EDISON

Deutsche Beteiligungs

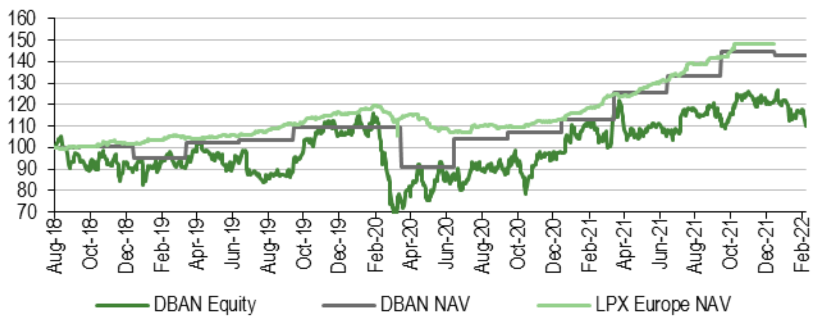
Solid investment pace in Q122

Investment companies
Private equity

22 February 2022

Deutsche Beteiligungs' (DBAG) NAV (defined as equity value per share) decreased slightly by 1.2% in Q122 (to end-December 2021) in TR terms, which puts the one-year TR at 26.1%. While the carried portfolio value decreased (mostly due to the contraction in market multiples), DBAG realised a €13.9m profit on agreed disposals. The company is making good progress in expanding its portfolio, with four new platform investments and 14 add-on acquisitions closed or agreed during the quarter. The operating performance of portfolio companies is in line with management expectations, which allowed DBAG to reiterate its guidance of €60–75m net profit in FY22.

DBAG performance versus LPX Europe NAV over three years



Source: Refinitiv, LPX Group, Edison Investment Research

Why consider Deutsche Beteiligungs now?

DBAG is a well-established player in the German PE mid-market. It has been increasing its exposure to new 'growth' sectors, which currently make up 44% of its portfolio and have proved resilient in the COVID-19 crisis, such as broadband/telecom businesses (29%), which are a play on the secular trend of network roll-out in Germany. At the same time, DBAG's industrial portfolio (currently valued slightly below acquisition cost on average) may appeal to investors seeking exposure to cyclical value companies, especially as supply bottlenecks ease and its portfolio companies pass on some of the cost inflation to customers.

The analyst's view

DBAG is making good progress in cash deployment, with several new platform investments and bolt-on acquisitions across its portfolio during Q122. DBAG's total investment volume (including transactions not yet closed) amounted to €81m (Edison calculation), which puts it well on track for FY22 to meet its target of investing €114m pa in FY22–24. This also translates into a robust investment pace of DBAG Fund VIII (which is now c 41% invested including agreed transactions), in line with DBAG's plans to launch a successor fund by FY24. DBAG sees a high number of opportunities in the market, highlighted by 83 potential acquisition targets examined during the quarter (74 in Q121), and has sufficient resources to continue its investment agenda. As at end December 2021, DBAG had €201.3m available resources (including €106.7m in an undrawn credit line), fully covering its €200.3m co-investment commitments alongside DBAG funds.

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Price	**€33.65**
Market cap	**€633m**
NAV*	**€690m**
NAV per share*	€36.70
Discount to NAV	8.3%

*As at end-December 2021. Defined as equity value

Yield	2.1%
Shares in issue	18.8m
Code/ISIN	DBAN/DE000A1TNUT7
Primary exchange	LSE
AIC sector	Flexible Investment

52-week high/low	€40.50	€32.01
NAV* high/low	€37.16	€29.82

*Defined as equity value

Gearing

Net cash at 31 December 2021	13.7%

Fund objective

Deutsche Beteiligungs is a Germany-based and listed private equity (PE) investment and fund management company that invests in mid-sized companies in Germany and neighbouring countries via MBO transactions and growth capital financings. There is a focus on growth-driven profitable businesses valued between €50m and €250m. It also manages €2.6bn of third-party capital, which generates stable recurring fee income.

Bull points

- Solid track record, with an average management buyout (MBO) exit multiple of 2.7x.
- Growing exposure to broadband, IT and healthcare.
- Stable and recurring cash flow from fund services.

