

Deutsche Beteiligungs

Market decline weighs on H118 performance

Deutsche Beteiligungs (DBAG) reported €19.3m net income for the first half of FY18, with a 4.5% dividend-adjusted NAV return. NAV per share declined slightly to €29.43 at end-March 2018, after payment of the €1.40 FY17 dividend. Management has lowered earnings guidance for FY18 due to a decline in market valuation multiples that also weighed on returns in the first half, while the underlying progress of portfolio companies remains broadly on track. The recent sharp decline in the share price premium to NAV to 19.6% suggests the market may now be applying an underlying discount to the NAV of the private equity investment portfolio.

12 months ending	Share price (%)	NAV (%)	LPX Europe (%)	LPX Europe NAV (%)	SDAX (%)	FTSE All-Share (%)
30/04/14	11.8	10.0	18.8	9.9	22.7	14.0
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	16.8	20.0	16.0	14.6	13.0
31/03/18	26.8	17.4	13.0	7.0	18.2	(1.2)

Source: Thomson Datastream, Bloomberg. Note: *11-month period due to change in financial year end. Discrete total return performance in euros.

Steady underlying progress in H118

DBAG reported a €20.3m overall net investment gain for H118, with valuation gains for the majority of its investments over the period. Higher expected earnings for portfolio companies in 2018 versus 2017 made the largest contribution to valuation gains, but this effect was offset to a large extent by a decline in market valuation multiples. Both DBAG's private equity investments and fund investment services businesses reported positive earnings. New MBO investments were completed in Sjølund and netzkantor nord alongside the DBAG ECF fund, but the half year was characterised by a high level of transaction activity at the portfolio company level.

Outlook: Reduced earnings guidance for FY18

The market decline in the first quarter of 2018 led to lower market earnings multiples being used to value DBAG's portfolio companies at end-March 2018. As a result, DBAG's management has lowered its guidance for FY18 and now expects net income to be 10% to 20% lower than the €43.0m average of the last five financial years. This compares to previous guidance for a more than 20% increase in net income versus the reference level. This revision does not reflect any significant change in the underlying outlook for portfolio companies. We note that the guidance assumes constant market earnings multiples and so is subject to upward or downward revisions following significant market moves.

Valuation: Premium to NAV has sharply narrowed

DBAG's share price premium to NAV has sharply narrowed from 72.1% in mid-January 2018 to 19.6% currently. With no factors to suggest any change in the outlook for the fund services business, it appears the market may be applying a c 16% underlying discount to the NAV of the private equity investment portfolio, compared to a c 37% premium previously (see page 4).

Investment companies

25 May 2018

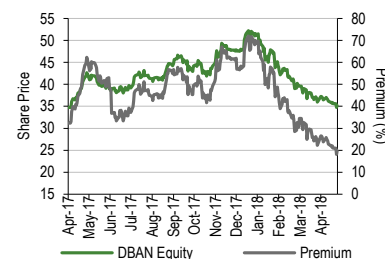
Price	€35.20
Market cap	€530m
NAV*	€443m

NAV per share*	€29.43
Premium to NAV	19.6%

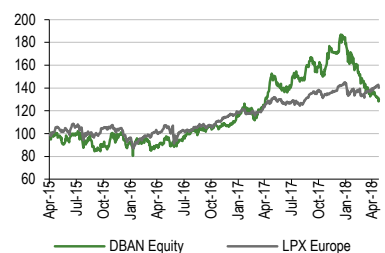
*As at 31 March 2018.

Yield	4.0%
Ordinary shares in issue	15.0m
Code	DBAN
Primary exchange	Frankfurt
Sector	Private equity
Benchmark	N/A

Share price/premium performance



Three-year performance vs index



52-week high/low	€52.20	€34.75
NAV high/low	€30.34	€28.54

Gearing

Gross*	0.0%
Net cash*	30.6%

*As at 31 March 2018.

