HARDMAN & CO.

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NB PRIVATE EQUITY PARTNERS

Value creation in a higher-rate environment

In this note, we explore how the sources of value creation have evolved and how NBPE's GP partners are expected to organically and inorganically generate incremental EBITDA growth to offset higher interest costs. Long-term target returns for new deals on the NB platform are unchanged, despite the short-term interest rate noise. This note builds on the drivers of historical superior EBITDA (see *2023 CMD: value creation from growing companies*). Investors should note that interest rates are just one of many factors that GPs manage. NB's views on value creation were outlined in its piece, *Navigating value creation in private equity*.

- **Target returns:** Across the NB platform, the net IRR target on new deals is still above 20%, in line with 2018. Looking at the 10 most recent co-investment deals on the NB platform, 93% of value is expected to come from organic growth, 17% from M&A and negative 14% from multiple contraction. The contribution from debt paydown is minimal. In 2006, 63% was expected from organic growth.
- **Incremental EBITDA growth options increasingly important due to rate environment:** Organic options include market share gains, optimising revenue, and new tech-enablement. Alongside this is value-adding M&A. We expect greater GP return dispersion, but NB has a strong track record of partnering with high-quality managers in their core area of expertise.
- **Valuation:** The 24% discount is in line with direct peers (average 25%), and it (like peers) widened sharply in 2022, to well above historical levels. In this note, we consider what may lead to a reversion to more historical levels of discount. The NAV appears resilient and conservatively valued, making the discount absolutely and relatively anomalous.
- **Risks:** Sentiment to costs, the cycle, residual positions in listed companies following IPOs in 2020-21, and the duration of the discount are the key issues for NBPE, as they are across the whole listed sector. Many of these sentiment issues do not reflect reality, as we see it. The benefits from the current strategy may not yet be fully appreciated.
- **Investment summary:** With over 93% of the portfolio invested in direct equity, NBPE is the only listed vehicle focused on the attractive co-investment strategy within the market-beating PE sector. The company and GP selection have proved resilient in downturns, and ongoing premiums on exit should give investors comfort in the NAV. Its portfolio is diversified by name, sector, GP and geographically, but it has enough concentration for individual investments to add value. The discount is anomalous with long-term, market-beating returns.

Financial summary and valuation

Year-end Dec ($m)	2019	2020	2021	2022	2023E	2024E
Interest and dividend income	13	10	6	5	6	13
Net fin. assets/liab. gains (FVTPL)	106	224	532	(76)	-	197
Total expenses	40	48	75	38	37	46
Net asset change from ops.	78	185	463	(109)	(31)	164
PE invest.	1,087	1,255	1,569	1,401	1,313	1,556
Net debt (incl. ZDP)	(184)	(189)	(46)	(66)	(5)	(119)
NAV per share ($)	19.11	22.49	31.65	28.38	28.08	30.85
NAV per share (£)	14.43	16.45	23.37	23.59	22.03	24.20
S/P prem./disc. (-) to NAV*	-16%	-29%	-21%	-33%	-24%	-32%
Dividend p/sh ($)	0.57	0.58	0.72	0.94	0.94	0.94
Yield	2.6%	2.6%	3.2%	4.7%	4.5%	4.5%
Year-end exch. rate (£:$)	1.324	1.367	1.354	1.203	1.275	1.275

*2023-24E NAV to current s/p; Source: Hardman & Co Research

Closed End Investments

Source: LSEG

Market data

EPIC/TKR	**NBPE/NBPU**
Price (£)	**16.48/$20.75**
12m high (£)	17.4/$22.0
12m low (£)	13.8/$17.0
Shares (m)	46.2
Mkt cap (£m)	762
NAV (Jan'24)	£21.58/$7.48
Disc. to £ NAV (%)	-24
Free float	100%
Ctry/Ccy of listing	UK - GBP/$
Market	FTSE 250, STMM

Description

NB Private Equity Partners (NBPE) leverages the platform of its manager, the PE division of Neuberger Berman (NB), including NB's relationships, deal flow and expertise, and has built a portfolio of ~86 direct investments diversified by manager, sector, geography and size. It focuses on investing in companies that benefit from secular tailwinds and/or lower cyclicality, with high barriers to entry, or the delivery of mission-critical products or services.

Company information

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Key shareholders

Quilter Cheviot	13.3%
Evelyn Partners	9.0%
City of London IM	6.8%
Treasury shares	6.3%
Cazenove Capital	6.1%
New Jersey Div. of Inv.	5.3%

Diary

Late Mar	Feb NAV

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Disclosure: the relevant analyst is a shareholder in NBPE.

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Unchanged targets

Rising and higher rates have multiple effects on PE businesses

We reviewed the potential impacts of a higher interest rate environment in detail in our note, *2023 CMD: value creation from growing companies*. In our view, consideration needs to be given to the impact on i) investee companies, ii) the mitigation they, and their GP managers, may adopt, iii) M&A market activity, iv) PE returns, and v) ratings for established, profitable companies like NBPE's investee businesses (see risks section below). While there may appear to be a number of complex impacts, we believe investors should first put them into the following strategic context.

