EDISON

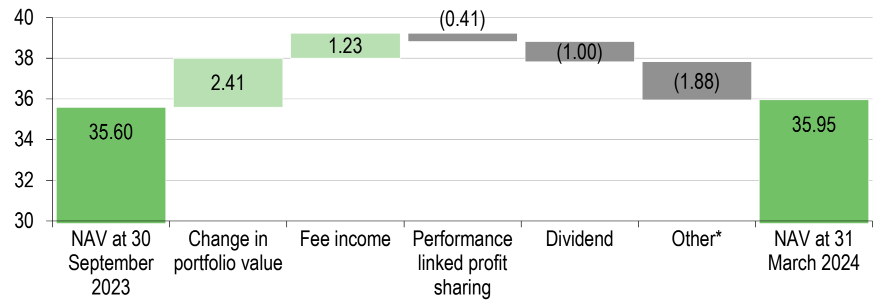
Deutsche Beteiligungs

Successful exits assist H124 performance

Investment companies
Private equity

Deutsche Beteiligungs (DBAG) reported an NAV total return of 3% in H124 (to March 2024) following the first-time recognition of 2024 portfolio company budgets and 2024 consensus forecasts for peers in Q124. Its H124 return includes a net €19m negative effect from the incorporation of additional portfolio valuation factors. DBAG's H124 performance was supported by the successful sale of in-tech at a healthy 3.2x multiple on invested capital (MOIC). DBAG also closed the initial investment in a 51% stake in ELF Capital. Its shares now trade at a c 22% discount to NAV.

DBAG's H124 NAV bridge



Source: DBAG, Edison Investment Research. Note: *Other includes share buybacks as well as other income and expense items.

Mid-market private equity remains attractive

While interest rate normalisation may somewhat dilute gross internal rates of return across the private equity (PE) sector, we note that the industry puts a greater emphasis on driving operational change (based on in-house value creation teams) and value-accretive, bolt-on M&A activity rather than pure financial engineering. In particular, the PE mid-market (which DBAG focuses on) offers several potential advantages: 1) many of the acquired companies have not been owned by PE before (92% of DBAG's buyouts in 2019–23 were from families and founders), potentially providing an opportunity for value creation; 2) portfolio exits are less dependent on the IPO market (DBAG rarely uses IPOs as an exit route and two-thirds of its exits are to trade buyers); and 3) deals are less reliant on funding via syndicated loans (which have been muted recently) and also often involve less leverage versus large/mega buyouts. PitchBook reported that even in the tough environment in 2023, European mid-market deal value was up 12.1% year-on-year.

An experienced player in the German PE mid-market

DBAG is a well-established investor and asset manager in the PE mid-market and a go-to partner for private company owners, especially families and founders, across Germany and neighbouring countries (eg Italy). Its industrial and industrial technology portfolio (which together with industrial services made up c 45% of the portfolio at end-March 2024) has been shifting away from more traditional industrial businesses in recent years. Moreover, DBAG has been tapping into a wider set of sectors more strongly for several years now, with significant exposure to so-called 'growth' areas, including IT services and software (28% of end-March 2024 portfolio value), broadband/telecom (8%) and healthcare (6%).

28 May 2024

Price		**€28.15**
Market cap		**€529.4m**
NAV*		**€673.1m**
NAV per share*		€35.95
Discount to NAV		21.7%

*As at end-March 2024.

Yield		3.6%
Shares in issue (excluding treasury shares)		18.6m
Code/ISIN		DBAN/DE000A1TNUT7
Primary exchange		Frankfurt
52-week high/low	€33.35	€24.85
NAV high/low	€36.04	€34.38

Gearing

Net gearing at end-FY23	0.0%

Fund objective

Deutsche Beteiligungs is a German-based and listed private equity investment and fund management company that invests in mid-sized companies in Germany and neighbouring countries via management buyout transactions and growth capital financings. It also manages c €2bn of third-party capital, which generates stable recurring fee income. Following the acquisition of a majority stake in ELF Capital, DBAG expanded its offer to include private debt.

