

Deutsche Beteiligungs

Building future potential

Deutsche Beteiligungs (DBAG) reported FY18 net income of €33.6m, at the top of management's guidance range, with a 7.8% dividend-adjusted NAV return for the financial year. While net income was lower than in FY17, a €1.45 per share FY18 dividend has been proposed, representing a 3.6% increase on the prior year. FY18 saw DBAG reinvesting and growing its investment portfolio, agreeing seven new investments and one disposal, following an exceptional FY17 during which six new investments and seven divestments were agreed. DBAG has broadened its expertise outside of its traditional core sectors and, at end-FY18, 31% of the portfolio was represented by consumer goods, information technology, media & telecoms, real estate and healthcare companies. Relatively immature investments (younger than two years) now account for over half of DBAG's invested capital, and this contributes to a conservative outlook for FY19 while providing more promising medium-term prospects.

12 months ending	Share price (%)	NAV (%)	LPX Europe (%)	LPX Europe NAV (%)	SDAX (%)	FTSE All-Share (%)
31/10/14	19.4	15.5	5.9	12.3	(0.0)	9.2
30/09/15*	22.6	9.2	22.3	11.1	24.7	4.6
30/09/16	20.8	15.6	9.3	3.3	11.7	(0.5)
30/09/17	58.5	23.5	25.1	14.6	28.3	9.9
30/09/18	(20.6)	7.6	6.4	12.1	(0.4)	4.7

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

Reinvesting in FY18 after an exceptional FY17

After making an exceptional number of successful divestments in FY17, DBAG maintained a similar pace (but higher value: €85.1m versus €62.9m) of investment in new and existing portfolio companies in FY18. Financial resources remain strong at €119.0m and commitments to the DBAG ECF and DBAG Fund VII funds suggest an average annual investment rate of c €94m over the next two to three years.

Cautious for FY19, but positive medium-term view

DBAG expects up to 20% higher net income in FY19 than in FY18, but guidance is stated relative to the five-year average, and FY19 net income is expected to be 20% to 40% lower than this average. Caution is expressed over prospects for FY19 partly due the immaturity of DBAG's current portfolio and the 'J' curve value development that a private equity investment typically follows. This is reflected in guidance for FY20 and FY21 net income to be more than 40% higher than in FY19.

Valuation: Substantially narrowed premium to NAV

DBAG's share price premium to NAV has narrowed from 75.8% in January 2018 to 6.2% currently. After an exceptionally strong FY17, DBAG's slower NAV progress in FY18 and its cautious outlook for FY19 appear to have substantially lowered market expectations for its future growth. Our analysis suggests that the market may now be applying a c 30% underlying discount to the NAV of DBAG's private equity investments, compared to a c 40% premium previously (see page 4).

Investment companies

7 December 2018

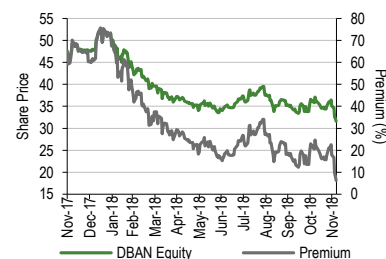
Price €31.60
Market cap €475m
NAV* €448m

NAV per share* €29.76
 Premium to NAV 6.2%

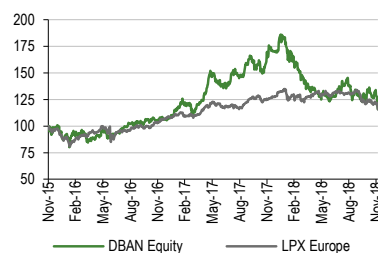
*As at 30 September 2018.