Putting interest rates into context:

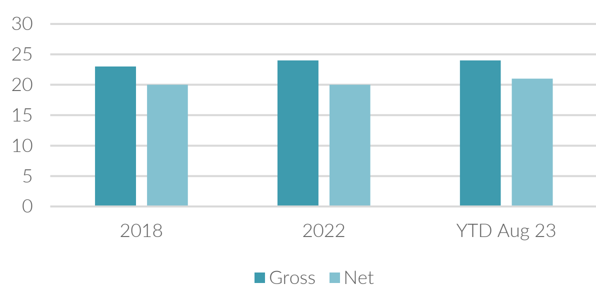
- they are short-term while PE is long term;
- co-investments give NBPE flexibility;
- they are just one of many issues to be considered – in our view, managing AI likely to be much more important; and
- PE-backed businesses are well placed to manage the risk because of incremental skills GPs brings.

- ► NBPE is investing for the medium-to-long term and the interest rate environment is short-term. Our understanding from GPs market-wide is that, in their plans, most did not assume that the ultra-low, post-pandemic rates would endure for the life of investments.
- ► We are already nearly two years into the rising rate environment with many effects already seen and potentially more visibility over future cost of capital.
- ► The co-investment model is capital-efficient, giving NBPE much more flexibility to adapt investment to the environment than a fund-of-funds approach. With more than $110bn invested in private equity, of which $35bn is in co-investments, NB has very close relationships with GPs, and the platform sees significant deal flow in co-investment, which NBPE can leverage.
- ► Interest rates are just one of many issues GPs manage. Private equity's historical outperformance is, in our view, in part, due to the way GPs, market-wide, often used digitalisation and cloud technology to enhance their investee companies' operational performance. A PE manager has resources and networks that are unavailable to standalone businesses. Looking forward, in our view, the potential for long-term incremental value added from effective tech-enablement and AI may be much more important than short-term interest rates.
- ► Market-wide, PE managers have shown incremental treasury skills in managing interest rates. Many fixed a lot of debt at lower costs before most of the interest rate increases, are able to access whole market funding, and extended debt maturity to a time when rates are expected to be lower again. Investee companies, which, typically, are showing strong growth, and which are not conducting M&A, could see a relatively rapid paydown of debt, thus reducing the sensitivity to rising rates.

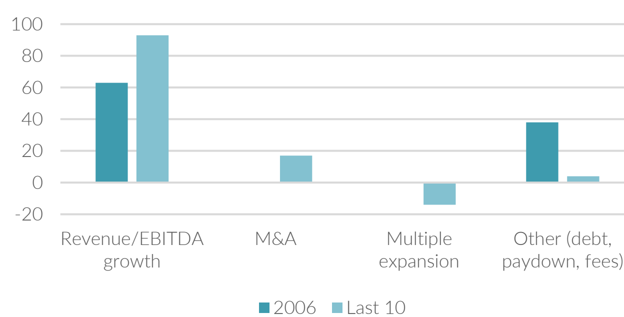
Across NB platform, net IRR target still above 20% on recent deals, in line with 2018. Mix of how the returns will be generated sees increasing focus on EBITDA growth and M&A, less from debt paydown.

As the left-hand chart below shows, the expected IRR in managers' plans is unchanged (indeed, net IRR is very marginally up) since 2018. What has changed is the mix of how the expected returns will be generated. In the past, two thirds were expected to come from EBITDA growth and one third from cash generation, paying down debts, etc. Now, 93% is expected to come from organic growth, 17% from M&A, just 4% from other factors such as debt paydown and negative 14% is expected from multiple contraction (i.e., managers are expecting lower multiples in the future).

Sponsor base case gross and net IRR (%)



Managers' planned sources of value creation (%)



Source: NBPE November investor presentation slides 8-9, Hardman & Co Research

How incremental EBITDA will be earned

GPs need to not only grow EBITDA but to grow faster because of drag to earnings of higher interest costs. Picking the right partner GPs is more important than ever.

To maintain IRR targets, and deliver relative outperformance to listed companies, GPs will need to generate incremental EBITDA growth in a market environment which may see slower market-wide growth for some years. In the following sections, we consider the incremental organic options, why accelerated M&A bolt-on deals at acceptable prices are more likely for PE-backed businesses and how the trust's co-investment strategy aids this process. It is likely that the dispersion among PE managers will increase, with those with the greatest expertise and skills enhancing the operating performance of investee businesses the most and thus delivering greater outperformance than the pack as a whole. NB's management notes seven levers to value creation in its insight piece, *Navigating value creation in private equity*.

