

Deutsche Beteiligungs

Macro environment provides some headwinds

Deutsche Beteiligungs (DBAG) agreed the seventh MBO of DBAG Fund VII (cloudflight.io), which as a result will reach 60% allocation of its investment commitments, reflecting solid portfolio ramp-up. The first months of 2019 witnessed a rebound in equity markets, allowing DBAG to post €29.0m net income for Q219 on the back of portfolio valuation. At the same time, however, the subdued outlook of the German economy coupled with some sector-specific challenges increase the risk of lower than expected growth prospects in portfolio companies and translated into an €8.4m negative valuation impact in Q219.

12 months ending	Share price (%)	NAV (%)	LPX Europe (%)	LPX Europe NAV (%)	SDAX (%)	FTSE All Share (%)
30/04/15	60.8	16.4	24.6	15.3	17.7	21.0
31/03/16*	(7.0)	12.6	(1.3)	1.4	4.6	(14.2)
31/03/17	24.0	15.5	20.0	16.0	14.6	13.0
31/03/18	26.8	16.4	13.0	7.0	18.2	(1.2)
31/03/19	(12.8)	4.2	2.4	12.5	(8.3)	8.2

Source: Thomson Datastream. Note: *11-month period due to change in financial year end. Discrete rolling total return performance in euros up to last reported NAV.

Performance back in the black

DBAG's NAV per share rebounded 7.0% q-o-q in Q219 in total return (TR) terms and amounted to €28.56, translating into a one-year TR of 4.2%. This was achieved amid a broader stock market recovery, as 71% of DBAG's portfolio as at end-March 2019 was valued based on multiples of listed global peers. H119 net income came in at €7.6m (59% lower y-o-y) and thus the targeted FY19 net income of c €29–38m implied by the guidance remains under pressure. However, we acknowledge that DBAG's long-term NAV returns are much more important than net profit booked in any given year. The fund services segment's profit was down 17.3% y-o-y to €1.8m in H119 with lower fee income due to exits coupled with higher personnel costs.

Steady deployment of investing commitments

In H119, DBAG finalised three investments and provided additional funding to existing holdings for add-on acquisitions, deploying €56m. Moreover, after the reporting date, DBAG Fund VII agreed its seventh MBO, which will result in it reaching a committed capital deployment level of 60%. The fund is acquiring the software developer cloudflight.io, which was formed following the merger of Austria's Catalysts GmbH and Crisp Research. DBAG is paying €8.0m for a 12% stake as part of the deal.

Valuation: 4.1% yield and 24% premium to NAV

DBAG's shares have traded in a broad corridor of a 10–30% premium to NAV over the last 12 months. In our view, this premium is largely attributable to the market-implied value of the fund services business. DBAG currently trades at a 24.5% premium to end-March 2019 NAV, which implies an LTM earnings multiple of the fund services business at 26.4x (if we assume a discount in line with the broader market represented by the LPX Europe Index). DBAG's shares currently offer a dividend yield of c 4.1% vs the peer average of 3.2%.

Investment companies private equity

23 May 2019

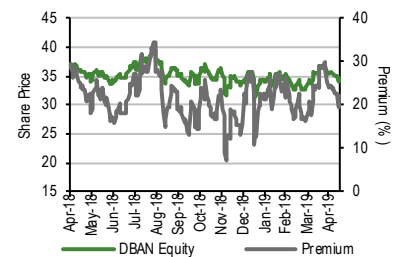
Price	€35.55
Market cap	€535m
NAV*	€429.6m

NAV per share*	€28.56
Premium to NAV	24.5%

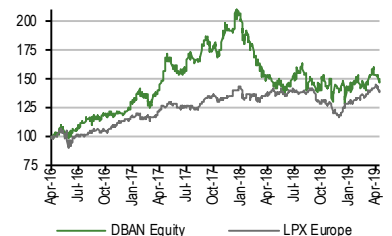
*As at 31 March 2019.

Yield	4.1%
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	€39.55	€31.05
NAV/share high/low	€29.50	€28.05

Gearing

Gross*	0.0%
Net cash*	15.0%

*As at 31 March 2019.

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Exhibit 1: Deutsche Beteiligungs at a glance

Investment objective and fund background

DBAG 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

- 14 May 2019: Q219 results – NAV 1Y TR 4.2% vs LPX Europe NAV TR 2.4%.
- 2 May 2019: DBAG Fund VII agreed to invest in cloudflight.io.
- 29 January 2019: DBAG ECF sold its investment in PSS.
- 21 January 2019: DBAG acquires radiology practice to radiology group.

