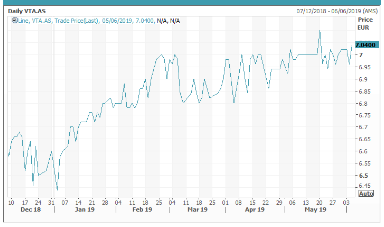
06 June 2019

HARDMAN & CO.

Financials



Source: Refinitiv

Market data

EPIC/TKR	VTA .NA, VTA.LN VTAS LN*
Price (€)	7.04/6.98/614p
12m High (€)	7.32/7.28/655p
12m Low (€)	6.44/6.52/585p
Shares (m)	36.6
Mkt Cap (€m)	257
Trail 12-mth. yield	8.8%
Free Float	70%
Market	AEX, LSE

Description

Volta Finance 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 Branch

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Key shareholders

Axa Group	30.4%

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VOLTA FINANCE LTD

9% yield from diversified corporate loan portfolio

Volta invests in a broad portfolio of structured finance assets, maintaining flexibility to optimise long-term returns in highly dynamic markets. Its five-year 10% p.a. shareholder return has been generated by predictable coupons and dividends and not from capital gains. Volta's long-term NAV returns have beaten peers for an in-line volatility. Its deep market understanding has identified assets mis-priced for risk. Economic downturns create opportunities as well as threats.

- **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. It has a flexible mandate, meaning that Volta can respond rapidly to market opportunities.

- **Follow the cash:** While structured finance markets have their complexities, if investors "follow the cash", most of these become much clearer. Looking through the terminology, at its heart, Volta earns returns by collecting payments from hundreds of end-borrowers and by picking the right assets.

- **Valuation:** Volta trades at a 12% discount to NAV. The closest peer structured finance funds trade at a ca.7% discount (the gap has narrowed substantially in the past year). Medium term, Volta has delivered faster NAV growth than its immediate peers and an in-line volatility, making this discount an anomaly.

- **Risks:** Credit risk is a key sensitivity (Volta has a widely diversified portfolio). We believe the valuation of assets is robust noting the multiple controls to ensure its validity. Sentiment towards its own and underlying markets affects NAV. Volta's long $ position is only partially hedged.

- **Investment summary:** Volta is an investment for sophisticated investors as there may be sentiment-driven, share-price volatility. However, long-term returns have been good: 10% p.a. returns (dividend re-invested basis) over five years. The current portfolio-expected NAV return is similar. The yield is 8.8%, and we believe will be covered by predictable income streams.

Financial summary and valuation

Year-end Jul (€m)	2014	2015	2016	2017	2018	2019E	2020E
Coupons & dividend	31.4	33.7	34.7	33.2	38.5	39.1	41.0
Operating income	37.5	46.0	36.5	35.0	37.2	40.8	42.8
Inv. managers' fees	-4.1	-4.5	-4.3	-4.6	-4.6	-4.7	-4.8
Adj. perform. fees	-2.5	-3.5	-1.3	-1.2	-1.4	-2.1	-2.3
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	32.8	34.4
Statutory PTP	44.0	47.6	12.6	38.7	22.7	32.4	34.1
Underlying EPS (€)	0.82	0.98	0.80	0.77	0.82	0.90	0.94
NAV	273.6	299.2	289.3	305.5	305.7	315.6	327.2
S/P disc. to NAV	6%	14%	11%	16%	16%	18%	20%
Gearing	0%	9%	12%	12%	14%	14%	13%
Dividend yield	8.5%	8.8%	8.8%	8.8%	8.8%	8.8%	8.8%

Source: Hardman & Co Research

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Executive summary

Focus on the cash; Volta earns returns from a widely diversified portfolio of loans

Volta's investments are primarily in the Collateralised Loan Obligation (CLO) market and related areas. In our initiation note, *Delivering the structured finance opportunity*, published on 5 September 2018, we went into detail unravelling some of that market's perceptions that this was a complex and opaque business. Looking through the terminology, Volta earns the cash to pay its 8.8% dividend yield from ca.700 corporate borrowers. It achieves this exposure through debt and equity instruments in the CLO structures; however, in managing these investments, Volta is no different from any other investment company and investors should apply the same basic principles to its investments as they do across the market. AXA IM (the manager) has a proven track record demonstrating skill in picking the right assets. We believe the perceived complexities that may deter some investors, create opportunities for others.

Key attractions: 12.9% p.a. returns over past five years (to end-July); well controlled risks; flexible mandate to optimise returns; and buying at a greater NAV discount than peers, 8.6% dividend yield covered by predictable income streams.

