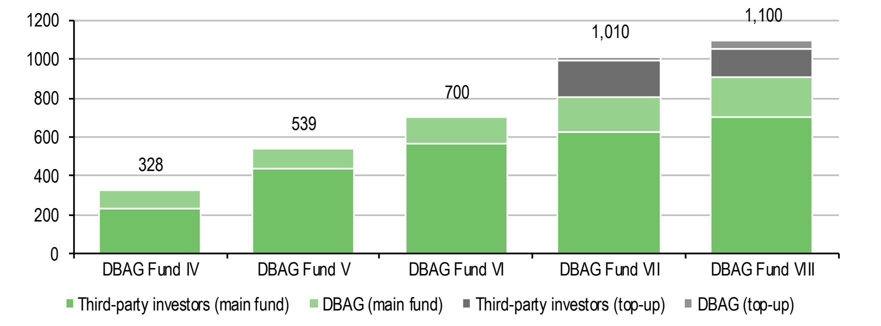
Deutsche Beteiligungs

Guidance beat assisted by a successful exit

Investment trusts
Private equity

Deutsche Beteiligungs (DBAG) posted net income of €45.9m in FY19, which is 20% above the upper end of its guidance range. This was supported by a €39.7m valuation uplift on the disposal of inexio, agreed in September 2019. For FY20, DBAG expects NAV to be up to 10% lower (vs the current €472.1m as defined by DBAG), but more than 20% higher income from the fund services segment (FY19: €3.0m). The latter should be driven by the recent launch of DBAG Fund VIII with a targeted size of €1.1bn including the top-up fund. It is worth noting that 75% of the third-party commitments made to the fund so far have been by returning investors.

DBAG-advised funds becoming larger over time (€m of commitments)



Source: DBAG, Edison Investment Research

The market opportunity

DBAG is a well-positioned player in the German private mid-market segment. It has shown its ability to benefit from higher market valuations, both before the onset of the 2008/09 crisis and more recently in 2017, with a high number of exits at that time (see the analysis in our recent outlook note). Recurring income from fund services provides a degree of stability. We also note DBAG's growing exposure to its focus sectors in recent years (eg broadband telecom). The first exit from its focus portfolio (inexio, a broadband telecoms company), completed recently at a 7.5x money multiple, strengthens DBAG's investment case.

Why consider investing in Deutsche Beteiligungs?

- Solid track record, with an average management buyout (MBO) exit multiple of 2.7x since 1998.
- Increasing exposure to the German broadband sector (31% at end-FY19).
- Steady income from the fund services segment.
- Dividend yield of c 4%, ahead of peer average.

Valuation: Premium to NAV at 26%

DBAG's shares continue to trade at a premium to NAV (defined as total equity), which in our view comes from the market-implied value of the fund services business. This is supported by the launch of DBAG Fund VIII, which will drive fee income going forward. The premium to end-September NAV rebounded to the current 26% after announcing the disposal of inexio. DBAG's shares currently offer a dividend yield of c 4% vs the peer average of 3.2%.

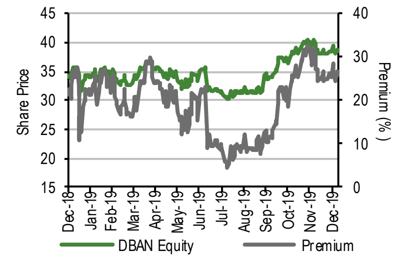
14 January 2020

Price	**€38.55**
Market cap	**€580.0m**
NAV*	**€460.2m**
NAV per share**	€30.59
Premium to NAV	26%

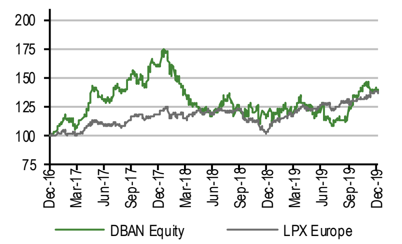
*defined as total equity
**As at end-September 2019.

Yield	3.9%
Ordinary shares in issue	15.0m
Code	DBAN
Primary exchange	Frankfurt
AIC sector	Private Equity
Benchmark	N/A

Share price/discount performance



Three-year performance vs index



52-week high/low	€40.55	€30.15
NAV*** high/low	€30.59	€28.05

***Including income.

Gearing

Gross*	0.0%
Net cash*	15.1%

*As at end-September 2019.

