Deutsche Beteiligungs

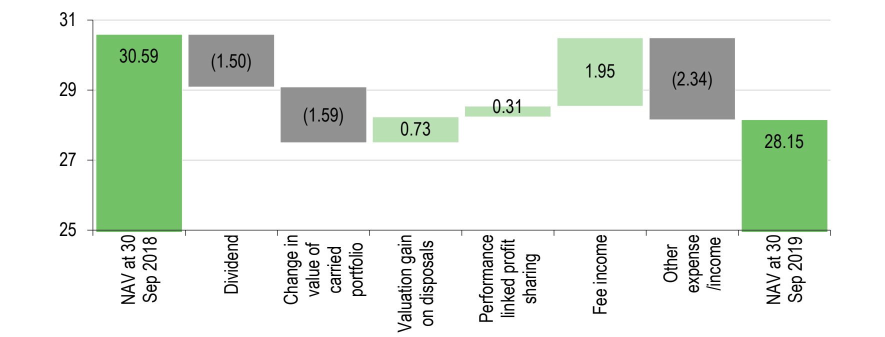
Minor negative NAV total return in FY20

Investment companies
Private equity

8 December 2020

Deutsche Beteiligungs (DBAG) saw a mixed impact from the COVID-19 crisis on portfolio earnings in FY20, with its ‘growth’ sectors (broadband/telecom in particular) proving resilient, while its industrial portfolio was hit harder. Strong public equity markets drove an increase in the average EBITDA multiple used to value its portfolio (8.8x vs 7.8x in FY19). DBAG’s mid-term ambition to FY23 assumes a strong pickup in investments through the recently launched DBAG Fund VIII and long-term investments carried out solely from DBAG’s own balance sheet. Portfolio growth should be funded by a combination of debt and equity.

DBAG’s NAV performance in FY20 (€/share)



Source: Edison calculations based on company data

The market opportunity

DBAG is a well-established player in the German private equity (PE) mid-market segment. It has shown its ability to benefit from market cyclicality, delivering an average exit multiple of 2.7x since 1998, despite several market downturns. We note DBAG’s increasing exposure to its new ‘growth’ sectors (especially broadband/telecom), which have so far proved more resilient. At the same time, DBAG’s industrial portfolio (currently valued at 0.9x acquisition cost) may be interesting to investors seeking exposure to cyclical value companies that could benefit from a broader economic recovery.

Why consider investing in Deutsche Beteiligungs?

- Solid track record, with an average MBO exit multiple of 2.7x and growth financings of 3.4x since 1998.
- Growing exposure to broadband/telecommunications, IT services/software and healthcare (35% at end-FY20).
- New buyout fund will increase recurring income from fund services.

Valuation: Offering a 2.4% dividend yield

DBAG’s shares tend to trade at a premium to NAV (defined as total equity), which in our view reflects the market-implied value of its fund services business. The premium currently stands at 19.7% (close to its five-year average of 23%). Based on the proposed €0.80 dividend per share from FY20 earnings (down from €1.50 per share in the prior year), DBAG offers a 2.4% yield.

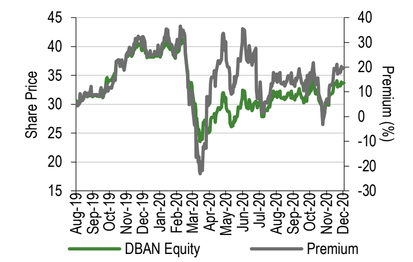
Price	**€33.70**
Market cap	**€507.0m**
NAV*	**€423.5m**

NAV per share*	€28.15
Premium to NAV	19.7%

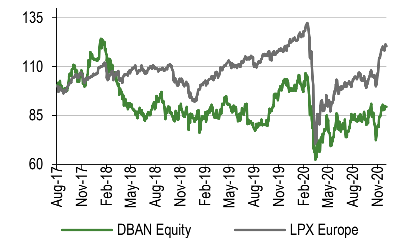
*Excluding income. As at end-September 2020.

Prospective yield	2.4%
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	€23.50
NAV* high/low	€30.57	€23.94

*Including income.

Gearing

Gross*	3.1%
Net cash*	1.2%

*As at end-September 2020.