Forthcoming

AGM	February 2020
Interim results	8 August 2019
Year end	30 September
Dividend paid	Following the AGM
Launch date	December 1985
Continuation vote	N/A

Capital structure

FY18 net expense ratio*	0.0%
Net cash	15.0%
Annual mgmt fee	N/A (self-managed)
Performance fee	N/A (self-managed)
Company life	Unlimited
Loan facilities	€50m (undrawn)

Fund details

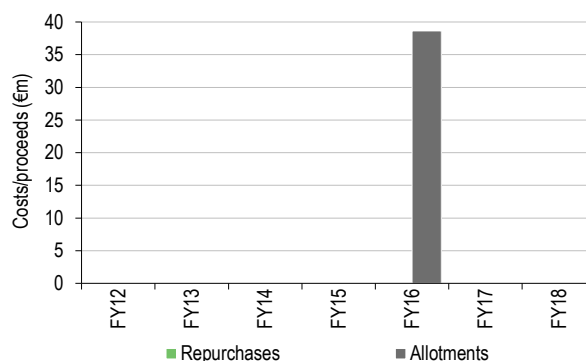
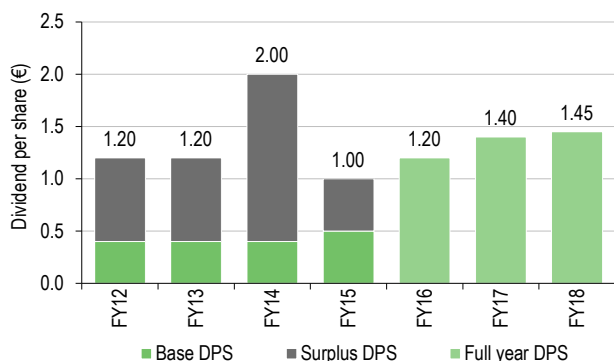
Group	Deutsche Beteiligungs
Manager	Team managed
Address	Boersenstrasse 1 60313 Frankfurt am Main, Germany
Phone	+49 69 95787-01
Website	www.dbag.com

Dividend policy and history (financial years)

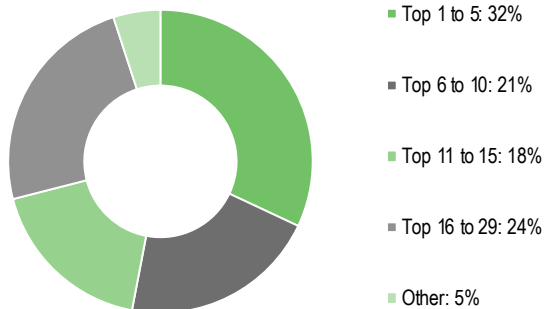
DBAG's policy is to pay a stable or rising annual dividend. Prior to FY16, a base dividend was paid, supplemented by a surplus dividend based on realised gains.

Share buyback policy and history (financial years)

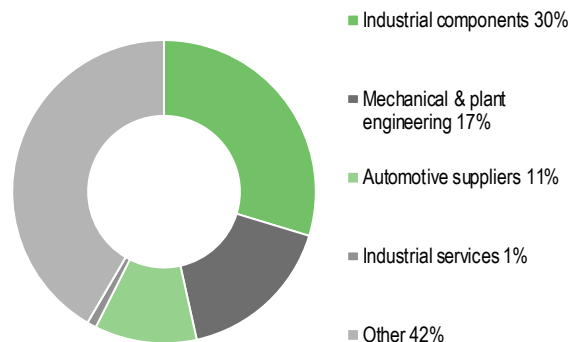
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



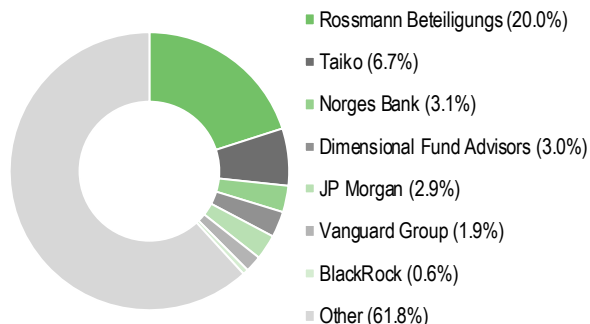
Concentration of portfolio value by size (as at 31 March 2019)**



