EDISON

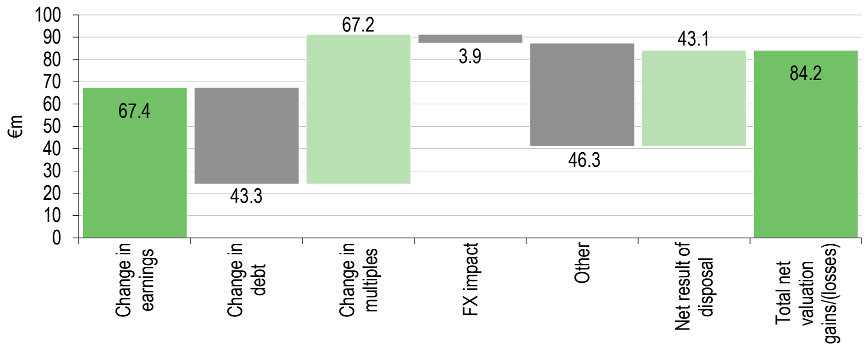
Deutsche Beteiligungs

Solid liquidity for new investments

Investment companies
Private equity

Deutsche Beteiligungs (DBAG) posted a healthy 14% NAV total return in H123 (ending March 2023) due to expanding public peer multiples, the first-time recognition of 2023 budgeted results (in Q123) and value-accretive add-on acquisitions. Proceeds from recent realisations have provided DBAG with sizeable capital to pursue new investments (management remains committed to investing €96m pa on average in 2023–25), though global M&A markets remain relatively muted, limiting DBAG's investment activity. DBAG's shares now trade at a 14% discount to NAV, whereas they traded at an average 18% premium in 2017–21 (despite its NAV not reflecting its fund services business).

DBAG's portfolio valuations rise as earnings outlook and multiples improve



Source: DBAG

Why consider Deutsche Beteiligungs now?

DBAG is a well-established investor and asset manager in the German private equity (PE) mid-market and a go-to partner for private company owners, especially families and founders. It has been increasing its exposure to new 'growth' sectors including IT services and software (18% of end-March 2023 portfolio value), broadband/telecom businesses (17%) and healthcare (11%). At the same time, DBAG's industrial portfolio (currently valued at 1.1x acquisition cost on average) may appeal to investors seeking exposure to cyclical value companies in anticipation of a potential rebound in the German economy on the back of an abating energy crisis, adjusting supply chains and a recovery in foreign demand.

The analyst's view

DBAG recently collected significant proceeds from the full disposals of Cloudflight, Pmflex and Heytex and the partial exit from GMM Pfaudler (it was yet to receive the consideration for the sale of BTV Multimedia at end-March 2023). This allowed DBAG to pay down most of its drawn credit facility and retain a sizeable level of financial resources (€55.9m), which together with the available credit line covered 73% of its outstanding commitments at end-March 2023. It is therefore well-positioned to continue its investment activity. That said, while it saw a sequential pick-up in reviewed investment opportunities, they tend to be smaller on average (at the lower end of its targeted €50–250m range in terms of enterprise values), which is likely due to more limited debt availability for M&A deals.

25 May 2023

Price		**€29.65**
Market cap		**€558m**
NAV*		**€646m**
NAV per share*		€34.38
Discount to NAV		13.8%

*As at end-March 2023.

Yield		2.7%
Shares in issue		18.8m
Code/ISIN		DBAN/DE000A1TNUT7
Primary exchange		Frankfurt
52-week high/low	€37.60	€20.85
NAV high/low	€33.59	€30.81

Gearing

Net gearing at 31 March 2023	0.0%

Fund objective

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 countries via management buyout transactions and growth capital financings. There is a focus on growth-driven profitable businesses valued between €50m and €250m. It also manages c €2bn of third-party capital, which generates stable recurring fee income.

Bull points

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

Bear points

- Significant exposure to German industrials, which have been facing macroeconomic headwinds.
- Public markets downturn, macro uncertainty and higher interest rates translating into lower private equity deal volumes.
- Higher average leverage of portfolio companies versus pre-COVID-19 levels.

