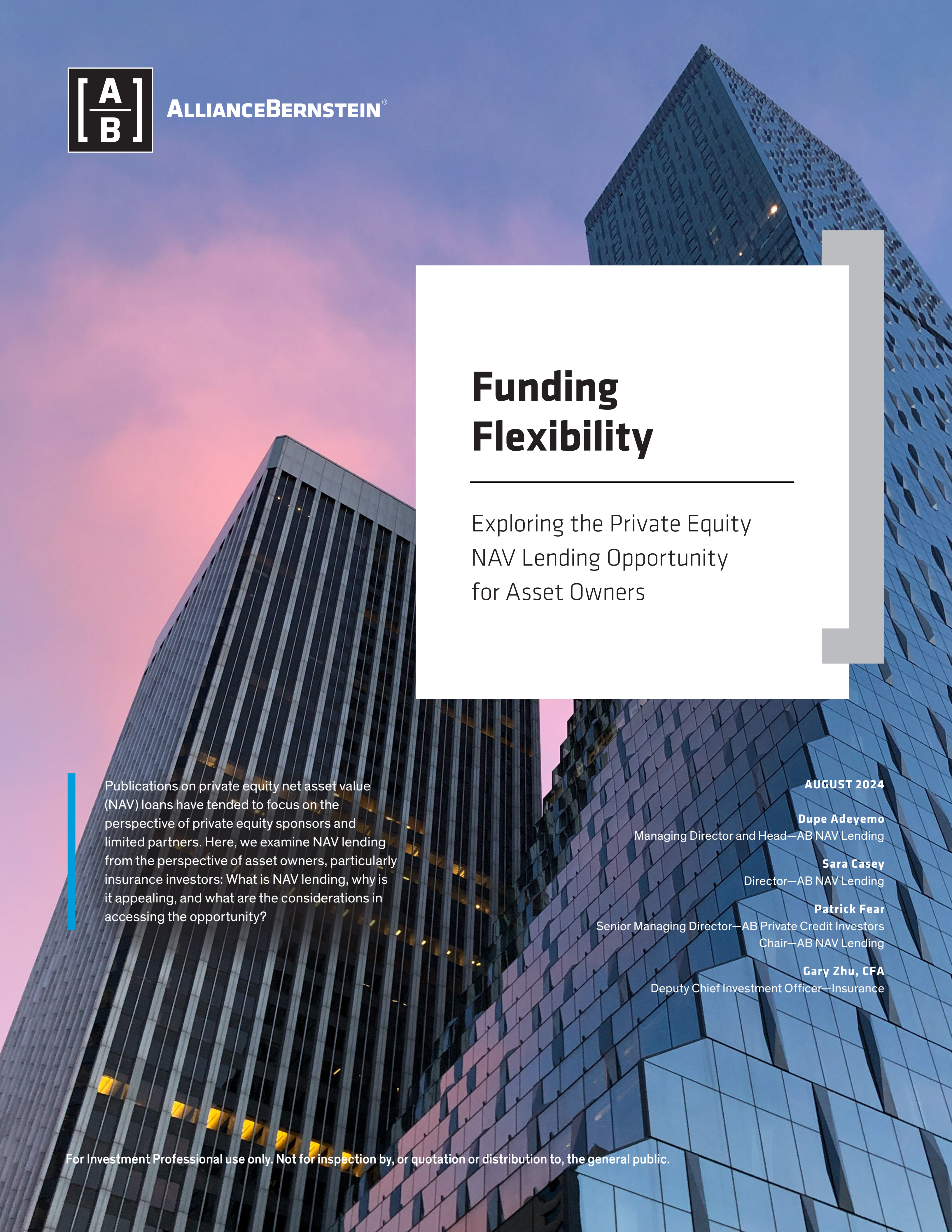


ALLIANCEBERNSTEIN®

Funding Flexibility

Exploring the Private Equity NAV Lending Opportunity for Asset Owners

Publications on private equity net asset value (NAV) loans have tended to focus on the perspective of private equity sponsors and limited partners. Here, we examine NAV lending from the perspective of asset owners, particularly insurance investors: What is NAV lending, why is it appealing, and what are the considerations in accessing the opportunity?