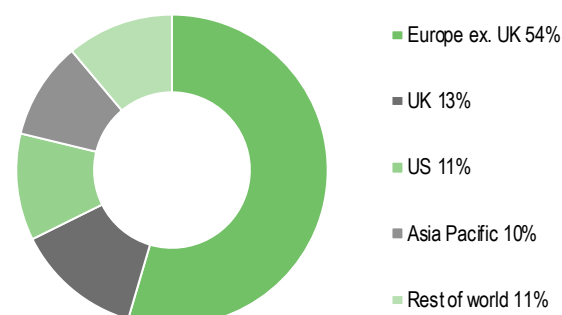
Portfolio exposure by sector (as at 31 March 2019)**



Shareholder base (as at 15 May 2019)



Portfolio companies' revenues by region (latest available data)



Source: DBAG, Edison Investment Research, Bloomberg, Thomson Reuters. Note: *Based on expenses net of fee income; adjusted for non-recurring items. **Does not include co-investment funds.

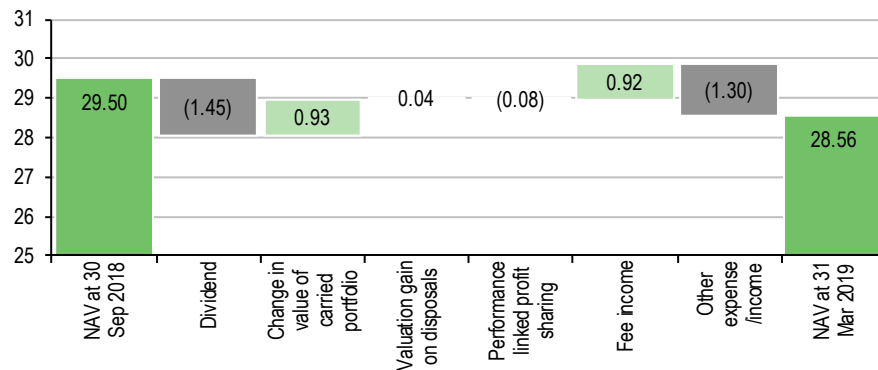
H119 highlights: Equity markets rebounded...

DBAG reported a net profit of €7.6m for H119 – 59% lower than the €18.5m posted in H118. The company's results were influenced by lower capital market valuations that are used as a reference to value DBAG's private equity investment portfolio. In H119, the negative impact stood at €12.9m (compared to a negative impact of €15.6m in H118), which was caused by the market downturn in late 2018 (as DBAG recorded a €47.8m negative impact in Q119 ended December 2018). Equity per share decreased to €28.56 from €29.50 at end-September 2018, which translates into a 1.7% increase (including dividend of €1.45 paid in Q219), and a 4.2% y-o-y performance.

The fair value of DBAG's portfolio amounted to €389.7m, up 11.8% from €348.7m at end-September 2018. The increase was driven mostly by investments (€56.2m), as after a harsh Q119 and the subsequent rebound in Q219, the effect of net valuation changes came in at a moderate positive €10.4m. During H119, DBAG added to its portfolio FLS, Kraft & Bauer and Sero, and also made follow-on investments in duagon, Frimo, netzkontor, BTV, the radiology group and Telio. We note that as of end-March 2019, the purchase of radiology group was not yet finalised.

Derecognitions (including portfolio exits and the deconsolidation of insolvent entities) of €25.6m were primarily related to the disposal of Cleanpart in Q119. The portfolio value was assisted by an overall positive €22.4m effect arising from the increased earnings prospects of portfolio companies in the current year versus 2018, with the effect of the roll-over from 2018 to 2019 reflected in Q119 results. In Q219 alone, portfolio companies' growth prospects deteriorated, contributing a negative €8.4m to portfolio value, as overall economic momentum slowed, while selected sectors (eg automotive and wind energy) faced additional headwinds. Other changes in portfolio value amounted to €0.8m and included improved planning assumptions in DNS:net and inxio, driving their value up by €6.7m. The effect was offset by a compliance incident at one of the portfolio companies. DBAG applied a risk discount to that company's valuation, which resulted in a full write-off of company's value at the reporting date,

Exhibit 2: DBAG's NAV performance H119 (€/share)



