NB Private Equity Partners

NBPE has had an exceptional 2021, but prospects remain bright...

Update
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Summary

NBPE's mission is to invest in private companies to generate long term growth. It does so through co-investing in opportunities alongside a wide array of leading third-party private equity managers. With NB seeing regular deal flow from the highest quality managers, this allows them to be highly selective on investments they choose for the portfolio.

NBPE's **Portfolio** is attractive in our view in terms of its concentration (being neither too diversified nor too narrowly focussed), its exposure to the technology, industrial technology, consumer & e-commerce and healthcare sectors, and its maturity with holdings having been held for an average of 3.5 years.

The latter is particularly relevant given NBPE's exceptional NAV **Performance** during 2021. The typical expected private equity holding period is three to five years according to NB, which, if correct, would mean that further realisation activity cannot be ruled out. Given the average uplift to valuations three quarters prior to an exit or IPO for the portfolio has been 83% in 2021 and 44% on average over the last five years, this would suggest further NAV growth could be the consequence if achieved.

NBPE's **Dividend** policy is to target an annual dividend yield of at least 3% of the NAV. In line with this, on 13 January 2022, the company announced a semi-annual dividend of $0.47 per share, an increase of 14.6% since the last dividend payment in August 2021. Whilst NBPE's Charges are not low in absolute terms, co-investing enables NBPE to invest in deals largely free of management and performance fees to the underlying private equity sponsors. This gives it a distinct advantage over many peers.

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Analyst's View

As we highlight in **Portfolio** and **Gearing**, NBPE's co-investment model offers several advantages including diversification, access to deal-flow and close control over the balance sheet/cash deployment, enabling the team to respond to changes in market conditions in real-time. Shareholders pay only one layer of fees on the majority of NBPE's co-investments. As such NBPE can be viewed as having a significant advantage over peers.

Realisations have been the engine of NBPE's growth, reflecting the evolution of the portfolio towards primarily direct equity investments over the last four years. The team have been investing in companies that NB expects to benefit from secular growth trends and which are arguably relatively defensive. NBPE's balance sheet means that investors have a somewhat geared exposure to these companies.

The very strong performance in 2021 has shown the benefits of all of these factors, contributing to NAV total returns of 40.7%. When the final Q4 private company figures are in (most of the 31 Dec valuations should be incorporated by the end of Q1 2022), this should put NBPE firmly on the listed private equity podium in terms of calendar year performance. In our view, the portfolio's maturity should give grounds for confidence for the years ahead, not to mention the types of companies and sectors that NBPE is currently exposed to. It would appear that the market also shares our enthusiasm, with the **Discount** having narrowed over the year. Based on JPMorgan Cazenove estimates, NBPE currently trades on a discount of c. 14%.

BULL
Unique investment strategy, with returns now driven by 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
Geared exposure to companies which are themselves often geared
Underlying investments are illiquid
Valuations on portfolio companies are performed relatively infrequently

Portfolio

NBPE's mission is to invest in private companies to generate long term growth. It does so through co-investing in opportunities alongside a wide array of private equity managers (also known as 'sponsors' - 55 currently), based on the deal-flow shown to Neuberger Berman's private equity platform – see **Management**. The weight of resources that NB is able to call on in managing NBPE is a key advantage for shareholders, with the managers seeing regular deal flow from the highest quality sponsors, in turn allowing them to be highly selective on investments they choose for the portfolio. As we discuss in **Gearing**, it also allows more precise balance sheet management and has ensured NBPE is amongst the most fully invested of the peer group over a period in which it has very much been beneficial to be so.

The vast majority of the portfolio (91%) now represents investments in the equity of 94 companies, as well as a small lump of legacy income and fund investments. Since the beginning of 2018, the focus has been purely on equity investments in private companies, which have historically delivered the highest total returns in the portfolio. Currently, 18 investments in the portfolio are publicly listed, a result of private equity holdings IPO-ing, and this represents a historically high 19% of the portfolio. Typically the shares in such companies remain under the control of the sponsor, but the expectation is that over time these shares will be sold in the market, proceeds distributed to NBPE and then redeployed into private opportunities once more.

