Asset Securitization Report

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Antares anticipates CLO issuance as industry headwinds lessen

By John S. Hintze January 16, 2023, 10:00 a.m. EST 5 Min Read

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Last summer, as talk about a U.S. economic recession started in earnest, and banks faced stricter capital requirements, most collateralized loan obligation (CLO) managers put the brakes on new offerings. As Antares Capital heads into 2023, however, the direct lender sees friendlier CLO dynamics. In fact, the big middle-market lender is likely to issue over the next few months its first CLO since last April, when it priced a $1.2 billion transaction led by Deutsche Bank Securities.

The direct lender, majority owned by the CPP Investments that acquired it from GE Capital in 2015, manages nearly $60 billion in assets, including $10 billion across 10 middle-market CLOs. Seth Painter, managing director of structured products at Antares, said the CLOs fund approximately half of Antares' balance sheet, with another 40% of financing coming from bank credit lines, and the remaining 10% from issuing unsecured bonds.

Started in 1996 by professionals from Heller Financial, Antares has grown alongside its clients. It began a syndicated lending desk in the early 2000s that originates larger loans for private equity-sponsored clients and syndicates them to other CLOs, thus offering a suite of financing options ranging from club deals to syndication. Antares announced January 10 bringing over Seth Katzenstein, formerly of Intermediate Capital Group, to move beyond middle-market CLOs to head up its tradeable credit business, issuing CLOs backed by loans to larger corporations.

Antares' CLOs range from $2 billion to $400 million in size and typically invest in single B-rated, direct-lending credits. In an interview with Asset Securitization report, Painter discussed issues impacting the CLO market in 2023.

ASR: CLO issuance dropped off significantly in 2022, and Wall Street anticipates it falling even further in 2023. What is Antares' outlook?

Painter: We expect issuance to be light for at least the first half of the year or until there's more certainty around recession risk, higher rates, and what that means for asset defaults. We broadly agree with most Wall Street analysts who forecast issuance in the $80 billion to $100 billion range.

Painter: There's been tremendous pressure on the arbitrage since Q2 of last year, when CLO liability spreads widened rapidly. That was particularly problematic for CLO managers and their equity investors, whose warehouses were heavily ramped. So many managers and their equity investors opted to hold off issuing, stay in their warehouses, and wait it out.

This arbitrage issue can persist longer for middle-market CLOs because their liabilities are highly correlated to the larger BSL CLO market, while their asset spreads have historically been slower to widen. So it takes longer for the arbitrage to catch up.

ASR: Did this impact Antares?

Painter: To an extent it did impact our CLO issuance last year. However, our access to diverse funding sources allows us to be a bit more selective and patient, and it helps us to optimize our return on equity. We've diligently managed our sources of funding, so in a dislocation like this we're not forced to issue and increase our cost of funds.

ASR: What is your outlook for CLOs?

Painter: We've reached a point where we think the yields on our recently originated assets have caught up with the widening liabilities. The arbitrage is not what it was two years ago or even a year ago, but it now makes sense to us—that's a fairly recent dynamic, so you may see us issue soon.

ASR: CLOs' BBB and even AAA tranches have been trading at significant discounts to par. Are these discounts attractive to investors?

Painter: Yes. CLO tranches are trading at a discount. 'AAA's are trading around 97 and 'BBB's around 90. From a fundamental credit perspective, it's fair to say those pricing levels do appear attractive to investors compared to historical returns. For context, CLO 'AAA's have never experienced a default and 'BBB's' risk of default is very low.

On a relative value basis, investors have different considerations in terms of how they deploy their cash, or they may see [a deeper recession ahead and] prices dropping further, and so they don't want

Asset Securitization Report

ASR: **Interest rates and inflation remain high, and a recession appears likely. How does that impact Antares' CLOs?**

Painter: As it relates to rates, our portfolio is 100% floating rate, so generally a rising rate environment is good for us—we have less duration risk than fixed-rated products. The question then becomes, "can our portfolio companies service their debt." And fundamental to our investment process and underwriting is a stress test of credits under various rate environments, so this is nothing new for us. In terms of inflation, we've purposely allocated to less cyclical sectors, so most of our portfolio companies have been able to pass through higher costs.

When we think about new deals, [we noticed that] spreads and the original issue discount (OID) have widened meaningfully in the last nine to 12 months—100 basis points or more year over year. The structures are more lender friendly, leverage has come down, and loan-to-value (LTV) is also lower. So we actually really like this market; we can earn better economics on stronger credits.

ASR: And what if the recession deepens?

Painter: Certainly if the recession is a bit deeper and more severe, you're likely to see cracks in some portfolios. But our expectation is for that not to materialize, and we expect our portfolio companies to hold up quite well.

ASR: The loan market was mostly closed to leveraged borrowers last year. How has that impacted Antares?

Painter: The leveraged buyout market has certainly slowed, and where we continue to be active is with our existing portfolio of companies. We often were involved in their original financing, and now they're making smaller acquisitions and need incremental financing.

ASR: The Federal Reserve increased capital requirements for several large banks last summer that typically purchase CLOs' highly rated tranches. Did that also impact middle-market CLOs?

Painter: Certainly some of the larger banks have been impacted, but the regional banks less so. Increased capital requirements tend to impact banks across many assets, and really any activity that

Asset Securitization Report

ASR: Have there been other changes to the middle-market CLO investor base?

Painter: Further down the capital structure the investor mix has been fairly consistent, although one interesting dynamic has been the higher spreads drawing more inquiry from atypical investors across the capital structure. Some hedge funds and other investors can opportunistically hit their return targets when they put a bit of leverage on the investment.

John S. Hintze

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TRENDING

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The Arizona-based lender has been in business for 35 years and has branches in over 20 states.

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