Bear points

- Impact of cost inflation and supply bottlenecks on DBAG's industrial portfolio.
- Ample dry powder in the market translating into high competition for quality assets.
- High valuations in most resilient sectors.

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Q122 results: Driven by market multiples

DBAG's NAV (defined as equity value per share) decreased slightly by 1.2% in Q122 (to end-December 2021) to €36.7 per share. The main earnings and, in turn, NAV driver, remains the PE investments segment, which generated an €11.9m loss in Q122 (versus a €20.1m profit in Q121) on the back of portfolio revaluations. The fund services segment continues to support DBAG's results and liquidity profile, with steady fee income (€11.0m in Q122, broadly stable y-o-y) and a pre-tax profit of €3.7m (versus €4.8m in Q121). Overall, the consolidated net loss was €8.2m (or €0.48 per share).

Exhibit 1: Income statement by segment (€m)

	Q122	Q121	y-o-y
Net income from investment activity	(9.3)	23.7	N/A
Other income/expenses	(2.5)	(3.7)	N/A
PE investments pre-tax profit	**(11.9)**	**20.1**	**N/A**
Fund services income	11.0	11.1	(1%)
Other income/expenses	(7.3)	(6.3)	16%
Fund services profit pre-tax	**3.7**	**4.8**	**(23%)**
Consolidated net profit	**(8.2)**	**24.9**	**N/A**

Source: DBAG

The loss in the PE investments segment in Q122 stemmed from net downward value adjustments in DBAG's carrying portfolio of €24.8m, which was partially offset by €13.9m gains on two partial disposals (Telio and Poll Immobilien, see below for details). We note that, in line with its standard practice at the end of the calendar year, DBAG changed the base used to value its portfolio. The market multiples were changed to those based on 2022 consensus (from 2021 in the previous quarter); similarly, the earnings of the portfolio companies were rolled forward to budgeted 2022 figures. This was the main contribution to the €18.5m positive valuation impact of the change in earnings in Q122 (versus €54.9m in Q121 on the back of recovery from the pandemic-affected 2020). This was accompanied by a negative impact from the change in multiples of €66.5m, as the FY22 multiples of public companies were on average lower than the 2021 figures (with the markets assuming positive earnings growth of the peers used to value DBAG's portfolio), but also due to weaker share prices of some listed peers during the quarter. The valuation impact of the change in net leverage was a positive €20.6m, as in aggregate DBAG's portfolio companies reduced their debt despite several leveraged bolt-on acquisitions made in the period (see further details on page 4).

It is worth noting that the revenue growth and margins of some of DBAG's portfolio companies (especially in its 'core' industrial sectors) were curbed by ongoing pandemic-induced supply chain disruptions which, together with strong customer demand (partially fuelled by fiscal and monetary stimulus) and a shift in the composition of global demand (eg less travel and services and more IT spending), has driven inflation to abnormally high levels (eg 5% in the eurozone in 2021). As higher input costs are gradually passed on to customers, some of DBAG's portfolio companies may experience earnings tailwinds from gradually passing on higher input costs to customers in 2022.

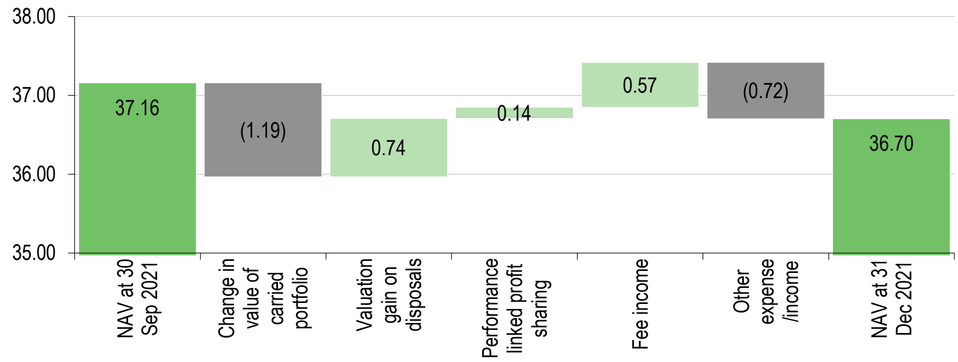
Exhibit 2: Net gains and losses on portfolio measurement and derecognition (€m)

