

Recovery has stalled: great setback for private equity sentiment

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- Situation assessments have fallen, expectations also deteriorated
- Assessments of interest rate level have improved surprisingly, expectations dominate
- Opinions on availability and terms of acquisition finance hit rock bottom

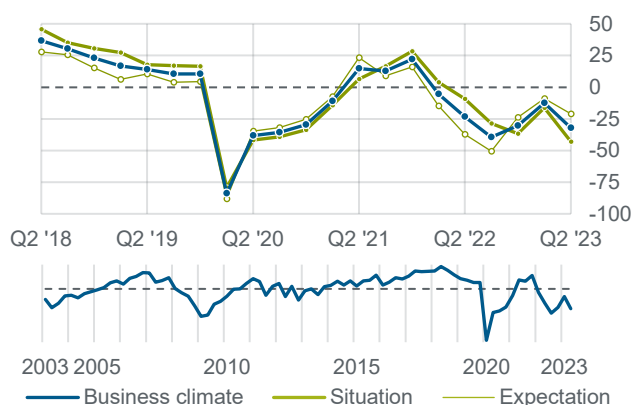
Sentiment upturn stalls abruptly

Sentiment in the German private equity market cooled off again significantly in the second quarter of 2023. The business sentiment indicator fell by -19.5 points to -32.0 balance points. Situation assessments fell steeply and expectations also deteriorated. Thus, the indicator for the current business situation decreased by 26.8 points to -43.0 balance points and the indicator for business expectations dropped by 12.3 points to -21.1 balance points.

Economic pessimism has returned

The gravest economic worries had initially eased at the start of the year, making the economic development of (potential) portfolio enterprises more predictable again. That significantly boosted sentiment among PE investors. But business confidence in the German economy has now clouded over again after a series of disappointing economic data. This is obviously weighing on the mood of private equity investors. The returning uncertainty around (potential) portfolio enterprises is also leading to lower assessments of deal flow. They are decreasing with respect to both level and quality and now lie just below the long-term average. This situation explains the reluctance to engage in new investments despite the continued very positive assessments of entry valuation levels. This has not reduced the willingness to engage in new investments within the next six months, giving cause for hope. However, the most recent key interest rate rises will increase the cost of debt capital, which is typically used for PE transactions. The sentiment indicators for the availability and conditions of acquisition finance have thus hit new lows. Despite the most recent key interest rate increases, assessments of the interest rate level in the capital markets have surprisingly risen. This is mainly due to expectations, which improved more strongly than situation assessments. One reason for the positive development might be that an end to the central banks' interest trajectories is slowly coming into view. This does nothing to change the actual interest rate level but the negative mood here in any case has less to do with the level than with the speed of the interest rate reversal.

Development of private equity sentiment indicator



Source: KfW Research, BVK and DBVN.

Key data of private equity sentiment components

Values in balance points

	Q2/23	Δ Q1/23	Low	High
Business climate	-32.0	↓-19.5	-83.7	+36.8
Business situation	-43.0	↓-26.8	-79.3	+45.7
Business expectations	-21.1	↓-12.3	-88.2	+27.9
Fundraising	-36.3	⇨+0.9	-67.9	+46.7
Entry valuations	+31.4	↓-6.3	-34.5	+60.3
Exit opportunities	-33.8	↓-14.7	-86.6	+56.6
New investment	-2.4	⇨-4.1	-77.0	+27.3
Dealflow quantity	-4.2	↓-18.7	-29.1	+21.8
Dealflow quality	-5.9	↓-17.6	-24.3	+23.3
Depreciations	-27.4	⇨-2.3	-52.7	+33.4
Economy	-51.0	↓-7.8	-90.9	+76.1
Interest rates	-75.0	↑+13.7	-88.8	+37.7
Availability M&A fin.	-74.7	↓-22.2	-74.7	+34.5
Conditions M&A fin.	-92.5	↓-19.3	-92.5	+35.4

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

“The sentiment turnaround in the German private equity market has ended abruptly”, said Dr Fritzi Köhler-Geib, Chief Economist of KfW. “The dark clouds that are gathering on the economic horizon again have obviously spoiled the mood for private equity investors. The bleaker economic outlook is affecting investor mood through their portfolio and potential target companies. The most recent interest rate increases also contributed to the setback because they lead to lower availability and less favourable terms for the debt capital typically used for the transactions. However, expectations for new exposures envisaged for the rest of the year are still positive, which gives cause for hope.”

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

“The macroeconomic environment has choked off the budding rebound in sentiment of the past two quarters”, said Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association. “The uncertainties about the economic development of both portfolio and potential target companies have likely increased and are thus weighing incessantly on sentiment. Market sentiment will not improve substantially until the economic worries and interest rates abate. Assessments of deal flow and transaction financings will then brighten again as well. On the investment side, however, challenging times also provide attractive entry or add-on opportunities for an existing portfolio. The persistently positive assessments of entry valuations underscore this.”

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 Beteiligungskapital – 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, normalised to their respective historical mean balance values as baseline level. As a result, the maximum or minimum value of the indicator may exceed or fall below +100 or -100 as the actual maximum or minimum. 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 Private Equity and Venture Capital Association (BVK)** is the voice and 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
Beteiligungskapital 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