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Deutsche Beteiligungs is a research client of Edison Investment Research Limited

Exhibit 1: Deutsche Beteiligungs at a glance

Investment objective and fund background

Deutsche Beteiligungs is a Germany-based and listed private equity investment and fund management company that invests in mid-sized companies in Germany and neighbouring German-speaking countries via MBO transactions and growth capital financings. There is a focus on growth-driven profitable businesses valued between €50m and €250m. DBAG's core objective is to sustainably increase net asset value.

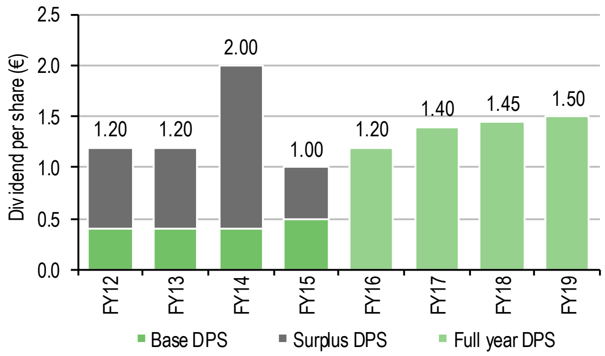
Recent developments

- 10 Dec 2019: DBAG initiates DBAG Fund VIII.
- 14 Nov 2019: annual dividend declaration of €1.50 per share.
- 28 Sep 2019: DBAG announces disposal of its investment in inexio.
- 12 Sep 2019: announces up to €14m investment in STG with DBAG ECF.
- 23 Aug 2019: DBAG invests €26m in Cartonplast alongside DBAG Fund VII.
- 8 Aug 2019: Q319 results – NAV 1Y TR 3.3% vs LPX Europe NAV TR 5.1%.

Forthcoming		Capital structure		Fund details	
AGM	20 February 2020	FY19 net expense ratio*	0.2%	Group	Deutsche Beteiligungs
Interim results	10 February 2020	Net cash	15.1%	Manager	Team managed
Year end	30 September	Annual mgmt fee	N/A (self-managed)	Address	Boersenstrasse 1
Dividend paid	Following the AGM	Performance fee	N/A (self-managed)		60313 Frankfurt am Main, Germany
Launch date	December 1985	Company life	Indefinite	Phone	+49 69 95787-01
Continuation vote	N/A	Loan facilities	€50m (undrawn)	Website	www.dbag.com

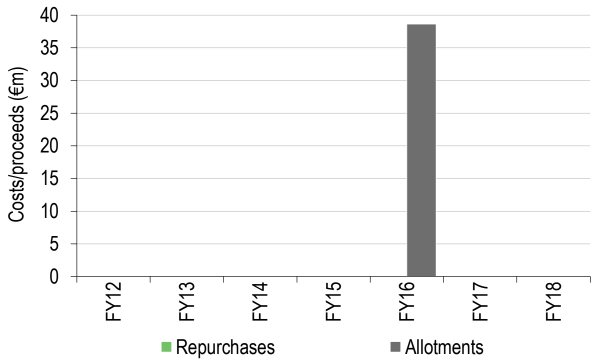
Dividend policy and history (financial years)

DBAG's policy is to pay a stable or rising annual dividend. Prior to FY16, a base dividend was paid, supplemented by a surplus dividend based on realised gains.

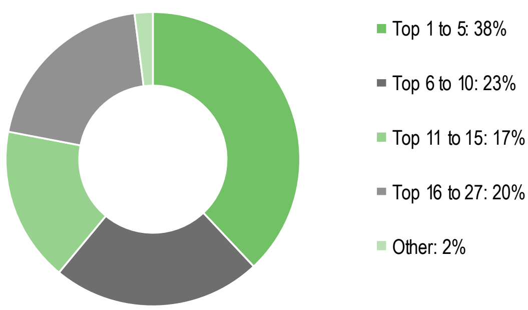


Share buyback policy and history (financial years)

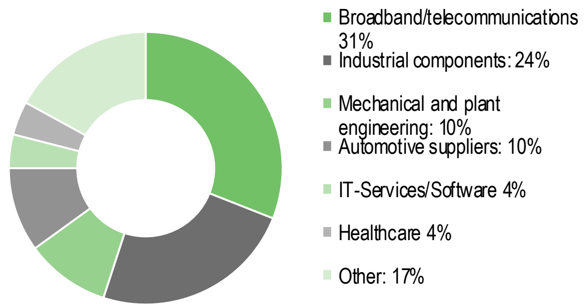
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



