Accessing the APAC private credit opportunity

KEY HIGHLIGHTS

APAC Private Credit Serves a Market Gap: There has been an explosion in the global private credit market, particularly in the US and Europe post the Global Financial Crisis, filling the void left by banks retreating. In comparison, the APAC private credit market remains in its infancy as domestic bank lending still dominates. This stands in stark contrast to the capital requirements of businesses in a region driving global economic growth. An opportunity exists to participate in the continued growth of APAC by serving this gap in the market for private credit.

Benefits of this Asset Class for Investors: Investors are expected to benefit from diversification into a large, diverse region that is not readily accessible. There is also an attractive risk-adjusted yield premium over those being offered in other regions or fixed income asset classes. These can be delivered amidst the backdrop of strong creditor protections underpinning the underlying loans.

How to Navigate the Risks: Key risks of investing in APAC private credit stem from the sheer diversity of the multiple jurisdictions and the complexity of managing different regimes and cross-border elements of many of the deals. This requires a deep understanding of the markets including regulations, customary business practices and broad corporate landscape and promoter histories. A long track-record of having completed deals is the only way to gain the expertise required to navigate the potential pitfalls of investing in this asset class.

Introduction to TCP and Our Approach: The TCP team of dedicated APAC credit professionals has a combined 100 years of direct, "boots-on-the-ground" experience operating within the APAC region. We have offices across Hong Kong, Sydney, Melbourne and Wellington and the additional resources and reach of the broader Tanarra Group at our disposal. Following on the success of our Fund I with over $400 million of capital deployed since inception in 2017, we launched Fund II in 2Q 2021, targeting net BBSY + 7-8% returns for investors. For investors interested in gaining increased exposure to the Asian region, we have included an Opportunistic sleeve targeting net BBSY + 9-10% returns. We are well-placed to capitalise on this unique APAC private credit opportunity for both borrowers and investors and look forward to supporting the continued economic growth of the region through carefully selected private credit financings.

TANARRA CREDIT PARTNERS

Tanarra Credit Partners ("TCP") is an Asia-Pacific private credit manager with offices in Melbourne, Sydney, Hong Kong and Wellington. It is led by Peter Szekely, Graham Lees and Peter Han, with Michael Tierney as senior advisor, who together have 100 years of combined global credit markets experience. The board is chaired by Christine Christian AO who has over 30 years experience in financial services. TCP is the credit vertical of Tanarra Group, an alternative investment platform managing in excess of A$2 billion.

Since inception in 2017, TCP has grown to manage A$550 million of investor capital and has successfully demonstrated an ability to originate a diversified portfolio of high-quality loans across its broad professional network.

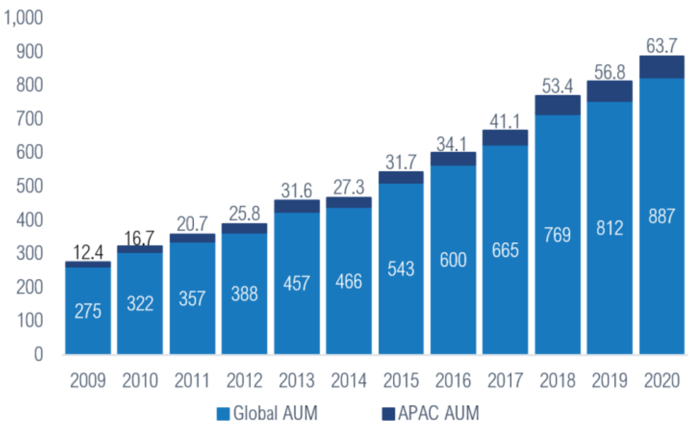
TCP AP Fund II is available for commitments, including an Asia-focused Opportunistic sleeve, underpinned by cornerstone investments of A$250 million from existing investors. For more information, please contact TCP as provided below.