Portfolio concentration is an area the managers do focus on and is a differentiator to peers in the listed private equity (LPE) peer group. The manager's aim is to have a properly diversified portfolio such that a poorly performing investment doesn't negatively affect the whole too much. On the other hand, they aim to ensure that investments are large enough that if an investment is successful, it is able to 'move the needle' in terms of NAV growth. As at 31 December 2021, ten companies make up approximately 35% of the portfolio. As at 31/12/2021, the largest 20 investments made up 52% of the portfolio. We outline the top ten holdings in the table below, illustrating that aside from the top three investments (including two holdings of now public companies), the portfolio has no investment greater than 3%. In our view, this shows that the portfolio is well balanced and should ensure an attractive risk/reward ratio on the NAV while at the same time giving shareholders visibility on performance drivers. Its top two companies, Constellation Automotive and Autostore, at 31 December 2021, were numbers sixteen (1.8% of NAV) and seven (2.7% of NAV) respectively at the beginning of the year and have driven significant value for NBPE in 2021.

Top Ten Investments

	SECTOR	VALUE (% OF PORTFOLIO)
Constellation	Business Services	6.5
AutoStore	Industrial Technology	6.4
Agiliti	Healthcare	3.8
Action	Consumer	3.0
MHS	Industrial Technology	2.9
USI	Financial Services	2.8
GFL	Business Services	2.7
Kroll	Financial Services	2.6
Renaissance	TMT	2.2
Marquee Brands	Consumer	2.2
TOTAL		**35.1**

Source: Neuberger Berman, as of 31/12/2021

As we discuss in **Performance**, 2021 was an exceptional year for NAV returns. The managers have for a number of years now been positioning the portfolio for the 'late cycle' by being very selective on opportunities shown to them and investing in defensive growth companies. They have tended to focus in four broad areas: technology, industrial technology, consumer & e-commerce and healthcare. Many of the most recent investments made over the last 12 months fit within these sectors. However, this focus helped insulate underlying earnings during 2020 and has helped strong earnings growth as the global economy has rebounded.

Another reason for the exceptional performance seen in 2021 is the strong realisations seen from the portfolio, which are a key driver for valuation increases. We understand that the managers remain bullish on future prospects for realisations given the increasingly mature portfolio. According to NB's expectations, private equity managers typically look for a partial or full exit of investment between three and five years after acquisition (although it can be longer than this). With the average age of the portfolio at 3.5 years and a significant proportion (65%) in the typical 3-5 year holding period or longer, the prospects for future realisations appear bright.

Gearing

As we discuss in **Portfolio**, one of the advantages of NBPE's manager investing solely through co-investments is that the team can manage balance sheet optimisation with much more precision than other LPE trusts. This is because the managers are able to make new investment decisions in 'real-time' when opportunities present themselves, as opposed to committing to a fund (or funds) that make investments over several years. Compared to a directly investing single manager fund, NBPE has a much wider pipeline of potential investments. As shown at NBPE's Capital Markets Day in September 2021, from the beginning of 2020 to mid-2021, the Neuberger Berman platform has reviewed 480 opportunities from over 300 private equity firms. As a result, the managers are clearly likely to have a greater number of opportunities to deploy capital more consistently over time, given the strength of the Neuberger platform deal flow. As such, adding extra returns through gearing, with lower balance sheet risks than peers, is potentially a key advantage for NBPE.

NBPE has been geared over the long term, which means shareholders have benefitted from the strong portfolio returns generated. Of course, if NBPE experiences a negative period of returns, then gearing will exacerbate falls. NBPE's investment level of greater than 100% is in marked contrast to the LPE peer group, which has on average been less than 100% invested and thereby suffered cash drag (or dilution to NAV returns from portfolio returns as a result of cash holdings).

The strong realisation activity in the portfolio in 2021 and the resulting cash balances mean that at 31 December, NBPE was 106% invested, and NBPE remains one of the most fully invested LPE trusts in its peer group. The managers have a long-term target range of being between 110% and 120% invested (i.e. c. 10–20% geared on a NAV basis), although the managers have more recently said they are currently targeting the lower end of this range. Over the course of 2020, the investment level peaked at c. 133% before falling back. As we discuss in **Discount**, we believe part of the reason for the discount widening out during 2020 was (aside from general illiquidity in what was an unstable market) worries that NBPE was potentially too highly geared for a scenario in which markets remained volatile, and valuations continued to fall. Subsequent action by the board and manager, as well as developments within the portfolio, have meant that gearing has reduced substantially.

