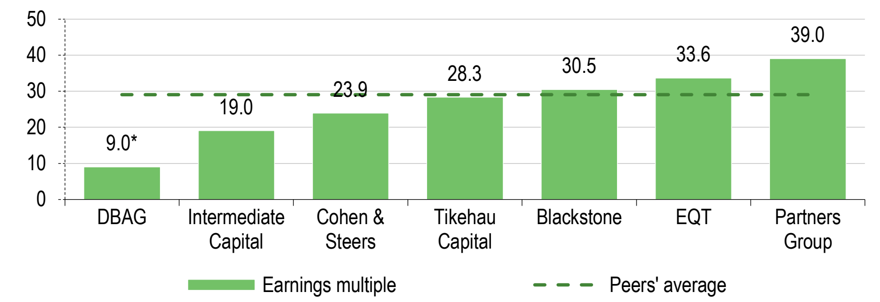
Deutsche Beteiligungs

Strong firepower for new acquisitions

Investment companies
Private equity

Deutsche Beteiligungs (DBAG) posted a 24.5% NAV total return in 9M21, even after the dilutive impact of the recent €100m share issue. This was mainly a function of improved earnings expectations of portfolio companies, coupled with disposal gains on DNS:Net and Rheinhold & Mahla, as well as a €26.0m uplift upon the announced exit from blikk. Results were further supported by the profit from DBAG's fund services (up to €13.9m in 9M21 vs €6.6m in 9M20) following the start of DBAG Fund VIII's investment period. While DBAG closed only one acquisition in Q321 (R+S, its second long-term investment), the management underlines the continued strong pipeline of opportunities (up to 86 in Q321 vs 81 in Q221).

Implied FY21e earnings multiple of DBAG's fund services segment vs peers



Source: Refinitiv, Edison Investment Research. Note: *See Valuation on page 6 for a detailed description of our underlying assumptions.

Why consider Deutsche Beteiligungs now?

DBAG is a well-established player in the German private equity (PE) mid-market. It has been increasing its exposure to new 'growth' sectors, which currently make up 43% of its portfolio and have proved resilient in the COVID-19 crisis. In particular, these include broadband/telecom businesses (25%), 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, even if their earnings recovery has been partially curbed by supply bottlenecks and cost inflation recently.

The analyst's view

DBAG's shares currently trade at a 10.8% premium to NAV, visibly below the five-year average of 18.6%. If we assume that DBAG's PE investments segment is valued at a discount to NAV in line with its peers (currently at 11%), it implies a P/E multiple for DBAG's fund services business of 9.0x based on new management guidance of segmental profit of €16–17m for FY21e. This implies a c 69% discount to the current average FY21e multiple for listed alternative asset managers of c 29x (based on Refinitiv consensus), suggesting that DBAG's current market valuation may be relatively undemanding. DBAG's shares now offer a dividend yield of 2.1% based on the FY20 pay-out of €0.80 per share. While the dividend per share is unlikely to return to pre-COVID-19 levels (€1.50 in FY19) in the near term, we note that DBAG's dividend policy is for a stable or rising dividend per share, with a mid-term FY23 target of €1.00–1.20 communicated last year.

16 August 2021

Price	**€37.90**
Market cap	**€712.7m**
NAV*	**€643.3m**
NAV per share*	€34.21
Premium to NAV	10.8%

*As at end-June 2021.

Yield		2.1%
Shares in issue		18.8m
Code		DBAN
Primary exchange		Frankfurt
AIC sector		Flexible Investment
52-week high/low	€39.07	€25.65
NAV high/low	€34.21	€27.40

Gearing

Net cash at end-Q321	15.4%

Fund objective

Deutsche Beteiligungs is a German-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.

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9M21: Higher earnings expectations versus end-2020

DBAG reported net income of €131.2m in the first nine months of FY21 (9M21) ending June 2021 (versus a €24.6m loss in 9M20, see Exhibit 1), driven mainly by strong revaluations in the PE segment, which posted a €118.0m pre-tax profit (versus a loss of €31.2m in 9M20).

