EDISON

Deutsche Beteiligungs

Targeting a high volume of new investments

Investment companies
Private equity

21 May 2021

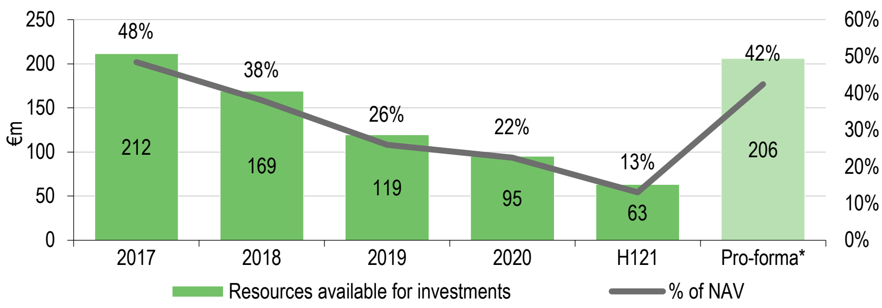
Deutsche Beteiligungs (DBAG) reported a 17.3% NAV total return in H121, which includes an €0.80 dividend paid in the period (implying a 2.4% yield). NAV growth was primarily driven by the improved earnings prospects of portfolio companies and gains on the disposals of Rheinhold & Mahla and DNS:NET. DBAG recently significantly increased its available cash resources through a €106m equity issue and is now well positioned to embark on its extensive investment agenda. Its funds in the investment phase (DBAG Fund VII and DBAG Fund VIII) are currently 79% and 14% invested respectively. DBAG will also make long-term investments entirely from its own balance sheet, with its second such deal closed in H121.

Price	**€33.95**
Market cap	**€638.4m**
NAV*	**€484.9m**
NAV per share*	€32.23
Premium to NAV**	5.3%

*As at end-March 2021. **Not adjusted for the recent share issue.

Yield		2.4%
Shares in issue		18.8m
Code		DBAN
Primary exchange		Frankfurt
AIC sector		Flexible Investment
52-week high/low	€39.07	€25.23
NAV high/low	€32.23	€23.94

DBAG's available liquidity including open credit lines



Source: DBAG, Edison Investment Research. Note: *Pro forma figure includes proceeds from recent share issue and after reporting date disposals and investment.

Gearing

Net gearing at end-Q221	9.0%

Fund objective

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

Bull points

- Solid track record, with an average management buyout exit multiple of 2.7x.
- Growing exposure to broadband, IT and healthcare.
- Stable and recurring cash flow from fund services.

Bear points

- Significant exposure to German industrials may weigh on performance in a prolonged recovery scenario.
- Ample dry powder in the market translating into high competition for quality assets.
- High valuations in most resilient sectors.

Why consider Deutsche Beteiligungs?

DBAG is a well-established player in the German private equity (PE) mid-market segment. The company has been increasing its exposure to new 'growth' sectors, which currently make up 44% of its portfolio and have proved resilient in the COVID-19 crisis. In particular, these include broadband/telecom businesses (33%), which are a play on the secular trend of network roll-out in Germany. At the same time, DBAG's industrial portfolio (currently valued slightly below acquisition cost on average) may appeal to investors seeking exposure to cyclical value companies that could benefit from a broader economic recovery. Additionally, DBAG's shares currently trade at premium of 9.2% (adjusted for the recent share issue), below their five-year average of 18.6%.

The analyst's view

DBAG has recently taken a number of steps aimed at a significant increase in its investment activity, including: 1) team expansion (80 employees from 75 at end-FY19 and DBAG expects further expansion), 2) upsizing its credit facility to €106.7m (of which €50.3m remains undrawn) and 3) a recent successful equity issue with gross proceeds of €106m. DBAG intends to invest c €120m pa in the current and subsequent two years, 40% more than its historical three-year average. We estimate that after accounting for the capital raise and collecting the disposal proceeds from the DNS:Net and Rheinhold & Mahla disposals, DBAG currently has c €206m firepower. Importantly, it also sees an increasing number of deal opportunities.