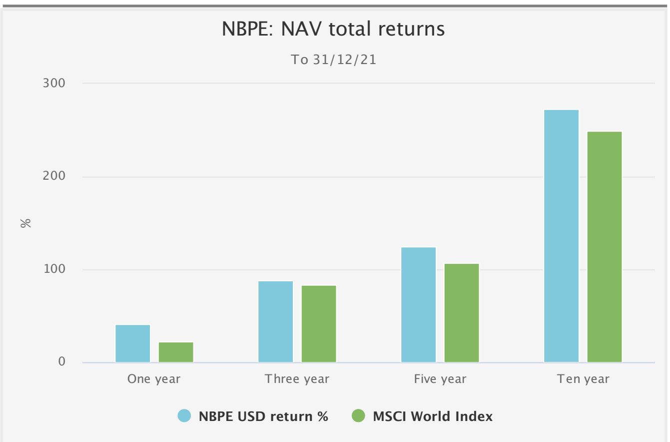
NBPE's gearing is made up of two zero dividend preference share classes with an aggregate accrued liability of $162 million at 31 December 2021. In January 2022, the board announced that NBPE would repay the 2022 ZDPs in full at their maturity date, 30 September 2022. NBPE has significant available liquidity to repay the 2022 ZDPs in full, and this will simplify its capital structure. The 2024 ZDPs remain outstanding and mature in 2024. NBPE has a total credit facility of $300m (with no borrowings drawn as at 31 December 2021). NBPE pays interest on this loan at a rate of LIBOR+2.875%, with a 1% LIBOR floor, and it is available through to December 2029. During 2021, NBPE announced $401 million of total realisations with $389 million received. NBPE's available liquidity at 31 December 2021 stood at $416 million ($116m cash and $300m available bank line), which more than covers the ZDP full repayment entitlement of both the 2022 and 2024 issues. In our view, this shows how strong NBPE's balance sheet really is. As such, despite being one of the more fully invested of the LPE peer group, we believe that the higher gearing NBPE employs does not necessarily mean that the trust is the riskiest. Certainly, the NAV volatility may be higher as a result of gearing (all things being equal and balanced by its diversified portfolio), but NBPE is arguably less exposed to balance sheet risks. A clear differentiation to the fund of funds and some direct investors is the limited exposure to off-balance sheet liabilities in the forms of uncalled commitments.

Performance

2021 was an extraordinary year for NBPE in performance terms, with NAV total returns of 40.7% (although as at 31/12/2022, 74% of the portfolio had yet to be valued at that date). NAV performance has been driven in large part by realisations ($389m received, representing 31% of the portfolio valued at the start of 2021). This represents 14 full and partial exits, which corresponds to 88 direct equity investment holdings at the start of the year. As we outline in **Portfolio**, the managers are bullish on future prospects for realisations given the increasingly mature portfolio, the manager's positioning in sectors underpinned by secular growth trends and the fact that a majority of the realisations achieved last year came outside of the top ten holdings at the start of the year.

Whilst past performance is no guide to future performance, the strong NAV performance during 2020 and 2021 means that, as the graph below shows, NBPE is well ahead of world equities over the short and the long term. Share price total returns have been even stronger over 2021, with the discount narrowing over the calendar year to provide an accelerant to returns for shareholders who have owned shares over the entire period, delivering a share price total return of 65.0% for the calendar year 2021 (Source: NB).

Fig.2: NAV Performance Vs World Equities



Source: Neuberger Berman

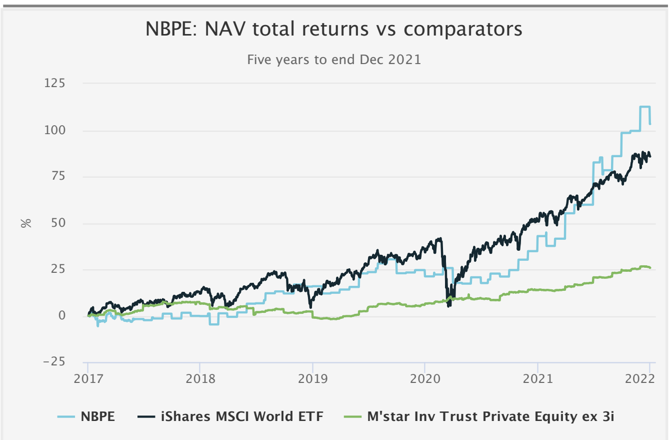
Past performance is not a reliable indicator of future results.