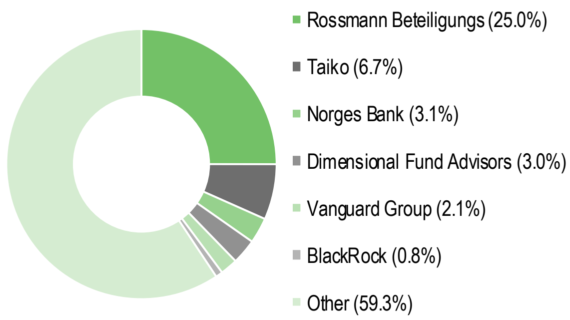
Concentration of DBAG's portfolio value by size (as at 30 September 2019)



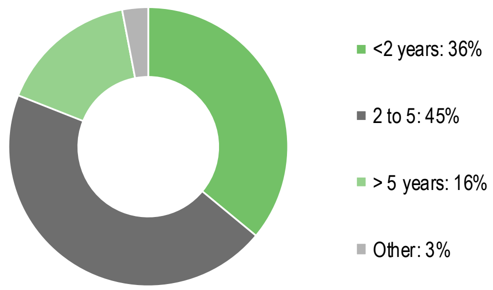
DBAG's portfolio exposure by sector (as at 30 September 2019)



Shareholder base (as at 19 December 2019)



Concentration of DBAG's portfolio value by age (as at September 2019)



Source: DBAG, Edison Investment Research, Refinitiv. Note: *Based on expenses net of fee income; adjusted for non-recurring items.

Results highlights: Fuelled by profitable exits

In FY19, DBAG reported a net profit of €45.9m, which is clearly ahead of the guidance given by management in July 2019 (which was for net profit to be down by more than 40% vs the €48m reference point, but at least positive). In line with its strategy of stable or rising dividend, DBAG declared an increase in dividend per share to €1.50 (from €1.45 in the prior year), which translates into a dividend yield of c 4%. The solid bottom line was largely assisted by the €39.7m uplift booked on the successful exit from inexio (see more detailed commentary later in the note), which was completed after reporting date and was recorded as an unrealised gain at end-September 2019. Moreover, DBAG reported a €13.3m net gain on realised disposals (vs €4.6m in FY18, see Exhibit 3), largely related to the Novopress and Infiana exits.

Excluding the unrealised gains on agreed transactions, the valuation impact from the change in market multiples used to value DBAG's holdings would have been -€22.7m due to a decline in the market valuations of peers in Q419. We understand this was particularly true for DBAG's core industrial segments, which were affected by headwinds from the economic slowdown and ongoing US-China trade war, as well as sector-specific challenges (such as weak order intake in the automotive sector, higher commodity prices or slow capacity additions in the German wind energy sector).

Exhibit 2: Income statement by segment (€m)

	FY19	FY18	y-o-y
Net result of investment activity	49.6	31.1	60%
Other income/expenses	(7.6)	(6.9)	9%
Private equity investments profit	**42.1**	**24.2**	**74%**
Fund services income	28.2	29.7	(5%)
Other income/expenses	(25.1)	(24.1)	4%
Fund services profit	**3.0**	**5.6**	**(46%)**
Consolidated net profit	**45.9**	**29.7**	**54%**

Source: DBAG

Exhibit 3: Result of valuation and disposal (€m)

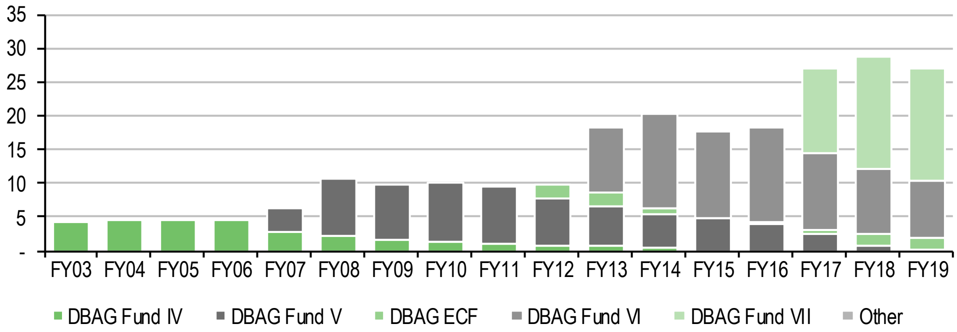
	FY19	FY18
Changes in fair value of unlisted investments	51.3	30.8
Change in earnings	*46.5*	*38.4*
Change in debt	*(12.7)*	*(22.3)*
Change in multiples	*18.3**	*3.6*
Change in exchange rates	*3.6*	*0.3*
Change, other	*(4.5)*	*10.9*
Net result of disposal	13.3	4.6
Other	(2.0)	(2.3)
Total	**62.7**	**33.1**

Source: DBAG. Note: *Includes €39.7m uplift from inexio exit, which was concluded after the reporting date.

