Deutsche Beteiligungs

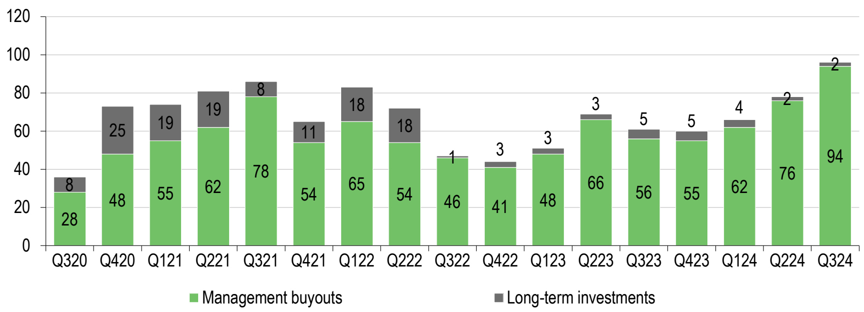
Doubling down on investment opportunities

Investment companies
Private equity

14 August 2024

Deutsche Beteiligungs (DBAG) reported a c 4% NAV total return in 9M24, supported primarily by higher valuation multiples on the back of more benign public markets and the successful realisation of in-tech. DBAG's management has recently experienced a significant increase in deal flow, which we attribute to the first signs of a recovery in global M&A activity, reduced competition (as evidenced by two of its competitors no longer pursuing new investments), as well as cross-deal flow from the recently acquired ELF Capital Group. This has encouraged the company to issue a €100m convertible bond to further boost its dry powder.

DBAG's number of opportunities increased considerably in recent quarters*



Source: DBAG. Note: *x-axis shows quarters of DBAG's financial year (to end-September).

Mid-market private equity remains attractive

While interest rate normalisation may somewhat dilute gross internal rates of return across the private equity (PE) sector, we note that the industry puts a greater emphasis on driving operational change (based on in-house value creation teams) and value-accretive, bolt-on M&A activity rather than pure financial engineering. In particular, the PE mid-market (which DBAG focuses on) offers several potential advantages: 1) many of the acquired companies have not been owned by PE before (92% of DBAG's buyouts in 2019–23 were from families and founders), potentially providing an opportunity for value creation; 2) portfolio exits are less dependent on the IPO market (DBAG rarely uses IPOs as an exit route and two-thirds of its exits are to trade buyers); and 3) deals are less reliant on funding via syndicated loans (which have been muted recently) and also often involve less leverage versus large/mega buyouts. PitchBook reported that even in the tough environment in 2023, European mid-market deal value was up 12.1% year-on-year.

An experienced player in the German PE mid-market

DBAG is a well-established investor and asset manager in the PE mid-market and a go-to partner for private company owners, especially families and founders, across Germany and neighbouring countries (eg Italy). Its industrial and industrial technology portfolio (which together with industrial services made up c 45% of the portfolio at end-June 2024) has been shifting away from more traditional industrial businesses in recent years. Moreover, DBAG has been tapping into a wider set of sectors more strongly for several years now, with significant exposure to so-called 'growth' areas, including IT services and software (29% of end-June 2024 portfolio value), broadband/telecom (6%) and healthcare (6%).

Price		**€24.90**
Market cap		**€468.2m**
NAV*		**€669.0m**
NAV per share*		€36.09
Discount to NAV		31.0%
*As at end-June 2024.		
Yield		4.0%
Shares in issue (excluding treasury shares)		18.4m
Code/ISIN		DBAN/DE000A1TNUT7
Primary exchange		Frankfurt
52-week high/low	€33.40	€23.10
NAV high/low	€36.09	€35.28

Gearing

Net gearing at end-June 2024*	1.7%

*Excludes convertible bonds.

Fund objective

Deutsche Beteiligungs is a German-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. It also manages c €2bn of third-party capital, which generates stable recurring fee income. Following the acquisition of a majority stake in ELF Capital, DBAG expanded its offer to include private debt.

