EDISON

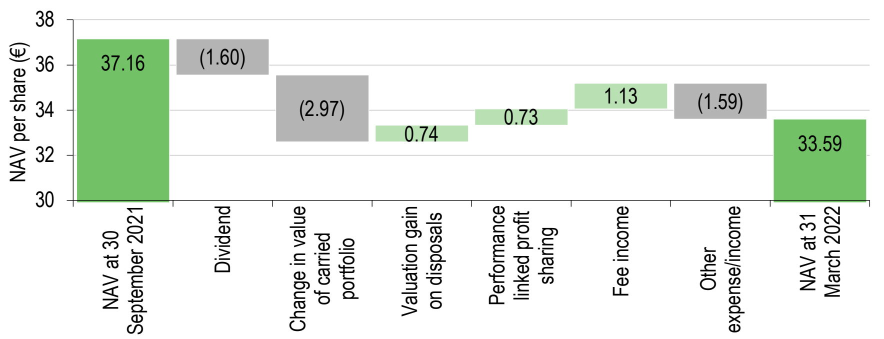
Deutsche Beteiligungs

Valuations hit by macro headwinds

Investment company
Private equity

Deutsche Beteiligungs (DBAG) reported a 5.3% NAV decrease to €631.6m (defined as equity value) in H122 in total return terms. The main driver of the decrease was the revaluation of the held portfolio, which reduced NAV by 8pp, on the back of contracting market valuation multiples (amid the recent public market sell-off) and higher discount rates to reflect the risk of several companies not achieving their respective FY22 budgets. Meanwhile, DBAG continues its capital deployment agenda and invested a significant €92m in H122 versus its €114m annual investment target and has sufficient resources to continue to do so.

DBAG's NAV* development in H122 ending March 2022



Source: DBAG, Edison Investment Research. Note: *Defined as equity value per share.

Why consider Deutsche Beteiligungs now?

DBAG is a well-established player in the German private equity (PE) mid-market segment. It manages a balanced portfolio covering industrials (44% of the portfolio at end-March 2022), being its 'core' expertise, and 'growth' sectors of IT, telecom and healthcare (45%), with other investments making up 11% of the portfolio. DBAG shares are currently trading at an 15% discount to NAV (compared to a five-year average premium of 19%). This is despite the NAV not reflecting the value of its fund services segment, which generates considerable recurring income (FY22 guidance of €14–16m profit). Additionally, the current share price implies a healthy 5.6% dividend yield and management has confirmed its dividend policy of at least flat DPS of €1.60/share paid annually.

The analyst's view

DBAG's industrial portfolio has been experiencing market headwinds for a prolonged time, which started even before the pandemic and have now been exacerbated by the war in Ukraine and China's zero-COVID policy, leading to higher energy and raw material prices, as well as further supply chain issues. However, the company has been increasing its exposure to 'growth' sectors over the last five years. In particular, these include broadband/telecom businesses (24% of the portfolio), which are a play on the secular trend of network roll-out in Germany, and more recently IT services and software companies which will make up 19% of the portfolio after closing of the recent transactions (from 15% at end-March 2022 and compared to 5% at March 2020).

NOT INTENDED FOR PERSONS IN THE EEA

26 May 2022

Price	**€28.70**
Market cap	**€540m**
NAV*	**€632m**
NAV per share*	€33.59
Discount to NAV*	14.6%

*As at end-March 2022. Defined as equity

Yield		5.6%
Shares in issue		18.8m
Code		DBAN
Primary exchange		Frankfurt
AIC sector		Flexible Investment
52-week high/low	€40.50	€27.30
NAV high/low	€37.16	€32.23

Gearing

Net cash at end-Q222	10.1%

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.

Analysts

Milosz Papst	+44 (0)20 3077 5700
Michal Mordel	+44 (0)20 3077 5700

investmenttrusts@edisongroup.com

Edison profile page

Deutsche Beteiligungs is a research client of Edison Investment Research Limited

H121 results: Reflecting the deteriorating environment

DBAG reported a €35.8m net loss in H122 ending March 2022 (H121: €73.1m net profit), due to a downward revision of its portfolio value amid deteriorating macroeconomic conditions and declining public market valuations. Meanwhile, the fund services segment continues to generate stable income, broadly in line with management expectations.