We note that at present, 71% of DBAG's portfolio is valued based on the multiples method, while 7% is still valued at cost. On average, portfolio holdings are valued at 1.4x initial cost (including 1.1x for core sectors and 1.7x for focus sectors), which compares with DBAG's average historical realized exit multiple of 2.7x for MBOs and 3.3x for growth financings.

The fund services segment delivered fee income of €28.2m. This was down 5% y-o-y due to: 1) DBAG Fund V entering a phase with no fees charged; 2) disposals/deconsolidation within the DBAG Fund VI portfolio; and 3) lower transaction-based fees in DBAG ECF (see Exhibit 4). Together with the set-up costs associated with the new MBO fund (DBAG Fund VIII), this has translated into a segment result of €3.0m (vs €5.6m last year). However, the recent fund launch should drive up fees considerably in FY20 and beyond (see below for details).

Exhibit 4: DBAG fee income by fund (€m)



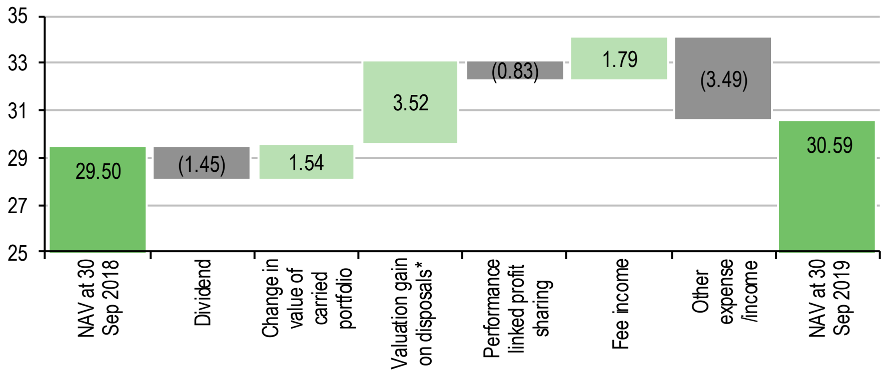
Source: DBAG, Edison Investment Research

NAV performance

During FY19, DBAG's NAV increased 9.1% in total return (TR) terms to €30.59 per share. This is within the range guided at the end of FY18 at 8.8–11.7% and also clearly ahead of DBAG's average cost of capital of 5.7%. Please note that we refer to the balance sheet value of equity, rather than DBAG's reported NAV, which excludes assets and liabilities other than those directly related to the portfolio.

The main contributor to NAV accretion was value changes within the portfolio (+€5.06 per share), especially those stemming from agreed and realized transactions (+€3.52), while fees collected from DBAG funds contributed €1.79 (compared to €1.90 in FY18). Other expense and income was up to €3.49 vs €2.57 in FY18, with the increase partially being the result of an actuarial change in the discount rate applied to the balance sheet value of pension obligations, which lowered DBAG's NAV by €6.5m (or €0.43 per share).

Exhibit 5: DBAG's FY19 NAV performance to end-September 2019 (€/share)



Source: DBAG, Edison Investment Research. Note: *Including disposals after reporting date.

FY20 guidance and KPIs

With the announcement of FY19 results, DBAG introduced new key performance indicators (KPIs), which will also be the reference point for communicating management guidance going forward. The former KPIs (consolidated net income and return on equity) are being replaced by NAV growth and income earned in the fund services segment, while shareholder returns (the third KPI) remain unchanged. According to management, the new approach will provide better visibility on performance in each of DBAG's two operating segments.

For FY20, DBAG's management provides cautious guidance amid subdued economic conditions in the German industrials sector. At the same time, however, it anticipates healthy development of the fund services business on the launch of DBAG Fund VIII as described below. The detailed guidance is stated as follows:

- NAV expected to decrease by up to 10% at end-FY20.
- Net income from the private equity investments segment more than 40% lower than the five-year average.
- Net income from the fund services business to be more than 20% ahead of FY19.
- Group net income guidance is for 20–40% below the five-year historical average.

