Eagle Point Credit Company Inc. (ECC)

Updated June 25th, 2019 by Samuel Smith

Key Metrics

Current Price:	$18	**5 Year CAGR Estimate:**	4.7%	**Volatility Percentile:**	25.6%
Fair Value Price:	$15	**5 Year Growth Estimate:**	-5.0%	**Momentum Percentile:**	62.4%
% Fair Value:	121%	**5 Year Valuation Multiple Estimate:**	-3.8%	**Growth Percentile:**	0.5%
Dividend Yield:	13.5%	**5 Year Price Target**	$11	**Valuation Percentile:**	26.8%
Dividend Risk Score:	NA	**Retirement Suitability Score:**	NA	**Total Return Percentile:**	0.5%

Overview & Current Events

Eagle Point Credit is a closed-end fund launched and managed by Eagle Point Credit Management LLC. It was formed on March 24, 2014 and is domiciled in the United States. It invests in fixed income markets of the United States, primarily equity and junior debt tranches of collateralized loan obligations that mainly consist of below investment grade U.S. senior secured loans. Eagle Point Credit is a popular CLO fund among institutional investors thanks to management's long term buy-and-hold philosophy and conservative approach to running the business.

The company reported Q1 earnings on May 22nd. Q1 net investment income and realized capital gains came in at $0.36 per share, down from $0.38 in Q4 2018. Net asset value of $13.70 per share at March 31st, 2019 rose from $12.40 as of December 31st, 2018 and management estimates NAV per share has risen still further to $14.33-$14.43 as of April 30, 2019. Excluding proceeds from called investments, ECC received cash distributions of $1.13 per weighted average common share from its investment portfolio during the quarter, which was in excess of its aggregate quarterly common distribution and other recurring operating costs.

Management invested $58.5M in gross capital and $14.5M in net capital during Q1, in large part funded with the proceeds from the sale of investments. Furthermore, the company converted three of its existing loan accumulation facilities into CLOs. On May 16, 2019, the company realized a loss of ~$4.5M, or $0.18 per share, on a write-off of the residual amortized cost associated with called CLO equity investments. Eagle Point plans to redeem 909,000 shares of 7.75% series A term preferred stock due 2022 on June 28, 2019; redemption price per share will be $25 plus an amount equal to all unpaid dividends and distributions on shares accumulated.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS							$1.90	$2.28	$2.05	$2.20	***$1.56***	***$1.21***
DPS							$2.35	$2.40	$3.25	$2.40	***$2.40***	***$1.20***
Shares							23	23	23	23	***23***	***23***

Eagle Point Credit's growth prospects could get a tailwind from outflows in senior loan ETFs, which would result in lower prices and higher effective yields. The company is poised to profit from price dislocations in the senior loan market, which would make their capital raises more accretive. Furthermore, the CLOs that dominate ECC's balance sheet will benefit from widening bank loan spreads. In the meantime, many of their CLOs are older and are therefore at risk of being called and generating lower returns. If management can effectively sell out of its debt tranches and further move into equity positions to boost yield, they can offset this and keep returns healthy.

At the same time, however, they need to exercise care not to take on excessive risk, especially so late in the cycle. Management is also looking to lengthen investment periods through resets and re-financings in order to boost yield. The negative of this move, however, is that refinancing activity disrupts cash flows and also incurs additional fees which eat into short term returns. Due to these headwinds and the fact that management has a penchant for overdistributing earnings, we believe earnings will continue to decline by 5.0% per year over the next half decade, leading to another steep dividend cut.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E							10.5	7.0	9.8	8.2	***11.4***	***9.4***
Avg. Yld.							11.8%	15.0%	16.2%	13.3%	***13.5%***	***10.5%***

Eagle Point Credit's earnings are rather choppy, but it is still possible to calculate its average price to earnings ratio with some certainty. Thus far in its history, it has averaged a 9.4 trading multiple to its earnings. Given that earnings will likely be shrinking leading to another dividend cut, we believe that this is a fair estimate of fair value relative to its current 11.4 multiple. Therefore, we expect a 3.8% annual headwind to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout							124%	105%	159%	109%	***154%***	***99%***

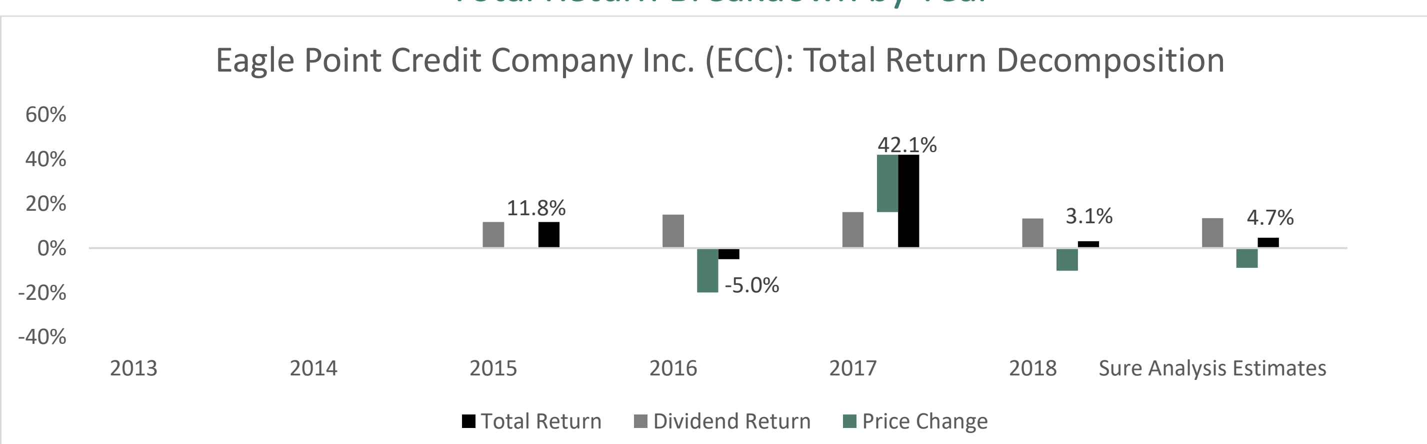
The number one risk here is obviously an acceleration in defaults and bankruptcies in underlying borrowers which would lead to increased losses and a rapid deterioration in net asset value for Eagle Point Credit. As a result, the company is not recession resistant even though it has yet to go through one.

The good news here is that the company employs a very aggressive hands on approach to its investments and uses wide diversification, mitigating this risk significantly. Still, in a broad downturn in the economy, this is a very real risk. Furthermore, the fund's leverage could force it to issue equity or sell assets at dilutive prices in order to sustain its mandatory debt coverage ratios. These risks aside, CLO equity does offer attractive return potential late in the credit cycle. A look back at the financial crisis shows that some of the best performing CLO equity tranches were issued immediately prior to the economy crashing. This in large part due to the reinvestment option inherent to CLO equity. The main competitive advantage for Eagle Point Credit is its hands-on approach to its investments, enabling it to mitigate risks and drive greater risk adjusted returns than it would otherwise.

Final Thoughts & Recommendation

Eagle Point Credit is a unique company given its closed end fund model. While the 13.5% dividend yield is enticing, the expected declines in earnings (-5% annually) as well as multiple compression (-3.8% annually) give it a mediocre 4.7% annual total return outlook over the next half decade. As a result, we view it as a sell.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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