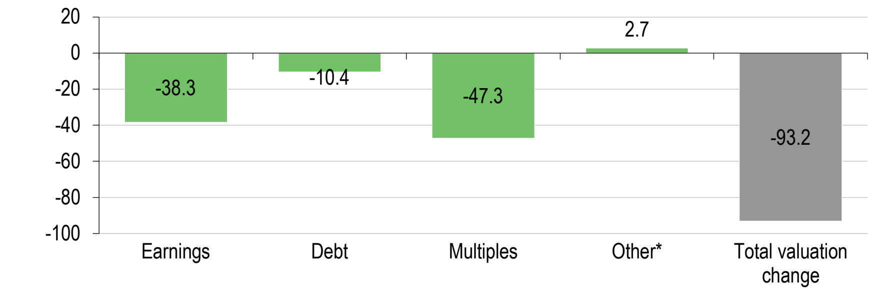
Deutsche Beteiligungs

New valuations look conservative

Deutsche Beteiligungs (DBAG) has updated its portfolio values, which led to a considerable revaluation loss in Q220, and in turn a net loss for H120 at €76.7m (or €5.10/share). Unlike many of its listed private equity peers, DBAG has already reflected in its NAV both the reduced long-term earnings prospects of its companies and lower peer multiples. This contributed to DBAG's relative underperformance with one-year NAV total return (to end-March) at -16.2% vs LPX Europe NAV at +8.7%. DBAG's fund services posted a €3.5m profit in H120 covering 88% of other ongoing costs. The eighth PE fund was closed with €1.1bn in commitments, but is not expected to start investing and collecting fees in FY20.

DBAG's carried portfolio's gross value change in H120 split by source



Source: DBAG, Edison Investment Research. Note: *FX impact, income from portfolio.

The market opportunity

DBAG is a well-established player in the German private mid-market segment. It has shown its ability to benefit from market cyclicality, delivering an average exit multiple of 2.7x since 1998, withstanding several market downturns. Recurring income from fund services provides a degree of stability by covering most ongoing costs and giving DBAG flexibility with respect to exits. We also note DBAG's growing exposure to its new focus sectors (eg broadband telecom), which should prove more resilient to the current downturn than DBAG's core industrial sectors.

Why consider investing in Deutsche Beteiligungs?

- Solid track record, with an average management buyout (MBO) exit multiple of 2.7x and growth financings of 3.4x since 1998.
- Increasing exposure to 'focus' sectors (37% at end-Q220).
- Steady income from the fund services segment.
- NAV based on conservative valuations relative to the market.

Valuation: Record-low premium to NAV

DBAG's shares tend to trade at a premium to NAV (defined as total equity), which in our view comes from the market-implied value of its fund services. The recent market turmoil has sent DBAG's shares to a 21% premium to NAV (which looks low vs the three-year average of 30%). DBAG's last dividend payout implies a 5.2% yield, but amid current conditions DBAG has so far refrained from providing guidance for the next payout.

Investment companies
Private equity

29 May 2020

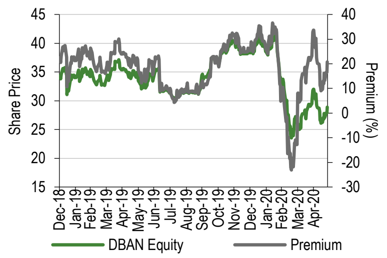
Price	**€28.90**
Market cap	**€434.8m**
NAV*	**€360.1m**

NAV per share*	€23.94
Premium to NAV	20.7%

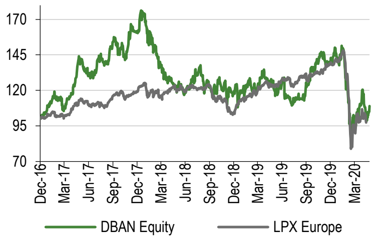
*Defined as total equity. As at end-March 2020.

Yield	5.2%
Ordinary shares in issue	15.0m
Code	DBAN
Primary exchange	Frankfurt
AIC sector	Private Equity
Benchmark	N/A

Share price/discount performance



Three-year performance vs index



52-week high/low	€41.75	€23.50
NAV* high/low	€30.59	€23.94

*Including income.

Gearing

Gross*	0.0%
Net cash*	6.2%

*As at end-March 2020.

