

Private equity sentiment drops to crisis level

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- Outlook remains very pessimistic: business expectations significantly below situation assessments
- Fundraising and exit environment has declined sharply again
- Indicators of economic activity and interest rate level have dropped to new all-time lows

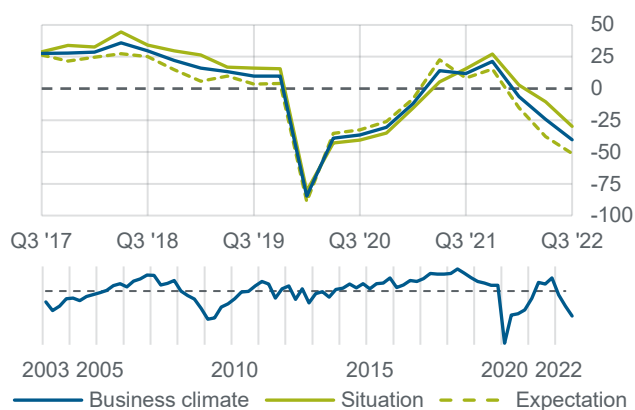
The private equity market is in a 'crisis mood'

The German private equity market experienced yet another sharp loss of confidence in the third quarter of this year. The business climate indicator fell by 16.2 points to -40.4 balance points. The only time the level has ever dropped this low was during the financial crisis at the beginning of 2009 and the outbreak of the coronavirus pandemic in 2020. Situation assessments dropped slightly more steeply than expectations. The indicator for the current business situation nosedived by 19.2 points to -29.7 balance points, while the indicator for business expectations dropped by 13.3 points to -51.1 balance points. With a gap of -21.4 points between situation assessments and the reduced expectation level, private equity investors anticipate a continuing substantial deterioration of the environment in the next six months.

Beginning recession is ruining sentiment

Germany is drifting into recession. As a result, the economic sentiment indicator has fallen sharply to a new low. Given the aggressive key interest rate rises introduced to combat high inflation rates, the sentiment indicator on interest levels also slipped further and now marks a new all-time low. Debt capital typically plays a large role in private equity transactions, which may serve to explain why sentiment has responded so vigorously to rising interest rates. Not only do they weigh on the fundraising activities of new PE funds, they also make borrowing more costly. The impact of disrupted supply chains and increased energy prices on the economy has already put pressure on the German stock market since the start of the year. The increasingly growing prospect of recession has significantly increased that pressure, leading to the second strongest decline in the sentiment indicator on valuation adjustments. Entry valuations, however, have not been able to benefit further. Their indicator remains hardly unchanged in the green. The indicators on deal flow show that the economic environment appears to have made potential target enterprises less common and more unattractive. Given the situation on the stock market and growing economic worries of potential buyers, exit opportunities are also becoming increasingly limited. The exit environment is therefore cooling off more and more.

Development of private equity sentiment indicator



Source: KfW Research, BVK and DBVN.

Key data of private equity sentiment components

Values in balance points

	Q3/22	Δ Q2/22	Low	High
Business climate	-40.4	↓-16.2	-84.7	+35.8
Bus. situation	-29.7	↓-19.2	-80.5	+44.5
Bus. expectations	-51.1	↓-13.3	-88.9	+27.2
Fundraising	-55.9	↓-24.0	-69.5	+45.1
Entry valuations	+20.6	↔+0.4	-33.1	+61.7
Exit opportunities	-48.9	↓-20.7	-87.8	+55.4
New investment	-11.2	↓-8.4	-76.9	+27.4
Dealflow quantity	-8.6	↓-13.8	-28.9	+21.9
Dealflow quality	-7.1	↓-11.1	-24.3	+23.3
Dealflow innovativeness	-6.5	↑+9.3	-46.5	+33.1
Taxation framework	-6.9	↓-8.4	-38.9	+24.7
Write-downs	-35.8	↓-28.8	-53.6	+32.4
Economy	-92.8	↓-17.8	-92.8	+74.1
Interest rates	-89.5	↓-13.8	-89.5	+34.8

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

Dr Fritzi Köhler-Geib,
Chief Economist of KfW

'Germany is on a pathway to recession, which clearly weighs on business sentiment in the German private equity market', said Dr Fritzi Köhler-Geib, Chief Economist of KfW. 'The steep interest rate rises, which are likely to continue, are a challenge not just for the typical private equity financing strategy but for target enterprises, which are additionally being plagued by strong increases in energy costs. For many businesses, the top priority for now is to get through winter as unscathed as possible. After that, a great deal of uncertainty will be removed. But labour shortages, supply bottlenecks and the energy crisis will force many businesses to reposition themselves. It is very likely that this will generate investment opportunities for private equity investors.'

Ulrike Hinrichs,
Managing Director of the German Private Equity and Venture Capital Association (BVK)

'The private equity market cannot decouple itself from the overall economic environment. This applies even more to the later-stage segment than to the venture capital segment. By now, a recession is clearly being priced in, which also explains the historically low valuation of the economic environment,' said Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). 'The competition for the most attractive businesses in the current environment is likely to intensify. At the same time, existing portfolio companies must be steered through the crisis. In the long term, the difficult exit environment and the fundraising situation will prove to be the greatest burden.'

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.



Bundesverband Deutscher
Kapitalbeteiligungsgesellschaften e.V.

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.

Deutsche Börse
Venture Network