

LEVFIN INSIGHTS

CLO Insight: Equity investor Flat Rock Global says it's not a great time to agree to a two-year non-call on a new-issue deal

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Flat Rock Global is a New York-based alternative credit manager focused on CLO equity. LFI spoke with Shiloh Bates, chief investment officer and managing director, on his views on CLO equity performance this year.

Prior to joining Flat Rock Global, Bates was a managing director at Benefit Street Partners where he worked on corporate acquisitions. During his 20-year career, Mr. Bates has worked for several CLO managers and invested over \$1.3 billion in CLO securities.

Are there barriers to investing in CLO equity that are changing to include a broader investor base?

Because CLO equity is such an inefficient asset class, success requires many years of direct CLO experience. I'm often told that new entrants are joining the field, but when I attend CLO conferences I just see the same CLO equity buyers I've known for years. I wouldn't recommend CLO equity for tourists to the asset class.

Replacing capital – How's this going for managers after the record issuance in 2021?

According to the Flat Rock CLO Equity Index, the asset class returned 9.5% in 2020 and 29.2% in 2021. These compelling returns are going to see additional capital inflows this year. CLO equity's floating-rate nature should also be desirable as the Federal Reserve continues to increase rates. Even with the volatility caused by Ukraine, the loss rate on loans is expected to be low this year.

Third-Party CLO funds – How big is this market?

Third-party CLO funds that are 40-Act filers with the SEC total \$1.6 billion AUM, a very small slice of the market. The substantial majority of CLO equity is held in GP/LP funds that don't report their holdings. Of course, many of these holders are the managers themselves.

AAA vs. Equity influence?

Given the recent volatility in the market, AAA has been successful in negotiating better terms and rate. Usually, CLO equity can be patient in a warehouse and wait to bring the CLO to market when the debt terms are more favorable. It's not a great time to agree to a two-year non-call on a new issue deal.

What's Flat Rock's view on CLO third-party funds focused on secondary or new issue?

My view is that to be successful in the asset class you need to look at both primary and secondary. Similarly, I'd recommend diversity by manager and vintage, and even some middle-market CLO equity. Investment mandates that limit the investment universe will only lead to less attractive returns.