ASIA-PACIFIC PRIVATE CREDIT OPPORTUNITY UNDER-SERVED

It is well-known that private credit as an asset class has enjoyed explosive growth over the past couple of decades. Total assets under management (AUM) globally is estimated to be over US$887 billion as of December 2020 and is set to surpass US$1 trillion. While private credit in Asia-Pacific (APAC) has also enjoyed strong growth recently, with estimated total AUM of US$64 billion as of December 2020, it remains a small and underweight segment comprising only 7% of the total global private credit market.

This severe "underweight" allocation is more pronounced when considered in light of the significant and growing contribution of APAC to the global economy, accounting for one-third of global output. The economic growth of the region continues to outpace the rest of the world at 4.5% (compared to 1.6% in Europe and 2% in North America) in 2019 according to data from the International Monetary Fund (IMF).

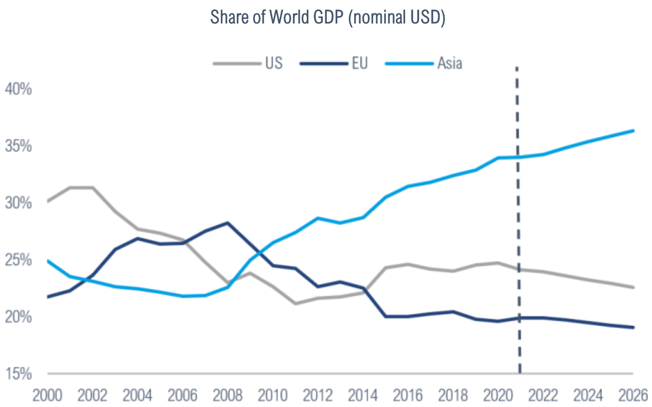
Fig.1: Global Private Credit AUM Growth 2009-2020 (US$bn)



Source: Preqin Pro.

Looking forward, IMF expects APAC outperformance to continue over the next 5 years with emerging Asia's real GDP forecast to be 35% larger in 2026 (versus a 12% and 8% increase for the US and Europe, respectively).

Fig.2: Asia's growing share of world economic activity



Source: IMF World Economic Outlook, April 2021.

In addition, the APAC region has managed the COVID-19 pandemic well to-date relative to other parts of the world, and is outperforming on various metrics. Should this outperformance continue, APAC is well positioned to continue its role as the main driver of global economic growth as the world re-opens and travel resumes amidst vaccine program roll-outs.

The high sustained economic growth of the region has continued to fuel the need for capital in order to finance growing businesses across APAC. This trend is set to accelerate further as APAC's share of the global economy continues its rise as we emerge from the pandemic.

TCP sees strong demand for credit that is not being met adequately via traditional funding channels which still remain heavily bank-driven in APAC. As more global investors turn their attention to APAC, seeking exposure to this increasingly important and relevant region, we see an unprecedented opportunity to meet the demands of an attractive, growing yet significantly under-served private credit market.

Fig.3: Asia Pacific funding gap

Proportion of Asian businesses that are small to mid-sized corporates

Estimated finance gap for Asian small to mid-sized corporates

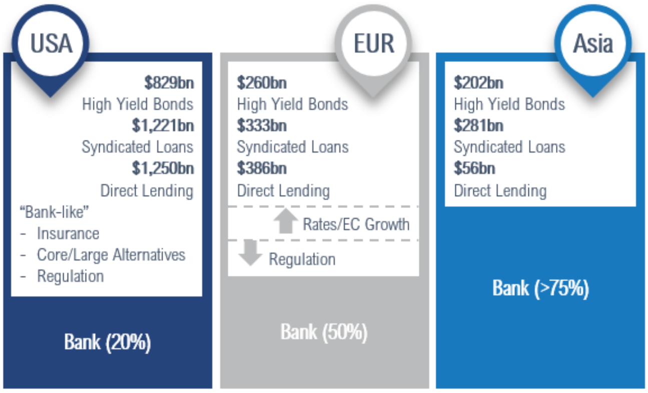
Asia Pacific region needs a developed non-traditional financing system. Small and mid-sized corporates represent 96% of all enterprises in Asia and are the main engine for employment and GDP growth, however they often struggle to source traditional financing. It is estimated that small to mid-sized corporates in the region face a US$4.1 trillion annual funding gap in 2019.