AUGUST 2024

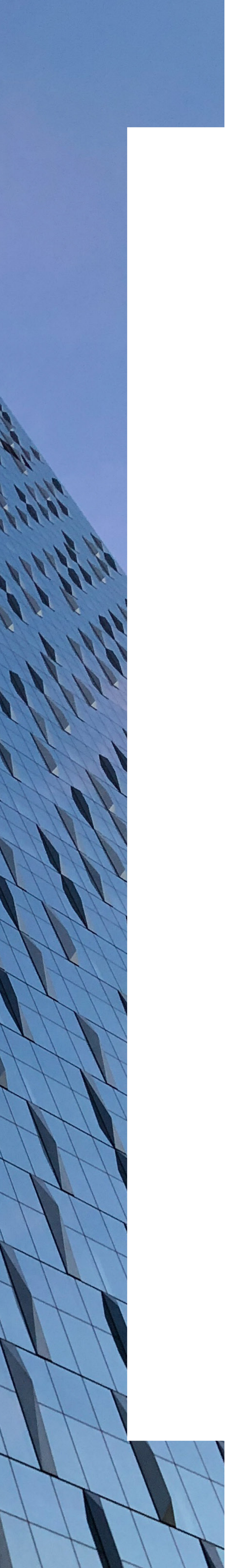
Dupe Adeyemo
Managing Director and Head—AB NAV Lending

Sara Casey
Director—AB NAV Lending

Patrick Fear
Senior Managing Director—AB Private Credit Investors
Chair—AB NAV Lending

Gary Zhu, CFA
Deputy Chief Investment Officer—Insurance

For Investment Professional use only. Not for inspection by, or quotation or distribution to, the general public.



Executive Summary

Since its beginnings in the early 2000s, the market for NAV lending has continued to grow and develop as a source of flexible capital for private equity sponsors and their funds. As funds advance through their investment cycles, loans backed by their underlying investments can supplement up-front capital commitments from limited partner investors.

We believe NAV loans represent a compelling proposition for many stakeholders:

- Private equity sponsors have access to a nondilutive alternative capital source with multiple uses in both offensive and defensive applications.
- Limited partners in private equity funds benefit when NAV loans are used to unlock value at the underlying portfolio companies.
- Discerning NAV lenders with strong sourcing networks can underwrite and execute loans with attractive return potential and robust covenants.
- Asset owners, including insurance investors, can add a complementary investment-grade asset class to their private market allocations.

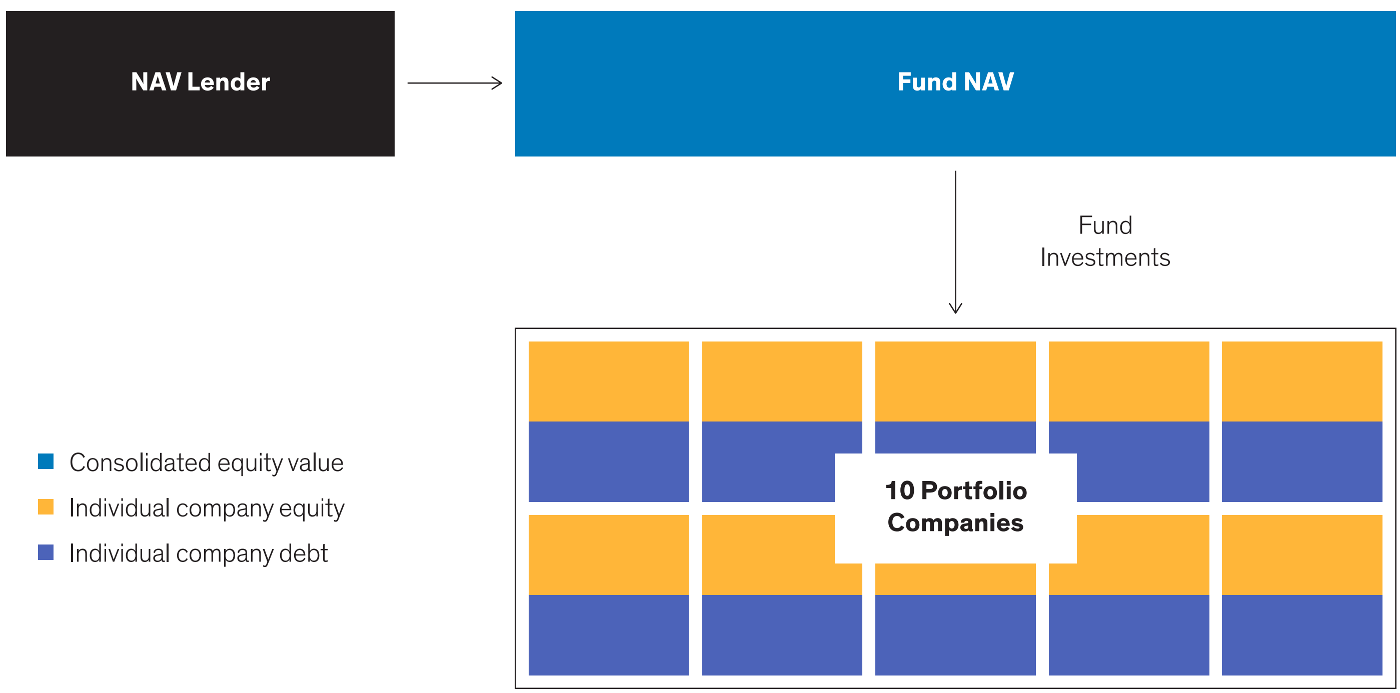
For Investment Professional use only. Not for inspection by, or quotation or distribution to, the general public.