Yield 4.6%
 Ordinary shares in issue 15.0m
 Code DBAN
 Primary exchange Frankfurt
 Sector Private equity
 Benchmark N/A

Share price/discount performance



Three-year performance vs index



52-week high/low €52.20 €31.60
 NAV high/low €29.76 €28.81

Gearing

Gross* 0.0%
 Net cash* 26.6%

*As at 30 September 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

- 30 November 2018: FY18 results – NAV TR +7.6% vs LPX Europe NAV TR +12.1%.
- 14 November 2018: €1.45 per share dividend proposed for FY18.
- 14 October 2018: Gerhard Roggemann became DBAG supervisory board chairman.
- 8 October 2018: DBAG agreed to invest c €11m in SERO Schröder Elektronik Rohrbach, an electronics manufacturing services provider, alongside DBAG Fund VII.
- 28 September 2018: DBAG agreed to invest c €14m in Kraft & Bauer, a provider of fire extinguishing systems for tooling machines, alongside DBAG Fund VII.
- 24 September 2018: DBAG agreed to invest c €9m in FLS, a provider of software for real-time schedule and route planning, alongside DBAG ECF II.

Forthcoming

AGM	February 2019
Quarterly results	7 February 2019
Year end	30 September
Dividend paid	February 2019
Launch date	December 1985
Continuation vote	N/A

Capital structure

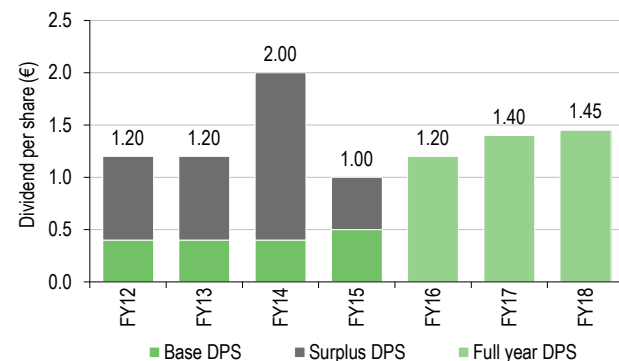
FY18 net expense ratio*	0.0%
Net cash	26.6%**
Annual mgmt fee	N/A (self-managed)
Performance fee	N/A (self-managed)
Company life	Unlimited
Loan facilities	€50m

Fund details

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

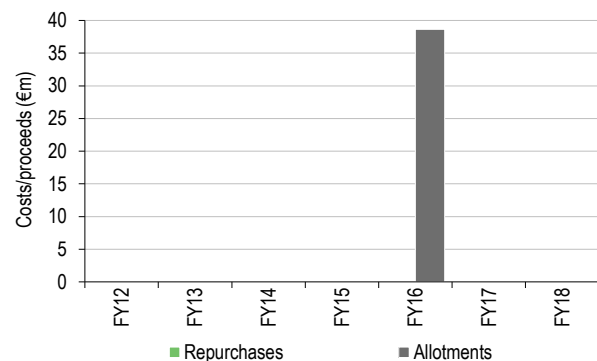
Dividend policy and history (financial years)

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

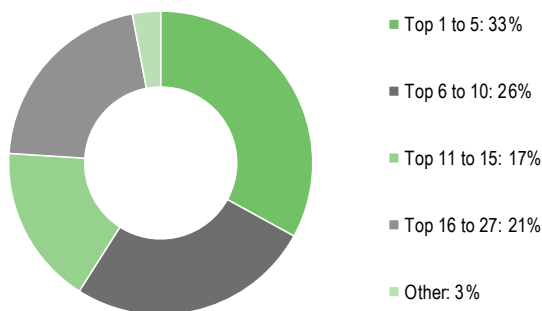


Share buyback policy and history (financial years)

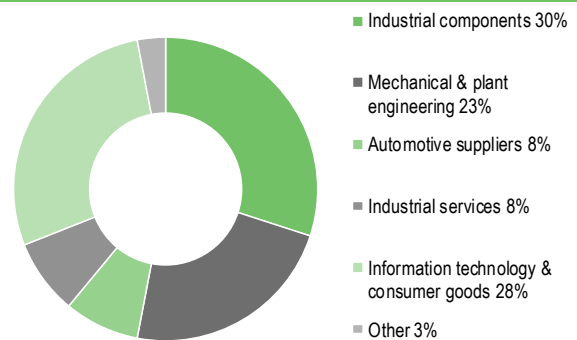
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



