The Italian connection

As Octagon and Conning come under the umbrella of large Italian insurer Generali, we spoke to the firms' CEOs about their expectations for credit in general and their firms in particular

by **Tom Davidson**

Octagon Credit Investors is one of the best known names in the leveraged loan market, and the sixth largest US CLO manager according to our latest half-year manager rankings. It is owned by Conning, a global investment management firm that specialises in serving the insurance industry and has more than $200 billion of assets under management.

When news broke in July that Conning had a new owner in the form of Italian insurance giant Generali, it seemed like a great excuse to sit down with Woody Bradford, CEO of Conning, and Andy Gordon, CEO of Octagon, to discuss what that new ownership means, as well as their views on the credit market.

Tom Davidson: *Before we go on to the Generali deal, how do you feel the first half of the year went for you?*
Andy Gordon: The first half came together a little differently than we thought it was going to play out. The CLO market started out fine in the first quarter, and then the arbitrage got challenging. The second quarter was more difficult for firms that use third-party equity as opposed to captive equity, and we always use third-party equity. Our growth slowed a little bit on the CLO front, but we had nice growth in separately managed accounts and other managed funds to balance it out.
Woody Bradford: The first half of the year, I think, fooled a lot of people — almost everybody was certain there was going to be a recession. Recession predictions have finally moderated, which maybe means the recession's finally coming. But I think the same headline is true across Conning as it is for Octagon. We're in some ways in unplanned territory, but performance has been very good in the face of unpredictable market outcomes. I think it's worked out pretty well for our clients.
TD: *Moving on to the news about Generali*

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acquiring Conning, what's the background to the change of ownership on your side?
WB: Generali Group is acquiring all of Conning Holdings Limited, which includes Conning, Octagon and two other brands inside our family, Global Evolution and Pearlmark in emerging market debt and real estate, respectively. Cathay Life [the previous majority owner of Conning] is not exiting its position and will continue to be an owner of the combined company.

We'll end up with a structure that has Generali owning 83.25% and Cathay owning about 16.75%. Cathay has committed to keep the revenues that they have with us for at least ten years, so every one of our investment teams that manages money for Cathay will be able to continue doing that.

There are no activities that Generali has today in the US that overlap with anything we're doing, so what we've done together is extremely additive. There are no material cost synergies here, this deal is purely about growth, and the opportunity to grow together. We think there's a lot that we'll be able to do together, with their existing assets, bringing opportunities to new clients, and bringing some of their capabilities to some of our existing clients.
TD: *And what does the deal mean for Octagon in particular?*
WB: Generali has an incredibly strong presence across Europe, and a powerful distribution network there that we think will be able to help all our companies.

In terms of the Generali insurance company's balance sheets, there are two ways to think about that. There's an asset allocation they have today, and mandates with outside managers. We expect to be able to compete for those and take on new opportunities.
AG: With respect to Octagon, we have a pretty well-developed distribution operation here in the US. But we're one of the few large managers that doesn't have a European operation, and Generali is extremely strong there. And Generali does not have any below-investment-grade capabilities or money under management in that asset class. So we can potentially partner to provide loan investment opportunities to a wider investor base in Europe, which is something we've said we are interested in.
TD: *Can you tell us more about your plans for Europe? Are you looking at buying an existing European CLO manager?*
AG: We had a small operation in Europe before the great financial crisis, and priced one CLO in the European market. Back then we decided that the growth potential for Octagon in the US was so much greater than the growth potential in Europe.

So we do have some familiarity with Europe. But now with Generali as our partner, that opportunity may be more important. We'll see where it goes, but I will say that we don't think you should run a European loan business from the US. I think, with the resources that Generali has to bring to bear in that marketplace, we will have the capability to build something very competitive that's a good cultural fit with our business. Making acquisitions brings a whole different level of risk from an execution perspective, and from my perspective Octagon's a pretty special place, and we want to preserve that.

TD: *The other big trend in the credit market over the last few years is the growth of private credit. Do you have any plans in that space?*

AG: I think the way the BSL and private credit markets are converging and competing for deals, it's inevitable we're going to need to add a private credit capability. With the size of the transactions that are now being done in the private credit market, many deals now could go either broadly syndicated or private.

Our research capabilities are where they need to be to do that, so then the question is: do we have the right fund structure and capital for private credit? Because CLOs are not a good vehicle to do private credit, for all the reasons you know. Previously, Octagon's access to the capital required to compete in private credit was a real question mark. Hopefully the Generali transaction solves some of that. We're putting the pieces together, but we don't have the right vehicles set up yet to really be a player. I think that will change over time.

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> *Octagon*

TD: *Looking forward, what opportunities or risks do you see in the second half of the year?*

AG: For the second half of the year, I think the risk of recession has come down but I don't think it's zero, and there is still going to be volatility. For the loan market, it will be very company specific. You can't erase the fact that we're a floating rate asset class and rates have gone up roughly 500 basis points for our borrowers. If they weren't hedged, or went into this year over-levered, it's going to be a little tight from a cashflow perspective. So I would say I'm cautiously optimistic for the second half of this year. But I think there are going to be periods of volatility, where if you choose the right credits, you're going to be well rewarded.

Andy Gordon *CEO, Octagon Credit Investors*

Based: *New York*
Career: *before co-founding Octagon in 1994, Gordon was a vice president of the acquisition finance division of Manufacturers Hanover Trust Company, then a managing director at Chemical Securities*
Education: *Duke University*

What's the best investment in credit?
Obviously, it's a risk return question, but I still think CLO triple As in the primary are a very good buy for the risk. For a top tier manager, we're seeing triple A risk at around 7%. That seems pretty compelling. Similarly, at the bottom of the stack, you're talking low teens for double B paper for a top tier manager.

What's the worst investment in credit?
There's a number of them, but I'll choose a loan that's a weak single B, because you've now got real price action risk to the downside. The downward price movement when a single B is downgraded to triple C is pretty big. Borrowers that have questionable near-term business prospects, that are unhedged, and are B3, are a difficult asset to love.

What would you change about the credit industry?
We don't have enough time! But one thing that's bothered me for a while is the way loan market underwriters disclose credit agreement terms prior to new issue commitment.

The terms shared with asset managers who are looking to commit to a credit are full of "to be determined" notes. The loan market gives you too short a period to truly understand the document, for a specific reason — they don't want you to comment.

Woody Bradford *CEO, Conning*

Based: *Boston*
Career: *multiple senior roles at Putnam Investments, then an operating partner at global private equity firm Advent International*
Education: *Worcester Polytechnic Institute and Harvard Business School*

What's the best investment in credit?
Markets are moving fast. If you ask me in two weeks, you might get a different answer!

Speaking from an insurance company viewpoint, who are many of our clients, you can take a quality bias right now to set off some recession risk and still get paid well. Andy mentioned triple A CLOs, I'll go for high quality mortgages. You can take five-year exposure and get 160bp over and put that away. If rates fall, you may regret some of that, but as a hedge, I think it's a good place to be.

What's the worst investment in credit?
The standard answer is commercial mortgages. It's a huge risk to bet on a return to normal occupancy.

There's a little bit of the baby with the bathwater situation with commercial mortgages though, and it's very sector and geography specific. Multi-family housing in some of the sunbelt states is growing like crazy.

What would you change about the credit industry?
Data standards, quality, transparency, and a preference for regulators and politicians to spend time helping us work with clients to fulfil their fiduciary duty rather than bantering around acronyms.