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Exhibit 1: Company 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

- 8 May 2018: Q218 results – NAV TR +1.6% vs LPX Europe NAV TR -1.6%.
- 16 April 2018: FY18 earnings guidance reduced, primarily due to the effect of lower market valuation multiples at end-March 2018.
- 5 April 2018: DBAG invests up to €11m in portfolio company duagon as part of capital increase to finance merger with MEN Mikro Elektronik.
- 8 February 2018: Q118 results – NAV TR +2.6% vs LPX Europe NAV TR +5.3%.
- 15 January 2018: Announcement of MBO investment in netzkantor nord, a fibre optic network construction and network management services provider.

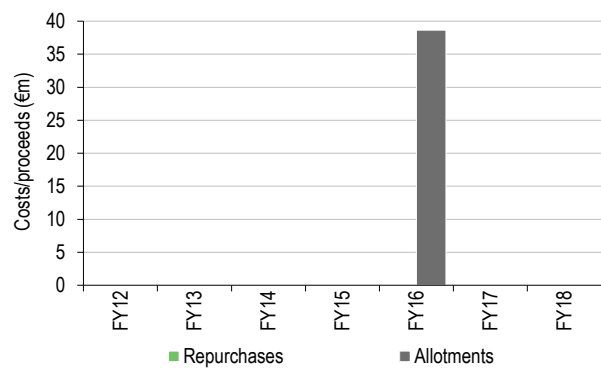
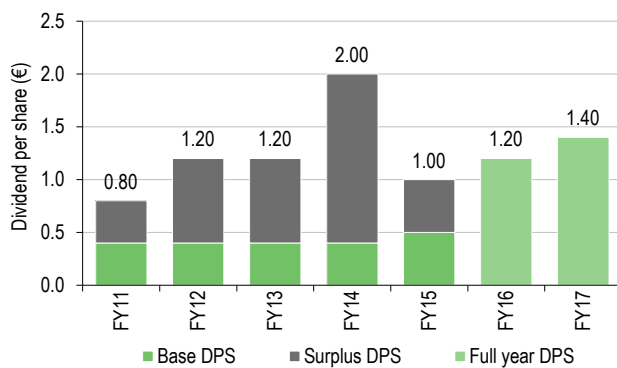
Forthcoming		Capital structure		Fund details	
AGM	February 2019	FY17 net expense ratio*	0.4% (0.8% unadjusted)	Group	Deutsche Beteiligungs
Quarterly results	7 August 2018	Net cash	30.6%**	Manager	Team managed
Year end	30 September	Annual mgmt fee	N/A (self-managed)	Address	Boersenstrasse 1
Dividend paid	February 2019	Performance fee	N/A (self-managed)		60313 Frankfurt am Main, Germany
Launch date	December 1985	Company life	Unlimited	Phone	+49 69 95787-01
Continuation vote	N/A	Loan facilities	€50m	Website	www.dbag.de

Dividend policy and history (financial years)

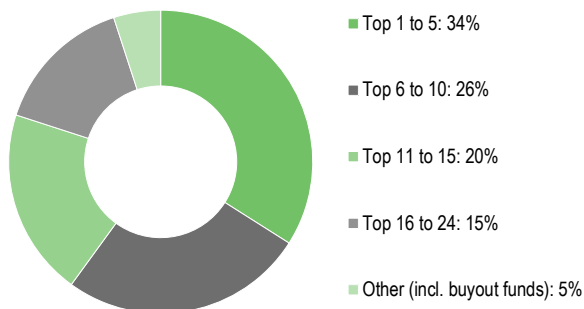
DBAG's policy is to pay a stable or rising annual dividend. Prior to FY16, a base dividend was paid, supplemented by a surplus dividend based on realised gains.

Share buyback policy and history (financial years)

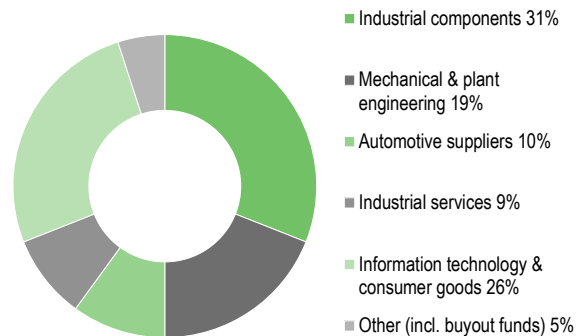
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