Bull points

- Solid long-term track record, with average MBO and growth financings exit multiples of 2.7x and 2.9x, respectively, as at end-FY23.
- Emphasis on 'growth sectors', such as IT services and software, healthcare and broadband telecom, as well as on energy transition/sustainability themes.
- Recurring cash flow from fund services.

Bear points

- Significant exposure to cyclical sectors, which have been facing macroeconomic headwinds.
- Interest rate normalisation may reduce prospective private equity returns, put pressure on interest coverage ratios and/or lead to refinancing issues across private equity-backed companies in the medium term.
- Higher average leverage of portfolio companies versus pre-COVID-19 levels.

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H124 NAV TR at 6% on a like-for-like basis

Following the solid 18.1% NAV total return (TR) in FY23 (ending September 2023), DBAG's H124 NAV TR was 3%. This includes the negative effect of changes in accounting estimates of €19m (see below), adjusted for which NAV TR would have been 6%. Moreover, DBAG recognised a positive impact from the first-time inclusion of 2024 budgeted earnings of its portfolio companies in Q124. This was partly offset by higher risk cuts to budgeted earnings implemented in Q224. As a result, the overall contribution from earnings to DBAG's net gains and losses on measurement stood at €12.1m in H124 (see Exhibit 1). This includes positive contributions from several sectors, including IT services & software, as well as industrials and industrial technology (partly coming from add-on acquisitions).

An expansion in multiples had a €33.2m positive impact on DBAG's net gains and losses in H124, despite the negative denominator effect from the first-time use of 2024 earnings expectations in peer valuation multiples (which is a recurring pattern for DBAG in the first quarter of its financial year). The multiples effect was supported by DBAG's two recent successful disposals (which contributed more than half of the effect in Q224), most notably the sale of in-tech (see below for details), as well as rebounding public multiples.

The impact from the change in net debt across DBAG's portfolio was a negative €10.2m in H124, as the positive contribution of the deleveraging of 14 portfolio companies was offset by debt funding for new bolt-on acquisitions, as well as planned growth financing. As a result, DBAG recorded a pre-tax profit in its PE investment segment of €19.2m (versus €75.7m in H123, which was supported by the public market rally at that time, see Exhibit 2). DBAG's management reiterated its FY24 NAV guidance of €675–790m (vs €673.1m at end-March 2024).

DBAG's fund services business generated income of €23.5m in H124 (of which €0.7m was from ELF Funds) compared to €22.6m in H123, with the increase driven by fees from DBAG ECF IV and DBAG Luxemburg, as well as add-ons by portfolio companies held by DBAG Fund VIII. The segment posted a pre-tax profit of €5.6m in H124 and EBITA of €7.1m, the latter calculated as pre-tax earnings adjusted for amortisation of intangible assets (arising mostly in conjunction with the ELF Capital acquisition) and interest. DBAG's pre-tax profit represents a run-rate consistent with management's FY24 guidance of €9–13m. EBITA fell slightly in H124 from €7.3m in H123, mostly due to an increase in the average headcount.

Exhibit 1: DBAG's gross gains/(losses) on measurement and disposal portfolio by sources

€m	H124	H123
Changes in fair value of unlisted investments	30.9	41.2
Change in earnings	*12.1*	*67.4*
Change in debt	*(10.2)*	*(43.3)*
Change in multiples	*33.2*	*67.2*
Change in exchange rates	*(0.8)*	*(3.9)*
Other	*(3.4)*	*(46.3)*
Net result of disposal	7.5	43.1
Total	**38.4**	**84.3**

Source: DBAG

Exhibit 2: Income statement by segment (€m)

	H124	H123	y-o-y
Net income from investment activity	26.9	81.3	(67%)
Other income/expenses	(7.7)	(5.6)	37%
PE investments pre-tax profit	**19.2**	**75.7**	**(75%)**
Fund services income	23.5	22.6	4%
Other income/expenses	(17.9)	(15.3)	17%
Fund services profit pre-tax	**5.6**	**7.2**	**(23%)**
Consolidated net profit	**24.6**	**82.6**	**(70%)**