Organic growth options

Incremental organic growth options driven by value added to companies

The key to understanding what growth NBPE's investee companies may generate over and above historical and listed peer levels, is to appreciate the value added by NBPE's GPs to their core of mid- to large-sized investments. GPs bring a scale well above the level of the standalone businesses; and, with that scale, comes specialist resourcing, networks, expertise, market knowledge and the ability to repeat playbooks with proven track records. In addition, the substantial financial resources mean that GPs can be nimble and react quicker to the market environment, allowing management to focus on investing in the business for the long term – not managing for the short-term reporting, like listed peers. Standalone businesses, without the greater certainty of the GP funds' financial resources, are also more likely to spend time on sorting out finance, rather than investing in growing the business.

Faster and greater adoption of tech-enablement

We believe one significant factor in NBPE investee companies delivering superior EBITDA growth in the past was the faster adoption of state-of-the-art technology. given the great flexibility and adaptability of PE-owned companies. GPs have the incremental human and financial resources and expertise to drive forward such changes to a greater extent than the businesses could do on a standalone basis. Historically, this was perhaps most evident in the digitalisation of previously analogue operations, including the adoption of cloud-based technology. In our view, PE-backed businesses have competitive advantages in the adoption of technology, such as AI, from their broad market contacts, economies of scale vs. standalone operations, ability to repeat successful playbooks and financial resources. It is still way too early to quantify such benefits; merely, we note that the probability of superior operational performance from them is high.

Market share gains as PE-backed businesses can focus on the business rather than firefighting

A sustained higher-interest-rate environment is likely to present more operational challenges to businesses than just higher financing costs. Demand is likely to be weaker and access to capital more difficult as banks reassess the risk outlook. We have, in previous notes, highlighted that the operational benefits a PE backer brings are more valuable in challenging conditions. By way of example, suppliers/credit agencies are more likely to have confidence in a business with access to a well-funded parent like a PE fund than a standalone business. Consequently, better contractual terms are likely. Easier access to such funding means that a business can continue its long-term investment plans and not face the financing challenges of non-PE-backed businesses. Overall, we expect PE-backed businesses to see some market share gains as a consequence of focusing on growing the business, not financing it.

Many NBPE investee companies have inflation pricing power

The main driver to higher, sustained interest rates will be a higher inflation environment. Company performance, *inter alia*, thus will be dependent, in part, on the ability to pass on cost inflation to their customers. We believe NBPE's investments have a greater ability to do this than the market average, reflecting a mix of:

- secular growth drivers such as ageing population and technology adoption;
- mission-critical services giving pricing power over customers;
- products and services, which represent a small proportion of customer total costs; and
- products and services, which improve customer efficiency and so save other costs for them.

Better treasury management limits impact of rising rates on bottom-line earnings

Further benefits of being backed by PE capital management include:

- Market-wide, many GPs were active in fixing their interest costs in 2020/21 (at lower than current levels) and extending the duration (e.g. 56% of NBPE investee company debt is not contractually due until 2027 or later). We are not brave enough to predict the timing of rate cuts, but the probability is that total financing costs will be lower in 2026/27 than at present. So, by extending the duration of debt to this date and later, PE-backed businesses may not feel the full effect of the short-term rise in interests, thereby reducing the burden further.
- Access to the cheapest, whole-market funding. The growth of private credit has been material in recent years, and we believe that GPs have the expertise and networks to access this source of funding in a way standalone businesses have not. This means that PE-backed businesses can access the cheapest, and most available financing from across capital markets.
- We believe the PE backer is more likely to negotiate better terms with, for example, a much greater prevalence of covenant-lite documentation than standalone businesses. In NBPE investee companies, 81% of debt was covered by such favourable clauses, as of June 2023.[1]
- As noted above, the presence of a well-financed PE backer, and its procurement teams, is also likely to give greater confidence to other financers and suppliers. In more challenging times, this confidence allows the PE-backed business to focus on growth rather than firefighting liquidity requirements.
- The level of gearing is driven by the ability to pay. While average debt/EBITDA is 5.4x across the NBPE portfolio, in areas such as business services (4.5x) and consumer/e-commerce (3.8x), it is lower, and in TMT (7.2x) higher. Given the relative growth rates in TMT, the time to recoup the extra cost of higher interest rates is likely to be broadly similar.
- There has also been a significant uptick in M&A follow-on investments, with PE managers investing further capital in businesses to fund these acquisitions. While the amount of equity increases, the prices at which the deals may be done, combined with EBITDA-enhancing synergies, sees an increase in overall returns on equity.
- In addition, across the market, we have also seen an increased use of structured/quasi equity rather than debt or common equity. While the cost is

[1] NBPE investor presentation, slide 12. Note: covers 65% of direct equity portfolio.

higher than debt, it should be lower than common equity. The proportion of equity invested in deals has increased, which provides opportunities for a co-investment specialist.

