NB Private Equity Partners

NBPE's realisation activity shows its portfolio is 'in demand'...

Update
24 May 2024

Overview

NB Private Equity Partners (NBPE) approach is distinct from peers, and in our view offers investors an interesting vehicle with which to harness the strengths of the private equity investment model.

In focussing only on their highest conviction co-investment opportunities, NB aims to tilt the odds for shareholders. The team favour companies that demonstrate a high degree of financial resilience. These characteristics show up in the NBPE portfolio's impressive revenue and earnings growth. In particular, over 2022 and 2023 which might both be considered 'tough' years, as we show in the **Portfolio section**, NBPE's portfolio has significantly outpaced the MSCI World Index in these years—proving more resilient and we understand at times surprising on the upside.

2023 was a relatively slow year for private equity exits, with industry-wide deal volumes about 30% lower than in 2022, and about 45% lower than 2021 levels. On the other hand, NBPE's portfolio generated $171m of cash proceeds from 12 partial and full exits during 2023. As such, NBPE is bucking the industry trend, with 2023 representing a 42% increase relative to 2022. NBPE's managers believe this is reflective of the high-quality, and the "in demand" nature of many of the companies in the portfolio. With almost 50% of the portfolio being pre-2020 investments, the 'harvesting stage' is getting closer.

Long-term NAV outperformance has been driven by direct private equity investments, which have achieved a gross IRR of 14.8% (five years to 31/12/2023). As we discuss in the **Performance section**, this has resulted in NBPE outperforming the peer group average and global indices in NAV and share price terms over five years. In 2023, the performance of public holdings weighed on NBPE's NAV performance, masking the continued growth from the private companies (+5.5% in local currencies), so the outperformance gap over five years has narrowed.

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Analyst's View

With realisation activity having increased in H2 2023, NBPE has stepped up the pace of investment in 2024. NBPE has a number of competing options for its cash, including the **Dividend**, buybacks, or funding investments. Any option must further consider the maturity of the 2024 ZDPs in October, which the board have announced their intention to repay. As we discuss in the **Gearing section**, NBPE has a strong balance sheet which gives the managers and board plenty of flexibility to be opportunistic.

In our view, as we discuss in the **Discount section**, buybacks will continue to be opportunistic and tactical, and the dividend will remain the main way capital will be returned to shareholders. We think the board's three pillars make sense over the longer term. Absent an aggressive buyback programme, lower interest rates, growth in the underlying private equity companies, and higher realisation activity may be catalysts for the discount to narrow.

Whilst realisation activity is arguably the most visible value driver for private equity portfolios, it is very far from being the only driver. As we discuss in the **Portfolio section**, private equity managers have plenty of other levers at their disposal to drive value creation within portfolios. NBPE's underlying companies continue to deliver strong growth and are increasingly mature. This means that if interest rates start to fall, precipitating a rebound in deal activity, NBPE should be in a strong position to capitalise. Investors who are taking a long-term view may see the current discount to NAV as a potentially attractive entry point.

BULL
Unique investment strategy, with returns driven by direct equity co-investments
Manager has a high degree of control over the timing of new investments and, therefore, also over the balance sheet
Wide discount in absolute terms

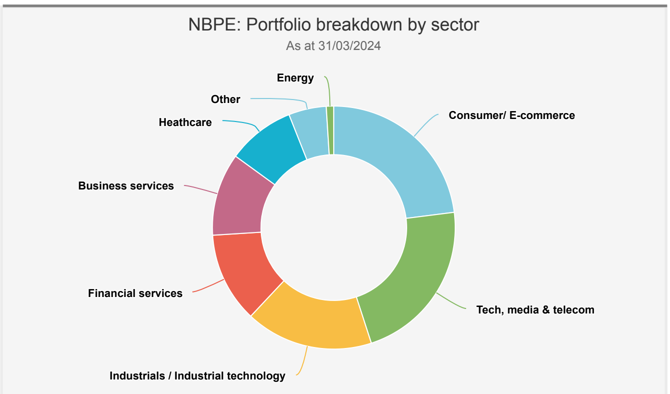
BEAR
Illiquid underlying holdings, which are themselves often geared
Deal activity in private equity markets generally may remain muted
Valuations of portfolio companies are performed quarterly