Source: DBAG

NAV accretion from the €20m buyback programme

The company's approach to shareholder distributions shifted recently from a pure dividend policy to a broader distribution policy, as management highlighted that it would consider buybacks on a more regular basis. It has recently launched a buyback programme of up to €20m, which will involve the repurchase of up to 800,000 shares, which represents around 4.25% of its share capital. As at 28 May 2024, the company had repurchased 208,415 shares. Importantly, the company now trades at a double-digit discount to NAV (despite the fact that its NAV does not account for the value of its asset management business; it only primarily captures its PE investment portfolio). Therefore, the current share buybacks are NAV accretive. DBAG has so far spent 25% of the amount earmarked under the current buyback programme, which translated into an 0.3% NAV accretion. Moreover, DBAG's paid a €1.00 dividend per share from FY23 in February 2024, which represented a c 3.7% dividend yield at the closing price on the ex-dividend date.

Successful disposal of in-tech at a strong 3.2x MOIC

In terms of realisations in H124, DBAG closed the disposals of GMM Pfaudler (a manufacturer of glass-lined reactors and components for the chemical and pharmaceutical industries) and R+S (a provider of technical building services), both agreed in FY23. Furthermore, it agreed the full disposal of in-tech (a software development, testing and validation business) to a trade buyer at a price that translates into a healthy 3.2x MOIC over a holding period of less than two years. The transaction resulted in a €13m unexpected contribution to DBAG's Q224 results, which we calculate implies that in-tech was sold at a c 33% uplift to its previous carrying value. Moreover, DBAG agreed the partial sale of another IT software and services company, Solvares, a provider of field service management, field sales management and transport management and logistics solutions. The transaction was agreed with Five Arrows (the alternative assets arm of Rothschild & Co) at a valuation that is slightly above the end-December 2023 carrying value.

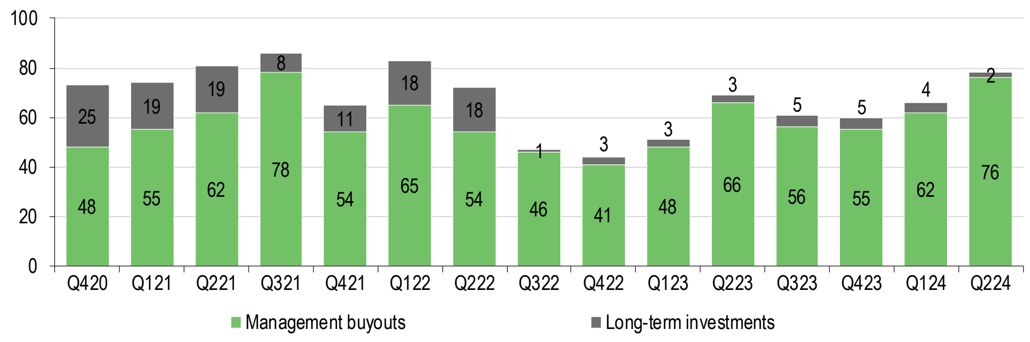
DBAG also completed a disposal following the insolvency of Gienanth, an iron foundry that produced castings for automotive suppliers, diesel and gas engine blocks. As this holding was already fully written-off in previous periods, this transaction had no impact on DBAG's H124 NAV TR.

DBAG sees more buyout investment opportunities

During H124, DBAG closed two new investments: the buyout of ProMik (announced in October 2023) and the long-term investment in NOKERA (announced in July 2023 in conjunction with the R+S realisation). ProMik is a provider of programming and testing solutions for the electronics manufacturing industry, in which DBAG invested €15m. NOKERA is a producer of buildings in serial and sustainable construction and positions itself as the largest technology-enabled platform for serial timber production. DBAG acquired a minority stake in the business by reinvesting €20m of the proceeds from the R+S exit into NOKERA (see our previous note for details). We also note that DBAG closed its initial investment in ELF Capital Group, including the private debt asset manager ELF Capital Advisory. DBAG acquired a 51% stake, with a gradual increase to 100% planned over the next five years. Finally, five add-ons were agreed or closed across DBAG's portfolio during the period. Interestingly, three of these were/are carried out by DBAG's new platform investments made in FY23: two for the agile software provider AOE and one for the biogas platform Avrio Energy (the other two add-ons are for akquinet and MTWH). Management previously highlighted that it sees a good pipeline of bolt-on opportunities for these two businesses.