Exhibit 1: Income statement by segment (€m)

	9M21	9M20	y-o-y
Net income from investment activity	126.8	(25.3)	N/A
Other income/expenses	(8.8)	(6.0)	47%
Private equity investments pre-tax profit	**118.0**	**(31.2)**	**N/A**
Fund services income	32.5	21.4	52%
Other income/expenses	(18.6)	(14.8)	26%
Fund services profit pre-tax	**13.9**	**6.6**	**111%**
Consolidated net profit	**131.2**	**(24.6)**	**N/A**

Source: DBAG

The result of the PE investments segment in 9M21 was primarily assisted by improved earnings expectations in portfolio companies (€113.4m, see Exhibit 2), especially in the broadband/telecom sector (including the impact from several bolt-on acquisitions completed by one of the platform investments), IT services/software companies and one company within the 'other' sectors bucket. Having said that, manufacturing businesses and related service providers (including automotive suppliers) also had a positive contribution. This, however, has been partially offset by supply bottlenecks, raw materials cost inflation and higher freight rates.

A further €35.1m positive effect came from the change in valuation multiples, including €26.0m attributable to the uplift upon the disposal of the blikk radiology group agreed in Q321. The remaining upward revaluations came mostly from broadband/telecom and IT services/software businesses, partially offset by write-downs of DBAG's holdings in automotive suppliers. Change in debt had a €28.1m negative impact, mostly associated with the financing of bolt-on acquisitions. We note that the share of companies with a net debt to EBITDA ratio above 3.0x fell to 45% at end-June 2021 from 72% at end-September 2020 on the back of improved earnings (see Exhibit 5). Finally, the company recognised a €19.8m net result of disposals, which includes: 1) a €4.2m gain on the sale of Rheinhold & Mahla (RM); 2) a €13.5m gain on the disposal of DNS:Net; and 3) the result on the disposal of DBAG's stake in the remaining externally managed foreign buyout fund.

DBAG values its portfolio at 1.34x cost at end-June 2021 (versus 1.3x at end-March 2021, 1.2x at end-December 2020 and 1.1x at end-September 2020), with its industrial portfolio still valued slightly below acquisition cost (at 0.9x), reflecting the COVID-19 impact and structural changes in the automotive sector. At the same time, its five broadband/telecom holdings are on average valued at a healthy 3.7x cost.

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

	9M21	9M20
Changes in fair value of unlisted investments	121.9	(41.9)
Change in earnings	*113.4*	*(61.3)*
Change in debt	*(28.1)*	*(42.1)*
Change in multiples	*35.1*	*60.6*
Change in exchange rates	*(0.4)*	*0.2*
Change, other	*1.9*	*0.8*
Net result of disposal	19.8	1.6
Other	(0.3)	(0.1)
Total	**141.5**	**(40.3)**

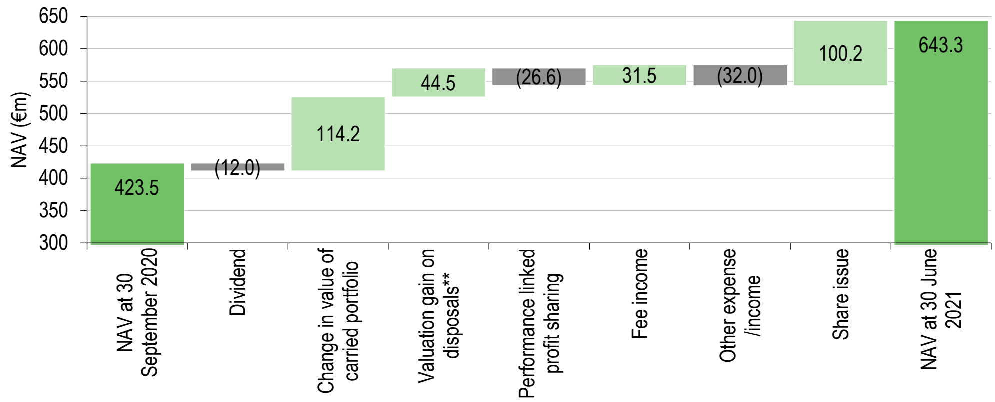
Source: DBAG

The fund services segment reported a €13.9m pre-tax profit in 9M21 (significantly up from €6.6m in 9M20), with income up to €32.5m from €21.3m in 9M20, mostly on the back of fees from DBAG Fund VIII, whose investment phase started in August 2020 (€13.9m fees in 9M21) 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. The above was partially offset by the decline in fees from DBAG Fund VII to €10.8m from €13.1m last year, as these are now calculated based on invested rather than committed capital. Net expenses for the segment increased to €18.6m from €14.8m in 9M21, primarily due to higher provisions for variable remuneration, as well as team expansion.