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Deutsche Beteiligungs is a research client of Edison Investment Research Limited

Exhibit 1: Company at a glance

Investment objective and fund background

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

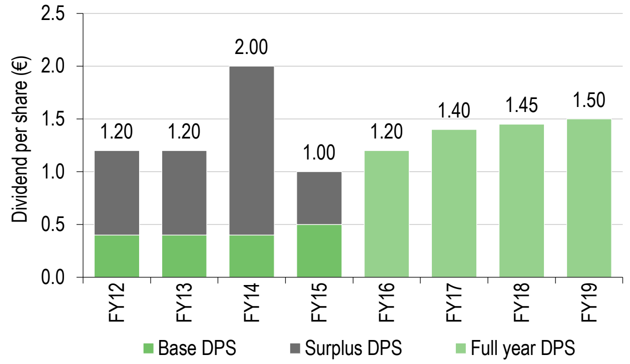
Recent developments

- 13 May 2020: DBAG Fund VIII successfully closed with €1.1bn capital.
- 13 May 2020: H120 results – NAV TR -16.8% vs LPX Europe NAV TR +2.3%.
- 5 May 2020: New forecast for FY20, DBAG expects minor net loss in H220.
- 20 Mar 2020: Forecast for FY20 withdrawn.
- 25 Feb 2020: Annual dividend paid at €1.50 per share.
- 28 Sep 2019: DBAG announces disposal of its investment in inexio.

Forthcoming		Capital structure		Fund details	
AGM	25 February 2021	FY19 net expense ratio*	0.2%	Group	Deutsche Beteiligungs
Interim results	6 August 2020	Net cash	4.0%	Manager	Team managed
Year end	30 September	Annual mgmt fee	N/A (self-managed)	Address	Boersenstrasse 1
Dividend paid	25 February 2020	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	€50m (undrawn)	Website	www.dbag.com

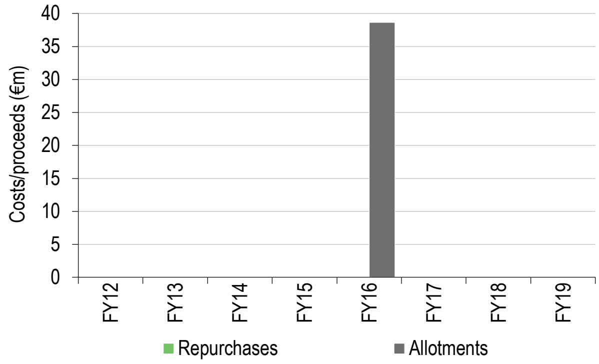
Dividend policy and history (financial years)

DBAG's policy is to pay a stable or rising annual dividend. Prior to FY16, a base dividend was paid, supplemented by a surplus dividend based on realised gains. The guidance of a stable dividend until 2022 has been withdrawn, while the policy remains unchanged in principle.

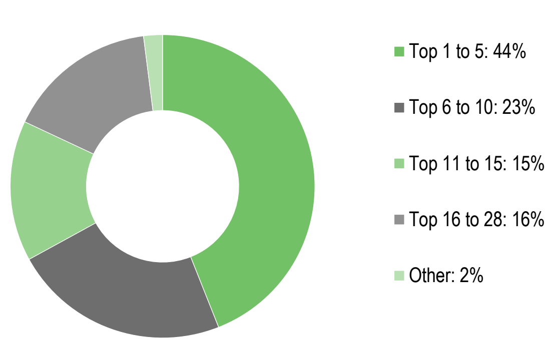


Share buyback policy and history (financial years)

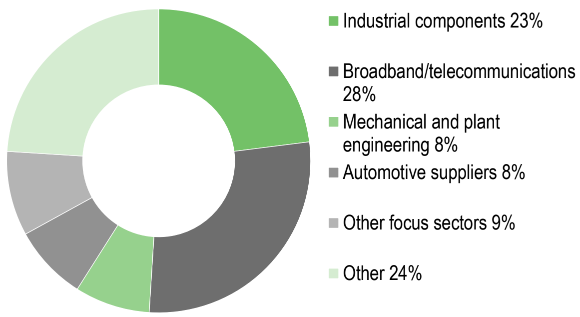
Share buybacks and capital increases are used to manage longer-term capital requirements. In FY16, €38.6m was raised through a 10% capital increase.



