APAC Private Credit: Benefits and considerations in uncertain times…

In February of this year, we wrote about our expectation that 2022 would represent a banner year for private credit, driven by high levels of activity in capital markets, as well as increased focus on the asset class as a structural hedge against inflation and rising interest rates.

Since then, inflationary pressures and economic uncertainty have increased, driven by a tight labour market, rising energy costs, ongoing supply chain disruptions, geopolitical events, and significant adverse weather, in particular flooding in northern NSW and QLD, and a hangover from 10 years of loose monetary policy.

The sharp and prolonged increase in inflation has led central banks globally to aggressively raise interest rates, and this is set to continue in the near term. These significant interest rate and yield curve movements have led to increased volatility and downward price pressures in equity and fixed income bond markets.

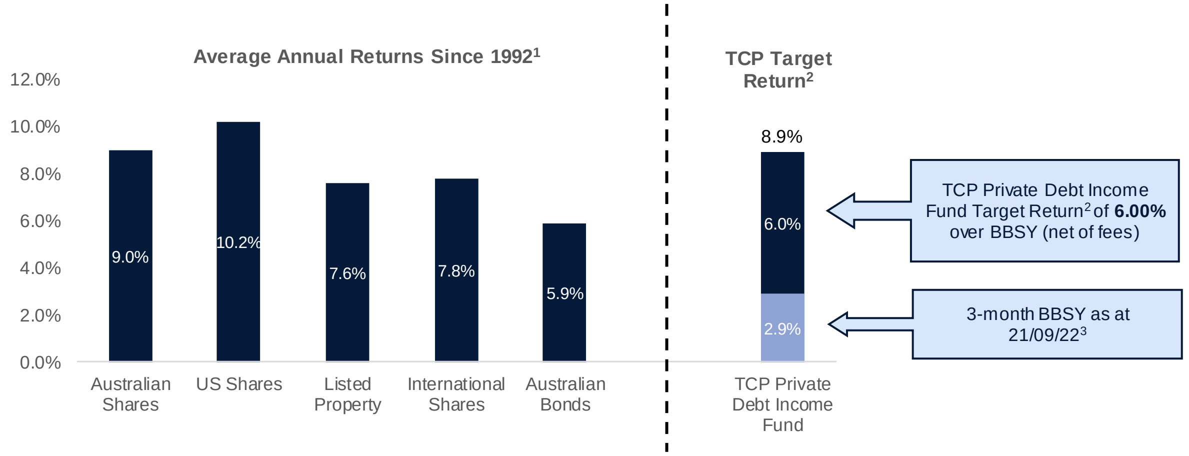
In this environment private credit presents an attractive investment proposition relative to other asset classes, with favourable risk-adjusted returns, a floating rate profile and strong downside protections for Investors. However, it is important to acknowledge that with increased economic turbulence can come additional risk, making Manager selection crucial to achieving through the cycle success.

PRIVATE CREDIT OFFERS ATTRACTIVE YIELDS RELATIVE TO LONG-RUN AVERAGE RETURNS OF OTHER ASSET CLASSES…

TCP's Private Debt Income Fund is a floating rate product, with loans priced at a fixed margin over BBSY. This means total returns to investors move in tandem with the base rate.

As interest rates in Australia rise from emergency lows to more normalized levels, total returns from private credit appear increasingly attractive relative to long-run average returns from other major asset classes.

Whilst equities and fixed income may, at times, present opportunities to generate above average returns, it may be challenging to achieve above-average results over the long-term, particularly within a diversified portfolio. In contrast, private credit offers reduced volatility and consistent cash returns.



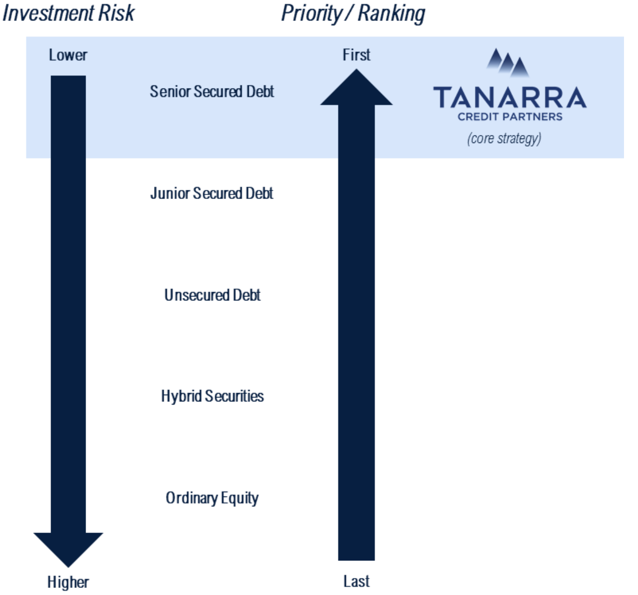
[1] Source: 2022 Vanguard Index Chart - data assumes no transaction costs or taxes and the reinvestment of all income. Note, past performance is not a reliable indicator of future perfromance and returns.