Bull points

- Solid long-term track record, with average MBO and growth financings exit multiples of 2.7x and 2.9x, respectively, as at end-FY23.
- Emphasis on 'growth sectors', such as IT services and software, as well as on energy transition/sustainability themes.
- Recurring cash flow from fund services.

Bear points

- Significant exposure to cyclical sectors, which have been facing macroeconomic headwinds.
- Interest rate normalisation may reduce prospective private equity returns, put pressure on interest coverage ratios and/or lead to refinancing issues across private equity-backed companies in the medium term.
- Higher average leverage of portfolio companies versus pre-COVID-19 levels.

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9M24 performance supported by higher multiples

DBAG posted an NAV total return of 4.2% for the first nine months of FY24 (9M24; to end-June 2024), resulting in a broadly flat NAV over the last 12 months in total return euro terms. The 9M24 performance was primarily driven by the c €40m positive impact from higher valuation multiples applied to DBAG's PE investments (see Exhibit 1). Management highlighted that half of DBAG's portfolio companies' peer groups contributed positively. The impact of multiples also reflects two recent disposals, primarily the successful exit from in-tech completed during the period (see below). The positive contribution from changes in earnings stood at €27m in 9M24 and was assisted by most sectors (healthcare, industry and industrial technology in particular, eg Congatec), partly on the back of add-on acquisitions. However, this was offset by the €28m negative impact from higher debt across the portfolio companies, which was particularly driven by add-on acquisitions across DBAG's healthcare exposure, as operasan acquired three renal medical care centres in the period.

DBAG's fund investment services segment reported €36.2m of income and an EBITA of €11.7m, which represents a slight year-on-year increase (see Exhibit 2). The segment's pre-tax profit reached €9.0m in 9M24, down from €11.3m in 9M23 due to the impact of the amortisation of intangible assets in conjunction with the ELF Capital Group acquisition.

Management updated its FY24 NAV guidance, narrowing the previously indicated range of €675–790m to €675–710 (or €36.41–38.30 per share), which assumes stable public market valuations. At the same time, DBAG reiterated its mid-term expectations for FY26 of NAV of €840–980m and earnings before taxes of the fund investment services segment of €11–16m.

DBAG's portfolio at end-June 2024 consisted of 37 portfolio companies and one externally managed foreign buyout fund, with the top 15 investments making up 70% of its portfolio value.

Exhibit 1: DBAG's gross gains/(losses) on measurement and disposal portfolio by sources

€m	9M24	9M23
Changes in fair value of unlisted investments	36.6	56.4
Change in earnings	*27.3*	*74.8*
Change in debt	*(28.0)*	*(70.1)*
Change in multiples	*40.2*	*96.7*
Change in exchange rates	*(0.2)*	*(3.1)*
Other	*(2.7)*	*(42.0)*
Net result of disposal	7.5	63.3
Total	**44.1**	**119.7**

Source: DBAG

Exhibit 2: Income statement by segment (€m)

	9M24	9M23	y-o-y
Net income from investment activity	31.1	113.6	N/A
Other income/expenses	(13.1)	(9.8)	34.6%
PE investments pre-tax profit	**17.9**	**103.9**	**N/A**
Fund services income	36.2	35.2	3.0%
Other income/expenses	(27.2)	(23.9)	13.9%
Fund services pre-tax profit	**9.0**	**11.3**	**(19.9%)**
Consolidated net profit	**25.7**	**114.3**	**N/A**

Source: DBAG

DBAG's management sees a good deal pipeline ahead

DBAG's management highlighted that it has recently seen a significant pickup in buyout investment opportunities to 94 in April to June 2024 compared to 76 in the period January to March 2024 and 56 in the period April to June 2023 (see exhibit above). We understand that this is due to a combination of several factors. Firstly, deal activity across global M&A markets is slowly rebounding amid expectations of monetary easing. Secondly, DBAG's management indicated a more benign competitive environment amid ongoing consolidation in the German PE mid-market, as evidenced by two of its competitors no longer pursuing new investments. Finally, DBAG benefits from cross-deal flow from ELF Capital, a manager of credit funds in which DBAG recently acquired a majority stake (though we note that DBAG does not plan to tap into ELF Capital's debt funding for its PE transactions).