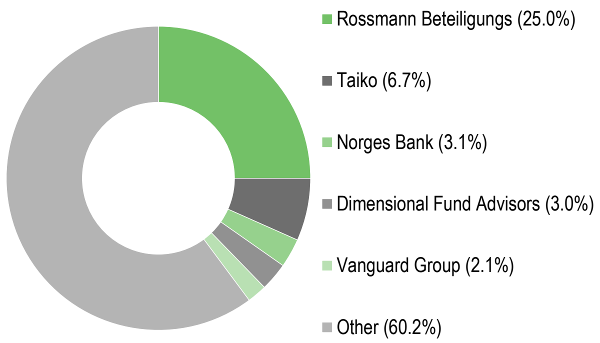
Concentration of DBAG's portfolio value by size (as at end-March 2020)



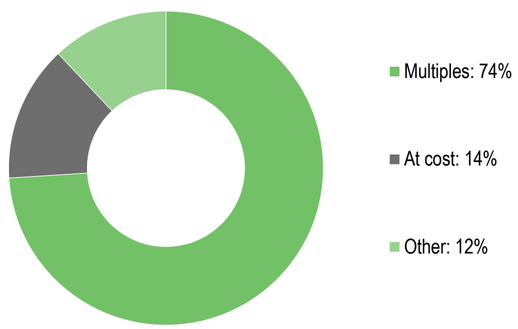
DBAG's portfolio exposure by sector (as at end-March 2020)



Shareholder base (as at 21 May 2020)



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



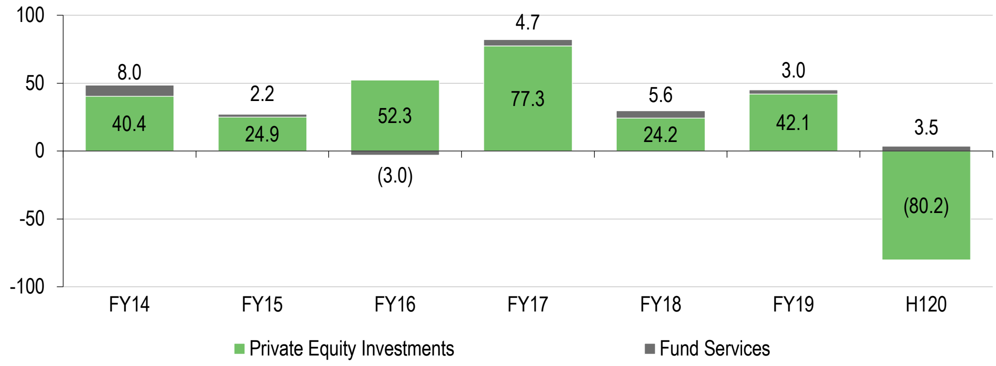
Source: DBAG, Edison Investment Research, Refinitiv. Note: *Based on expenses net of fee income; adjusted for non-recurring items.

Financial results

The H120 results depressed by coronavirus crisis

DBAG's financial results in H120 (especially Q220) were heavily affected by the ongoing coronavirus crisis through downward portfolio revaluation, which had a strong impact on both the bottom line and the balance sheet of the company. The private equity segment delivered a pre-tax loss of €80m (of which €78m is attributable to Q220), while costs were held under control at €4m (+6% y-o-y, in line with long-term averages). As described further in the note in detail (see below), the revaluation loss was driven by both the change in multiples of quoted peers (as 74% of the portfolio is valued with a multiples method), as well as incorporation of revised long-term earnings forecasts (ie excluding short-term impact of COVID-19) of portfolio companies. We note that the above-mentioned revaluations apply to DBAG's carried portfolio, as exit activity was subdued. The two completed exits (inexio and Romaco) were performed at previously agreed prices and were neutral to DBAG's results. The fund services segment on the other hand delivered a pre-tax profit of €3.5m, which was ahead of budget, with the twofold year-on-year growth supported by a low base effect (one-off costs of H119). As a result, the net loss for the period came in at €77m and prompted DBAG to revise its FY20 forecasts (see page 5).

Exhibit 2: DBAG's PBT by segment (€m)