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H121 results: Strong uplifts at portfolio companies

DBAG reported net income of €73.1m in H121 ending March 2021 (versus a €76.7m loss in H120, see Exhibit 1), stemming primarily from strong revaluations in the PE segment, which recorded a €64.7m pre-tax profit (versus a loss of €80.2m in H120).

Exhibit 1: Income statement by segment (€m)

	H121	H120	y-o-y
Net income from investment activity	70.7	(76.2)	N/A
Other income/expenses	(5.9)	(4.0)	49%
Private equity investments profit	**64.7**	**(80.2)**	**(181%)**
Fund services income	21.8	14.3	52%
Other income/expenses	(12.7)	(10.8)	17%
Fund services profit	**9.1**	**3.5**	**161%**
Consolidated net profit	**73.1**	**(76.7)**	**N/A**

Source: DBAG

The result of the PE investments segment was primarily driven by improved earnings expectations in portfolio companies (€103.6m, see Exhibit 2). Moreover, DBAG booked a €7.9m positive effect from the change in valuation multiples, although it varied between sectors, with broadband telecom and industrial companies contributing positively, while holdings predominantly exposed to the automotive sector contributed a negative €13.2m. At end-September 2020 (latest available data), 76% of DBAG's portfolio was valued using the multiples method, with the remaining 24% attributable to other valuation methods, including recently acquired companies valued at cost and holdings to be exited valued at the agreed disposal price.

Change in debt had a €45.1m negative impact, which was mostly associated with acquisition financing. Importantly, the share of companies with a net debt to EBITDA ratio above 3.0x fell to 48% at end-March 2021 from 72% at end-September 2020 on the back of improved earnings. Finally, the company recognised a €4.2m gain on the sale of Rheinhold & Mahla (RM) and a €13.5m gain on the agreed disposal of DNS:Net. In case of the latter, as the transaction has not yet completed, the uplift was recognised under the 'other' changes in portfolio value line alongside some other minor value movements.

DBAG values its portfolio at 1.3x cost at end-March 2021 (versus 1.2x at end-December 2020 and 1.1x at end-September 2020), with its industrial portfolio valued slightly below acquisition costs (at 0.9x), reflecting the COVID-19 impact and structural changes in the automotive sector.

Exhibit 2: Net gains and losses on portfolio measurement and derecognition (€m)

	H121	H120
Changes in fair value of unlisted investments	79.9	(94.7)
Change in earnings	*103.6*	(38.3)
Change in debt	*(45.1)*	(10.4)
Change in multiples	*7.9*	(47.3)
Change in exchange rates	*(0.7)*	0.9
Change, other	*14.3*	0.4
Net result of disposal	4.2	1.1
Other	0.2	0.3
Total	**84.3**	**(93.2)**

Source: DBAG

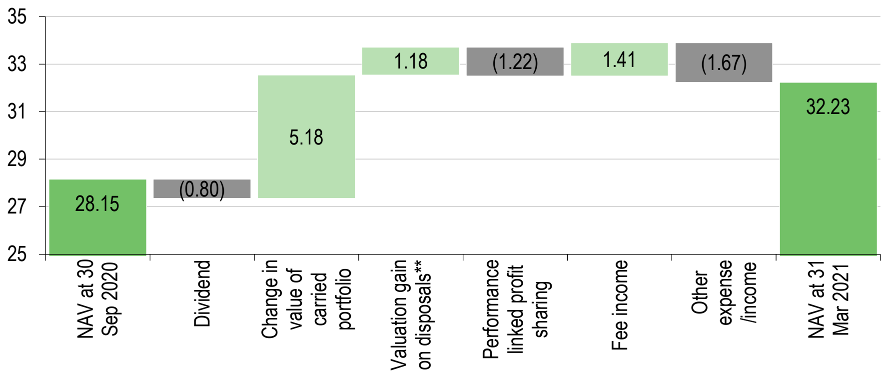
The fund services segment posted a €9.1m pre-tax profit in H121 (significantly up from €3.5m in H120), with income up to €21.8m from €14.3m in H120, mostly on the back of fees from DBAG Fund VIII, whose investment phase started in August 2020 (€9.2m fees in H121) as well as capital calls from the top-up funds of both DBAG Fund VII and VIII. We note that the main funds collect fees based on committed capital, while fees from their respective top-up funds are based on capital invested. Net expenses for the segment increased to €12.7m from €10.8m in H120 due to team expansion and higher provisions for variable remuneration.