On the longer perspective, DBAG aims to increase NAV by more than 20% between FY20 and FY22 and expects the result in the fund services segment to be over 10% ahead of FY20, with group net income in FY22 targeted to be more than 40% higher.

New buyout fund launched: DBAG Fund VIII

In December 2019, DBAG initiated its new buyout fund, which had already gathered €1.05bn of capital commitments close to the targeted fund size of €1.1bn (with remaining commitments expected by the company in early 2020). Total commitments will come from both external investors (€845m) and DBAG itself (€255m). Similar to DBAG Fund VII, the new fund consists of a main fund (€910m) and a top-up fund (€190m) with the latter providing flexibility to pursue larger transactions. The fund has a four- to six-year investment horizon and will target equity investments of €40–100m, which translate into total enterprise values between €75m and €250m.

DBAG Fund VIII, with a volume of €1.1bn, is similar in size to its predecessor (DBAG Fund VII: €1.01bn). This gives the investment team flexibility in selecting the companies for the fund's portfolio and takes into account the number of companies available in the relevant market segment. In addition, DBAG's investors benefit from lower fees on the capital under management due to the ongoing trend towards a shorter investment phase compared to the market. The limited fund growth is thus put into perspective because DBAG launches its new funds at shorter intervals (DBAG Fund VI: 2013, DBAG Fund VII: 2016, DBAG Fund VIII: 2020). At the same time, DBAG has slightly increased its contribution with 23% of total commitments compared to the 19–20% range for DBAG Funds V–VII. We believe DBAG Fund VIII may complete its first investments in the second quarter of 2020 at the earliest, given that its predecessor (DBAG Fund VII) still has some dry powder left.

DBAG will charge a management fee on committed capital in the main fund at 2% pa (in line with DBAG Fund VII), while the management fee in the top-up fund will be charged on capital invested at 1.75% (higher than the 1.0% charged in the case of DBAG Fund VII). Consequently, we estimate that this should translate into annualised incremental fees for DBAG of €18.2m (excluding the top-up fund) and up to €21.5m pa (in the case of full utilisation of the top-up fund). This compares with total fees received by DBAG in FY19 of €28.2m (from the buyout funds V–VII as well as DBAG ECF).

The initiation of the fund has been accompanied by an adjustment to DBAG's investment strategy. Management announced that it does not intend to launch any further ECF funds focused on growth financings and recently also small MBOs. In the current (second) investment period of DBAG ECF, 68% of the €97m commitments have already been allocated (of which DBAG contributed 41%). From now on, smaller MBO deals will be executed by the buyout funds (including in particular DBAG Fund VIII), while longer-term investments in minority stakes in owner-managed, mid-market enterprises will be conducted exclusively from DBAG's own balance sheet.

Financial resources and commitments

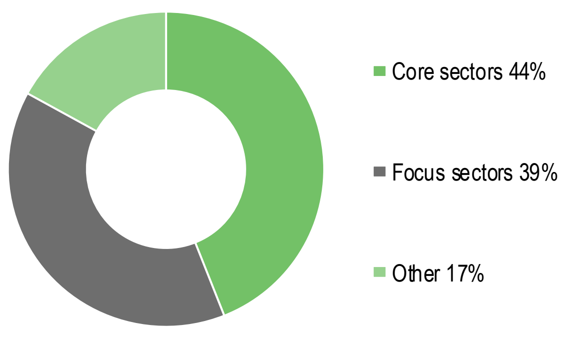
DBAG ended FY19 with €69.4m in financial resources, which included €43.9m in cash and €25.5m in liquid, short-term securities. Its €50m credit line remained undrawn, bringing available resources to €119.4m, covering 92% of capital commitments towards already launched DBAG funds (mainly DBAG Fund VII). After accounting for post-reporting date events, ie €35.6m investments (Cartonplast and STG) and c €44m proceeds from the inexio disposal, the available resources amount to c €128m. After accounting for the commitments to DBAG Fund VIII (€255m), this covers one-third of its overall commitments. However, given the four- to six-year investment horizon of the new fund, with some time required for initial ramp-up, as well as management expectations that DBAG will invest a total of c €90m annually over the next three years, its commitments seem to be well covered at this stage.