This strong performance comes on the back of 2020, over which NBPE delivered a NAV total return of c. 21.4% against the MSCI World Index return of 12.5% (Source: Morningstar). The managers have been positioning the portfolio for the 'late cycle' since 2018 by being very selective on opportunities shown to them and investing in defensive growth companies (see Portfolio for more detail). This served the trust well through 2020 but has also meant many of the companies were positioned in sectors that were overall less impacted by the downturn. During 2021, only a very small proportion of the portfolio was marked down in value, which reflects a combination of earnings growth and sector positioning in high-quality assets favoured among investors, both for their resilience as well as potential future growth opportunities.

As well as the astute positioning, the managers attribute the increasingly strong performance of NBPE down to focusing on direct equity investments, which started becoming a more meaningful allocation in the portfolio approximately four years ago and today represents 91% of the portfolio's fair value. Additionally, the portfolio has grown increasingly mature, with the current average vintage of 3.5 years compared to the typical private equity holding period of three to five years according to NB expectations. With a maturing portfolio, there may be a healthy pace of realisations in future years. Should realisations and strong uplifts continue, further NAV growth could be the case.

The five-year NAV total returns of NBPE (with all figures in GBP) can be seen below, in which NAV returns are well ahead of equity markets over this period. As we noted above, over this period, NBPE has been evolving its strategy and working towards a pure focus on equity investment. Historically, the portfolio constituted a mixture of direct equity, income and legacy funds – the latter two having generated lower returns than equity investments historically.

Fig.3: NAV Performance



Source: Morningstar

Past performance is not a reliable indicator of future results.

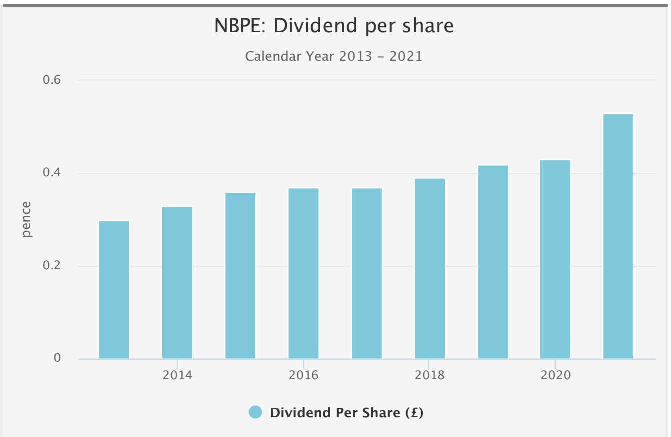
Dividend

For almost a decade, NBPE has paid a dividend, and its policy is to target an annual dividend yield of at least 3% of the NAV. This is paid semi-annually. The most recent semi-annual dividend of 47 cents was declared on 13 January 2022, to be paid on 28 February 2022. At the time of writing, based on the exchange rate, this is equivalent to an annualised dividend yield at the current price of c. 3.6%, which is higher than the AIC Private Equity Sector's average dividend yield of c. 2.6%, and in line with the AIC Global Equity Income sector's dividend yield of c. 3.6%.

Like multiple trusts across the listed private equity sector, NBPE's dividend can be viewed as a payment from capital. Nevertheless, NBPE does not sell assets in order to pay dividends, rather dividends are ultimately paid as a result of realisations over time, and the trust has available cash and an available credit facility (if needed) to fund dividends. This is a relatively common feature in the listed private equity sector and, given the significant discounts that many trusts currently trade at, represents a relatively attractive method of returning capital at NAV.

