

»» Business climate continues to improve

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- VC fundraising climate ascends to new heights
- Assessment of VC deal flow dips
- Satisfaction with entry prices at rock bottom

Business confidence hits new record high

The German private equity market continued to smash records in the early summer, with sentiment reaching a new high. The business climate index of the German Private Equity Barometer rose by 3.4 points to 65.2 balance points in the second quarter of 2017. The indicator for the current business situation rose by 3.5 points to a record 68.6 balance points while the indicator for business expectations climbed by 3.3 points to 61.8 balance points. The submarkets trended in opposite directions yet again. Confidence among early-stage investors fell slightly, while later-stage investors were more confident again.

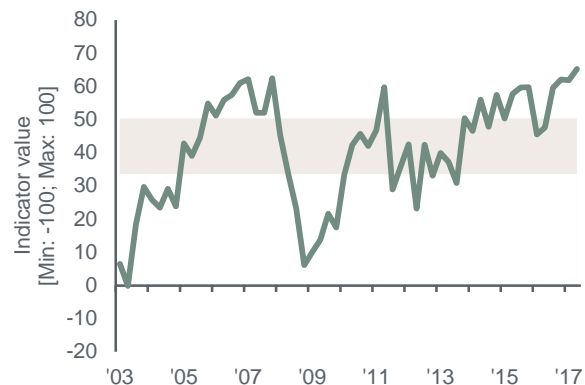
The positive general business sentiment is coupled with very good assessments of the fundraising, exit and promotional environment. The level and quality of deal flow are still regarded as satisfactory. Investors' satisfaction with entry prices, on the other hand, has sunk to a new low. Pressure on write-downs has also increased for the sixth consecutive quarter.

VC climate has cooled but remains very good

Business confidence in the venture capital market dipped marginally in early summer. The business climate indicator of the early-stage segment dropped by 3.4 points to what is still a very good 56.3 balance points in the second quarter of 2017. Investors took a virtually unchanged view of their current business situation but are more pessimistic about future business. The indicator for the current business situation dropped by 2.1 points to 57.6 balance points, while the indicator for business expectations fell 4.6 points to 55.0 balance points.

The VC market environment is heterogeneous. The fundraising climate has virtually leapt to a new record high, and the assessments of the exit, promotional and tax environment remain very good. The indicators for entry prices, pressure on write-downs, level and quality of deal flow, in turn, dropped very significantly. Pressure on write-downs and deal flow were still rated very positively in the previous quarter – tangible reasons for a drastic deterioration are not identifiable, however.

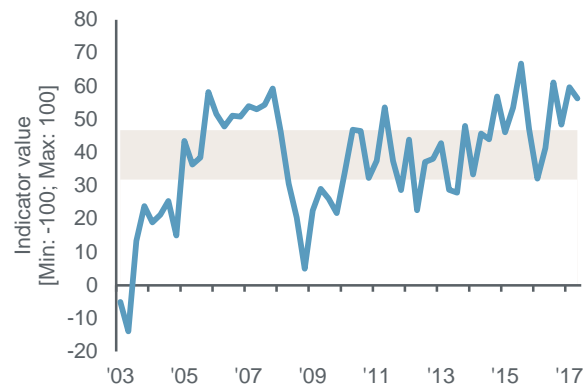
Business climate indicator – overall market



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 investors are in high spirits

After taking a breather at the start of the year, the business climate in the later-stage segment of the private equity market made another successful attempt to break the record. In the second quarter of 2017 the business climate indicator rose by 8.0 points to 71.5 balance points. Investors rated their business situation better than ever. The indicator for the current business situation climbed 7.1 points to 76.3 balance points, while the indicator for business expectations improved by 8.9 points to 66.6 balance points.

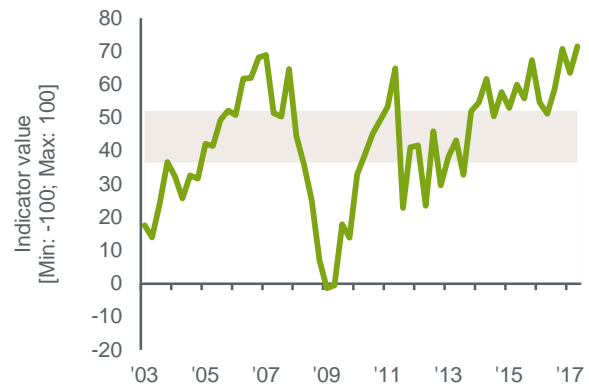
The improved business climate in the later-stage segment is being supported by what remains a very good fundraising climate – which did receive a significant dampener, however – and very good exit opportunities. The possibilities for exiting from investments through secondary or buyback trades, in particular, were rated better than ever. Furthermore, the demand climate picked up noticeably. The levels and quality of deal flow improved substantially in early summer. Later-stage investors’ satisfaction with entry prices, however, dipped again moderately and reached a new historic low.