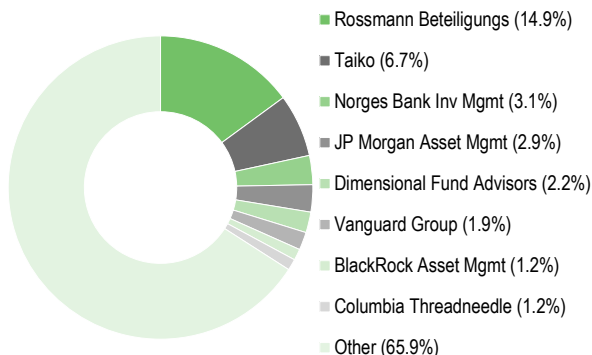
Concentration of portfolio value by size (as at 31 March 2018)***



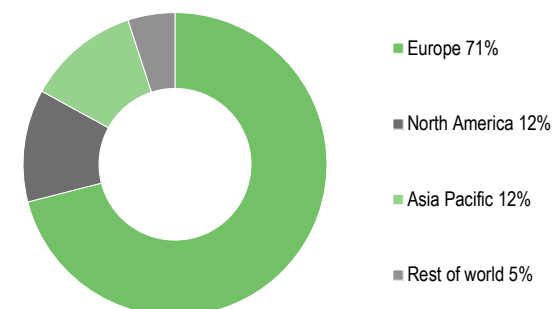
Portfolio exposure by sector (as at 31 March 2018)***



Shareholder base (as at 24 May 2018)



Portfolio companies' revenues by region (latest available data)***

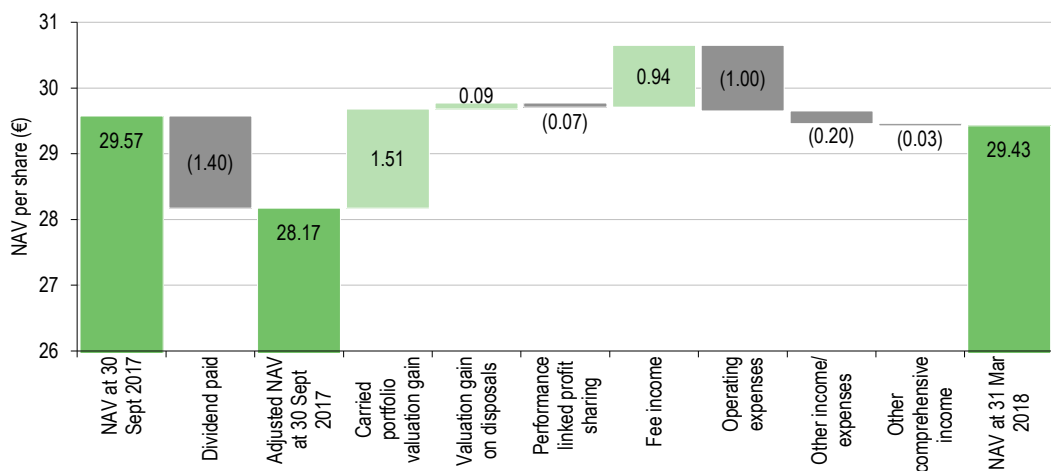


Source: DBAG, Edison Investment Research, Bloomberg, Thomson Reuters. Note: *Based on expenses net of fee income; adjusted for non-recurring items. **Including €73.8m of securities classified as long-term assets. ***Does not include co-investment funds.

Highlights of the first half of FY18

DBAG reported €19.3m net income for the first half of FY18, with a 4.5% dividend-adjusted NAV return. Higher expected portfolio company earnings in 2018 versus 2017 made the greatest contribution to valuation gains, but this was largely offset by a decline in the market earnings multiples used to value portfolio companies. In the first quarter of FY18, there was an expected reduction due to moving from 2017 to 2018 EV/EBITDA market multiples, and this effect was compounded by a broad market decline in the second quarter of the financial year. Pre-tax earnings were positive for both business lines for the half year, with private equity investments generating €16.5m and fund investment services contributing €2.9m. NAV per share declined slightly from €29.57 at end-September 2017 to €29.43 at end-March 2018, after payment of the €1.40 per share FY17 dividend, as illustrated in Exhibit 2.