NAV development

DBAG reports net asset value (NAV) attributable solely to its private equity investments, which amounted to €622.7m at end-June 2021 (€33.12 per share), translating into a 20.3% total return. In our analysis, in order to capture the performance of the whole group, we use DBAG's equity value as NAV which stood at €643.3m at end-June 2021 (€423.5m at end-September 2020), translating into €34.21 per share, according to our calculations. The NAV per share total return was 24.5% in 9M21 after accounting for the dilutive effect of the €100m share issue (compared to LPX Europe NAV at 19.8%). The main value driver was the change in value of portfolio holdings, adding €114.2m (including accrued income) to the NAV, which excludes gains on disposals and revaluations to the agreed price of the disposals not closed yet (a further €44.5m). While the ongoing costs (net of other operating income) increased significantly to €32.0m, we note that these include fund services segment costs that are offset by generated fee income (the segment's pre-tax margin increased to 43% from 31% in 9M20). We calculate the annualised net expense ratio at a minor 0.3% of DBAG's average assets under management (AUM) (compared to 0.1% in FY20).

Exhibit 3: DBAG's 9M21 NAV* performance to end-June 2021 (€m)



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

Management has raised its FY21 guidance

On the back of the uplift from the agreed blikk exit, as well as positive revaluations of portfolio companies as at 30 June 2021, DBAG's management raised its FY21 guidance (previously reiterated in May 2021). It currently expects net income in the PE investments segment in the range of €125–140m (vs €65–75m previously), which would translate into an NAV (as reported by DBAG) of €620–690m (after accounting for the recent c €100m capital raise), implying a c 0–11% increase compared to the end-June 2021 level. DBAG's management generally assumes stable market multiples of listed peers, which are the reference point for valuing a major part of DBAG's portfolio (76% based on last available data as at end-September 2020). Hence, the expected NAV increase stems from operational developments of DBAG's portfolio companies, as well as some contribution from changing the valuation method of companies acquired in Q420 (as newly acquired businesses are normally valued at cost during the initial 12 months). Earnings from the fund services segment are now forecast in a €16–17m range (€15–16m previously) compared to €13.9m already booked during the first nine months of FY21. The management is currently updating its mid-term ambition to 2024 (last updated in November 2020), which should be released together with the FY21 annual report in December.

Recent portfolio developments

Blikk sold at a solid 2.1x MOIC to EQT Infrastructure V

On 9 July 2021, DBAG announced the sale of blikk, which marks the third disposal from DBAG's 'growth' portfolio and the first exit done by DBAG Fund VII. DBAG achieved a multiple of invested capital (MOIC) of 2.1x, which is attractive given the relatively short holding period as the business was acquired in May 2019 (the transaction was agreed in March 2017, but closure was delayed due to a prolonged regulatory approval process). As mentioned above, the sale was carried out at a c €26.0m uplift to carrying value as at end-June 2021 and is expected to close in Q421.

Blikk is a group of radiology and nuclear medical service centres, which DBAG developed by initially acquiring two radiology practices (from a group of 18 physicians) and subsequently adding new centres through bolt-on acquisitions, growing the business to €95m of revenues and 732 employees in 2020. Over the holding period, DBAG invested €18.7m in the entity (for an 11% stake), and DBAG Fund VII provided a further €87.0m (holding together with DBAG a 61.7% stake). We note that in January 2021, the nephrology division of the blikk group (managed by operasan) was spun off and will be developed as a separate healthcare platform investment. DBAG Fund VII acquired a 71% stake in operasan, of which 13% is attributable to DBAG, which invested €3.2m.

Blikk is being acquired by the EQT Infrastructure V fund, which agreed to purchase stakes held both by DBAG and its MBO fund, as well as the stake held by blikk's management. DBAG will reinvest part of the proceeds and will hold an up to 15% stake (of which up to 3% will be attributable to DBAG, which will pay a low-single digit million-euro amount). We consider the deal another indication of the interest of foreign institutional investors (including infrastructure funds) in the German PE market supporting DBAG's exit activity. Earlier this year, DBAG sold its stake in broadband telecom business DNS:Net to 3i Infrastructure at a very healthy 5.8x MOIC (the transaction was closed in June 2021 and is described in detail in our previous update note).

