Breaking the mould

NBPE's co-investment model provides significant benefits for investors...

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2023 relative to prior years. For the sector as a whole, private equity exits in 2023 fell 30% year on year and were down 45% compared to 2021.

It was striking then, when looking through **NB Private Equity Partners' (NBPE)** activity last year, to see that exits actually rose in 2023 relative to 2022. The trust generated $171m from 12 partial and full exits last year, up 42% on the prior 12 month period.

Those exits were also achieved at an average write up of 11%. This is below the trust's impressive five-year average of 37% but given how much tongue wagging there has been about private equity valuations being too high, it was another sign that valuations in the NBPE portfolio are relatively conservative.

It also illustrates how lacking in nuance a lot of the debate around private equity has been since rate hikes started. Although it's easy to see why a sector which makes ample use of gearing might be impacted by higher borrowing costs, clearly not all private equity investments are created equal.

NBPE provides a simple example of this, given its unique approach of focusing solely on co-investment opportunities. As the tides of a low interest rate world have started to recede, the benefits this model accrues to investors have become more apparent.

A clear strength here is the managers' ability to be more selective when making their investments. The NBPE managers get access to Neuberger Berman's extensive deal flow but are able to invest solely in what they believe are the highest conviction opportunities. These tend to be businesses which can deliver strong growth over the long-term with low expected cyclicality.

Looking at last year's performance, you can see that the managers have gone some way in achieving this. Leaving aside the write ups on exits, year on year EBITDA growth for NBPE portfolio companies rose 22% in 2023 compared to 2022. The equivalent average for companies in the MSCI World Index was just 4%.

It's also worth noting that NBPE's co-investment model means the vast majority of its investments – 98% at the time of writing – are not subject to management or performance fees, something that further enhances the returns these investments can deliver for shareholders.

Aside from these lower fees and the ability to focus solely on the best investment opportunities, the co-investment model also enables NBPE to better manage its balance sheet.

Again, this has become a more acute problem since interest rate hikes began. For NBPE it has meant that the range of potential investments the managers must consider when making use of cash have broadened. Today they have to weigh up funding new investments, buybacks, dividends, and paying down borrowing.

This process is tricky to manage as is. However, if you were to add in the potential for capital calls then it would only compound the problem. The co-investment model that NBPE uses means that this is not a problem the managers have to deal with. As a result, they can have a much stronger grasp over their balance sheet and capital allocation, reducing the risk of becoming overstretched.

To give a more tangible example of how this works in practice, the NBPE Board have announced they will repay the final entitlement of £65m to zero-

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dividend preference shareholders later this year. They also made two investments worth $38m earlier this year and have committed to investing a further $28m in a third investment.

However, when you factor in the trust's existing cash holdings, access to an RCF, and announced realisations, liquidity available to the mangers totals approximately $358m. As a result, even when you include this year's investments and the zero-dividend repayment, the managers still have plenty of headroom to manage the dividend, share buybacks and fund further investments.

Indeed, in the company's latest annual report, the NBPE board conducted a balance sheet analysis looking at these options. They believe that even if no realisations were achieved and valuations fell by 10%, the trust would still be able to meet all of the potential cash flow obligations described above. It would be hard to argue that the co-investment model does not play a significant role in enabling this, given the level of predictability and oversight it gives to the managers.

Despite these strengths, NBPE currently trades at a c. 26% discount to NAV, arguably due to the broad-brush approach investors continue to approach the private equity sector with.

But as we can see, the co-investment model does provide meaningful differentiation to NBPE, with significant benefits for investors. We think these will only become more apparent as time progresses, with the potential for significant upside for long-term investors, particularly if we start to see interest rates come down again.

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