

»» Sentiment remained bullish in the final quarter

15 February 2017

Author: Dr Georg Metzger, phone +49 69 7431-9717, georg.metzger@kfw.de
 Press contact: Christine Volk, phone +49 69 7431-3867, christine.volk@kfw.de

- Confidence reached new heights among later-stage investors at the end of the year as early-stage investors put on the brakes again
- Early-stage investors are more positive about the tax environment than in the past ten years
- Fundraising climate among later-stage investors is better than ever

Business climate remained very good in the final quarter

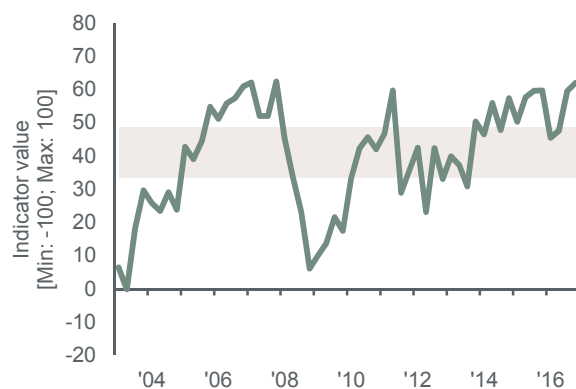
The year 2016 ended with the best business climate in the German private equity market since 2007. In the final quarter, the business climate index of the German Private Equity Barometer rose 2.5 points to 62.1 balance points. The indicator for the current business situation climbed 4.4 points to 64.6 balance points, while the indicator for business expectations increased by 0.6 points to 59.5 balance points. However, equity investors differ in their assessments of the business climate. While later-stage investors' sentiment was at record high the end of the year, the mood among early-stage investors dropped again.

2016 was a positive year for the German private equity market. It was the year with the best fundraising climate on average and with the lowest pressure on write-downs so far, and it was marked by a very good exit climate. However, the downside was the very high entry prices for equity investments. Already in 2015, investors were more dissatisfied with prices than ever before – and that did not change in 2016 either.

Early-stage investors' sentiment slips again

Despite cooling off significantly, the business climate on the venture capital market remained good in the final quarter. The business climate indicator of the early-stage segment fell by 12.7 points to 48.3 balance points in the fourth quarter of 2016. The trend – euphoria in summer, gloom in winter – is consistent with the previous year's. At the same time, early-stage investors have corrected the assessment of their business situation downward much less than their business expectations. The indicator for the current business situation fell by 8.2 points to 49.9 balance points, while business expectations plummeted by 17.3 points to 46.8 balance points. The previous quarter's noticeably higher optimism has thus evaporated again for the time being. This slump was precipitated by a renewed surge in entry prices that apparently could not be offset by what remains a very good fundraising climate, a tax environment rated the best in ten years, and large, high-quality demand.

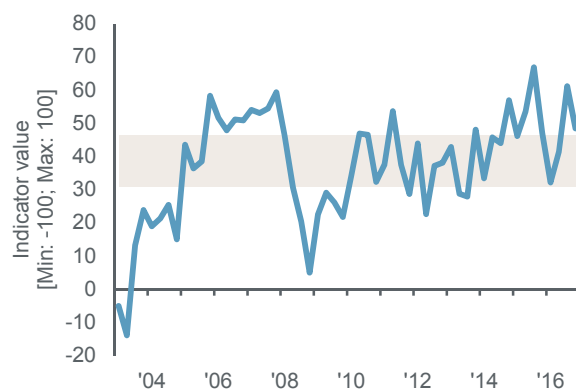
Business climate indicator – overall market



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 investor sentiment peaked at year-end

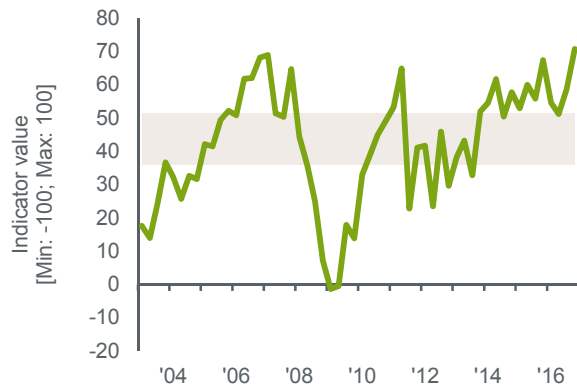
Later-stage investors carried the momentum on from the previous quarter’s sentiment reversal and ended the year in high-spirits. The business climate indicator climbed by 12.0 points to 70.7 balance points in the final quarter of 2016, with the indicator for the current business situation rising 12.4 points to 73.9 balance points and business expectations climbing 11.6 points to 67.6 balance points. A renewed rise in the fundraising climate (also to a record level) was probably crucial for achieving the top mark. This was also supported by higher demand quality and a very good environment for exit opportunities and write-downs. Record-high entry prices for equity investments, however, are the downside of the very good fundraising climate, as growing private equity competes for fewer investment opportunities. The assessment of the demand for private equity also dropped to a low in the final quarter.