Following the robust H121 results, DBAG reiterated its FY21 guidance (see Exhibit 4), upgraded at end-March 2021, and still expects net income from investment activity at €65–75m (versus €30–35m previously) and group net income of €70–80m (vs €40–45m previously). This may seem cautious given that the H121 results are already within these ranges. However, DBAG's results are dependent, among other things, on public equity market developments as well as its realisation activity, which is difficult to predict accurately. Moreover, DBAG will incur higher personnel expenses in H221 given the recent team expansion.

NAV development

DBAG's net asset value (NAV) per share stood at €32.23 at end-March 2021 compared to €28.15 at end-September 2020. After accounting for the €0.80 DPS paid out during the period, this implies a robust half-year NAV total return of 17.3%, as well as a one-year total return of 38.0% (although the latter is subject to a low base effect due to the pandemic outbreak). The main value drivers of the NAV uplift in H121 were changes in value of the carried portfolio, paired with higher fee income as described above. The aggregate value of other expenses and income reduced DBAG's NAV by €1.67 per share, compared to €0.95 in H120 (up 75% y-o-y). The increase is predominantly related to changes in the remuneration of DBAG Fund VII's manager,[1] while the ongoing costs of DBAG (both operating and interest) increased by only 27% y-o-y as described above. Taking into account dilution from the recent share issue, we calculate the adjusted end-March 2021 NAV per share at c €31.10.

Exhibit 3: DBAG's H121 NAV* performance to end-March 2021 (€/share)



Source: DBAG, Edison Investment Research. Note: *NAV defined as equity per share. **Including agreed disposals.

Financing and strategy

DBAG has confirmed its guidance for FY23 (see Exhibit 4) and aims to significantly increase new investment volumes this year and over the next two years to €120m pa, c 40% above the average of the previous three years. This includes both investments alongside DBAG funds, as well as long-term financings entirely from DBAG's own balance sheet. We note that DBAG Fund VIII was launched before the end of the investment period of DBAG Fund VII (its predecessor), which still has c €220m available to invest until July 2022. DBAG plans to allocate smaller management

[1] While the exact figure was not disclosed, the amount was recognised in the position 'Net gains and losses from other assets and liabilities of investment entity subsidiaries', which amounted to €6.9m compared to €0.2m in H120.

buyout (MBO) opportunities to DBAG Fund VII, while larger deals will be performed by DBAG Fund VIII, which at present is 14% invested, leaving c €950m at its disposal (including the top-up fund).

Nevertheless, as the forecast does not include the potential launch of any new fund, DBAG's estimates are for diminishing assets under management (AUM) (including committed capital of funds still in the investment phase) in the fund services segment, which reflects steady disposals from older funds. DBAG also expects increased cash flow from PE investments. Its ambition is to reach €95–110m in net income in FY23, c 120% higher than FY19 (and compared to a €17m loss in FY20).

