EDISON

Deutsche Beteiligungs

Full-year results

Private equity investment and asset management

Investment companies

Now in its 50th year, Deutsche Beteiligungs (DBAG) is a seasoned private equity investor in mid-sized German companies. In FY14, it reported a 15.8% NAV return and over 10 years has achieved a 12.5% compound annual NAV total return. Following the sale of Homag, DBAG is cash-rich and, after a relatively quiet period, the pace of investment has picked up in the first quarter of FY15. The shares trade at a 26% premium to NAV but, like 3i in the UK, DBAG has developed its third-party asset management activity and, when considering DBAG's two business segments separately, its valuation does not look demanding (see page 11).

As at 31/10/14	Total share return (%)	Total NAV return (%)	LPX Europe (%)	DAX 30 index (%)
1 year	19.4	15.3	5.9	3.2
3 years	64.0	48.7	64.8	51.9
5 years	86.3	67.4	99.4	72.2
10 years	347.4	225.3	67.6	135.5

Source: Thomson Datastream, Morningstar. Note: Cumulative total return performance data in euros as at last published NAV.

Homag drives FY14 earnings and dividend increase

For the year to 31 October 2014, with the divestment of Homag contributing €19.4m, DBAG's net income increased 48% to €47.8m. The carried portfolio of unquoted investments saw an 18.5% increase in NAV, benefiting from the majority of companies forecasting higher earnings and reducing their debt in 2014 as well as the revaluation of recent investments from cost to fair value. Fee income from fund management and advisory services increased 15% to €21.7m helped by a full year of DBAG Fund VI fees. Homag's sale crystallised €47.9m of capital gains in DBAG's German GAAP accounts, enabling a substantial €1.60 surplus dividend to be declared with the total dividend increasing by €0.80 to €2.00 per share.

Three new investments already made in FY15

Following a quieter period in FY14, the first quarter of FY15 has seen DBAG announce three new investments totalling €36.7m. While the timing of further transactions remains unpredictable, management notes that the deal pipeline remains strong and DBAG is not capacity constrained by the three recent transactions. On a comparable basis, management expects a 0-10% increase in DBAG's net income in FY15, which suggests a 15% to 20% gain in the carried portfolio value based entirely on forecast earnings growth. Fee income is forecast to be lower in FY15 due to one-off effects and divestments.

Valuation: Fund business supports premium rating

DBAG shares have recently moved from parity to a 26% premium to NAV, compared with the 10% discount the LPX Europe index trades on. However, the implied earnings multiple of DBAG's asset management business is significantly lower than that of 3i in the UK, its most direct peer. This supports our view that DBAG's premium rating can be explained by its predictable stream of recurring management and advisory fee income.

6 February 2015

Price	**€28.05**
Market cap	**€384m**
NAV*	**€303m**
NAV per share*	**€22.18**
Premium to NAV	26.5%
FY14 dividend yield	7.1%

*Last published NAV as at 31 October 2014.

Shares in issue	13.7m
Free float	70%
Code	DBAN
Primary exchange	Frankfurt

Share price performance

%	1m	3m	12m
Abs	7.8	26.9	30.5
Rel (local)	(6.3)	8.4	9.1
52-week high/low		€28.1	€18.3

Business description

Deutsche Beteiligungs is a Germany-based listed private equity company focused on mid-sized companies in Germany and neighbouring German-speaking countries.

Next event

Q115 results	16 March 2015

Analysts

Gavin Wood +44 (0)20 3681 2503

Martyn King +44 (0)20 3077 5745

financials@edisongroup.com

Edison profile page

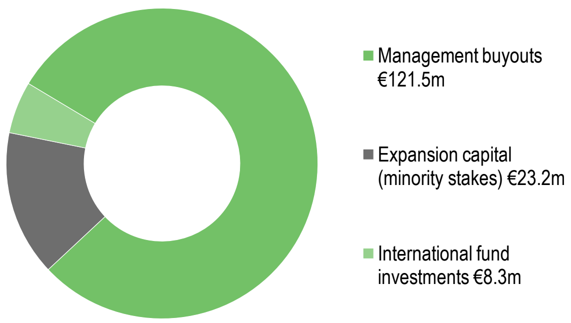
Deutsche Beteiligungs is a research client of Edison Investment Research Limited

Exhibit 1: DBAG at a glance

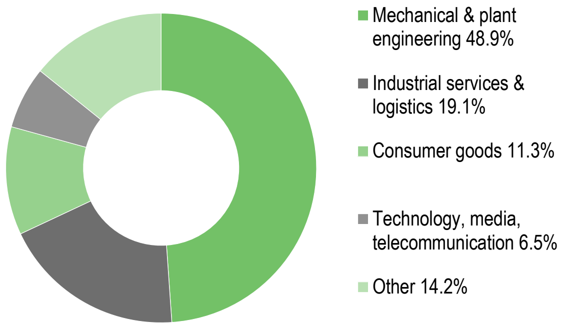
Investment objective and fund background	Recent news
DBAG acquires subsidiaries of corporate groups and mid-sized enterprises in Germany and neighbouring German-speaking countries. It focuses on growth-driven profitable businesses valued at between €50m and €250m.	22 January 2015 – FY results to 31 October 2014. 22 December 2014 – €14m investment in Gienanth iron foundry. 15 December 2014 – €8m investment in Pfaudler Process Solutions. 27 November 2014 – €2.00 per share total dividend for FY14. 24 November 2014 – €12.5m investment in Huhtamaki Films.