Portfolio

NB Private Equity Partners' (NBPE) approach is distinct from peers in the listed private equity sector, and in our view, offers investors an interesting vehicle with which to harness the strengths of the private equity investment model. In focussing only on co-investments, the team select what they see as the highest conviction opportunities from Neuberger Berman's (NB) considerable deal flow, and therefore, aim to tilt the odds for shareholders. NBPE currently has equity investments in 87 companies, led by 53 different managers, meaning a high degree of inherent diversification. 98% of NBPE's co-investments do not attract underlying management or performance fees, meaning from a cost perspective, the odds are already tilted in the shareholder's favour. NB's investment committee have worked together on average for 20 years and bring a considerable level of experience to bear when selecting investments and building portfolios, which must also help: as we discuss in the **Performance section**, their track record is strong.

We show below the most recently announced portfolio breakdown, illustrating that technology, consumer and e-commerce, industrial technology, financial, and business services sectors represent a total of 85% of the portfolio. The team are sector-agnostic when investing but aim to build a portfolio of businesses that provide direct exposure to a broad set of attractive subsectors and end markets.

Fig.1: Sector Breakdown



Source: NB

Underpinning investment decisions is a belief that each company can grow revenue and EBITDA meaningfully over time given their inherent characteristics such as competitive positioning, providing mission-critical products or services, having diversified end markets, and strong backing from management and private equity managers. The team believe that providers of mission-critical products and services often display high customer retention, enabling the companies to pass on reasonable cost increases, and therefore, demonstrate a high degree of financial resilience. These characteristics show up in the NBPE portfolio's impressive revenue and earnings growth, in particular over 2022 and 2023, which might be considered rather more 'tough' years. As we show below, NBPE's portfolio has significantly outpaced public markets, as represented by the MSCI World Index in these years. We would highlight that these earnings statistics are BEFORE interest (and tax, depreciation, and amortisation). Higher interest costs are one of the factors, we believe, behind the slowdown in private equity deal activity. If interest rates fall, these headwinds will turn into a tailwind when comparing year-on-year growth, and higher deal activity could provide a catalyst for improved sentiment towards NBPE's **Discount**.

2023 was a relatively slow year for private equity exits, with industry-wide deal volumes about 30% lower than in 2022, and about 45% lower than 2021 levels. NBPE's portfolio on the other hand generated $171m of cash proceeds from 12 partial and full exits during 2023. A further $39m was received post-year-end from transactions which had been announced but had not yet closed, taking total announced realisations to $210m. That NBPE is bucking the industry trend, with 2023 representing a 42% increase relative to 2022, NBPE's managers believe is reflective of the high-quality, and the "in demand" nature of many of the companies in the portfolio.

In terms of investment, one of the advantages of the NBPE co-investment model is that investment activity can be tailored to the precise circumstances of the trust. In 2024 so far, NBPE has stepped up the pace of investment, having deployed a total of $38m into two new investments in the healthcare sector; Benecon, an employee health benefits solutions provider, and Zeus, a leader in mission-

Underlying Revenue & Earnings Growth

			2023		2022	
Ticker	**Sample size**	**% of portfolio**	**Revenue growth**	**EBITDA growth**	**Revenue growth**	**EBITDA growth**
NBPE	Top 30	75	13	18	15	16
	LPE sector average	c. 65	16	19	24	20
	MSCI World Index		8	4	5	6

Source: Kepler Partners, Bloomberg. LPE sector data taken from most recently published interim or annual accounts.
Past performance is not a reliable indicator of future results

critical components for lifesaving medical procedures. It is worth noting that NBPE has a number of competing options for cash, including the **Dividend**, repaying debt, buybacks, or funding investments, but as we discuss in the **Gearing section**, NBPE has a strong balance sheet. This means the team have plenty of flexibility and can be opportunistic.