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A solid 14% NAV total return in H123

DBAG's positive NAV momentum continued in Q223 (ended March 2023), resulting in an NAV total return (TR) of 14% in euro terms in H123 (c 5% over the 12 months to end-March 2023) and a net profit of €82.6m in H123 (vs a loss of €35.8m in H122). This was mainly driven by expanding valuation multiples across the portfolio (€67.2m positive effect in H123) on the back of higher public peer multiples across almost all sectors (the mDAX and DAX were up c 24% and 29% between end-September 2022 and end-March 2023, respectively) and recognition of agreed disposal prices (BTV Multimedia in particular).

Furthermore, the operating performances of DBAG's portfolio companies added €24.1m to portfolio valuations, with nearly all portfolio companies contributing positively in H123, with only two exhibiting visible negative contribution. The operating performance impact includes €67.4m from the first-time introduction of 2023 budgeted figures in the Q123 valuations (the total earnings impact during this quarter was €23.9m) and add-on acquisitions (see below for details). This was partly offset by the €43.3m impact of increasing net debt (primarily due to financing of add-on acquisitions). At end-March 2023, 64% of DBAG's portfolio companies (by value) had a net debt to EBITDA ratio of at least 4.0x (and 72% had a ratio at or above 3.0x), compared to 53% (73%) at end-2022.

We note that the valuation impact from operating performance already captures a recent slowdown in new orders across DBAG's industrial portfolio (factory orders in the Germany economy reduced significantly by 10.7% m-o-m in March 2023). Industrial and industrial technology companies made up 32% of DBAG's portfolio value at end-March 2023, with a further 12% in industrial services companies. Overall, DBAG's portfolio holdings from industrial sectors were held at 1.1x cost at end-March 2023 (vs 1.0x at end-2022).

DBAG's fund services segment (which had assets under management of €2.6bn at end-March 2023) continues to deliver a steady income stream, with H123 income of €22.6m (up c 3% y-o-y). This together with the c 5% y-o-y decline in the segment's net expenses (last year's figure included higher consultancy expenses and a €2m one-off expense related to the departure of a board member) translated into a segment profit of €7.2m (up 25% y-o-y), on track to meet the FY23 guidance of €13–15m (vs €15.4m reported in FY22).

Exhibit 1: Income statement by segment (€m)

	H123	H122	y-o-y
Net income from investment activity	81.3	(35.8)	N/A
Other income/expenses	(5.6)	(5.8)	-2.9%
PE investments pre-tax profit	**75.7**	**(41.5)**	**N/A**
Fund services income	22.6	21.9	3.1%
Other income/expenses	(15.3)	(16.1)	-4.9%
Fund services profit pre-tax	**7.2**	**5.8**	**25.4%**
Consolidated net profit	**82.6**	**(35.8)**	**N/A**

Source: DBAG

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

	H123	H122
Changes in fair value of unlisted investments	41.2	(60.5)
Change in earnings	*67.4*	*22.8*
Change in debt	*(43.3)*	*10.7*
Change in multiples	*67.2*	*(95.9)*
Change in exchange rates	*(3.9)*	*3.3*
Other	*(46.3)*	*(1.4)*
Net result of disposal	43.1	13.9
Total	**84.3**	**(46.6)**

Source: DBAG

The positive portfolio developments encouraged DBAG's management to raise its FY23 guidance for net income to €85–115m (vs €70–80m previously) and for NAV to €610–715m (vs €605–675m previously). We note that DBAG's full-year guidance always assumes public market multiples in line with the levels as at the last reporting date.

