BLUEDOT CAPITAL

Guest Snapshot:

NAV Financing

March 2024

ESG and impact investing advisory with the goals of value enhancement and risk management.

Blue Dot Capital is a sustainable finance consultancy. We partner with investment management firms, with a primary focus on private markets firms, to support the end-to-end development and execution of ESG and impact investing programs, capabilities, and products.

Since April 2020, Blue Dot has advised investment management firms with $1.7 trillion+ in collective AUM.

New York, NY www.bluedotcapital.co hello@bluedotcapital.co

Blue Dot's Guest Snapshot Series

In our Guest Snapshot series, the Blue Dot Capital team, in collaboration with guest experts, unpacks topics such as regulations, geopolitics, and energy policy, and their ramifications for how investment managers design and execute their sustainable investment strategies and programs.

Snapshot: NAV Financing

For this Snapshot, we are joined by Claire Hedley, Head of ESG and Greg Hardiman, Managing Director from 17Capital to discuss the state of play of NAV financing.

Background

Net asset value (NAV) financing is a lending strategy that is executed against the net asset value of the underlying investments. It is being increasingly adopted by private equity managers to meet a range of financing needs.

In this Snapshot, we discuss the evolving dynamics of NAV financing against the current macro backdrop.

Q&A

Q: To set the stage for our readers, let's distinguish NAV financing from the other financing modes that cater to private funds and sponsors and hone in on the specific types of NAV financing that 17Capital focuses on.

A: NAV financing is backed by the consolidated equity value, or net asset value, of a portfolio of private assets. NAV financing solutions can be structured in a variety of forms, ranging from senior loans to preferred equity. 17Capital focuses on providing NAV finance to leading investors across the private equity ecosystem, including management companies, funds, and limited partners.

Management companies access NAV finance to address a range of strategic objectives for the private equity firm itself, including augmenting GP commitments to new funds, expanding into new strategies, and transitioning firm-level ownership.

Private equity funds use NAV finance to drive value creation across the portfolio, primarily through funding add-on M&A and other follow-on investments. Sponsors opportunistically utilize NAV finance to facilitate portfolio company debt management and liquidity acceleration to fund investors, with the latter typically implemented through a recallable distribution to increase the investment capacity of the fund.

There are a range of NAV financing solutions serving the limited partner community as well. Limited partners utilize NAV finance to create capacity for new investments, rebalance portfolio exposure, and accelerate liquidity. Unlike a secondaries sale, NAV finance allows the investor to retain their underlying exposure and future equity upside.

Q: Private markets investing is at an inflection point: Exit opportunities remain limited, sponsors and their portfolio companies are navigating higher cost of capital, and consolidation in private markets continues. How do these factors influence the NAV financing opportunity set? From your vantage point, are you seeing regional variances in how these factors are impacting the deal pipeline?

A: NAV financing is a valuable toolkit throughout all market environments, with the opportunity set growing as a function of adoption by the largest institutional sponsors and underlying AUM growth. At 17Capital, we have observed consistent year-on-year growth in deal flow of roughly 25-50% over the past several years, including over $40 billion in opportunities reviewed in 2023.

That said, the specific use cases and catalysts for NAV financing can be influenced by broader market conditions. In an environment characterized by slower exit activity, we have seen accelerated demand for additional growth capital at the fund level, enabling sponsors to continue executing on accretive add-on M&A amid longer hold periods while retaining strong operating flexibility at their underlying portfolio companies. Muted realizations impact the liquidity profile of both general partners and limited partners alike, which has supported a steady flow of opportunities to help these types of counterparties continue to make new fund commitments. These trends are consistent across our target markets of North America and Europe, with the majority of activity being driven by the top 100 sponsors by AUM.

Q: How does a focus on material environmental, social, and governance considerations fit into the sourcing and evaluation parameters of NAV financing?

A: At 17Capital, we believe integrating ESG considerations into our investment process helps us to make better investment decisions and drive long-term value for our investors. As a provider of NAV finance the ESG approach focuses on seeking to ensure those to whom we provide finance are upholding appropriate ESG standards where practicable and identifying any material ESG-related risks that may exist at the manager or the underlying portfolio companies.

Throughout the investment process, we consider ESG alongside other investment diligence topics such as team, track record, fundraising, and investment strategy. During the screening phase, ESG is included in the transaction scorecard, with any potential ESG concerns raised for further review. During the diligence phase, a more detailed evaluation is undertaken to assess the manager’s ESG program and the exposures of the underlying portfolio. We review ESG materials produced by the manager and send a proprietary ESG questionnaire to gather detailed information about the manager’s ESG policies, governance, approach to climate, and social topics. The underlying portfolio companies are run through RepRisk, an independent

ESG tool which screens for any ESG controversies. A detailed summary and key findings are included in the Investment Committee memo for each deal. Post investment, we continue to monitor the manager and underlying managers via an annual questionnaire and RepRisk. Any direct monitoring of portfolio companies regarding ESG management is the responsibility of the underlying fund manager of the funds invested in.

As a provider of NAV finance solutions, 17Capital's approach to managing ESG differs from those fund managers that make direct investments. While 17Capital cannot directly manage or control ESG at underlying companies, it can take steps to seek to influence ESG at the underlying manager primarily through engagement on ESG topics and, where possible, structure of loan contracts. In 2022, 17Capital structured its first ESG-linked loan that provided an economic incentive for the underlying manager to make progress on ESG within its organization. While not suitable for all transactions, we believe thoughtful and selective use of ESG-linked loans is an important tool available to 17Capital to seek to drive change while also enabling underlying managers to demonstrate their commitment to ESG.

Q: What are the top-of-the-agenda environmental, social, and governance topics that you are focusing on for your ongoing monitoring and engagement with managers?

A: Carbon strategies, human rights, and biodiversity are the key topics that we are focusing on in our ongoing engagement and monitoring with our managers. In addition to the ESG-linked loans discussed above, engagement is the other tool in our toolkit to seek to influence underlying managers. For us, engagement means purposeful, targeted communication with underlying managers with the goal of encouraging change or addressing a market-wide or systemic risk or topic. Where needed, we do this via one-on-one interactions regarding manager-specific ESG topics or risk alerts. Last year, as part of our engagement program, we launched the 17Capital ESG Accelerator. This is a unique program that draws together ESG leads from across 17Capital's private equity managers to network, share insights, and collaborate. The program has been well received by our underlying managers, and we look forward to hosting more workshops this year and beyond.

About 17Capital

17Capital is the leading provider of NAV financing solutions for the private equity industry. It specializes in providing non-dilutive capital to high-quality private equity management companies, funds, and institutional investors as part of their toolkit for value creation and portfolio management. 17Capital offers portfolio finance across the entire capital structure, providing a broad range of financing options. Investments are structured to support clients' objectives while keeping the interests of GPs and LPs aligned. Founded in 2008, 17Capital operates primarily from London and New York and has completed over 100 investments, deploying $13 billion since inception.
For additional information, please visit 17Capital's website at 17capital.com.

Guest Authors:

Claire Hedley, Head of ESG, 17Capital
Greg Hardiman, Managing Director, 17Capital

BLUEDOT CAPITAL