What's in a Name? Defining Private Equity NAV Lending

Before delving deeper into an assessment of the opportunity in NAV lending, it's important to set out some basic terminology. For the purpose of this paper, we'll focus on loans provided to individual private equity funds against the value of the funds' investments in private equity (*Display 1*). In doing so, we'll leave aside NAV lending beyond this segment, such as NAV loans collateralized by infrastructure, real estate, portfolios of interests in private equity funds or credit assets.

DISPLAY 1: HOW NAV LENDING WORKS

Illustrative NAV Loan Structure



Illustrative example only. Does not represent an actual investment.

Source: AllianceBernstein (AB)

Dimensioning the Appeal of NAV Lending

From our perspective, NAV lending is a compelling opportunity for insurance asset owners, given that it offers:

- Steady market growth that's expected to accelerate and persist across market cycles
- Inherent protections that mitigate downside risk and enable loans to attain investment-grade ratings
- Attractive risk-adjusted returns
- Flexibility for the private equity lifecycle, which provides tailwinds for market adoption

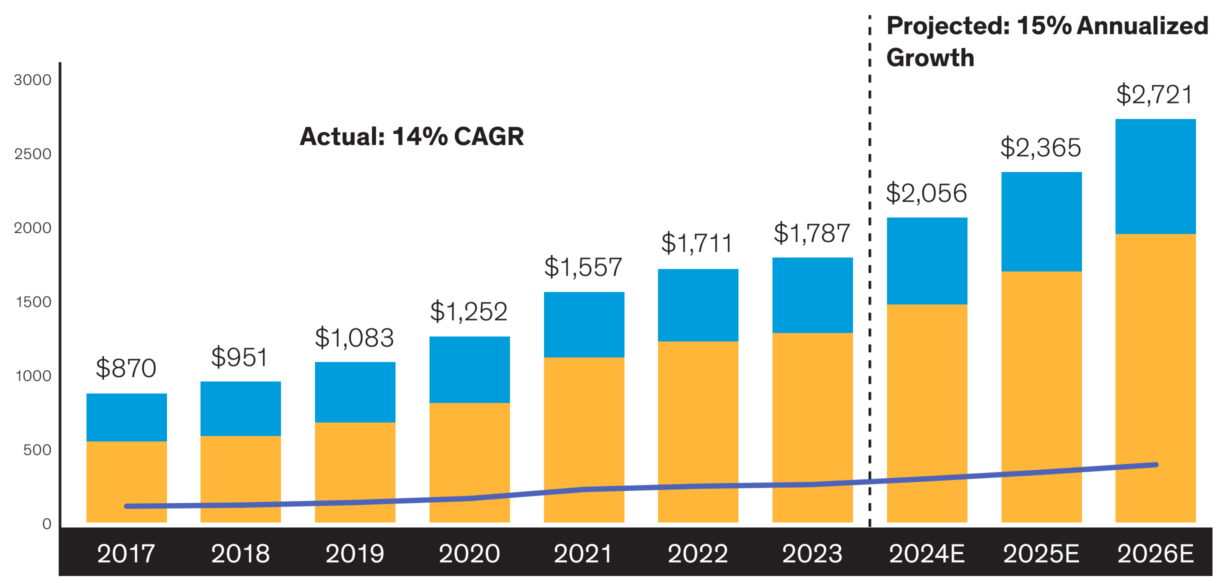
A growing market: We believe that NAV loan growth will continue and accelerate, and we estimate that the size of the global market will increase from $75 billion to nearly $350 billion by 2030.[1]