Agreement to sell Telio to Charterhouse Capital Partners

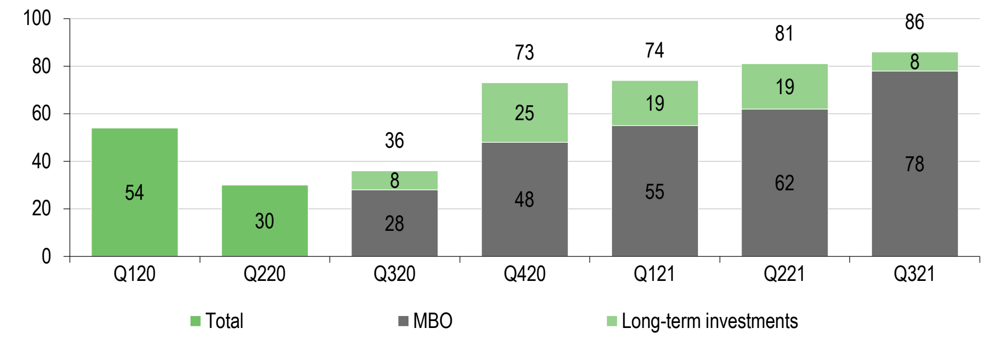
DBAG agreed to sell Telio Management in June 2021 after an over five-year holding period (initial investment in April 2016) at a 1.8x MOIC, which is somewhat below DBAG's long-term historical average multiple on buyout investments of c 2.7x (though still representing an 80% gross return). The exit valuation is in line with Telio's last prior carrying value, hence DBAG has not recognised any uplift on the deal.

Telio specialises in developing, installing and operating communications and media systems for correctional facilities (currently covering 700 facilities in 21 countries). DBAG and DBAG Fund VI invested €74.5m for an 83% stake in the company (of which €14.3m and 15.3% were attributable to DBAG, respectively). Telio's +22% revenue CAGR since DBAG's initial investment to €83.0m in 2020 was supported by both organic growth and acquisitions (two of which involved additional funding from DBAG). The company is being sold to Charterhouse Capital Partners, a UK-based PE investor focusing on European mid-market opportunities. DBAG and DBAG Fund VI will reinvest part of the disposal proceeds into a c 13% stake in Telio (of which 2.5% will be attributable to DBAG).

Ample new investment opportunities, one deal closed in Q321

DBAG's recently adopted strategy assumes c €120m new investments per annum in the current and subsequent two years. So far, the company has invested €58.2m in the first nine months of FY21 (ending September 2021), which includes in particular the acquisitions of congatec, operasan and R+S Group (which combined represent a c €43m investment), with the rest likely being add-ons to existing platform investments. In Q321, DBAG completed the acquisition of R+S and the merger of DING and Vitronet (discussed in detail in our previous update note). The merger did not involve any additional DBAG funding. We note that no major further investments were agreed in Q321 (except for the re-investments in minority stakes in blikk and Telio). However, DBAG's management underlines the continued solid number of new investment opportunities the company is pursuing (see Exhibit 4). We acknowledge that PE deals require a certain amount of time to be completed and the timing of deal closure may at times be difficult to predict.

Exhibit 4: DBAG's available investment opportunities by quarter



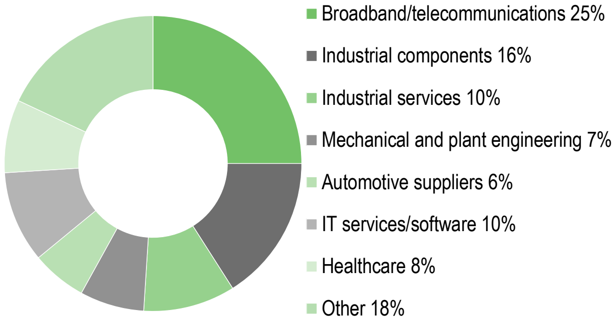
Source: DBAG

DBAG continues to have ample dry powder for new investments, which stood at €205.5m at end-June 2021 (covering c 75% of its co-investment commitments alongside DBAG funds), according to the management. This includes €159.3m of financial resources (26% of DBAG's NAV) and the €46.2m undrawn part of the credit facility. DBAG also has €7.9m of cash held at the level of its investment entity subsidiaries. On top of this, the company will receive the proceeds from the sale of blikk and Telio (net of the reinvestment amount, which has not been confirmed yet) and a €24.8m deferred advisory fee to DBAG Fund VII accrued until end-June 2021 (DBAG communicated earlier that its intention is to collect the fee from the proceeds of the first exit of the fund, which will be blikk). DBAG plans to repay the drawn part of its credit facility (€60.5m) upon receipt of these proceeds.