	Q122	Q121
Changes in fair value of unlisted investments	(24.8)	36.0
Change in earnings	*18.5*	*54.9*
Change in debt	*20.6*	*5.8*
Change in multiples	*(66.5)*	*(28.8)*
Change in exchange rates	*2.7*	*(0.1)*
Other	*(0.1)*	*4.0*
Net result of disposal	13.9	0.8
Total	**(10.9)**	**36.8**

Source: DBAG

Funds managed by DBAG charge management fees based on committed capital (except for top-up funds), so fee income is independent of investment pace and stable over time (with the exception of funds in the divestment phase, where income decreases gradually following exits). In Q122, DBAG's fee income was broadly flat (€11.0m versus €11.1m in Q121), whereas the segment's profit decreased 23% y-o-y to €3.7m, reflecting an increase in personnel costs (due to the expansion of the investment team) and higher fixed salaries, according to the company. Simultaneously, DBAG confirmed its previously announced guidance of FY22 PE investment profit of €60–75m and fund services profit of €11–12m (detailed in our previous note) and highlighted that portfolio companies are developing in line with expectations.

Exhibit 3: DBAG's Q122 NAV* performance to end-December 2021 (€/share)



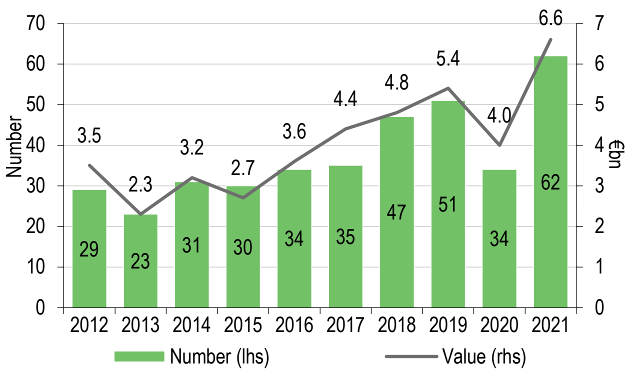
Source: DBAG, Edison Investment Research. Note: *NAV defined as equity per share.

Portfolio developments

During Q122, DBAG completed two previously announced investments (Dantherm and Itelyum) and agreed two further acquisitions (freiheit.com and in-tech). Also, eight portfolio companies made 14 add-on acquisitions (of which 11 were closed during the period), most of which were leveraged and did not require capital support from DBAG. M&A activity in DBAG's target market ('mid-market' – companies with an enterprise value of €50–250m) remains robust, with 62 transactions worth €6.6bn structured by financial investors in Germany in 2021 (see Exhibit 4). This implies a 13% CAGR in terms of value in 2016–21. Similarly, the number of investment opportunities available to DBAG remains high, as in Q122 its team analysed 83 potential deals (compared to 74 a year earlier), of which 18 were potential growth financings in minority stakes (versus 19 in Q121).

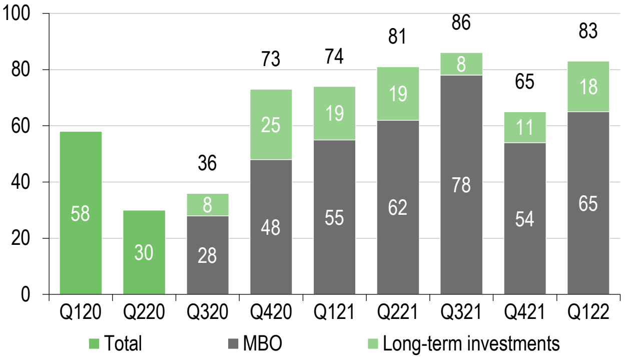
DBAG recognises several broader trends in the German mid-market. Firstly, the increase in deal count and volume suggests stronger interest in the PE industry in smaller targets (which on a global level is illustrated by several small-cap strategies launched by well-established international general partners) and a greater willingness by owners to sell businesses to PE investors. We should highlight that mid-market companies are often still owned by the founder or their family (more than half of the 62 transactions in the German mid-market involved family disposals). DBAG emphasises the ongoing generational change, with the current generation of owners more willing to cash out instead of focusing on passing the business on to their children. In this context, DBAG's long-term presence in this market subsegment and extensive contact network allows it to remain one of the preferred buyers, with 25 closed MBO transactions in the last 10 years. Increased interest from PE funds in smaller companies is underpinned by the popularity of buy and build strategies (with bolt-on acquisitions representing 65% of all PE deals in Europe in 2021, according to PitchBook Data).