Existing funds have ample firepower for investments

The new buyout opportunities will be pursued primarily through DBAG's investments alongside DBAG-managed funds, which mostly seek acquisitions of a majority stake, including the flagship buyout funds focused on equity investments of €40–220m and Expansion Capital Funds (ECF) focused on small management buyouts with an initial equity ticket of €10–40m (and up to €60m with follow-on capital increases). DBAG's latest flagship buyout fund is DBAG Fund VIII; its investment period ends in December 2026 and DBAG Fund VIII currently has significant dry powder, especially following the recent disposal of in-tech. Management had indicated earlier that upon completion of this exit, the fund will be only c 30%+ invested, all else being equal (therefore, DBAG is in no rush to launch its successor, which is more likely in 2026). The company also manages the DBAG ECF IV fund; its investment period ends in December 2028. At end-September 2023 (last available data), DBAG had €106.9m and €38.1m outstanding commitments to DBAG Fund VIII and DBAG ECF IV, which will be drawn upon new investments by these funds.

Furthermore, DBAG's management underlined the good environment to pursue new private debt investments alongside ELF Capital Funds (to which it has already made €100m in commitments), and that DBAG made its first private debt investment through an ELF Capital Fund in the last reported quarter, which has an expected internal rate of return (IRR) in the mid-teen percentage range. Given the ample opportunities on the buyout and private debt side, DBAG is less likely to prioritise long-term balance sheet investments (which comprise mainly investments in family-owned businesses to support growth or change of ownership), as these have a longer holding period (usually more than seven years). Therefore, it expects one to two such deals per year.

Solid balance sheet after disposals and convertible debt issue

The particularly good window of opportunity for new investments encouraged DBAG to issue €100m worth of senior unsecured convertible bonds in July 2024 (see our flash note for details). DBAG's liquid resources at end-June 2024 stood at €121.8m and included €31.7m of financial resources and €90.2m of undrawn credit lines (out of the total €110.2m, maturing in June 2027). The in-tech and Solvares disposals, coupled with the above-mentioned convertible debt issue, will add a further €150m liquidity. All the above liquid resources cover most of DBAG's outstanding investment commitments at end-June 2024 of €299.6m. We also note that DBAG's balance sheet liabilities include a c €33.5m purchase price obligation related to the remaining 49% stake in ELF Capital Advisory, though the final price will be determined based on the performance of the acquiree.

New investment into UNITY

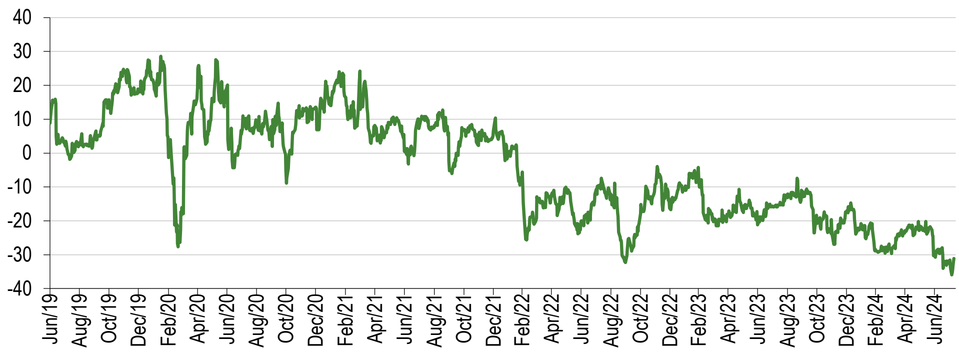
Between September 2023 and June 2024, DBAG closed two new investments: the buyout of ProMik (announced in October 2023) and the long-term investment in NOKERA (announced in July 2023 in conjunction with the R+S realisation), discussed in our previous note. In early August 2024, DBAG announced the acquisition of a controlling stake in UNITY, a management consultancy specialising in technology consulting and digital transformation processes, which in 2023 generated revenue of €72m according to preliminary figures. DBAG's management indicated that the company grew its revenues by an average 13% in recent years, above the broader market growth of 7%. It now has a wide client base of DAX40 companies and mid-sized enterprises across the DACH region, with some prominent clients including Airbus, GEA, Lufthansa Technik, Mercedes-Benz and Miele. UNITY joins other DBAG portfolio companies from the IT software and services sector, such as Akquinet, AOE, Cloudflight and freiheit.com. Moreover, DBAG's portfolio companies executed nine add-on acquisitions between end-September 2023 and end-June 2024 (of which seven have already been closed in the period), including two by Akquinet and two by AOE.

