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Adams Street's Diehl: Daily NAVs not 'an exercise in transparency'

Managing partner and head of investments at Adams Street discusses what managers should actually do if they want to combat the rising redemptions from private credit funds.

BY SELIN BUCAK

Daily net asset value (NAV) pricing, which some have promoted as the answer to private credit's transparency problem, does not tell investors what they actually need to know, according to Jeffrey Diehl, managing partner and head of investments at Adams Street Partners.

'In our view, daily NAV pricing is really not an exercise in transparency,' Diehl said. Because if the underlying marks are wrong, it doesn't matter if it's published more frequently.

'If you have optimistic marks in your book and that's producing a NAV, whether you produce that monthly or daily, it doesn't really matter.'

He said that daily NAVs are mainly a way to distribute funds to defined contribution pension markets and 401(k)s, so he views them as a marketing and distribution strategy, rather than transparency.

The question of providing daily valuations for private credit holdings has become increasingly talked about. Major alternatives managers like Apollo are pushing to mark their funds on a daily basis in an effort to improve transparency in an asset class that has been criticised for its opacity.

The valuations in private credit funds, particularly those offered to individual investors through semi-liquid structures, came under the spotlight this year due to an increase in withdrawal requests from some of the largest business development companies (BDCs) in the US.

Concerns have been raised particularly around the accuracy of valuations after some funds revealed significant markdowns on certain loans from one quarter to the next. For example, BlackRock cut the NAV on its listed private debt fund, BlackRock TCP Capital Corp, by around 19%, after one of its positions, Renovo Home Partners, went from 100 cents on the dollar to zero within a month.

More info on risky loans needed

In Diehl's opinion though, the overall industry is healthy and is returning to a normal default cycle. But what investors need – more than daily NAVs – is consistent information on what he calls the 'left tail loan book,' which is the riskier loans that have higher leverage, not as much interest coverage and are running into some challenges.

He says that while some of the redemptions are driven by individual investors reacting to negative headlines, there is also another problem.

'If you're an investor and you ask your financial adviser whether you should be in private credit, the financial adviser may not have enough information to answer the question about the quality of the manager that you're with,' he said.

He believes that if managers can disclose a common set of statistics regularly about that left tail portion of their loan books, they can move from verbal reassurances to presenting actual statistics.

'Obviously that doesn't exist today, but hopefully will in the future,' he added.

He also said that although some institutions may be able to go into the loan book and make their own assessment on every single line, smaller investors may not have as much sophistication or resources.

What to look out for

Diehl suggests several metrics that investors can look at, though they can often be buried in footnotes or scattered quarter to quarter. These include looking at payment-in-kind loans, non-accrual rates, the share of loans to borrowers with greater than 60% loan-to-value, and where the interest coverage ratio is below one.

Other metrics investors should pay attention to are when a borrower is carrying debt above six times ebitda, cumulative realised losses relative to current NAV and sector concentration.

One of the problems in BDC portfolios that Diehl noticed is what he's called camouflaging problem loans – something direct lenders can do due to their optimism or self-interest. This is when lenders use restructuring tactics to hide distressed loans as healthy and avoid formal defaults.

He noted the case of Pluralsight, the Vista-owned software company. At the end of 2023, six of the seven direct lenders valued the loan around 95 to 99 cents on the dollar, which went down to 84-97 cents by the end of March 2024. Vista wrote off its entire $4bn equity stake in late May that year and the lenders marked it down to 29 cents in the third quarter of 2024.

'It seems that that company was running into trouble and it probably was visible to at least the lead lender,' Diehl said. 'So one would have thought that that mark would have been more reflective of where ultimately that business ended up.'

Of course, if managers adopted Diehl's recommendations and started disclosing more information, those with weaker statistics would likely see further increases in redemptions. But the ones with better statistics would be able to reassure investors.

'I think private credit is healthy and BDCs are a good product,' he added. 'But the key is hopefully managers can provide more transparency so that investors can understand which managers are well situated and which are not.'

In the meantime, he expects the redemption wave to last for several more quarters.