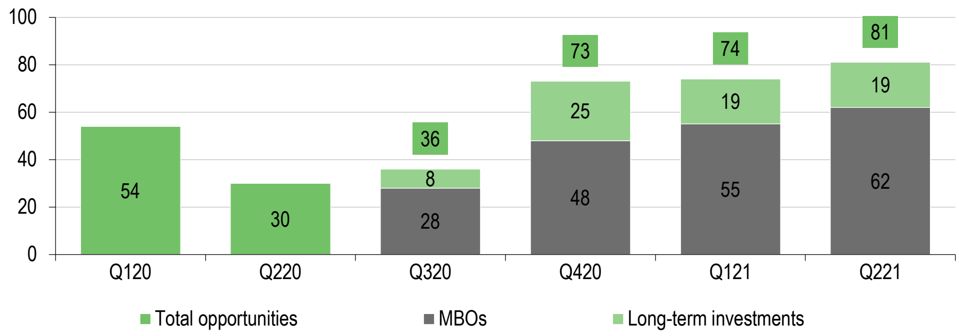
Exhibit 4: DBAG's FY21 guidance and FY23 ambition

€m	FY20	Previous FY21 forecast	Current FY21 forecast	Ambition for FY23
PE investments segment				
NAV	422.0	415–460	450–505	590–660
PBT	(16.9)	30–35	65–75	95–105
Cash flow	(33.5)	(5)-0	-*	40–45
Fund services segment				
Income	30.6	42–44	42–44	41–43
PBT	9.5	15–16	15–16	10–11
AUM	2,583	2,320–2,440	-*	2,010–2,115
DBAG				
Net income	(16.8)	40–45	70–80	95–110

Source: DBAG. Note: *Unchanged versus previous FY21 forecast.

Importantly, DBAG has experienced a pick-up in deal opportunities in recent quarters (after a temporary standstill in Q220), with 81 in Q221 (including 19 potential long-term investments) compared to just 30 a year ago. These opportunities are acquisition targets that went through an initial screening process as well as a discussion within the broader investment team, based on which they were categorised as aligned with the investment objectives of the respective investment manager.

Exhibit 5: DBAG's deal flow – potential investments by quarter



Source: DBAG

In H121, DBAG invested €37.5m (18% less year-on-year), predominantly in two new MBOs: congatec (€23.8m, described in our earlier note) and operasan (€3.2m, described below). The remaining investments were made as add-on acquisitions, including FLS (€4.9m), which has merged with two other companies into Solvares Group. Additionally, after the reporting date, it invested €15m in provider of technical building services R+S and supported portfolio company Sero with €3.6m to perform an add-on acquisition.

At end-March 2021, DBAG had €63.1m in available liquidity, including €12.8m of financial resources on its balance sheet and €50.3m of undrawn credit lines (one credit line was recently upsized to €66.7m from €50.0m, and both credit lines currently stand at €106.7m). Additionally, DBAG had €22.0m in callable receivables (mostly related to DBAG Fund VII fees) and €7.6m in the group's investment entity subsidiaries. Proceeds from the disposals of DNS:NET and RM are expected to be received in Q321 and, based on the management comments made during the analyst call, we understand that they will strengthen DBAG's available liquidity by more than €50m. While RM was sold at a price below acquisition cost, the company had been conservatively valued on DBAG's books and consequently the transaction resulted in a gain of €4.2m in Q221.

Additionally, DBAG's firepower was significantly increased in April 2021, when the company placed 3.76m new shares and raised gross proceeds of c €105m (not included in its revised FY21 NAV guidance of €450–505m). The proceeds will be used to finance further investments, alongside DBAG-managed funds and on DBAG's own balance sheet as well. It is worth highlighting that c 99% of the rights issues were exercised, which we believe to some extent shows the high level of trust from DBAG's existing investors. Having said that, this was likely also due to the 25% dilution and the fact that the shares were offered at a discount, with the subscription price at €28.0 per share, while the existing shares traded at c €34.0–36.0 during the subscription period.