In terms of realisations, DBAG completed the successful disposal of in-tech (a software development, testing and validation business) in Q324, which yielded a strong multiple on invested capital (MOIC) of 3.3x and an IRR of 68% (the deal was announced in April 2024). We note that the disposal price represented a very healthy 63% uplift to the carrying value reflected in DBAG's books six months earlier, reinforcing its portfolio valuations. Moreover, Abbelen from More than Meals group (DBAG's portfolio company) was sold in Q324. DBAG also made a partial exit from Solvares and full disposals of GMM Pfaudler and Gienanth in H124 (as discussed in our previous note).

Valuation

DBAG continues to trade at a discount to last reported NAV (currently 31%, see Exhibit 3), while historically it traded at a premium to NAV (the average premium over the five years to end-2021 was c 18%). We believe this was due to the share price reflecting the additional value of DBAG's fund services business, which manages c €2bn of third-party capital and whose value is not directly captured within its reported NAV.

Exhibit 3: DBAG's historical discount/premium to NAV (%)



Source: DBAG, LSEG Data & Analytics, Edison Investment Research

We believe it is instructive to examine the market-implied valuation of both DBAG segments in 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 in DBAG's fund services segment, we use a group 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): Blackstone, EQT, Partners Group, Intermediate

Capital, Tikehau Capital and Cohen & Steers. We also added CVC Capital Partners, which recently completed its IPO. In the case of PE investments, we use the peer group shown in Exhibit 5, excluding 3i.

Exhibit 4: Analysis of DBAG's market value by segment

Fund services in line with peers	
Earnings multiple applied to fund services segment's valuation	23.3x
Implied value of fund services segment*	€256.6m
Implied value of private equity investments segment	€211.7m
Implied discount of private equity investments value to DBAG's end-June 2024 NAV**	65%
Private equity investments in line with peers	
Discount applied to private equity investments value to DBAG's end-June 2024 NAV	24.6%
Implied value of private equity investments segment**	€468.2m
Implied value of fund services segment	€9.1m
Implied FY24e earnings multiple of fund services segment*	0.8x

Source: DBAG, Edison Investment Research. Note: *Based on the midpoint of management guidance. **Multiple and discount are calculated based on DBAG's NAV excluding intangible assets arising from the ELF Capital acquisition.

Assuming the fund services segment is valued in line with peers (at a 23.3x FY24e earnings multiple) and using DBAG's current market capitalisation, the implied value of DBAG's PE investments would be c €212m (65% below its end-June 2024 NAV, which we conservatively adjust for the intangibles arising from the ELF Capital acquisition), while DBAG's peers currently trade at an average c 25% discount.