Forthcoming announcements/catalysts		Capital structure		Fund details	
AGM	24 March 2015	FY14 net expense ratio*	0.7% (2.2% unadjusted)	Group	Deutsche Beteiligungs
First quarter results	16 March 2015	Net gearing	Net cash	Manager	Team managed
Year end	31 October	Annual management fee	N/A	Address	Boersenstrasse 1, 60313 Frankfurt am Main, Germany
Dividend	25 March 2015	Performance fee	N/A		
Launch date	December 1985	Company life	Unlimited	Phone	+49 69 95787-01
Wind-up	N/A	Loan facilities	N/A	Website	www.deutsche-beteiligung.de

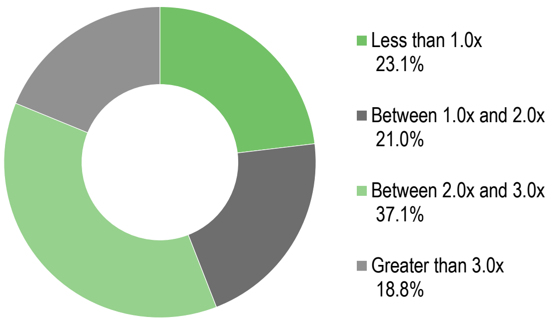
Portfolio split (as at 31 October 2014)**



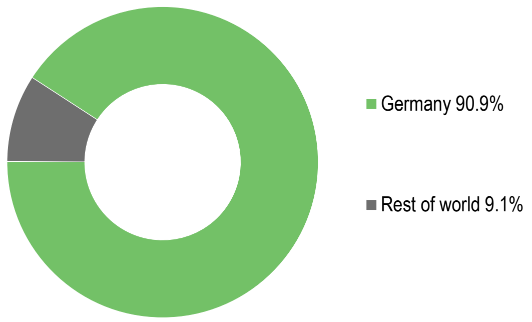
Sector breakdown (as at 31 October 2014)**



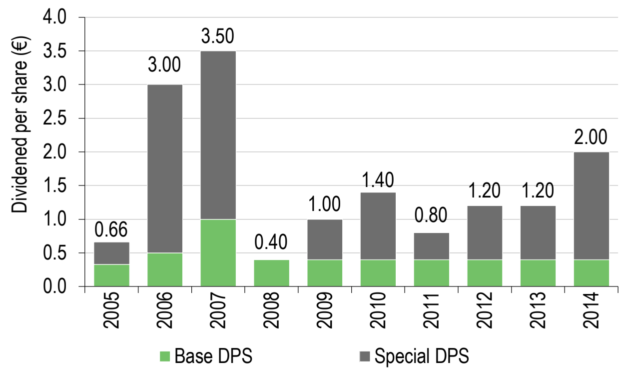
NAV split by net debt/EBITDA 2014 (as 31 October 2014)**



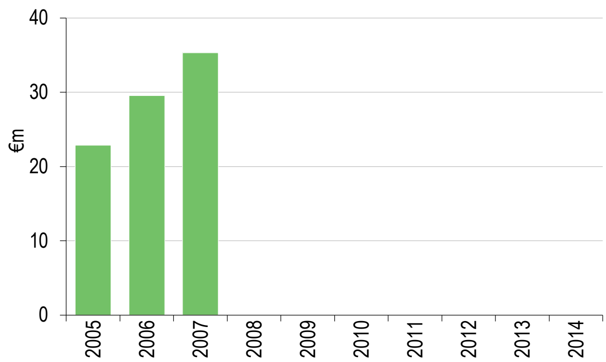
Geographic split of investments (as at 31 October 2014)**



Dividend history



Share buyback history



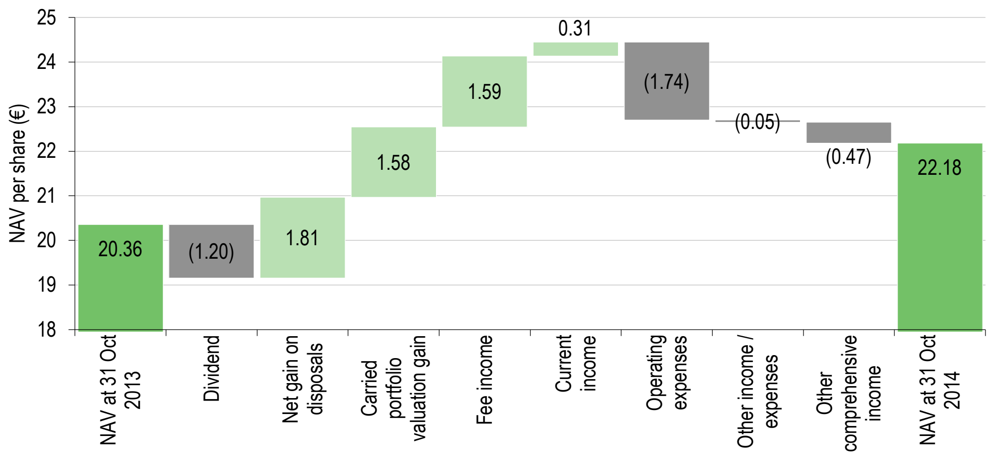
Source: DBAG, Edison Investment Research. Note: *Based on expenses net of fee income; adjusted for performance-related remuneration. **Does not include parallel funds.

