

Year started off on a subdued note

28 May 2019

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- Early stage sentiment slips from record high level but remains good
- Later-stage climate stabilises
- VC fundraising climate climbs to all-time high, entry prices ease

Business climate drops at start of year

Sentiment in the German private equity market continued to fall after the turn of the year as well. In the first quarter of 2019, the business climate index of the German Private Equity Barometer dropped by 3.1 points to 64.7 balance points. Market players viewed the current business situation more negatively and had more pessimistic expectations. The indicator for the current business situation dropped by 2.7 points to 70.7 balance points, while the indicator for business expectations fell 3.5 points to 58.6 balance points. The market environment, however, has exhibited varying developments. The fundraising climate improved substantially and remained just under its all-time high. Assessments of the level of deal flow, in turn, reached a new record. In addition, the easing of the price environment in the past quarters led to greatly improved satisfaction with entry valuations. At the same time, this development is coupled with a sharp drop in assessments of exit opportunities. Investors also assessed write-down pressure more negatively again, which is now higher than average.

VC business climate remains very good despite drop

The business climate in the VC market was unable to maintain the record level from the final quarter of the previous year and cooled at the start of the year. The business climate indicator of the early-stage segment fell by a relatively sharp 12.6 points to 66.7 balance points in the first quarter of 2019. VC investors have further downgraded their assessments of their current business situation and their expectations. The indicator for the current business situation fell to 71.1 balance points (-11.5), while the indicator for business expectations dropped to 62.4 balance points (-13.7). The VC market environment remains strong, however. The fundraising climate scaled new heights to beat the previous record of the final quarter of 2017. Assessments of the strength of deal flow also continued trending upwards and climbed to a new record high. Moreover, entry prices eased noticeably. Assessments of deal flow quality and exit opportunities, on the other hand, slipped back into their 'normal' range.

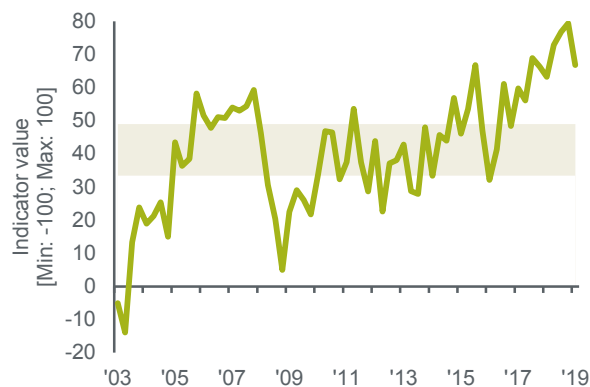
Business climate indicator – overall market



Note: The grey shaded area shows the normal range defined on the basis of historic indicator values.

Sources: KfW Research, BVK.

Business climate indicator – early-stage market



Note: The grey shaded area shows the normal range defined on the basis of historic indicator values.

Sources: KfW Research, BVK.

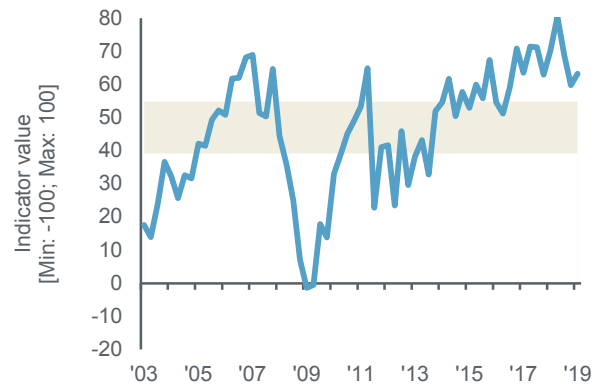
Later-stage climate stabilises

After dropping sharply in the second half of 2018, sentiment in the later-stage segment stabilised at the start of the year. The business climate indicator rose slightly by 3.5 points to 63.2 balance points in the first quarter of 2019. Later-stage investors rated both their current business situation and their business expectations slightly more positively again. The indicator for the current business situation rose to 70.4 balance points (+3.4), while the indicator for business expectations climbed to 56.0 balance points (+3.6). Despite the drop in sentiment in the second half of 2018, the market environment appears to be very stable so far. The fundraising climate is on a very high level and assessments of deal flow level and quality and of companies' innovation activity are rated 'good'. In addition, later-stage investors' dissatisfaction with entry prices at the start of the year improved significantly. By contrast, the exit environment has worsened, particularly the assessments of the IPO exit channel. Opinions here shifted within four quarters from a record high in the first quarter of 2018 to now well below average.