[2] This is a target return and may not be achieved. All-in target return of 8.9% is equal to the target return over BBSY of the TCP Private Debt Income Fund of 6.00%, *plus* the current 3-month BBSY rate as at 21/09/22

[3] 3-month BBSY as at 21/09/22 (Source: https://w w w 2.asx.com.au/connectivity-and-data/information-services/benchmarks/benchmark-data/bbsw)

[1]BBSY (bank bill swap rate) is the primary short-term base rate used for pricing AUD loans. It is published daily by the ASX for maturities between 1 and 6 months and represents the average bid rate for Prime Bank Eligible Securities, being bank accepted bills and negotiable certificates of deposit issued by eligible Prime Banks. Current Prime Banks include Australia's four major banks.

THIS RETURN PROFILE APPEARS MORE ATTRACTIVE WHEN CONSIDERED ON A RISK-ADJUSTED BASIS…



Investors in TCP's Private Debt Income Fund benefit from various downside protections that reduce the risk of capital loss and help to ensure that appropriate returns are maintained relative to any changes in credit risk.

Most notable is the first ranking security position held by Lenders, which provides priority in the payout order relative to equity or other unsecured creditors. This significantly reduces the risk of capital loss for debt investors, with any losses being borne first by equity. When structuring new loans, the debt/equity ratio is carefully considered in this context to ensure an appropriate equity buffer exists.

In addition to security, loan documents typically include a range of other protections, including financial maintenance covenants, as well as a range of restrictions placed on Borrowers aimed at minimizing cash leakage. Financial covenants are typically tested quarterly and can provide Lenders with an early warning sign of stress, and an opportunity to engage with the Borrower to assess whether changes to the loan structure are required to ensure protection of our capital position, and that returns remain appropriate relative to risk.

HOWEVER, IT'S NOT ALL ONE-WAY TRAFFIC… MANAGER SELECTION IS CRITICAL TO ACHIEVING THROUGH THE CYCLE SUCCESS…

Whilst higher interest rates may enhance investor returns, they also make it more difficult for a Borrower to service their debt. This can become problematic for lenders who have not considered this scenario in their analysis and have provided debt at a level that is too high.

Additionally, current economic uncertainty presents both supply and demand side risks for businesses that may have an adverse impact on earnings, potentially reducing both debt serviceability and business valuations.

TCP's investment process is characterized by detailed cash flow and sensitivity analysis to assess a business's capacity to service debt under a range of different economic and downside scenarios. Furthermore, we are cautious around sectors subject to economic cyclicality, with a focus on businesses that display underlying strength and resilience, and those exposed to strong macro tailwinds.

When markets are bullish, leverage multiples tend to rise and terms and conditions are relaxed. When the tide turns it is these transactions that will come under pressure first. Thus, discipline through the cycle is crucial to ensure stability of returns.

A key market differentiator for TCP is that the majority of our investments are self-originated loans, as opposed to participations in someone else's deal. As such, we control the structuring, and maintain the dominant seat at the table in a downside scenario.

CONCLUSION

We believe private credit represents an attractive opportunity for investors, particularly given current market conditions. However, whilst the features of private credit provide various benefits for investors, these are only effective to the extent loans are appropriately structured relative to risk, making Manager sector crucial to achieving through the cycle success.

TCP's extensive market experience through numerous credit cycles, strong investment track record, and ability to self-originate and structure new investments makes it the manager of choice.

TANARRA CREDIT PARTNERS

Tanarra Credit Partners ("TCP") is an Asia-Pacific Private Credit manager with offices in Melbourne, Sydney, Hong Kong and Wellington. TCP's senior investment team has 100 years of combined global credit markets experience.

Since inception in 2017, TCP has grown to manage over $750 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 is the credit vertical of Tanarra Group, an alternative investment platform managing in excess of $3 billion.

Both TCP AP Fund II and TCP Private Debt Income Fund (a retail and wholesale PDS investing into TCP AP Fund II) are available for commitments. Both funds have been awarded a Lonsec Rating of 'Investment Grade'.

For more information, please contact TCP as provided below.

CONTACTS

Peter Szekely
Managing Partner
Hong Kong / Sydney
peter.szekely@tanarracp.com
+61 491 312 538 (AU)
+852 9190 8635 (HK)

Graham Lees
Managing Director
Sydney
graham.lees@tanarracp.com
+61 423 545 797

Peter Han
Managing Director
Hong Kong
peter.han@tanarracp.com
+852 6109 7032