FY14 results show strong progress

Above-average NAV growth achieved in FY14

For the year to 31 October 2014, DBAG's NAV per share increased by 15.8% before dividends, substantially ahead of the 11.5% increase in FY13 and also above the 15.3% 10-year average annual return before dividends. DBAG's 12.5% 10-year compound annual NAV total return (with dividends reinvested) compares favourably with the equivalent 5.3% and 8.9% returns of the LPX Europe and DAX 30 indices. The main components of the change in NAV during the year are shown in Exhibit 2. The divestments of Homag and Dr. Vogler added 9.4% to NAV, net of transaction costs and related remuneration, and valuation gains on the unquoted portfolio added 8.2% to NAV. €21.7m fee income and €4.2m current income from portfolio companies offset €23.9m operating expenses, while a €6.7m increase in pension provisions reduced NAV by 2.6%.

Exhibit 2: DBAG's NAV per share increased to €22.18 during FY14



Source: DBAG, Edison Investment Research

IFRS net income increased to €47.8m in FY14 from €32.3m in the prior year, with IFRS EPS increasing from €2.36 to €3.49. A greater contribution from realised and unrealised gains on the portfolio (€50.3m versus €34.5m) was only offset to a small extent by higher net expenses (€27.7m versus €26.1m), while an increase in fee income was largely offset by lower current income.

Gain on Homag disposal

The IFRS €24.6m gain on the divestment of listed Homag represented the largest part of DBAG's €50.3m net valuation gains. Net of transactions costs and related remuneration, Homag contributed €19.4m to DBAG's net income. The sale of Homag to a trade buyer was agreed in July 2014; the price of €26.00 per share, a 12% premium to the average market price over the previous three months, represented a 46% increase compared with the market price at 31 October 2013. DBAG first invested in Homag in 1997, acquiring a 25.1% holding, and added to its stake (co-investing with parallel funds) in 2006. DBAG realised part of its holding at Homag's IPO in 2007 and made a further investment (co-investing with parallel funds) in 2012. Total proceeds from the divestment, 2007 IPO and dividends received represent a cash exit multiple of 3.5 times the total investment made and a 15.0% internal rate of return (IRR) from the initial investment in 1997.

Carried portfolio valuation gains

Unrealised gains on the carried portfolio of unquoted investments totalled €21.6m. The seven new investments from the preceding 12 months were revalued from transaction cost to fair value, which contributed €14.2m of the gains. Earnings growth and re-rating made similar contributions to overall valuation gains with the majority of portfolio companies' forecasts for 2014 earnings (the valuation basis) being higher than 2013; debt levels were also reduced.

Fee income and current income

Fee income is driven by the value of capital committed to and invested in DBAG's co-investment funds and not linked to investment performance (see page 10). Fund management and advisory services fee income increased from €18.9m to €21.7m in FY14 primarily due to the effect of DBAG Fund VI fees being receivable for the full year compared to only nine months in FY13. DBG Fonds I fee income increased due to €1.2m of non-recurring performance-linked remuneration being received, which offset a decline in DBAG ECF fee income due to an agreed fee reduction. DBAG Funds IV and V fee income declined due to the divestment of Homag part-way through the year.

Exhibit 3: Fee income analysis

€m	FY14	FY13
DBG Fonds I	1.8	0.7
DBG Fonds III	0.0	0.0
DBAG Fund IV	0.4	0.6
DBAG Fund V	5.0	5.9
DBAG ECF	0.9	2.1
Other	0.0	0.0
Management fee income	8.2	9.3
Advisory fee income – DBAG Fund VI	13.5	9.6
Total fee income	**21.7**	**18.9**

Source: DBAG

Current income comprises distributions from portfolio companies and buyout funds, interest on profit-sharing certificates and loans to portfolio companies as well as release of retentions from disinvestments. Current income declined from €6.5m to €4.2m primarily due to a large one-off receipt in the prior year.

Operating expenses and taxes

The largest component of operating expenses is personnel costs, which increased from €13.8m to €16.5m principally due to the effect of transaction-related remuneration resulting from the disposal of Homag. Net operating expenses saw a smaller increase from €26.3m to €28.0m, largely due to a lower VAT charge as well as a VAT refund relating to prior years. DBAG typically incurs a group tax charge representing c 1% of pre-tax income. This reflects German tax legislation under which only 5% of capital gains are chargeable to corporation tax.

Performance by business segment

Exhibit 4: Indicative performance by business segment in FY14

€m	Investments	Fund Services	Group
Segment income	54.5	23.7	76.2
Segment expenses	(13.0)	(16.7)	(27.7)
Segment net income before taxes	41.5	7.0	48.5
Pre-tax margin	75%	29%	64%
Taxes & minority interests	-	-	(0.7)
Consolidated net income	-	-	47.8
Proportion of group net income	85%	15%	-
Portfolio value	153.1	-	-
Assets / Assets under management	303.8	1,298	-

Source: DBAG. Note: Figures are unaudited. €2m synthetic internal transfer between divisions to reflect management fees on DBAG's share of fund assets has been eliminated in group figures.

Starting from the first quarter of the current financial year, in its financial report DBAG will include an analysis separating the performance of its two business segments: Investments and Fund Services. Management has provided an indication of the separate financial performance of these two segments in FY14 as shown in Exhibit 4. The business drivers differ with investment income primarily derived from portfolio gains whereas fund services income is based on total committed and invested capital and is thus more predictable. While underlying expenses should be relatively stable for both segments, the c 70% fund services cost income ratio for FY14 is likely to reflect performance-related remuneration expense with no offsetting performance fees charged.

