

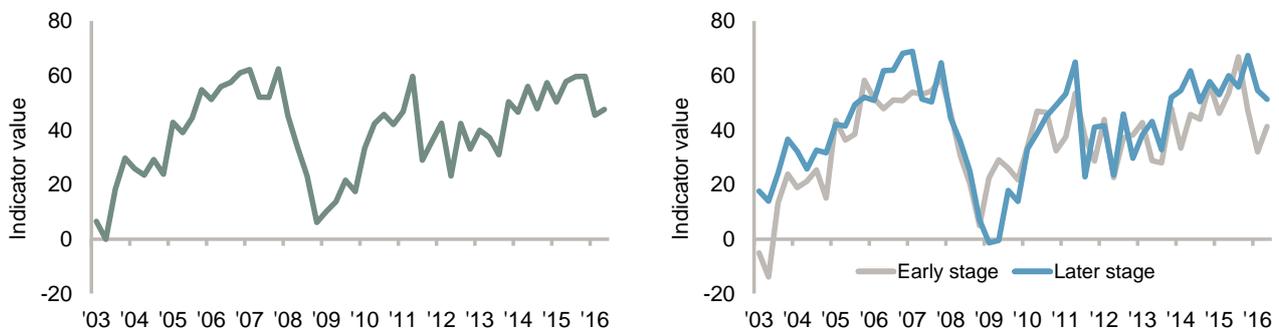
»» Business sentiment is stabilising again

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- Investors again deeply dissatisfied with entry prices, but exit climate has reached a high
- Demand for VC has reached a record level – but VC providers deplore quality and innovative content
- Demand for later stage equity capital is near its low

German Private Equity Barometer – business climate



Source: KfW Research, BVK

Business climate held steady in early summer

Sentiment on the German private equity market stabilised again in early summer. After the slump at the start of the year, the business climate index of the German Private Equity Barometer rose slightly by 2.2 points to 47.6 balance points in the second quarter of 2016. At the same time, the indicator for the current business situation fell by a moderate 1.6 points to 49.3 balance points, while the indicator for business expectations strengthened somewhat and increased by 5.9 points to 45.9 balance points. Unlike the preceding quarter, market sentiment in the early-stage and later-stage segments is currently moving in opposite directions. After the business climate in the early-stage segment fell from its record high to below its historic mean value within half a year, it recovered significantly in early summer. Market sentiment in the later-stage segment, in turn, has fallen slightly.

Early-stage financiers are more optimistic

Sentiment among early-stage financiers improved noticeably in early summer. In the second quarter of 2016 the business climate indicator rose 9.3 points to 41.3 balance points and is now significantly above its historic mean value after the sharp sentiment correction in the previous quarters. Early-stage financiers are taking a much more positive view again of both their current business situation and their expectations for the future. The indicator for the current business situation has climbed 9.4 points to 42.7 balance points, while the indicator

for business expectations has improved by 9.2 points to 39.9 balance points. The early-stage financiers' assessments of market factors varied. The fundraising and exit climate both remained unchanged on a high level. Pressure on write-downs has also remained on a normal level and entry prices are still unfavourable. There were more vigorous corrections to deal flow, however. While their assessment of the intensity of VC demand jumped to a record high, early-stage financiers were more unhappy with the quality of demand than they have been since early 2009. Their assessment of its innovative content is also much more negative than before, but remains on a very high level overall.

Sentiment of later-stage financiers is down again

The sentiment correction continues in the later stage of the private equity market. Although the business climate indicator fell only slightly by 3.3 points to 15.3 balance points in the second quarter of 2016, it still just barely remains on a good level. The renewed drop in sentiment was due to a more negative assessment of the current business situation, while expectations for the future have improved slightly. The indicator for the current business situation dropped by 9.7 points to 53.1 balance points, while the indicator for business expectations has improved by 3.1 points to 49.5 balance points. The fundraising climate and pressure on write-downs were given almost the same very good rating, and the exit climate, particularly for trade sales, has returned to a very high level. By contrast, assessments of entry prices

and demand for equity capital have fallen near their lows. The assessment of the innovative content of potential target enterprises has virtually plummeted, in a similar way as the trend in the early-stage segment.