DBAG also recorded an uptick in new buyout opportunities in Q224, to 76 compared to 66 in Q223, with a further two long-term investment opportunities (versus three in Q223), see Exhibit 3. During the Q124 analyst call, management highlighted good deal flow in sectors such as industrial services, industrial technology and IT – sectors with better visibility in terms of earnings and valuations.

Exhibit 3: Number of investment opportunities by quarter



Source: DBAG, Edison Investment Research

DBAG's industrial portfolio steadily shifting its focus

The recently exited GMM Pfaudler and Gienanth are examples of DBAG's older (first investments in 2014 and 2015, respectively) and more traditional industrial holdings. DBAG's exposure to this kind of company has been declining as a percentage of its overall industrial portfolio in recent years, with some other recent disposals/de-recognitions including Silbitz (a manufacturer of bent aluminium and steel components, sold for a symbolic price in FY22), Heytex (a manufacturer of textile print media and technical textiles, sold in FY23) and FRIMO (a provider of tools and machinery for the automotive industry, de-recognised following insolvency in FY23). DBAG's top 15 holdings at end-March 2024 (making up c 69% of its portfolio value) still include some industrial names DBAG invested in more than five years ago: Oechsler (a producer of plastic components, for industries such as the automotive sector, acquired in 2015), Karl Eugen Fischer (a manufacturer and developer of cutting systems for the tyre industry, acquired in 2018), as well as duagon (a provider of network components for data communication in railway vehicles, acquired in 2017).

That said, DBAG's top 15 holdings now also include more recent industrial investments that have different business profiles from the above-mentioned companies, such as congatec (an industrial technology company focused on high-performance embedded computer products), Dantherm (a provider of heating, cooling, drying, ventilation and air cleaning technology) and MTWH (a manufacturer of metal applications for the luxury goods industry). Furthermore, there are two industrial services companies among DBAG's top 15 holdings: Cartonplast (a provider of a pool system for the rental of reusable plastic layer pads) and NOKERA. The above-mentioned buyout of ProMik is also a good illustration of DBAG's changing emphasis within its industrial and industrial technology portfolio.

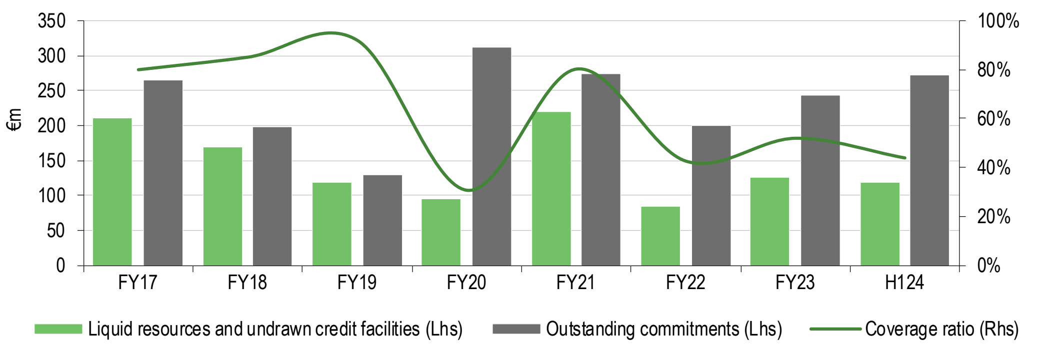
Recent disposals put DBAG in a solid balance sheet position

DBAG's available liquidity at end-March 2024 stood at €119.1m, of which €32.5m was in cash and equivalents, and €86.7m in undrawn credit lines (the company's credit liabilities stood at €50m at end-March 2024). The total volume of DBAG's credit lines of €106.7m (both drawn and undrawn, expiring in May 2025), coupled with €30m of outstanding promissory notes (with remaining terms between three and seven years) represents c 21% of DBAG's current portfolio value, which is broadly in line with ratios across UK-listed PE peers of c 10–25%, according to our calculations.