Source: Asia Development Bank, Bank for International Settlements.

APAC REGION REMAINS OVERLY-DEPENDENT ON BANK FINANCING; GLOBAL BANKS IN RETREAT

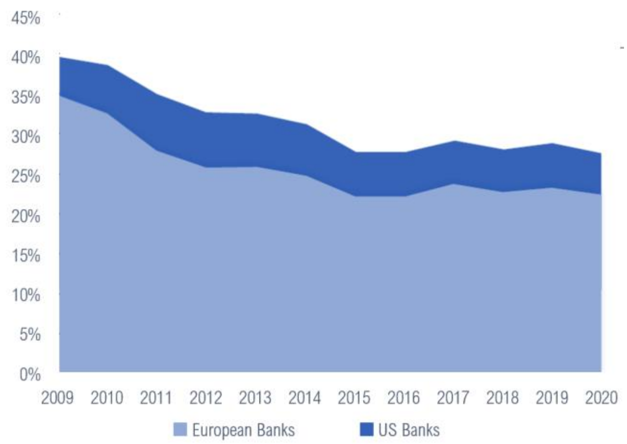
Traditionally, APAC businesses and economies leaned heavily on the domestic bank market to finance growth. While this remains largely true today, there is increasing demand from borrowers for non-bank financing driven by rising awareness of the benefits of the flexibility provided by institutional funding solutions. Furthermore, the impact of regulatory changes, such as Basel III/IV that impose increased capital costs and requirements for banks, has led to general retrenchment of global and domestic banks in some of their less profitable corporate lending activities.

Fig.4: Bank disintermediation



Source: StepStone Private Debt, Reuters Credit Suisse, Bloomberg, Barclays. As of 2019.

Fig.5: % of total cross-border claims on Asian banking assets



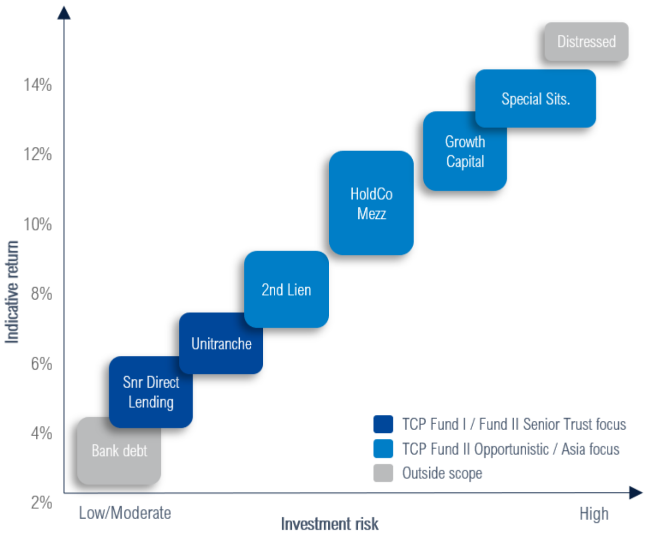
Source: World Bank, Bank for International Settlements, broker research. As of June 2020.

The middle-market (small and mid-sized corporates) lending space has been particularly hard hit by its over-reliance on the bank market. Banks have generally turned focus away from this middle-market as they look to optimise use of scarce regulatory capital and extract efficiencies, pivoting towards larger relationships. On the other hand, while there are several distressed / special-situations focused investors emerging in the region, these financiers often only get involved when borrowers are already at the precipice of financial trouble and accordingly, extract equity-like returns. Consequently, they represent a "last resort" funding alternative for borrowers.