Market sentiment at a crossroads?

Sentiment on the German private equity market stabilised in early summer. In the early-stage segment the mood improved after the previous slump. The business climate index jumped above its long-term mean value again. In the later-stage segment the business climate remained good despite the drop. The situation on the equity market is currently mixed. On the fundraising and exit side it is very good in a long-term comparison. On the investment side, however, entry prices are still being perceived as too high, while the quality of deal flow is causing some dissatisfaction. Even if screening new investment opportunities and investment negotiations currently requires greater effort, equity providers continue to exhibit a strong willingness to

invest. And prospects are good as well. "We expect the business climate to improve in the current quarter", said Dr Jörg Zeuner, Chief Economist of KfW Group. "For the young innovative growth enterprises to take advantage of this, it will remain crucial for them to convince their investors of their competitive advantages. A successful strategy includes realistic forecast scenarios as well as the right choice of investors with industry knowledge." Ulrike Hinrichs, Executive Board Member of the BVK (German Private Equity and Venture Capital Association), added: "private equity is popular with start-ups and SMEs, which is reflected accordingly in increased demand. While this enables investors to choose from a number of investment options, they also need to be able to identify the most promising enterprises. The lively investment activity especially in the venture capital market demonstrates that this works. I therefore expect sentiment to continue trending positive in the second half-year, also because of an improving business outlook." ■

Appendix: Equity market climate in figures

German Private Equity Barometer

Climate indicators		Q1/2003 to Q2/2016		2014		2015				2016	
		Max	Ø	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Business climate	Total	62.4	39.4	47.8	57.4	50.3	57.8	59.7	59.7	45.4	47.6
	ES	66.8	36.5	43.9	56.8	46.1	53.5	66.8	47.1	32.0	41.3
	LS	68.9	41.5	50.4	57.8	52.9	60.0	55.8	67.4	54.6	51.3
Market factors:											
Fundraising	Total	58.3	6.1	34.5	38.5	41.8	38.3	48.1	58.3	38.8	39.9
	ES	42.4	-11.5	5.8	26.2	11.8	-17.0	13.7	42.4	10.2	10.2
	LS	70.0	19.9	56.8	46.5	61.9	70.0	69.8	69.4	57.4	59.0
Acquisition prices	Total	62.7	5.9	0.6	-11.9	-27.1	-30.2	-42.7	-27.6	-23.3	-32.6
	ES	70.9	29.1	23.8	18.3	-9.6	9.0	-19.8	-4.5	-3.7	0.2
	LS	54.5	-11.2	-16.0	-30.7	-38.0	-52.3	-55.1	-41.9	-37.1	-52.0
Exit opportunities	Total	58.6	6.6	39.5	38.8	50.7	57.2	58.6	52.5	38.1	49.8
	ES	46.0	-5.3	17.6	32.3	23.0	35.1	28.1	26.0	13.0	14.4
	LS	74.5	14.9	54.2	42.9	66.5	68.2	74.5	68.1	55.3	69.0
Demand	Total	63.6	45.3	44.2	42.9	34.3	35.9	49.8	45.8	38.8	39.1
	ES	78.2	52.3	58.9	73.2	51.4	48.6	58.8	66.2	55.9	78.2
	LS	65.9	41.2	34.2	24.0	22.8	29.0	44.6	33.2	26.8	15.8
Demand quality	Total	41.4	26.1	24.9	14.9	17.2	23.7	26.5	23.4	31.1	22.6
	ES	63.8	33.3	25.0	29.7	29.8	27.1	25.8	37.9	35.9	19.4
	LS	43.2	20.8	24.8	5.4	8.8	21.7	26.9	14.5	27.9	24.3

Comments and Abbreviations:

Differences to previous publications are due to extrapolation.

E(arly)S(tage)

L(ater)S(tage)

Source: KfW Research, BVK

Calculation of the German Private Equity Barometer:

The German Private Equity Barometer is based on a quarterly survey of the 200+ members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK). 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 all BVK members.