Exhibit 4: MBO transactions in the German mid-market segment* involving financial investors



Source: DBAG, business magazine FINANCE. Note: *Transaction values in the range €50–250m.

Exhibit 5: DBAG investment opportunities



Source: DBAG

As at end-December 2021, DBAG's portfolio consists of 33 companies, which can be broadly divided into three segments (see Exhibit 7, left-hand side): 1) DBAG's core sectors (industrials – products, technology and services); 2) growth sectors (broadband, IT and healthcare); and 3) other. Industrial companies represent 45% of the portfolio value (while being valued at 0.9x cost) and growth companies make up 44% of the portfolio (valued at 2.6x cost).

In Q122, DBAG completed the acquisitions of Dantherm and Itelyum. **Dantherm** is a provider of heating, cooling, drying, ventilation and air conditioning (HVAC) solutions based in Denmark, but 30% of its revenues are generated in the DACH region, its core market. It is a well-established player founded in 1958, which has grown predominantly through acquisitions to a business generating c €150m revenues annually. The HVAC market is growing at a steady single-digit percentage rate pa, driven by climate change and the wellness trend, and DBAG intends to continue its inorganic growth strategy through bolt-on acquisitions. DBAG (and DBAG Fund VII) provided Italy-based **Itelyum** with growth financing, and acquired a minority stake in this complex industrial waste recycling company. The investment underpins DBAG's geographic expansion into the Italian market, and fits into the broader sustainability megatrend.

Both of the new investments that have been signed but not yet closed in Q122 are companies from the IT services and software sector. **Freiheit.com** is a developer of customised software, specialising in the implementation of complex software projects for companies (including blue chips). DBAG provided €21.2m to the company (for a 16% stake), with another €93.2m coming from DBAG Fund VIII (its fifth investment), thereby acquiring a majority position in January 2022. The business is similar to Cloudflight, acquired by DBAG in mid-2019, although the latter focuses on SME digitalisation processes. **In-tech** is a technology company specialising in engineering services and software for the automotive industry (which represents c 90% of its revenues). DBAG will acquire a 15% stake for €15m, and DBAG Fund VIII will acquire a majority position for an undisclosed amount.

Most of DBAG's platform companies pursue a buy and build strategy and during the quarter closed 11 add-on acquisitions (and agreed to three further acquisitionss). Most of the transactions were leveraged and DBAG contributed only a minor €6m overall to these deals. The aforementioned digitalisation company Cloudflight acquired two companies in Germany and agreed to acquire one in Poland with no capital support from DBAG. Silbitz (predominantly supplying the wind energy sector) acquired another iron foundry in Germany (DBAG invested €1m in the process). DBAG also contributed €2m to support Solvares (a provider of scheduling and route optimisation software) in acquiring two companies (including the UK operations of FLS). Furthermore, the companies in the broadband telecommunications sector – netzkontor and vitronet – completed five bolt-on acquisitions (with no DBAG contribution). Lastly, two transactions were agreed but not yet closed. DBAG agreed to provide €3m to an acquisition by operasan (a nephrology business) and Sero (a manufacturer of electronic components) agreed to acquire a company in the US.

Exhibit 6: Add-on acquisitions by DBAG portfolio companies in Q122

DBAG company	DBAG fund	Target	Status	DBAG's capital contribution (€m)
Fire	DBAG Fund VIII	ABBS Group, Belgium	Closed	-
Cloudflight	DBAG Fund VII	Cognostics, Germany	Closed	-
Cloudflight	DBAG Fund VII	Macio, Germany	Closed	-
Cloudflight	DBAG Fund VII	Divante, Poland	Agreed	-
operasan	DBAG Fund VII	MVZ Herne, Germany	Agreed	3
Sero	DBAG Fund VII	Syncron EMS, USA	Agreed	-
Silbitz	DBAG Fund VI	Torgelow iron foundry, Germany	Closed	1
vitronet	DBAG ECF	Alexander Piten Tief- und Straßenbau, Germany	Closed	
vitronet	DBAG ECF	Horstmann Fernmeldebau, Germany	Closed	
vitronet	DBAG ECF	Diroba, Germany	Agreed	
netzkontor	DBAG ECF	MFB-Com, Germany	Closed	
netzkontor	DBAG ECF	MMD, Germany	Closed	
Solvares	DBAG ECF	FLS UK, UK	Closed	2*
Solvares	DBAG ECF	Opheo Solutions, Germany	Closed	