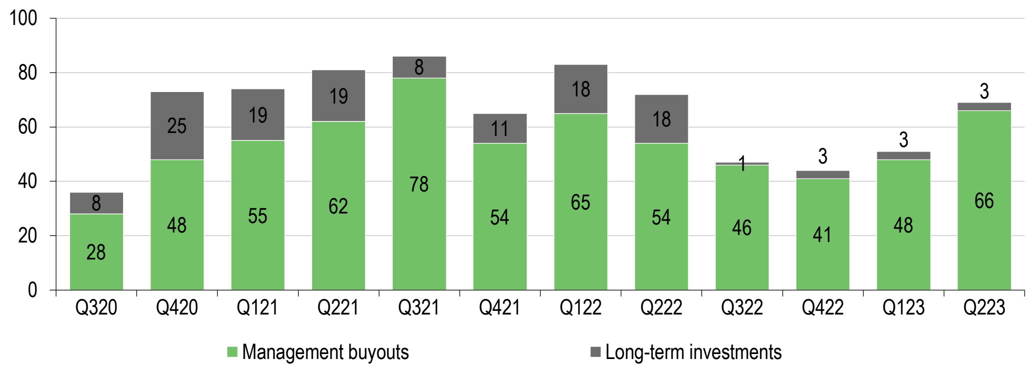
Ample firepower for new investments

DBAG's recent exits provide the company with a comfortable financing position to pursue further investments (its medium-term targeted investment volume remains €96m pa over 2023–25). DBAG reported a net cash inflow from its investment activity of €73.4m in H123 on the back of proceeds from recent full disposals of Cloudflight, Pmflex and Heytex and a partial exit from GMM Pfaudler (see our previous note, Robust exit activity in Q123, for details). DBAG also reported the disposal of Frimo (which was a global provider of tooling and plants for the production of high-performance plastic components primarily for car interiors, acquired in 2016) following the company's insolvency (which was already reflected in DBAG's NAV prior to H123).

The exit proceeds allowed DBAG to pay down most of the drawn part of its €106.7m credit facility (of which €10m remained drawn at end-March 2023) and translated into €55.9m of financial resources. Together with the undrawn credit facility, this results in €152.6m of available liquidity, covering 73% of its outstanding co-investment commitments alongside its funds. The commitments should be drawn over a few years, as the investment period of DBAG Fund VIII (the only fund still in its investment phase) ends in December 2026. Importantly, DBAG's available liquidity does not include the proceeds from the BTV Multimedia sales, which are yet to be collected.

DBAG's new investment activity in H123 was limited to add-on acquisitions, with five deals completed and three agreed in the period. These included two add-ons each to akquinet and netzkontor, as well as add-ons to Karl Eugen Fischer, in-tech, MTWH and operasan (only operasan involved an equity contribution from DBAG, of €1m). While DBAG saw a sequential pick-up in investment opportunities in Q223 to 69, versus 51 in Q123 and 44 in Q422 (see Exhibit 3), management noted that the enterprise values for these potential deals was closer to the lower end of DBAG's target range (€50m to €250m). Debt funding availability likely played a role here, as both banks and private debt funds remain selective in their deal selection and may be reluctant to enter into larger transactions.

Exhibit 3: DBAG's investment opportunities by quarter



Source: DBAG

Valuation: Still traded at a significant discount to NAV

DBAG's NAV reflects its PE investment portfolio. Having said that, DBAG manages fee-generating third-party assets of close to €2.0bn (assets under management including DBAG's investment portfolio at end March 2023 was €2.6bn). Historically, DBAG's shares have traded at a premium to NAV (the five-year average to end-2021 equals 18%), which we believe reflects the market-implied value of the fund services segment (Exhibit 4). However, with the softening valuations in the listed PE space amid macroeconomic headwinds, it currently trades at a c 14% discount to NAV. This compares to a 20–40% discount for most peers despite NAV underperformance (3i, which also manages third-party assets and generates fee income, trades at a c 9% premium to NAV currently).

Exhibit 4: Share price premium/(discount) to NAV over five years (%)

Source: Refinitiv, Edison Investment Research

We estimate the market-implied value of both DBAG segments for 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 to DBAG's fund services segment, we use a group[1] 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). In the case of PE investments, we use the peer group shown in Exhibit 6 excluding 3i.

Exhibit 5: Analysis of DBAG's market value by segment

Fund services in line with peers	
Earnings multiple applied to fund services segment's valuation	17.6x
Implied value of fund services segment*	€246.1m
Implied value of private equity investments segment	€311.0m
Implied discount of private equity investments value to DBAG's end-March NAV	52%
Private equity investments in line with peers	
Discount applied to private equity investments value to DBAG's end-March NAV	28.5%
Implied value of private equity investments segment	€462.0m
Implied value of fund services segment	€95.5m
Implied FY23e earnings multiple of fund services segment*	6.8x

Source: DBAG, Edison Investment Research. Note: *Based on the midpoint of management guidance.