NAV loans offer private equity funds a flexible source of capital that's non-dilutive (the fund isn't required to give up any ownership or equity in its portfolio companies to obtain the capital); this feature has been a key factor in the growing adoption of NAV loans. As this form of financing becomes more widely accepted, and as the private equity market grows, NAV lending opportunities will likely expand.

To provide some context on the growth of the private equity market: Since 2017, assets under management (AUM) in North American middle market private equity have risen by 14% annualized. By the end of 2023, that total stood at nearly $1.8 trillion (*Display 2*).

DISPLAY 2: LARGE MARKET WITH SECULAR TAILWINDS AND ATTRACTIVE DYNAMICS

North American Middle Market Private Equity AUM (USD Billions*)



	2017	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E
NAV	$546	$583	$672	$806	$1,112	$1,222	$1,278	$1,470	$1,692	$1,947
NAV Lending TAM†	$109	$117	$134	$161	$222	$244	$256	$294	$338	$389

■ Dry Powder ■ NAV — NAV Lending TAM

There can be no assurances that any investment objectives will be achieved.

CAGR: compound annualized growth rate; TAM: total addressable market. NAV lending market size and growth estimate per AB Private Credit Investors market research.

*Historical data sourced from PitchBook's *2023 Annual US PE Middle Market Report,* where 2023 is through June 30, 2023; private equity AUM growth forecast applies the most recent five-year CAGR of 15% and assumes the percentage of dry powder remains consistent with 2023.
†NAV lending TAM is calculated at a 20% loan-to-value ratio of North American middle market private equity NAV.

As of June 30, 2024 | **Source:** PitchBook and AB

1 Market growth and size estimates are from AB-Private Credit Investors

For Investment Professional use only. Not for inspection by, or quotation or distribution to, the general public.

Inherent protections that help mitigate downside risks:

- **Low loan-to-value (LTV) ratios that provide a sizable cushion:** LTV ratios in investment-grade NAV lending are typically 5% to 25% at deal closing, and these relatively low levels provide a substantial cushion against markdowns in an underlying fund's NAV.[2]
- **Diversified and divisible collateral:** The underlying collateral (the fund's investments in multiple portfolio companies) is diversified and divisible, so NAV loans benefit from the diversification of idiosyncratic company risk. In general, even if the value of several underlying companies is impaired, one successful exit—a private equity fund selling its investment in a company—would be enough to repay the entire NAV loan.
- **Robust loan covenants:** NAV lenders are armed with a broad array of covenants that put guardrails around the financial condition of the private equity fund and its portfolio companies that seek to de-risk a loan if the concentration of the underlying portfolio or the LTV ratio rise to unacceptable levels (including as a result of asset sales). For example, the lender can increase the cash-flow sweep—cash recouped from successful portfolio company exits to pay off the loan over time—which accelerates repayment. Lenders may also have the right to challenge the valuations of underlying portfolio companies.

Attractive return potential: Loans in the investment-grade NAV lending segment are generally executed with targeted net returns of 8% to 10%, which is 300 to 500 bps above the current Secured Overnight Financing Rate (SOFR). Based on these return expectations and the inherent protections available, NAV lending seems to offer a compelling risk-adjusted return proposition.

Flexibility for the Private Equity Lifecycle

NAV lending's ability to unlock value plays a key role in the lifecycle of the private equity industry.

A brief example illustrates how limited partners in private equity funds may benefit from an NAV loan. Let's assume that a North American private equity buyout fund has taken controlling positions in several profitable companies and that the fund is now six years into its life.

One of the fund's portfolio companies, with equity currently valued at $75 million, is targeting a $50 million acquisition that would result in a combined company with an equity value of $125 million after the transaction (*Display 3*).

