Sentiment on private equity market still very good

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- Fundraising climate soars to new heights
- Demand for capital continues to rise – later-stage investors are also satisfied again

Despite dipping slightly, private equity market is in high spirits
The business climate in the German private equity market dropped slightly in the final quarter of 2017. At 66.1 balance points, however, the index of the German Private Equity Barometer ended the year only 4.0 points below its third-quarter record level. That is because market participants have more modest expectations for the first half of 2018. The indicator for the current business situation rose slightly to 71.6 balance points (+1.1), while the indicator for business expectations decreased to 60.7 balance points (-9.1).

In terms of sentiment, 2017 was a year of superlatives in the German private equity market. Assessments of the business climate, fundraising climate, exit conditions and promotional environment have never been better. It has thus taken exactly ten years to break the record high levels of the pre-crisis year 2007 on an annual average basis. But the downside was the entry price level, which investors have never been less happy about. Top marks for fundraising conditions, the write-down and innovation climate and the exit and promotional environment, as well as lowest approval levels for entry prices, make the final quarter symbolic of the record sentiment in 2017.

VC fundraising climate – rapid ascent to all-time high
The business climate in the venture capital market remained very good at the end of the year. The business climate indicator of the early-stage segment dropped only moderately to 65.6 balance points in the final quarter of 2017. It is thus a mere 3.4 points below its highest level in the third quarter. While the indicator for the current business situation was nearly unchanged at 66.9 balance points (+0.2), the indicator for business expectations fell by 7.1 points to 64.4 balance points.

The business climate in 2017 was sustained primarily by the fundraising climate and promotional environment, which both received outstanding scores on an annual average basis. Both indicators reached a new all-time high in the final quarter of 2017. Among them, the fundraising climate clearly surpassed its previous record level.
Later stage: Demand is returning
In the later-stage segment of the German private equity market, the year ended with a moderate decline in business sentiment. The business climate indicator was down a mere 4.5 points to 66.6 balance points in the final quarter of 2017 but still remained on a very high level. The indicator for the current business situation rose by 1.6 points to 75.3 balance points, while the indicator for business expectations shed 10.7 points to close at 57.8 balance points.

The very good business climate in the later-stage segment is based on what is now an outstanding market environment. After later-stage investors deplored the quantity and quality of their deal flow just a year ago, these variables have also improved steadily in the past four quarters. All that remains is the very high level of dissatisfaction with the entry valuations ascertained but this has at least diminished slightly after six consecutive increases in the final quarter.

Record year for business climate, market environment still excellent
A year of superlatives has ended for the German private equity market. There was hardly a business climate indicator that failed to approach or break a record. The outlook for 2018 is also good. Unlike in the US, the interest turnaround in Europe cannot yet be predicted so that the conditions for fundraising and exits are likely to remain very good. Although demand for venture capital is rising because enterprises are becoming increasingly more receptive to equity capital investors, declining start-up activity in the wake of what appears to be an endless labour market boom might slow down the deal flow at least in the VC segment and contribute to higher valuations. Competition among equity investors for the best deals will therefore remain intense and investors will have to continue responding to the challenge of high entry valuations.

One man’s pain is another man’s pleasure. For start-ups, higher entry valuations mean that they can obtain more capital for their company share. That gives them better growth prospects and the opportunity to partly make up for their obvious competitive disadvantage on an international level. "Investors’ assessment of the innovative strength of start-ups is currently keeping pace with the development of VC entry prices", said Dr Jörg Zeuner, Chief Economist of KfW. "Therefore, on average the higher valuations also reflect higher growth prospects when they are successful. It is normal for different investors to arrive at different assessments of the potential success of innovative technologies and business models. That is also why opinions vary on what is a reasonable price. Still, it is important to keep an eye on how entry prices develop." Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK), took a positive view of the year: "It has been an outstanding year for the German private equity market. Sentiment is extremely good across all segments. This should translate into record investment and fundraising figures. The good assessment of the fundraising and exit environment is particularly pleasing and makes us optimistic about the year 2018. The ambitious valuations are likely to continue for the time being but they also provide opportunities on the exit side."
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.