All of this means that there currently exists a meaningful market gap for borrowers that are not yet large enough to access the high yield bond or syndicated loan market, yet face an increasingly conservative domestic bank market applying inflexible, "check the box" underwriting criteria. These borrowers also tend to be owned by founders who are typically highly averse to equity dilution and losing operational control, leaving them short of funding options.

Notwithstanding these overarching trends, TCP believes that banks will not be replaced given their dominant market positions in the segments they serve, large networks and access to cheap capital. TCP strategy is not to compete with banks, but rather become the alternative lender of choice where other attributes such as speed, creativity and reliability are more important requirements for the borrower, or engage with borrowers that do not have access to traditional funding sources.

Fig.6: Illustrative fixed income investment risk/return profiles



Source: IHS Markit (2017) The Rise of Private Debt.

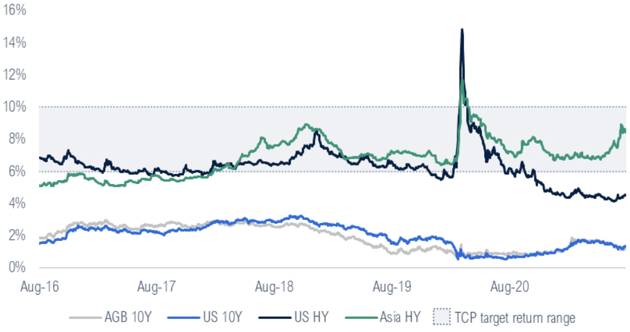
WHAT MAKES APAC PRIVATE CREDIT ATTRACTIVE?

There are several benefits conferred from an allocation to APAC private credit:

1) Unique diversification opportunity: Allocations to APAC private credit provides a differentiated, uncorrelated asset class that enables investors to more effectively diversify portfolio exposure. In particular, as the underlying loan positions typically feature proprietary origination and sourcing, investors allocating to APAC private credit are gaining access to a truly different set of cash flows via an asset class that is not readily available. Even for investors from within the region, diversification benefits are highly relevant as many are heavily concentrated in their own domestic fixed income markets and will benefit from adding intra-regional exposure.

2) Potential for meaningful yield pick-up: Monetary policy and central banks' stance remains ultra-easy and is expected to be so for the foreseeable future. As yields from traditional credit products continue to compress to near-zero, investors are searching for income. APAC private credit offers the potential for meaningful yield premiums over what is being offered in other regions (US and Europe), or other traditional fixed income asset classes (public corporate bonds and sovereign bonds), with potentially better risk profiles.

Fig.7: APAC private credit can provide stable yield premium to traditional fixed income products



Source: Bloomberg, Credit Suisse, JPMorgan.

3) Strong creditor protections: APAC private credit transactions still remain predominantly relationship-driven compared to the US or Europe, with more bespoke features that enable lenders to influence negotiations and retain valuable creditor protections. Coupled with the dynamic discussed earlier where credit demand significantly outstrips supply, APAC private credit deals are typically "covenant-heavy" with a fairly full suite of lender rights and controls including amongst others:

- information rights;
- cash flow controls;
- distribution restrictions;
- veto rights over significant corporate transactions;
- various forms of guarantees from related parties.

While enforcement regimes can differ across the region as each country has its own insolvency frameworks, there is a broad trend of improvement and convergence to global standards.

TCP has demonstrated its ability to provide its investors above market protections through 85% of our Asia Pacific Fund I investments in structures with maintenance financial covenants. This is in contrast to most global and larger Australian private credit funds which largely invest into covenant-lite structures.

NAVIGATING RISKS AND CHALLENGES OF THE APAC PRIVATE CREDIT MARKET

Operating in the APAC private credit market is not without risks and challenges. In general, these stem from the sheer diversity of jurisdictions / markets that comprise APAC, with over 40 countries, each at different stages of economic development. Sourcing and origination therefore is more complex and the lack of a single, institutional network means that deal professionals need to develop local relationships in a geographically and culturally diverse region. Many deals are also cross-border transactions which layers on additional political, business, tax, regulatory, legal and enforcement complexities, making them more challenging to manage to a successful completion.