Asset allocation: Nearly 40% invested in focus sectors

Until 2013, DBAG's main competencies and portfolio composition were centred around four **core sectors:** industrial components, mechanical and plant engineering, automotive suppliers and industrial services. Subsequently, however, the company has made a strategic decision to pursue opportunities in selected new areas (which it now refers to as 'focus sectors'), including broadband/telecommunications, IT services/software and healthcare. In recent years, the importance of these sectors has gradually increased as they now represent 39% of DBAG's portfolio (as at end-September 2019, before the inexio exit). Simultaneously, the portfolio allocation to DBAG's core sectors declined from 94% in FY13 to 44% in FY19. This move seems to be paying off, demonstrated by the solid contribution to NAV total return from the new sectors and the recent successful disposal of DBAG's investment in inexio.

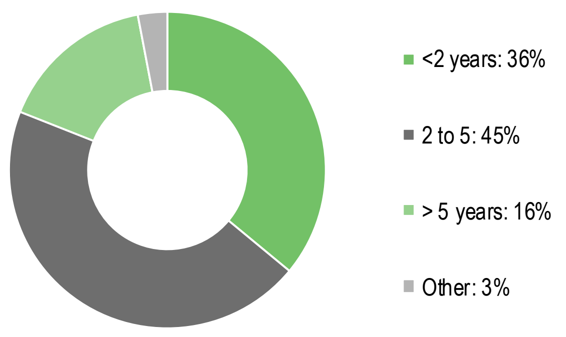
The share of focus sectors may increase further, given that DBAG sees a more limited set of attractive investment opportunities in its core sectors at present amid the recession in the German industrial sector. At the same time, we note that the latter means that the positive impact of optimisation processes in DBAG's core sectors may start to become visible later than initially expected. It also means that holding periods might extend by an additional one to two years vs the long-term average of 4.9 years.

Exhibit 6: Portfolio split by sector



Source: DBAG

Exhibit 7: Portfolio split by age of investment



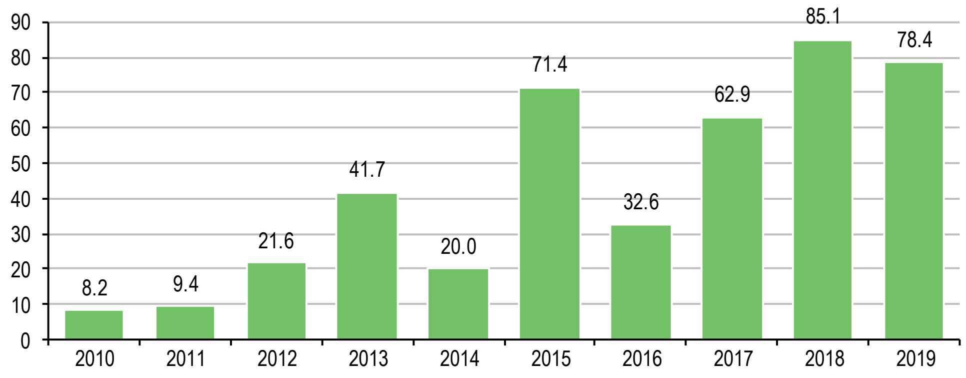
Source: DBAG

Companies from DBAG's core and focus buckets displayed varying dynamics in FY19. In the core sectors, 13 companies which were included in DBAG's portfolio throughout the whole financial year reported muted aggregate revenue and EBITDA growth of 4.7% and 0.2%, respectively. Meanwhile, four holdings from the focus sectors (DNS:NET, vitronet, BTV Multimedia and netzkontor nord) reported significantly higher revenue and EBITDA growth at 31.6% and 29.8% y-o-y, respectively, although this was largely fuelled by acquisitions (with organic growth of single-digit levels). The M&A activity may have contributed to the higher leverage of the companies from focus sectors, with average net debt to EBITDA at 4.5x for these compared to core sector companies at 2.4x. On the other hand, broadband telecommunications companies normally exhibit more stable earnings compared to the industrial sector and thus can service a higher debt load.

Initial and follow-on investments in FY19

In FY19 (ending September 2019), DBAG continued its portfolio diversification. It completed five new investments, while its portfolio companies concluded six acquisitions. In total, the company deployed €78.4m (vs the record-high level of €85.1m in FY18). This included c €57m invested in new holdings and c €21m invested in the further development of DBAG's portfolio companies, according to our calculations. New investments were made in both focus sectors (€33m – blikk, FLS, Cloudflight) and core sectors (€24m – Kraft & Bauer, SERO). A further two investments – Cartonplast (€26.0m) and STG Group (€9.6m) – were concluded (in November) after the end September reporting date. For a detailed discussion of transactions completed and announced during the year, see our previous notes. As at end-November 2019 (post the inexio disposal), DBAG's portfolio consists of 28 holdings.

