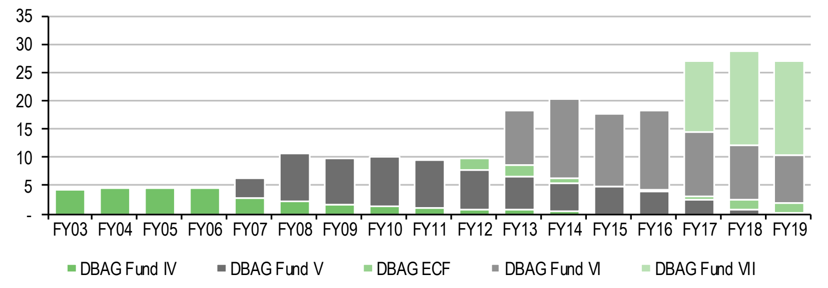
EDISON

Deutsche Beteiligungs

Expanding the companies in broadband sector

Deutsche Beteiligungs (DBAG) reported a marginal net loss in Q120, with income from the fund services segment offset by a more muted result from the private equity investments segment. The recent launch of DBAG Fund VIII should soon start to generate sizeable fee income. Macroeconomic and geopolitical headwinds continue to weigh on portfolio value growth (with c 50% of DBAG's portfolio in German industrials). However, in the longer term, DBAG should benefit from its buy-and-build strategy in the better-performing broadband sector.

DBAG fee income by fund (€m)



Source: DBAG, Edison Investment Research

The market opportunity

DBAG is a well-positioned player in the German private mid-market segment. It has shown its ability to benefit from higher market valuations, both before the onset of the 2008/09 crisis and more recently in 2017, with a high number of exits at that time (see the analysis in our previous outlook note). Recurring income from fund services provides a degree of stability. We also note DBAG's growing exposure to its focus sectors in recent years (eg broadband telecom). The first exit from its focus portfolio (inexio, a broadband telecoms company), agreed in Q419 at a 7.5x money multiple, strengthens DBAG's investment case.

Why consider investing in Deutsche Beteiligungs?

- Solid track record, with an average management buyout (MBO) exit multiple of 2.7x since 1998.
- Increasing exposure to the German broadband sector (22% at end-Q120).
- Steady income from the fund services segment.
- Dividend yield of c 4%, ahead of peer average.

Valuation: Premium to NAV at c 17%

DBAG's shares continue to trade at a premium to NAV (defined as total equity), which in our view comes from the market-implied value of the fund services business. This is supported by the launch of DBAG Fund VIII, which will drive fee income once the investment period commences. The premium to end-December NAV dropped to the current c 17% amid a broader market sell-off on the back of the coronavirus outbreak. DBAG's shares currently offer a dividend yield of c 4% vs the peer average of 3.1%.

Investment trusts
Private equity

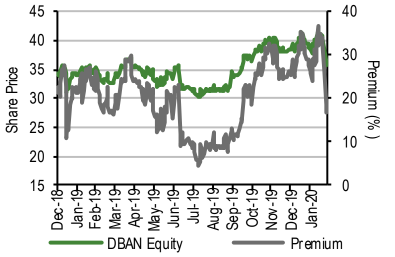
3 March 2020

Price	**€35.75**
Market cap	**€537.8m**
NAV*	**€459.9m**
NAV per share**	€30.57
Premium to NAV	16.9%

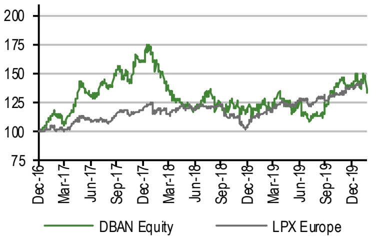
*Defined as total equity. **As at end-December 2019.

Yield	4.2%
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	€41.75	€30.15
NAV* high/low	€30.59	€28.56

*Including income.

Gearing

Gross*	0.0%
Net cash*	4.0%

*As at end-December 2019.