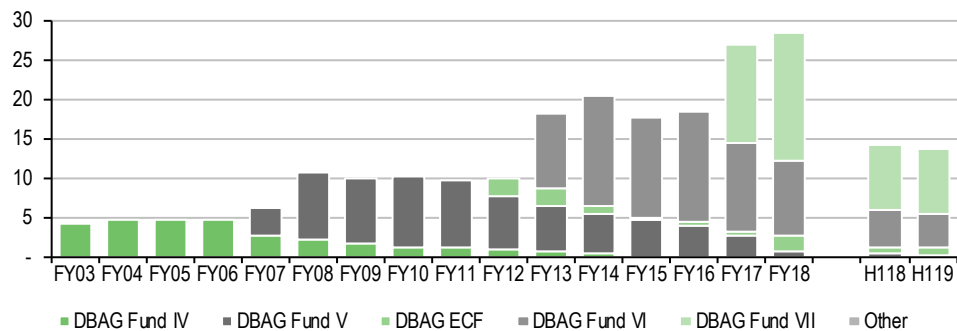
Source: DBAG, Edison Investment Research

The Fund Investment Services division reported fee income of €13.8m (down 3.4% y-o-y, excluding fees paid by DBAG) in H119. The lower fee income is attributable mostly to DBAG Fund VI and DBAG Fund V. Fees from DBAG Fund VI amounted to €4.5m (32% of DBAG's total fee income) and was down 8% y-o-y on the back of lower AuM as Cleanpart was sold in Q119 and Unser Heimatbäcker was written-off due to insolvency. Fees from DBAG Fund V on the other hand are no longer paid as the two-year period following the end of the customary disposal phase ended in February 2019. Having said that, as its portfolio was already largely realised, fees from this fund represented only 2.3% of DBAG's fee income in FY18.

Segment profit came in at €1.8m, 17.3% lower y-o-y and in line with DBAG's FY19 earnings guidance. This is despite a non-recurring effect recognised in Q118 related to an adjustment for

remuneration that DBAG had received for the work performed by members of the investment team on supervisory bodies of DBAG Fund V portfolio companies of €0.9m. On top of lower fee income, this was also driven by higher personnel costs, which increased 20% y-o-y on the group level due to higher staffing and temporary duplication of positions, as well as a one-off correction of transaction-based fees from DBAG ECF relating to the previous year of €0.5m. We note that further acquisitions alongside ECF II in H219 would trigger transaction-based fees and also increase the recurring management fees (which are based on invested rather than committed capital in case of this fund), assisting the segment result. The transaction fees were introduced in DBAG ECF in FY18 and amounted to €0.4m in H119.

Exhibit 3: DBAG fee income by fund (€m)



Source: DBAG, Edison Investment Research

Recent investments and dividend distribution lowered DBAG's financial resources to €64m at end-March 2019 from €119m at end-September 2018. This compares to undrawn capital commitments of €154m (FY18: €198m) towards DBAG Fund VII and new vintages of DBAG ECF, which are callable until 2022. Financial resources covered 42% of these commitments (down from 60% at end-FY18), with additional liquidity secured by the currently open and undrawn credit line of €50m. The remaining €40m should be funded by disposal proceeds. At end-March 2019, this represents 9% of DBAG's NAV (7% at end-FY18)

...but short-term macro and sector outlook weakens

The overall muted economic outlook, as well as challenges in certain sectors have led to the incorporation of reduced growth expectations or increased probability of risk materialisation in the valuation of some portfolio companies in Q219. This resulted in a net negative impact on portfolio value of €8.4m. Still, expected earnings change contributed a positive €22.4m to portfolio value overall in H119, as in Q119 alone the impact was a positive €30.9m. The latter included the multiples roll-over effect (ie moving from 2018 to 2019 budgeted results). The main areas, where portfolio companies experience worse than expected developments, are: 1) slowdown in the demand for wind turbines due to regulatory bottlenecks (eg Silbitz, Sjølund), 2) uncertainties in the automotive sector, eg due to Worldwide Harmonized Light Vehicle Test Procedure roll-out (eg Dieter Braun, Sero), 3) high commodity prices (eg More than Meals, PolyTech).

The German economy has slowed down recently (even if partially due to the temporary industry-specific challenges) and is set to develop at 0.8% GDP in 2019, which is the IMF's second-lowest expectation for European economies. According to the IMF, the slowdown in underlying economic momentum is triggered by lower global demand for industrial goods, which translates to slowing exports growth; in 2018 the growth rate decreased to 2.0% y-o-y from 4.6% in 2017 and the European Commission expects it to decrease to 1.1% growth in 2019. This is particularly important given DBAG's high exposure to the industrial sector (we estimate 59% as at end-March 2019).