Accelerated M&A opportunities should add value over time

The chart on page four highlights that, in 2006, M&A was not included as a material driver to returns but that, in the most recent deals across the NB Platform, it accounts for nearly a fifth of value creation. In 1H'23, there were 1,827 US M&A bolt deals, after 5,312 in 2022. They accounted for nearly 80% of US buyouts in the period, up from just over 60% in 2018. Such deals can add complementary products, help reach new geographies and customers and bring economies of scale/operational improvements to the business. In the insight piece, *Private equity is harnessing the power of M&A to grow*, NB cites case studies for two investee companies, Solenis and Renaissance. A return to more normal markets in 2024, should macroeconomic or geopolitical risks moderate, could also see a market-wide recovery in M&A activity. In looking at why NBPE investments specifically may see more opportunities than the past, or standalone competitors, in making both value-added, bolt-on and strategic acquisitions, we note:

NBPE investee companies have a greater probability than average of value-added because of a mix of:

- **Being in fragmented market**
- **Planned in advance**
- **M&A being core PE competency**
- **GP market awareness**
- **Access to financing**
- **Management capacity**

- ► Investments have been in sectors/subsectors with often fragmented market shares, increasing the bolt-on acquisition optionality.
- ► Indeed, a detailed M&A plan is often part of the initial PE investment case, with potential targets pre-identified and tracked on an ongoing basis by the GP. Planning a deal well in advance means it can be executed more quickly when the opportunity arises, and synergies achieved rapidly.
- ► M&A is a core competency of PE and, consequently, the GP brings deal expertise likely to be unavailable to standalone businesses.
- ► GPs, typically, have the market breadth, networks and sector knowledge to identify new targets, evolving with the market conditions.
- ► The PE fund comes with committed funding, meaning that deals can be concluded with more speed and certainty. This has a real value to sellers in uncertain times.

Recent green shoots driven by selling boards being more comfortable with current prices and some PE funds approaching liquidation phases

Market-wide, we have heard comments that the green shoots of recovery in late 2023 market activity reflect:

- ► More listed companies have been more willing recently to accept current prices rather than holding out for historical ones, with more public-to-private options.
- ► Some listed company boards appear more willing to accept current prices for non-core divisions, thus increasing carve-out opportunities; as mature PE funds approach their liquidation period, their managers may be willing to accept a certain price now rather than holding out for a hoped-for but unknown better price at some unknown date in the future.
- ► Good but not prized assets may not be suitable for a continuation fund. The limited PE activity seen throughout 2023 increases the chances of such situations crystallising into deals in 2024.

Management insight

In its insight piece, *Navigating value creation in private equity*, NB identifies seven levers that private equity managers use to generate returns, depending on the

idiosyncrasies of investee companies and general market conditions. The key drivers are consistent with our analysis.

- *"Investment Selection: Selecting companies that stand to benefit from secular tailwinds, resilient business models, high barriers to entry, recurring or re-occurring revenue and the potential to create sustainable earnings growth.*

- *Management Incentivization: Recruiting, retaining and motivating experienced managers to oversee the business operations of a company. Meaningful management incentive plans increase alignment and can improve exit outcomes for private equity investors and senior management teams.*

- *Resources and Capital to Support Growth: Allocating the operating resources and/or capital to a company to expand products and services, augment distribution and sales efforts, and/or increase geographic footprint. If properly implemented, these tools can bend the growth curve of a company upwards.*

- *Operational Improvement: Providing resources for optimizing revenue and pricing, cutting costs, enhancing procurement and consolidating vendors, re-tooling sales incentives and otherwise improving margins.*

- *Strategic M&A: Sourcing, executing and integrating corporate acquisitions — preferably at accretive valuation multiples — to bolster supply chains, expand products and services, and access new customers. M&A can also be utilized to deleverage capital structures and provide interest coverage relief.*

- *Free Cash Flow Generation/Debt Paydown: Using a company's free cash flow to pay down debt both increases equity in the capital structure and lessens future interest costs.*

- *Multiple Expansion: Participating in an increase in the multiple of earnings at which a company is valued."*

NBPE-specific opportunities/management

NB track record of identifying opportunities with value drivers

NBPE has delivered, in the 10 years to October 2023, a cumulative NAV total return of 202%, nearly double the MSCI World Index's 118%. Looking forward, NB will continue its investment approach of i) more deal flow in co-investment across the platform (see page 4 of note, 2023 CMD: value creation from growing companies – in 2023, NB saw ca.11 co-investment deals a week, compared with just 8 in 2018), ii) investing with discipline and selectivity – the current conversion rate of opportunities to investments is ca.8%, a lower ratio than in the past, iii) focusing on high-quality companies and industries with the best managers, as skill in adding value and growing EBITDA is increasingly important, iv) constructing a well-diversified portfolio with a prudent and balanced approach to bottom-up portfolio construction, and v) identifying value-creation opportunities.

Below PE average gearing and dependence on leverage for returns

- NBPE delivered a last-reported weighted average debt-to-EBITDA ratio of 5.4x, which is lower than the broader PE market average leverage (in our view, 6x-7x). NB evaluates leverage and it is a consideration at investment at the start; the 5.4x also reflects the maturity of the portfolio, with debt paid down and/or EBITDA grown since initial investment. In its *CMD presentation* (slide 22), NBPE noted that its top 30 private investee company weighted average interest coverage ratio was 2.6x, double the estimated market PE coverage of 1.3x.

