

NAV financing: a private equity stakeholder guide

Relatively new in private equity, but long-established in other asset classes, NAV financing is growing rapidly as a highly flexible solution for GPs and LPs in a fast-evolving PE ecosystem.

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Net asset value (NAV) financing is a well-established practice within banking, particularly for liquid and illiquid asset classes. Historically applied to equity funds, credit funds, macro funds and more, it has recently gained traction within private equity (PE) funds, especially buyout funds. This method of financing represents a significant evolution in the lifecycle of PE funds, serving residual financing needs post-investment.

Similar to how subscription lines were created to bridge the gap between asset origination and capital call receipt, NAV facilities now address ongoing financing needs beyond the investment period. As these financing solutions become more prevalent, they facilitate increased dialogue among lenders, general partners (GPs), and limited partners (LPs).

When is NAV financing used?

NAV financing can be used both to support growth and to be in line with a more defensive approach.

Growth-orientated applications may include:

- Finance transformational or bolt-on portfolio acquisitions.



- Proactive optimisation of fund level and portfolio company leverage.

Defensive applications may include:

- Protection against dilution of equity interest.
- Liquidity to support portfolio investments.
- Facilitating dividend recap: lock in performance returns and accelerate distributions.

GP consent from LPs for NAV financing

In many cases a transaction does not require explicit approval from the Limited Partner Advisory Committee or the LP.

However, when LPs invest in a fund, they accept many risks, due to the skill and integrity of the GP. The limited partnership agreement (LPA) and accompanying fund documentation govern and help drive this interaction, but cannot hope to capture all eventualities, how the parties to the agreement interpret their obligations in terms of their level of service, and the depth of engagement. Therefore, there needs to be an inherent degree of trust that governs the beginning and maintenance of a LP/GP relationship.

As such, whether or not explicit consent is required to implement a NAV facility, it is important for parties to clearly communicate the motivation for the transaction and the financing need being solved.

‘NAV facilities now address ongoing financing needs beyond the investment period.’

'NAV financing is poised to become a mainstay in the private equity ecosystem, offering robust solutions for liquidity and capital challenges.'

Key considerations for GP/LP engagement

NAV financing is highly bespoke, making effective communication critical. The following nine points should guide GP/LP interactions:

1. Transaction rationale

Clearly establish the transaction's purpose and merits, whether defensive, accretive, or supportive, ensuring stakeholder alignment.

2. Transaction process

Significant discussions between GPs, formation lawyers, and NAV providers typically unfold over months. Engagement timing with LPs is bespoke, influenced by market or portfolio sensitivities.

3. Impact on KPI performance

Evaluate KPIs (IRR, MOIC, DPI) before and after the transaction.

4. Portfolio implications

Assess pre- and post-transaction portfolio leverage. Address misconceptions about leverage increases, noting that transactions often optimise leverage for seasoned companies or facilitate acquisitions, reducing leverage on a pro forma basis. Consider the debt versus equity split and the appropriateness of the debt structure.

5. Transaction structure

Justify the proposed structure, collateral scope, enforcement rights, cash-flow sweeps, and associated risks. Most transactions involve an SPV borrower, similar to company acquisitions, which isolates the transaction from the fund while allowing GP discretion in capital structuring.

6. Legal amendments

Address any legal implications, such as preferential claims, covenants, or necessary fund restructuring.

7. Finance counterparty

Discuss the identity of finance providers, their alignment of incentives, identification of any conflicts of interest and their understanding of corporate credit. This helps gauge their suitability for constructive engagement under stressed conditions.

8. Explicit consents (if any)

Identify any explicit consent requirements from stakeholders, determined through legal due diligence.

9. Fiduciary responsibilities and stakeholder interests

LPs must recognise they are part of a broader limited partnership. Decisions by GPs may not suit all individual investors, but GPs have a fiduciary duty to act in the best interest of all LPs collectively.

Market Outlook

NAV financing's flexibility makes it suitable for various liquidity and capital needs, ensuring its longevity in the private equity financing landscape. Much like the evolution and acceptance of subscription lines, NAV facilities are set to become integral within private equity. The adoption across alternative asset classes is growing, driven by extended hold periods, economic headwinds, and an increased awareness of the benefits of unlocking value creation and recycling equity to drive enhanced fund performance.

By fostering clear communication and alignment between GPs and LPs, the industry can fully leverage this versatile financial tool. ■

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SUMMARY

NAV financing is growing rapidly as a highly flexible solution for GPs and LPs in a fast-evolving PE ecosystem.

NAV financing can be used both to support growth and for a more defensive approach.

NAV financing is highly bespoke: effective communication is critical.

Clearly communicate the transaction rationale and merits, identify any conflicts of interest and preservation of stakeholder alignment.

NAV facilities are set to become integral within private equity.