Dividends

DBAG's German GAAP accounts, which do not recognise unrealised gains, form the basis for determining dividend payments. While Homag contributed €19.4m to DBAG's FY14 reported IFRS net income, its sale crystallised €47.9m of capital gains in DBAG's German GAAP accounts enabling a substantial €1.60 surplus dividend to be declared and the total dividend increased by €0.80 to €2.00 per share, representing a payout of €27.4m. DBAG's dividend policy is to pay a sustainable base dividend supplemented by a surplus dividend allowing shareholders to participate in the realisation of successful investments in each financial year. As illustrated in Exhibit 1, surplus dividends have been paid in nine of the last 10 years reflecting a steady pace of realisations over this time. Although there is a reasonable expectation for realisations to continue over the next few years as DBAG's investment portfolio matures, as their timing is unpredictable a surplus dividend cannot be assumed in any particular financial year. While the €0.40 base dividend represents a 1.5% yield on the current share price, the €1.32 average total dividend over the last five years represented a 6.0% pa yield on the FY14 year-end share price of €21.83.

Commitments and financial resources

At 31 October 2014, DBAG had total undrawn capital commitments of €199.1m relating to the DBAG ECF and DBAG Fund VI parallel funds that have investments periods ending in May 2017 and February 2018. Benefiting from the divestment of Homag, DBAG had financial resources of €150.7m at the end of FY14, with the expectation that the remaining €48.4m would be funded from realisations. With €36.7m already invested in FY15, undrawn capital commitments have reduced to €162.4m and financial resources, taking the FY14 dividend payment into account, are estimated to be €86.6m. Given the two- to three-year remaining investment periods, which imply an average run-rate for investment of c €60m pa, with fee income and current income broadly covering expenses, DBAG should be adequately funded for 12-18 months without any realisations. No further parallel fund launches are expected until DBAG Fund VI approaches the end of its investment period.

Investment portfolio

DBAG aims to have a diversified portfolio and typically holds investments for four to seven years. The targeted average annual internal rate of return is 20% for expansion capital financings and 25% for MBOs. DBAG focuses on mid-market companies typically generating annual revenues of €50m to €500m, with enterprise values generally between €50m and €250m.

Current portfolio profile

At 31 October 2014, DBAG's portfolio comprised €127m financial assets and €26m loans and receivables totalling €153m. Financial assets represent the equity held in portfolio investments while loans and receivable comprise loans, silent partnerships and profit-sharing rights held predominantly in companies recently added to the portfolio. Portfolio concentration has reduced following the sale of Homag and the five largest investments (by value) represented 53.2% of the portfolio at the year end. While the mechanical engineering and plant construction sector represented 48.9% of the portfolio (see Exhibit 1), the investee companies operate in very different niche markets and geographical regions.