Exhibit 2: DBAG's NAV per share progression in H118



Source: DBAG, Edison Investment Research

Although lower market earnings multiples had a substantial negative effect on valuations across the portfolio at end-March 2018, there were positive valuation changes for most investments over the half year. There were valuation gains for 11 portfolio companies and the two international buyout funds, with the investments in four portfolio companies included at fair value for the first time (having been held at cost for the first year following acquisition). Valuations were reduced for nine portfolio companies, and four investments held for less than one year were still valued at their acquisition cost at end-March 2018.

Although DBAG completed two new investments (Sjølund and netzkontor nord) alongside DBAG ECF during the first half of FY18, the period was characterised by a high level of transaction activity involving DBAG's existing portfolio companies. During the first quarter, Cleanpart sold its healthcare business line; Silbitz was partially disposed to strategic investor JFSC Sistema, which had already taken a minority stake in Gienanth; Pfaudler agreed two strategic acquisitions; vitronet agreed three strategic acquisitions; and Polytech agreed a merger with Israeli company G&G Biotechnology, accompanied by a capital increase. During the second quarter, the merger of duagon with MEN Mikro Elektronik was agreed, with DBAG investing up to €11m alongside DBAG Fund VII to finance the transaction as part of a capital increase. In the same quarter, DBAG increased its stake in Unser Heimatbäcker alongside DBAG Fund VI, and international buyout fund DBG Eastern Europe sold one of its two remaining investments.

Commitments and financial resources

At 31 March 2018, DBAG had €226.8m in undrawn capital commitments to the DBAG ECF and DBAG Fund VII funds. Based on these two funds' expected investment programmes, DBAG's management anticipates an average annual investment run rate of c €70m.

During the first half of FY18, DBAG's financial resources (including fixed-income funds and fixed-rate securities, acquired as cash investments but classified as long-term assets) declined from €161.6m to €135.5m. Cash outflows to meet capital calls for new and follow-on investments totalled €42.5m, largely covered by €35.6m of cash inflows relating to disposals and refinancing of investments, and the €21.1m FY17 dividend was paid to shareholders in the period. Although DBAG's outstanding commitments exceed its current financial resources, DBAG has sufficient funds to meet its expected financial commitments over at least the next 12 months. In addition to its current funds, portfolio realisations would add to financial resources and DBAG can also draw on its €50m credit facility to manage short-term cash-flow timing differences.

Lowered FY18 earnings guidance

In April 2018, DBAG announced that it expects to report net income for the year to 30 September 2018 that is moderately (10% to 20%) lower than the €43.0m average of the last five financial years (the reference level previously used for management's earnings guidance). Previous guidance, first given at the time of the FY17 results and confirmed with Q118 results, was for a significant (more than 20%) increase in net income. Management's new guidance for €34m to €39m net income in FY18 is materially lower than the previous guidance, which implied net income of more than €51m.

The revision to the forecast is largely due to lower market earnings multiples being applied in the valuation of portfolio companies at 31 March 2018, which is primarily a consequence of the market decline in the first quarter of 2018. There is also a smaller negative effect from individual portfolio companies not yet achieving the planned strategic and operational improvements in the current financial year. However, management notes that the development of portfolio companies rarely follows a linear progression individually or in aggregate, particularly over shorter time periods, and is not overly concerned by any of the deviations from plan that occurred in the half year. The guidance assumes constant market earnings multiples and so is subject to upward or downward revisions following significant market moves.

Valuation: Sharply narrowed premium to NAV

DBAG's published NAV does not reflect the market value of its fund services business, which has c €1.6bn of third-party assets under management and generates a substantial recurring fee income stream. DBAG's share price does reflect the value of this business as well as its private equity investment portfolio, and we see the value attributed by the market to the fund services business as the principal reason for DBAG's shares trading at a premium to NAV almost continuously over the last three years, as illustrated in Exhibit 3.