DISPLAY 3: ILLUSTRATIVE NAV LOAN: GROWTH OPPORTUNITY

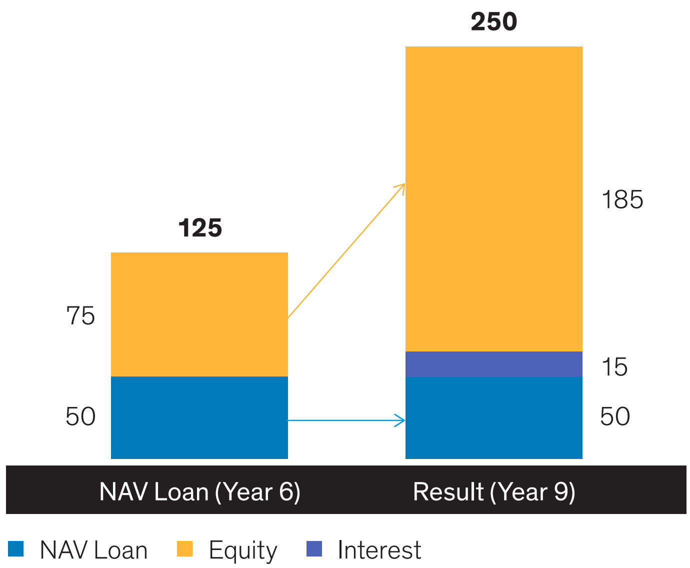
Profile of Borrower

- Fund Strategy: North American buyout
- Total Commitments: $525 million
- Called Capital: $500 million
- Fund Age: 6 years
  - NAV: $675 million
  - Underlying Portfolio: 8 companies

NAV Loan Structure

- Loan Amount: $50 million
- Term: 3 years
- Pricing: SOFR + 600 bps
- Use of Proceeds: Support acquisition by portfolio company

Use of NAV Loan and Outcome (USD Millions)



For illustrative purposes only. There can be no assurances that any investment objectives will be achieved.

As of June 30, 2024 | **Source:** AB

2 According to Preqin, only about 2% of buyout and growth private equity funds with more than $100 million, from 1990 to 2020, returned less than 0.5 times total value to paid-in capital, based on performance as of December 31, 2023.

But the fund doesn't have sufficient capital: out of $525 million in total investor capital commitments, it's already called $500 million, and the private equity sponsor would prefer not to issue more debt or raise dilutive equity at the portfolio company level.

Instead, the fund obtains a $50 million NAV loan with a three-year term at a rate of SOFR + 600 bps, and contributes the proceeds to the acquiring company. Three years later, the private equity fund sells the combined portfolio company in a transaction that values the equity at $250 million, an increase of $125 million from its value immediately after closing on the acquisition.

In this example, the NAV loan helped unlock significant value for the private equity fund, and by extension its limited partners. Without the flexibility of the NAV loan, the fund might have missed out on a lucrative opportunity—or been forced to raise more equity capital, which would have diluted the returns of existing equity investors.

Understanding the Keys to Success

As NAV lending continues to make inroads with the private equity community, it offers a growing opportunity for asset owners, including insurance companies. However, to invest in NAV loans, asset owners typically need to work with lenders—and not every lender will be equally successful. In our view, getting it right requires a collection of attributes that foster sourcing opportunities and the ability to make sound lending decisions grounded in extensive due diligence and risk management.

An Expansive Sourcing Network: Identifying NAV loan opportunities is very much about relationships: building a strong network with private equity sponsors is a key to uncovering potential deals. NAV loan opportunities don't emerge at a regular cadence, and they're often directly originated, so being there at the right time is key.

Underwriting Expertise: To prudently underwrite NAV loans, it's critical to evaluate both private equity funds and their underlying portfolio companies, with a particular focus on corporate valuation. At the fund level, track record, leadership, governing documents and structure must all come under scrutiny. At the underlying portfolio company level, key focus areas are industry tailwinds, idiosyncratic risks, capital structure and valuation—is the company really worth what the sponsor says it is?

Implementation Capabilities and Flexibility: NAV loans are intended to be a flexible solution for private equity sponsors. But achieving that objective requires extensive experience to structure loans that enable sponsors to continue prudently managing the underlying company portfolio while managing the lender's risk.

Execution Certainty: With the growing adoption of NAV loans, some lenders view these loans as opportunistic investments within broader mandates. In these cases, the lenders may lack the needed processes, procedures and risk appetite for NAV loans. This could make loan execution (and deploying capital in NAV loans) less certain than working with lenders that have dedicated financial—and human—capital focused on NAV loans.

