated that raising financing from grants, crowd funding, trade credit, banks, credit cards, leasing companies, and angel capital have an easier general financing process. Over forty-five percent (45.3%) 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, fifty-six percent (56%) of respondents are not planning to raise financing in the next six months and sixteen percent (16%) of respondents are unsure. The most popular reasons for not planning to raise capital are having enough cash flow (69%), sufficient financing in place (32%), weak economy (12%), and belief that the business would be rejected (9%). Fifty-one percent (51%) of respondents indicated need for external financing due to planned future growth or expansion, half (50%) of the respondents indicated need for external financing due to expected working capital fluctuations, and forty-six percent (46%) of respondents indicated need for external financing due to expected increase in demand.

Expected access rates

Nearly fifty-eight percent (57.5%) of respondents expect it will be a difficult business environment in which to raise new financing in the next six months, almost twenty-six percent (25.9%) of respondents expect it will be the same, and about seventeen percent (16.5%) of respondents expect it would be easy. Sixty-seven percent (67%) of respondents are planning to obtain a bank business loan, forty percent (40%) of respondents are planning to apply for asset-based loan, and thirty-eight percent (38%) are planning to raise financing through community development financial institutions or credit unions. Sixty-one percent (61%) of respondents indicated growth or expansion (including acquisition) as a main purpose to raise financing and eighteen percent (18%) of respondents said the main purpose is working capital fluctuations. Respondents indicated higher confidence for successful financing from family and friends, credit cards, grants, leasing and factor companies, merchant cash advance, private equity groups, and personal loans.

Hiring/growth outlooks and financing failure impacts

Forty-two percent (42%) of respondents are not planning to hire any additional employees in the next six months. Forty-seven percent (47%) of respondents are planning to hire from one to five employees, and six percent (6%) of respondents are planning to hire from six to ten employees. Sixty-four percent (64%) of respondents expect slower business growth if their business is unable to raise new external financing in the next six months, thirty-seven percent (37%) of respondents will reduce number of employees, sixteen percent (16%) of respondents will sell the business or shut down and sixteen percent (16%) of respondents will hire fewer new employees than planned. Five percent (5%) of respondents directly tie their growth plans (expansion, inventory, hiring, etc.) to 2014 holiday season expectations (versus just within the next six months). Only three percent (3%) of respondents did hire additional workers for the 2014 holiday season. The average revenue change expectation in the next 12 months is a seven percent (7%) increase, although the average revenue change for the last 12 months was a nearly two percent (1.6%) increase.

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