We note that the number of companies within the portfolio has gently drifted down to the current level of 85. New investment activity over 2023 was muted, with a total of only $22m invested, and an investment level of only 101%, at the lower end of the target range of 100%-110%. Lower activity is reflective of a degree of caution by NB, despite seeing a large number of opportunities through the year. The team are also seeing higher levels of M&A activity within portfolio companies themselves, where companies are taking advantage of the opportunity to scale businesses more quickly through accretive acquisitions and backed two follow-on investments, to support M&A, in the year.

Whilst realisation activity is arguably the most visible value driver for private equity portfolios, it is very far from being the only driver. As with M&A transactions representing significant, and sometimes transformative activity going on under the surface, private equity managers have plenty of other levers at their disposal to drive value creation within portfolios. In the recently published annual report, NB identifies what they see as the seven levers that private equity managers use to generate returns depending on the idiosyncrasies of investee companies and general market conditions.

Private Equity Valuation Creation Levers

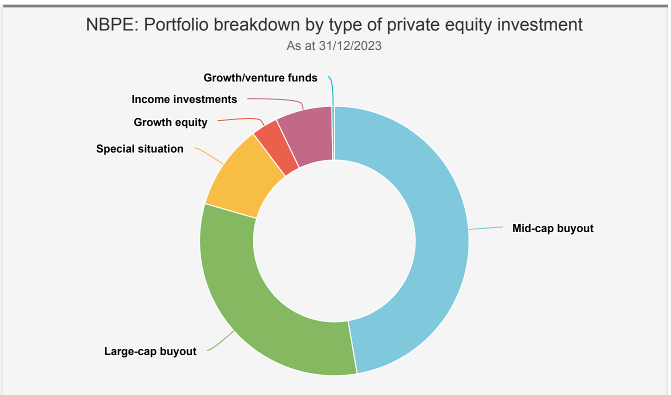
NB VALUE-CREATION LEVER	KEPLER EXPLANATION
Investment selection	Essentially "stock-picking"
Management incentivisation	Recruiting, retaining and motivating experienced managers
Resources & capital to support growth	Helping to bend the "growth curve" upwards
Operational improvement	Optimising revenue, cutting costs, otherwise improving margins
Strategic M&A	Sourcing, executing and integrating acquisitions, at accretive valuation
Free cash flow generation/debt paydown	Maximising cash generation, giving the company more options
Multiple expansion	Participating in a rise in valuations, a result of increasing scale or otherwise

Source: NBPE annual report 2023, Kepler Partners

NB illustrate that sponsors are able to drive value using a number of different ways, but the effectiveness of each lever will be determined by each company's circumstances but also the prevailing market conditions. Current market conditions mean that the first five in the table above are those that will have the biggest impact currently, but the ability to execute these initiatives will vary between managers. This is why NBPE is highly selective of the considerable deal flow that NB sees, only partnering with top-tier private equity managers who have the experience and resources to drive value through the cycle and are able to demonstrate this through their track record.

We show below a breakdown which illustrates that the majority of the portfolio is invested in mid-cap buyouts, which in our view, typically require less financial leverage and/or change in valuation multiple (the final two levers in the table above) to deliver a strong result for investors. NBPE has a small rump of legacy income and fund investments, which are in run-off mode. Within the below, as of 31/12/2023, public equities (all portfolio companies that have undergone IPO) represented c. 10% of the portfolio value, and the team expect this to continue to reduce over time.