Area of Focus: With a broad array of NAV loan opportunities, it's important to identify and deploy capital in market segments with persistent relative return premiums. We believe that NAV loans to middle market private equity funds represent one of those segments. Its persistency reflects illiquidity and the limited number of market participants possessing sourcing relationships and the expertise to appropriately underwrite NAV loans.

NAV Lending: The Insurance Portfolio Dimension

The private credit landscape today offers a wide array of strategies: direct lending, mezzanine lending, distressed debt and special situations, real estate credit, real asset credit, and specialty finance strategies—including NAV lending.

How should insurance investors think about integrating an NAV lending strategy in the portfolio mix?

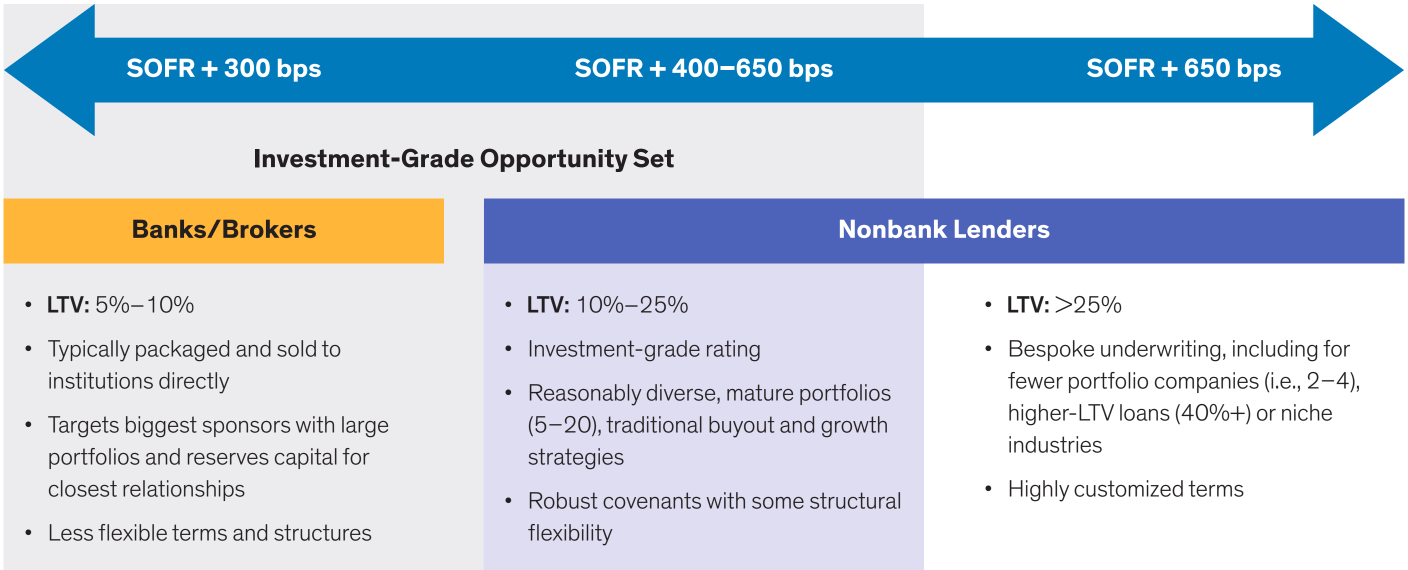
In our view, diversifying strategies such as NAV lending can play a role as strong complements to income-seeking and total-return private credit building blocks, helping round out insurance investors' overall private asset allocations. Because there is a broad spectrum of NAV loans in the market, it's important to understand how characteristics differ along that continuum.

NAV loans are generally segmented based on risk. At one end of the spectrum (*Display 4, page 5*) are deals by nonbank lenders that offer a higher degree of flexibility but tend to be riskier and impose a higher cost of capital. On the conservative end of the spectrum, loans can be investment-grade rated.[3] They're typically provided by banks—generally highly structured, less flexible and with lower interest rates—or private lenders, offering economic terms that typically fall somewhere in the middle of the two extremes.

3 Both KBRA and S&P have ratings methodologies for NAV loans that start with a quantitative framework (such as measuring asset coverage, liquidity and other characteristics), making modifications based on qualitative factors, such as manager track record.