Consequently, effective coverage of the APAC private credit market necessarily requires long-standing relationships, deep understanding of various key markets and access to local networks which are time-consuming and costly to establish. It is these challenges that also create the opportunity for specialised and experienced operators like TCP to capture relatively higher risk adjusted returns while presenting higher barriers to entry for those who are less prepared in dealing with the nuances of the market.

TCP APPROACH TO APAC PRIVATE CREDIT OPPORTUNITY SET

As fundamental credit investors, the key focus for TCP is to ensure that appropriate downside protection is implemented in all our deals through:

- select sourcing via multi-faceted and proprietary channels;

- rigorous, bottoms-up credit due diligence and analysis;

- transaction structuring and documentation.

From our long experience in the APAC private credit markets, we know that these elements are most effective in jurisdictions with robust legal and regulatory frameworks that enable lenders to enforce contracts. Therefore, our focus will be on situations and borrowers primarily domiciled in the developed APAC economies in Japan, Korea, Taiwan, Singapore and Hong Kong, along with our core markets in Australia and New Zealand.

Fig.8: Considerations for private credit lending in Asia Pacific

Key: No · Mostly · Yes

Issue	Australia	New Zealand	Hong Kong	Singapore	Japan	South Korea	Taiwan
Ability to hold & perfect security	Yes	Yes	Yes	Yes	Yes	Yes	Mostly
Freely negotiate financing terms	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Creditor-friendly enforcement regime	Yes	Yes	Yes	Yes	Mostly	Yes	Mostly
Repatriation of funds	Yes	Yes	Yes	Yes	Mostly	Mostly	Mostly

Source: Baker McKenzie.

These are also ranked as being amongst the easiest countries to do business according to the World Bank.

Fig.9: Ease of doing business rankings

Rank	Economy	Score
1	New Zealand	86.8
2	Singapore	86.2
3	Hong Kong	85.3
4	Denmark	85.3
5	South Korea	84.0
6	United States	84.0
7	Georgia	83.7
8	United Kingdom	83.5
9	Norway	82.6
10	Sweden	82.0
14	Australia	81.2
15	Taiwan	80.9
29	Japan	78.0

Source: World Bank Doing Business database. As of May, 2019.

Furthermore, most businesses in these countries enjoy some exposure to the higher growth economies of emerging Asia, especially as intra-regional trade continue to trend higher. We believe this approach is the right way to access the rapid growth and dynamism of this exciting "Asian growth story" while mitigating the risks attached to investing in emerging markets.

We are currently seeing a strong pipeline of various deals across the spectrum including direct lending deals in Australia / New Zealand, opportunistic financing situations as well as property-backed senior and mezzanine loan opportunities from various parts of APAC. Selected examples of such financing opportunities include:

- Senior secured loan against luxury branded residential property asset in Japan at low-teens IRR;
- Mezzanine loan against a consumer appliance business backed by a leading sponsor in Korea at mid-teens IRR;
- Senior secured loan against industrial property in Hong Kong at high single-digit IRR;
- Mezzanine loan against a logistics / storage business in Australia at high single-digit IRR;
- Senior secured share backed financing supported by a New Zealand infrastructure business at low-teens IRR.

The TCP team expects this activity to continue for the foreseeable future as the capital shortage dynamics mentioned earlier in this paper continue to play out.

OVERVIEW OF THE TANARRA GROUP

Tanarra Credit Partners is the private credit vertical of Tanarra Capital Australia Pty Ltd ("Tanarra") – a diversified alternative asset firm founded by John Wylie AM, the former chief executive of Credit Suisse and Lazard in Australia, and co-founder of corporate advisory and investment firm, Carnegie, Wylie & Company. Tanarra has offices in Melbourne, Sydney, Brisbane, Perth, Wellington, Tokyo, and Hong Kong.

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