Strong IRR and gross multiples on historical investments

- In terms of evidencing good manager selection and value added to date, we note the five-year to end-October annualised gross IRR (15%) and the 2.3x gross multiple of cost on realisation. We note the portfolio investee company operating metrics (LTM to June 2023 weighted average growth in revenue and EBITDA of 15%). These evidence the continued value added by the GPs during the initial stages of the higher-rate environment.

70% of investee companies have done M&A

- In terms of M&A, 70% of NBPE's top 30 private companies have completed M&A during ownership, including both of those whose business case included small-scale roll-up and a few with more opportunistic transformational deals.

Rolling over investments in successful existing deals where model is already proven, rather than taking realisation opportunities and re-investing in new companies, is a feature

- Another element of positioning for the recent environment, management noted, was that it continues to back winning investments by maintaining or re-investing over $113m of value since 2020 into five existing portfolio companies, when they had options to realise all or a proportion of the holdings. These re-investments were, at end October 2023, valued at 1.3x the rolled value, an IRR of 27% over a weighted average hold period of 1.5 years (in addition to the 2.9x realised return (31% IRR) on these investments from the original investments).

In the right sectors

- In the following portfolio section, we show the sector diversity. While it indicates a focus on companies in sectors, it does not give the full picture. If we took the analysis one stage further and looked at subsectors, we believe that the growth resilience would be even more evident. Consumer/ecommerce is a very good example of such an allocation, with some subsectors showing strong secular growth and others very much more challenged.

Diversified by manager

- NBPE's strategy sees it partner with 53 managers (at end-December 2023) thus introducing diversification. It is not dependent on one manager but instead has a range of GPs with expertise in their specific sector or niche.

Not in venture, where valuation ratings most exposed to rising rates

- Impact on ratings: as the sector review slides of the CMD presentation (42-46) show, the vast majority of NBPE investee companies are EBITDA-positive, as it is investing in established, profitable businesses. It is not present at the venture capital stage, where valuation ratings are most vulnerable to the discounting of future cashflows at higher discount rates.

Risks

While NBPE's portfolio has below broader PE market gearing, it will still be impacted by the interest environment. In considering any potential adverse effects, we note:

Mitigation of Impact on investee companies' earnings includes pricing power, secular growth, disruptive business models, bias to products/services, which improve customers' efficiency and bolt-on deals at lower prices

- A company with £100m EBITDA and £540m of debt (at 5.4x, in line with NBPE's portfolio average) would pay £32.4m if its funding costs were 6%, but £59.4m if the financing rate rises to 11%. The incremental £27m is 27% of the opening EBITDA. Further increases in rates, or an extended higher-for-longer environment could exacerbate the problem, while NBPE's investee company strong EBITDA growth, would reduce it. As we noted above, this is mitigated by i) GPS, market-wide, spreading the impact over many years by fixing the majority of debt, ii) above-average pricing power, which allows the passing on of price increases, iii) investment in secular growth sectors and subsectors (see section on p7 for the distribution of debt by the sector growth opportunities), iv) offering disruptive service models, v) providing efficiency-improving services, which are more in demand, vi) an increased element of equity contribution, and vii) greater potential M&A. NBPE investee companies are carrying below-PE-market-average leverage (which, in our view, is around 6x-7x, biased by larger

deals).[2] As we also noted above, the vast majority of debt is also covenant-lite. Not all PE will be affected identically, and NBPE's positioning appears to be lower-than-average risk.

Chosen niche means NBPE has not fully reflected slower market-wide activity

- Higher rates have affected market activity, and a continued period of uncertainty and high rates could see this continue. However, NBPE's strategy has moderated the effects: i) NBPE has continued to see exits at uplifts to carrying value, reflecting its choice of attractive businesses and being in the mid-market, which has slowed less than large deals; and ii) the number of opportunities for co-investment has been rising as GPs seek greater equity support in deals.

- The changing drivers, identified on page 3, mean that value is being created through organic growth and M&A and not through multiple expansion, which may lead to lower uplifts on exit going forward, but overall returns should remain unchanged.

PE manager target returns unchanged

- As noted in the previous sections, target returns are unchanged in the plans submitted to NB for recent deals compared with the past, but the mix of returns has changed significantly. Looking at the two aspects of the impact on PE returns:

  - While market-wide PE disclosure has tended to focus on EBITDA, we believe most investors focus on bottom line, cash, and earnings growth. It has only been with the recent rapidly rising rates that there has been a divergence between them and EBITDA. The divergence is driven by the change in interest rates and how long their effects take to be felt. A falling rate environment is likely to see a positive gap between PE-backed earnings vs. EBITDA relative to the market. PE is a long-term investment while the interest rate environment is short-term.