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Edison profile page

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Exhibit 1: Deutsche Beteiligungs at a glance

Investment objective and fund background

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

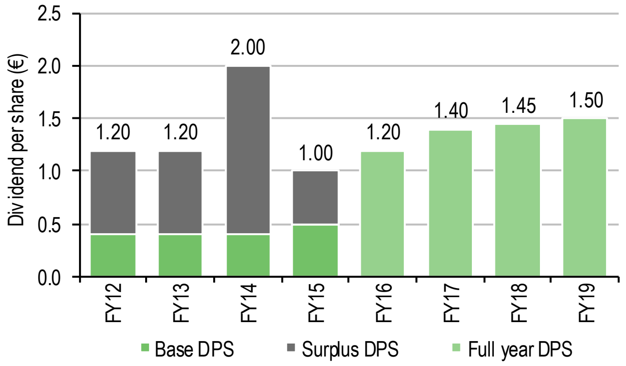
Recent developments

- 10 Feb 2020: Q120 results – NAV TR -0.1% vs LPX Europe NAV TR 4.5%.
- 10 Dec 2019: DBAG launches DBAG Fund VIII.
- 14 Nov 2019: annual dividend declaration of €1.50 per share.
- 28 Sep 2019: DBAG announces disposal of its investment in inexio.
- 12 Sep 2019: announces up to €14m investment in STG with DBAG ECF.
- 23 Aug 2019: DBAG invests €26m in Cartonplast alongside DBAG Fund VII.

Forthcoming		Capital structure		Fund details	
AGM	25 February 2021	FY19 net expense ratio*	0.2%	Group	Deutsche Beteiligungs
Interim results	13 May 2020	Net cash	4.0%	Manager	Team managed
Year end	30 September	Annual mgmt fee	N/A (self-managed)	Address	Boersenstrasse 1 60313 Frankfurt am Main, Germany
Dividend paid	25 February 2020	Performance fee	N/A (self-managed)		
Launch date	December 1985	Company life	Indefinite	Phone	+49 69 95787-01
Continuation vote	N/A	Loan facilities	€50m (undrawn)	Website	www.dbag.com

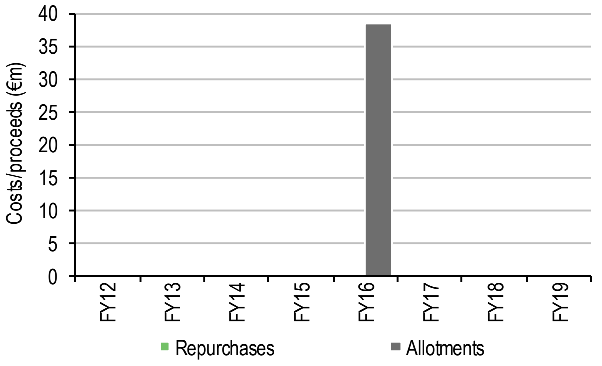
Dividend policy and history (financial years)

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

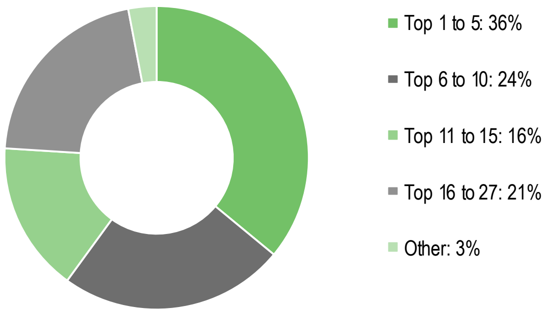


Share buyback policy and history (financial years)

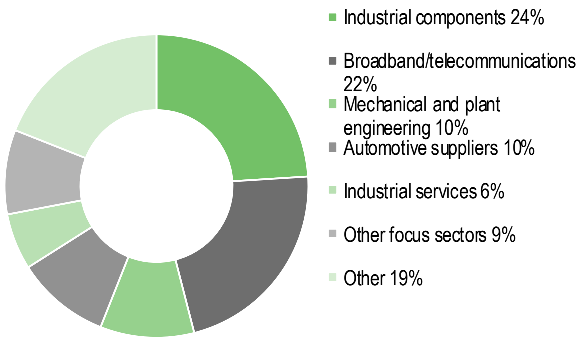
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