Some sectors lack available labour as the unemployment rate in Germany reached 3.2% – a level unseen since 1980. These factors, as well as other signs of easing economic momentum such as customers demanding longer payment periods, and deferring orders are visible to some extent in most of the portfolio companies according to the management. Having said that, the risk of a severe economic downturn seems limited at the moment.

Currently DBAG's portfolio is relatively young, with 45% of capital invested (37% of portfolio value) representing investments held for less than two years at end-March 2019. This leads to a conservative short-term outlook with a limited number of exits and calls for a more longer-term approach towards DBAG's performance.

DBAG Fund VII and DBAG ECF II increasing allocation

In H119 DBAG finalised three new investments alongside DBAG Fund VII and DBAG ECF II as well as several follow-on investments deploying a total of €56m in the process. We believe that this highlights DBAG's ability to steadily deploy its capital, as it is in line with its target to invest c €94m per annum over the next three years. Three newly acquired companies – Kraft & Bauer Holding, SERO Schröder Elektronik Rohrbach and FLS (Fast Lean Smart) – were described in detail in our [previous note](#) and no new holdings were added to the portfolio in Q219. At the end of March, DBAG Fund VII had already allocated 58% of its investment commitments of €808m (with 22% out of the further €202m from the top-up fund allocated as well) and including the investment in cloudflight.io agreed upon after reporting date, the allocation will reach 60%.

cloudflight.io

After the reporting date, in a transaction agreed on 2 May 2019, DBAG will deploy €8.0m in exchange for a 12% stake in newly formed Cloudflight Holding GmbH and, together with DBAG Fund VII, agreed to acquire a majority stake. This resulted from DBAG Fund VII acquiring majority stakes in Austria's Catalysts GmbH and Crisp Research AG through an MBO with each of the founders retaining a significant stake in the business. The two companies were merged into a new entity (cloudflight.io), and further acquisitions are planned as part of its growth strategy. This is the seventh MBO of DBAG Fund VII and upon expected closing in June 2019 the fund will have invested 60% of its capital commitments.

cloudflight.io is a digital transformation & service provider in Europe. It specialises in data-driven applications and cloud-native architectures and employs around 350 software and cloud specialists in 14 locations. The company delivers software solutions to companies such as Adidas, Bayer, Bosch and Eon. The merger and growth financing will be leveraged to allow the company to pursue its European growth strategy. The market for cloudflight.io should grow by 30% pa in the coming years according to DBAG.

Disposals

In Q119, DBAG completed the sale of Cleanpart to Mitsubishi Chemicals Corporation as agreed in Q418, receiving €19.0m and realising a quite attractive 2.4x money multiple after a 3.5-year holding period. This compares with DBAG's respective historical averages of 2.8x and 4.9 years (which already reflect complete write-downs of unsuccessful investments). In January this year, DBAG sold its investment in PSS for a yet undisclosed price. The investment was relatively small, as DBAG invested €2.3m for a minority stake of PSS back in 2017. The investment was sold to the majority shareholder and any payments will occur after subsequent sale by the new sole owner. Unser Heimatbäcker filed for insolvency and was excluded from the portfolio in Q219. The insolvency burdened the portfolio valuation by €1.6m in H119 and was already reflected in full in Q119 results.

Buy-and-build

Although DBAG's management acknowledges that it does not always have the opportunities to deploy a buy-and-build strategy in the German mid-sized sector (for instance due to lack of enough suitable acquisition targets), it continues to deploy this approach in selected cases. BTV Multimedia (acquired in August 2018) performed its second acquisition purchasing DKT A/S in March 2019. DKT, like BTV, is a broadband network equipment manufacturer, with a market presence in Denmark and neighbouring European markets, and had revenues of €15m. The first 'add-on' to BTV was Anedis (a major competitor in the German market) in Q119 where DBAG contributed €2.2m to the deal. The acquisition of DKT will be financed as part of the refinancing of the investment in BTV. The combined entity should deliver approximately €65m in revenues pa, and DBAG's total invested capital in the entity currently amounts to €7.0m.

The acquisition of radiology group was not yet finalised as at end March 2019. The transaction was agreed in March 2017, when DBAG committed €15m for an 11% stake in the newly formed group. DBAG highlighted that all legal prerequisites have now been fulfilled and it expects to close the transaction by the end of June 2019. During H119 DBAG, alongside DBAG Fund VII, provided funds for the acquisition of two additional practices that will become part of the group. The closing of the transaction would invoke the drawdown of additional funds. netzkontor nord acquired BFE Nachrichtentechnik in H119, but transaction details were not disclosed.