Exhibit 8: DBAG portfolio investments in the respective financial years (€m)



Source: DBAG

In November 2019, DBAG co-invested €9.6m alongside DBAG ECF, acquiring a 36% stake in **STG Group**. The total investment volume (including investment by DBAG ECF) reached €23.3m, which translates into a DBAG-controlled stake of 88%. The transaction marked the seventh MBO of the DBAG ECF fund, which provides growth financing to companies and recently expanded its strategy to include majority positions. With this investment, DBAG ECF's allocation of committed capital reached 68%.

STG Group constructs, operates and maintains municipal fibre optic networks in the fibre-to-the-home (FTTH) infrastructure. Approximately 20,000 households are connected to STG's network operated in the Ruhr area in Germany. In 2018, the company generated c €16m revenues. We note that it is DBAG's sixth investment focused on broadband business. DBAG considers the company a potential platform for a buy-and-build strategy. The business should benefit from the current low market penetration, as only 7% of German households have access to fibre optic networks (one-third of the EU average).

Disposals and deconsolidation

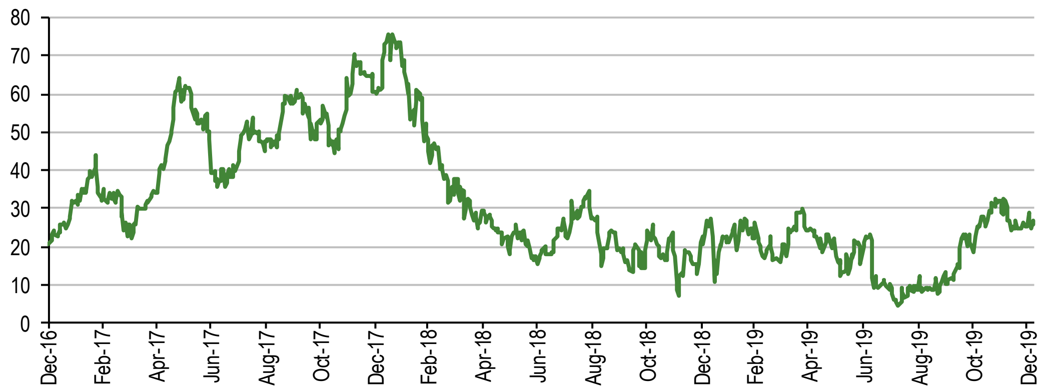
During FY19, DBAG exited five investments which delivered c €64m in cash proceeds. DBAG Fund VI sold its investments in **Cleanpart** and **Infiana** at money multiples of 2.4x and 2.2x, respectively after holding periods of 3.5 and 4.8 years (vs DBAG's historical MBO average of 2.7x and 4.9 years, respectively). The fund has also fully written off its investment in **Unser Heimatbäcker**, which filed for insolvency in December 2018. DBAG ECF sold its investments in **Novopress** and **PSS**, at respective money multiples of 15.7x and 0.5x. We note that PSS was the fund's smallest investment (€2.3m at cost). See our earlier notes for details on transactions announced prior to Q419.

Post the reporting date, DBAG completed the disposal of its stake in inexio, generating €44m in cash proceeds (which represents an exit multiple of 7.5x) and booking an uplift of €39.7m. DBAG initially invested €3.2m in the company in May 2013 alongside DBAG ECF. Over time, DBAG increased its stake and participated in the capital raise as part of the MBO executed by Warburg Pincus in 2016. Consequently, DBAG's equity investment increased to €7.5m (representing a 6.9% stake). inexio is a provider of fibre optic broadband to rural parts of southern Germany, which expanded organically as well as through M&A in recent years. It has grown its annual revenues to €78m from €28m at the time of DBAG's investment. It constitutes the first exit from DBAG's focus portfolio.

Valuation

DBAG's reported NAV is exclusively attributable to the value of its private equity investment portfolio and does not account for the fair value of its fund services business, which at end-FY19 represented third-party assets under management of c €1.4bn and generates considerable recurring fee income. We note that on DBAG Fund VIII's launch, the total AUM should increase to c €2.5bn from €1.7m at end-FY19. In FY19, the segment generated €28.2m in fees, translating into a pre-tax profit of €3.0m. Consequently, there is an inherent premium when comparing DBAG's share price with its reported NAV, which disguises any underlying premium or discount that the market may be applying to the value of DBAG's private equity investment portfolio. We believe this is the primary reason that the company's shares have traded at a premium to NAV over the last three years, as illustrated in Exhibit 9. Over the last year, DBAG's shares traded at a premium of around 10–30%, which currently stands at 26% after a rebound from a multi-year low of 4.3% in August 2019 (which we believe was triggered by the profitable disposal of inexio).