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Exhibit 1: Company at a glance

Investment objective and fund background	Recent developments
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. It has a focus on growth-driven profitable businesses valued at €50–250m. DBAG's core objective is to sustainably increase net asset value.	■ 30 November 2020: FY20 results, NAV TR* -2.2%. ■ 27 November 2020: Changes to management board. ■ 29 September 2020: Capital markets day 2020. ■ 14 August 2020: DBAG Fund VIII – first MBO announced (Multimon). ■ 6 August 2020: 9M20 results – NAV TR* -4.8%.

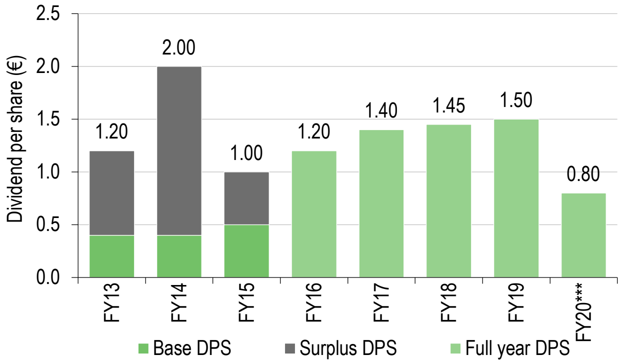
Forthcoming		Capital structure		Fund details	
AGM	25 February 2021	FY20 net expense ratio**	0.1%	Group	Deutsche Beteiligungs
Interim results	10 February 2021	Net cash	1.2%	Manager	Team managed
Year end	30 September	Annual mgmt fee	N/A (self-managed)	Address	Boersenstrasse 1
Dividend to be paid	February 2021	Performance fee	N/A (self-managed)		60313 Frankfurt am Main, Germany
Launch date	December 1985	Company life	Indefinite	Phone	+49 69 95787-01
Continuation vote	N/A	Loan facilities	€90m	Website	www.dbag.com

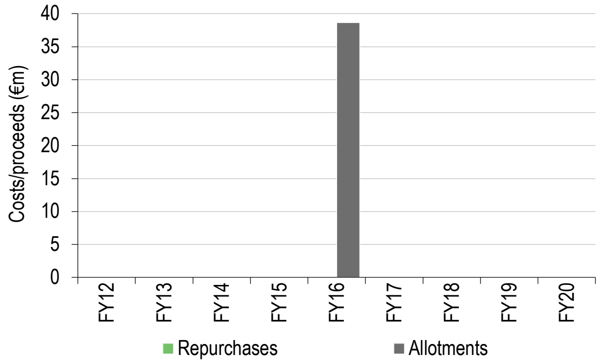
Dividend policy and history (financial years)

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. DBAG decided to lower its dividend to €0.80 per share paid out from FY20 earnings and to return to a stable or rising dividend next year, with a mid-term target until FY23 of c €1.00–1.20 per share.

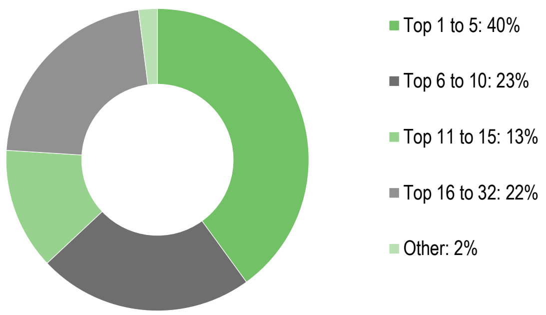
Share buyback policy and history (financial years)

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

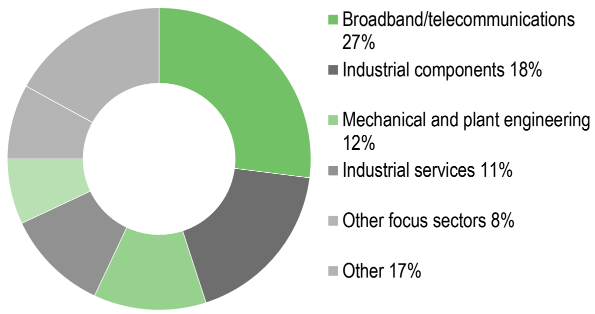




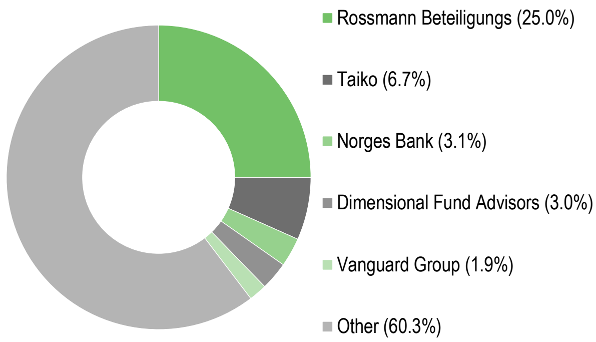
Concentration of DBAG's portfolio value by size (at end-September 2020)