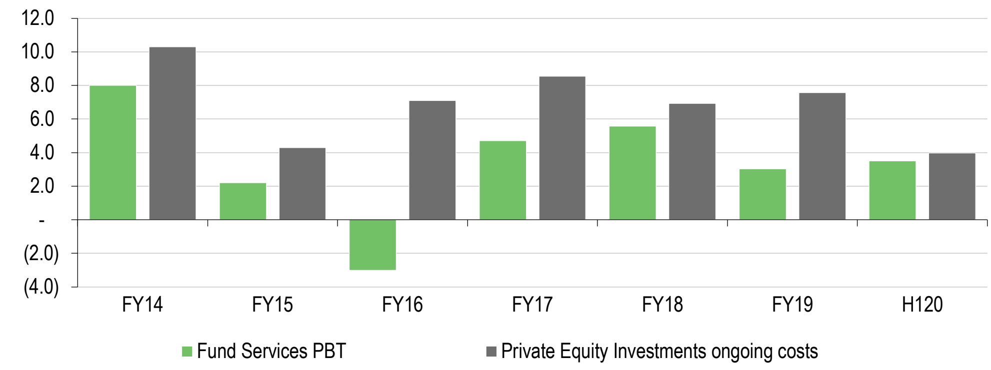


Source: DBAG

DBAG remains flexible in its exit decisions

The company's financial results are inherently volatile and depend on the development of portfolio companies (reflected in their carrying value), the timing of investments and portfolio realisations (to a lesser extent), as well as changes in earnings multiples in the broader equity markets. This has been particularly highlighted by the downturn in Q220. However, we note that DBAG's ongoing operations are supported by recurring and stable (cash) income from its fund services segment, which covers most of its ongoing operational costs (88% in H120, see Exhibit 3). We believe that this gives DBAG more flexibility when it comes to deciding on the timing of its portfolio exits. Moreover, as at end-March 2020 DBAG had €22.5m in cash and short-term securities and €50m of available and undrawn credit line, which translates to €72.5m of available resources. An additional €18.5m of cash and equivalents is held by the investment entity subsidiaries, some of which is to be distributed to DBAG in the future.

Exhibit 3: Fund services segment's PBT vs private equity segment's net other expenses (€m)



Source: DBAG, Edison Investment Research. Note: Private equity segment net expenses include fees on DBAG's co-investments charged by the fund services segment.

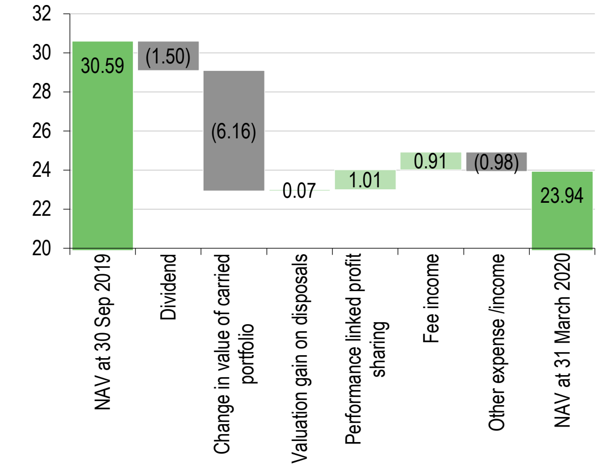
Expecting further losses in H220

Due to its volatile P&L, DBAG usually formulates its forecast for result of its private equity investments segment and net income in reference to five-year averages. At the same time, its NAV and fund services result forecast is normally communicated in reference to the prior year's figure. COVID-19 prompted DBAG's management to revise its FY20 forecast after evaluating the impact on its portfolio, which however is subject to a high level of uncertainty depending on how the macro environment evolves. Management now expects further deterioration of NAV (of up to 10%) in H220 and a corresponding net loss in FY20 (although more limited than in H120). DBAG's guidance continues to be based solely on expected developments within portfolio companies and assuming stable market multiples (currently as at end-March 2020). We understand management's view that currently risks outweigh opportunities, and we believe companies' earnings forecasts can deteriorate amid a prolonged (or resumed) lockdown. On the other hand, we need to highlight that market multiples at end-March 2020 were likely depressed, as at least partially they reflected outdated consensus and subsequently increased as the forecasts were revised (see Exhibit 5). This leads us to believe the current guidance for the private equity investments business is rather conservative. The company expects income from the fund services segment in FY20 to be significantly higher (at least 20%) than in FY19, which could rise as much as 100% y-o-y. We note that H120 income was 15% higher than the full-year FY19. On the liquidity side, management expects DBAG will end FY20 with available liquidity below €100m (€72.5m at end-March 2020).