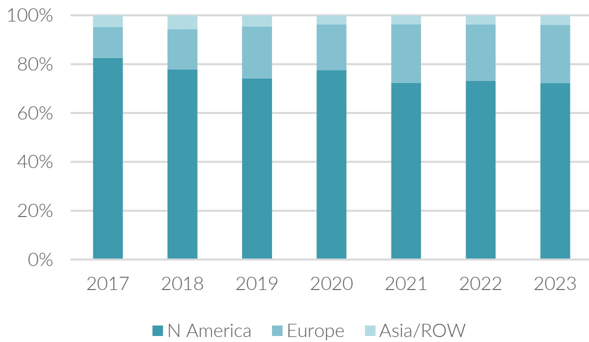
  - In our view, growth business ratings are more exposed to the impact of higher interest rates as there is a greater proportion of the valuation dependent on future earnings power. Arguably, higher-growth PE businesses, therefore, should see a greater fall in ratings than average. However, the degree to which this effect will be felt will vary. As the sector review slides in NBPE's *CMD presentation* (42-46) show, the vast majority of NBPE investee companies are EBITDA-positive, as it is investing in established, profitable businesses. It is not present at the venture capital stage, where valuation ratings are most vulnerable to the discounting of future cashflows at higher discount rates.

[2] See, for example, https://www.forbes.com/sites/davidwmccombie/2022/05/16/private-equitys-playbook/ or UK average at 6.5x https://www.privateequityreportinggroup.co.uk/Media/Annual-review-finds-private-equity-backed-businesses-continue-to-outperform-public-companies-January-2024

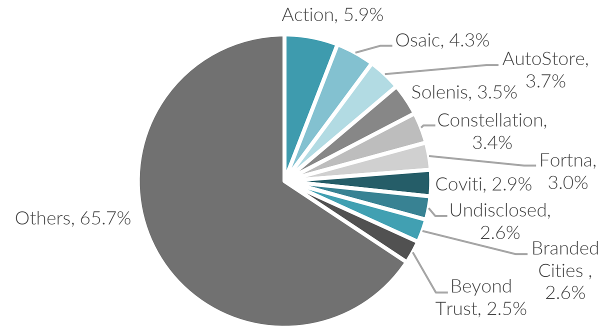
Portfolio summary (Dec'23)

The charts below show some of the trends in the portfolio. There has been a continuation of trends, rather than anything dramatic, which is not surprising, given the long-term nature of NBPE's investments.

Geographical mix of assets (% portfolio value)

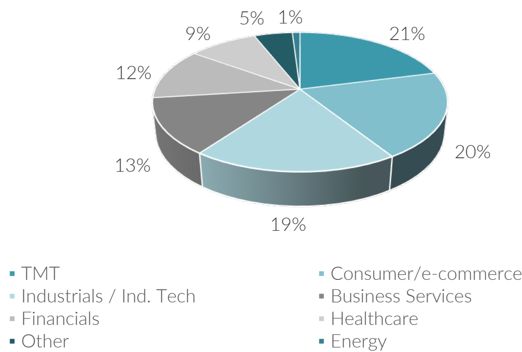


Largest holdings (% fair value)

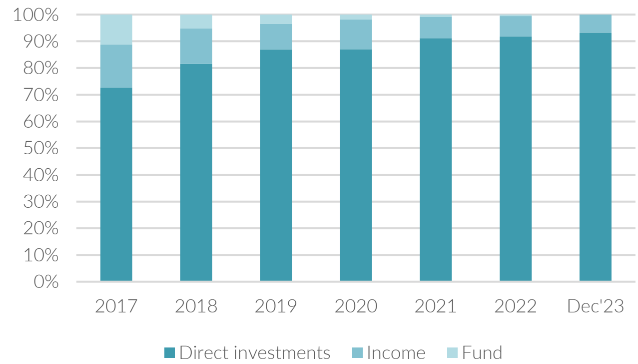


Source: NBPE December factsheet, Hardman & Co Research

Sectoral mix of investments (% portfolio value)