Fig.2: Portfolio Breakdown

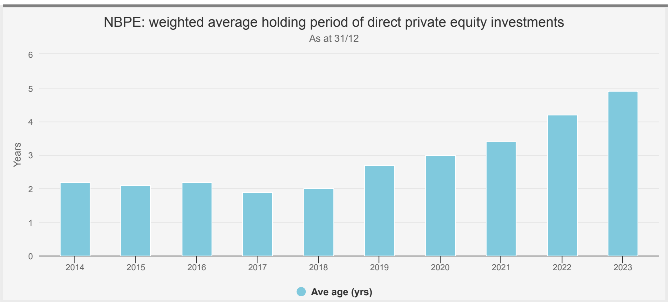


Source: NBPE

NBPE's portfolio has been steadily maturing, and as of 31/12/2023, the weighted average age of the investments was 4.9 years despite the impressive realisation activity achieved during the year. Mathematically, the relatively small number of investments made during 2023 will have had an influence on this rising higher. Almost 50% of the portfolio is pre-2020, so the managers believe it is fair to assume that the 'harvesting stage' is getting closer.

In terms of outlook, realisations continue to be achieved at a premium to holding value on average, with transactions made during 2023 at an 11% uplift to the valuation three-quarters prior to an announced realisation. In our view, this continues to serve as an illustration of the conservatism built into the NAV. The portfolio companies' strong and resilient revenue and earnings growth they have achieved over the past couple of years, combined with private equity managers' ability to drive value gains within their investments may mean that long-term investors may see the current discount (see **Discount section)** to NAV as a potentially attractive entry point.

Fig.3: Vintage



Source: NB

Gearing

NBPE's board and managers have historically employed structural gearing to enhance long-term returns. As such NBPE has been amongst the most fully invested over time of all the listed private equity trusts, reflecting the board's willingness to employ gearing but also the way the managers invest capital, which enables a large degree of balance sheet control.

NBPE has one remaining class of zero-dividend preference shares, which is due to be repaid in October 2024 with a capital entitlement of £65m, but also has a revolving credit facility which extends to 2029. The credit facility allows the managers plenty of flexibility in being able to keep NBPE fully invested.

NBPE has a long-term target of being between 0% and 10% geared. As of 31/03/2024, the gearing position was c. 102% invested, which is relatively low compared to NBPE's longer-term history and the target range. We understand this reflects not just an element of caution from the managers, but also a desire to be in a position to take advantage of opportunities. According to NB, total available pro-forma liquidity as of 30/04/2024, including undrawn credit facilities, cash, and announced realisations that have not yet closed, is $362m, representing 29% of NAV, meaning plenty of firepower is at the manager's disposal.

The £65m repayment of the zero-dividend preference shares later this year will absorb some of this, but post-year-end there have been $38m of new investments in Benecon and Zeus, two US healthcare businesses, and a further $28m committed to a third investment approved but not yet closed. Together, this represents a total of $147m of outward cashflow, and therefore, NBPE has c $215m of headroom absent any further realisations.

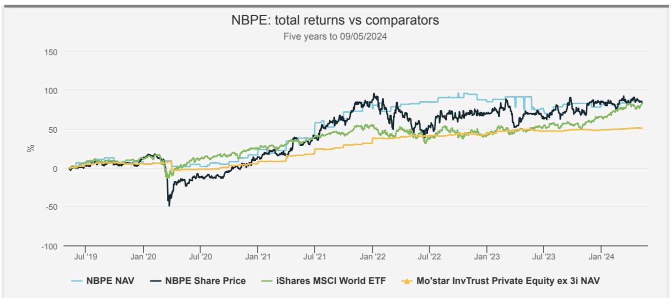
Given that expected outstanding legacy commitments are just $33m on an adjusted basis (adjusted for amounts the manager expects to be called), and the control the investment team have over deploying capital, NBPE, therefore, has a solid balance sheet. This claim is backed up by an analysis conducted by the board and reported in the annual accounts, in which the board and manager believe that even in a downside scenario in terms of a 10% fall in valuations, and no further realisations, NBPE could continue to fund its existing commitments, pay dividends, maintain reserves allocated to share buybacks, pay ongoing expenses, and also repay the 2024 ZDPs at maturity.