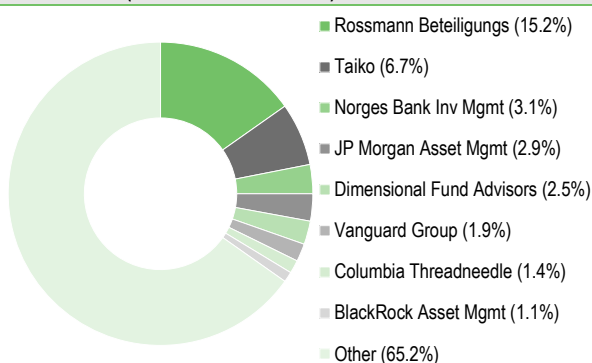
Concentration of portfolio value by size (as at 30 September 2018)***



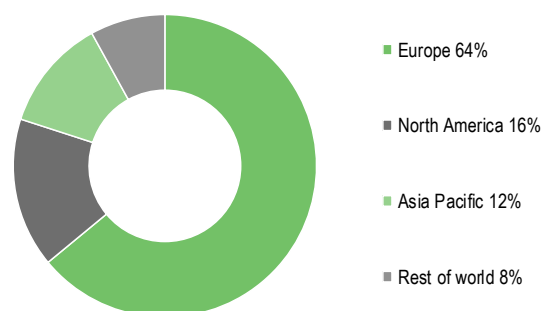
Portfolio exposure by sector (as at 30 September 2018)***



Shareholder base (as at 30 November 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 €55.5m of securities classified as long-term assets. ***Does not include co-investment funds.

FY18 performance highlights

DBAG reported €33.6m net income for FY18 (at the top end of its most recent guidance range), with a 7.8% dividend-adjusted NAV return, after incorporating the effects of a change in accounting policy (effective at end-June 2018 and applied retrospectively to end-September 2017 – see our [August 2018 note](#) for details). NAV per share increased from a restated €29.01 at end-September 2017 to €29.76 at end-September 2018, after payment of the €1.40 per share FY17 dividend.

During the year, portfolio company earnings growth was the most significant driver of valuation gains, contributing €17.2m of the €33.7m gross valuation gain. The net €3.1m positive contribution from changes in market valuation multiples included a positive €13.6m effect from the sale price negotiated for the disposal of Cleanpart and valuation uplifts to reflect expressions of interest from potential buyers in other portfolio companies (which are required to be recognised as the most accurate indicators of current market values), while there was a negative €10.5m effect from the decline in the market multiples used to value portfolio companies compared with a year earlier.

Pre-tax earnings were positive for both of DBAG's business lines in FY18, with private equity investments generating €27.6m, compared with €77.3m in FY17. The previous year had benefited from an exceptional level of gains on disposal, reflecting sale prices predominantly being agreed at significant premiums to prior portfolio valuations. Fund investment services contributed €6.0m to earnings in FY18, compared with €4.7m in FY17, with fee income for the year rising from €28.1m to €29.4m. Increases in fee income from DBAG Fund VII and DBAG ECF outweighed decreases in fee income from DBAG Funds V and VI, which reflected the decline in each fund's assets as a result of the divestments made during FY17.

Investment activity continued at a steady pace throughout FY18, with DBAG agreeing five new investments alongside DBAG ECF and two new investments alongside DBAG Fund VII. Following its investments in Sjølund and netzkontor nord in the first half of the year, DBAG ECF completed its first new investment period (DBAG ECF I) after only 12 months, following a management buyout (MBO) investment in von Poll Immobilien. DBAG ECF started its second new investment period (DBAG ECF II), scheduled to run to December 2020, with an MBO investment in BTV Multimedia. This was followed by an MBO investment in FLS, a provider of software for real-time schedule and route planning, which was agreed shortly before the year end.