Exhibit 9: Share price premium to NAV over three years (%)



Source: Refinitiv, Edison Investment Research. Note: Positive numbers indicate a premium, negative numbers a discount.

DBAG's reported equity (which we treat as an equivalent of NAV, as discussed above) at end-September 2019 stood at €460.2m, which compares to the current market capitalisation of €576.2m. We estimate the price tag on the fund services segment implied by DBAG's market capitalisation using two scenarios. If we assume that the private equity investments business is valued at a discount to NAV in line with the current discount of the LPX Europe index (9.9%), the value of the fund services business amounts to €165.5m and translates into an earnings multiple of 54.6x (LTM basis). This compares to our last estimate from September, when the LPX discount amounted to 11.2%, implying a multiple of 24.9x. Alternatively, if we assume the market is valuing the company's private equity business in line with its last reported NAV, this implies a value attached to the fund services business of around €119.8m (21% of the market cap), implying an LTM earnings multiple of 39.5x. This compares to our previous calculations at the time of the Q319 results of an 11.1x earnings multiple based on similar assumptions.

While these multiples may seem high, we believe the market is already discounting the higher fee income from the upcoming launch of DBAG Fund VIII (as discussed earlier in the note). Moreover, we believe that significant uplift on the recent disposal of inexio was a share price development catalyst. Finally, we note that in each of the last five financial years, DBAG recognised positive net disposal gains (including gains on agreed but yet to be finalised exits). These represented up to c 20% of DBAG's beginning NAV, suggesting its portfolio valuation may be considered quite conservative.

Peer group comparison

We have compared DBAG with other listed private equity investment companies with a prime focus on Europe in Exhibit 10. However, we acknowledge that DBAG is the only company in the group that targets mid-sized companies in German-speaking countries. Moreover, unlike all the peers except 3i in the UK, DBAG also manages third-party funds. As discussed earlier, we see the value of DBAG's fund service business as the main reason that its shares trade at a premium to its reported NAV. This contrasts with the peers that do not manage third-party funds, some of which are trading at a wide discount to NAV. DBAG's c 4% dividend yield is among the highest in the peer group (the average is 3.2%).

DBAG's 8.2% NAV total return in sterling terms (9.1% in euro terms) over one year to end-September 2019 lagged that of the peer group. We believe the main contributor to performance was DBAG's relatively high exposure to the German industrial market, which experiences more intense headwinds from the slowing economy and trade war threats than other sectors. In the longer term, performance is more aligned with the peer group, although lower than the average.

Exhibit 10: Listed private equity investment companies peer group as at 18 December 2019*

% unless stated	Region	Market cap £m	NAV TR 1 year	NAV TR 3 years	NAV TR 5 years	NAV TR 10 years	Price TR 1 year	Price TR 3 years	Price TR 5 years	Price TR 10 years	Premium/ (discount)	Dividend yield
Deutsche Beteiligungs	Europe	492.9	8.2	46.8	107.4	193.3	1.3	31.2	118.6	229.4	26.0	3.9
3i	Global	10,586	19.9	83.7	211.2	344.8	28.8	98.5	266.4	463.7	24.6	3.4
HgCapital Trust	UK	1,053	25.2	73.8	141.0	264.0	18.1	72.5	157.1	254.7	3.4	1.9
ICG Enterprise Trust	UK	687	6.1	44.7	73.8	205.0	2.2	48.5	66.2	218.5	(14.7)	2.2
Oakley Capital Investments	Europe	542	25.9	57.8	77.6	171.4	19.2	76.3	53.7	168.8	(12.5)	1.6
Princess Private Equity	Global	643	10.9	42.8	109.0	171.0	(2.2)	42.6	125.1	372.2	(7.8)	6.1
Standard Life Private Equity	Europe	541	0.6	32.0	85.1	202.0	5.7	47.6	81.2	290.0	(20.2)	3.6
Average		**2,342.2**	**14.8**	**55.8**	**116.3**	**226.4**	**12.0**	**64.3**	**125.0**	**294.6**	**(4.5)**	**3.2**
Rank in peer group		**7**	**5**	**4**	**4**	**5**	**6**	**7**	**4**	**5**	**1**	**2**

Source: Morningstar, Edison Investment Research. Note: *Performance to end-September 2019. TR = total return in sterling terms.

EDISON

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