

Private equity environment is improving only slowly

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- Recovery of business confidence from coronavirus slump remained shallow in fourth quarter of 2020
- Coronavirus crisis is keeping write-down pressure high and weighing on private equity deal flow
- Satisfaction with promotional environment reaches new high

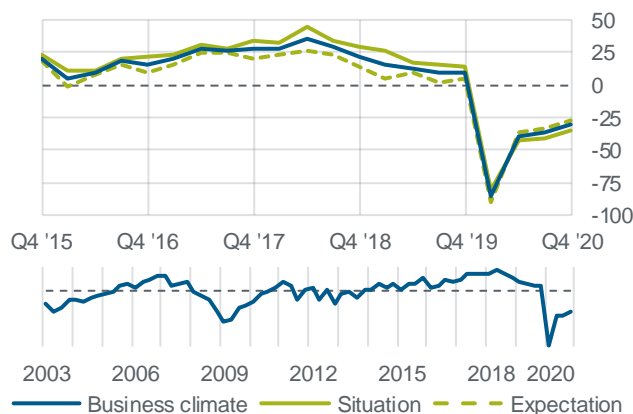
Private equity business environment has stalled

Sentiment in the German private equity market continues to recover at a sluggish pace. At -30.9 balance points, the sentiment indicator of the later-stage segment hardly improved in the fourth quarter of 2020 (+6.1). Thus, it made up for only around half of the downturn from the first quarter because the path of recovery flattened halfway out of the coronavirus slump. The coronavirus crisis thus continues to weigh heavily on sentiment and impacts on assessments of both the current business situation and expectations. The indicator for the current business situation stood at -35.0 balance points (+5.6 points), while the indicator for business expectations was only insignificantly higher, at -26.9 balance points (+6.6).

Market environment remains moderate despite recovery

All sentiment indicators of the German private equity market rose in the final quarter but gains were mostly moderate. Overall, only three indicators are currently on a similar level as before the coronavirus crisis. The first one is the assessment of entry valuations which, however, is an indicator that historically moves in the opposite direction to the general trend. The second one relates to assessments of the promotional environment and tax framework. These are the only two sentiment indicator dots that are green but they were not affected by the coronavirus slump either. The promotional environment even reached a new high in the final quarter, most likely due to the recently added coronavirus support which benefits the affected companies. All other indicators only partly offset the losses caused by the coronavirus crisis. This probably has to do with the fact that the typical target group of private equity investments – successful SMEs – was hit hardest by the coronavirus crisis and great uncertainty remains as to how they will get through it. For this reason it is not just the indicator for write-down pressure that is a deep red but the level and quality of deal flow are also reduced, as is private equity investors' appetite for new investments.

Development of later stage business climate indicator



Sources: KfW Research and BVK.

Key data of later-stage sentiment indicators

Values in balance points

	Q4/20	Δ vs. Q3/20	High	Low
Business climate	-30.9	+6.1	+35.4	-85.2
Business situation	-35.0	+5.6	+44.5	-80.5
Business expectations	-26.9	+6.6	+26.3	-89.8
Fundraising	-7.0	+19.2	+45.3	-69.2
Entry evaluations	-6.7	+0.4	+60.2	-33.2
New investments	-20.7	+18.5	+19.7	-74.4
Exit opportunities	+4.6	+39.7	+56.0	-86.4
Dealflow quantity	-9.4	+18.7	+22.7	-28.2
Dealflow quality	-3.6	+18.3	+23.7	-22.0
Funding	+33.5	+10.9	+33.5	-30.5
Taxation framework	+18.4	+2.7	+24.6	-39.1
Innovation	-7.9	+4.7	+33.4	-46.2
Write-downs	-32.8	+11.1	+32.0	-54.1

The colour coding of the balances and the variations is based on the historical values of the respective indicator (1st tercile 'red', 2nd tercile 'amber' and 3rd tercile 'green'). Indicator design may lead to deviations from previous publications.

Sources: KfW Research and BVK.

KfW Research German Private Equity Barometer 4th quarter 2020

Comments on the current trend

'The German private equity market started the year with a liability because the crisis-induced uncertainty remains a heavy burden', said Dr Friederike Köhler-Geib, Chief Economist of KfW. Unlike in the venture capital market, in which high risk is part of day-to-day start-up business, here it is the uncertainty about the situation of established SMEs that is depressing the mood of market players. The uncertainty probably won't go away until the economic recovery is reflected in the books.'

'The signs of economic recovery and the buoyant stock markets are obscuring the fact that Germany's SMEs continue to experience challenging times. The economic aftermath of the pandemic will reverberate through small and medium-sized enterprises for a long time. This will directly affect the sentiment of SME investors, which are particularly affected in new investments, deal flow and valuation adjustments', added Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). 'But right now, investment companies are demonstrating their important function as experienced financing partners who are at their portfolio enterprises' side to guide them through the crisis as best they can. Nonetheless, the sluggish sentiment improvement shows that great uncertainty still remains in the market.'

Calculation of the German Private Equity Barometer

The German Private Equity Barometer is based on a quarterly survey of the approx. 200 members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK) and further German private equity companies. The German Private Equity Barometer has been published as a separate sentiment indicator for the German later-stage private equity market since the second quarter of 2019. Previously, the German Private Equity Barometer also included assessments of venture capital companies, which are now presented separately in the German Venture Capital Barometer. It reports the business climate in the later-stage segment of 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, adjusted by their respective historical mean value.