Investors remain upbeat

The business climate in the German private equity market remained good overall in the final quarter of 2016. Upbeat later-stage investors, however, drowned out the early-stage investors, whose sentiment has cooled off again but still remains good. The two events of global economic relevance that took place in the final quarter – the election of Donald Trump as US President and the Fed’s interest rate reversal – presumably did not affect this trend. At least they are and were not expected to have any direct short-term effects on the German private equity market. Positive as well as negative impacts may become felt in the medium term if the transatlantic mobility of capital and businesses changes as a result of subsequent measures.

There have also been economic policy developments in Germany. The Law on the further development of the off-setting of tax losses of corporations was passed at the end of December. It enables corporations to continue utilising what are referred to as unused losses existing after a change in shareholders, for instance when a private equity company acquires a stake. This is particularly relevant for VC providers, and accordingly, their assessment of the tax environment is the best it has been in ten years. This is surely also due in part to the fact that sales proceeds from participations under the ‘INVEST grant for venture capital’ programme will be practically tax-free from 2017.

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

“The positive mood among equity investors is primarily due to the fact that we currently have the best conditions in almost ten years for fundraising and exits, that is, at the start and at the end of the equity investment process”, said Dr Jörg Zeuner, Chief Economist of KfW. “It’s only in between, when they conclude the deals, that investors are dissatisfied, partly with the strength of the deal flow, but particularly with the high entry prices. But this is the downside of the outstanding fundraising and exit environment and, hence, an unavoidable negative.”

“All in all, the environment for private equity capital remains favourable. Not even the high company valuations can weigh on sentiment because they will eventually pay off for the investors when they sell their investments”, added Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). “We are particularly pleased with the good fundraising mood. But it should not hide the fact that we need more domestic investors especially for venture capital funds. Furthermore, policymakers have provided a boost to the venture capital area with the course they have set for loss carry-forwards and the INVEST grant, so we generally look to the year 2017 with confidence.”

■

Annex: Sentiment on the German private equity market in figures

German Private Equity Barometer

Sentiment indicators		Q1/2003 to Q4/2016		2015				2016			
		Max	Avg.	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Business climate	All	62.4	40.1	50.3	57.8	59.7	59.7	45.5	47.6	59.6	62.1
	ESF	66.8	37.2	46.1	53.5	66.8	47.1	32.1	41.3	61.1	48.3
	LSF	68.9	42.3	52.9	60.0	55.8	67.4	54.5	51.2	58.7	70.7
Market factors											
Fundraising	All	58.3	7.9	41.8	38.3	48.1	58.3	39.1	40.3	55.4	59.9
	ESF	42.4	-9.7	11.8	-17.0	13.7	42.4	10.3	10.2	39.7	38.0
	LSF	70.0	21.8	61.9	70.0	69.8	69.4	57.7	59.2	65.6	76.9
Entry prices	All	62.7	4.3	-27.1	-30.2	-42.7	-27.6	-23.8	-32.8	-32.9	-38.3
	ESF	70.9	27.8	-9.6	9.0	-19.8	-4.5	-3.9	0.1	1.4	-13.7
	LSF	54.5	-12.8	-38.0	-52.3	-55.1	-41.9	-37.7	-52.1	-53.3	-54.0
Exit opportunities	All	58.6	8.1	50.7	57.2	58.6	52.5	38.5	50.0	43.4	53.9
	ESF	46.0	-4.2	23.0	35.1	28.1	26.0	13.1	14.4	27.4	27.2
	LSF	74.5	16.7	66.5	68.2	74.5	68.1	55.6	69.2	55.8	70.2
Level of demand	All	63.6	45.1	34.3	35.9	49.8	45.8	38.7	39.0	45.1	35.7
	ESF	78.2	53.1	51.4	48.6	58.8	66.2	56.2	78.2	77.5	73.6
	LSF	65.9	40.4	22.8	29.0	44.6	33.2	26.6	15.9	25.6	11.8
Quality of demand	All	41.4	25.9	17.2	23.7	26.5	23.4	30.9	22.4	10.4	33.0
	ESF	63.8	33.4	29.8	27.1	25.8	37.9	36.0	19.2	30.1	41.5
	LSF	43.2	20.5	8.8	21.7	26.9	14.5	27.6	24.2	-1.7	27.5

Explanations and abbreviations:

Differences to previous publications are due to extrapolation.

E(arly) S(tage) F(inanciers)

L(ater) S(tage) F(inanciers)

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.