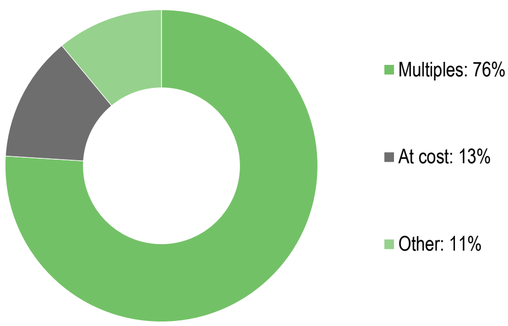
DBAG's portfolio exposure by sector (at end-September 2020)



Shareholder base (as at 8 December 2020)



DBAG's portfolio value by valuation method (at end-September 2020)



Source: DBAG, Edison Investment Research, Refinitiv. Note: *TR – total return, assuming dividend reinvested into portfolio in the quarter of ex-div date. **Based on expenses net of fee income; adjusted for non-recurring items. ***Declared dividend for FY20.

FY20 results highlights: Declining portfolio earnings

DBAG reported a net loss of €16.8m in FY20, ending September 2020 (vs a net profit of €45.9m in FY19, see Exhibit 2), affected by the €25.2m loss in its PE investments segment. This was driven by the combined impact of lower earnings of portfolio companies (especially in its core industrial sectors) and additional debt funding, which was only partially offset by higher peer multiples used to value its portfolio holdings (see details below). Consequently, DBAG's net valuation declined by €24.3m during the fiscal year.

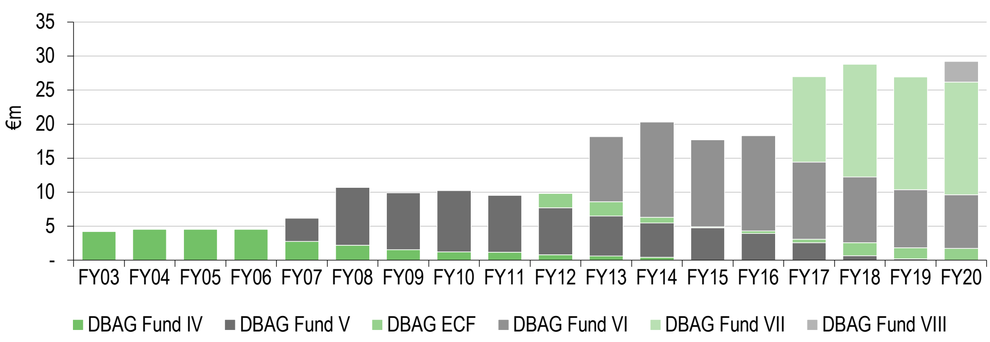
Exhibit 2: Income statement by segment (€m)

	FY20	FY19	y-o-y
Net result of investment activity	(16.9)	49.6	N/A
Other income/expenses	(8.4)	(7.6)	N/A
Private equity investments profit	**(25.2)**	**42.1**	**N/A**
Fund services income	30.6	28.2	9%
Other income/expenses	(21.1)	(25.1)	(16%)
Fund services profit	**9.5**	**3.0**	**212%**
Consolidated net profit	**(16.8)**	**45.9**	**N/A**

Source: DBAG

Meanwhile, its fund services business generated an income of €30.6m and a profit of €9.5m (vs €28.2m and €3.0m in FY19, respectively), with earnings assisted by a lower variable remuneration and the launch of DBAG Fund VIII (allowing DBAG to start collecting fees on committed capital, see Exhibit 3). DBAG's overall operating expenses were also supported by representation and travel costs being lower by €0.4m y-o-y.

Exhibit 3: DBAG fee income by fund (€m)



Source: DBAG, Edison Investment Research

NAV performance: Minor 2.2% loss in a 'bumpy' year

DBAG's net asset value (NAV) (defined as equity value) declined to €423.5m at end-September 2020 from €460.2m at end-September 2019, translating into an NAV per share of €28.15 at the end of September 2020 (vs €30.59 at end-September 2019). After accounting for the €22.6m dividend (€1.50 per share) paid earlier this year, this implies a total return of negative 2.2% in FY20. Fee income from DBAG's fund services business contributed a positive €1.95 to NAV per share (€29.3m) in FY20. NAV as reported by the company stood at €422.0m at end-September 2020.