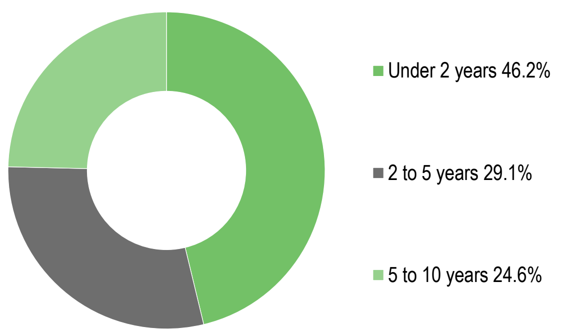
Exhibit 5: Current investment portfolio

Company	Location	Core business	2014 Revenue €m	Employees	First Inv't	Type of inv't	Co-inv't fund	Fund Equity share (%)	DBAG Inv't cost €m	DBAG Equity share (%)	DBAG Portfolio value €m
JCK KG	Quakenbrück, Germany	Textile retail business, mainly for discounters in Germany	€575m	1,050	Jun-92	Exp'n capital	DBG Fonds I	14.4%	3.0	3.6%	**5-10 years**
Grohmann GmbH	Prüm, Germany	Plants for industrial automation worldwide	€95m	790	Dec-96	Exp'n capital	N/A	0.0%	2.1	25.1%	
Clyde Bergemann Group	Wesel, Germany; Glasgow, UK; Delaware, US	Components for power plants worldwide / service business	US$545m	1,800	May-05	MBO	DBAG Fund IV	45.1%	9.2	15.7%	€35.9m
FDG SA	Orly, France	Supermarket services in France / neighbouring countries	€111m	760	Jun-10	MBO	DBAG Fund V	64.1%	4.9	15.5%	
Romaco GmbH	Karlsruhe, Germany	Packaging technology machines / plant worldwide	€113m	450	Apr-11	MBO	DBAG Fund V	77.3%	11.2	18.7%	**2-5 years**
Broetje-Automation GmbH	Wiefelstede, Germany	Aircraft assembly automation machines / plant worldwide	€89m	550	Mar-12	MBO	DBAG Fund V	77.9%	5.6	18.8%	
Spheros GmbH	Gilching, Germany	Air-con. / heating systems, water pumps, roof hatches for buses in Eur, LatAm, Asia	€197m	770	Mar-12	MBO	DBAG Fund V	65.3%	13.9	15.7%	€42.6m
Plant Systems & Services PSS GmbH	Bochum, Germany	Industrial services for energy and process industries in Germany, Netherlands	€28m	190	Nov-12	Exp'n capital	DBAG ECF	28.5%	2.3	20.5%	
Heytex Bramsche GmbH	Bramsche, Germany	Textile print media / technical textiles worldwide	€75m	305	Dec-12	MBO	DBAG Fund V	68.0%	6.4	17.1%	**1-2 years**
Inexio KGaA	Saarlouis, Germany	Telecoms / IT services based on high-quality fibre-optic infrastructure in Germany, Belgium, Luxembourg	€34m	170	May-13	Exp'n capital	DBAG ECF	8.1%	5.1	5.8%	
Formel D GmbH	Troisdorf, Germany	Car manufacturer and supplier services worldwide	€157m	4,500	May-13	MBO	DBAG Fund V	62.4%	10.4	15.1%	
Stephan Machinery (ProXES) GmbH	Hameln, Germany	Liquid / semi-liquid food product manufacturing machines / plant worldwide	€81m	180	Jun-13	MBO	DBAG Fund V	78.5%	5.9	18.8%	€57.5m
DNS:NET Internet Service GmbH	Berlin, Germany	Telecoms / IT services based on high-quality fibre-optic infrastructure in Germany	€10m	30	Sep-13	Exp'n capital	DBAG ECF	14.6%	7.0	10.4%	
Schülerhilfe (ZGS Bildungs-GmbH)	Gelsenkirchen, Germany	Education and tutoring services in Germany	€52m	350	Oct-13	MBO	DBAG Fund VI	75.9%	9.8	17.8%	
FY14 investments											**<1 year**
Unser Heimatbäcker GmbH	Pasewalk, Germany	Bakery chain in Germany	€107m	2,300	Jun-14	MBO	DBAG Fund VI	66.3%	9.9	15.6%	€9.9m
FY15 investments											**<1 year**
Infiana Group	Forchheim, Germany	Plastic-based release liners / specialised films worldwide	€207m	1,000	Nov-14	MBO	DBAG Fund VI		12.5	17.0%	
Pfaudler Process Solutions Group	Schwetzingen, Germany	Glass-lined reactors / components for chemical / pharma. industries worldwide	US$224m	1,450	Dec-14	MBO	DBAG Fund VI		8.0	15.0%	€34.5m
Gienanth GmbH	Eisenberg, Germany	Iron foundry in Germany	€150m	880	Dec-14	MBO	DBAG Fund VI		14.0	19.0%	
FY14 divestments											
Homag Group AG	Schopfloch, Germany	Woodwork machines / plant for furniture / construction supplies industries	Sold Jun-14	5,085	Jan-97, Feb-07, Dec-12	MBO	DBAG Funds IV & V	19.4%	27.5	20.1%	
Dr. Werner Vogler	Bad Homburg, Germany	Auto manufacturer regional representative in Germany	Sold Oct-14		Feb-95	Exp'n capital	DBG Fonds I	30.0%	5.5	0.0%	
Buyout funds											**>10 years**
Harvest Partners IV	New York, US				Oct-01	Buyout fund			N/A	9.9%	
DBG Eastern Europe II	Jersey, Ch. Islands				Jan-03	Buyout fund			N/A	14.9%	N/A

Source: DBAG, Edison Investment Research

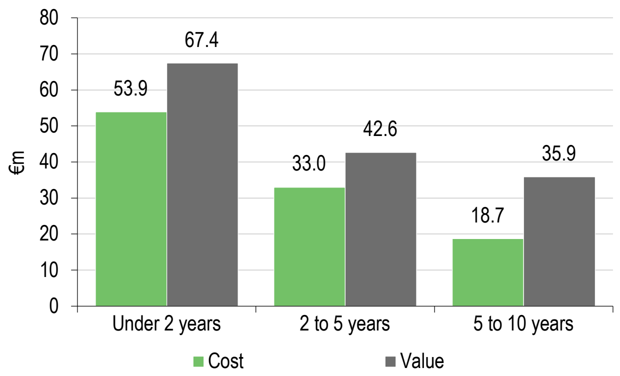
As illustrated in Exhibit 6, following the sale of Homag and Dr. Vogler, DBAG had a relatively young portfolio with eight of the 15 investments in companies having been held for less than two years at 31 October 2014. Taking into account the three recently-announced new investments, 13 of the 18 portfolio companies have been held for less than three years, which suggests that a limited number of divestments should be expected over the next couple of years given the typical four- to seven-year holding period. As a primary source of funding for new investments, at least one divestment would be expected within the next two years (see Commitments and financial resources).

Exhibit 6: Portfolio value by holding period



Source: DBAG. Note: Excludes residual investments

Exhibit 7: Portfolio cost and value by holding period



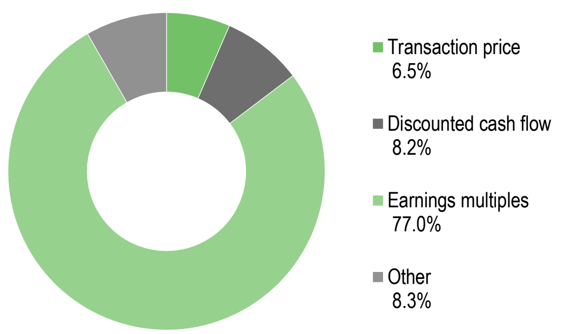
Source: DBAG. Note: Excludes residual investments

€7.1m or 4.7% of the portfolio value at 31 October 2014 related to the residual value of exited investments including representations and warranties.