Private equity-backed businesses usually employ higher leverage than public ones, and NBPE's portfolio companies are no different. On a look-through basis, NBPE's portfolio has a weighted average net debt-to-EBITDA ratio of 5.3x, meaning that, with the weighted average valuation multiple of 14.9x on an EV/EBITDA basis, borrowings make up roughly one-third of the capital structure (or 55% on a loan to NAV basis). As we show in the table in the **Performance section**, this is higher than public markets, but broadly in line with underlying portfolios in the LPE peer group.

Performance

NBPE has been a strong performer, both within the peer group and relative to public equities. Since the board decided to focus entirely on equity co-investments, the percentage of the portfolio invested in income investments has fallen progressively. As a result, performance has been increasingly driven by direct equity investments, which have achieved a gross IRR of 16% over the five years to 31/03/2024, and a realised return gross multiple over cost over the same period of 2.5x. As the graph below shows, as a result of this increasing focus on equity investments, and their strong performance, NBPE has outperformed world equities and Morningstar's weighted average of the peer group over five years. This shows the experience for sterling investors, who in addition to the strong underlying NAV performance, have benefitted from the strength of the US dollar.

Fig.4: Five-Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

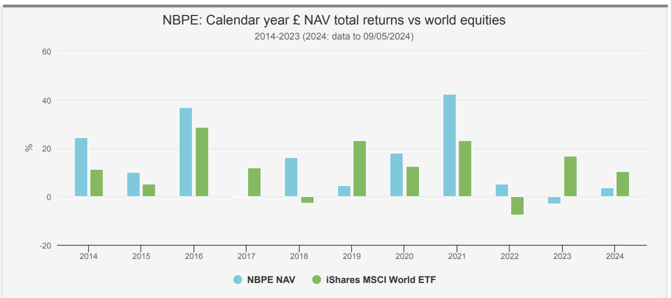
After a strong relative performance over 2023, NBPE's performance has been relatively muted in absolute terms, whilst those of public equities have powered ahead and so the outperformance gap over five years has narrowed. It is perhaps ironic that critics of private equity were saying not long ago that with equity markets having fallen precipitously in 2022, private valuations should fall in sympathy. Having not been written up aggressively, many followers of private equity argued that valuations need not be written down as a result. With equity markets having rebounded, private market valuations are perhaps more comparable, and the critical voices have become rather more silent.

At times over recent years, private company valuations have been seen as higher than public markets, but as we illustrate in the **Portfolio section**, growth rates have been significantly higher than the aggregate numbers for public market indices. The only true way to determine whether valuations are fair is to compare them with what companies are eventually sold at. In our view, it is very rare for constituents of the LPE sector to announce sales of investments at below carrying value, and NBPE's statistics back this up. Over the last five years, the average write-up on a sale from the NBPE portfolio has been 39%, and during 2023 reflecting a more muted background for dealmaking, has still been 11%.

In terms of share price returns, we think it interesting that the five-year NAV and share price total returns are almost exactly the same. As we discuss in the **Discount section**, lower interest rates and higher realisation activity may be the catalyst for the discount to narrow. However, for long-term shareholders, as the experience over the last five years shows, despite an element of discount volatility at times, what really counts for shareholders is the NAV performance, as long as at the same time the discount does not widen too much.

The graph below shows that NBPE's strong showing in 2020 and 2021 was an important driver of its index-beating returns over the past five years. However, it also shows that 2022 and 2023 have been harder going. We attribute this to an element of mean reversion, noting significantly lower private equity exit activity across the industry, and specifically related to NBPE, the falls in the valuations of NBPE public holdings. In fact, in USD terms, private investments increased in value by 4.4% and 5.3% for 2022 and 2023 respectively, but these returns were outweighed by valuation movements in quoted holdings and foreign exchange. Holding publicly traded investments is not part of NBPE's core strategy, but rather a result of private equity managers partially exiting investments through IPOs. The decision on when to sell down remaining holdings is exclusively that of the sponsor rather than NB in almost all cases. NBPE's public stock exposure peaked in December 2021 at c. 20% of the direct equity portfolio. Through sales and falls in value, this has now fallen back to c. 10% (as of 31/12/2023) and NBPE has continued to see realisations from the quoted portfolio YTD.