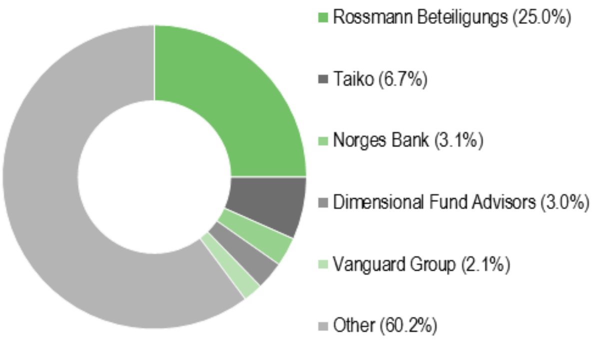
Concentration of DBAG's portfolio value by size (as at 31 December 2019)



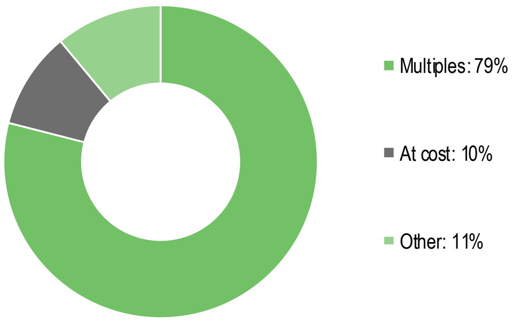
DBAG's portfolio exposure by sector (as at 31 December 2019)



Shareholder base (as at 12 February 2020)



DBAG's portfolio value by valuation method (as at December 2019)



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

Results highlights: Neutral portfolio valuation effect

DBAG's Q120 net loss amounted to €0.2m. The fund services segment generated a pre-tax profit of €1.7m compared to €1.5m in Q119, up 18% y-o-y. The increase in fund services profit came from lower operating costs, in particular a decline in consultancy expenses for transactions that had not yet been completed, as well as the absence of set up costs for DBAG Fund VIII. However, this was offset by a loss in the private equity investments segment of €1.9m. There were no new disposals agreed during the period and the change in the net valuation of the portfolio companies was close to nil, while costs increased slightly to €2.0m. While the disposal of inexio was completed in the period, the agreed price was reflected in the Q419 portfolio valuation. We note that while DBAG Fund VIII has been launched, it has not started its investment phase and thus no fee income from the fund was recorded in Q120.

Exhibit 2: Income statement by segment (€m)

	Q120	Q119	% y-o-y
Net result of investment activity	0.1	(21.1)	N/A
Other income/expenses	(2.0)	(1.8)	11%
Private equity investments profit	**(1.9)**	**(22.9)**	**N/A**
Fund services income	7.4	7.6	(2%)
Other income/expenses	(5.7)	(6.2)	(7%)
Fund services profit	**1.7**	**1.5**	**18%**
Consolidated net profit	**(0.2)**	**(21.4)**	**N/A**

Source: DBAG

On average, the change in the valuation multiples based on listed peers was positive, adding €5.1m to the value of the portfolio compared to a negative €47.8m reported in Q119 amid the broader equity markets sell-off. We note that 79% of DBAG's portfolio is valued based on multiples (vs 69% at end-Q119). The share of the portfolio holdings valued at cost (investments younger than a year) decreased to 10% from 17% a year ago, which means that the impact of capital markets and macro trends on the portfolio's valuation has increased somewhat (see Exhibit 1 on page 2). It is worth noting that in Q120 the value of 12 investments were downgraded and 12 were upgraded, which indicates that portfolio diversification has helped DBAG mitigate the impact of a weak German industrial sector.

The change in earnings resulted in a €4.9m decline in DBAG's portfolio valuation vs a €30.9m gain in Q119. The outlook for German industrial companies (currently 50% of DBAG's portfolio) remains subdued due to an overall economic slowdown and global trade tensions, which have hit goods exports. In addition, the automotive industry faces pressure from tightening emission standards. The industry slowdown is also reflected in GDP forecasts, with the German government expecting 1.0% growth in 2020 vs earlier expectations of 1.5%. This is important given that DBAG has now changed the base for valuation multiples of its portfolio companies to budgeted profits for 2020.