Portfolio valuation

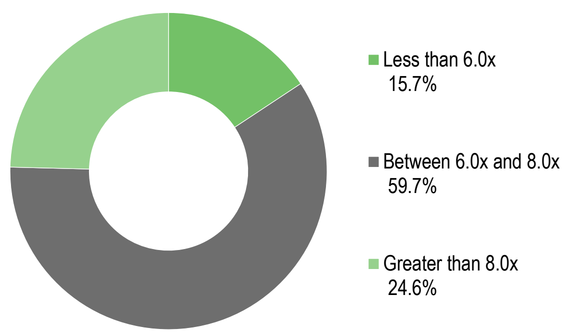
Of the eight younger investments, only Unser Heimatbäcker had been in the portfolio for less than one year at 31 October 2014 and thus was valued at cost. Exhibit 9 illustrates the spread of EV/EBITDA multiples for 13 of the 15 portfolio companies with an average valuation of 7.3x 2014 EV/EBITDA at 31 October 2014, which compares with the 7.1x and 6.7x EV/EBITDA average purchase valuation multiples for the investments made during 2013 and 2014 respectively. Two portfolio companies experiencing strong growth are valued using alternative methods, which include discounted cash flow.

Exhibit 8: Portfolio value by valuation method



Source: DBAG

Exhibit 9: Portfolio value by 2014 EBITDA multiple



Source: DBAG

To provide some context for the valuation of DBAG's investment portfolio, we consider the 12-month forward EV/EBITDA multiples of the large-cap DAX index and the small and mid-cap S-DAX index which are currently 8.3x and 10.2x respectively. As a broad comparison measure, DBAG's portfolio being valued at a c 30% discount to the S-DAX index appears reasonably prudent.

Recent new investments

Compared with the €20m invested in FY14 including one new investment, the first quarter of FY15 has seen a flurry of activity with €36.7m invested including three new investments. The €20m invested in FY14 was significantly below the €50m target and, similar to the previous two investments, the sole new investment was outside of DBAG's core manufacturing and industrial services sectors. This raised concerns that increased competition in the private equity market was limiting the number of transactions that DBAG could complete while also forcing it to look outside its sectors of core expertise. However, the recently announced deals largely address these concerns. While the number and value of DBAG's new investments fluctuated considerably between each of the last three financial years, taking a calendar year perspective, 2014 saw four new investments announced (three in DBAG's core sectors) with total investments of €52m, following five new investments and €31m invested in 2013, and four new investments with €30m invested in 2012.

Unser Heimatbäcker (Dahlback) – June 2014

DBAG invested €9.9m to take a 15.6% equity share in German bakery chain Dahlback, renamed Unser Heimatbäcker, alongside DBAG Fund VI, which acquired a 66.3% equity share. The business was sold by financial investor Steadfast. DBAG's investment is enabling Unser Heimatbäcker to accelerate its growth plans, which started with the acquisition of the De Mäkelbörger bakery group out of pre-insolvency restructuring proceedings in July 2014. Unser Heimatbäcker plans to integrate De Mäkelbörger, adding 1,200 employees and over 100 outlets, strengthening its market position in its home region of north-eastern Germany.

Infiana Group (Huhtamaki Films) – November 2014

DBAG invested €12.5m to take a 17.0% equity share in global specialised films business Huhtamaki Films, renamed Infiana Group, alongside DBAG Fund VI. The business was divested by Finland-based Huhtamäki Oyj to concentrate on its core food packaging business. DBAG's investment will enable the business to expand production capacity, develop products for new applications and increase its international diversification. Already well established with market-leading positions in the US and Europe, recent investments in new production facilities in Brazil and Thailand enable Infiana to expand in South America and Asia with limited further capital investment.

Pfaudler Process Solutions Group – December 2014

DBAG invested €8.0m to take a 15.0% equity share in process industries engineering specialist Pfaudler Process Solutions Group alongside DBAG Fund VI. The business was divested by National Oilwell Varco, a US-based supplier to the oil and gas industry. Pfaudler has global manufacturing operations with leading positions in its niche chemical and pharmaceutical markets. DBAG's investment will allow Pfaudler to exploit expansion opportunities as well as developing a global aftermarket service business: an area in which DBAG has considerable experience.

Gienanth – December 2014

DBAG is investing €14.0m to take a 19.0% equity share in iron foundry Gienanth alongside DBAG Fund VI. The business is being purchased out of administration and DBAG's investment will allow it to realise its growth potential while also improving profitability. With two sites in Germany producing hand- and machine-moulded castings, Gienanth has developed leading global market positions within its automotive and commercial vehicle markets.

Near-term prospects

DBAG's relatively young portfolio means there are limited prospects for realisations being made over the next few years. As a consequence, portfolio returns could be expected to be lower than average given that a significant proportion of value creation is often realised when a sale transaction is completed. This leaves returns to be primarily driven by valuation gains on the unquoted portfolio resulting from a combination of earnings growth, re-rating and debt repayment. Realisations are a primary source of funds for new investment and with only a few current portfolio investments approaching maturity, DBAG will need to maintain above-average levels of cash on its balance sheet to meet future capital commitments.

FY15 management guidance

DBAG management expects FY15 consolidated net income, excluding disposal contributions, to exceed FY14 by up to 10%, driven by a 10-20% increase in net valuation gains. This in turn implies a c 20% (c €30m) net valuation gain on the carried portfolio. No re-rating of investments (multiple expansion) is incorporated into the guidance, which means the portfolio companies are expected to deliver strong underlying earnings growth. The guidance suggests that FY15 net income will be c €24m, which equates to a c 9% NAV return excluding dividends.

While the expected NAV return in FY15 is lower than the actual return achieved in FY14 of 15.8%, the guidance reflects an anticipated strong underlying performance from portfolio companies. A lower return would be expected in FY15 for several reasons: no disposal gains are assumed in the forecast; following the Homag disposal, DBAG's cash balances are high and portfolio investments only account for c 50% of NAV resulting in a significant cash-drag on performance in FY15; and the FY14 result benefited from the revaluation of the seven new investments made in FY13 from cost to fair value while, in FY15, only one investment will see an uplift from a similar revaluation.