Industrials valued below acquisition costs on average but focus sectors at 1.6x cost

The change in DBAG's investment portfolio value reduced its NAV by €1.59/share (or €23.9m in total; see exhibit on the front page) in FY20, primarily triggered by revaluations (down €2.25 per share), only partially offset by distributions from portfolio companies (€0.64 per share). As a result, its portfolio (consisting of 32 holdings) is currently valued at c 1.08x acquisition costs (compared to

1.4x at end-September 2019). This includes 19 industrial companies valued at 0.9x acquisition cost, reflecting the sector challenges amid COVID-19 (which exacerbated the already weak industrial activity before the outbreak). Management flagged that a couple of the most severely affected companies have been fully or almost fully written down. On the other hand, the nine companies from the focus sectors (including six in broadband/telecom) were valued at 1.6x acquisition costs. While this is still below DBAG's average historical realised multiple, it is partially because these investments are relatively young and DBAG still has time to realise further value.

Exhibit 4: Result of valuation and disposal (€m)

	FY20	FY19
Changes in fair value of unlisted investments	(24.3)	51.3
Change in earnings	*(58.3)*	*46.5*
Change in debt	*(32.6)*	*(12.7)*
Change in multiples	*66.8*	*18.3**
Change in exchange rates	*(1.3)*	*3.6*
Change, other	*1.2*	*(4.5)*
Net result of disposal	1.6	13.3
Other	(0.2)	(2.0)
Total	**(22.8)**	**62.7**

Source: DBAG. Note: *Includes €39.7m uplift from inexio exit, which was concluded after the reporting date.

The valuation was mostly affected by the decline in earnings (negative €58.3m) in FY20, with DBAG's industrial companies posting a 32% y-o-y earnings decline while 'growth' sectors reported an 18% y-o-y increase (which we understand came mostly from M&A). On the other hand, the rebound in public equity markets since the March low translated into a €3.82/share (€57.4m) positive impact from the change in peer multiples used to value 76% of DBAG's portfolio as at end-September 2020 (with the remaining 11% valued using other methods including DCF and 13% valued at cost). A further positive impact of €9.4m came from the agreed but not yet finalised disposal of Rheinhold & Mahla, as well as the partial exit from Pfaudler completed post reporting date. The average EV/EBITDA multiple across DBAG's portfolio improved to 8.8x vs 7.8x in the prior year (though broadband/telecom multiples were lower).

The change in debt at the level of portfolio holdings reduced DBAG's NAV by a further €32.5m. However, the vast majority (€31.9m) came from incremental debt used to finance a particularly high number of add-on acquisitions in the period, with a minor €1.7m related to the drawdown of credit facilities or loans from German development bank KfW to support liquidity. On top of this, DBAG made additional equity injections of €5.2m (or 1.3% of acquisition costs) to portfolio companies to support their debt raising efforts during the fiscal year.

Management guidance: Growth in NAV and fee income

Together with the FY20 results, management has published guidance for FY21 and updated its mid-term targets to FY23 (see Exhibit 5). DBAG's NAV forecast for FY21 implies NAV growth of 1–12% after adjusting for the expected dividend payout of €0.80 per share. We believe this reflects the uncertain economic outlook after the re-introduction of COVID-19 related restrictions coupled with relatively high overall public market valuations at present.

At the same time, its mid-term guidance (Ambition 2022/2023 originally published during the capital markets day in September 2020) implies NAV growth (adjusted for dividends) of c 23% pa in the subsequent two fiscal years, likely assuming some performance and valuation catch-up in its core industrial sectors. However, it will be also driven by the high level of expected investments at around €120m pa by 2023 compared to DBAG's five-year average of €72m (as highlighted in the FY20 results presentation). This will include investments alongside DBAG Fund VIII whose investment phase started in August 2020 (see our previous note for details), as well as long-term investments through DBAG's own balance sheet.