NAV down 17% over the quarter

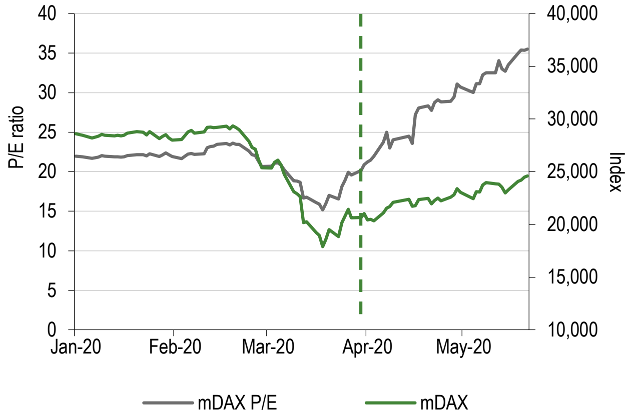
DBAG's NAV (defined as equity value) decreased to €360.1m from €460.2m during the first half of FY20, implying NAV per share of €23.94 at the end of March 2020. After adjusting for the €22.6m dividend (€1.50 per share), this implies a 16.8% deterioration in total return terms. We note that Q120 performance was almost flat, and the loss is mostly attributable to the recent market turmoil. The main driver of NAV performance was the revaluation of the investment portfolio reducing NAV by €6.16/share (€92.7m in total), see Exhibit 4. The downward revision of earnings had a negative impact of €38.3m on portfolio value (or €2.55 per share). These updated forecasts were applied to market multiples of quoted peers at end-March 2020, which had an even greater impact on portfolio value of €47.3m (€3.14/share). We note that DBAG forecasts are based on long-term earnings prospects (ie excluding the one-off effect of the current lockdown). These were applied to somewhat depressed market multiples, as the market valuations reacted more quickly than analysts contributing to the consensus estimates. DBAG excluded a small portion of the peers that had their consensus updated to assure comparability of data. We note that the P/E ratio in the German mid-cap market (illustrated by the mDAX index) has already rebounded to 35.5x currently from 20.9x at end-March, which resulted from both updated consensus and a 16.9% index growth. Around 14% of DBAG's portfolio is valued at cost and has not been affected by revaluations (7% at end-FY19) and exits executed in H120 were already included at disposal price in end-FY19 NAV. Fee income contributed a positive €0.91 to NAV per share (€0.92 in H119).

Exhibit 4: DBAG's NAV performance in H120 (€/share)



Source: DBAG, Edison Investment Research.

Exhibit 5: Ongoing revisions of forecasts for companies within mDAX (highlighted end-March)



Source: Bloomberg, Edison Investment Research

DBAG Fund VIII launched, but investments postponed

DBAG currently manages AUM of €1.7bn (+1% y-o-y), of which €1.3bn (+8% y-o-y) is external investors' capital. The capital deployed into portfolio companies (ie excluding not yet invested resources) amounted to €1.4bn at end Q220, up 26% y-o-y. We note that DBAG's AUM reflects invested cash amounts and is not subject to revaluations.

DBAG recognises AUM of a newly set up fund once the investment period begins, and in parallel starts to collect fees. In Q220, DBAG successfully completed its eighth PE fund (DBAG Fund VIII), which is its largest fund so far, with €1.1bn of committed capital (€255m provided by DBAG), including its €190m top-up fund. DBAG Fund VIII was initially supposed to perform its first investments right after closure. However, the M&A market has now come to a standstill and it is likely (based on the experience from the 2008/09 crisis) that it will not re-open for several months. Consequently, management does not expect the fund to start its investment phase in the current fiscal year (ending September 2020).

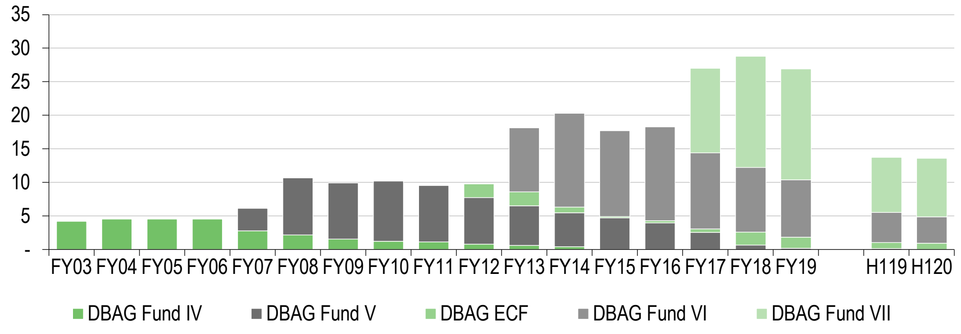
On one hand this postpones the fee income from the fund, which once commenced will significantly support DBAG's cash flows. On the other hand, this gives DBAG more flexibility in managing its current cash resources, with the focus on supporting existing portfolio holdings at present. DBAG's current commitments towards its funds (excluding DBAG Fund VIII) of €86.2m are 84% covered with available resources.

