Successful start for equity investors

Very good business climate but diverse momentum: early-stage investors were more confident as the mood among later-stage investors calmed down

Fundraising climate reached new peak

Extreme differences in demand: venture capital on record high level while later-stage funding dropped to all-time low

Equity investors went into 2017 with great confidence

The business climate in the German private equity market changed very little at the start of the year and remained on a very high level. In the first quarter of 2017 the business climate index of the German Private Equity Barometer stood at 61.8 balance points (-0.2 points). At the same time, the indicator for the current business situation climbed moderately by 0.5 points to 65.1 balance points, while business expectations fell slightly by 1.0 points to 58.6 balance points. The trend in the sub-markets was again uneven, but the direction reversed compared with the preceding quarter. While early-stage investors became more confident, later-stage investors were more subdued after the preceding record quarter.

At the start of the year there were no significant changes to the most important factors of the market environment. Investors remained dissatisfied with entry prices but were very happy with exit opportunities and fundraising – giving the latter another slightly improved record high rating.

Early-stage investors were again in high spirits

The business climate in the venture capital market recovered from its decline in the final quarter of last year. The business climate indicator of the early-stage segment rose by 11.3 points to 59.7 balance points in the first quarter of 2017. Investors gave nearly identical ratings to their business situation and business expectations. The indicator for the current business situation rose by 9.8 points to 59.7 balance points, while the indicator for business expectations increased by 12.8 points to 59.8 balance points.

Three records were broken in the VC market environment: the fundraising climate, public support and the level of deal flows have never been rated better. Exit opportunities and the deal flow quality were also rated very positively. Entry prices also appear to be improving. The level of dissatisfaction has tended to decrease since it hit rock bottom in the third quarter of 2015.
Sentiment in the later-stage segment remains high

The business climate in the later-stage segment of the private equity market cooled off slightly after the preceding quarter’s record high. The business climate indicator was down 7.2 points to 63.5 balance points in the first quarter of 2017 but remained on a very high level. At the same time, the indicator for the current business situation fell by 4.7 points to 69.2 balance points, while the indicator for business expectations dropped by 9.8 points to 57.8 balance points.

The main market environment factors boosted the business climate through an improved fundraising climate, which reached a new record level in the later-stage segment as well, and through exit opportunities that continued to receive very high ratings. By contrast, later-stage investors were more dissatisfied with entry prices than ever before, as well as with the levels of their deal flows. Moreover, the deal flow quality deteriorated substantially on the preceding quarter and the pressure on write-downs has increased profoundly. These are also the reasons for the drop in the business climate.

Investors started the year with confidence

The business climate in the German private equity market remained outstanding at the start of the year 2017. Early and later-stage investors converged again in their assessment of the business climate. Their views of the most important factors influencing sentiment remained nearly unchanged. Investors remained dissatisfied with entry prices – both in the early stage and in the later stage. However, their assessments of exit opportunities and fundraising, which reached a new record level, provided a glimmer of hope. Unlike their colleagues in the later stage, early-stage investors were happy with the strength of their deal flows.

In the first quarter, the Federal Cabinet approved the expansion of the German VC market. This has probably lifted the mood in the early-stage segment. At any rate, the assessment of the promotional climate has reached a new high.

“The current market environment is pointing to a very good VC year 2017”, said Dr Jörg Zeuner, Chief Economist of KfW. But he is concerned about the poor demand in the later stage segment. “We must also lead established companies into the next generation because SMEs will not be spared from the disruption of digitalisation. Private equity can be the right way to mobilise the necessary investments.” Zeuner sees political uncertainty as a risk. “Investors do not like uncertainty. Two thirds of equity investors fear negative impacts in the German private equity market if the EU is further weakened. So the outcome of the run-off election in France is good news against this background as well.”

“The continuing positive sentiment points to a stable market that is defying numerous odds, particularly with a view to the general political climate. This stability is good news for business founders and SMEs in search of capital”, added Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). Hinrichs is not surprised by the critical assessment of deal flows in the later stage. “That is an effect of the low-interest phase. Business owners are finding few attractive investment alternatives and therefore are holding off on the sale of their businesses. Besides, many businesses have been able to build up financial reserves in the past years when the economy was strong, and banks are offering good businesses very favourable lending terms.” Hinrichs emphasised the positive promotional climate for the early stage. “This assessment reflects the many measures which the German Federal Government has recently introduced to improve the environment for venture capital and business founders. They should translate into investment growth going forward.”
## Calculation of the German Private Equity Barometer

The German Private Equity Barometer is based on a quarterly survey which the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK) conducts among its roughly 250 members and further German private equity companies. The German Private Equity Barometer reports the business climate in the German private equity capital market. The business climate is calculated as the mean of the net balance of the weighted assessments of the current business situation (positive responses minus negative responses, expressed as a percentage) and the equivalent net business expectations for the coming six months. The responses provided by interviewees are weighted to reflect the volume of capital under management and the investment focus of the market.