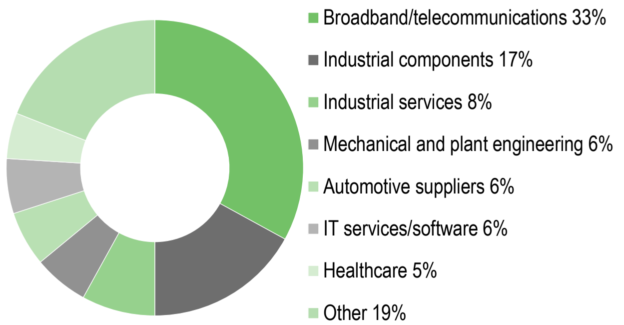
Based on the above, we estimate that DBAG currently has c €206m available for investment (excluding callable receivables and liquidity in the group's investment entity subsidiaries), which equals c 42% of its end-March 2021 NAV and covers nearly two years of investment activity at the pace assumed by management (assuming no disposals).

Current portfolio positioning

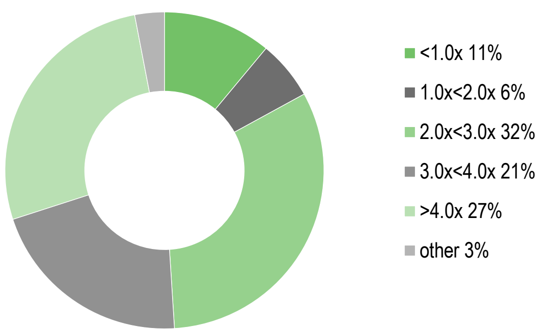
As at end-March 2021, 44% of DBAG's portfolio was attributable to the so-called growth sectors: broadband telecommunications, healthcare and IT (up 7pp y-o-y). Meanwhile, exposure to its historically core industrial sectors steadily decreased and at end-March 2021 stood at 37% of the portfolio. This represents a decline from 48% at end-September 2020. The above changes are a function of: 1) €88.7m new investments over the last 12 months, including close to 20 add-ons, which were performed predominantly in the growth sectors, 2) the continued subdued valuations of manufacturing companies, especially those with high exposure to the automotive industry, 3) the reclassification of one holding to the healthcare sector, and 4) deconsolidation of RM. We also note that Sero (one of DBAG's portfolio companies) will substantially reduce its exposure to the automotive sector following the completion of the Solid Semecs acquisition (see below for details).

Exhibit 6: DBAG's portfolio split at end-March 2021

By sector



By net debt to EBITDA



Source: DBAG

Second disposal from the growth portfolio: DNS:NET

In March 2021, DBAG (together with DBAG ECF) sold its 15.7% equity stake in DNS:NET, a provider of fibre-optic internet connections. The transaction has not been closed yet, and DNS:NET is still included in the portfolio value as at end-March 2021. DBAG and DBAG ECF invested in the company in 2013 and accompanied it through its expansion period (including a more than sixfold increase in households within the company's reach), providing a combination of equity capital and shareholder loans with a total volume of €25.8m. The acquirer is the UK-based investment company 3i Infrastructure, which we believe illustrates the growing interest of foreign institutional investors in the German PE market (supporting DBAG's exit activity). In particular, the recent strong growth in AUM of investment companies focused on infrastructure amid high investor interest bodes well for further realisations from the broadband/telecom portfolio.

The transaction represents DBAG's second realisation from its broadband/telecom portfolio following the inexio exit completed in early FY20. The purchase price has not been disclosed, hence we are not able to calculate the exit multiple. Having said that, we note that DBAG's entire broadband/telecom portfolio was valued at a healthy 2.5x cost at end-December 2020 and DNS:NET was (together with inexio) one of DBAG's first investments in the sector. We therefore consider it likely that the exit multiple was above 2.5x cost. Moreover, an uplift of €13.5m to the last carrying value was recognised in Q221 (supporting DBAG's net income from investment activity), which was already accounted for in the management guidance communicated on 26 March 2021.

Merger of two existing holdings to create large player: DING/vitronet

DBAG recently announced that it intends to merge DING and vitronet, two of its broadband/telecom portfolio holdings. DING (acquired in November 2019) is an end-to-end general contractor for fibre-optic projects, offering construction, operation, upgrade and subsequent network maintenance. It also offers infrastructure expansion services to the energy and utilities sector. vitronet (acquired in June 2017) offers broadband network roll-out and set-up services, covering planning and documentation, build-out, and management and maintenance. It also has in-house underground construction capabilities and a dark fibre leasing business.