After the reporting date, two add-on acquisitions to portfolio companies were performed as well. Firstly, duagon (a provider of network components, in particular for rolling stock communication) agreed to acquire OEM Technology Solutions, which also offers communication and management solutions for railway vehicles. The transaction will be financed without additional capital from DBAG funds. Secondly, Telio concluded an acquisition with additional equity investment from DBAG Fund VI. Transactions will not affect future fee income in the fund services segment, as the funds' fees are based on committed capital.

Valuation: Premium remains at c 10–30% to NAV

As discussed in our previous update notes, 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 currently represents third-party assets under management of c €1.4bn and generates considerable recurring fee income. In contrast, DBAG's market value reflects the value of both its fund services business and its private equity investments. 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 that this is the primary reason why the company's shares have traded at a premium to NAV for all of the last three years (currently at 24.5%), as illustrated in Exhibit 4.

Exhibit 4: 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 NAV performance mirrored the significant sell-off in late 2018 and subsequent rebound of early 2019. The NAV return during H119 (ending March 2019) amounted to 1.7% including a dividend of €1.45 paid in February, and 4.2% on a year-on-year basis. DBAG's reported NAV as at end-March 2019 stood at €429.6m, which compares to the current market capitalization of €535m. We estimate the price tag on the fund services segment implied by DBAG's market capitalisation in two scenarios. If we assume that 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 €105.4m (20% of the market cap). Based on the LTM earnings before tax of the latter segment, this translates into an earnings multiple of 18.6x. This compares to our last estimate as at Q119 results of a 13.1x earnings multiple based on similar assumptions. Alternatively, 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 (10.3%), the value of the fund services business goes up to €149.6m and translates into an earnings multiple of 26.4x. This compares to our last estimate from March, when the LPX discount amounted to 13% implying a multiple of 21.1x. However, in this context it is important to note that 13% of DBAG's current portfolio is valued at acquisition cost and will be moved to the multiples method basis 12 months after the acquisition date, and that we have not adjusted the multiple for the transaction-based fees earned by DBAG over the last 12 months.

Peer group comparison

We have compared DBAG with other listed private equity investment companies with a prime focus on Europe in Exhibit 5. However, we acknowledge that DBAG is the only company in the group that targets mid-sized companies in the 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 its peers that do not manage third-party funds, some of which are trading at a wide discount to NAV. DBAG's 4.1% dividend yield is among the highest in the peer group (average of 3.2%).

Exhibit 5: Listed private equity investment companies peer group as at 22 May 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	535.0	2.4	52.2	95.0	173.2	(14.2)	49.0	107.2	421.8	24.5	4.1
3i	Global	10,411.1	12.4	93.8	188.1	201.2	19.5	141.6	202.1	517.5	39.8	3.3
HgCapital Trust	UK	798.7	12.6	63.0	114.5	205.6	19.6	99.8	136.7	302.2	(0.1)	2.1
ICG Enterprise Trust	UK	607.2	12.8	54.8	78.5	185.6	8.5	74.5	58.6	507.5	(17.5)	2.5
Oakley Capital Investments	Europe	426.2	15.6	46.4	46.4	171.0	19.0	54.7	25.8	231.2	(25.2)	2.2
Princess Private Equity	Global	615.4	8.8	53.6	93.4	114.7	(0.3)	75.6	121.9	780.8	(10.2)	5.5
Standard Life Private Equity	Europe	548.9	8.3	42.7	81.9	160.4	12.7	91.8	101.2	890.7	(13.3)	3.6
Average		2,234.6	11.8	59.1	100.5	173.1	13.2	89.7	107.7	538.3	(4.4)	3.2
Rank in peer group		6	7	5	3	4	7	7	4	5	2	2

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

DBAG's NAV total return in sterling terms was broadly in line with the peer group over three and five years to 30 March 2019, ranking fifth and third out of seven, respectively. The company's one-year NAV TR performance was moderate at 2.4%, compared with average peer performance at 11.8%. The company posted a 10-year NAV return at the peer average of 173%. The share price performance in sterling terms is significantly below NAV returns over one and three years (-14.2% and 49.0%, respectively) and below the peer group average of 13.2% and 89.7%, respectively.

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