Fig.5: Calendar Year Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

As we discuss in the **Portfolio section**, NBPE's private investments continue to deliver strong earnings growth. The portfolio is increasingly mature, and NB highlights a number of levers that private equity teams can employ to drive value. Companies are increasingly helping to drive revenue and earnings growth through accretive bolt-on acquisitions. For companies that are able to consolidate fragmented markets, this is an important driver of gaining scale and efficiencies, and therefore, value growth. Whilst NBPE's realisation activity has been relatively strong, unless a catalyst emerges for renewed activity, sector-wide exit activity may remain muted. If the portfolio's underlying growth continues to outpace public markets, this should give grounds for optimism.

Underlying Portfolio Company Leverage & Valuation

TICKER	SAMPLE SIZE	SAMPLE % OF PORTFOLIO	NET DEBT TO EBITDA (X)	VALN:EV TO EBITDA (X)	NET GEARING % (DEBT TO EQUITY)
NBPE	Top 30	75	5.1	15.4	55
	LPE sector average		4.9	16.4	42
	MSCI World Index		1.5	11.9	14

Source: Partners, Bloomberg

Past performance is not a reliable indicator of future results.

Dividend

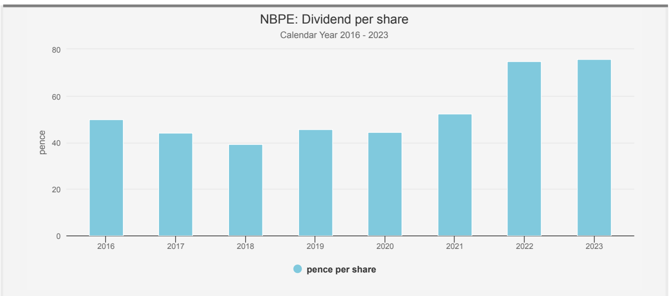
NBPE has a policy of maintaining or increasing the annual dividend and has a ten-year track record of delivering exactly that. Over this time, the semi-annual dividend has grown from $0.20 per share to $0.47 per share, representing a compound annual growth rate of 8.5%. The current dividend target for 2024 of $0.94 represents a dividend yield of 4.6% when converted into GBP at the current share price.

The board's policy is to pay a dividend that represents 3% of NAV or greater. We show below the sterling dividends received by investors, which are converted from dollars by the company at the time of the payment, so the actual amount received by shareholders varies with currency movements. In 2022, when the NAV declined over the year as a whole, the board chose to maintain the dividend level. The board also decided to maintain the dollar dividend amount paid in 2023, and because of dollar strength, the payout in pence rose.

Like most listed private equity trusts, NBPE's dividend can be viewed as a payment from capital, but one that is relatively predictable, and is fair to all shareholders. With the discount to NAV remaining wide (see **Discount section**), the board has stated that, in its view, dividends will remain the primary route for returning capital to shareholders. Over the last ten years, NBPE has returned c. $338m of capital and income via dividends. That said, given strong realisation activity in the portfolio, with $171m of realisation proceeds received in 2023, the board has increased the capital allocated to buybacks.

The board states that it "recognises the importance to shareholders of maintaining the Company's annual dividend yield target at 3.0% of NAV or greater". In many ways, dividends paid from capital can be viewed as more resilient than traditional income sources. However, for UK investors, because the dividend is paid in dollars the sterling amount paid depends on foreign exchange rates; therefore, the dividend could vary and is not guaranteed.