In this context, we note that DBAG's financial resources at end-September 2020 stood at €18.4m, with a further €76.9m available through undrawn credit facilities (after DBAG recently agreed on a second line with a volume of €40m). Moreover, it has €20.6m funding available through structured instruments and callable receivables. Still, this is well below DBAG's mid-term funding needs of €367.0m (as per management calculations), which include planned co-investments alongside DBAG Fund VIII (€232m including top-up fund) and planned long-term investments (€135m). Given that near-term realisations may be limited (see below for details), DBAG is likely to use a combination of debt and equity to fund these investments, especially given that it is again trading at a premium to NAV and has so far utilised only a minor part of its debt facilities.

Management expects fee income from fund services to increase significantly in FY21 to €42–44m from €30.6m in FY20, mostly on the back of fees from DBAG Fund VIII (as FY21 will be the first full fiscal year of collecting fees from the fund). This will be further assisted by fees from DBAG Fund VII, which will still be in its investment phase (until July 2022) and is currently 77% invested.

As fund services fee income in FY23 should decline only slightly (as funds in the realisation phase collect fees based on invested capital), its profit is planned at a visibly lower level (and moderately above FY20 level). This is due to the expected increase in operating expenses, including incremental costs associated with the expansion of DBAG's investment team. Assets under management are expected to decline as DBAG's funds in the realisation stage (including DBAG ECF as well as DBAG Fund V and VI) gradually sell down their portfolios.

Exhibit 5: DBAG's FY21 forecast and updated Ambition 2022/2023

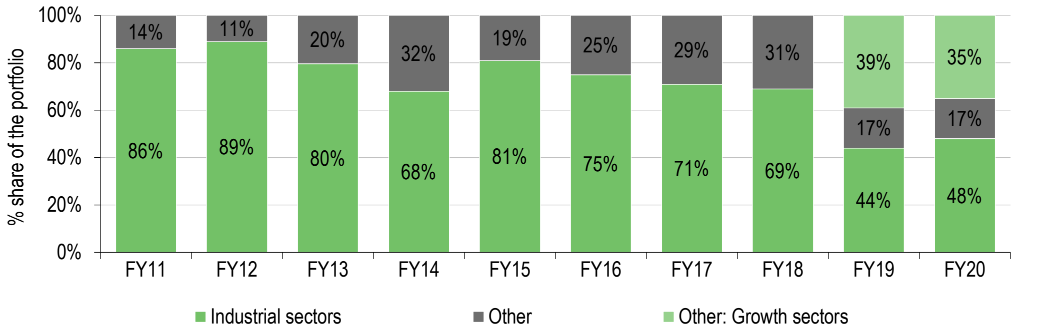
	FY20 actual (€m)	FY21 forecast (€m)	Ambition 2022/23 (€m)	Implied CAGR 2020–23
Net asset value	422.0	415–460	590–660	12-16%*
Private equity investments profit	(16.9)	30–35	95–105	-
Private equity investments cash flow	(33.5)	(5) to 0	40–45	-
Assets under management	2,583.0	2,320–2,440	2,010–2,115	-
Fee income	30.6	42–44	41–43	10–12%
Fund services profit	9.5	15–16	10–11	2–5%
Net income	(16.8)	40–45	95–110	-

Source: Company data. Note: *Dividend payments have not been added back when calculating the CAGR.

Portfolio: 35% of portfolio in 'growth' sectors

DBAG's gross investment portfolio as at end-September 2020 was valued at €428.5m. In FY20, DBAG's exposure to the so-called 'growth' sectors (previously called 'focus' sectors), broadband/telecom in particular, reached 35% at the expense of its industrial sectors, which made up c 48% of portfolio vs (81% at end-FY15, see Exhibit 6). We note that the industrial sectors include primarily DBAG's 'core' sectors it used to focus on in the past: mechanical and plant engineering, automotive suppliers, industrial services providers and industrial components manufacturers. However, its industrial exposure consists of a wide variety of businesses, including some more recent investments, eg Cartonplast (provider of reusable layer pads for the food industry) and Multimon (fire protection systems).

Exhibit 6: DBAG's sector exposure FY11–FY20



Source: DBAG

We note that the above change in portfolio composition in FY20 was mostly due to the more limited impact of the pandemic on 'growth' portfolio valuations, as these were valued at a money on invested capital (MOIC) of 1.6x cost at end-September 2020 vs 1.7x at end-September 2019 (compared to the industrial sector at 0.9x and 1.1x, respectively). Moreover, part of the ratio decline likely comes from the addition of new investments (valued at cost) during the year.