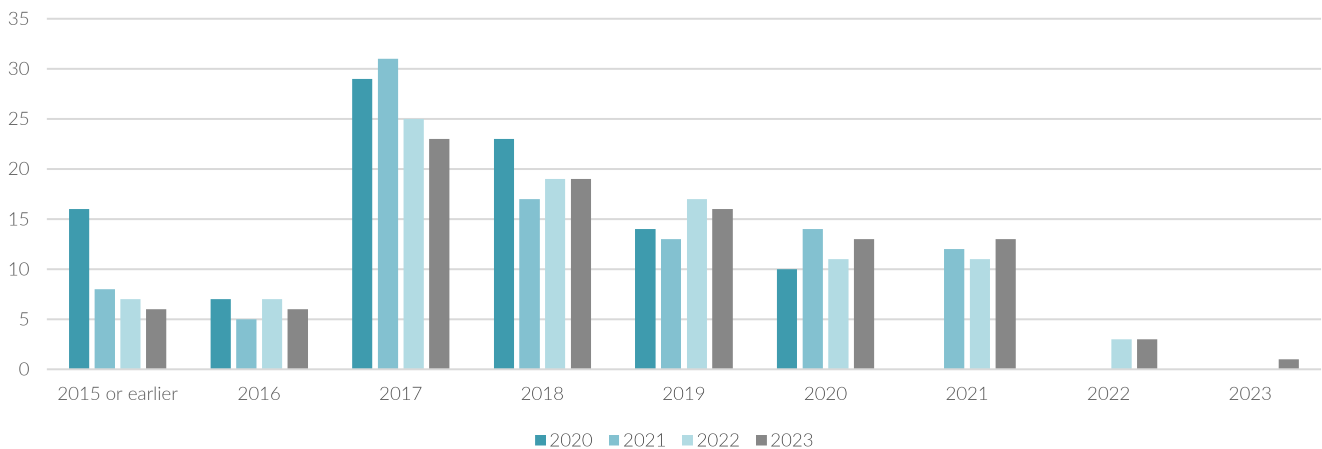


Mix by type of investment (% portfolio value)



Source: NBPE December factsheet, Hardman & Co Research

Mix of investments by vintage (% portfolio value)



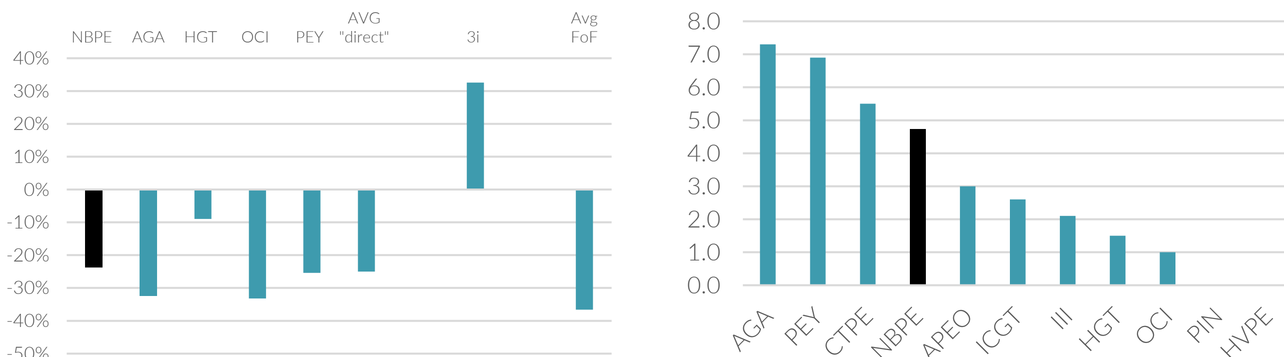
Source: NBPE December factsheet, Hardman & Co Research

Valuation

Discount is in line with direct investing PE peers

As the chart below shows, NBPE's current reported discount to NAV (24%) is in line with most of direct investing listed PE trusts. This appears anomalous with its business model. Its dividend yield is appreciably above the sector average.

Current share price discount to latest NAV (LHS, %), and dividend yield (RHS, %) for narrow and wider peers



Source: Company websites, factsheets and presentations, Hardman & Co Research, priced at 14 January 2024

We addressed sector-wide concerns about the validity of the current NAV and its resilience in earlier reports on NBPE, which appear to be more sentiment issues than reality. If NBPE were a trading company, we would use a GGM model, to reflect the value added by management. Using this model, it should trade on a multiple appreciably above NAV, given returns are a long way above cost of capital and that it has grown strongly over the medium term.

What could lead to a rerating?

We reviewed in detail in *our initiation* our view that there are two possible elements to a rerating, namely:

First element is sector rerating, which, arguably, has already started

The first element of a rerating would be a reversal of the 2022-1Q'23 increase in sector-wide discounts. This requires more confidence in NAV and economic resilience, driven by i) continued exit uplifts and returns, which could give investors this confidence, and ii) a risk-on rather than risk-off environment, which will help. This may coincide with further confidence that a US recession has been avoided or a market view that interest rates have peaked.

Second element is final 10%-15% of the discount to par. NBPE requires delivery of returns but may take more time.

At the end of 2018, the discount was 21%, falling to 16% at the end of 2019. This rose to 29% at the end of 2020 on COVID-19, before falling again, at end-2021, to 21%. The group's transition to being a co-investment vehicle has evolved (end-2017 nearly a third of PE investments were in income investments and funds against just 7% at 1H'23), so a migration from a fund-of-fund comparative valuation to a direct one has also been seen. Within this noise, and adjusting for the current business mix overall, we would characterise the trust as having a historical sustained discount of around 10%-15%. Given the returns in underlying companies driving market-beating investor returns, and the strong capital structure inherent in a co-investing vehicle, any discount appears a fundamental anomaly. In our view, eliminating it over the longer term is about delivery of returns, which, at some stage, is likely be recognised by the market.

