Insights

Are all protections created equal? Security, structures and how TCP works to preserve capital.

August 2025

- The best downside protection is the experience, discipline and character of the asset manager.
- Capital preservation is achieved through robust covenants, meaningful security and prioritising a lender's position in the capital stack.
- Private credit investments should be rigorously stress-tested against multiple downside scenarios.

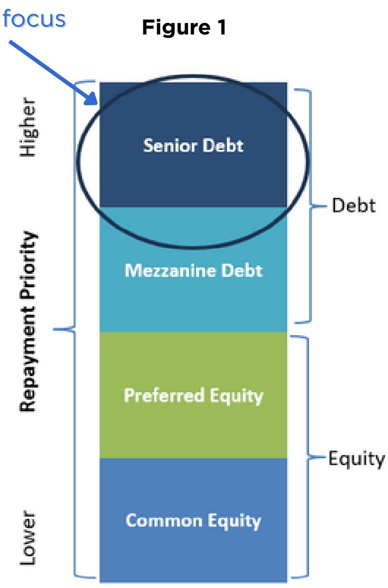
The burgeoning demand for the Private Credit asset class is driven by its attractive risk-adjusted returns and downside protection, aligning with managers' core focus on capital preservation. However, investors should have an understanding of the strategies used to protect their capital from underperformance.

Tanarra Credit Partners (TCP) views downside protection as a layered and active concept, one that must be evaluated through scenario testing, appropriate structures and importantly, able to be enforced throughout the life of a deal.

Priority

In the capital stack (Figure 1), position matters and priority ranking is the first line of defence. A senior lender sits at the top of the repayment hierarchy and is repaid before subordinated creditors and equity holders. An analysis of 3,500 loans and bonds by Moody's demonstrated that the average recovery rate of senior secured loans was 82%, compared to just 27% for subordinated creditors[1]. To date, TCP's investments have all been in senior positions.

Figure 1



[1] Moody's "Ultimate Recovery Database", published April 2007

TANARRA
CREDIT PARTNERS

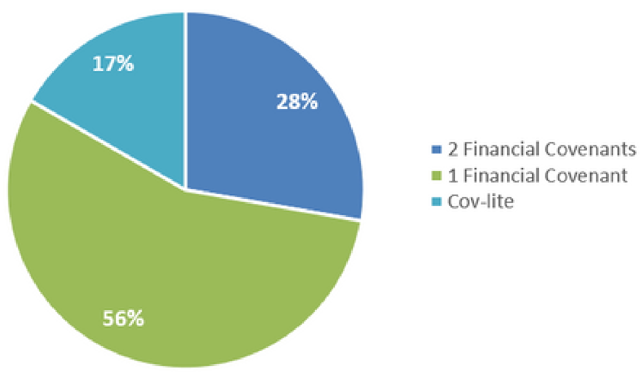
Not just lending — lending with discipline

Covenants

Covenants provide a critical form of downside protection, acting as an early warning system for lenders. Covenants are contractual obligations within a loan agreement which outline what a borrower must do, i.e. the borrower must retain a minimum cash balance to protect liquidity or maintain interest coverage[1] of greater than two times to protect serviceability. While covenant-lite loans[2] have grown in popularity – particularly for large, syndicated transactions – they should be reserved for strong issuers, and investors should be aware of what they are potentially losing.

Financial covenants allow lenders to detect financial distress early. This provides an opportunity to sit down with management or restructure the facility. On average, recoveries in covenant lite ('cov-lite') structures are 10-15% less than covenanted loans[3]; this is due to delayed intervention, and other borrower friendly terms which often accompany these structures. Less than 20% of TCP's present investments are in covenant-lite transactions (Figure 2). This reflects the strong rigour applied by TCP's disciplined credit selection and preference for bilateral transactions. TCP will only invest in 'cov-lite' credit where the team has strong confidence in the issuer.

Figure 2*



Security

Collateral enhances capital preservation, but quality is what's important. It is common for Private Credit transactions to include security over a borrower's assets. This grants the lender recourse to items such as equipment, inventory or cash held in bank accounts. In more structured arrangements, security may be taken over specific assets such as receivables or individual pieces of machinery.

While fixed assets may appear more attractive, often they are accompanied by lower levels of equity. Cash generative operating assets with significant equity contributions can be more reliable as the operating earnings sufficiently cover debt obligations and there is less reliance on asset recovery. Fixed assets in cyclical industries such as mining services can often lose value sharply or become illiquid during economic downturns. TCP avoids cyclical industries due to their unpredictable cashflows and volatile asset prices which can undermine the reliability of security. TCP invests in stable industries and structures its investments with at least a 50% equity buffer, which is intended to protect investor capital.