DBAG invested €96.8m in total in FY20, which covers €67.3m spent on six new investments (including five MBOs and one long-term minority investment) in both 'growth' and industrial sectors (see Exhibit 7), follow-on growth financings within its existing portfolio, in particular DNS:Net (€14.7m) and blikk, as well as the above-mentioned €5.2m equity injections to support debt raising. On top of this, it agreed on one further MBO of congatec (with €23.0m attributable to DBAG), which was completed in October 2020 (ie post balance sheet date).

In terms of prospective investments, DBAG remains focused on businesses with high visibility in terms of COVID-19 impact and does not intend to make a larger bet on a macroeconomic recovery scenario. Management prioritises investments in sectors such as 'industry-tech', software and IT services, as well as broadband and telecommunication.

Exhibit 7: Summary of DBAG's new investments in FY20

Company	First investment	Core business	DBAG fund	Type	DBAG Fund investment (€m)	DBAG's interest (€m)
Completed						
Cartonplast*	November 2019	Pool system for the rental of reusable plastic layer pads	DBAG Fund VII	MBO	149.3	25.3
DING-Gruppe*	November 2019	General contractor for FTTH fibre-optic infrastructures, in-house networks and media supply	DBAG ECF II	MBO	23.1	9.6
Multimon	September 2020	Provision of fire extinguishing systems	DBAG Fund VII	MBO	35.0	8.0
Deutsche Giga Access	September 2020	Provision of fast internet and communication services	DBAG Fund VIII	MBO	22.4	5.2
Hausheld	August 2020	Measurement and control systems for the digitalisation of energy turnaround and highly secure IT solutions for smart cities	N/A	Long-term financing	N/A	8.5
PM Plastic Materials	September 2020	Production of pre-wired and empty cable conduits, used primarily for electrical installations	DBAG Fund VIII	MBO	69.3	10.7
Announced						
congatec Holding	October 2020	Embedded computing with a focus on computer-on-modules (CoMs) and industrial single-board computers (SBCs)	DBAG Fund VIII	MBO	105.0	23.0

Source: Company data. Note: *Announced in FY19.

With respect to split by vintage, we note that 42% of DBAG's portfolio at end-September 2020 represents investments held between two and five years, with a further 29% held longer than five years. This compares with a normal PE realisation horizon of around three to five years. Having said that, we believe DBAG is unlikely to embark on a large realisation program of its industrial holdings in the near term given that these are more cyclical and are being affected by COVID-19 to a greater extent (resulting in extended holding periods). At the same time, its focus portfolio is younger (mostly acquired in 2017 or later except for DNS:Net) and we expect DBAG to spend more time on value creation initiatives (including 'buy-and-build' as illustrated by the recent high number of add-on acquisitions) before it decides to exit most of these investments. This suggests that DBAG's exit activity may be moderate in the near term.

In FY20, DBAG completed the disposal of inexio (agreed and revalued in FY19, as discussed in detail in our previous notes). It also agreed to sell Rheinhold & Mahla, an industrial services provider for ship interior fitting, below its original acquisition cost (although ahead of the last carrying value). Finally, it has made a partial exit from Pfaudler Group, a provider of mechanical engineering solutions for the chemical and pharmaceutical industries it invested in back in December 2014 (already reflected in end-September 2020 valuations). This followed a reorganisation involving the acquisition of 80% of Pfaudler's European and American core business by its Indian listed subsidiary (GMM Pfaudler) and GMM's second-largest shareholder. Subsequently, DBAG sold part of its 50%+ stake in GMM (held together with DBAG Fund VI), retaining a c 33% stake in GMM and 20% in the European and American operations. The transaction generated a c €8.0m cash inflow for DBAG.

Lower dividend in FY20, expected to rebound next year

DBAG aims to pay a stable dividend that increases whenever it is possible. However, amid the COVID-19 crisis, the company decided to lower the dividend to €0.80 per share (vs €1.50 paid last year). This still translates into a dividend yield of 2.4%. From next year, it expects to resume its dividend policy with annual payments of around €1.00–1.20 per share in FY21–23 (still below the FY17–19 payout of €1.40–1.50 per share). The reduction vs historical levels may be due to extended holding periods for its industrial investments (limiting the near-term realisation pipeline) coupled with DBAG's commitments to DBAG Fund VIII and its decision to perform long-term investments through its own balance sheet, which will require additional funds (and hence to conserve more of its capital).