Both companies have developed rapidly since acquisition, both organically and through add-on acquisitions. vitronet expanded its revenues from €64m in 2018 to €147m in 2020 (up 52% pa), supported by four add-on acquisitions performed during the holding period. DING on the other hand almost doubled its top line every year, with revenues increasing from €16m in 2018 to €121m in 2020. It also grew inorganically, performing five add-on acquisitions since acquisition by DBAG. The combined group will be a comprehensive services provider for the fibre-optic and energy sectors, with broad regional coverage and pro forma 2020 revenues of c €340m. Some operating synergies may come from the fact that DING has so far been more focused on regional projects, while vitronet already has experience in larger-scale projects. DBAG and DBAG ECF will hold c 39% and 46% in the merged entity (trading as vitronet Group), respectively. The transaction itself does not result in any immediate valuation impact (although DBAG aims to realise synergies between these companies) and does not require any capital support from DBAG. We understand that the size of the combined group, coupled with its growth profile, makes it an attractive candidate for both an IPO and a sale to a strategic buyer or another sponsor.

Investments after reporting date: R+S and Semecs

In May 2021, DBAG closed its second long-term investment from its own balance sheet, by investing €15m into R+S, a leading provider of technical building services. The company also provides personnel services and high-performance electrical wholesale operation and generated €360m in revenues in 2020. Despite the growth characteristic of the investment, DBAG acquired a majority stake in the company (75.1%). DBAG believes that the company occupies an attractive market position and is well equipped for further growth on the back of the current structure, created over the past two years.

Moreover, in April 2021, Sero (DBAG Fund VI portfolio), a manufacturer of electronic components, agreed on the acquisition of Solid Semecs, which is expected to close by mid-year. The transaction allows Sero to broaden its customer base beyond the automotive industry (which now accounts for 85% of its revenues), as Semecs manufactures printed circuit boards for a wide range of applications, for example medical equipment (70% of its sales are derived from a diverse base of industrial customers). Moreover, both companies will benefit from the combined production footprint (with Sero gaining access to a production site in Slovakia), which will provide them with the flexibility to handle different order sizes. DBAG supports the transaction with a €3.6m investment.

Valuation: Premium lower than five-year average

DBAG's NAV (defined as equity value) is almost entirely attributable to its PE investments portfolio, and the valuation of the fund services segment represents only a small fraction of NAV. Having said that, DBAG manages third-party assets of c €2.5bn (end-March 2021) and generates considerable fees. We believe that DBAG's shares regularly trade at premium to NAV, due to the market-implied value of the fund services segment (Exhibit 8). The current share price implies a 9.2% adjusted premium, significantly below the five-year average of 18.6%. We adjust the premium calculation for the recent share issue.

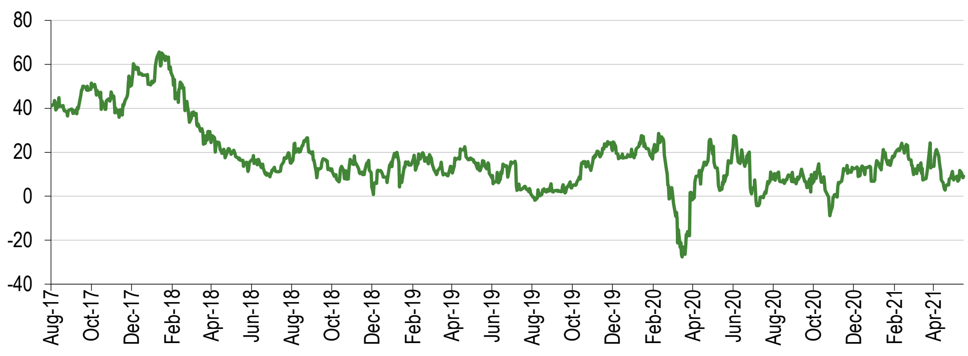
We analyse the potential value of fund services segment in two scenarios: assuming PE investments are valued by the market in line with DBAG's NAV, and assuming they trade at a discount equal to peer companies (14.2% excluding 3i, which similarly to DBAG manages third-party assets; see Exhibit 9). In the first scenario, the market-implied value of the fund services segment stands at €53.5m, translating into a 3.5x earnings before tax multiple based on the mid-point of company guidance for FY21 (compared to €143m and a 9.2x multiple in our previous report in February 2021). In the second scenario, the value amounts to €136.7m and an implied earnings multiple of 8.8x.