During FY18, DBAG Fund VII agreed and completed a new MBO investment in Karl Eugen Fischer, a manufacturer of cutting machines for the tyre industry, with DBAG contributing €22.7m for a 16.5% stake. The fund also agreed an investment in Kraft & Bauer, a provider of fire extinguishing systems for tooling machines, with DBAG agreeing to invest c €14m for a c 20% stake. After completion of the Kraft & Bauer deal, DBAG Fund VII will have called c 56% of its commitments. Shortly after the year end, in October 2018, DBAG Fund VII agreed an investment in SERO Schröder Elektronik Rohrbach, an electronics manufacturing services provider, with DBAG agreeing to invest c €11m to take a c 20% stake.

Commitments and financial resources

At 30 September 2018, DBAG had c €198m in undrawn capital commitments to the DBAG ECF and DBAG Fund VII funds. While capital calls totalling €90.1m were met during FY18, this was partly offset by the €39.7m commitment to DBAG ECF's second new investment period (DBAG ECF II). Based on these two funds' expected investment programmes, DBAG's management anticipates an average annual investment run rate of c €94m over the next two to three years. Although total outstanding commitments exceed current financial resources, DBAG has sufficient funds to meet its expected capital calls over the next 12 months, while portfolio realisations may further supplement financial resources. DBAG also has a €50m credit facility, with its maturity now extended to 2023, on which it can draw to manage short-term cash flow timing differences.

During FY18, DBAG's financial resources (which include fixed-income funds and fixed-rate securities that are held as cash investments but partly classified as long-term assets) declined from €161.6m to €119.0m, as the sale proceeds from the exceptional number of divestments completed in FY17 were reinvested in new and existing portfolio companies. At 30 September 2018, DBAG's financial resources comprised €23.6m in cash, €40.0m in short-term securities and €55.5m in securities classified as long-term holdings. Investment entity subsidiaries held a further €13.0m in financial resources (€7.8m in cash and cash equivalents, and €5.2m in securities).

During the year, there were €85.1m of investment cash outflows, which primarily related to new investments in KEF, Sjølund, netzkontor nord, BTV Multimedia and von Poll Immobilien, as well as follow-on investments in existing portfolio companies duagon, Polytech Health & Aesthetics and Unser Heimatbäcker. The other major cash outflow during the period was the €21.1m FY17 dividend payment. Investment cash inflows of €16.7m related to the refinancing of DBAG's investment in vitronet projekte, the disposal of a business line by Cleanpart, repayment of a shareholder loan by former portfolio company Coperion, and the partial divestment of DBAG's investment in Silbitz, with the €19m sale proceeds from the divestment of Cleanpart not received until after the year end, in October 2018.

Earnings guidance for FY19 and future years

DBAG management frames earnings guidance for each financial year with reference to average net income for the previous five years, rather than the prior financial year, which it sees as providing too volatile a reference point. This means that, while management expects an improvement in earnings in FY19 of up to 20% compared to FY18 net earnings of €33.6m, its guidance is for FY19 net income to be between 20% and 40% lower than the five-year average net income of €48m.

At a portfolio company level, DBAG management expects lower-than-average investment value development in aggregate in FY19 due the relative immaturity of the overall portfolio, with it being dominated by investments held for less than two years. Rather than reflecting any concern over portfolio companies' ability to meet their targets, this expectation is based on the typical 'J' curve value progression, with portfolio companies investing more heavily in the first couple of years following DBAG taking a stake, while the rewards of this investment are generally realised in the later years of DBAG's holding period. This is reflected in DBAG management's guidance that net income for FY20 and FY21 is anticipated to be more than 40% higher than in FY19.

Valuation: Premium to NAV has narrowed considerably

As we have consistently highlighted, DBAG's reported NAV does not reflect the fair value of its fund services business, which has c €1.5bn of third-party assets under management and generates substantial recurring fee income. This contrasts with DBAG's market value, which reflects the value of the fund services business as well as DBAG's private equity investments. This discrepancy leads to there being an inherent premium when comparing DBAG's share price to its reported NAV, which masks any underlying premium or discount that the market may be applying to the value of DBAG's private equity investment portfolio. We see the value attributed by the market to DBAG's fund services business as the principal reason for its shares having traded at a premium to NAV for nearly all of the last three years, as illustrated in Exhibit 2.

