
CLO Manager Corner Series: Sculptor Capital Management

Adeel Shafiqullah, head of European CLO management, discusses launch of manager's new captive CLO equity platform in context of its other strategies

The launch of Sculptor Capital Management's captive CLO equity platform in April, secured by an anchor commitment from Rithm Capital Corp, is a "strong validation" of the firm's support of Sculptor's CLO management business as well as the ability to be "opportunistic and nimble" with capital.

Speaking to SCI, Adeel Shafiqullah, head of European CLO management at Sculptor, says: "Having access to committed CLO equity capital that is able to provide warehouse equity, and ultimately CLO equity, for Sculptor's CLO platform allows us to be responsive and flexible in a variety of market conditions. For example, we can be opportunistic in terms of being able to capture periods of dislocation in the market, as well be patient in terms of ramping and securitising."

The launch of the captive CLO equity platform not only gives visibility to Sculptor's CLO issuance program and growth, Shafiqullah notes, but also provides an attractive combination of stable and flexible capital that can be deployed over a credit cycle. "The long-term and stable profile of CLO equity capital enables us to capture both the optimal asset purchasing period as well as the securitisation period for issuing a deal."

When it comes to unique differentiators as a manager, Shafiqullah highlights Sculptor's ability to work together as a cohesive team across different investment strategies and geographies. He says: "A culture of strong collaboration across various investment strategies has been in the DNA of the firm since its inception. As a leading alternative asset manager that has deep experience in corporate credit, asset-based finance, long/short equities, convertible and derivative arbitrage and real estate, we have access to investment teams that are experts in various sectors, geographies and across the entire capital structure. Therefore, when we are underwriting a new transaction or monitoring an existing credit in our CLO portfolios, it's important for us to reach out to our colleagues on other teams and get their input and views on a critical theme or aspect of our investment thesis."

Shafiqullah notes another differentiator as a manager is Sculptor's emphasis on active portfolio management facilitated by constructing a liquid underlying portfolio and overlaying structural optimisation using proprietary analytics apps. "We typically prefer more liquid capital structures because it's important to have the ability to trade a portfolio actively. As underlying fundamentals or valuations change, our investment thesis may change and it's important to be able to translate that into actionable trading decisions."

He adds: "Then when it comes to CLO management, a key aspect is continually optimising the portfolio to the CLO structure and actively managing it to achieve the best results for all investors. This includes a thorough understanding of CLO documentation and having robust systems from a portfolio analytics perspective. When you overlay all of that together it enables us to be proactive in terms of managing the lifecycle of our CLOs."

Shafiqullah says that it is also important to be cognisant of potential downside risks in CLO portfolios. "A key risk that we are highly focused on when we're underwriting a new loan, conducting portfolio reviews, and monitoring our existing deals is to understand where the weakest links are in the market in terms of loan documentation. I think some of the "LMEs"

(Liability Management Exercises) that we've seen in the loan markets and some of the resultant recoveries have pushed us to raise the bar in terms of getting comfortable with both credit as well as the structure and documentation of a loan."

This will continue to be a focus going forward, Shafiqullah highlights, because of the poor outcomes seen for lenders, where documentation combined with weak credit has led to some cases of low recoveries.

Additionally, one trend Shafiqullah says is topical in the market this year is the shrinking of the CLO market in terms of net new issuance. "You had more deals getting called than net new issuance. I think that trend starts stabilising and we go back to a growing market as CLO formation continues to pick up from where it is today."

On the liability side, Shafiqullah believes CLO liabilities will continue to remain an attractive option for investors across the capital stack from triple-As all the way down to junior mezzanine notes. "The primary driver for that is that the all-in carry that investors are looking at from the CLO product remains attractive on a relative value basis. And then when you overlay the outlook from a macro perspective, in terms of a slowing economy, more visibility on rates, the risk/return should still look attractive for CLO liabilities."

"As the rates cycle pivots, we think the second half may be more constructive than the first half of this year, as we have already seen a significant rally in spreads," Shafiqullah concludes.

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