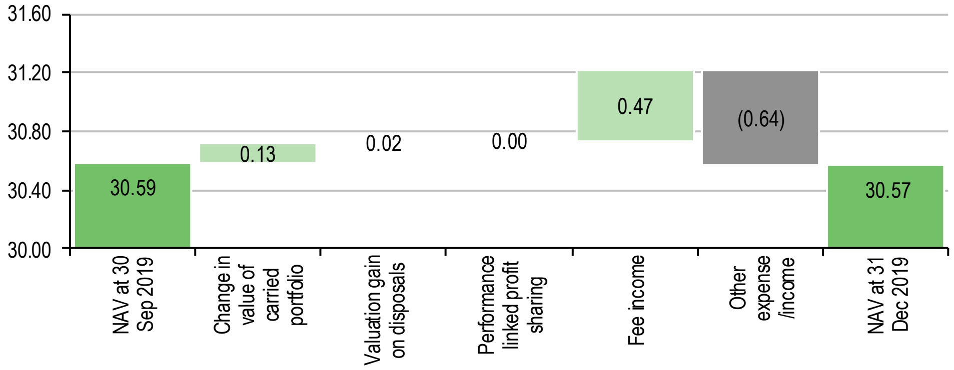
Exhibit 3: Result of valuation and disposal (€m)

	Q120	Q119
Changes in fair value of unlisted investments	(1.5)	(23.8)
Change in earnings	(4.9)	30.9
Change in debt	(1.5)	(9.9)
Change in multiples	5.1	(47.8)
Change in exchange rates	0.1	0.2
Change, other	(0.3)	2.7
Net result of disposal	0.3	0.2
Other	1.3	(0.3)
Total	**0.0**	**(23.9)**

Source: DBAG

During Q120 DBAG's NAV (defined as equity value) remained broadly stable and amounted to €30.57 per share at end December 2019. We note that over the period no disposals were agreed that could realise an uplift in valuation. The reported €0.02 per share valuation gain on disposals was based on a technical effect related to the disposal of inexio, which was agreed and booked in the Q419 results.

Exhibit 4: DBAG's Q120 NAV performance to end-December 2019 (€/share)

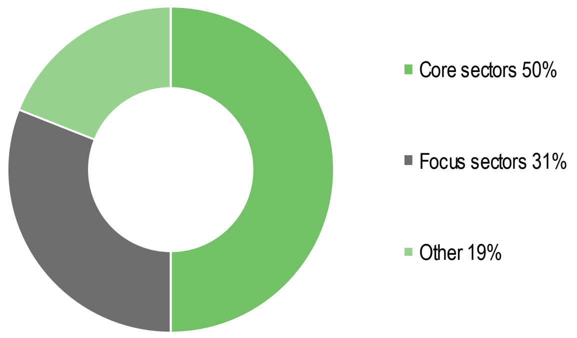


Source: DBAG, Edison Investment Research

Asset allocation: Buy-and-build in broadband

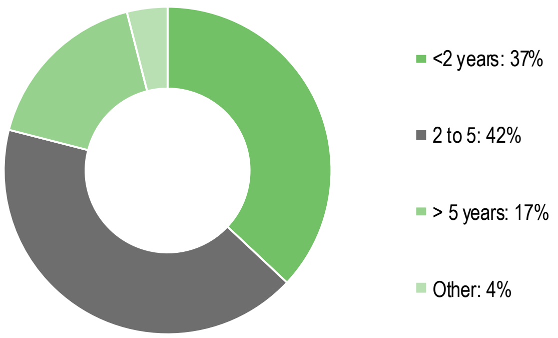
As at the end of Q120, DBAG's investment portfolio was worth €406.4m, down from €422.1m at end FY19, as the disposal of inexio, coupled with the downward revaluation of core sector companies, more than offset the acquisitions of Cartonplast and STG Group (see our previous note for details). Following the first disposal from the focus portfolio agreed in Q419, DBAG's exposure to focus sectors (broadband/telecommunications, IT services/software and healthcare) declined to 31% (from 39% at end FY19). Half of DBAG's portfolio value is attributable to industrial sectors, which experienced headwinds from various international trade tensions. However, management highlights that direct exposure to the Chinese market is limited to c 7% of total revenues of its portfolio companies.