DBAG's liquid resources cover c 44% of DBAG's €271.7m co-investment commitments alongside DBAG funds as at end-March 2024 (see Exhibit 4), which we consider a quite safe level. The outstanding commitments do not include potential further long-term investments funded entirely from DBAG's own balance sheet.

We also note that DBAG expects to collect more than €70m combined proceeds from the disposals of in-tech and Solvares (which were both among DBAG's top five holdings at end-March 2024), which would result in a commitment coverage ratio of c 70%, all else being equal. DBAG's management highlighted that these exits increase the granularity of its portfolio, which should support a more steady inflow of realisation proceeds in the coming years.

Exhibit 4: DBAG's commitment coverage ratio



Source: DBAG, Edison Investment Research

The currently outstanding commitments should be drawn over the next few years. Most notably, the latest end of the investment periods of DBAG Fund VIII and DBAG ECF IV (to which DBAG had €106.9m and €38.1m outstanding commitments at end-September 2023, respectively) are December 2026 and December 2028, respectively. All the other outstanding commitments are to DBAG funds whose investment periods have already ended, but which may still call capital for follow-on investments (in FY23, these capital calls amounted to c €30m). DBAG's management highlighted during the H124 earnings call that the launch of DBAG Fund IX is more likely in 2026, given the sale of in-tech by DBAG Fund VIII, which upon deal completion will be only c 30%+ invested, all else being equal.

Management highlighted that the €100m commitments it made to ELF Capital funds should be drawn over the next three years, but the funds should also return capital to DBAG quicker than the PE funds, with an average holding period for the private debt investments of around three years, compared to anywhere between three and seven years for DBAG's buyouts and long-term balance sheet investments.

Valuation

DBAG continues to trade at a discount to last reported NAV (currently 21.7%, see Exhibit 5), while historically it traded at a premium to NAV (the average premium over the five years to end-2021 was c 18%). We believe this is due to the share price reflecting the additional value of DBAG's fund services business, which manages c €2bn of third-party capital and whose value is not directly captured within its reported NAV.

Exhibit 5: DBAG's historical discount/premium to NAV

Source: DBAG, LSEG, Edison Investment Research

Private market factor brings DBAG closer to industry standard

With the publication of the end-March 2024 NAV, DBAG introduced certain changes to the methodology used to value its portfolio holdings. Generally, the company has been estimating the impact of changing valuation multiples on its portfolio fair values by extrapolating the entry multiple in line with the development of a reference multiple, which until recently reflected primarily the changes in valuations of local listed small-cap companies. This extrapolation takes into account the initial difference in the multiple at which DBAG acquired a company and the public peer multiples at the time of the transaction. This calibration is in line with the International Private Equity and Venture Capital Valuation (IPEV) guidelines.

However, DBAG's calibration process of valuation multiples across its portfolio companies will from now on reflect the development of both private and public valuations, which is broadly in line with the industry standard. This private market factor will be determined based on the correlation between the returns of the Cambridge Associates Europe Developed PE Index and the STOXX Europe 600 index. This is slightly different to the approach some other PE investment companies follow, which involves the use of a blend of public multiples and valuation multiples implied by recent private M&A transactions. That said, DBAG's revised methodology is likely to have a similar result of less volatile valuations of its portfolio holdings (both to the upside and to the downside), as private market valuations generally tend to be less volatile than public peers.

Furthermore, the calibrated multiples are now also being adjusted for a maturity factor (ie the progress DBAG's portfolio companies make in terms of delivering on the initial investment case, as well as their overall maturity). Examples of factors considered include strategic initiatives, operational improvements, progress in terms of add-on acquisitions, optimisation of financing structure and professionalisation of corporate governance. The changes in valuation methodology had a net €19m negative impact on DBAG's valuations in Q224 and mostly came from the private market factor, partly offset by an adjustment of the valuation multiple of one portfolio company to the sector-specific peer group multiple (given its advanced restructuring and positive overall development). No additional premium or discount has been applied to DBAG's portfolio to reflect the maturity factor.