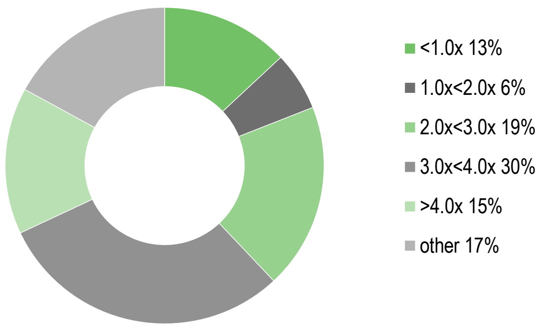
As at end-June 2021, DBAG's portfolio is valued at €541.6m and consists of 32 companies. The exposure to German industrials is gradually decreasing, yet it still accounts for 39% of portfolio value (-7pp y-o-y). DBAG's new investment activity is focused on new 'growth sectors' – broadband/telecommunications, IT and healthcare – which already comprise 43% of the portfolio (+5pp y-o-y, supported by their performance).

Exhibit 5: DBAG's portfolio split at end-June 2021

By sector



By net debt to EBITDA*



Source: DBAG. Note: *The 'other' category consists of companies agreed to be sold.

Valuation: Premium below historical 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 €2.6bn (end-June 2021) and generates considerable fees. We believe the fact that DBAG's shares regularly trade at a premium to NAV is due to the market-implied value of the fund services segment (Exhibit 7). DBAG shares currently trade at a 10.8% premium, significantly below the five-year average of 18.6%.

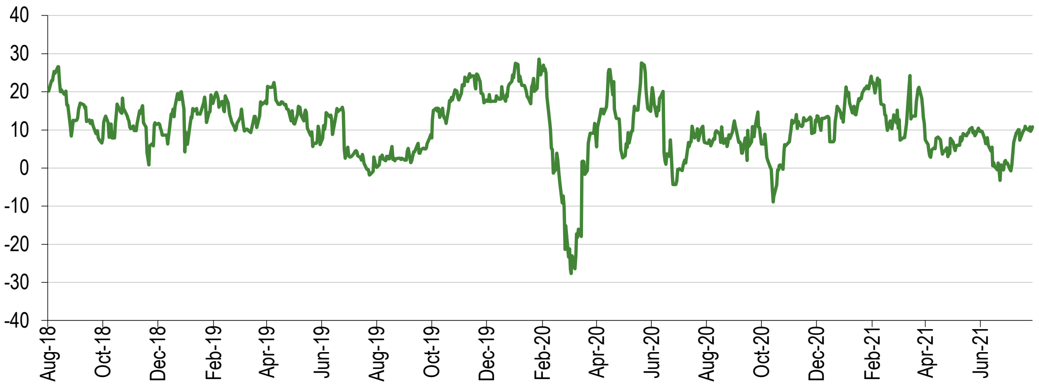
Assuming that the market assigns no discount to the reported carrying value of DBAG's PE investments (in line with LPX Europe index, which now trades broadly at par with NAV), the current market-implied premium translates into €69.4m of value attributed to the fund services segment, which in turn translates into a 6.6x earnings multiple of the segment. On the other hand, DBAG's direct peers (see Exhibit 9) excluding 3i and Eurazeo (which similarly to DBAG manage third-party assets) trade at a median discount of c 12.3%, which would imply a value for DBAG's fund services business of €148.6m and an earnings multiple of 9.0x.

Exhibit 6: 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	0.0%	(12.3%)
Implied value of private equity investments segment (€m)	643.3	564.2
Implied value of fund services segment (€m)	69.4	148.6
Implied FY21e earnings multiple of fund services segment**	6.6	9.0

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

Exhibit 7: Share price premium (discount) to NAV over three years (%)*



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

We have decided to compare the above implied value of DBAG's fund services business with listed asset managers with exposure to alternative unlisted assets, such as real assets, PE or infrastructure. We have selected companies that focus predominantly on closed-end (or similar) structures as we believe that one of the differentiating factors in the asset management industry is the ease of capital outflow potentially decreasing prospective fee income. Having said that, companies listed in Exhibit 8 fulfil this requirement to varying degrees, with the highest share of AUM managed through open-end funds of 46% (Cohen & Steers). We also underline that the group includes some players with significantly higher AUM than DBAG (eg Blackstone or Partners Group). Moreover, some of the managers invest their own capital, with the highest share reported by Intermediate Capital (c 13% of AUM).

Keeping the above in mind, we estimate that based on the 9.0x earnings multiple, the fund services segment is valued at a 69% discount to the average FY21e P/E multiple of the above-mentioned listed alternative asset managers of c 29.1x (based on Refinitiv consensus, see Exhibit 8). This suggests that DBAG's current market valuation may be relatively undemanding.

