

»» Divided sentiment at the end of the year

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- Early-stage business climate climbs to all-time high, later-stage climate cooler again
- 2018 saw highest average confidence level in 15 years
- Equity market environment remains very good and is virtually unchanged year-on-year

Sentiment cooled again at the end of the year but 2018 was the best of the past 15 years

Confidence in the German private equity market dropped for the second consecutive quarter. In the fourth quarter of 2018, the business climate index of the German Private Equity Barometer fell by 4.2 points to 67.9 balance points. Equity investors once again rated both their business situation and their expectations slightly lower. The indicator for the current business situation fell by 4.4 points to 73.2 balance points, while the indicator for business expectations lost 4.0 points to close at 62.6 balance points. But although confidence was lower in the second half-year, on average 2018 was the year with the best business climate since 2003, when the German Private Equity Barometer was launched.

The private equity market environment was also generally rated slightly better yet again in 2018 than the already strong year 2017. The assessments of fundraising, exit opportunities and innovation activity remained relatively steady on a very high level, while assessments of the quantity and quality of deal flow improved significantly. Moreover, the price climate for entry valuations was more relaxed, with dissatisfaction continually improving since the low of Q4/17.

VC business climate with third consecutive all-time high

The business climate in the VC market reached a new record level at the end of the year. The business climate indicator of the early-stage segment rose by 3.1 points to 79.8 balance points. Assessments of both the current situation and business expectations improved yet again. The indicator for the current business situation rose to 83 balance points (+2.9), while the indicator for business expectations climbed to 76.6 balance points (+3.4).

As was the case for the market as a whole, in 2018 the VC market environment also exceeded that of the previous year, which was already strong. On average for the year, assessments of fundraising, exit opportunities and innovation activity increased slightly and the quantity and quality of deal flow were rated significantly higher. The assessment of capital demand levels even climbed to a record high towards the end of the year.

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 climate under pressure

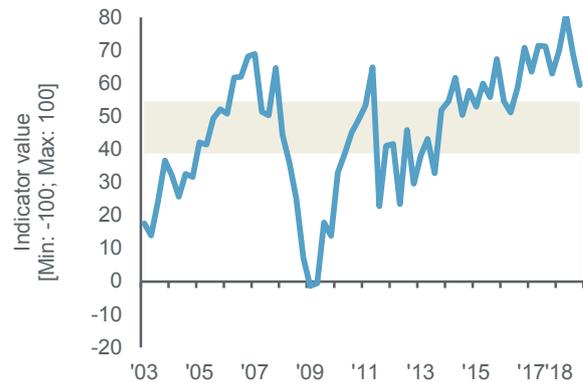
The business climate in the later-stage segment of the German private equity market decreased again at the end of the year. In the final quarter of 2018, the business climate index fell by 9.4 points to 59.4 balance points. It has thus returned to the good level of late summer 2016. Later-stage investors made significantly lower but similar assessments of the business situation and expectations. The indicator for the current business situation dropped to 66.2 balance points (-9.6), while the indicator for business expectations fell to 52.6 balance points (-9.2).

With the decline in sentiment, the negative trend of the third quarter thus continued and was not a temporary setback. However, there is no identifiable reason for a long-term downturn in the business climate in the market environment. Only the satisfaction with deal flow quality and write-down pressure dropped significantly at the end of the year. The slump in the stock markets may have generated pressure to recognise impairments in existing portfolios, which lowered the confidence of later-stage financiers.

Opposing dynamics in the equity market

At the end of 2018, sentiment in the German private equity market was divided. The early-stage climate reached a new record level, while the later-stage climate cooled significantly in the second half of 2018. The more subdued sentiment among later-stage investors might have been triggered by the slump in the stock markets. It generates pressure to make value adjustments in portfolio companies. Overall, however, the market environment remains very good both in the early stage and in the later stage. ‘Although the business climate in the segments of the German private equity market is currently divided, the outlook for both sub-segments remains positive thanks to a stable, positive market environment’, said Dr Jörg Zeuner, Chief Economist of KfW. ‘The euphoric sentiment in the VC market towards the end of the year signals that the strong investment activity of the first half has continued and the aggregate figures for 2018 will show the highest investment activity since the turn of the millennium. In the later-stage segment, sentiment currently appears to be shaped by the negative view of the stock markets. At any rate, we see no signs of a fundamental shift in sentiment.’

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), draws a positive conclusion: ‘2018 was another successful year for the German venture capital and private equity market. Last year, the business climate was rated better than at any time since we launched the German Private Equity Barometer together with KfW in 2003. What is particularly pleasing is the outstanding sentiment in the venture capital market, which has been restrained for a long time. We do not expect the market or sentiment in the sector to drop in 2019, even though investors in the later-stage segment in particular respond more sensitively to changes in the environment than venture capital players. The most recent downturn in sentiment in the later stage was understandable against the backdrop of general worries over the economy, Brexit, trade conflicts and stock market turmoil and is no cause for concern.’ ■

KfW Research

German Private Equity Barometer: 4th 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 Q4/2018		2017				2018			
		Max	Avg.	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Business climate	Total	77.1	43.6	61.9	65.2	70.2	64.3	66.7	77.1	72.1	67.9
	Early	79.8	41.0	59.7	56.1	68.9	66.3	63.0	72.5	76.6	79.8
	Later	80.8	45.6	63.5	71.4	71.2	62.9	70.0	80.8	68.8	59.4
Market climate											
Fundraising	Total	79.0	15.1	61.7	56.2	60.8	79.0	67.0	60.5	71.7	66.3
	Early	74.8	-1.2	44.3	58.4	48.6	74.8	61.3	54.2	64.4	65.5
	Later	82.3	28.1	80.4	54.5	73.9	82.3	73.3	66.2	78.0	66.9
Entry prices	Total	62.7	-1.6	-29.3	-45.6	-43.7	-49.4	-43.2	-41.4	-35.0	-30.3
	Early	70.9	22.2	7.5	-27.5	-15.6	-27.9	-19.4	-26.3	-1.1	-0.3
	Later	54.5	-19.1	-57.6	-58.2	-67.3	-64.9	-66.4	-53.8	-60.9	-51.5
Exit opportunities	Total	72.0	14.3	49.5	51.7	72.0	60.3	59.4	49.3	65.5	52.6
	Early	59.9	2.1	35.6	33.9	59.9	51.5	56.7	34.7	57.6	36.7
	Later	80.8	22.9	59.7	63.7	80.8	67.0	62.0	61.1	72.4	63.8
Level of demand	Total	64.6	46.5	46.5	44.4	51.0	56.9	57.1	64.6	63.0	63.3
	Early	86.0	56.0	84.8	61.2	63.5	72.3	78.5	78.7	82.5	86.0
	Later	65.9	40.4	17.6	32.9	40.5	45.5	37.5	53.4	48.4	46.9
Quality of demand	Total	43.1	26.7	25.3	30.2	32.0	29.3	28.5	40.0	43.1	32.3
	Early	63.8	33.3	43.3	17.0	24.3	19.8	27.8	39.8	44.5	45.1
	Later	43.2	22.0	12.0	39.2	38.1	36.2	29.1	40.2	42.1	23.1

Sources: 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.