DBAG retains the target of delivering a return on NAV at least matching its cost of equity but we note that it has calculated its cost of equity as 5.5% at the end of FY14, down from 8.1% a year earlier. Arguably, a lower cost of equity is justified by DBAG's more diversified portfolio following the sale of Homag and significant amount of cash on the balance sheet being reflected by a lower risk premium. In any case, as indicated above, if DBAG meets or beats its guidance for net income the NAV return could comfortably exceed its cost of equity, before any disposal gains.

German private equity market perspective

DBAG is focused on the mid-market segment of the private equity market in German-speaking regions which comprises a relatively small part of the overall German private equity market. Consequently, broader market trends act as a guide but may not fully reflect deal activity in DBAG's area of focus. The German M&A market has grown in value over the last few years, with trade buyers more active and transactions involving financial investors relatively stable. Liquidity has been a key driver of transaction activity with increased inflows into private equity funds and wider availability of acquisition finance. Greater competition for deals has led to a rise in valuations, particularly for those companies perceived as higher quality. DBAG has seen a relatively stable level of investment opportunities with its core mechanical engineering, automotive suppliers and industrial services sectors continuing to represent close to 50% of potential deals.

In addition to participating in formal sales processes, DBAG's established network of contacts enables it to originate transaction opportunities through proprietary deal flow. In FY14, c 30% of all transaction opportunities originated through direct contacts similar to c 35% in FY13. In FY14, DBAG screened 299 investment opportunities, 182 relating to potential MBOs and 117 to expansion financings, with further analysis undertaken on 250. On average over the last five years, 279 opportunities have been screened in each year with 249 warranting further analysis. Based on current indications, DBAG management expects activity in their segment to remain stable in the current financial year although they note that the supply of private equity capital is growing more strongly than deal flow which is likely to maintain upward pressure on valuations.

Over the last 10 years, DBAG has been among the leading private equity investors in the German mid-market buyout segment, structuring 15 of the total 271 transactions with the most active investor completing 16 deals. In addition, DBAG completed two international MBOs and two deals valued above the ceiling for classification in the mid-market segment. In 2014, DBAG was the most active investor in the German mid-market buyout segment, structuring four of the 31 transactions.

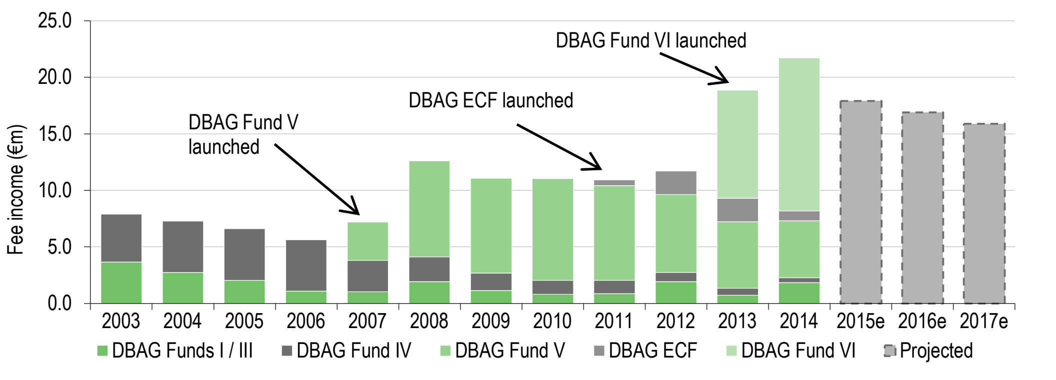
Stable rate of investment expected to continue

As noted earlier, while the rate of investment in FY14 was lower than management's €50m pa target, this can be attributed to the uneven timing of transaction completions. Including the three investments already announced in FY15, four MBOs were structured in calendar year 2014 with the total investment of €52.5m in line with management's target. DBAG management reports that market opportunities mean the deal pipeline remains strong currently, and sees no reason why three to four MBOs should not be completed in calendar 2015.

Fee income

Fees for fund services are linked to the amount of committed and invested capital. This means that the launch of a new fund leads to a step up in fee income while the divestment of mature investments results in a steady decline in fee income. The result is a 'saw-tooth' fee income profile as illustrated in Exhibit 10. DBAG's investment funds typically have a 10-year life with an initial four-year investment period and divestments made over the subsequent six years. In the case of DBAG Fund VI, within the investment period fees are charged at 2.0% on the committed capital and subsequently are charged at 2.0% on net invested capital. No fees are charged once the fund reaches the end of its life, even if investments remain in the fund.

Exhibit 10: Reported and projected fee income since DBAG Fund IV launch in 2002



Source: DBAG, Edison Investment Research. Note: projections assume a steady flow of divestments and exclude one-off effects.

At 31 October 2014, DBAG Fund VI held two investments with an additional three new investments made in the first quarter of FY15; DBAG ECF has made three investments; DBAG Fund V is still invested in seven companies and DBAG Fund IV has one remaining investment.

Valuation

Implied valuation of fund services business

One of the distinctive features of DBAG's business compared to many listed single-manager private equity peers is the recurring fee income generated by providing management and advisory services to its co-investment funds for third-party investors. Historically, limited information has been published relating to the profitability of the fund services business. However, from the first quarter of FY15, DBAG will be reporting separately on this business segment enabling its valuation to be assessed separately from the private equity investment business.