For Investment Professional use only. Not for inspection by, or quotation or distribution to, the general public.

DISPLAY 4: NAV LENDING MARKET SEGMENTS AND TARGETED GROSS SPREADS



There can be no assurances that any investment objectives will be achieved.

SOFR: Secured Overnight Financing Rate

As of June 30, 2024 | **Source:** AB

Investment-grade-rated NAV loans are appealing to a broad range of investors—notably those with restrictions or limitations on high-yield exposure, such as insurance investors. They offer attractive risk-adjusted-return potential, with target net returns generally in the range of SOFR plus a 300–500 bps on a portfolio basis. Compared with an investment-grade corporate portfolio, NAV lending currently offers an illiquidity premium of 5.8%.[4]

For US insurers, current risk-based capital charges are based on ratings from nationally recognized statistical rating organizations. A typical rating ranging from A to BBB translates into charges of 0.82%–1.52% for life insurers; 1.3%–2.1% for property and casualty insurers; and 1.6%–2.5% for health insurers. For accounting purposes, investment-grade NAV lending is included in Schedule D.

For European insurers, both KBRA and S&P are classified as external credit assessment institutions. Because of this, and unlike many private credit assets insurers invest in, solvency capital charges will be determined based on rating and duration (assuming the insurer is a Solvency II standard formula user). Assuming a duration of three years, an A-rated loan would have a spread-risk capital requirement of 4.2%, while a BBB loan would have a spread-risk capital requirement of 7.5%. If those same loans were unrated, they would incur a 9% capital requirement.

Given the relative size of the NAV lending market and the range of other private credit opportunities available, we would not expect insurance investors to allocate more than 5% of their general-account assets to NAV loans as a diversifying private credit strategy. Investors should also work through a number of portfolio-level considerations, including assessing the contribution of NAV lending to overall illiquid and private market exposures.

In conclusion, the NAV lending market is poised for significant growth as the private equity market continues to expand and sponsors increasingly adopt NAV lending as a regular fund financing tool. NAV loans offer several attractive characteristics: potential investment-grade ratings, a return premium to investment-grade corporates, favorable regulatory capital treatment for insurers and complementary private asset exposure within an overall investment allocation.

Given these factors, we believe that insurance investors should explore the opportunity in NAV lending, partnering with a manager that has a strong sourcing network and the ability to make lending decisions underpinned by extensive due diligence and risk management.

4 Assumes an NAV loan gross spread of 5.5%, an original issue discount of 2% and a weighted average life of three years. The ICE BofA BBB Corporate Index effective yield of 5.7% and SOFR of 5.3% were sourced from FRED as of June 30, 2024.

Nashville
501 Commerce Street
Nashville, TN 37203
United States
(212) 969 1000

New York
1345 Avenue of the Americas
New York, NY 10105
United States
(212) 969 1000

London
60 London Wall
London EC2M 5SJ
United Kingdom
+44 20 7470 0100

Singapore
One Raffles Quay
#27-11 South Tower
Singapore 048583
+65 6230 4600

Tokyo
Hibiya Parkfront 14F
2-1-6 Uchisaiwaicho,
Chiyoda-ku
Tokyo, 100-0011, Japan
+81 3 5962 9000

Toronto
200 Bay Street, North Tower
Suite 1203
Toronto, Ontario M5J 2J2,
Canada
(647) 375 2803

Sydney
Level 32, Aurora Place
88 Phillip Street
Sydney NSW 2000
Australia
+61 02 9255 1200

Hong Kong
39th Floor, One Island East,
Taikoo Place
18 Westlands Road
Quarry Bay, Hong Kong
+852 2918 7888

For Investment Professional use only. Not for inspection by, distribution or quotation to, the general public.

The value of an investment can go down as well as up, and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results.

Important Information

The information contained herein reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized.

The views expressed herein may change at any time after the date of this publication. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions.

References to specific securities are provided solely in the context of the analysis presented and are not to be considered recommendations by AllianceBernstein. AllianceBernstein and its affiliates may have positions in, and may effect transactions in, the markets, industry sectors and companies described herein.

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

Note to All Readers: The information contained here reflects the views of AllianceBernstein L.P. or its affiliates and sources it believes are reliable as of the date of this publication. AllianceBernstein L.P. makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized.