Exhibit 5: Portfolio split by sector



Source: DBAG

Exhibit 6: Portfolio split by age of investment



Source: DBAG

DBAG's portfolio companies continued to grow through M&A with six add-on acquisitions agreed (of which two were closed during the quarter) and negotiations with respect to another add-on are nearing completion. DBAG did not provide capital for the transactions agreed during the quarter.

The radiology group **blikk** (included in DBAG Fund VII's portfolio) took over a specialised hospital in Berlin (Klinik Helle Mitte), which increases its number of doctors by c 20%. It also agreed the acquisition of dialysis practice Morlock, which completed after the reporting date. **STG Group** (DBAG ECF) has only been in DBAG's portfolio since November 2019 but has already closed two acquisitions (Leinberger Group and ISKA Schön), with a third expected to be agreed shortly. STG, which constructs, operates and maintains fibre optic networks and generated €20m in revenues in 2018, expects to generate c €100m in annual revenues with these transactions. Leinberger Group is a full-service provider of supply and communication networks (c €22m in 2019 sales), while ISKA Schön is a subterranean construction specialist (telecommunications and trenching) with c €35m revenues in 2019. **Netzkontor nord** (DBAG ECF, broadband telecommunications) acquired Voss Telecom Services and SSF Telekommunikations Management, which broadened its regional presence in western Germany and thus reduces its reliance on the Schleswig-Holstein region.

Financial resources and commitments

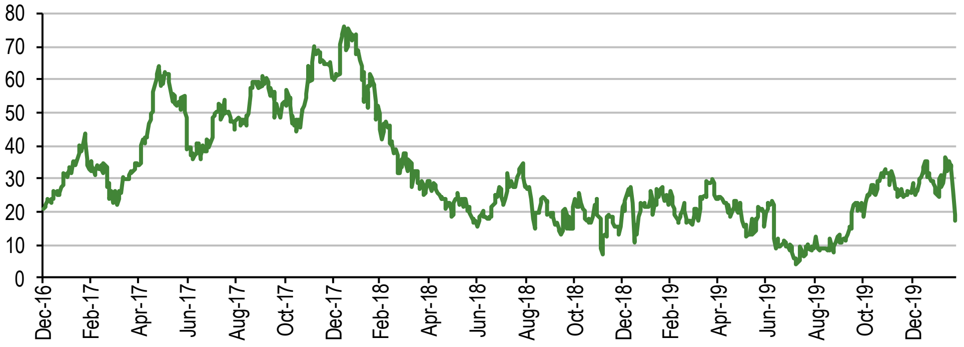
DBAG ended Q120 with €18.5m in financial resources, which included €13.0m in cash and €5.5m in liquid, short-term securities. While this is considerably lower than the end-FY19 figure (€69.4m), we note that DBAG has yet to recognise the cash proceeds from the sale of inexio and Infiana, which are currently held in subsidiaries (included in financial assets but excluded from the portfolio value). This led to an increase in other assets and liabilities of investment entity subsidiaries to €51.4m vs €3.4m a quarter earlier, which should be distributed to DBAG in Q220 and partially also in the following quarters shortly. DBAG will also receive c €6m from the final settlement of a disposal agreed in 2017, with no impact on NAV.

The financial position is also supported by a €50m credit line that remains undrawn, bringing available cash resources to €68.5m. The amount covers 77% of undrawn commitments for already launched DBAG funds (€88.5m). We note that once DBAG Fund VIII enters its investment phase, commitments will increase by €255m. After taking this into account and including the expected cash inflows, we estimate that DBAG's cash will cover one-third of its overall commitments. However, given the four- to six-year investment horizon of the new fund (with some time required for the initial ramp-up), as well as management expectations that DBAG will invest a total of c €90m annually over the next three years, its commitments seem to be well covered at this stage.

Valuation

DBAG's reported NAV is exclusively attributable to the value of its private equity investment portfolio and does not account for the fair value of its fund services business, which at end-Q120 represented third-party assets under management of c €1.4bn and generates considerable recurring fee income. We note that on DBAG Fund VIII's launch, the total AUM should increase to c €2.5bn (including DBAG's investment) from €1.7bn at end-Q120. For the 12 months ending December 2019, the segment generated €28.0m in fees, translating into a pre-tax profit of €3.3m. Consequently, there is an inherent premium when comparing DBAG's share price with its reported NAV, which disguises any underlying premium or discount that the market may be applying to the value of DBAG's private equity investment portfolio. We believe this is the primary reason that the company's shares consequently trade at a premium to NAV (Exhibit 7). DBAG's share price recently responded to the broader market sell-off amid the coronavirus outbreak, which has lowered its premium to NAV to the current 16.9%.