[1] Interest coverage is calculated as EBITDA or EBIT divided by interest expense.
[2] Loans with no scheduled financial covenant testing
[3] S&P, "Is Covenant-Lite Really A drag on loan recoveries", published February 2024
** The percentage of loans within APAC Fund II which have either 2 Financial Covenants, 1 Financial Covenant or is a Covenant Lite transaction*

TANARRA CREDIT PARTNERS

The bottom line

All protections are not created equal. As Private Credit grows in popularity and investment opportunities proliferate, investors must remain focused on the quality of the risk management behind the returns. The best downside protection is not found in a term sheet; it is in the mindset and actions of the asset manager.

Choosing the right Private Credit manager means assessing how they preserve capital. TCP protects capital by:

- Focusing on investments at the top of capital structure
- Ensuring appropriate covenants are established and enforced throughout the life of the facility
- Prioritising stable cash generative businesses with significant equity buffers.

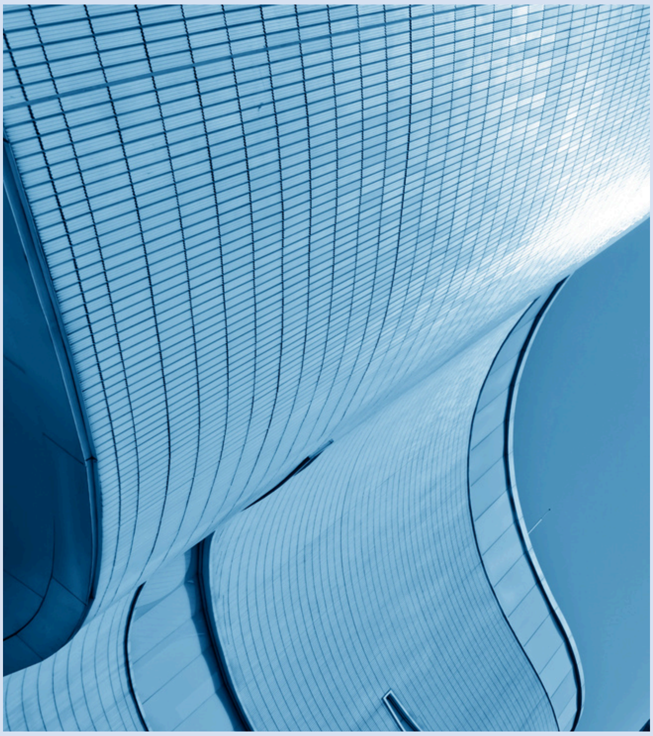
Every investment is rigorously stress-tested against multiple downside scenarios, guided by a single, critical question: If things go wrong, how do we get our money back? This step is integral to clearing TCP's Investment Committee approval process.

In a market where downside protection is key to long-term success, TCP distinguishes itself as a reliable and proven partner.

About the Tanarra Private Debt Income Fund

The TCP Private Debt Income Fund (PDIF) is an institutional grade private credit fund with no property exposure. In the past 12 months the PDIF has returned 8.41% net of fees[1] whilst maintaining a disciplined approach to capital preservation through senior security ranking, 50%+ equity buffers and tight lending covenants.

For more information about the TCP Private Debt Income Fund speak to a GSFM account manager.



[1] Past performance is not a reliable indicator of future performance

TANARRA CREDIT PARTNERS

About Tanarra Credit Partners

Tanarra Credit Partners (“TCP”) is an Asia-Pacific private credit specialist with offices in Sydney and Melbourne. TCP’s senior investment team has 50+ years of combined global credit markets experience.

Since inception in 2017, TCP has invested over $950 million of investor capital and has an excellent record of originating and structuring leveraged finance transactions across the Asia-Pacific region.

TCP is the credit team of Tanarra Group, diversified alternative asset investment firm, headquartered in Australia, with over A$3 billion in assets under management.

Investment Team

Peter Szekely
Managing Director

Alain Lidbury
Investment Associate

Daniel Wang
Investment Associate

For more information about the TCP Private Debt Income Fund, speak to a GSFM Account Manager

GSFM FUNDS MANAGEMENT

gsfm.com.au

Note
1. While TCP Private Debt Income Fund will generally distribute its available income quarterly, there is no guarantee that any income will be generated.