DBAG Fund VII is still in its investment phase and has invested 79% of its committed capital so far. Management sees room for one more buyout, keeping the remainder of capital for add-ons and support of its portfolio. While DBAG expected to close the final transaction before commencing investments of the next PE fund, it is important to note that this is not required for DBAG Fund VIII to enter the investment phase. In this context, we note that 86% of third-party capital in DBAG Fund

VIII comes from investors of previous DBAG funds. DBAG Fund VII's investment period ends no later than December 2022.

In H120 DBAG collected €13.7m in fees, compared to €13.8m in H119. This translates to an LTM fee income of 1.07% on third-party capital (excluding DBAG's capital and fees collected between segments). The main contributor remains DBAG Fund VII with €8.7m collected compared to €8.2m in H119. As a reminder, €202m of DBAG Fund VII's capital is placed in its top-up fund, with fees based on capital deployed instead of committed. Similarly, DBAG Fund VIII has a top-up of €199m (18% of total). The decrease in fees came from divestments in DBAG Fund VI, and DBAG Fund V ending its fee-collecting period in February 2019.

Exhibit 6: DBAG fee income by fund (€m)



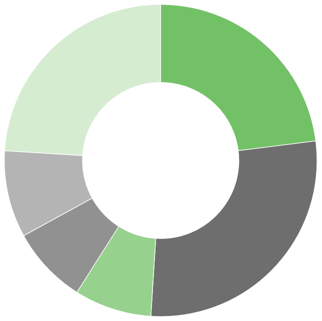
Source: DBAG, Edison Investment Research

Portfolio positioning: Timely reorganised portfolio

DBAG's current portfolio consists of 28 companies categorised in three main pools: core sectors, focus sectors and other. Historically DBAG's core competencies laid in German industrials and these make up 39% of the portfolio. Over the recent years DBAG searched for investments outside its core sectors and has been able to gradually decrease the exposure from 80% at end-FY15. The 11pp exposure drop in Q220 vs Q120 is mostly attributable to stronger downward revaluation in this bucket. As at end-H120, 23% of the portfolio is attributable to industrial components (-7pp y-o-y), 8% in mechanical and plant engineering (-9pp y-o-y) and 8% in automotive suppliers (-3pp y-o-y). These sectors were already experiencing downward pressure on order intake during the 2019 economic growth slowdown and were hardest hit by the recent lockdown operationally.

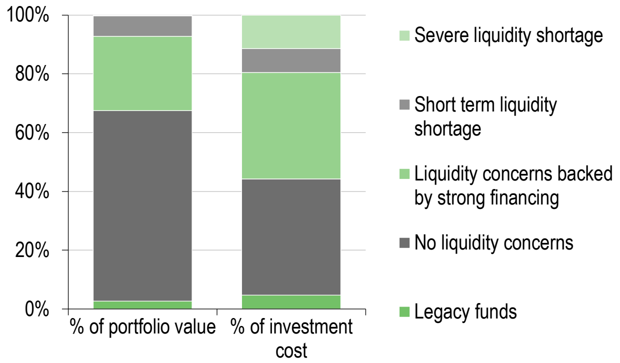
In the quarters leading up to the recent crisis, DBAG has been building exposure to the 'focus' sectors, which are mainly TMT-related. As at end-Q220, 37% of the portfolio is allocated to these focus sectors, of which 76% in broadband/telecommunications and 24% in other (which includes healthcare). These have been affected to a limited extent operationally by the recent crisis and remain DBAG's focus in terms of investment activity once the M&A market is revived. DBAG expects investment opportunities to arise amid the crisis, in particular in equity minority positions in companies seeking reliable long-term financing. Until recently, DBAG was executing these investments through its ECF funds (AuM of €393m, €175m attributable to DBAG), but going forward will be investing solely through its own balance sheet. DBAG does not intend to invest in distressed assets though as they remain outside of its core strategy.

Exhibit 7: Portfolio split by sector Q220



Source: DBAG

Exhibit 8: Portfolio* split by estimated liquidity



Source: DBAG. Note: *Current portfolio value of €308m; investment cost of €345m.