Equity investors remain in high spirits

The very good business climate in the German private equity market continued for the fourth consecutive quarter – with variations in sentiment between the submarkets, but with a very steady upward trend overall. The risk of a setback is mounting at the same time, however. Whether that will be merely a welcome cooling phase or whether it will mark a sentiment reversal will depend on the development of the overall economic and industry-specific market environment. The unprecedented good fundraising climate is being strongly driven by the low-interest environment. Accordingly, a possible interest rate turnaround could weigh on sentiment. Likewise, a correction in the stock markets or a cyclical downturn might make it hard to exit – these indicators correlate strongly with one another. At the moment, however, there are no signs of a trend reversal. The only remaining stumbling block are the high company valuations and the associated high entry prices. Both early and later-stage investors have never been more dissatisfied with them.

‘Equity investors’ dissatisfaction with high entry prices is understandable’, said Dr Jörg Zeuner, Chief Economist of KfW, ‘but they reflect the high potential of many new business models. Digital business models, in particular, are

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

often readily scalable. If they are successful, investors can expect enormous value increases. Start-ups also know this, of course, and go into negotiations with investors with the corresponding degree of confidence. SMEs are aware of their quality as well and expect interested investors to be ready to pay a certain amount. All of that is reflected in entry prices.’

Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK), added: ‘Market participants are increasingly sceptical about current valuation levels, whether in the venture capital or in the buyout segment. But valuations are not a major burden at the moment, as we are currently observing lively investment activity in all market segments. Private equity firms will not pay just any price either, and we are still nowhere near the much-debated bubble. Rather, firms are looking to reap benefits from the market situation. On the seller side, the current environment holds good opportunities for attractive valuations for equity sales. Those who are now selling can definitely do something to boost their fund performance.’

Annex: Sentiment on the German private equity market in figures

German Private Equity Barometer

Sentiment indicators		Q1/2003 to Q2/2017		2015		2016				2017	
		Max	Avg.	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Business climate	Total	65.2	40.9	59.7	59.7	45.5	47.6	59.6	62.1	61.8	65.2
	Early	66.8	37.9	66.8	47.1	32.1	41.3	61.1	48.3	59.7	56.3
	Later	71.5	43.2	55.8	67.4	54.5	51.2	58.7	70.7	63.5	71.5
Market climate											
Fundraising	Total	61.5	9.7	48.1	58.3	39.1	40.3	55.4	59.9	61.5	56.1
	Early	58.4	-7.6	13.7	42.4	10.3	10.2	39.7	38.0	44.3	58.4
	Later	80.2	23.4	69.8	69.4	57.7	59.2	65.6	76.9	80.2	54.2
Entry prices	Total	62.7	2.8	-42.7	-27.6	-23.8	-32.8	-32.9	-38.3	-28.9	-45.4
	Early	70.9	26.4	-19.8	-4.5	-3.9	0.1	1.4	-13.7	7.9	-27.2
	Later	54.5	-14.5	-55.1	-41.9	-37.7	-52.1	-53.3	-54.0	-57.6	-58.2
Exit opportunities	Total	58.6	9.6	58.6	52.5	38.5	50.0	43.4	53.9	49.3	51.6
	Early	46.0	-2.8	28.1	26.0	13.1	14.4	27.4	27.2	35.4	33.8
	Later	74.5	18.2	74.5	68.1	55.6	69.2	55.8	70.2	59.8	63.7
Level of demand	Total	63.6	45.2	49.8	45.8	38.7	39.0	45.1	35.7	46.8	44.4
	Early	85.0	53.8	58.8	66.2	56.2	78.2	77.5	73.6	85.0	61.3
	Later	65.9	39.9	44.6	33.2	26.6	15.9	25.6	11.8	17.7	32.7
Quality of demand	Total	41.4	26.0	26.5	23.4	30.9	22.4	10.4	33.0	25.6	30.2
	Early	63.8	33.3	25.8	37.9	36.0	19.2	30.1	41.5	43.8	17.3
	Later	43.2	20.7	26.9	14.5	27.6	24.2	-1.7	27.5	12.0	39.2

Differences to previous publications are due to extrapolation.

Source: 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.