Note to Readers in Canada: AllianceBernstein provides its investment-management services in Canada through its affiliates Sanford C. Bernstein & Co. LLC and AllianceBernstein Canada, Inc. It should not be construed as advice as to the investing in or the buying or selling of securities, or as an activity in furtherance of a trade in securities. **Note to Readers in the United Kingdom:** Issued by AllianceBernstein Limited, 60 London Wall, London EC2M 5SJ, registered in England, No. 2551144. AllianceBernstein Limited is authorised and regulated in the UK by the Financial Conduct Authority (FCA). **Note to Readers in Europe:** This information is issued by AllianceBernstein (Luxembourg) S.à r.l. Société à responsabilité limitée, R.C.S. Luxembourg B 34 305, 2-4, rue Eugène Ruppert, L-2453 Luxembourg. Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier (CSSF). **Note to Readers in Switzerland:** This information is directed at Qualified Investors only. Issued by AllianceBernstein Schweiz AG, Zürich, a company registered in Switzerland under company number CHE-306.220.501. AllianceBernstein Schweiz AG is a financial service provider within the meaning of the Financial Services Act (FinSA) and is not subject to any prudential supervision in Switzerland. Further information on the company, its services and products, in accordance with Art. 8 FinSA can be found on the Important Disclosures page at AllianceBernstein.com. **Note to Readers in Australia and New Zealand: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein Australia Limited (ABN 53 095 022 718 and AFSL 230698). Information in this document is intended only for persons who qualify as "wholesale clients," as defined in the Corporations Act 2001 (Cth of Australia) or the Financial Advisers Act 2008 (New Zealand), and should not be construed as advice. **Note to Readers in Hong Kong: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** The issuer of this document is AllianceBernstein Hong Kong Limited (聯博香港有限公司). This document has not been reviewed by the Securities and Futures Commission. **Note to Readers in Japan: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been provided by AllianceBernstein Japan Ltd. AllianceBernstein Japan Ltd. is a registered investment-management company (registration number: Kanto Local Financial Bureau no. 303). It is also a member of the Japan Investment Advisers Association; the Investment Trusts Association, Japan; the Japan Securities Dealers Association; and the Type II Financial Instruments Firms Association. The product/service may not be offered or sold in Japan; this document is not made to solicit investment. **Note to Readers in Singapore: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document has been issued by AllianceBernstein (Singapore) Ltd. ("ABSL", Company Registration No. 199703364C). AllianceBernstein (Luxembourg) S.à r.l. is the management company of the Portfolio and has appointed ABSL as its agent for service of process and as its Singapore representative. AllianceBernstein (Singapore) Ltd. is regulated by the Monetary Authority of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore. **Note to Readers in Taiwan: For Institutional Investor use only. Not for inspection by, distribution or quotation to, the general public.** This document is provided solely for informational purposes and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement. AllianceBernstein L.P. is not licensed to, and does not purport to, conduct any business or offer any services in Taiwan. **Note to Readers in China:** This information contained here reflects AllianceBernstein Hong Kong Limited ("AB") or its affiliates and sources it believes are reliable as of the date of this publication. This presentation has been provided to you for the sole use in a private and confidential meeting. AB makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this publication. This presentation is for informational purposes only and does not constitute investment advice. AB does not provide tax, legal or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions. This presentation or any information contained or incorporated by reference herein does not constitute an offer to sell or the solicitation of an offer to purchase any financial instrument, product or service sponsored by AB or its affiliates within the People's Republic of China ("PRC", for such purposes, excluding Hong Kong, Macao and Taiwan). **Note to Readers in Vietnam, the Philippines, Brunei, Thailand, Indonesia and India:** This document is provided solely for the informational purposes of institutional investors and is not investment advice, nor is it intended to be an offer or solicitation, and does not pertain to the specific investment objectives, financial situation or particular needs of any person to whom it is sent. This document is not an advertisement and is not intended for public use or additional distribution. AllianceBernstein is not licensed to, and does not purport to, conduct any business or offer any services in any of the above countries.

The [A/B] logo is a registered service mark of AllianceBernstein and AllianceBernstein® is a registered service mark used by permission of the owner, AllianceBernstein L.P.
© 2024 AllianceBernstein L.P., 501 Commerce St., Nashville, TN 37203

ICN20241270
USI–8450–0824
alliancebernstein.com