Exhibit 7: Share price premium to NAV over three years (%)



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

DBAG's reported equity (which we treat as an equivalent of NAV) at end-December 2019 was €459.9m, compared to the current market capitalisation of €537.8m. We believe the market is already discounting the higher fee income from DBAG Fund VIII (as discussed earlier in the note), which distorts multiples based on historical earnings. However, given no forecasts at hand, we present the value of the fund services segment implied by DBAG's market capitalisation and reported segment earnings using two scenarios. If we assume that the private equity investments business is valued at a discount to NAV in line with the current discount of the LPX Europe Index (10.5%), the value of the fund services business amounts to €126.4m and translates into an earnings multiple of 38.4x (LTM basis). This compares to our last estimate from January, when the LPX discount amounted to 9.9%, implying a multiple of 54.6x. Alternatively, if we assume the market is valuing the company's private equity business in line with its last reported NAV, this implies a value attached to the fund services business of around €78.0m (14% of the market cap), implying an LTM earnings multiple of 23.7x. This compares to our previous calculations at the time of the FY19 results of a 39.5x earnings multiple based on similar assumptions.

We believe that the significant uplift on the recent disposal of inexio was a share price development catalyst. Finally, we note that in each of the last five financial years, DBAG recognised positive net disposal gains (including gains on agreed but yet to be finalised exits). These represented up to c 20% of the corresponding year's opening NAV, suggesting DBAG's portfolio valuation may be considered quite conservative.

Peer group comparison

We have compared DBAG with other listed private equity investment companies with a prime focus on Europe in Exhibit 8. However, we acknowledge that DBAG is the only company in the group that targets mid-sized companies in German-speaking countries. Moreover, unlike all the peers except 3i in the UK, DBAG also manages third-party funds. As discussed earlier, we see the value of DBAG's fund service business as the main reason that its shares trade at a premium to its reported NAV. This contrasts with the peers that do not manage third-party funds, some of which are trading at a wide discount to NAV. DBAG's c 4% dividend yield is among the highest in the peer group (the average is 3.1%).

DBAG's 8.5% NAV total return in sterling terms (8.3% in euro terms) over one year to end-December 2019 lagged that of the peer group. We believe the main contributor to performance was DBAG's relatively high exposure to the German industrial market, which experiences more intense headwinds from the slowing economy and trade war threats than other sectors. Recent underperformance also influences longer-term figures, which are below the peers' average.

Exhibit 8: Listed private equity investment companies peer group as at 26 February 2020*

% 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	448.6	8.5	37.4	97.6	169.7	11.4	37.7	99.5	246.4	16.9	4.2
3i	Global	10,761	12.1	76.9	193.3	345.1	47.2	73.5	194.5	448.1	28.7	3.4
HgCapital Trust	UK	1,053	20.1	69.0	129.4	250.2	47.5	82.2	183.1	304.6	3.4	1.9
ICG Enterprise Trust	UK	643	11.2	48.7	87.2	189.0	26.0	57.4	100.5	294.9	(17.7)	2.4
Oakley Capital Investments	Europe	532	24.5	55.9	82.9	160.7	57.0	73.4	88.9	207.2	(22.3)	1.7
Princess Private Equity	Global	666	14.3	42.9	108.7	169.3	29.7	48.5	131.3	475.5	(9.1)	5.9
Standard Life Private Equity	Europe	540	5.4	33.0	86.4	195.1	11.8	31.6	90.2	340.8	(22.0)	3.6
Average		**2,366.0**	**14.6**	**54.4**	**114.7**	**218.3**	**36.5**	**61.1**	**131.4**	**345.2**	**(6.5)**	**3.1**
Rank in peer group		**448.6**	**6**	**6**	**4**	**5**	**7**	**6**	**5**	**6**	**2**	**2**

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

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