Exhibit 1: Income statement by segment (€m)

	H122	H121	Year-on-year change
Net income from investment activity	(35.8)	70.7	N/A
Other income/expenses	(5.8)	(5.9)	(3%)
Private equity investments profit	**(41.5)**	**64.7**	**N/A**
Fund services income	21.9	21.8	0%
Other income/expenses	(16.1)	(12.7)	27%
Fund services profit	**5.8**	**9.1**	**(37%)**
Consolidated net profit	**(35.8)**	**73.1**	**N/A**

Source: DBAG

Portfolio revalued after the recent equity market sell-off to end-March 2022

The private equity investments segment generated a €41.5m loss (H121: €64.7m profit), which stemmed from a €61m decline in portfolio valuations (down 11% vs end-September 2021) with segment costs remaining broadly flat, while gains on disposals amounted to €13.9m in H122.

The impact of change in multiples amounted to a negative €96m (reducing portfolio value by 17% vs end-September 2021) amid deteriorating global equity markets (see Exhibit 2). This particularly weighed on the valuations of DBAG's IT services and software holdings (which make up a third of DBAG's growth portfolio) as US-based tech indices[1] declined on average by 10% in the first three months of 2022. Consequently, DBAG's growth portfolio is currently valued at 2.0x cost vs 2.6x at end-December 2021. We note that 16% of the portfolio represents companies acquired less than 12 months before the reporting date and is valued at acquisition cost, including both industrial (Dantherm, Itelyum) and tech companies (in-tech, freiheit.com). Additionally, DBAG's portfolio valuations do not reflect further price declines in the public equity markets seen post end-March 2022.

DBAG's core portfolio of industrial companies (largely based in Germany) was affected by input cost inflation (including growth in energy prices) and supply chain bottlenecks triggered by the Russian invasion of Ukraine, Western sanctions on Russia and lockdowns in China as part of zero-COVID policy. As a result, the German government's council of economic advisers currently expects real GDP growth in Germany of 1.8% (vs 4.6% forecast earlier) and sees a risk of recession if supply chains and energy security continue to deteriorate. This was reflected in German equity valuations, with the DAX Index decreasing by 9% (and its industrial sub-index falling by 11%) in the first three months of 2022. DBAG's industrial portfolio is currently valued at 0.9x acquisition cost (unchanged versus end-December 2021).

The changes in earnings of the portfolio companies increased the valuation of the portfolio by €23m, mostly due to positive effects from add-on acquisitions closed during the period. On completion of an add-on acquisition, its budgeted results for the current year are added to the acquiring (platform) company's budget. As these bolt-on acquisitions are often carried out at a lower

[1] Calculation based on: Technology Select Sector Index, MSCI USA IMI Information Technology 25/50 Index, S&P 500 Equal Weight/Information Technology, S&P Global 1200/Information Technology, S&P Software & Services Select Industry Index, S&P North American Technology Software Index.

valuation multiple than the ratio at which the platform company is valued by DBAG (which is also applied to all completed add-ons), these transactions are normally value-accretive immediately. According to management, such uplifts had a meaningful positive effect on DBAG's NAV in H122.

The above effect offset the negative earnings contributions from higher-risk discounts applied to 11 of DBAG's portfolio companies which are unlikely to reach their budgeted results amid the above-mentioned macro headwinds.

Finally, DBAG posted an €11m valuation uplift from a change in debt as 12 companies raised €49m in debt (mostly to finance their M&A growth), while 12 other companies used their surpluses to repay €60m of debt.

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

	H122	H121
Changes in fair value of unlisted investments	(60.7)	79.9
Change in earnings	*22.8*	*103.6*
Change in debt	*10.7*	*(45.1)*
Change in multiples	*(95.9)*	*7.9*
Change in exchange rates	*3.3*	*(0.7)*
Change, other	*(1.7)*	*14.3*
Net result of disposal	13.9	4.2
Other	0.2	0.2
Total	**(46.6)**	**84.3**

Source: DBAG

Profit from fund services down in Q122 amid higher expenses

The fund services segment recorded a minor increase in fees earned (€21.9m in H122 versus €21.8m in H121), which is in line with management expectations. DBAG funds charge fees predominantly on committed capital, and new investments have only a minor impact on the fee calculation basis. The expenses of the segment increased 27% y-o-y to €16.1m, which in turn led to a 37% decrease in the segment's profit (€5.8m). This was driven by DBAG's recent team expansion, higher consultancy expenses and a c €2m one-off expense on benefits paid in relation to terminating the employment of former CFO Susanne Zeidler, which was split between DBAG's private equity investments and fund services segments on a pro-rata basis. According to DBAG's announcement in January 2022, during discussions regarding the long-term strategic direction of DBAG's business model, the supervisory board and Ms Zeidler agreed that she would resign from her position.

