Standing on the shoulders of giants

We take a look at NBPE, a trust which is managed using a unique co-investment strategy, and has the promise to become one of the future stars of the private equity space...

The private equity industry has seen dramatic growth over the past three decades as institutional investors have flocked to the asset class, thanks to its historic ability to deliver consistently strong returns, typically relatively uncorrelated to traditional equity benchmarks. Over more recent timeframes, this strong performance has continued. The AIC Private Equity sector, which represents a way for non-institutional investors to access the space, has outperformed the majority of other equity sectors over five years (to 21/01/2021), producing share price returns of more than 204%, on average.

Five Year Returns From AIC Sectors

AIC SECTOR	AVERAGE SHARE PRICE RETURN (%)	AVERAGE NAV RETURN (%)
UK All Companies	62.7	53.9
North America	80.1	77.1
Europe	94.6	93.8
Private Equity (UK Listed Direct)	204.3	148.6
Asia Pacific	218.3	189.6
Global	290.1	289.9

Source: JPMorgan Cazenove (to 21/01/2021)

Past performance is not a reliable indicator of future results.

However, not all private equity funds or trusts are created equal. Within the AIC Private Equity sector, we have seen a broad range of returns from the trusts. For example, over the past five years, three trusts within the sector have delivered NAV returns of more than 100%, while four trusts have seen negative NAV returns. Therefore, selecting the right manager is a crucial decision and, within an already relatively complex area of investing, can be a difficult one.

In this article we take a look at **NB Private Equity Partners (NBPE)**, which is unique within the AIC Private Equity sector because of the way it invests through co-investments alongside a wide range of lead private equity sponsors, which offers diversification without the reliance on a single lead manager and cost advantages as co-investments are typically made on a 'no management fee, no carried interest' basis. Thanks to its approach, it has a strong track record compared to peers in delivering NAV growth and income through a dividend.

Access to the inaccessible

Over the past five years, ending 21/01/2021, NBPE has delivered NAV returns of 74.2% in USD, while the share price has returned 115.2% (JPMorgan Cazenove). Despite the strength of these returns, the trust trades at a discount of close to 19%, making this a potentially interesting time to examine it.

NBPE is unique in the listed private equity sector in that the vast majority of investments made are through co-investments. These opportunities arise when the manager (or sponsor) leading a deal, seeks a partner or partners to participate in the investment. The co-investor has the benefit of full due diligence in order to make its investment decision, but if it chooses to invest, operating control of the company remains with the sponsor. Neuberger Berman is a well-known name in the private equity co-investment space and as such isn't reliant on only a small number of partners to introduce opportunities. Currently, Neuberger Berman is a partner in more than 500 active funds and has become a preferred strategic partner to numerous private equity sponsors, illustrating the access NBPE has to a broad flow of investment opportunities.

There are an abundance of advantages to this strategy. Arguably the most important benefit is the direct control the investment manager of NBPE has in the decision-making process. Neuberger Berman makes investments on a "real time" basis for NBPE, based on the available capital and the prospects going forward. This means that the board and manager can apply appropriate levels of leverage (currently 18% of NAV according to the AIC) offering the potential to enhance returns for shareholders, while adding a moderate level of risk which is mitigated by the ability to control capital pacing. The risks of employing gearing are subtly different to those risks that other private equity trusts run. **As we discuss in greater detail here**, NBPE's co-investing strategy differs from peers who either commit to a single manager's funds or to a range of different managers' funds. Commitments are called only when the manager has found and transacted on a deal. Given there is little visibility surrounding when these transactions will take place, unlike NBPE these funds are required to run an over-commitment strategy which also increases risks.

Another advantage of NBPE's approach is that shareholders will typically only be required to pay one layer of recurring fees. In fact, as of 31 December 2020 on 96% of the direct equity portfolio, NBPE does not pay underlying management fees or carried interest to third-parties. In comparison to a fund of funds, this represents a saving of the underlying management fee, which is typically 1.5–2% of committed capital and a typical carried interest fee of 20% of gains over an 8% hurdle. Investors in NBPE only pay the vehicle level fees on most investments– a 1.5% management fee and performance fee of 7.5%, measured annually and subject to a hurdle rate of 7.5%.

FTSE ALL-SHARE VS NBPE SECTOR ALLOCATIONS

FTSE ALL-SHARE SECTOR CLASSIFICATION	WEIGHTING (%)	NBPE SECTOR CLASSIFICATION	WEIGHTING (%)
Oil & gas	7	Energy	1
Basic materials	9	Other	5
Industrials	13	Industrials	13
Consumer goods	17	Consumer goods	19
Healthcare	9	Healthcare	14
Consumer services	12	Business services	11
Telecommunications	2	Comm / media	6
Financials	26	Financials	11
Technology	1	Information Technology	18
Utilities	3		

Source: NBPE & FTSE factsheets, as of 31 December 2020

As a result of the differentiated process, as well as the greater access to small/mid-cap companies that private markets provide, the NBPE sector weightings are significantly different to a typical UK listed equity index.

NBPE is a unique vehicle, offering investors a direct exposure to private equity without the usual associated costs. Through their co-investment strategy, the team are able to utilise capital more efficiently whilst increasing visibility, and benefitting from third-party experience. Given the significant discount the trust trades on and its steady historical performance, now could be an opportune time to look at this differentiated trust within the private equity sector.

To read more about the unique approach of NBPE, please click here

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