After an exceptionally strong FY17 performance, DBAG's slower NAV progress in FY18 and its cautious outlook for FY19 appear to have markedly reduced market expectations for its future growth prospects compared with a year ago, leading to a significant share price decline and resultant contraction of DBAG's share price premium to NAV (see Exhibit 2). DBAG's shares are currently trading at a c €28m or 6.2% premium to NAV – the narrowest level since May 2016.

Exhibit 2: Share price premium/discount to NAV over three years (%)



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

In our view, the value of DBAG's fund services business reflects the medium-term progression of its assets under management, which drives its fee income, but the valuation of this business is difficult to assess relative to annual earnings, which jump following the launch of a new fund, then decline in subsequent years as underlying investments mature and capital is returned to fund investors. Our previous analysis (in our [August 2017 note](#)), shortly after the launch of DBAG Fund VII, suggested the market was attributing a valuation of up to c €160m to DBAG's fund services business (which gives a market-implied valuation multiple of 27x reported FY18 earnings). If we assume that the longer-term outlook for the fund services business has not altered materially since this analysis, DBAG's current share price suggests the market is applying an underlying c €125m or c 30% discount to the NAV of its private equity investments. This compares to the implied c €180m or c 40% underlying premium to NAV in January 2018, when DBAG's headline premium to NAV was 75.8%, and it is also wider than the current c 20% discount of the LPX Europe index, which comprises a diversified peer group of European-listed private equity companies.

Peer group comparison

Exhibit 3 shows a comparison of DBAG with other listed private equity investment companies that primarily invest in Europe. However, DBAG is the only company in the group that focuses on mid-sized companies in German-speaking countries. A further differentiating feature is that DBAG manages third-party funds, unlike all of the peers except 3i in the UK. As noted above, we see the value of DBAG's fund service business as the main reason that its shares trade at a premium to its reported NAV. This contrasts with its peers that do not manage third-party funds, some of which are trading at a wide discount to NAV. DBAG's 4.6% yield is among the highest in the peer group.

Exhibit 3: Listed private equity investment companies peer group as at 6 December 2018*

% 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	420.0	8.7	85.6	111.7	165.2	(19.8)	83.6	138.5	378.4	6.2	4.6
3i	Global	7,423.6	23.4	121.4	206.7	47.6	6.4	124.6	215.6	125.2	0.6	4.8
Electra Private Equity	UK	156.8	1.9	49.4	113.8	228.2	5.4	75.1	159.4	368.4	(43.0)	2.2
HgCapital Trust	UK	698.0	15.7	74.9	107.2	160.8	25.0	107.4	107.7	238.0	(9.6)	2.5
ICG Enterprise Trust	UK	582.6	13.3	57.0	78.9	131.5	20.0	63.8	86.3	194.4	(17.8)	2.5
Oakley Capital Investments	Europe	368.6	14.3	48.0	38.2	166.8	22.8	46.4	26.2	215.1	(29.9)	2.5
Princess Private Equity	Global	603.5	11.7	72.3	95.8	108.0	7.7	102.7	136.3	251.7	(11.4)	5.7
Standard Life Private Equity	Europe	517.4	10.2	58.9	92.2	106.0	5.8	78.7	104.1	160.0	(18.4)	3.7
Average		1,346.3	12.4	70.9	105.6	139.3	9.2	85.3	121.8	241.4	(15.4)	3.6
Rank in peer group		6	7	2	3	3	8	4	3	1	1	3

Source: Morningstar, Edison Investment Research. Note: *Performance to end-September 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

DBAG's NAV total return in sterling terms has outperformed the peer group average over three, five and 10 years to 30 September 2018, ranking second or third out of eight in each of these periods, but is lower than average over one year. DBAG's share price total return has outperformed its NAV total return over five and 10 years, reflected in the share price moving from a discount to a premium over these longer periods. Despite its marked relative weakness over one year, DBAG's share price return is only modestly below the peer group average over three years, while it is ahead of the average over five years, and has considerably outperformed over 10 years.

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