DBAG expects weaker financial results from its portfolio companies, particularly in industrial sectors, yet considers the liquidity of portfolio companies as manageable. DBAG considers only 7.2% of its portfolio (by value) as companies experiencing liquidity bottlenecks that do not have external debt financing available at hand. Based on DBAG's investment cost, these companies represent 19.5% of the portfolio. We understand that DBAG's liquidity support to its portfolio companies would likely involve providing a limited amount as an equity component to allow them to obtain bank funding in the form of credit lines.

H120 quiet in terms of investments and exits

During H120, DBAG invested €45.6m into its portfolio. The two completed acquisitions – Cartonplast (€25.7m) and DING (renamed from STG, €9.6m) – were announced and agreed in FY19 (see our previous notes for details). The remaining €10m was invested into portfolio companies to support their inorganic growth, and we calculate that the main beneficiaries were radiology practices chain blikk (c €4m) and fibreoptic network provider DNS:NET (c €5m). Overall DBAG's portfolio companies performed eight add-on acquisitions and agreed a further two during H120, which includes investments not requiring DBAG's additional investment. The new investment activity was focused mostly on companies operating in the broadband/telecommunications sector.

Dividend policy

DBAG implemented its current dividend policy in FY16 and intends to pay a stable dividend that increases whenever it is possible. The change of policy from a dividend dependent on realised gains was based on an increased level of recurring fee income and a larger private equity investment portfolio. Under current policy, shareholders can expect a smoother progression of the dividend payment each year. In February 2020, DBAG distributed a dividend of €22.6m from FY19 income. This translated into a DPS of €1.50 compared with €1.45 a year earlier (+3.4% y-o-y).

Under the current volatile environment caused by the COVID-19 outbreak, DBAG decided to withdraw its earlier guidance for a stable dividend until 2022 (announced on 5 May 2020), and does not guide on its dividend payout for now. Having said that, the policy remains unchanged in principle.

Valuation: Premium to NAV volatile

As discussed in our previous update notes, DBAG's reported NAV is almost exclusively attributable to the value of its private equity investment portfolio and does not account for the fair value of its fund services business, which currently represents third-party assets under management of c €1.3bn and generates considerable recurring fee income. In contrast, DBAG's market value reflects the value of both its fund services business and its private equity 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 private equity investment portfolio. We believe that the value of DBAG's fund services business is the primary reason why the company's shares tend to trade at a premium to NAV.

During March 2020 DBAG's share price followed the broader market sell-off decreasing by 19% compared to the 25% decrease of LPX Europe. Before the NAV was updated as at end-March, DBAG traded at discount to NAV of up to 23% during March. Following the release of the updated NAV, the current premium is 20.7% (vs a three-year average at 29.9%).

The premium translates to €74.6m of excess market capitalisation over the end-March 2020 NAV. Assuming that this represents the market value of DBAG's fund services segment, it translates into an LTM earnings before tax multiple for the segment of 15.8x (compared to €89m and a 13.1x multiple in our previous note, respectively). We also use the approach of applying the current discount of the LPX Europe Index to the private equity investments business, assuming the segment is valued in line with the broader private equity market. At present, the discount stands at 28% (vs 0–20% on average over the last five years), which is likely overstated due to 1) some private equity companies calculating their respective portfolio value based on trailing results, and 2) portfolio revaluation frequency, with a large number of index constituents trading on pre-crisis NAV. Having said that, by applying the current LPX discount to the NAV, we arrive at a fund services segment value of €176.7m and an earnings multiple of 37.5x, which compares with our previous calculations published in early March (based on an LPX discount of 13%) of €126.4m and 38.4x.

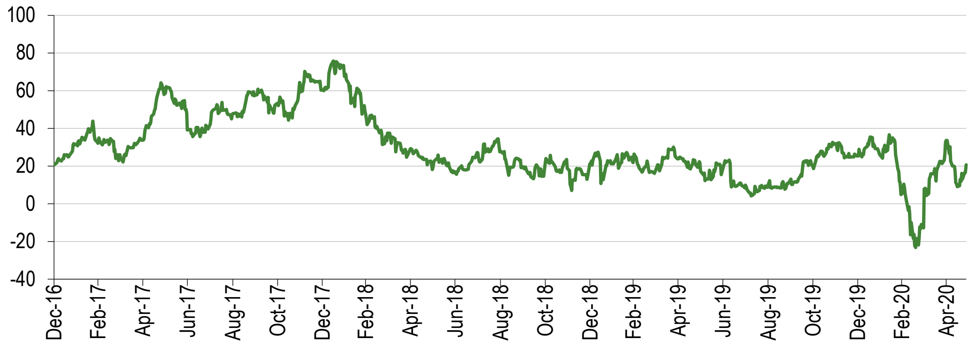
Exhibit 9: Analysis of DBAG's market value by segment

