US Market Commentary: CLO Q&A—Monroe Capital MD/Deputy CLO PM Chris Enas shares views on private credit CLO volume/origination challenges and AAA placement

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In an exclusive interview, LFI spoke with Monroe Capital's MD/deputy CLO portfolio manager Chris Enas about high-level private credit/middle-market CLO trends. The firm has $18.8bn of committed and managed capital, as of April 1. The firm's CLO platform has $4.6bn AUM in 14 active CLOs under management, supported by 68 analysts (10-20 credits per analyst), according to the latest Fitch Ratings CLO Manager Handbook.

What constrains the frequency of issuance of new PC CLOs; e.g., Triple A demand, BDC financing targets?

One constraint that has seemingly plagued the market over the last 12 months has been origination and deal flow at the manager level. The lack of new LBO and M&A activity in general, primarily due to the prolonged higher-rate environment, has tapered the speed at which CLO portfolios have been able to ramp up assets, whether in warehouse phase or within the reinvestment period.

What is the most difficult debt tranche to place?

All tranches across the CLO capital stack have their own intricacies when it comes to placing the bonds. At the top, with the AAAs, which is typically the largest tranche, managers are often tasked with sourcing/onboarding an anchor investor with liability costs that produce the most optimal net spreads for the equity. At the lower end of the capital stack with the BBs, investors are more often prone to asset-level risk within the portfolio, so a deeper diligence dive into the quality and construction of the overall CLO portfolio typically comes into play here.

What's the firm view on software, technology and recurring revenue loans in your deals? What assets are the most challenging?

We are a very active originator and participant in the software, technology and ARR landscape through our Technology Finance vertical. When it comes to software and technology, our investment thesis for our CLO funds is predicated on primarily underwriting borrowers operating in stable, mature end-markets with revenue models that are highly recurring in nature with a predominant focus on software-as-a-service (SaaS). However, ARR loans do not fit in traditional CLOs because they are not rated (mainly given the cash flow dynamics). We typically do not originate ARR deals for our CLO funds due to the complexities around cash flow dynamics of these borrowers as well as the higher debt-to-EBITDA leverage ratios which can raise flags with the ratings agencies required to rate the underlying asset.

What are some of the key metrics that are used to invest in private credit CLOs?

It is always important for the investor to first underwrite the manager as a whole and to assess their overall track record as a private credit manager, experience through credit cycles, the breadth of their origination capabilities, as well as their broader underwriting and portfolio management capabilities. An investor may also be focusing on what will complement their existing fixed income portfolio, such as a middle market private credit CLO. Once comfortable with the manager, the underlying assets within the private credit CLO portfolio can then be better vetted for industry diversification, debt service coverage ratios and credit protections (i.e. financial covenants), among other important criteria.

What is Monroe's view on hybrid private credit and possible BSL platform transactions?

We maintain a firm-wide investment strategy of originating and underwriting lower middle-market transactions with borrowers generating annual EBITDA in the $15mn-$50mm range. We have remained firm in our investment thesis here, dating back to the inception of our firm in 2004, while we see our directly originated product as a significant value-

add given we are able to control the origination, underwriting, and portfolio management processes in different ways. Further, we are also able to negotiate and structure enhanced credit protections within our governing credit agreements.

Does Monroe sell its equity in its PC CLOs or is it retained?

The vast majority of our CLO equity capital comes from multiple strategic LPs that maintain dedicated capital allocations for future CLO issuances. In the past, we have offered our CLO equity to smaller minority investors and third-party asset managers, although we prefer to retain our equity alongside our LPs.

What additional trends are you seeing in the market?

We've observed increased levels of competition heating up between syndicated markets and private credit, which is largely being driven by the current supply/demand imbalance with limited LBO activity and an increase in overall CLO issuance (BSL and PC). Similarly, robust demand for new loan supply at the manager level has underpinned a recent surge of refinancings and repricings in the marketplace, often meaningfully pushing out near-term debt maturities. We remain vigilant for signs of stress and potential maturity walls for middle-market borrowers.

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