Peer discounts imply an undemanding fund services valuation

We believe it is instructive to examine the market-implied valuation of both DBAG segments in two scenarios: 1) using the implied value of PE investments, assuming fund services are valued in line with peers; and 2) using the implied value of the fund services segment, assuming that PE investments are valued in line with peers. For peers in DBAG's fund services segment, we use a group of listed asset managers with exposure to alternative unlisted assets, such as real assets or PE (as described in detail in our August 2021 note): Blackstone, EQT, Partners Group, Intermediate

Capital, Tikehau Capital and Cohen & Steers. In the case of PE investments, we use the peer group shown in Exhibit 7, excluding 3i.

Exhibit 6: Analysis of DBAG's market value by segment

Fund services in line with peers	
Earnings multiple applied to fund services segment's valuation	24.2x
Implied value of fund services segment*	€266.5m
Implied value of private equity investments segment	€262.9m
Implied discount of private equity investments value to DBAG's end-March 2024 NAV**	57%
Private equity investments in line with peers	
Discount applied to private equity investments value to DBAG's end-March 2024 NAV	22.3%
Implied value of private equity investments segment**	€475.7m
Implied value of fund services segment	€53.7m
Implied FY24e earnings multiple of fund services segment*	4.9x

Source: DBAG, Edison Investment Research. Note: *Based on the midpoint of management guidance. **Multiple and discount are calculated based on DBAG's NAV excluding intangible assets arising from the ELF Capital acquisition.

Assuming the fund services segment is valued in line with peers (at a 24.2x FY24e earnings multiple) and using DBAG's current market capitalisation, the implied value of DBAG's PE investments would be c €267m (57% below its end-March 2024 NAV, which we conservatively adjust for the intangibles arising from the ELF Capital acquisition), while DBAG's peers currently trade at an average c 22% discount. While some of this difference could potentially be explained by the subdued German economy (which weighed on DBAG's historical performance versus listed PE peers, see Exhibit 7), DBAG's discount may still be considered wide given its portfolio changes in terms of sector exposure in recent years, as discussed above.

On the other hand, if we assume that the PE investments were valued in line with peers, then DBAG's current market capitalisation would imply a mere 4.9x FY24e earnings multiple for DBAG's fund services segment. This seems to be quite a low multiple, especially given management's earlier expectations of an increase in fund services pre-tax profit to €11–16m by FY26 upon the expected launch of DBAG Fund VIII's successor.

Exhibit 7: Listed PE investment companies peer group at 27 May 2024*

% unless stated	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**	**451**	**4.5**	**23.4**	**49.9**	**188.7**	**(5.1)**	**(20.8)**	**(3.1)**	**100.7**	**(21.7)**	**3.6**
3i	28,714	23.0	142.7	205.9	803.4	71.3	169.4	239.2	924.8	41.5	1.9
GIMV	1,109	13.2	27.1	24.2	118.3	1.5	(2.3)	5.2	79.8	(12.5)	5.6
HgT	2,250	10.0	60.3	161.2	444.2	38.3	55.3	148.4	488.1	(3.8)	1.3
ICG Enterprise Trust	801	2.0	44.9	97.1	244.5	23.1	27.9	62.7	158.0	(36.4)	2.7
Oakley Capital Investments***	861	4.4	76.6	159.8	281.8	4.7	63.2	157.0	223.3	(29.6)	0.9
Princess Private Equity Trust	648	1.1	14.6	55.0	199.0	1.1	5.2	43.0	217.2	(25.0)	3.3
Patria Private Equity Trust	868	5.1	56.6	112.6	288.9	34.4	34.9	81.6	265.2	(26.2)	2.9
Median	**5,036**	**8.4**	**60.4**	**116.5**	**340.0**	**24.9**	**50.5**	**105.3**	**336.6**	**(13.2)**	**2.7**
Rank	8	5	7	7	7	8	8	8	7	4	2

Source: LSEG, Edison Investment Research. Note: *12-month NAV performance in sterling terms based on end-March 2024 or latest earlier available NAV (end-October 2023 for ICG Enterprise Trust). **DBAG's 10-year NAV TR is calculated from end-April 2013 due to availability of data. ***Oakley Capital's three-, five-, and 10-year performances are calculated based on end-December 2020, 2018, 2013 respectively due to availability of data.

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