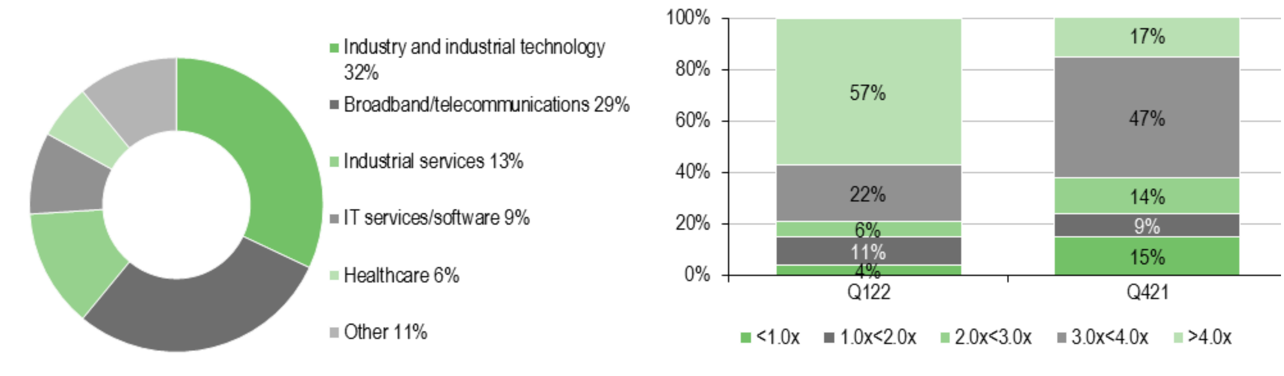
Source: DBAG, Edison Investment Research. Note: DBAG contributed €2m to Solvares in total.

Several leveraged acquisitions have led to a significant change in the net debt/EBITDA composition of the portfolio (see Exhibit 7, right-hand side). While the share of portfolio companies with leverage of at least 4.0x EBITDA increased considerably to 57% from only 17% at end-FY21, we see several factors that may have contributed to this. First, we need to highlight that overall debt across DBAG's portfolio decreased (as described on page 2). Secondly, some of the holdings in the +4.0x bucket may be companies with a high share of recurring revenue and at the same time valued at a higher multiple (eg broadband/telecom businesses), which have the capacity to incur more debt without taking on too much risk. Second, the leverage of some companies may not have increased significantly but was enough to move them from the upper end of the 3–4x bucket into the +4.0x group (illustrated by the 25pp decrease in the share of the portfolio with net debt/EBITDA of 3–4x). Nevertheless, we note that the share of portfolio companies with net debt/EBITDA of over 3.0x increased by 15pp to 79%.

We should also highlight that while most of the debt at portfolio level is floating rate debt, it usually has Euribor floors at 0%. This means that DBAG's portfolio companies have a certain runway in terms of interest expense from the point at which interest rates begin to increase in the eurozone Simultaneously, a meaningful part of the debt has been incurred temporarily to finance inorganic growth and is not intended to be structural debt in the long-term.

Exhibit 7: DBAG's portfolio split at end-December 2021

By sector	By leverage (versus September 2021)



Source: DBAG

Valuation: Trading at a discount to NAV

DBAG's shares usually trade at a premium to NAV, which likely stems from the fact that the market-implied value of the fund services segment is only marginally captured in DBAG's NAV. Only 3i and Eurazeo have meaningful share of third-party capital in their AUM. Unlike DBAG, Eurazeo recognises asset management activity in its NAV (20% of its NAV as at end-June 2021).