In our view, the premium represents a combination of the underlying premium or discount being applied by the market to the NAV of DBAG's private investment portfolio, and the value applied by the market to DBAG's fund services business. The €1.0bn DBAG Fund VII was launched at the end of 2016, leading to a step-change in the level of income generated by the fund services business in 2017. Following this, our analysis (included in our [August 2017 note](#)) suggested the market was attributing a valuation of up to c €160m to DBAG's fund services business (giving a market-implied valuation multiple of between 23x and 40x earnings).

Exhibit 3: Share price premium/discount to NAV over three years (%)



Source: Thomson Datastream, Edison Investment Research

DBAG's shares are currently trading at a c €90m or 19.6% premium to NAV, having just touched a low of 18.1%, which is its narrowest level since July 2016 and a level first reached in January 2015, shortly after DBAG started reporting separately on the performance of its fund services and private equity investments businesses. We see no reason for the earnings outlook for the fund services business to have altered materially since our August 2017 analysis, which suggests the market is applying an underlying c €70m or c 16% discount to the NAV of DBAG's private equity investments. This compares to the implied c €170m or c 37% underlying premium to NAV being applied to this business when the headline premium to NAV reached 72% in January 2018. This premium was arguably driven by the expectation of robust earnings growth continuing for several years, following DBAG's exceptionally strong performance in FY17. It appears the stock market weakness in early 2018, which contributed to the lowering of DBAG's earnings guidance for FY18, has substantially reduced market expectations for DBAG's NAV growth prospects, leading to the rapid narrowing of the premium to NAV shown in Exhibit 3.

Peer group comparison

Exhibit 4 shows a comparison of DBAG with a group of listed private equity investment companies that are primarily focused on Europe, although DBAG is the only company in the peer group that specialises in mid-sized companies in German-speaking countries. DBAG also manages third-party funds, which further differentiates it from most listed private equity peers, other than 3i in the UK. As noted above, we view this as the primary reason for DBAG's shares trading at a significant premium to its reported NAV, in contrast with the majority of the peers that do not manage third-party funds, some of which are trading at a significant discount to NAV. DBAG's 4.0% yield is the second highest in the peer group, and is appreciably higher than the peer group average.

DBAG's NAV total return in sterling terms to 31 March 2018 is ahead of the peer group average over one, three, five and 10 years, ranking second or third out of eight over each period. DBAG's share price total return has outperformed its NAV total return over most periods to end-March 2018, reflecting the shares moving from a discount to a premium to NAV over five and 10 years, while the premium has seen significant expansions and contractions since the end of 2014, contributing to the share price total return being lower than the NAV total return over three years.

Exhibit 4: Listed private equity investment companies peer group as at 24 May 2018*

Group/Investment	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	460.9	20.3	91.9	113.4	168.2	29.9	73.4	166.6	331.4	19.6	4.0
3i	Global	9,586.9	25.2	112.3	191.5	25.4	18.1	99.0	229.5	73.8	38.8	3.0
Electra Private Equity	UK	348.4	0.6	67.3	121.2	210.9	2.6	72.4	130.3	243.4	(18.3)	0.0
HgCapital Trust	UK	705.4	18.7	68.3	81.0	151.2	19.1	76.4	80.3	184.2	(0.0)	2.4
ICG Enterprise Trust	UK	587.3	13.6	51.3	69.2	111.5	19.9	47.4	78.6	115.9	(11.8)	2.5
Oakley Capital Investments	Europe	373.8	7.4	26.0	39.9	155.9	14.4	5.7	13.6	77.2	(25.7)	2.5
Princess Private Equity	Global	612.3	9.6	71.5	78.1	98.2	14.1	89.3	109.0	161.6	(9.2)	5.4
Standard Life Private Equity	Europe	508.9	10.5	56.8	81.6	70.6	10.8	60.3	101.4	76.4	(14.7)	3.8
Average		1,648.0	13.2	68.2	97.0	124.0	16.1	65.5	113.7	158.0	(2.7)	2.9
Rank in peer group		6	2	2	3	2	1	4	2	1	2	2

Source: Morningstar, Edison Investment Research. Note: *Performance data to end-March 2018. TR = total return. All returns expressed in sterling terms.

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