

»»» Private equity sentiment turns negative at start of year

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- Private equity sentiment in the red again, current business situation just barely positive despite decline, expectations have fallen more steeply
- Economic climate has cooled off drastically, fundraising, interest rate and valuation indicators have also fallen sharply
- Indicator for investment appetite has dropped significantly

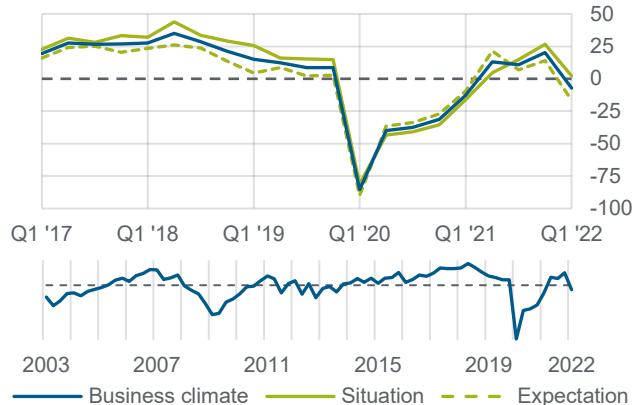
Private equity market sentiment has cooled off noticeably

Private equity sentiment experienced a sharp decline in Germany at the start of the year. The sentiment indicator of the later-stage segment slipped by 27.5 points to -7.2 balance points. The escalation of the war in Ukraine and resulting high economic uncertainty were likely the main cause for the drop in sentiment. The indicator for the current business situation fell by 24.4 points to 2.2 balance points, hovering just slightly above the long-term average. The indicator for business expectations plunged by 30.6 points to -16.5 balance points.

Most sentiment components have dropped

The decision by international central banks to speed up the interest rate reversal has led to a sharp drop in assessments of the interest rate level. The announcement of interest rate hikes reduces company valuations and makes fundraising more difficult, causing these indicators to drop significantly as well. In return, the indicator of entry valuations for new investments has climbed above zero for the first time since early summer of 2020 and is now just above its long-term average. Assessments of deal flow show a mixed trend. The indicator of the quantity of deal flow improved, but the indicator of the quality of deal flow dropped just slightly below its long-term average. Both are likely the result of the gloomier economic outlook for German SMEs caused by the war. The economic climate has cooled off drastically in the view of investors – even more steeply than during the coronavirus shock. This poorer economic outlook may have led to increased demand for private equity from SMEs (particularly where access to credit becomes more difficult due to the interest rate reversal) while disqualifying this demand from an investor's point of view. Their investment appetite appears to have decreased in response to this confluence of factors; the corresponding indicator has fallen sharply.

Development of private equity sentiment indicator



Key data of private equity sentiment components

Values in balance points

	Q1/22	△ vs. Q4/21	High	Low
Business climate	● -7.2	⬇️ -27.5	⬆️ +35.0	➡️ -85.5
Business situation	● +2.2	⬇️ -24.4	⬆️ +44.0	➡️ -81.0
Business expectations	● -16.5	⬇️ -30.6	⬆️ +26.0	➡️ -90.0
Fundraising	● -7.4	⬇️ -41.2	⬆️ +43.9	➡️ -70.6
Entry evaluations	● +1.4	⬆️ +15.8	⬆️ +62.3	➡️ -32.5
New investment	● +6.4	⬇️ -10.0	⬆️ +26.9	➡️ -77.4
Exit opportunities	● +9.6	⬇️ -14.8	⬆️ +54.7	➡️ -88.5
Dealflow quantity	● +15.5	⬆️ +6.5	⬆️ +21.9	➡️ -29.0
Dealflow quality	● -0.9	⬇️ -8.7	⬆️ +23.3	➡️ -24.3
Taxation framework	● +26.4	➡️ +4.4	⬆️ +26.4	➡️ -40.0
Write-downs	● -5.6	⬇️ -28.5	⬆️ +31.6	➡️ -54.4
Economic development	● -68.6	⬇️ -80.3	⬆️ +72.0	➡️ -93.0
Interest rates	● -39.3	⬇️ -33.0	⬆️ +32.7	➡️ -80.3

Colour scheme of sentiment indicator dots: values in the lowest tercile are marked 'red', in the medium tercile 'amber' and in the highest tercile 'green'. Indicator design may lead to deviations from previous publications.

Source: KfW Research, BVK and DBVN.

Comments on the current trend

'Just after it resumed its previous upward trend, sentiment in the German private equity market cooled off noticeably at the start of the year as a result of the dramatic developments', said Dr Fritz Köhler-Geib, Chief Economist of KfW. 'The escalation of the war in Ukraine has further increased the strain on the partly broken supply chains. This is weighing on the mood of SMEs and, hence, its investors. Despite higher demand for capital, their appetite for investments has obviously started to wane. The uncertain effects of the war on the energy supply of German enterprises are sure to contribute to this.'

'The interest rate reversal, Ukraine and the gloomier economic outlook are massive factors of uncertainty which are burdening the economy in general and SMEs in particular. This uncertainty makes it increasingly more difficult to plan the business development of existing portfolio enterprises but also possible new investments by private equity companies', said Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). 'So it is not surprising that many private equity investment firms are rather cautious with new investments in this environment, even though they rate the level of entry valuations more positively overall. The flipside is that pressure on valuations of the existing portfolio is growing in the medium term and the fundraising climate is deteriorating.'

Calculation of the German Private Equity Barometer

The **German Private Equity Barometer** is based on a quarterly survey of the members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK), the member investors of the Deutsche Börse Venture Network (since the 2nd quarter of 2021) and further private equity companies with registered offices in Germany. It reports on business sentiment in the German private equity market on the basis of assessments provided by private equity firms with a focus on mature small and medium-sized enterprises. All sentiment indicators represent the average of the balance of situation assessments (share of 'good' minus share of 'bad') and the balance of expectations identified at the same time for the coming six months, adjusted by their respective historical mean balance values. Because of the way the barometer is constructed, positive indicator values point to above-average sentiment and negative values to below-average sentiment.

The **German Venture Capital Association** is the voice in the face of the private equity industry in Germany. The association is committed to improving conditions and facilitating access to private equity so that even more businesses in Germany can benefit from private equity. It has some 300 members. These include around 200 private equity companies and investors as well as some 100 consulting firms and service providers of the industry.

The **Deutsche Börse Venture Network (DBVN)** was launched in 2015 and is now Europe's largest network for growth finance and 'Capital Market Readiness'. It focuses on providing efficient access to capital and has an extensive range of networking and training services. The network of more than 200 fast-growth businesses and more than 450 investors has already enabled 13 IPOs and numerous trade sales.



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