Given the higher visibility in terms of income generation in the asset management business, valuation multiples in the sector were less volatile in recent months than the market valuations of listed PE investment companies. Assuming the fund services segment is valued in line with peers (ie at a 17.6x FY23e earnings multiple), the implied value of DBAG's PE investments is €311m (ie 52% below its end-March 2023 NAV), while DBAG's peers currently trade at an average c 29% discount (excluding 3i, see Exhibit 6.

[1] Blackstone, EQT, Partners Group, Intermediate Capital, Tikehau Capital and Cohen & Steers.

The wider discount may be at least partially justified by DBAG's high exposure to the German industrials sector (see above), which has been experiencing market headwinds for a prolonged period, even before the pandemic. We believe this is an important factor behind DBAG's NAV underperformance versus peers.

While the macroeconomic outlook remains uncertain, it improved somewhat for Germany compared to late 2022, as the risk of a gas shortage has diminished, energy prices have softened and policy support for households and companies has been implemented. Moreover, supply chain bottlenecks have started to ease as China's economy reopened. The IMF forecasts only a mild recession in Germany in its latest World Economic Outlook from April 2023 (a 0.1% real GDP decline in 2023), though with a still elevated inflation rate of 6.2% in 2023. In a joint publication in April 2023, major German economic research institutes forecasted GDP growth of 0.3% in Germany for 2023 (vs a 0.4% contraction in the winter half-year 2022/23 publication), with inflation running at 6.0%, dampening private consumption. The European Commission (EC) expects Germany's GDP to increase 0.2% this year, highlighting that its industry has proven resilient to elevated production costs and equipment investment is set to recover as full order books support manufacturing and exports. That said, we acknowledge the weak March factory orders in Germany as discussed above, suggesting that the road ahead may not be entirely smooth.

Based on the latest payments for FY22, DBAG's dividend yield stands at 2.7%. DBAG decided to recommend a lower DPS to be paid from FY22 profits to secure liquidity in the current environment. That said, it intends to return to a €1.6 DPS in the medium term (2023–25).

Exhibit 6: Listed PE investment companies peer group at 24 May 2023*

% 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	**484**	**9.0**	**56.8**	**46.8**	**194.5**	**0.0**	**22.7**	**(12.5)**	**133.2**	**(13.8)**	**2.7**
3i	18,478	36.6	141.5	193.4	752.1	26.7	137.5	136.5	679.5	8.8	2.7
GIMV	1,039	(0.2)	21.8	17.5	89.9	(12.2)	2.9	7.4	73.0	(8.7)	5.9
HgCapital Trust	1,749	10.4	108.9	174.1	386.4	(19.6)	63.0	114.8	287.4	(18.9)	1.8
ICG Enterprise Trust	792	14.4	73.9	117.4	264.9	(9.9)	64.1	43.4	156.2	(38.8)	2.6
Oakley Capital Investments	820	17.8	99.9	190.1	304.0	8.9	147.2	192.2	232.0	(30.4)	1.0
Princess Private Equity	582	3.7	52.7	66.8	195.9	(17.0)	17.1	17.9	146.3	(34.6)	3.8
abrdn Private Equity Opps	683	7.8	87.8	118.8	290.5	(18.0)	79.5	52.2	206.7	(39.8)	3.3
Median	**3,449**	**12.9**	**83.8**	**125.4**	**326.2**	**(5.9)**	**73.0**	**80.6**	**254.4**	**(23.2)**	**3.0**
Rank	8	5	6	7	7	3	6	8	7	3	4

Source: Morningstar, Edison Investment Research. Note: *12-month NAV performance in sterling terms based on end-March 2023 ex-par NAV, or latest earlier available ex-par NAV (end January 2023 for ICG Enterprise Trust). **The 10-year period for DBAG, is calculated starting from end-April 2013 as end-March 2013 NAV is not available; for Oakley Capital Investments, the 3-year, 5-year and 10-year NAV TR calculations are based on end-December 2020, end-December 2018 and end-December 2013 values, respectively.

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