In some ways, dividends paid from capital could be viewed as more resilient than traditional income sources. On the other hand, given it is determined as a percentage of NAV, the dividend could vary and is not guaranteed, depending on what the board decide, and therefore one could argue the dividend is not progressive. Nevertheless, the company intends to target an annualised dividend yield of 3.0% on NAV with the goal to maintain or progressively increase the dividend over time. During times of significant market stress where NBPE's cash position could worsen, the illiquidity of the underlying portfolio could present challenges for the board in continuing to pay the dividend. One might argue that increasing gearing at that juncture to continue to pay the dividend might not be a wise course of action. It is worth noting during the market volatility in 2020 when many peers cut or suspended dividends,

Fig.4: 10-Year Dividend Payments



Source: NBPE

NBPE maintained its dividend pay-out. NBPE currently has a strong balance sheet, and the managers note that the **Portfolio** looks increasingly mature. Barring a significant market shock, this should mean NBPE continues to enjoy good liquidity and cashflows for the foreseeable future.

Management

The board is ultimately responsible for the overall strategy and performance of the trust but has delegated authority to the investment manager to execute the 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 Neuberger Berman.

Peter and Paul are part of the private equity division of Neuberger Berman Group, a very large global investment business that manages approximately $82 billion in private equity assets. This private equity platform has committed around $19bn to private markets over the last three years. These commitments continue to grow, and this gives the team a greater level of access than many of their peers in the sector. The manager can invest across the capital spectrum and leverage the significant resources of a global asset manager.

Investment decisions are made by an investment committee that comprises 14 members, each of whom has an average of 18 years with the firm.

The Neuberger Berman private equity business has a very deep team of c. 200 dedicated private equity professionals focussing on various types of private equity investing. These professionals are based across 11 offices globally. The team claim to have over 575 active private equity fund relationships. In the manager's view, they see a very high proportion of deal flow from their private equity relationships and have positioned themselves as 'strategic' co-investors 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 in sourcing and executing these co-investments.

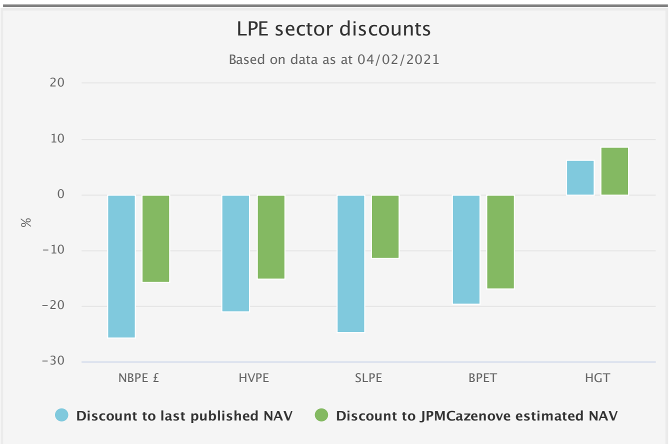
NBPE's board evolution has continued over the years, and most recently, the board appointed Louisa Symington-Mills as a new director in June 2021. The Manager also made the decision not to seek re-election of NB Managing Director Peter von Lehe to the board of NBPE at the 2021 AGM; however, as noted above, Peter remains actively involved in NBPE's management and investment activities. With these recent board changes, NBPE's five-person board is now entirely independent, which we believe, is yet another step NBPE has made towards making itself more attractive to investors. Louisa will be familiar to many LPE investors in her previous roles as former COO of LPeC, the Listed Private Capital Association. Previously she was a listed alternative funds equity research analyst at Royal Bank of Scotland and Jefferies.

Discount

Based on the January 2022 announcement of the NAV as at 31/12/2021, NBPE's strong NAV momentum continues (see **Performance**). Private equity holdings reflect valuations as at 30 September, but the 31 December NAV statement does include changes to listed equity holdings (c. 19% of fair value) and FX moves.

Based on NBPE's current share price of £18.90 and NBPE's 31 December 2021 Sterling NAV of £22.71, this results in NBPE trading on a c. 17% discount. The current discount is narrower than NBPE's five-year simple average discount of c. 23.0% according to figures from Morningstar but is wider than the Morningstar Investment Trust Private Equity peer group's average current discount of c. 9.4%. NBPE's discount could therefore be viewed as an attractive entry point. That said, valuations for NBPE and the peer group are historic and not all on the same dates, making accurate comparisons of discounts across the peer group quite difficult. Based on JPMorgan Cazenove estimates, NBPE currently trades on a discount of c. 14%.