Approach	Private equity investments at NAV	Private equity investments in line with LPX Europe
Discount applied to private equity investments value	0%	(28%)
Implied value of private equity investments segment (€m)	360.1	258.0
Implied value of fund services segment (€m)	74.6	176.7
Implied LTM earnings multiple of fund services segment (x)	15.8	37.5

Source: DBAG, LPX-Group, Edison Investment Research

We note that the market may be discounting the delay in fee income from DBAG Fund VIII, which could translate into a lower market value assigned to the fund services segment. The market value of the private equity investments business could also be under pressure, as the extent of the impact of the coronavirus lockdown is still uncertain and DBAG's portfolio companies' forecasts could be subject to downgrades in the coming months. On the other hand, as we explained earlier in the note, we see DBAG's current portfolio valuation as conservative.

Exhibit 10: Share price premium (discount) to NAV over three years (%)



Source: Refinitiv, Edison Investment Research

Peer group comparison

In comparison to other private equity funds' performance, DBAG falls short of average in terms of both NAV and share price return over the last 10 years. The short-term underperformance is partially explained by DBAG's exposure to mid-sized companies in German-speaking countries and the industrials sector, but we believe the NAV revaluation frequency and policy plays an even greater role. Out of six peers only 3i and HgCapital reported NAV as at end-March 2020, which incorporated updated forecasts of portfolio companies as well as current market conditions in terms of valuations. HgCapital's outperformance comes from its focus on investments in IT-related companies, which have not been strongly affected by the lockdown. While Princess Private Equity has incorporated the drop in peer multiples applied to companies' valuations, we believe the fund uses last reported results as the basis of valuations instead of budgeted values for a significant share of the portfolio. Standard Life Private Equity (SLPE) has a fund-of-funds structure, and its NAV represents valuations provided by the respective fund managers. This naturally leads to at least part of the NAV being outdated, when underlying funds report their respective NAVs post-SLPE's reporting date. ICG Enterprise Trust and Oakley Capital Investments have not reported NAV as at end-March, with the latest available data as at end-January 2020 and end-December 2019, respectively. Keeping in mind all the above, DBAG is the only company in the selected peer group that reported a negative NAV performance for the last 12 months and it has the lowest five-year and 10-year NAV total return in the peer group Given the limited comparability of NAV total returns, it may be instructive to look at share price total returns as well. Here, DBAG is still below the peer average in terms of one-, three-, five- and 10-year total returns, which we believe stems mostly from exposure to the German industrials sector, which is experiencing headwinds.

Exhibit 11: Listed private equity investment companies peer group as at 27 May 2020*

% unless stated	Region	Market cap £m	NAV TR 1 year	NAV TR 3 years	NAV TR 5 years	NAV TR 10 years	Price TR 1 year	Price TR 3 years	Price TR 5 years	Price TR 10 years	Premium/ (discount)	Dividend yield
Deutsche Beteiligungs	**Europe**	**391**	**(8.6)**	**11.7**	**76.2**	**124.6**	**(16.8)**	**(7.3)**	**23.7**	**136.7**	**20.7**	**5.2**
3i	Global	8,230	3.5	54.3	161.6	263.9	(16.6)	17.6	98.3	284.3	7.5	4.1
HgCapital Trust	UK	974	15.2	55.1	119.9	226.1	10.2	57.0	132.4	242.9	1.3	2.0
ICG Enterprise Trust**	UK	487	10.1	41.1	88.0	189.6	(19.5)	4.8	28.8	150.4	(38.3)	3.2
Oakley Capital Investments**	Europe	394	23.7	54.8	81.7	159.0	(0.7)	35.2	24.9	99.6	(41.2)	2.2
Princess Private Equity	Global	522	3.0	19.8	87.5	126.3	1.1	14.9	90.7	261.5	(21.6)	6.9
Standard Life Private Equity	Europe	449	15.1	41.3	100.4	214.0	(24.7)	(6.0)	35.9	176.9	(38.9)	4.5
Average		**1,842.5**	**11.7**	**44.4**	**106.5**	**196.5**	**(8.4)**	**20.6**	**68.5**	**202.6**	**(21.9)**	**3.8**
Rank in peer group		**7**	**7**	**7**	**7**	**7**	**5**	**7**	**7**	**5**	**1**	**2**

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

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