Sufficient resources to keep up investment pace

DBAG's financial resources decreased during H122 to €64m (from €112.8m at end-September 2021) and, including the €107m undrawn credit line, DBAG had €171m available for investment (FY21: €220m). The liquidity position in relation to unfunded commitments improved during the period, as commitments decreased by €83m following capital calls for new investments. As a result, the 'funding gap' (difference between commitments and available liquidity) narrowed to €20m from €54m. In addition, a further €7.7m cash is available at subsidiary level.

Revision of management guidance

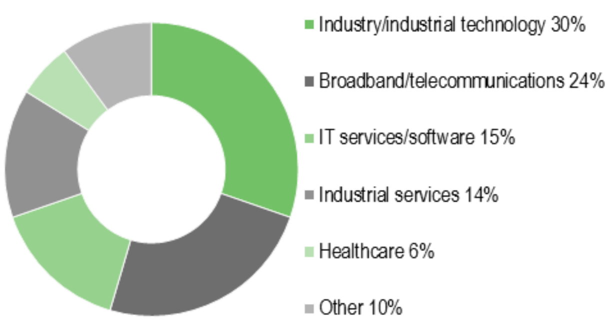
DBAG has announced its updated guidance, which takes into account portfolio and macroeconomic developments in H122, as well as planned disposals. DBAG now expects a net loss of €15–25m in FY22, which (given the €33.5m loss in H122) implies an H222 net profit of €8.5–18.5m. The fund services segment is expected to generate an FY22 profit of €14–16m (up from €11–12m previously), implying €8–10m in the second half of the year. This is a 40–75% increase over H122 in the absence of one-off expenses and significantly lower variable performance-linked remuneration costs expected by DBAG. The above translates into net income in the private equity investments segment of €0–8m in H222, meaning that DBAG's valuation uplifts and other gains/income should at least cover the segment's ongoing costs. We highlight the fact that DBAG normally designs its guidance based on stable valuation multiples compared to the last reporting date (end-March 2022 in this case), hence it does not capture the subsequent continued sell-off in public markets.

Current portfolio positioning

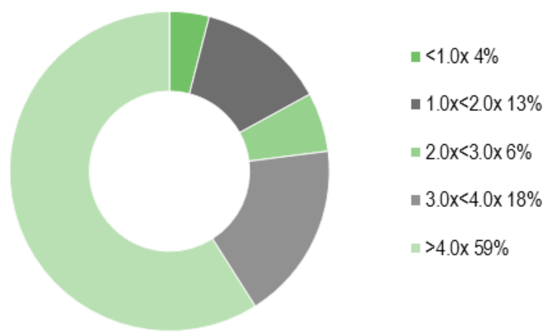
At end-March 2022, DBAG's portfolio consisted of 36 platform companies, which mostly follow a buy-and-build strategy. The portfolio is split between 'growth sectors' (broadband telecoms, healthcare and IT; 45% of the portfolio) and 'core sectors' (industrial services, industrials and industrial technology; 44%) with the remaining 10% exposure labelled as 'other'. The sector split remained broadly stable over the last year, despite new investments and disposals, as well as carrying value fluctuations over the period. The platform companies often use external debt to finance acquisitions (15 add-ons in H122 and 17 in FY21), and overall the portfolio is quite leveraged, with 60% of portfolio value allocated to companies with a net debt to EBITDA ratio of more than 4.0x. However, we note that part of the high average leverage is attributable to companies from 'growth' sectors, which have more predictable earnings and can thus take on more debt. During H122, the share of the portfolio with leverage of 3.0x EBITDA or more increased to 77% from 63%, which was predominantly a result of new debt incurred to finance add-on acquisitions. Nevertheless, the change was amplified by reduced earnings expectations in some portfolio companies.

Exhibit 3: DBAG's portfolio split at end-March 2022

By sector



By net debt to EBITDA



Source: DBAG

Record-high investment volume

In the first half of FY22, DBAG was quite active as it invested €92m alongside its managed funds and from its own balance sheet. This represents more than twice the amount invested a year earlier (€37.5m) and compares to €57m invested on average annually over the last 10 years. DBAG funds have completed four new investments: freiheit.com, Dantherm, in-tech and Itelyum (described in our last note) with DBAG providing €82m in total. Additionally, its portfolio companies announced a further 18 add-on acquisitions (15 of which completed in the period) – predominantly using their own resources and external debt, with DBAG providing €10m in total.