Fig.6: Sterling Dividends



Source:NBPE

Management

The board sets the overall strategy and is ultimately responsible for the performance of NBPE, but the board has delegated NB to act as investment manager to execute day-to-day management and the investment strategy. The investment manager's senior professionals are responsible for the day-to-day management of the trust and, with respect to NBPE, management is led by Peter von Lehe and Paul Daggett, both managing directors at NB.

Peter and Paul are part of the private equity division of NB, a very large global investment business that manages over $115 billion of commitments in private equity strategies. The commitments made through the private equity platform give the team a greater level of access than many of their peers. NB aims to be a capital solutions provider for GP partners and not competition, able to leverage the significant resources of the team and wider asset management business.

Investment decisions are made by an investment committee that comprises 13 members, who have an average of 30 years of professional experience and have worked together for an average of more than 20 years. NB has more than 420 private market professionals, located across 12 global locations. The team claim to have more than 745 active private equity fund relationships. In the managers' view, they see a very high proportion of deal flow from their private equity relationships and have positioned themselves as a capital solutions provider and strategic partner, who are often brought in very early on in the investment process to help cornerstone a deal. They achieve this because they are not seen as a competitor to sponsors. Their large size and the speed with which decisions can be made, given their specialist teams, can be competitive advantages when sourcing and executing these co-investments.

Discount

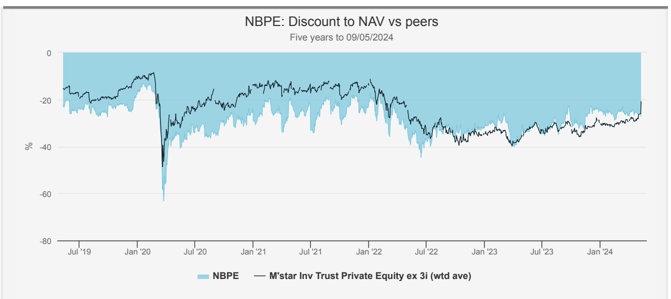
NBPE has traded at a wide discount to NAV in absolute terms over the past five years, as have most constituents of the LPE sector. The graph below shows that prior to 2022, NBPE traded at a slightly wider discount when compared to the peer group average. However, since then, NBPE has traded at a slight premium to the peer group. In our view, this reflects the uniquely differentiated proposition that NBPE offers investors wishing to access the private equity asset class.

The board has previously said that its plans to address the discount rest on three pillars. Firstly, it believes that continued strong relative NAV performance is a key determinant of attracting investors. Secondly, it continues to invest in its investor relations (IR) offering. Finally, it believes that NBPE's governance—with a fully independent board—should also be attractive, and over time lead to a narrower discount to NAV.

Compared to some peers, we think it is fair to say that NBPE has perhaps been a less enthusiastic buyer of its own shares. That said, with $5m worth repurchased during the whole of 2023, in Q1 2024 NBPE has already exceeded last year's total, having repurchased a total of $5.4m of shares. This followed an announcement that with the strong realisations seen over 2023, the board had increased the amount of capital allocated for buybacks. As part of the framework for considering buybacks, the board considers NBPE's financial position, use and cost of leverage, the investment level relative to its target, and the vintage year diversification of the portfolio. Jefferies, the company's broker, has a mandate to repurchase NBPE shares based on certain set criteria.

In our view, buybacks will continue to be opportunistic and tactical, and the dividend will remain the main way capital will be returned to shareholders, and over the last ten years, NBPE has returned $338m via dividends. We think the board's three pillars make sense over the longer term. Absent an aggressive buyback programme, lower interest rates, and higher realisation activity may be the catalysts for the discount to narrow. In reality, we think that for long-term shareholders, what really counts is the NAV performance, as long as at the same time the discount does not widen too much. As we illustrate in the **Performance section**, the five-year NAV and share price total returns are almost exactly the same, which underlines this point. For those investors who take a long-term view, the current discount to NAV of 27% may prove to have been an attractive entry point in time to come.

