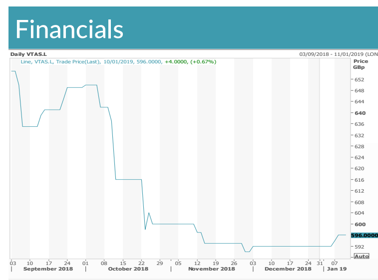
14 January 2019

Financials



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	VTA .NA, VTA.LN VTAS.LN
Price (p)	6.70/6.64/600p
12m High (p)	7.32/7.28/655p
12m Low (p)	6.46/6.52/590p
Shares (m)	36.6
Mkt Cap (€m)	245
Trail 12-mth. yld	9.3%
Free Float	70%
Market	AEX, LSE

Description

Volta is a closed-ended, limited-liability investment company that pursues a diversified investment strategy across structured finance assets (primarily CLOs). It aims to provide a stable stream of income through quarterly dividends.

Company information

Independent Chairman	Paul Meader
Independent Non-Executive Directors	Graham Harrison Stephen Le Page, Atosa Moini, Paul Varotsis
Fund Managers AXA IM Paris	Serge Demay A Martin-Min François Touati
Co. sec. /Administrator	BNP Paribas Securities Services SCA, Guernsey

BNP: +44 1481 750853

www.voltafinance.com

Key shareholders

AXA Group	30%

Diary

Mid Feb	Jan Monthly report

Analyst

Mark Thomas 020 7194 7622

mt@hardmanandco.com

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VOLTA FINANCE LIMITED

Investment opportunities at this point of the cycle

With market concerns that the credit cycle might turn, in this note, we explore the opportunities Volta has in these conditions. While MTM losses are likely to increase, and some of the market prices of Volta's holdings will not reflect their long-term value, there are upsides. We note: (i) spreads are likely to widen; (ii) more mis-pricing opportunities are likely to emerge; (iii) Volta has a broad diversification and a good credit track record; and (iv) its profile is very different from 2007-2008.

- **Strategy:** Volta aims to preserve its capital across the credit cycle and to provide a stable stream of income (via quarterly dividends) by investing in a diversified portfolio of structured finance assets. The company has a flexible mandate, meaning that it can respond rapidly to market opportunities.
- **2018 Report and Accounts:** We have also taken the opportunity to review the 2018 R&A released in October. Of particular note is an incremental risk reduction in credit (lower impact of increasing default rate), valuation (even greater market pricing) and liquidity risks (33-month extension to Repos facility).
- **Valuation:** Volta trades at a 13% discount to NAV. Peer structured finance funds, and a range of other debt funds, on average, trade at smaller discounts. In the medium term, Volta has delivered faster NAV growth than its immediate peers and an in-line volatility, making this absolute and relative discount an anomaly.
- **Risks:** Credit risk is a key sensitivity (Volta has a widely diversified portfolio). We examined the valuation of assets, highlighting the multiple controls to ensure its validity in our *initiation note* in September. NAV is affected by sentiment towards its own and underlying markets. Volta's long $ position is only partially hedged.
- **Investment summary:** Volta is an investment for sophisticated investors as there could be sentiment-driven, share-price volatility. However, long-term returns have been good: ca.13% p.a. returns (dividend reinvested basis) over five years. The current portfolio expected NAV return is broadly similar. The yield is 9.3% and will be covered, in our view, by predictable income streams.

Financial summary and valuation (Hardman & Co adjusted basis)

Year-end July (€m)	2014	2015	2016	2017	2018	2019E	2020E
Coupons & dividend	31.4	33.7	34.7	33.2	38.5	37.0	38.8
Operating income	37.5	46.0	36.5	35.0	37.2	38.8	40.6
Inv. managers' fees	-4.1	-4.5	-4.3	-4.6	-4.6	-4.6	-4.7
Adj. perform fees	-2.5	-3.5	-1.3	-1.2	-1.4	-1.7	-1.9
Total expenses	-7.9	-10.3	-7.2	-7.0	-0.9	-0.9	-0.9
Total comp. income	29.5	35.7	29.3	28.0	29.9	31.1	32.6
Statutory PTP	44.0	47.6	12.6	38.7	22.7	30.8	32.3
Underlying EPS (€)	0.82	0.98	0.80	0.77	0.82	0.85	0.89
NAV	273.6	299.2	289.3	305.5	305.7	314.0	323.8
S/P disc. to NAV	10%	18%	15%	20%	20%	22%	24%
Gearing	0%	9%	12%	12%	14%	14%	13%
Dividend yield	9.0%	9.3%	9.3%	9.3%	9.3%	9.3%	9.3%

Source: Hardman & Co Research

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Update on Volta's attractions

Summary

Turn in the cycle presents opportunities as well as threats. In particular, we expect wider spreads and an increased number of mis-pricing opportunities.

In our *initiation note* in September, we highlighted a number of Volta's attractions. In this note, we initially review these in the light of a potential turn in the credit cycle. The key conclusion is that such conditions are likely to present a much-enhanced re-investment environment, which is an offset to rising defaults. Should any deterioration be gentle, these opportunities could exceed credit losses, although sentiment is likely to prove volatile. The current discount already builds in a material downside. Over the long term, Volta's returns are driven by cashflows, which are likely to be prove much more stable than the near-term market price of some of its assets.

Key attractions: ca.13% p.a. returns over past five years; well controlled risks; flexible mandate to optimise returns; and buying at a greater NAV discount than peers.

In addition to considering this turn in the cycle, we have also updated the issues we identified in our initiation. Over the past five years, Volta has delivered ca.13% share price returns (dividends re-invested basis), a higher return than benchmark indices (both equity and bond). Manager projections on the existing portfolio indicate a similar income yield outlook. Critically, the distribution on monthly returns has a bell-shaped pattern indicative of a business that manages risk well. We note the Sharpe ratio (another measure of risk/return) has been more attractive than for peers. One reason for this attractive profile is that the fund's income has primarily been driven by interest coupons and has not been reliant on volatile capital gains (or losses). We also note that the underlying exposure is to hundreds of end-borrowers, creating credit risk diversification. AXA IM, the fund manager, has a proven track record and has the scale to: (i) access and negotiate attractive deals unavailable to smaller participants; (ii) build a significant market presence with the associated market intelligence across a broad range of investment opportunities; and (iii) invest heavily in back- and mid-office control functions.

Volta's opportunities at this stage of the cycle

Upside opportunities

Potential for spreads to widen and income increase

For nearly two years, credit spreads have been tightening and covenants on new underlying loans have been weakening. While this created some capital gains (especially in FY17) and some opportunities in CLO equity tranches (which benefit from CLOs restructuring their own finances), it has overall been a challenging re-investment environment. Concern about credit is likely to see wider spreads meaning that the underlying income on re-investment is likely to improve. The balance of increased income against increased credit loss will be dependent on the speed of credit deterioration. A slow, steady decline could see greater bottom line profitability.

More mis-pricing opportunities

Not all assets are likely to show the same rate of deterioration and, in particular, sentiment to specific sectors/sub-sectors is likely to create mis-pricing opportunities. Volta has a track record of better-than-market assessment of credit and its long-term NAV performance suggests it has been good at identifying mis-priced assets.

In its equity raise at end-November, TFIF specifically highlighted opportunities from market disruption.

We note in its 26 November Market update and intention to issue new ordinary shares statement, Twenty-Four Income Fund stated "The recent volatility in equity and credit markets has, however, finally spilled over into the European ABS market, pushing spreads in some parts of the market to levels that we have not seen since 2016. We strongly believe that the market is now mispricing risk in this sector, as it has many times before, presenting an excellent opportunity to issue further capital to the benefit of both existing and new shareholders. Fundamental performance in the underlying loan pools remains stable, and within expectations, indicating that the derating of the sector is due to risk sentiment across all markets, driven mainly by geopolitical events. Typically such instances offer a short-lived opportunity to access significant value."

Track record of lower-than-market losses

Volta has consistently reported a good credit performance, which is believed to be better than the comparable market-wide statistics (noting default statistics have limited value as positions may be sold at a loss ahead of the default event but the company could still report zero defaults). It has attributed this success to the analytical process by which it identifies opportunities together with the detailed market knowledge available as part of the AXA IM group (see section below). By way of example, the eight USD CLO equity positions that were initially purchased (and held to maturity) in Volta in 2006/2007, on average saw principal payments representing 74% of the nominal amount of the tranche. At the CLO inception, CLO equity tranches are collateralized by a principal amount that is in the area of 70% to 75% (depending on overall fees supported by the CLO). It basically means that the track record on these USD-terminated deals is no net loss (reflecting the fact that re-investment in loans at discounts compensated losses incurred). We understand that, for CLO Debt investments, Volta has never suffered a loss when there have been losses on similar assets in the market.

Broad diversification…

The Volta portfolio is broadly diversified by counter-party (ca.700 in all), geography, and economic sector. The largest five underlying exposures now account for 3% of the portfolio. The type of instrument also gives further diversification with assets, which might be regarded as lower-than-average risk, including the Bank Balance sheet transactions. In its November monthly update, Volta highlighted that its exposure to the UK is 6% of underlying risk and that a hard landing scenario would be historically consistent with annual defaults rates in the UK of 9-14%.

…a different profile from that in the financial crisis.

On p34 and p35 of our initiation note in September, we examined the major differences between Volta pre financial crisis and today. In summary, it was a much more concentrated portfolio with much greater underlying leverage. We note that leverage within Volta has been structured so as to minimise the probability that it would be a forced seller in distressed conditions. The asset manager also believes the market is much stronger with more professional participants, and a regulator and board that had previously experienced extreme downside conditions.

Downside risk

Rising defaults likely to see MTM losses

The speed of any deterioration in credit will be critical to losses relative to re-investment opportunities. Increased defaults are likely to see falling capital values and the geared nature of the CLO-equity-related investments is likely to magnify this. The seniority and security of the underlying position held makes the picture somewhat more complicated as in a default scenario, senior debt holders may still get repaid, potentially even in full. However, directionally MTM losses are to be expected.

Effect on sentiment-driven MTM hard to predict but highly probable market will over-react with impact on Volta's near-term NAV

In addition to likely actual losses, a potentially more important unknown is the effect on sentiment and the degree to which market prices are likely to over-react relative to long-term value. The uncertainty when credit losses are rising means the market applies a higher discount rate than might be expected to apply over a whole cycle and consequently market prices might be expected to fall below long-term values. This will have a direct impact on Volta's NAV – negatively going into the downturn and then positively when the effect reverses when conditions turn more positive. It does not affect cash flow but the falling NAV is likely to affect sentiment to Volta's value. We note, for example, that through December 2018 the estimated NAV fell from €8.27 to €7.71, a fall of 40c net of the 16c dividend. This 4.8% drop was driven by sentiment as we do not believe the expected losses to cashflow over the period would have been anything like this level. The current discount provides a significant cushion against this factor and as noted above such conditions provide greater opportunities for re-investment.

What the company said in its 2018 Report and Accounts

Management cautious in outlook

We note two aspects of particular interest in the outlook sections of the Chairman's and investment manager's statement.

- "For the next annual period, we are optimistic that performance should be at or above our target returns." [1]
- As expected with robust current credit conditions, the strong probability is that market-wide credit will deteriorate from here. The portfolio positioning reflects this. "Once again, I am going to be cautious, if only because the current cycle has been remarkably long lived. We cannot know precisely when this will end but, with the global equity market rally now over a decade old, it is time to be alert."[2]

Emphasis on underlying cashflows rather than short-term MTM

Highlights diversification, flexible mandate, track record and covered dividend

- The Chair also comments on the impact of a downturn. "…as I have also emphasised many times, whilst any financial markets downturn will manifest itself in shorter term, mark-to-market capital erosion, it is unlikely to erode materially the Company's strong cash flows. Whatever the short-term vagaries of markets, these strong cash flows underpin our long-term returns. Volta has a number of advantages: very broad diversification of the portfolio (spread across well over 700 individual credits); the ability of our Investment Manager to be nimble across a wide spectrum of credit assets; its proven ability to add value; and our attractive, stable, well-covered dividend. These advantages are unlikely to go away just because the economic cycle softens. Thus, Volta should prove attractive to investors through the next downturn, whenever that may occur, and beyond. In the meantime, we should enjoy the supportive economic environment and positive market sentiment that has underpinned one of the longest bull markets in history."[3]

Management increased shareholdings by 14% in year to end-July 2018

- We note the confidence of the board is reflected in their share holdings. Not only have they taken part of their fees in shares but there have been open market purchases as well. The five directors at end-July 2018 held nearly 252k shares, up 14.4% on the year before.

[1] P7 2018 Report and Account
[2] P3 2018 Report and Account
[3] P3 2018 Report and Account

Company core attractions in detail

In our *initiation note* in September, we noted that Volta has a number of attractions as an investment. We have updated them below to reflect the new information in the October Report and Accounts.

NAV return ca.8% in FY18 despite challenging conditions

- Volta delivered a 7.8% annual NAV return in the year to end-July 2018. After a modest first half, the 2H NAV increase was 4.7%.

Beaten equity and loan indices and not correlated with them

- In the five years to end-July 2018, Volta has delivered higher share price and NAV returns (12.9% and 11.9%, respectively) than its bond benchmarks (US High Yield Bonds (H0A0 Index 5.3%); US Loans Market (S&P LSTA Index 3.9%); European High Yield Bonds (HE00 Index 5.5%); and the European Loans Market (S&P ELLI Index 4.8%) and towards the higher end of equity indices (S&P 500 (13.1%), MSCI European (total return – 9.9%).

Forecast yield on assets 11.4% of NAV

- Based on the manager's modelling, the portfolio at the end of FY'18 had an expected gross yield of ca.10%. By introducing a modest degree of gearing, Volta expects to see pre-expenses NAV returns of 10.8%. While market conditions vary, the actual NAV returns have generally exceeded the projected IRR. Should current favourable credit conditions continue, this could recur in FY'19.

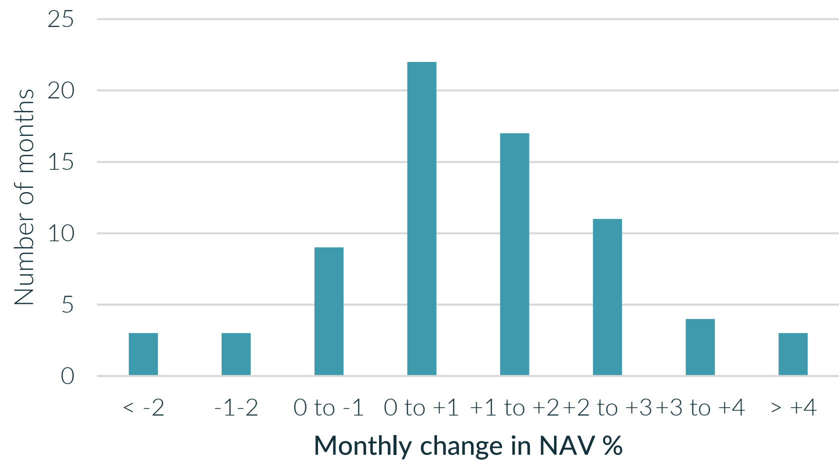
Better Sharpe ratio than peers

- One measure of value-added performance is the Sharpe ratio. This ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk. Subtracting the risk-free rate from the mean return, the performance associated with risk-taking activities can be isolated. Generally, the greater the value of the Sharpe ratio, the more attractive the risk-adjusted return. Volta reports this half yearly and has consistently delivered a higher-than-peer average Sharpe ratio. In the July 2018 Report and Accounts, its three -year Sharpe ratio was 1.5x compared with 0.4x at Carador, 1.0x at Fair Oaks and TFIF (Blackstone/GSO loan fund uses a mark to model valuation and so is not a fair comparator). This continues Volta's long-term delivery of a better Sharpe ratio.

Ideal bell-shaped distribution of monthly returns

- Importantly, the distribution of actual NAV monthly returns shows the bell-shaped pattern of a business, which manages risk well. Most months deliver a steady NAV improvement (0% to +1%), there is a clear bias to positive months, and the number of months with extreme gains or losses is small.

Distribution of monthly returns since January 2013

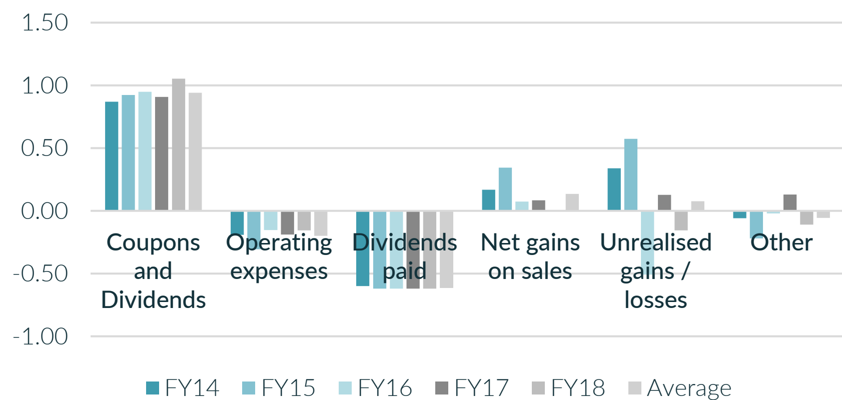


Source: Hardman & Co Research, Volta monthly reports through to December 2018

Volta's long-term performance is driven by the coupons and dividends received, rather than more variable capital gains

- From FY'14 to FY'18 on average, dividends and coupons added €0.91 p.a. to Volta's NAV against an average of €0.13 per share for realised gains and €0.08 for unrealised gains (see Figure below). The relative stability of these income lines is also visible in the Figure below and occurs because the portfolio is highly diversified. On our estimates, even the total failure by all the largest five underlying borrowers would still leave the dividend covered.

Annual contribution to Volta's NAV since 2014 (€ per share)



Source: Hardman & Co Research, Volta annual reports

Below-market credit losses

- Volta's choice of CLO managers has resulted in a below-market default experience. With market conditions seeing easing credit covenants, we believe picking the right manager becomes increasingly important.

Non-correlated asset

- Volta's NAV performance is not correlated with equity markets (or indeed with other "CLO" funds) giving investors a high return with risk diversification. The correlation co-efficient between the Volta share price and S&P 500, AEX and or FTSE100 has been low. While some of the concerns driving these equity markets will have an impact on Volta, there are other factors at play. The long-term NAV correlation with peers is also relatively low.

Correlation co-efficient of monthly NAV changes: Volta and closest peers (August 2014 to November 2018)

	Blackstone /GSO €	Fair Oaks $	Carador $
Reported Currency	0.16	0.71	0.70
Converted to € (no hedge assumed)	0.16	0.78	0.72

Source: Hardman & Co Research, Fund monthly report s

Fund manager with good track record…

- The fund manager, AXA IM, has an excellent track record in structured-finance funds. In the Figure below, we highlight by way of example its performance in US CLO equity tranches. We have chosen the early 2000s to show performance over the long term. We note CLOs originated during the financial crisis have seen annualised returns roughly double those launched in more benign macroeconomic conditions shortly before.

US CLO tranches annual IRR to June 2017 (%)

Vintage	2001	2002	2003	2004	2005	2006	2007
Wells Fargo Market Data	7.6	10.5	3.6	8.0	14.2	16.4	17.6
AXA IM	16.2	20.4	10.9	12.2	14.9	18.4	21.2

Source: AXA IM

Being part of AXA IM gives operational leverage

- Volta is supported by all AXA IM's structured finance departments, especially the securitized and structured assets (SSA) team. These units all sit on the same floor and have daily contact in addition to a weekly SSA market meeting in which the market situation is discussed. We see a number of practical advantages from being part of this team, including greater access and pricing power when negotiating investments, market intelligence, and the scale to invest in specialist skills.

Fund manager renumeration closely aligned to fund performance

- We note the investment manager's performance is closely aligned to the fund. While coupon and dividend income rose from €33m to €38m in 2018, the contribution from unrealised movements swung from a gain of €4.6m to a loss of €5.7m. Investors "income" thus fell by 20%. The elimination of the investment manager's performance fee saw their income fall 26%.

Discount above average

- Volta trades on a discount to NAV of 13%. We detail in the section below some factors that might be driving this level of discount and what could see the market re-evaluate it.

Details from 2018 Annual Report

Summary

Performance by asset class		
	Est. annual performance	Average weight
Bank balance sheet transactions	9.2	14.7
USD CLO equity	7.7	12.7
Eur CLO equity	12.2	12.4
CLO warehouse	14.1	3.1
USD CLO debt *	11.2	39.3
Eur CLO debt	4.0	2.3
Cash corporate credit	5.4	2.5
ABS	7.0	4.4
Total	7.8	

*Source: Volta Finance 2018 Report and Accounts p4 * includes benefit from Repos gearing*

One of Volta's competitive advantages is a broad, flexible mandate allowing it to take market opportunities as they arise. Taking a directional view, they commented ""Strategically, we expect to continue increasing the Bank Balance Sheet transaction bucket and the CLO equity bucket (favouring "controlling positions") and to correspondingly decrease the CLO Debt bucket during the next annual period. At some point in time, with the expected decrease of the CLO Debt bucket, we might reduce the leverage that is in place on CLO Debt tranches."[4]

Risk

Default risk has lower sensitivity than last year due to change in asset mix

The base case scenario is to project the rate of occurrence of defaults at the underlying loan portfolio level at ca.2.0% per year, which was assumed to approximate the market consensus projected default rate as at 31 July 2018 (base case scenario as at 31 July 2017:2.8% per year).

Impact of increase in default rate on prices of each asset class and gross asset value (GAV)					
		1.5x historical average		2x historical average	
	% of GAV	Price impact	Impact on GAV	Price impact	Impact on GAV
At July 2018					
US$ CLO equity	10.4	-6.8	-0.7	-21.7	-2.3
Eur CLO equity	14.3	-10.9	-1.6	-25.9	-3.7
US$ CLO debt	38.7	0	0	-0.2	-0.1
Eur CLO debt	2.2	0	0	0.7	0
All CLO tranches	65.6		-2.3		-6.1
BBST	15.0	-10.0	-1.5	n/a	n/a
At July 2017					
US$ CLO equity	11.9	-14.8	-1.8	-25.9	-3.1
Eur CLO equity	11.5	-12.6	-1.5	-26.9	-3.1
US$ CLO debt	38.0	0.4	0.2	0.4	0.2
Eur CLO debt	3.4	0.2	0.0	0.2	0.0
All CLO tranches	**64.8**		**-3.1**		**-6.0**
BBST	13.0	-12.6	-1.6	N/a	N/a

Source: Hardman & Co Research, Volta July 2017 R&A. Note CLO 1.0 tranches are ones issued post 2009, CLO 2.0 post 2010 (no CLO issued in 2009)

One perceived risk for the business was that when the US authorities removed the "risk retention requirement" for CLO issuers to retain 5% of the risk of all CLO structures issued in early 2018 it would limit Volta's re-investment opportunities. European regulations, which govern AXA IM, the Investment Manager, have not changed and, while the exact effect of the US change is still emerging, it would restrict Volta's ability to purchase future "non-EU-compliant" US CLOs. However,

[4] P7 2018 Report and Account

AXA IM does not, at this stage, believe that this will constrain Volta's overall activities and will simply return the company to the position of a few years ago. At that time, their market presence was such that many issuers structured their deals to meet EU requirements and clearly Volta's diversity means not all asset classes are affected by the change.

Other risks:

Liquidity risk reduced with extended Repos facility

- We note in terms of liquidity risk that the Repos facility has seen its scheduled final repayment date extended from 18 March 2020 to 15 December 2022.

Modest increase in top 5 concentration risk but still very low

- We note there has been a modest increase in concentration risk with the top 5 average exposure to individual issues in the underlying CLO equity sub-portfolios as a percentage of Volta's gross asset value increasing from 0.86% end-July 2017 to 1.08% end-July 2018. We do not view the change as material and Volta still has a very broadly diversified underlying portfolio.

Valuation and assumptions

The approach to valuation has seen a further enhancement to market prices

We highlighted in our initiation report the checks and balances that Volta has in place to ensure that its assets are appropriately valued. These include, wherever possible, third parties providing pricing data and for this to be verified by other third parties. Since last year, we note that all CLO equity securities are now valued using non-binding quoted market prices from a third party such as the arranging bank or other market participants.

As usual, some assumptions changed to reflect portfolio mix

We also note that the assumptions used in valuing bank balance sheet transactions have seen some modest changes reflecting the underlying assets. The approach is to use discounted projected cashflow models based on: (i) discount rates within a range of 8.0% to 12.0% (2017: 5.0% to 12.0%); (ii) constant default rates within a range of 0.2% to 2.4% (2017: 0.5% to 1.4%); (iii) prepayment rates within a range of 0.0% to 15.0% (2017: 0.0% to 10.0%); and (iv) recovery rates within a range of 50.0% to 60.0% (2017: 50.0% to 64.0%). The changes reflect changes in underlying assets rather than changed assumptions.

Reconciliation audited to estimated NAV has seen smaller adjustments giving confidence in monthly estimated NAV numbers.

Prior to its full audit, Volta publishes an estimated NAV. The reconciliation back to the audited number is provided on p37 of the 2018 Report and Accounts. We take comfort from the fact that "amendments to valuations used in the published Estimated NAV" in 2018 was €2k vs. €316k in 2017, €1.9m in 2016. The 2018 gap between estimated and audited NAV was thus 0.01% of the portfolio.

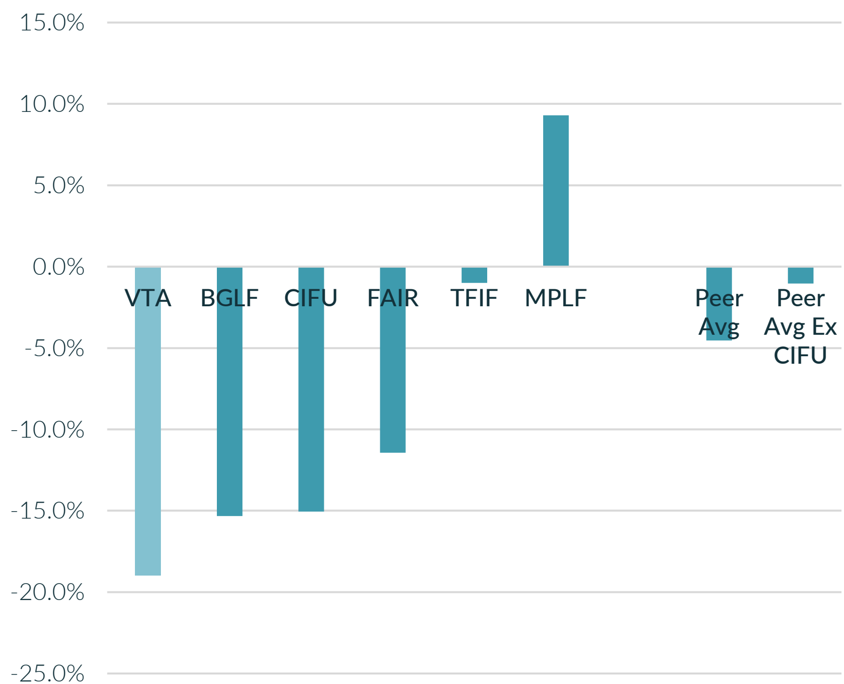
Valuation

Discount to NAV

Discount materially larger than peers in structured debt fund space

Compared with its structured debt peers, on market price to NAV, Volta is trading at a material discount (we have used end November NAV's as several peers have yet to publish the end-December NAVs and we cannot make an accurate comparison). Volta has outperformed peers modestly over the past few months but given the historical performance, risk profile and portfolio mixes identified in the sections below, this relative discount appears anomalous.

Current share price discount to November NAV for Volta and peers



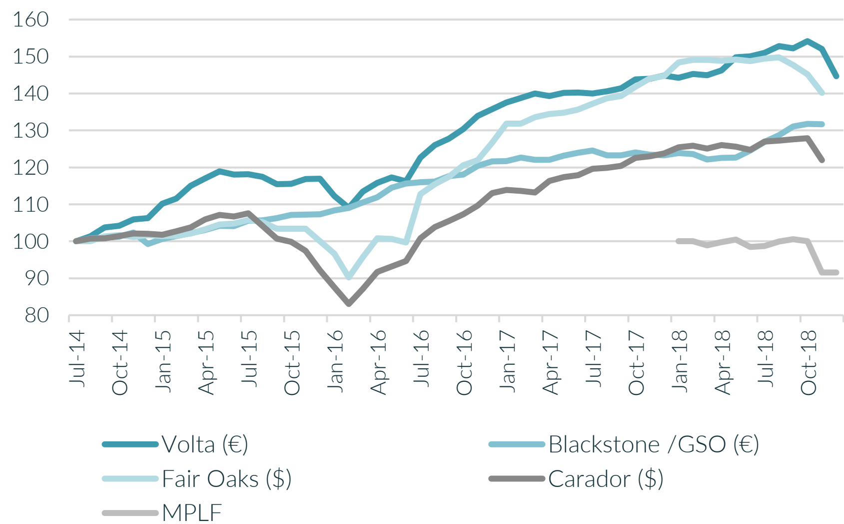
Source: Hardman & Co Research Monthly reports for Volta (VTA), Carador (CIFU), TwentyFour Income Fund (TFIF), Fair Oaks Income Fund (FAIR), Blackstone/GCO Loan Financing Ltd (BGLF), and Marble Point Loan Financing Date: 11 January 2019

NAV performance relative to peers

NAV performance has been at top end of peer range

The Figure below shows the cumulative performance of the funds most closely aligned to Volta based on the NAV as reported since July 2014 (a date reflecting the longest time available for public information for this group). It is impossible for us to re-translate the NAV on a constant currency basis as we do not know what the effect of hedging and different currency funding polices would be. However, if we assumed totally unhedged positions, the FX would increase the performance of Carador and Fair Oaks since July 2014. The former would still have underperformed Volta by ca.1% p.a. Fair Oaks would have outperformed; however, this is solely attributable to the performance in the month of July 2016 when, as can be seen in the Figure below, Fair Oaks delivered an exceptional 13% in one month (nearly twice the level of any other fund in any month since July 2014). Fair Oaks noted "significant increases in both of the Master Fund's equity and mezzanine positions" but we have no further details.

Performance indexed to July 2014, reported currency basis



Source: Hardman & Co Research Note Marble Point from listing. Not all funds have given estimated NAVs for December yet

Triggers for market re-evaluation of discount

Historically, dramatic reductions in discount to NAV generated by share price increases; these have been driven by a mix of market sentiment and company-specific issues.

The share price discount to NAV is wider than historical and peer average levels. This could reflect a number of possible drivers each of which we discuss below. We believe that the most likely driver of long-term share price growth, and a reduction in the discount to NAV, is the delivery of the expected total shareholder returns and the market having greater confidence in their sustainability over the medium term. Looking at the portfolio as it stands, the most critical feature will be delivery of returns as credit default increases. In the near term, a modest deterioration of credit is likely to see much greater opportunities for higher-return re-investment as the yield of all loans will increase. In addition to this macro-development, we note:

Broadening awareness of Volta

- The board has taken several steps to broaden knowledge of the company and so ensure that there is a better understanding of the real (NAV) volatility. The UK listing was partially to do this and saw a positive reaction. On 3 September 2018, Volta added a sterling listing to its Euro listing on the UK exchange. We note that Volta has recently engaged multiple sponsored research houses to distribute the message to the widest possible audience. We sense the board has appetite to expand the fund, which should materially assist with the limited share price liquidity and, with that, we expect an active engagement with existing and potential shareholders in a range of fora. Improving awareness and the associated liquidity should help reduce the discount.

11 December, Volta announced it believes it is excluded security under NMPI rules and so IFAs can recommend it to retail shareholders.

- We note Volta's announcement on 11 December that after due enquiry it is the opinion of the Board that the company's shares qualify as an "excluded security" under the non-mainstream pooled investments ("NMPI") rules and are therefore excluded from the FCA's restrictions that apply to NMPIs. The Board therefore believes that independent financial advisers can recommend the company's shares to retail investors (although it comes with usual legal caveat that financial advisers should seek their own advice on this issue).
-

Volta Key Information Document disclosure not driven by business performance. Greater understanding of the business could see less share price volatility.

- The Key Information Document disclosure could be seen as a relative dis-incentive to potential investors with Volta having a longer hold period and greater sensitivity than peers. As noted above, the historical NAV performance does not justify the historical share price volatility. As the market gets a broader appreciation of how Volta's multi-manager approach has, and is likely to, deliver returns, there might be less share price volatility and KID disclosure more in line with peers.

Checks and balances in place to ensure validity of monthly NAV. Less reliant than some on mark-to-model due to both portfolio mix and valuation approaches.

- The discount could reflect concerns that the NAV is not truly representative of the value of the business because the modelling/valuation assumptions do not reflect a realisable value. We detail in the section on of our initiation note in September why we believe Volta adopts appropriate valuation techniques. It is worth noting that the most-illiquid assets, for which modelling is important, form a lower proportion of the group than in most peers. We also note that the very stable performance in Blackstone's NAV is inconsistent with peers and partially reflects its mark-to-model valuation – in periods of stress, this is likely to give Blackstone a higher NAV and in favourable environments a lower one.

Buyback but only as part of long-term programme

- The board is active in its consideration of a tender at NAV/repurchases in the market (which would be at a significant discount to NAV if executed at current prices). It says it will use such discount control measures if it believes them to be in the best interests of shareholders, noting "these mechanisms can be a double-edged sword". On the upside, it creates a buyer for the shares, and it could be perceived as putting a cap on the discount, which the market might then close itself. It is likely to reduce the discount in the short term. On the downside, it could create liquidity problems, the capital can be better deployed in the fund (subject to the level of discount), it shrinks the business and so worsens the total expense ratio and it sends a very mixed message especially if, as seems likely over the medium term, Volta has new investment opportunities and comes to market for further equity funding. Accordingly, we note the policy, as described in the 2018 R&A is to "make the Company more attractive to new investors". We believe the board would use a buyback as part of a long-term strategy rather than a short-term "sticking plaster".

Volta delivered better short-term returns => portfolio positioning does not justify discount

- Volta has delivered a faster-than-peer NAV growth since the end of 2017 suggesting its portfolio positioning with less CLO Equity does not justify a discount. Further delivery of returns could trigger a rating re-evaluation.

Increased market confidence of sustainability of returns through weaker credit market conditions

- We believe that performance over the past five years reflects the favourable macroeconomic environment with limited credit defaults, CLO Debt, which had been purchased at a discount being redeemed at par, and a positive sentiment towards CLO investment generally. Looking forward, while Volta has accessed high return re-investments, it might take delivery of NAV to convince all in the market that such returns are sustainable. This might take more time (and effort) than Volta benefiting from the rising sentiment in good markets.

- We note the announcement by Carador on 28 August that it would put a possible orderly wind down to shareholders (with an opportunity to elect to roll over their holding in the company's shares into Blackstone/GSO Loan Financing Limited (TIDM: BGLF) for those wishing to keep CLO exposure). We believe this is driven by company-specific factors inter alia noting its performance has been behind Volta's, the different portfolio mix with returns generated from a different asset mix, and the dividend cut earlier in 2018. A continuation of Volta's historical delivery would generate good long-term returns for shareholders and we do not expect such a development here (noting of course that an orderly wind down, subject to the administration cost, would see the discount eliminated assuming the valuations are correct).

Portfolio (November 2018)

We believe investors should focus on the process by which Volta allocates assets rather than the exposures at any specific time. As can be seen in the Figure below, the portfolio mix has seen a reasonable degree of volatility over the past 30 months.

Portfolio composition by asset type (%)

	Jan-16	Jul-16	Jan-17	Jul-17	Jan-18	July-18	Nov 18	Average
US CLO equity	13	11	11	13	11	12	15	12
US CLO debt	33	41	39	39	39	39	39	39
Eur CLO equity	5	11	12	12	12	13	15	12
Eur CLO debt	13	11	5	3	2	2	1	4
CMV	0	0	0	0	2	2	2	1
CLO warehouse	5	0	0	4	0	4	3	2
Bank balance sheet transactions	13	13	14	13	15	15	14	14
Cash corporate credit equity	4	3	3	3	3	3	3	3
Cash corporate credit debt	1	1	0	0	0	0	0	0
ABS residual positions	7	4	2	2	2	3	2	3
ABS debt	1	3	2	3	2	2	3	2
Cash	5	2	12	8	12	6	4	7

Source: Hardman & Co Research; Volta Monthly Reports

Euro CLO debt down, equity up

- The proportion of European CLO debt has reduced from 13% of the portfolio to just 1% (primarily in 2H16). This market did tighten due to lack of supply and was judged expensive relative to US equivalent. Volta has invested in European CLO equity (up from 5% to 15%) noting that some CLOs should benefit more from lowering their own financing costs than they lose on underlying loans re-pricing.

US CLO debt and equity broadly stable

- US CLO debt has increased from 33% to 39% (primarily in 1H'16) falling from 40% in April with two debts totalling €12m being called in May.
- Asset Backed Security (ABS) residual positions (equity) have reduced from 7% to 2% and ABS debt has been stable at ca.2-3%.

Capitalised Manager Vehicle likely to increase with drawdown of existing commitment; new deals unlikely to be material given change in retention rule.

- Capitalised Manager Vehicle (CMV) exposure is 2% of the portfolio and the committed facility means this might be expected to rise over time. Some CLO managers established legally separate CMVs, primarily to use third-party capital to fund the 5% retention until recently required in the US. The underlying assets and exposures are the same as a normal CLO but their segregation into a CMV vehicle means the overall risk in the CMV is marginally higher. This generates higher returns (typically 3%-4%) albeit liquidity is low. Volta's detailed market knowledge is a competitive advantage in identifying which CMVs have an optimal risk/return.

Selective CLO warehouse funding (only where Volta would invest in end CLO equity)

Rapid churn likely

- CLO warehouse exposures are volatile. A CLO manager needs funding as it builds a portfolio of loans, which in due course will be placed in the CLO. Funding warehouses gives Volta underlying exposures that are similar to CLO equity, but the portfolio is less diverse at times. For bearing these risks, an incremental return is expected. Most of the time, Volta allocates to CLO warehouses for the purpose of investing in the CLO equity tranche that will result from the warehouse. Warehousing the loan portfolio permits a greater control of the portfolio as it is built and better economic terms when purchasing the equity tranche (most of the time Volta commits to purchasing a significant portion of the equity and accordingly achieves better economics).

Financials

We have revised our assumed return from 11.4% to 10.8% gross return on financial assets valued through the P/L to reflect the expected yield reported in the 2018 Report and Accounts. We continue to assume realised gains on sale of ca.1% of the portfolio but no other market movement gains or losses. The effect is to reduce 2019E earnings from €0.90 to €0.84, still well in excess of the expected dividend of €0.62.

Profit and loss account (€m)

Year-end July	2013	2014	2015	2016	2017	2018	2019E	2020E
Coupons and dividend recd.	**0.0**	**31.4**	**33.7**	**34.7**	**33.2**	**38.5**	**37.0**	**38.8**
Net gains on sales	0.0	6.1	12.6	2.7	3.1	0.0	3.0	3.0
Unrealised gains and losses	0.0	12.2	21.0	-18.5	4.7	-5.7	0.0	0.0
Net gain on fin. assets at FV through P/L	**79.2**	**49.7**	**67.2**	**18.9**	**40.9**	**32.7**	**40.0**	**41.8**
Net FX	-0.5	1.6	-8.2	0.3	5.6	-2.0	0.0	0.0
Net gain on IR derivatives	2.3	-0.3	0.0	0.0	0.4	-0.9	0.0	0.0
Interest expense on repo	0.0	0.0	-0.2	-0.9	-1.1	-1.4	-1.4	-1.4
Net bank int. & charges	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Operating income	**81.0**	**50.9**	**58.8**	**18.2**	**45.7**	**28.4**	**38.6**	**40.4**
Inv. managers' fees	-2.6	-3.6	-3.9	-4.1	-4.1	-4.2	-4.6	-4.7
Inv. managers' performance fees	-7.7	-1.9	-5.0	0.0	-1.5	0.0	-1.6	-1.8
Directors' renumeration & expenses	-0.4	-0.4	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5
Other expenses	-1.1	-1.0	-1.8	-0.9	-0.8	-1.0	-1.0	-1.0
Total expenses	**-11.8**	**-6.9**	**-11.2**	**-5.6**	**-6.9**	**-5.7**	**-7.8**	**-8.1**
Profit and total comp. income	69.2	44.0	47.6	12.6	38.7	22.7	30.8	32.3
Avg. no shares for EPS calculation (m)	32.8	36.1	36.5	36.5	36.5	36.56	36.59	36.61
Statutory EPS (p)	2.11	1.22	1.31	0.34	1.06	0.62	0.84	0.88
Total dividend (p)	0.62	0.60	0.62	0.62	0.62	0.62	0.62	0.62

Source: Volta, Hardman & Co Research

To derive our adjusted profit and loss., we strip out the capital movements, including: (i) unrealised gains/losses; (ii) FX movements; and (iii) net gain of IR derivatives. We have left in realised gains which, although volatile, have been converted in to cash and some capital gains might be expected to form part of the normal course of business. We have also backdated the current management fee structure and adjusted it to the new level of profitability.

Hardman adjusted profit and loss account (€m)

Year-end July	2014	2015	2016	2017	2018	2019E	2020E
Coupons and dividend recd.	31.4	33.7	34.7	33.2	38.5	37.0	38.8
Net gains on sales	6.1	12.6	2.7	3.1	0.0	3.0	3.0
Net gain on fin. assets at FV through P/L	**37.5**	**46.2**	**37.4**	**36.2**	**38.5**	**40.0**	**41.8**
Interest expense on repo	0.0	-0.2	-0.9	-1.1	-1.1	-1.1	-1.1
Net bank int. & charges	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Operating income	**37.5**	**46.0**	**36.5**	**35.0**	**37.2**	**38.8**	**40.6**
Inv. managers' fees	-4.1	-4.5	-4.3	-4.6	-4.6	-4.6	-4.7
Inv. managers' performance fees	-2.5	-3.5	-1.3	-1.2	-1.4	-1.7	-1.9
Directors' renumeration & expenses	-0.4	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5
Other expenses	-1.0	-1.8	-0.9	-0.8	-0.9	-0.9	-0.9
Total expenses	**-7.9**	**-10.3**	**-7.2**	**-7.0**	**-7.3**	**-7.7**	**-8.0**
Profit and total comp. income	29.5	35.7	29.3	28.0	29.9	31.1	32.6
Adjusted EPS (€)	**0.82**	**0.98**	**0.80**	**0.77**	**0.82**	**0.85**	**0.89**
Dividend cover (x)	**1.36**	**1.58**	**1.29**	**1.24**	**1.32**	**1.37**	**1.44**

Source: Volta, Hardman & Co Research

Balance sheet (€m)

@ 31 July	2013	2014	2015	2016	2017	2018	2019E	2020E
Financial assets at FV through P/L	238.7	256.3	307.3	324.1	321.3	325.7	359.7	367.7
Derivatives	1.6	0.0	0.0	1.2	0.7	1.3	1.3	1.3
Trade and other receivables	0.0	0.0	38.1	5.0	0.3	12.9	2.9	2.9
Cash and cash equivalents	9.7	19.5	0.4	10.9	37.1	20.5	4.8	6.6
Total assets	250.1	275.8	345.8	341.3	359.4	360.4	368.7	378.5
Loan financing under repos	0.0	0.0	27.3	40.3	38.1	42.7	42.7	42.7
Interest payable on loan financing	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.2
Derivatives	0.0	0.2	0.3	0.0	0.0	0.1	0.1	0.1
Trade and other payables	3.8	2.0	19.0	11.6	15.6	11.7	11.7	11.7
Total liabilities	3.8	2.1	46.6	52.0	53.8	54.7	54.7	54.7
Net assets	246.3	273.6	299.2	289.3	305.5	305.7	314.0	323.8
Period-end no. shares (m)	35.3	36.5	36.5	36.5	36.5	36.6	36.6	36.6
NAV per share (€)	6.97	7.50	8.20	7.92	8.36	8.36	8.58	8.85
Total debt to NAV	0%	0%	9%	12%	12%	14%	14%	13%

Source: Volta, Hardman & Co Research

Cashflow (€m)

Year-end July	2013	2014	2015	2016	2017	2018	2019E	2020E
Total comprehensive income	69.2	44.0	47.6	12.6	38.7	22.7	30.8	32.3
Net gain on financial assets at FV in P/L	-79.2	-49.7	-67.2	-18.9	-40.9	-32.7	-40.0	-41.8
Net movement in unrealised gain on revln. derivatives	-2.3	0.3	0.1	-1.5	0.5	-0.5	0.0	0.0
Interest expense on repos	0.5	-1.6	0.2	0.9	1.1	1.4	1.4	1.4
FX losses on re-translation repos	0.0	0.0	-0.9	-0.3	-2.2	0.4	0.0	0.0
(Increase)/decrease in trade receivables	-1.3	-1.8	0.0	0.0	-0.1	0.1	0.0	0.0
Increase/(decrease) in trade payables	0.1	0.1	2.0	-1.5	1.6	-1.7	0.0	0.0
Directors/other fees paid in cash	5.4	0.0	0.2	0.1	0.1	0.2	0.2	0.2
Net cash inflow/(outflow) from operating activities	-7.6	-8.6	-18.0	-8.5	-1.0	-10.3	-7.7	-8.0
Cashflow from investing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Coupons and dividends recd.	32.7	31.4	33.3	33.6	34.4	38.0	36.0	38.8
Change in margin/deriv. sett.	1.7	1.5	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of financial assets	-46.5	-71.5	-99.3	-127.0	-109.0	-138.8	-153.8	-153.8
Proceeds from sales of financial assets	24.2	72.2	96.9	84.9	125.5	114.2	133.8	148.8
Net cash outflow from investing activities	12.1	33.6	30.9	-8.5	50.9	13.4	16.0	33.8
Cashflows from financing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends paid	-15.3	-17.0	-22.3	-22.6	-22.7	-22.7	-22.7	-22.7
Net sales of shares	15.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from repos	0.0	0.0	28.2	13.3	0.0	4.2	0.0	0.0
Interest paid on repos	0.0	0.0	-0.1	-0.8	-1.1	-1.3	-1.4	-1.4
Net cash inflow from financing activities	0.6	-16.8	5.8	-10.2	-23.7	-19.7	-24.0	-24.0
Net increase in cash and cash equivalents	5.1	8.2	18.7	-27.2	26.2	-16.6	-15.7	1.8
Opening cash and cash equivalents	5.2	9.7	19.5	38.1	10.9	37.1	20.5	4.8
Effect of FX	-0.5	1.6	0.0	0.0	0.0	0.0	0.0	0.0
Closing cash and cash equivalents	9.7	19.5	38.1	10.9	37.1	20.5	4.8	6.6

Source: Volta, Hardman & Co Research

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research@hardmanandco.com

35 New Broad Street
London
EC2M 1NH

+44(0)20 7194 7622

www.hardmanandco.com