Market is showing signs of change

The business climate in the German private equity market cooled slightly at the start of the year 2019. However, in the early-stage segment the situation is different from that of the later stage segment. While the early-stage climate was 'merely' unable to maintain its record level, the later-stage climate cooled noticeably in the second half of 2018 already but has now stabilised. At the same time, both segments are in a similar and so far stable market environment. That environment, however, changed significantly at the start of the year. The past four years saw high levels of dissatisfaction with entry prices demanded in new transactions. On the other hand, exit opportunities for divestments were very good. Dissatisfaction with the price environment now eased noticeably at the beginning of the year, while assessments of exit opportunities fell sharply. "The fundraising climate has been very good for some time now and kept entry prices high", said KfW economist Dr Georg Metzger. "Even the growing number of investment opportunities did nothing to change this. Now, however, the negative mood in the stock markets has impacted on entry prices. Equity investors are likely to take advantage of this for new business."

Business climate indicator – later-stage market



Note: The grey shaded area shows the normal range defined on the basis of historic indicator values.

Sources: KfW Research, BVK.

Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK), added: "The minor current downturn in sentiment means confidence has stabilised on a high level and merely underscores that the equity market is quite capable of correcting itself and not turning into a bubble unchecked, as some observers have already postulated. This is also consistent with the fact that we have evidently reached peak price levels. With a view to the industry's future, it is now important to make use of the good fundraising environment and secure new funds for investment in the future. After all, demand for equity capital from companies of all sizes remains unabated." ■

KfW Research

German Private Equity Barometer: 1st Quarter 2019

Annex: Sentiment in the German private equity market in figures

German Private Equity Barometer

Differences to previous publications are due to extrapolation.

Sentiment indicators		Q1/2003 to Q1/2019		2017			2018				2019
		Max	Avg.	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Business climate	Total	77.0	44.0	65.2	70.2	64.3	66.9	77.0	72.3	67.8	64.7
	Early	79.4	41.4	56.1	68.9	66.3	63.2	72.8	76.8	79.4	66.7
	Later	80.4	45.9	71.4	71.2	62.9	70.2	80.4	69.0	59.8	63.2
Market climate											
Fundraising	Total	79.0	16.1	56.2	60.8	79.0	67.1	59.9	71.9	66.1	76.6
	Early	82.4	0.1	58.4	48.6	74.8	61.5	53.0	64.5	65.4	82.4
	Later	82.3	28.8	54.5	73.9	82.3	73.0	65.9	77.9	66.6	72.3
Entry prices	Total	62.7	-1.8	-45.6	-43.7	-49.4	-42.9	-41.3	-35.5	-31.0	-12.2
	Early	70.9	22.1	-27.5	-15.6	-27.9	-18.9	-25.7	-1.0	-0.5	13.9
	Later	54.5	-19.3	-58.2	-67.3	-64.9	-66.1	-53.8	-61.0	-51.8	-30.2
Exit opportunities	Total	72.0	14.6	51.7	72.0	60.3	59.6	49.4	65.8	53.3	28.5
	Early	59.9	2.4	33.9	59.9	51.5	56.9	35.0	57.6	37.1	20.5
	Later	80.8	23.1	63.7	80.8	67.0	62.3	61.0	72.6	64.3	34.7
Level of demand	Total	68.3	46.8	44.4	51.0	56.9	56.8	64.3	62.7	63.0	68.3
	Early	91.0	56.5	61.2	63.5	72.3	78.7	79.0	82.6	85.9	91.0
	Later	65.9	40.6	32.9	40.5	45.5	37.0	52.8	48.4	47.1	52.4
Quality of demand	Total	43.0	26.8	30.2	32.0	29.3	28.2	40.2	43.0	32.1	34.3
	Early	63.8	33.4	17.0	24.3	19.8	27.7	40.4	44.6	45.1	37.7
	Later	43.2	22.1	39.2	38.1	36.2	28.6	40.1	41.9	23.2	31.9

Sources: KfW Research, BVK.

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.