Financials

Profit and loss								
Year-end Dec ($m)	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024E**
Interest and dividend income	16.5	17.4	12.5	9.5	5.7	4.5	5.5	13.0
Expenses								
Inv. mgt. and services	11.9	14.3	15.3	16.7	22.5	21.1	18.8	17.7
Carried interest	7.9	-	6.9	15.2	37.2	-		7.4
Finance costs								
Credit facility	3.2	4.5	8.5	6.3	4.1	6.0	10.0	13.0
ZDP shares	3.4	4.8	6.0	6.4	6.9	6.0	3.2	2.4
Administration and professional fees	4.0	3.6	3.7	3.5	4.3	4.5	4.8	5.2
Total expenses	30.4	27.3	40.4	48.1	75.1	37.7	36.9	45.6
Net investment income (loss)	**(13.9)**	**(9.9)**	**(27.9)**	**(38.6)**	**(69.3)**	**(33.1)**	**(31.4)**	**(32.6)**
Net realised gain (loss) on inv. and fx	89.4	64.4	33.8	90.2	212.4	51.2	-	65.7
Net change in unrealised loss	23.9	(7.8)	72.1	133.3	319.7	(127.1)	-	131.3
Net realised and unrealised gain (loss)	113.3	56.6	105.9	223.5	532.1	(75.9)	-	197.0
Net change in net assets from ops.	**99.4**	**46.6**	**78.0**	**184.9**	**462.7**	**(109.1)**	**(31.4)**	**164.4**
Non-controlling interest	(0.1)	-	(0.1)	(0.4)	(0.5)	0.1	(0.5)	(0.5)
Net change in net assets	99.2	46.6	77.9	184.6	462.2	(108.9)	(31.9)	163.9
Average no shares (m)	48.8	48.8	47.5	46.8	46.8	46.8	46.5	46.4
EPS ($)	2.03	0.95	1.64	3.95	9.88	(2.33)	(0.69)	3.53
DPS (p)	0.50	0.53	0.57	0.58	0.72	0.94	0.94	0.94

Source: NBPE, Report and Accounts, Hardman & Co Research

Balance sheet								
@ 31 Dec ($m)	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024E**
PE financial assets	961.4	1,019.9	1,087.0	1,254.6	1,569.3	1,401.4	1,313.3	1,555.6
Cash	25.8	23.0	9.5	3.0	116.5	7.0	165.8	13.7
Other assets	5.0	11.0	4.4	9.1	3.5	2.7	7.5	7.5
Proceeds receivable	7.6	8.1	1.5	0.6	0.3	0.2	0.2	0.2
Total assets	**999.7**	**1,062.0**	**1,102.5**	**1,267.4**	**1,689.6**	**1,411.3**	**1,486.8**	**1,577.0**
Liabilities								
ZDP share liability	71.1	134.9	146.1	157.0	162.0	72.8	80.4	0.0
Credit facility loan	60.0	40.0	47.0	35.0	0.0	0.0	90.0	132.8
Carried interest payable to Special LP	7.9	0.0	6.9	15.2	37.3	0.0	0.0	7.4
Payables to inv.	3.2	3.7	3.9	4.6	5.8	5.2	5.2	5.2
Net deferred tax liability	3.5	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Accrued expenses and other	1.5	9.4	2.6	2.4	2.2	4.1	5.3	5.3
Total liabilities	**147.2**	**188.8**	**206.5**	**214.2**	**207.3**	**82.1**	**180.9**	**150.7**
Net assets	**852.5**	**873.2**	**895.9**	**1,053.2**	**1,482.3**	**1,329.2**	**1,305.9**	**1,426.3**
Class A	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Class B	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional paid in capital	525.2	525.2	497.1	496.6	496.6	496.6	496.6	496.6
Retained earnings	335.1	355.9	406.4	563.8	992.4	839.5	815.6	929.5
Shares in treasury	-9.2	-9.2	-9.2	-9.3	-9.3	-9.3	-9.2	-9.2
Total equity ownership	851.5	872.4	894.8	1,051.7	1,480.2	1,327.3	1,303.5	1,4237.4
NCI	1.0	1.0	1.1	1.5	2.1	1.9	2.4	2.9
Total net assets	**852.5**	**873.3**	**895.9**	**1,053.2**	**1,482.2**	**1,329.2**	**1,305.9**	**1,426.3**
Period-end no shares (m)	48.8	48.8	46.8	46.8	46.8	46.8	46.5	46.2
Adj. NAV per share ($)	**17.45**	**17.87**	**19.11**	**22.49**	**31.65**	**28.38**	**28.08**	**30.85**
NAV growth (%)	10%	2%	7%	18%	41%	-10%	-1%	10%
NAV total return	13%	6%	10%	21%	45%	-8%	2%	13%
Adj. NAV per share (£)	**12.91**	**14.03**	**14.43**	**16.45**	**23.37**	**23.59**	**22.03**	**24.20**
Exch. rate (£:$)	1.352	1.274	1.324	1.367	1.354	1.203	1.275	1.275

Note: December 2023 NAV from factsheet. Actual 4Q valuations may see this change. Source: NBPE Report and Accounts, Hardman & Co Research

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