Exhibit 7: Analysis of DBAG's market value by segment

Approach	Private equity investments at NAV	Private equity investments in line with peers*
Discount applied to private equity investments value	0%	(14%)
Implied value of private equity investments segment (€m)	584.9	501.7
Implied value of fund services segment (€m)	53.5	136.7
Implied FY21e earnings multiple of fund services segment**	3.5	8.8

Source: DBAG, Edison Investment Research. Note: *Peer group average excluding 3i. **Based on the mid-point of management guidance.

Exhibit 8: Share price premium (discount) to NAV over three years (%)*



Source: Refinitiv, Edison Investment Research. Note: *Recent discount adjusted for the shares issue.

Peer group comparison

On the back of strong portfolio uplifts in Q221, DBAG's one-year total return in sterling terms is 32.9%, above the peer average. The longer-term performance, however, is below the peers, which stems from lower returns directly before the COVID-19 outbreak, which affected the returns. We believe this was caused by high exposure to German industrials, which experienced macro headwinds at that time. Apart from DBAG, two peers trade at a premium to NAV: 3i (which follows a similar business model to DBAG) and HgCapital Trust (which has a tech-focused portfolio that is likely to be appealing to investors). The remaining peers trade at discounts ranging from 23% to 12%. DBAG's dividend yield is currently in line with peers, which stems from a lowered payout (€0.80 per share compared to €1.50 a year earlier) paired with a lower than historical average premium to NAV. DBAG expects it will be able to increase the payout next year, yet DPS is likely to be lower than before COVID-19.

Exhibit 9: Listed private equity investment companies peer group at 20 May 2021*

% 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**	**551.4**	**32.9**	**24.4**	**85.0**	**167.9**	**47.1**	**4.9**	**82.3**	**178.7**	**9.2****	**2.4**
3i	Global	12,033.1	22.7	51.2	160.7	304.7	51.0	50.4	204.3	459.6	33.5	3.1
HgCapital Trust Ord	UK	1,444.7	43.3	87.9	162.6	274.0	45.2	91.4	219.6	293.7	0.4	1.5
ICG Enterprise Trust	UK	735.8	22.5	53.1	109.3	210.8	58.0	38.0	122.0	259.6	(22.7)	2.2
Oakley Capital Investments	Europe	583.3	18.2	71.6	116.2	157.4	58.5	87.4	143.6	128.6	(19.9)	1.4
Princess Private Equity	Global	710.0	34.8	47.2	107.6	174.6	34.5	35.4	138.6	251.8	(16.5)	3.2
Standard Life Private Equity	Europe	703.4	26.1	47.2	96.5	189.2	78.8	51.7	158.0	270.8	(12.4)	2.9
Average		**2,701.7**	**27.9**	**59.7**	**125.5**	**218.4**	**54.3**	**59.0**	**164.3**	**277.4**	**(6.3)**	**2.4**
Rank		**7**	**3**	**7**	**7**	**6**	**5**	**7**	**7**	**6**	**2**	**4**

Source: Morningstar, Edison Investment Research. Note: *12-month NAV performance in sterling terms based on end-March 2021 ex-par NAV, or latest earlier available ex-par NAV (end-January for ICG Enterprise Trust and end-December 2020 for Oakley Capital Investments). **Adjusted for recent share issue.

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