Having said that, currently DBAG's shares are traded at an 8.3% discount to NAV (vs a c 20% premium a year ago). Its NAV performance lags the PE companies in the peer group, as it is the third-worst performer in the one- and three-year periods, most likely due to its relatively high exposure to industrial companies, which experienced significant headwinds even before the onset of the pandemic and are still being valued below acquisition cost on average by DBAG. However, DBAG's 10-year NAV TR is broadly in line with the peer group. The 8.3% discount is still markedly narrower than the 19.6% median discount in the peer group (excluding 3i and Eurazeo, see Exhibit 8), as the market is likely attributing additional value to the fund services segment.

Exhibit 8: Listed PE investment companies peer group at 22 February 2022*

% unless stated	Region	Market cap £m	NAV TR 1y	NAV TR 3y	NAV TR 5y	NAV TR 10y**	Price TR 1y	Price TR 3y	Price TR 5y	Price TR 10y	Premium/ (discount)	Dividend yield
Deutsche Beteiligungs	**Europe**	528.3	**17.1**	**40.1**	**77.4**	**241.6**	**16.3**	**26.3**	**56.1**	**300.0**	(8.3)	2.4
3i	Global	12,632.5	36.6	73.0	171.4	569.3	29.0	107.7	145.0	1,069.3	5.1	3.1
Eurazeo	Global	4,626.6	34.1	32.5	85.3	131.3	31.3	27.0	68.6	414.7	(29.4)	2.1
GIMV	Global	1,177.2	14.7	9.5	32.8	100.0	2.3	17.3	16.9	114.6	2.5	4.7
HgCapital Trust	UK	1,882.6	39.2	111.0	191.8	367.5	39.8	150.8	209.8	466.7	(0.3)	0.5
ICG Enterprise Trust	UK	809.9	33.2	64.7	119.7	242.5	35.5	70.2	112.5	377.2	(27.4)	2.2
Oakley Capital Investments	Europe	724.2	34.7	98.2	147.4	240.7	48.1	154.3	180.8	256.6	(24.6)	1.1
Princess Private Equity	Global	713.0	10.9	48.8	84.7	193.3	20.2	87.0	112.8	364.6	(19.1)	5.4
Standard Life Private Equity	Europe	805.6	37.4	67.6	120.3	267.0	49.0	99.4	134.9	507.8	(20.1)	2.6
Average		**2,921**	**30.1**	**63.2**	**119.2**	**264.0**	**31.9**	**89.2**	**122.7**	**446.4**	**(14)**	**3**
Rank		**9**	**7**	**7**	**8**	**5**	**8**	**8**	**8**	**7**	**4**	**5**

Source: Morningstar, Edison Investment Research. Note: *12-month NAV performance in sterling terms based on end-December 2021 NAV, or latest earlier available NAV (end-October for ICG Enterprise Trust, end-September for GIMV and HgCapital Trust and end-June for Eurazeo). **Last available NAV at the beginning of the 10-year period was end-January 2012 for ICG Enterprise, end-March 2012 for 3i and end-November 2011 for DBAG due to reporting period change during the period.

Assuming that the market is assigning a discount to the reported carrying value of DBAG's PE investments in line with the current median discount to NAV of DBAG's peers, the fund services segment is valued at €71.0m or a mere 6.2x earnings multiple, based on the midpoint of FY22 management guidance. At the same time, asset managers trade at an average FY22e P/E multiple of 18.0x (see our August 2021 note for details on the peer group selection, and potential factors behind discount to peers). If we assume that the fund services segment trades in line with the average peer P/E FY22e ratio (taxes and minorities are negligible in the case of DBAG), the implied value of the PE investments segment is €426m (ie a 39% discount to NAV). While none of the asset managers is a direct comparator, we believe DBAG's current valuation remains undemanding, especially given its goal of reaching €17–19m in fund services profits (supported by the launch of a new buyout fund) by FY24.

Exhibit 9: Analysis of DBAG's market value by segment

Approach	PE investments in line with peers*	Fund services in line with peers**
Discount applied to PE investments value (%)	(20)	(39)
Implied value of PE investments segment (€m)	561.8	426.3
Implied value of fund services segment (€m)	71.0	206.5
Implied FY21e earnings multiple of fund services segment*** (x)	6.2	18.0

Source: DBAG, Edison Investment Research. Note: *Peer group median excluding 3i and Eurazeo. **Blackstone, Partners Group, EQT, Intermediate Capital, Tikehau Capital, Cohen & Steers. ***Based on the midpoint of management guidance.

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