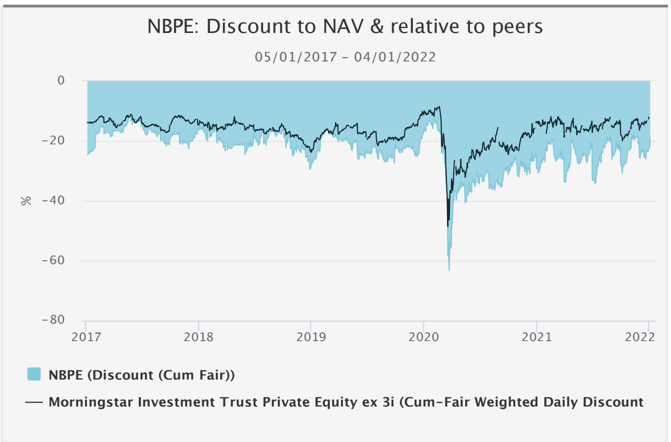
Fig.5: Listed Private Equity Peer Group Discounts To NAV



Source: Cazenove, Individual trust's websites

During the first onset of COVID-19 in March 2020, share buybacks were suspended and are yet to restart. However, as one might expect, the board regularly monitors the discount. It must be cautioned that the market liquidity of investment trusts is affected by significant downward market movements, which can intensify discount movements, as was the case in 2020. Therefore, investors must be aware that NBPE's discount, in addition to those of alternative listed private equity funds, is prone to the rapid widening of discounts during distressed market conditions.

Fig.6: Discount To NAV



Source: Morningstar

Charges

As we highlight in **Portfolio** and **Gearing**, NBPE's co-investment model of investing offers several advantages over other approaches to private equity investing (broadly: optimal diversification, deal-flow and control over the balance sheet/cash deployment in new investments). However, co-investing also enables NBPE to invest in deals largely free of management and performance fees to the underlying private equity sponsors, meaning a significant advantage over fund of fund peers, which often pay two layers of management and performance fees on their investments (typically 1.5 – 2% of committed capital and a typically carried interest fee of 20% of gains over an 8% hurdle). NBPE currently pays no fees on 97% of the direct equity portfolio.

With a management fee of 1.5% p.a. on 'private equity fair value' (i.e. investments, excluding cash), NBPE's management fee is in line with that of most direct-investing LPE funds. Neuberger Berman is also entitled to a 7.5% performance fee on NAV gains over a 7.5% per annum hurdle, subject to a highwater 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). NBPE's fee structure costs investors significantly less than accessing these funds directly. The trust's AIC OCF for the six months to the end of June 2021 was 2.03%, of which management fees represented 1.7% (since it is calculated based on private equity fair value but presented in this ratio as a percentage of NAV).

The KID RIY figure in July 2021 was 3.69%, of which 0.83% was carried interest (performance fees). It is worth noting that calculation methodologies do differ between companies and versus the AIC OCF.

ESG

The board of NBPE implemented a responsible and social investment policy in August 2020 and has confirmed that it believes in responsible investment. Neuberger Berman, as a business, has had ESG integrated into its investment process since 2007. Within NBPE's policy, the managers aim to identify and avoid those companies which are potentially exposed to adverse outcomes, and although not focussed on impact investments, the manager believes that companies that deliver a positive sustainability potential can be an important driver of returns. While this may not be present in every investment, the manager would consider this as an investment merit where relevant.

The Neuberger Berman Private Markets team believe material ESG factors are an important driver of long-term returns, offering the potential for both opportunity and risk mitigation. ESG factors are an integral part of the Neuberger Berman private equity team's due diligence process. As a co-investor, Neuberger Berman performs due diligence on each prospective investment and aims to ensure that the company and sponsor are appropriately managing ESG risks. The Neuberger Berman private equity investment team work closely with the firm's dedicated ESG team to ensure the implementation of industry best practices.

The team provides a breakdown of the directly invested portfolio as they currently see it, showing that the vast majority of the portfolio is either 'positive' or 'neutral' – and illustrating the point that the ESG process has been used for quite some time, and is working. We imagine that investors who have an ESG requirement might like to see the proportion of positive companies continue to increase. However, we believe that it is a significant development that the team provided the below information and look forward to seeing how the ESG reporting develops.

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