Here, it is worth keeping in mind that DBAG's mid-term ambition to FY23 assumes a lower income from fund services of €10–11m (which at the mid-point implies an earnings multiple at 14.1x and a still wide c 51% discount to the average FY21e P/E multiple of the peer group). However, we understand that it does not account for any new MBO fund, while DBAG has historically launched a new fund every three to four years (the most recent was launched last year). At the same time, the management ambitions factors in the decline in fee income from earlier funds (most notably DBAG Fund VI and DBAG Fund VII).

Exhibit 8: Asset management companies peer group at 16 August 2021*

Company	Market capitalisation (US$m)	Assets under management	FY21 P/E (x)	AUM split
DBAG	835	€3bn	N/A	Private equity and debt (100%)
Blackstone	138,000	US$649bn	30.5	Private equity (32%), real estate (30%), credit & insurance (25%), hedge fund solutions (13%)
EQT	49,965	€71bn	33.6	Real assets (52%), private capital (48%)
Partners Group	46,794	US$109bn	39.0	Private equity (50%), private debt (22%), private real estate (14%), private infrastructure (14%)
Intermediate Capital	8,856	€45bn	19.0	Corporate investments (52%), capital market investments (29%), real assets investments (10%), secondary investments (9%)
Tikehau Capital	5,351	€31bn	28.3	Real assets (35%), private debt (32%), capital markets strategies (15%), private equity (13%), direct investments (5%)
Cohen & Steers	4,254	US$96bn	23.9	Open-end funds (46%), institutional accounts (42%), closed-end funds (13%)

Source: Companies data, Refinitiv. Note: *AUM value and split as at latest available data.

Peer group comparison

In Exhibit 9 we present DBAG's peers focused on PE investments. We underline that only 3i combines both DBAG's business models of managing its own portfolio and external capital, which explains its prevailing premium to NAV. DBAG's NAV return falls behind the peer group average across one to 10 years, which stems from lower returns directly before the COVID-19 outbreak (affected by the slowdown in the German manufacturing sector), as well as a slightly below average return in the last year. The peers trade at discounts of 7–21% to their NAV, except for 3i, GIMV and HgCapital Trust (the latter has a tech-heavy portfolio that is likely more appealing to investors). DBAG's dividend yield falls slightly behind the average, but we need to note that only DBAG, Eurazeo and GIMV pay their dividend once a year and their last 12 months' yield is still fully affected by the lower pay-out associated with the COVID-19 uncertainty.

Exhibit 9: Listed private equity investment companies peer group at 10 August 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**	**604**	**20.8**	**29.2**	**92.9**	**173.6**	**16.4**	**13.9**	**67.4**	**170.3**	**10.8**	**2.1**
3i	Global	13,006	26.6	55.9	148.0	362.5	45.5	45.2	154.4	510.0	28.3	2.9
Eurazeo	Global	5,965	34.4	32.3	83.4	131.0	55.6	19.9	76.3	155.0	(10.8)	1.7
GIMV	Global	1,250	8.0	4.4	39.6	62.9	(0.3)	15.7	38.8	101.8	12.9	4.5
HgCapital Trust Ord	UK	1,734	43.3	88.0	162.5	286.1	53.2	95.9	235.6	305.1	17.5	1.3
ICG Enterprise Trust	UK	793	29.8	53.1	108.7	199.9	44.5	31.4	114.5	231.7	(17.4)	2.3
Oakley Capital Investments	Europe	627	25.6	77.0	117.4	159.7	71.7	109.7	224.1	172.2	(21.1)	1.3
Princess Private Equity	Global	793	19.8	43.8	92.6	161.7	37.3	45.3	138.5	249.5	(7.2)	4.7
Standard Life Private Equity	Europe	696	23.0	48.2	98.5	194.3	69.0	60.6	149.0	284.4	(20.0)	3.0
Average		**3,108**	**26.3**	**50.3**	**106.3**	**194.8**	**47.1**	**53.0**	**141.4**	**251.2**	**(2.2)**	**2.7**
Rank		**9**	**7**	**8**	**6**	**5**	**8**	**9**	**8**	**7**	**4**	**6**

Source: Morningstar, Edison Investment Research. Note: *12-month NAV performance in sterling terms based on end-June 2021 ex-par NAV, or latest earlier available ex-par NAV (end-April for ICG Enterprise Trust and end-March for HgCapital Trust and GIMV).

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