Fig.7: Discount To NAV



Source: Morningstar

Charges

NBPE's sole focus on co-investments offers several advantages, including real-time deployment of capital, enabling control over the balance sheet and cash deployment (see **Gearing section**), as well as an ability to achieve optimal diversification (see **Portfolio section**). However, co-investing also enables NBPE to achieve a significant fee advantage over many peers. By co-investing alongside third parties, NBPE can invest in deals largely free of management and performance fees payable to the underlying private equity sponsors. Fund-of-funds peers often pay two layers of management and performance fees on a proportion of their investments, typically 1.5% to 2% of committed capital and typically a carried interest fee of 20% of gains over an 8% hurdle. As of 31/12/2023, NBPE paid no management fees or carried interest to third parties on 98% of the direct equity portfolio.

NBPE's management fee is 1.5% p.a. on 'private equity fair value', i.e. investments, excluding cash, and is in line with that of most direct-investing LPE funds. NB is also entitled to a 7.5% performance fee on NAV gains over a 7.5% per annum hurdle, subject to a high-water mark. We note that this performance fee is lower than that of other direct-focussed funds, although it is charged on unrealised gains. Directly investing managers typically only receive carry-on realised gains. The trust's OCF for the year to the end of December 2023 was 1.94%.

The most recent KID RIY figure, as of 21/08/2023, was 3.63%. Of this, 0.94% was carried interest, i.e. performance fees, which are averaged over five years in the KID. It is worth noting that calculation methodologies can differ between companies and versus the OCF.

ESG

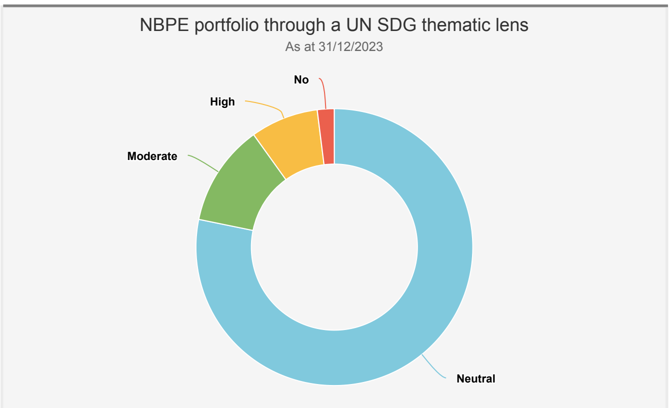
The team at NB believe that ESG is a fundamental part of investment risk and opportunity assessment. In August 2020, and updated in September 2023, NBPE's board implemented a responsible investment policy, which can be found **here**.

ESG factors are an integral part of the NB private equity team's due diligence process. As a co-investor, NB performs due diligence on each prospective investment and aims to ensure that the company and sponsor are managing ESG risks appropriately. The team also aim to monitor ESG risks during the time of any investment. The NB Private Markets investment team work closely with the dedicated ESG teams to support the implementation of industry best practices.

As a mark of the success of the team for their ESG efforts, in the 2023 UN PRI assessment, NB scored above the median of all reporting signatories and large investment management peers globally for their ESG integration efforts in every UN PRI reported category. NB achieved top scores in multiple categories including the Policy, Governance and Strategy category (formerly, Investment and Stewardship Policy) and the Indirect – Private Equity category. Alongside this, NB Private Markets received the British Private Equity & Venture Capital Association's Excellence in ESG Award (LP Category) for its commitment to fostering innovation of ESG objectives, engagement with private equity managers, and efforts related to ESG data and climate initiatives.

The team provided a breakdown of the directly invested portfolio as they currently see it, showing that overall, 19% of the portfolio has a positive potential from a UN Sustainable Development Goal (SDG) thematic perspective.

Fig.8: Portfolio Through A Sustainability Lens



Source: NB

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