Furthermore, three investments have been agreed that are yet to be completed. In March 2022, DBAG Fund VII agreed a management buyout (MBO) of akquinet – a company in the IT services & software sector, which implements ERP systems and customises the development of software solutions. DBAG has agreed to invest up to €4.7m alongside its fund. DBAG Fund VII is now closing its investment period, with akquinet being its final MBO (although some further minor investments can be made to support the growth of portfolio companies). In H122, DBAG received the deferred management fee from DBAG Fund VII to the amount of €28m. DBAG will also invest alongside DBAG Fund VIII in MTW Holding. The transaction will mark the seventh MBO by DBAG Fund VIII (since the beginning of its investment phase in mid-2020) and DBAG's third investment in Italy. MTW Holding comprises three companies (Metalworks, Mengoni & Nassini and FGF) that design and manufacture accessories for luxury fashion brands (eg belt buckles, fastening systems, logos and jewellery). The fund will acquire a majority position (62%) and the former sponsor (Bravo Capital Partners) and company management will remain minority shareholders. DBAG will invest up to €13m in the transaction. The third transaction announced is a long-term investment in the newly established datahub**,** an acquisition made solely from DBAG's balance sheet. DBAG will invest up to €25m to acquire two data centres, which were formerly part of the akquinet group (to be acquired by DBAG Fund VII as above). On closure of the announced transactions, DBAG investments so far in FY22 will reach €135m, up 128% y-o-y and 76% more than the annual average over the last five years.

Two partial exits at 4% of opening portfolio

During H122, DBAG made two partial exits totalling €25.5m in last carrying value – 4% of the end-FY21 portfolio value. DBAG has sold part of its shares in Telio (communication systems for correctional facilities), as well as unlocked value in von Poll Immobilien (real estate agency), which completed refinancing.

Peer group comparison

DBAG clearly underperforms its peers over both the long and short term. We understand that its high exposure to industrials (compared to peers) has weighed on its performance both in the period leading to the outbreak of COVID-19, as well as in the current economic slowdown – as it experiences headwinds from demand changes, high materials costs and supply chain disruptions. Nevertheless, the underperformance is potentially overstated, as only three out of six peers presented in Exhibit 4 (HgCapital, Princess, 3i) have their portfolios valued as at end-March 2022, ie reflecting the recent deterioration in market conditions to the same degree as DBAG. The most recent performance figures available for ICG and Oakley are as at end-January 2022 and end-December 2021, respectively; and while abrdn Private Equity Opportunities already reported its end-March 2022 NAV, it is based predominantly on end-December 2021 portfolio valuations.

DBAG trades at a narrower discount compared to the group, which in our view is attributable to its fund services segment, which is not reflected in the NAV, while generating a recurring income. Among peers, 3i has a similar business model which is also reflected in its narrowest discount in the group. DBAG also pays one of the highest dividends among peers, with the current dividend yield at a healthy 5.6%.

Exhibit 4: Listed private equity investment companies peer group at 25 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**	**462.2**	**8.3**	**31.6**	**60.7**	**213.6**	**(16.6)**	**2.0**	**13.6**	**178**	**(14.6)**	**5.6**
3i	Global	12,029.3	44.5	82.1	168.2	615.9	24.1	56.3	120.5	848	(6.4)	3.3
HgCapital Trust Ord	UK	1,825.7	30.9	118.2	194.3	405.9	39.7	123.5	218.4	502	(8.0)	1.8
ICG Enterprise Trust	UK	772.9	24.2	69.0	113.8	256.8	15.3	46.6	90.8	278	(33.3)	2.5
Oakley Capital Investments	Europe	707.7	34.7	98.2	147.4	240.7	43.2	125.5	207.0	250	(30.4)	1.7
Princess Private Equity	Global	681.1	9.2	47.7	76.1	194.9	4.9	42.5	62.1	254	(24.6)	5.8
abrdn Private Equity Opps	Europe	707.2	38.2	87.7	130.4	283.7	22.4	64.7	105.7	380	(34.9)	3.0
Average		**2,787.3**	**30.3**	**83.8**	**138.4**	**333.0**	**24.9**	**76.5**	**134.1**	**419**	**(22.9)**	**3.0**
Rank		**7**	**7**	**7**	**7**	**6**	**7**	**7**	**7**	**7**	**3**	**2**

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).

Valuation: Trading at a discount to NAV

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 2022) and generates considerable fees. DBAG's shares regularly trade at a premium to NAV (five-year average of 19%), which we believe is due to the market-implied value of the fund services segment (Exhibit 5). Given the recent strong decrease in DBAG's share price (22% over the first three months of 2022) it currently trades at an unusual 15% discount to NAV, still narrower than peers despite NAV underperformance.

