PEPPERDINE
PRIVATE CAPITAL ACCESS INDEX

Quarterly Survey Report | Second Quarter 2013

PEPPERDINE PRIVATE CAPITAL MARKETS PROJECT
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Pepperdine Private Capital Index Survey Responses
Second Quarter 2013

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 April 4 to April 26, 2013 and contrasted with survey results collected from January 14 to January 28, 2013.

Second quarter survey results revealed that 59% of respondents report the current business environment as difficult to raise new business financing and only 33% of those who applied for business loans from a bank were successful. The research also shows that many small business owners are tapping into their personal assets to fill financing gaps with 41% of business owners saying they transferred personal assets to their business over the last 3 months.

Previous quarter results showed that about 54% of private businesses attempted to get a bank loan in the previous year and 40% of them were successful. Today, 33% of businesses were successful in securing a bank loan. The application-to-loan ratio is alarmingly low.

About Pepperdine Private Capital Access and Private Capital Demand Index

The Q2-2013 Private Capital Access and Private Capital Demand Index survey results were generated from responses by 1,948 business owners. Index weights were derived using factor analysis and then the resulting raw index values were scaled from zero to one hundred. 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 fifty for an index represents a low level of access or demand, while a value greater than fifty can be interpreted as relatively high capital access or demand.

Businesses involved in services accounted for 30% of respondents followed by construction (11%), retail trade (9%), and finance & real estate (9%). Approximately 69% of respondents have less than or equal to $1 million in revenues, followed by 17% reporting between $1 million and $5 million. 9% of respondents have negative net income, 56% of respondents have net income between $0 and $100,000, followed by 24% reporting between $100,000 and $500,000. 36% 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 5 and 10 years. Approximately 68% of respondents have less than or equal to five employees.

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
Change	1.2	0.7
Pct. Change	4.7%	2.1%

The Q2-2013 PCD Index number for the entire sample is 33.4, reflecting weakness in demand for external loans and other financing. This number represents a 2.1% increase from the Q1 demand indication of 32.7 (year low). The Q2 PCA Index is 26.8, which is a 4.7% increase from the Q1 index value of 25.6, but still 3.6% decline from the Q2-2012 index value of 27.8. The PCA numbers reflect slightly decreased difficulty securing loans and other business financing sources compare to PCA numbers in first quarter.

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

<$ 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
Change	1.7	1.1
Pct. Change	6.9%	3.3%

The Q2-2013 PCD Index number for small businesses is 34.3, reflecting weakness in demand for external loans and other financing. This number represents a 3.3% increase from the Q1 demand indication of 33.2. The Q3 PCA Index for small businesses is 26.3, which is a 6.9% increase from the Q1 index value of 24.6.

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

<$ 5M REVS	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
Change	2.4	-1.9
Pct. Change	7.5%	-6.2%

The Q2 PCD Index number for lower middle market companies is 28.7, reflecting weakness in demand for external loans and other financing. This number represents a 6.2% decrease from the Q1 demand indication of 30.6. The Q2 PCA Index for lower middle market companies is 34.3, which is a 7.5% increase from the Q1 index value of 31.9. 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 (28.7 vs. 34.3) and higher access (34.3 vs. 26.3).

Current demand for external financing

Twenty-six percent (26%) of respondents attempted to raise external financing in the last three months. About fifty four percent (54%) of respondents indicated need for external financing due to planned growth or expansion including acquisitions (not yet realized), 55.6% of respondents indicated need for external financing due to working capital fluctuations, and 47.1% of respondents indicated need for external financing due to increased demand already realized. Nearly forty-six percent (45.5%) of those who indicated need for external financing reporting high or extremely high need due to planned growth. Fifty-nine percent (59%) of respondents believe the current business financing environment is restricting growth opportunities while 52% of respondents believe it restricting their ability to hire new employees.

Accessibility rate

Sixty-eight percent (68%) of respondents characterize the current business environment as difficult to raise new business financing and only 16.5% of respondents characterize the current environment in regards to raise new financing as easy. Only 33% of those who applied for bank business loans were successful. Nineteen percent (19%) of respondents were successful obtaining asset-based loans while 20% were able to raise private equity. Forty-three percent (43%) of respondents indicated growth or expansion including acquisitions as their main purpose to raise external financing. Forty-one percent (41%) 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, or trade credit are the most satisfied with pricing and contract terms, whereas respondents who raised financing through mezzanine lenders, venture capital, personal credit cards, factor companies or private equity groups are the least satisfied with pricing and contract terms. Respondents also indicated that raising financing from mezzanine lenders, banks, angels, leasing companies and grants have easier general financing process. Forty-eight percent (48%) 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 6 months, 53% of respondents are not planning to raise financing in the next 6 months, and 19% of respondents are unsure. Fifty-three percent (53%) of respondents indicated need for external financing due to planned future growth or expansion, 52% of respondents indicated need for external financing due to expected working capital fluctuations, and 50% of respondents indicated need for external financing due to expected increase in demand.

Expected access rates

Sixty-five percent (65%) of respondents expect it would be a difficult business environment in which to raise new financing in the next 6 months, 15% of respondents expect it would be the same, and only 20% of respondents expect it would be easy. Sixty-three percent (63%) of respondents are planning to obtain a bank business loan, 44% of respondents are planning to apply for business credit line, and 37% are planning to raise financing from personal loan. Fifty-eight percent (58%) of respondents expect a need for external financing due to planned growth or expansion (including acquisition), and 19% of respondents expect to raise financing due to working capital fluctuations. Respondents indicated higher confidence for successful financing from personal credit cards, family and friends, crowd funding, trade credit, or leasing.

Hiring/growth outlooks and financing failure impacts

Forty-five percent (45%) of respondents are not planning to hire any additional employees in the next 6 months. Another forty-five percent (45%) of respondents are planning to hire from 1 to 5 employees, and 5% of respondents are planning to hire from 6 to 10 employees. 67% of respondents expect slower business growth if their business is unable to raise new external financing in the next six months, 48% of respondents will hire fewer employees than planned, and 17% of respondents will reduce number of employees. The average revenue change expectation in the next 12 months is 6.2%, although the average last 12 months revenue change was -0.4%.

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