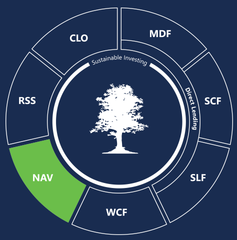


PEMBERTON

NAV Financing – An opportunity for insurance CIOs

May 2024

The rise of NAV financing for private equity buyout funds is drawing the attention of insurance company chief investment officers due to the attractive risk/return characteristics and strong structural credit protection features in a nascent and fast-growing asset class.

Providing cross-collateralised loans against portfolios of seasoned assets owned by PE sponsors (through funds with a diversified holding of usually around 10 portfolio company investments), NAV financing in the buyout arena is accelerating quickly amid growing awareness and adoption of the instrument by both GPs and LPs as a highly flexible tool that can be applied to a myriad of capital, liquidity, and value creation objectives.

NAV finance offers a range of compelling risk/reward features for insurance allocators and other fixed-income investors that make the asset class appealing either as an adjunct to, or as an alternative to, other public and private debt offerings – providing highly attractive returns on an absolute and risk-adjusted basis.

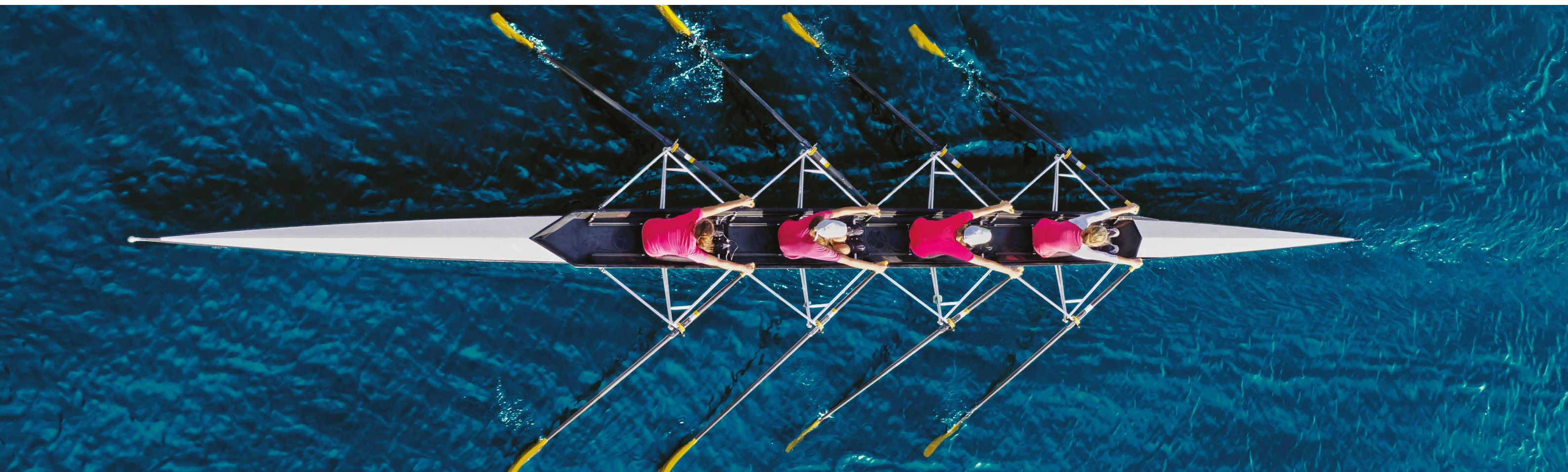
The Key Attributes of NAV Finance

Generic core credit characteristics:

- Cross-collateralised nature of NAV loans
- Lending against seasoned portfolio assets
- Low LTV ratios and high equity cushions
- Multiple repayment sources and options
- Beneficial priority cash sweep structures
- Embedded structural lender protections
- Ultra-low loan loss/default probabilities
- Investment-grade rated (usually A-/BBB+)

Insurance-specific characteristics:

- Sub-IG returns for investment-grade risk
- Favourable Solvency II capital treatment
- ~200bps+ premium to public equivalents
- Low volatility versus publicly traded debt
- Portfolio and balance sheet diversification
- Accessible via funds and/or co-investment



NAV facilities can be structured in a range of bespoke risk/return profiles according to the requirements of the borrower, the lender and underlying fund investors – ranging from senior debt to preferred equity.

The lower-risk core NAV product – which generally has low loan-to-value (LTV) ratios in the range of 10-30%, high equity cushions of 70-90%, and tight financial covenants – is especially applicable to insurance investors looking for yield enhancement and diversification into asset classes that also carry favourable solvency capital requirement (SCR) treatment under the Solvency II regime.

As loans that are cross-collateralised on seasoned portfolio assets, with multiple sources of repayment and low LTVs, core NAV financing facilities carry investment grade ratings – typically A- or BBB+. However, these loans deliver attractive sub-investment grade returns – yielding anywhere from 200bps to 400bps over equivalent publicly traded debt, with substantially lower volatility than public market equivalents and ultra-low loan loss/default rates.

NAV financing is as an all-weather strategy that can deliver attractive risk/reward outcomes throughout the economic cycle, in both good and bad environments, with the multi-asset and highly diversified nature of the product acting as a risk mitigant and volatility buffer for investors in deteriorating credit markets.

In addition defensive NAV Financing transactions offer strong appealing characteristics for insurance CIOs, namely an investment grade rating and a favourable SCR treatment. This result in a very attractive return on regulatory capital and an interested cash yield to generate income for the balance sheets.

Given the rapid growth in awareness and adoption of the NAV asset class – which several industry estimates have predicted could grow almost tenfold from its current market size of $80-100bn to around $700bn by 2030 – the asset class remains very under-served, with fewer than 10 dedicated institutional capital providers alongside the banks that have traditionally dominated the lending space but which are now generally pulling back due to regulatory capital pressures.

As a leading private credit manager, Pemberton leverages its local market expertise, enabled by an extensive office network located across the 10 key European economies, to maintain value-additive relationships with LPs. This local market presence and experience, drawing on our review of over 3,375* deals, provides a distinct advantage in identifying, evaluating, and realising investment opportunities, making us an attractive partner for institutional investors such as insurance companies. As NAV finance rapidly matures into a mainstream instrument widely adopted by the PE buyout ecosystem, Pemberton is poised to continue to provide our investors with diversified, attractive risk-adjusted returns.

*Companies reviewed since 2019.

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