Exhibit 5: Share price premium (discount) to NAV over three years (%)*

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

We estimate the market-implied value of both DBAG segments in two scenarios: 1) the implied value of private equity investments, assuming fund services are valued in line with peers; and 2) the implied value of the fund services segment, assuming the private equity investments are valued in line with peers. As peers to DBAG's fund services segment, we use a group[2] of listed asset managers with exposure to alternative unlisted assets, such as real assets, PE or infrastructure (as described in detail in our August 2021 note). In the case of private equity investments, we use the peer group as presented in Exhibit 4 above, excluding 3i.

2 Blackstone, EQT, Partners Group, Intermediate Capital, Tikehau Capital and Cohen & Steers.

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

Fund services in line with peers	
Earnings multiple applied to fund services segment's valuation	17.4x
Implied value of fund services segment*	€304.5m
Implied value of private equity investments segment	€235.2m
Implied discount of private equity investments value to DBAG's NAV	63%
Private equity investments in line with peers	
Discount applied to private equity investments value to DBAG's NAV	26.2%
Implied value of private equity investments segment	€466.1m
Implied value of fund services segment	€73.6m
Implied FY21e earnings multiple of fund services segment*	4.9x

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

Given high visibility in terms of income generation in the asset management business, valuation multiples in the sector were less volatile in recent months compared to the greater uncertainty about the value of underlying companies in PE portfolios. Having said that, assuming the fund services segment is valued in line with peers (17.4x earnings multiple), the implied value of private equity investments is at €235m, ie 63% below its NAV, while peers trade at a 26% discount. On one hand, DBAG's wider discount may be justified by NAV underperformance and exposure to German industrials. On the other hand, a 63% discount seems relatively wide, especially given that DBAG's portfolio value is already reflecting developments in the first quarter of 2022, unlike some peers. Assuming that PE investments are valued in line with peers (which is less likely than the first scenario in our view), the value of the fund services segment is €74m, a 4.9x earnings multiple versus the 17.4x peer average.

General disclaimer and copyright

This report has been commissioned by Deutsche Beteiligungs and prepared and issued by Edison, in consideration of a fee payable by Deutsche Beteiligungs. Edison Investment Research standard fees are £60,000 pa for the production and broad dissemination of a detailed note (Outlook) following by regular (typically quarterly) update notes. Fees are paid upfront in cash without recourse. Edison may seek additional fees for the provision of roadshows and related IR services for the client but does not get remunerated for any investment banking services. We never take payment in stock, options or warrants for any of our services.

Accuracy of content: All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report and have not sought for this information to be independently verified. Opinions contained in this report represent those of the research department of Edison at the time of publication. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations.

Exclusion of Liability: To the fullest extent allowed by law, Edison shall not be liable for any direct, indirect or consequential losses, loss of profits, damages, costs or expenses incurred or suffered by you arising out or in connection with the access to, use of or reliance on any information contained on this note.

No personalised advice: The information that we provide should not be construed in any manner whatsoever as, personalised advice. Also, the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The securities described in the report may not be eligible for sale in all jurisdictions or to certain categories of investors.

Investment in securities mentioned: Edison has a restrictive policy relating to personal dealing and conflicts of interest. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report, subject to Edison's policies on personal dealing and conflicts of interest.

Australia

Edison Investment Research Pty Ltd (Edison AU) is the Australian subsidiary of Edison. Edison AU is a Corporate Authorised Representative (1252501) of Crown Wealth Group Pty Ltd who holds an Australian Financial Services Licence (Number: 494274). This research is issued in Australia by Edison AU and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. Any advice given by Edison AU is general advice only and does not take into account your personal circumstances, needs or objectives. You should, before acting on this advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Product Disclosure Statement or like instrument.

New Zealand

The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (i.e. without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision.

United Kingdom

This document is prepared and provided by Edison for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

This Communication is being distributed in the United Kingdom and is directed only at (i) persons having professional experience in matters relating to investments, i.e. investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "FPO") (ii) high net-worth companies, unincorporated associations or other bodies within the meaning of Article 49 of the FPO and (iii) persons to whom it is otherwise lawful to distribute it. The investment or investment activity to which this document relates is available only to such persons. It is not intended that this document be distributed or passed on, directly or indirectly, to any other class of persons and in any event and under no circumstances should persons of any other description rely on or act upon the contents of this document.

This Communication is being supplied to you solely for your information and may not be reproduced by, further distributed to or published in whole or in part by, any other person.

United States

Edison relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. This report is a bona fide publication of general and regular circulation offering impersonal investment-related advice, not tailored to a specific investment portfolio or the needs of current and/or prospective subscribers. As such, Edison does not offer or provide personal advice and the research provided is for informational purposes only. No mention of a particular security in this report constitutes a recommendation to buy, sell or hold that or any security, or that any particular security, portfolio of securities, transaction or investment strategy is suitable for any specific person.