Valuation: Premium close to historical average again

As highlighted in our earlier notes, DBAG's reported NAV is almost entirely attributable to the value of its PE investment portfolio and does not account for the fair value of its fund services business, which represented third-party assets under management of c €2.2bn at end-September 2020 and generates considerable recurring fee income. In contrast, DBAG's market value reflects the value of both its fund services business and its PE investment portfolio. 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 PE investment portfolio.

During March 2020 DBAG's share price followed the broader market sell-off, decreasing by 19% compared to the 25% decrease of LPX Europe. As it traded on pre-COVID-19 NAV, this resulted in a temporary discount to NAV with a peak of 23% (the last time DBAG shares traded at a discount to NAV was in 2014). Since then, DBAG's shares have rebounded (alongside the broader equity markets), which together with updated valuations of portfolio companies now translates into a 19.7% premium, close to the c 26% average premium over the last three years.

The premium implies €83.5m of excess market capitalisation over the end-September 2020 NAV. Assuming that this represents the market value of DBAG's fund services segment, it translates into an FY21e earnings before tax multiple for the segment (based on the midpoint of management guidance) of 5.4x. We also use the approach of applying the current discount of the LPX Europe Index to the PE investments business, assuming the segment is valued in line with the broader PE market. At present, the discount stands at 10% (vs a 0–20% range over the last five years), and by applying it to DBAG's NAV, we arrive at a fund services segment value of €124.4m and an earnings multiple of 8.0x.

Exhibit 8: Analysis of DBAG's market value by segment

Approach	Private equity investments at NAV	Private equity investments in line with LPX Europe
Discount applied to private equity investments value	0%	-10%
Implied value of private equity investments segment (€m)	423.5	382.6
Implied value of fund services segment (€m)	83.5	124.4
Implied FY21e earnings multiple of fund services segment*	5.4x	8.0x

Source: DBAG, LPX-Group, Edison Investment Research. Note: *Based on the mid-point of management guidance.

Exhibit 9: Share price premium (discount) to NAV over three years (%)

Source: Refinitiv, Edison Investment Research

Peer group comparison

DBAG posted one- and three-year NAV total returns below the peer average, which we believe stems from higher exposure to German industrials experiencing headwinds prior to the COVID-19 market downturn. This has also had an impact on its longer-term NAV TR, with five-year and 10-year performance also below the peer average. DBAG is currently (apart from HgCapital Trust and 3i) the only fund in our peer group trading at premium to its NAV, which we explained in the valuation section. On an LTM basis, DBAG's dividend yield of 4.5% is visibly above the peer group. We note, however, that COVID-19 has affected the ability to pay out dividends in the sector and prospective yields are likely to be lower on average. DBAG has already declared a dividend of €0.80 to be paid out of FY20 earnings, which translates into a 2.4% yield (see above for details).

Exhibit 10: Listed private equity investment companies peer group as at 2 December 2020*

% 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**	**457**	**0.3**	**17.0**	**99.6**	**163.9**	**(4.8)**	**(27.2)**	**59.2**	**123.8**	**19.7**	**4.5**
3i	Global	10,879	6.0	56.9	181.5	304.7	(11.3)	21.5	156.6	398.5	8.2	3.1
HgCapital Trust Ord	UK	1,255	22.2	76.7	167.2	306.9	25.9	86.0	208.5	337.8	5.0	1.6
ICG Enterprise Trust**	UK	649	(2.1)	29.6	79.6	184.1	(6.8)	14.3	56.0	236.6	(30.7)	2.4
Oakley Capital Investments**	Europe	490	14.1	60.9	108.4	159.8	13.7	66.5	98.4	115.2	(29.1)	1.7
Princess Private Equity	Global	699	13.3	40.5	116.8	171.5	13.0	19.1	124.0	297.1	(24.2)	2.6
Standard Life Private Equity	Europe	532	4.0	30.7	88.4	191.2	(4.6)	6.7	80.2	266.8	(28.1)	3.8
Average		2,417	**9.6**	**49.2**	**123.7**	**219.7**	**5.0**	**35.7**	**120.6**	**275.3**	**(16.5)**	**2.5**
Rank		**7**	**6**	**7**	**5**	**6**	**5**	**7**	**6**	**6**	**1**	**1**

Source: Morningstar, Edison Investment Research. Note: *Performance to end-September 2020. TR=total return in sterling terms. **Latest available NAV as at end-June for Oakley Capital Investments and end-July for ICG Enterprise Trust.

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