Based on the indicative performance by business segment in FY14 provided by management (see Exhibit 4), we consider the separate valuations of DBAG's two business segments. Assuming DBAG's €303m NAV represents the valuation of its private equity investment business and taking DBAG's current €384m market capitalisation, this leaves a residual value of €81m which can be attributed to the fund services business, implying a 12x multiple of pre-tax income.

For comparison purposes, we apply the same methodology to 3i, which operates a similar business model to DBAG. At 30 September 2014, 3i reported £3,426m NAV and £16m underlying profit from the fund management business for the half-year. We assume the £3,426m NAV reflects the valuation of 3i's private equity investment business. Based on 3i's current £4,631m market valuation, this leaves a residual value of £1,205m to be attributed to the fund management business, implying a 38x multiple of annualised underlying profit.

We recognise that the high implied earnings multiple of 3i's fund management business reflects a combination of expectations for NAV progression and growth in assets under management and differing expectations for DBAG and 3i mean there is no presumption that they should trade on the same earnings multiples. However, the analysis, which shows its shares trading at a meaningful discount to a direct peer, provides a useful perspective on DBAG's valuation, different from a more traditional share price discount to NAV comparison (see below).

Peer group comparison

DBAG's business is differentiated from private equity peers by its regional and sector focus on the German Mittelstand, and by the significant component of recurring fee income generated from its management of co-invested funds for third-party investors. This makes a direct comparison with the listed private equity peer group more difficult, although we see both as primarily driven by NAV development over the long term.

Exhibit 11: Listed private equity investment companies peer group comparison

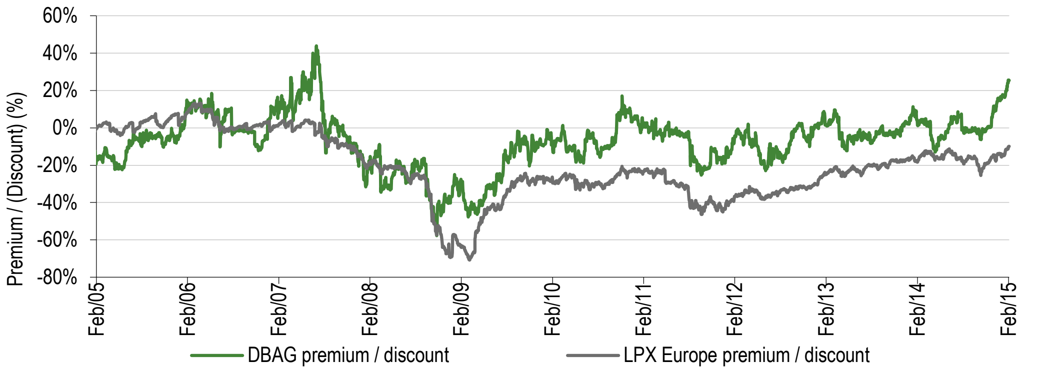
As at 31 October 2014	Country	Mkt cap £m	Price TR 1 year	Price TR 3 year	Price TR 5 year	Price TR 10 year	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (Ex Par)
Deutsche Beteiligungs AG	Europe	286.1	10.1	49.0	61.6	403.9	11.9	42.2	43.1	319.2	26.1
3i	Global	4,630.7	12.0	118.5	74.4	44.1	19.7	38.8	44.7	57.9	25.2
Altamir	Europe	284.9	(3.6)	52.7	93.4	149.1	8.4	26.3	36.5	174.2	(33.6)
Dunedin Enterprise	UK	76.6	(10.3)	40.2	46.3	73.9	(2.6)	2.3	36.1	67.9	(26.8)
Electra Private Equity	UK	1,082.1	12.1	68.4	113.4	241.1	14.9	42.7	84.5	261.4	(11.3)
GIMV NV	Global	753.9	(5.4)	3.0	4.8	120.5	(5.3)	(1.1)	2.7	69.1	3.3
HgCapital Trust	UK	405.5	0.1	12.0	42.7	257.9	8.3	14.2	53.9	249.4	(7.8)
Average		**1,074.3**	**2.1**	**49.1**	**62.4**	**184.4**	**7.9**	**23.6**	**43.1**	**171.3**	**(3.6)**

Source: Morningstar, Thomson Datastream, Edison Investment Research. Note: TR=total return. All returns expressed in sterling terms. Market cap and discount as at 5 January 2015.

As shown in Exhibit 11, DBAG's NAV total return in sterling terms to 31 October 2014 has outperformed the peer group average over one, three and 10 years and is in line with the average over five years. DBAG's 10-year NAV total return in euro terms (12.5% pa) compares favourably with its closest peers, the LPX Europe index (5.3%, all listed private equity companies in Europe) and the LPX Direct index (6.0%, all listed private equity companies that invest directly).

As illustrated in Exhibit 12, similar to peers, DBAG shares moved to a significant, although smaller, discount to NAV during the global financial crisis, but recovered during 2009, subsequently trading at or around the NAV. DBAG's current 26% share price premium to NAV is above both the 12-month average (2% premium) and the three-year average (2% discount).

Exhibit 12: DBAG's share price premium/discount to NAV in relation to peers over 10 years



Source: Bloomberg, Morningstar

Since November 2014, the LPX Europe index has seen a narrowing of the average share price discount to NAV from 16% to 10% compared with the widening of DBAG's share price premium to NAV from parity to 26%. This has pushed the differential between DBAG and the index to 35%, its highest level for three years. Excluding a brief narrowing in April and May 2014, the differential has ranged between 10% and 39% over the last five years and its 10-year peak was 47%.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand