

»» German private equity market: Business climate index remains very strong

30 October 2018

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- Early-stage investors are still euphoric – later stage drops from record high
- Fundraising climate improves again
- Demand remains very good as early-stage investors are more satisfied with the quantity and later-stage investors with the quality of deal flow

Fundraising climate in private equity market remains very good despite drop

The German private equity market has shifted down a gear after its record-breaking-run. In the third quarter of 2018, the business climate index of the German Private Equity Barometer fell by 5.0 points to 72.1 balance points, which is still very good. Equity investors rated both their business situation and their expectations slightly lower than in the preceding record quarter. The indicator for the current business situation dropped by 2 points to 77.6 points, while the indicator for business expectations fell by a more pronounced 7.9 points to 66.6 balance points.

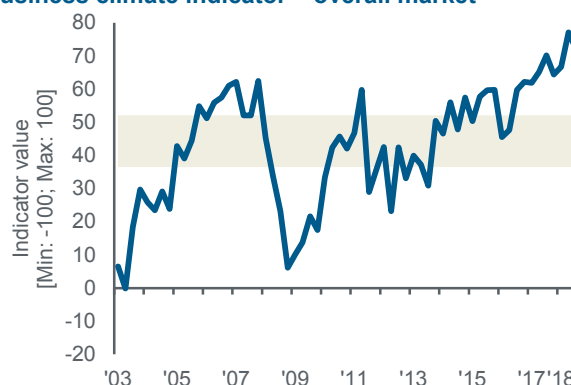
The very good business climate continues to be bolstered by what is also a very good overall market environment. Equity capital providers are highly satisfied with the quantity and quality of their deal flow, the low pressure on write-downs and the fundraising and exit climate, both of which are again close to their peak levels.

VC business climate marks new all-time high

The business climate on the VC market continues to soar, with the indicator of the early stage segment climbing by 4.1 points to 76.6 balance points. Assessments of both the current situation and business expectations exceeded the record levels of the previous quarter. The indicator for the current business situation climbed to 80.1 balance points (+5.6), while the indicator for business expectations rose to 73.2 balance points (+1.4).

The business climate was boosted by many factors. The fundraising climate, the exit environment, pressure on write-downs, as well as the level and quality of deal flow all improved. In the exit environment the IPO opportunities were rated better than at any time in the past ten years. This could be a ripple effect of the IPOs of NFON and Home24 in May and June 2018, which were deemed successful. The level of demand scored slightly below its previous peak level, while it is only since last quarter that VC investors have given very good marks for quality again. The level of dissatisfaction with entry valuations also decreased.

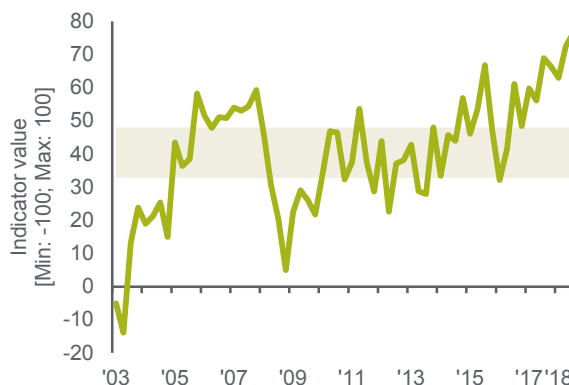
Business climate indicator – overall market



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.

Business climate in the later stage segment cannot maintain record level

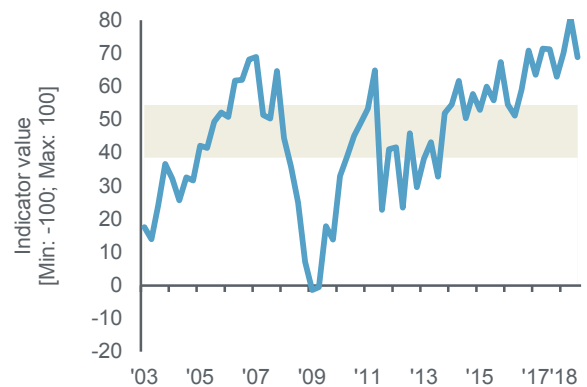
The business climate in the later-stage segment of the German private equity market fell in late summer. The index dropped by 12 points to 68.8 balance points in the third quarter of 2018. This is still very good but clearly below the record level of 80 points in the previous quarter. Later-stage investors rated both their business situation and their expectations lower again. The indicator for the current business situation dropped to 75.8 balance points (-9.0), while the indicator for business expectations fell more sharply to 61.8 balance points (-15.0).

The pronounced decline in the business climate in the later-stage segment of the private equity market presumably represents a setback after its record-breaking run. After all, the market environment remains very favourable. Most indicators improved or were rated from stable to positive, as was the case in the VC market. Satisfaction with entry valuations, however, dropped again after the positive signal from the previous quarter. The sub-indicator of investment appetite for new equity investments also dropped.

Business climate remains strong – signs of weakness in the market environment are gone

The German private equity market was in good shape in late summer. The business climate fell slightly overall but remains very good. The early-stage climate exceeded the previous quarter’s peak level again slightly, while the later stage segment took a breather from its record-breaking run. The signs of weakness in the market environment that appeared in the previous quarter have vanished. ‘The German private equity market remains strong and the recently emerging sentiment turnaround has failed to materialise for now’, said Dr Jörg Zeuner, Chief Economist of KfW. ‘We are particularly pleased about the new record level of investor confidence in the VC market. Investment appetite is high, so with the newly created KfW Capital we can take steps together to close the remaining market gaps. We have identified very high VC demand and a clear improvement in the quality of deal flow. In the later-stage segment, on the other hand, dissatisfaction with entry valuations currently appears to be affecting investment readiness. Here, demand has grown significantly since the low at the end of 2016, which would suggest more favourable entry prices. But what ultimately determines the price is the high quality of German SMEs.’

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 setback in the sentiment of later-stage investors comes as no surprise, given the increase of the past years and the record level achieved. On the investment side, the greatest burdens continue to be the generally ambitious company valuations and first uncertainties about the business cycle. What is pleasing is the continuing positive sentiment among venture capitalists. This should increase investment appetite, which is why we are optimistic that more venture capital will flow into start-ups in Germany this year than last year. At the same time, venture capitalists can be expected to make use of the positive market environment particularly for exits and fundraising to lay the foundation for successful years. The new KfW Capital will surely make an important contribution to mobilising more capital for German venture capital funds.’ ■

KfW Research

German Private Equity Barometer: 3rd Quarter 2018

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 Q3/2018		2016	2017				2018		
		Max	Avg.	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Business climate	Total	77.1	43.3	62.2	61.9	65.2	70.2	64.3	66.7	77.1	72.1
	Early	76.6	40.4	48.4	59.7	56.1	68.9	66.3	63.0	72.5	76.6
	Later	80.8	45.4	70.8	63.5	71.4	71.2	62.9	70.0	80.8	68.8
Market climate											
Fundraising	Total	79.0	14.3	60.0	61.7	56.2	60.8	79.0	67.0	60.5	71.7
	Early	74.8	-2.2	37.8	44.3	58.4	48.6	74.8	61.3	54.2	64.4
	Later	82.3	27.5	77.0	80.4	54.5	73.9	82.3	73.3	66.2	78.0
Entry prices	Total	62.7	-1.1	-38.5	-29.3	-45.6	-43.7	-49.4	-43.2	-41.4	-35.0
	Early	70.9	22.6	-14.1	7.5	-27.5	-15.6	-27.9	-19.4	-26.3	-1.1
	Later	54.5	-18.6	-54.0	-57.6	-58.2	-67.3	-64.9	-66.4	-53.8	-60.9
Exit opportunities	Total	72.0	13.7	53.9	49.5	51.7	72.0	60.3	59.4	49.3	65.5
	Early	59.9	1.5	27.1	35.6	33.9	59.9	51.5	56.7	34.7	57.6
	Later	0.8	22.2	70.2	59.7	63.7	80.8	67.0	62.0	61.1	72.4
Level of demand	Total	64.6	46.2	35.7	46.5	44.4	51.0	56.9	57.1	64.6	63.0
	Early	84.8	55.5	73.3	84.8	61.2	63.5	72.3	78.5	78.7	82.5
	Later	65.9	40.3	11.9	17.6	32.9	40.5	45.5	37.5	53.4	48.4
Quality of demand	Total	43.1	26.6	32.9	25.3	30.2	32.0	29.3	28.5	40.0	43.1
	Early	63.8	33.1	41.3	43.3	17.0	24.3	19.8	27.8	39.8	44.5
	Later	43.2	22.0	27.5	12.0	39.2	38.1	36.2	29.1	40.2	42.1

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.