Some of this difference could potentially be explained by the subdued German economy (which weighed on DBAG's historical performance versus listed PE peers, see Exhibit 5). According to the July 2024 projections of the International Monetary Fund, German GDP will increase by a mere 0.2% in 2024, followed by 1.3% in 2025, as it expects continued weakness in the manufacturing sector to dampen economic recovery. DBAG's management highlighted that selected portfolio companies are currently facing challenges, in some cases due to macro factors and in other cases due to poor management. We also note that, while DBAG has delivered a number of successful exits in recent years, we calculate that its average ratio of disposals to opening NAV in FY19–23 stood at c 11%, below the level implied by PE's usual holding period of three to five years (DBAG disposals in 9M24 of €64.8m represented 11% of opening NAV excluding intangible assets). Still, DBAG's discount may be considered wide given its portfolio changes in terms of sector exposure in recent years, as discussed in our previous note.

On the other hand, if we assume that the PE investments were valued in line with peers, then DBAG's current market capitalisation would imply a mere 0.8x FY24e earnings multiple for DBAG's fund services segment. This seems to be quite a low multiple, especially given management's expectations of an increase in fund services pre-tax profit to €11–16m by FY26 (upon the expected launch of DBAG Fund VIII's successor). We also note that, based on the minimum €1.00 dividend per share as per DBAG's recently updated distribution policy, the company's shares now offer a 4.0% yield. On top of this, the company launched a buyback programme of up to €20m earlier this year, which will involve the repurchase of up to 800,000 shares, or c 4.25% of its share capital (excluding dilution from the convertible bond). To 9 August 2024, DBAG had spent c €11m on repurchasing 423k shares at an average price of €26.28 (which means that the buybacks were NAV accretive).

We note that the €30.7952 conversion price of the recently issued convertible bonds represents a c 14.7% discount to DBAG's end-June 2024 NAV, which would translate into a minor 2% end-June 2024 NAV per share dilution upon conversion.

Exhibit 5: Listed PE investment companies peer group at 13 August 2024*

% 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**	**400**	**1.7**	**14.8**	**41.9**	**176.6**	**(9.3)**	**(19.7)**	**(10.5)**	**85.9**	**(31.0)**	**4.0**
3i	29,717	22.9	123.9	197.8	786.8	61.0	187.3	224.7	983.0	40.9	2.0
GIMV	970	13.2	27.1	24.2	118.3	4.0	(10.1)	(10.4)	76.0	(25.7)	0.0
HgT	2,348	12.2	46.7	134.4	438.0	32.8	43.9	147.6	522.5	(2.1)	1.3
ICG Enterprise Trust	826	4.4	44.3	96.6	243.3	12.7	25.4	58.2	167.2	(34.3)	2.6
Oakley Capital Investments	893	7.5	62.6	132.9	308.4	17.7	45.3	139.9	269.8	(28.5)	0.9
Princess Private Equity Trust	615	1.1	5.3	43.3	198.2	(8.1)	3.0	49.9	224.7	(27.7)	6.9
Patria Private Equity Trust	839	5.8	45.6	99.5	281.3	21.9	27.0	89.0	249.8	(29.2)	3.0
Median	**5,173**	**9.6**	**50.8**	**104.1**	**339.2**	**20.3**	**46.0**	**99.8**	**356.1**	**(15.2)**	**2.4**
Rank	8	7	7	7	7	8	8	8	7	7	2

Source: LSEG Data & Analytics, Edison Investment Research. Note: TR, total return. *12-month NAV performance in sterling terms based on end-June 2024 or latest earlier available NAV (end-March 2024 for GIMV, end-April 2023 for ICG Enterprise Trust). **DBAG's 10-year NAV TR is calculated from end-July 2014 due to availability of data.

Exhibit 6: Five-year discrete performance data

Last 12 months ending	Share price (%)	NAV (%)	SDAX (%)	UK All-Share index (%)
30/06/20	(4.3)	2.3	3.0	(13.0)
30/06/21	16.4	20.8	31.2	21.5
30/06/22	(23.8)	3.8	(25.6)	1.6
30/06/23	16.3	17.4	12.4	7.9
30/06/24	9.3	1.7	5.6	13.0

Source: DBAG, LSEG Data and Analytics. Note: All percentages on a TR basis in pounds sterling.

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