Thomas Majewski

Founder & managing partner

Eagle Point Credit Management

It is possible to hit a home run with a print and sprint CLO, but execution is difficult

Periods of loan price volatility can present opportunities to create 'print and sprint' CLOs away from the normal loan warehousing process. CLO collateral managers can create a portfolio of discounted assets in a quick securitisation focused mainly on buying loans in the secondary market.

However, the challenges of quickly lining up both loan assets and CLO debt liabilities can cause these transactions to fail. It's like the quote about transwarp beaming from Star Trek — as Scotty says: "It's like trying to hit a bullet with a smaller bullet, while wearing a blindfold, riding a horse."

With the US broadly syndicated loan market down multiple points since the start of May, we have seen numerous attempts at 'print and sprints' by CLO equity investors and collateral managers seeking to capture the opportunity.

At the same time, investment grade CLO liabilities are gapping out, creating both a discounted asset buying opportunity and a widening liability sale concern. If a CLO collateral manager can lock today's debt liabilities ahead of further widening, while also ramping a large portfolio of cheaper secondary loans, they could hit a home run. But if loans rally just as they press the pricing button, their equity return could get squeezed by the higher-than-modelled purchase price.

For this reason, print and sprint transactions work best in short periods where loan price dislocation leads the widening of CLO debt liabilities (and not vice versa). In other words, you want the loan opportunity to exist before CLO debt widens in concert, instead of locking widening debt liabilities before loans are attractively priced. We saw a brief window that worked like this in early 2019, when CLO debt spreads held in for a short period while loans were for sale.

Volatility makes the sprint more difficult

Things get trickier when price volatility oscillates from both sides, making good times to purchase loans also the most challenging times to sell CLO debt. We are in such an environment today. Dealers need weeks — and sometimes months — to line up a CLO triple A anchor, complicating the blistering nature of the print and sprint.

The premium equity investors must pay for expeditious liability execution to get around the timing mismatch isn't cheap. For instance, the transaction that started the recent wave of print and sprints paid nearly 20 basis points more than the market average pricing at the time.

> The CLO that started the wave of prints and sprints paid near 20bp more than the market average

Short non-call periods may be best

Equity investors are generally comfortable taking on wide debt costs if they believe they can soon correct the initial expensive cost of capital by refinancing or resetting the CLO debt. For this reason, depending on your outlook for CLO debt spreads, it may be valuable for equity investors to secure a short non-call period, even if at the cost of a shorter reinvestment period.

This preference, coupled with the desire to clear liabilities, quickly drove the offering spreads for short non-call triple As wide in primary markets. Today, we are seeing an inverted term structure in triple A spreads: three-year reinvestment periods are coupled with a one-year non-call print that is meaningfully wider than senior notes with a five-year reinvestment period and a two-year non-call.

These illustrations are just a few of the roadblocks investors encounter in trying to navigate print and sprints. Items such as rating agency timing, CLO mezzanine execution, or simply navigating the arranger landscape, all add to the complexity, and it is why most of these transactions don't hit their mark without experienced CLO equity investors or CLO collateral managers.

In a market with limited secondary majority equity opportunities, if you're able to hit the bullet with a smaller bullet, while blindfolded and riding a horse, the print and sprint transaction may be the best CLO you price all year.

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