In our initiation note, we highlighted the following:

- long-term returns are above peers and benchmarks;
- risks are well controlled with the ideal bell-shaped distribution of monthly NAV;
- returns have been earned from predictable sources like interest and coupons from loans and bonds, which more than cover the high (8.8%) dividend yield;
- Volta has a flexible mandate to invest in different type of CLO securities and can optimise returns depending on market conditions;
- AXA IM (the manager) has competitive advantages in origination, risk control and market information given its huge scale in the structured finance market;
- Volta trades on a discount of 12% to NAV, above peers and historical levels.

Our review also considered the potential risks in investing in Volta.

Credit risk is hugely diversified

- Volta's as exposure to over 700 individual borrowers (top five just 2% of portfolio), diversified by name, sector, geography, and economic sensitivity.

Sentiment can create volatility but also creates opportunities

- With assets marked to market, changes in sentiment can have a dramatic effect and market prices can diverge from expected cashflows (or real values). While this creates short-term volatility, greater asset mis-pricing, potentially increases returns (CLOs originated in 2007 earned ca.2x the level of 2004 deals).

Favourable conditions in underlying markets make re-investment challenging; however, flexible mandate means Volta can invest in areas benefiting from these conditions

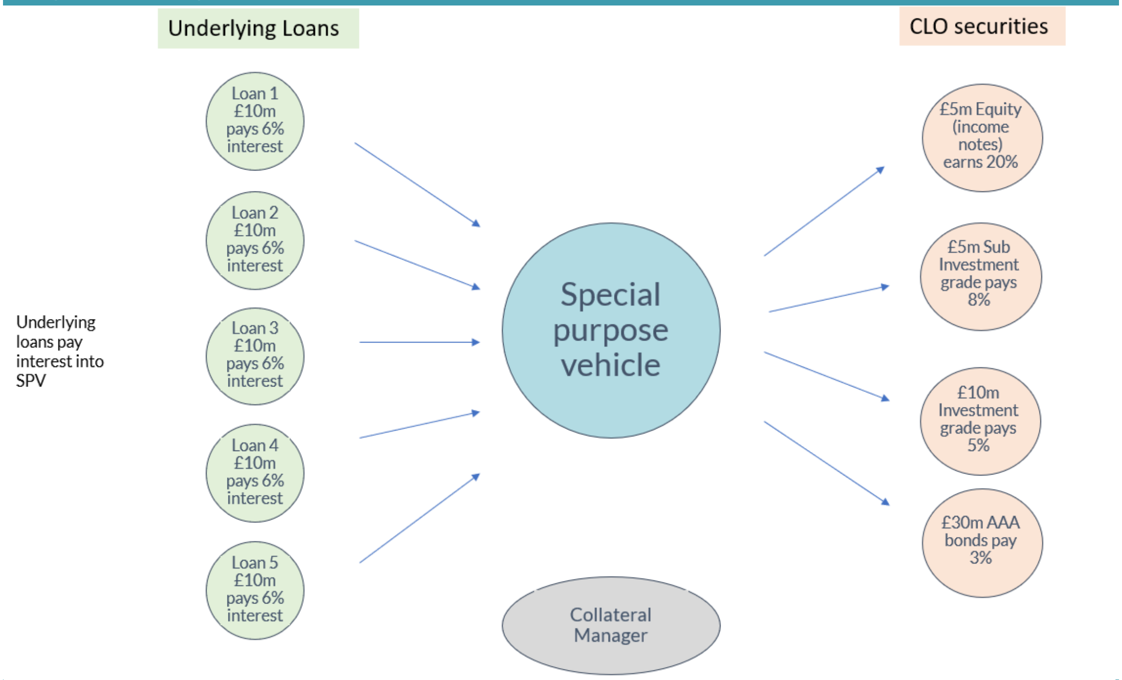
- When economic conditions are favourable (as they have been for some time), loan yields fall, credit covenants ease and existing loan repayments increase. This makes re-investment more challenging, although Volta's flexible mandate means it can access value-added areas.
- There are not always liquid markets to value Volta's assets. We have reviewed the multiple checks and balances in Volta's approach noting asset sales have been in line with the accounting value.
- Other risks: Gearing has been kept modest and structured to ensure there are no forced sales of assets at a discount. Interest rate sensitivity is complex but, at current levels, is likely to be broadly neutral. Changes in FX rates can have a short-term impact as Volta does not fully hedge its net long $ position.

What is a CLO

CLO structures are just portfolios of loans

A CLO structure is, at its heart, very simple. A portfolio of loans is acquired by a company (a special purpose vehicle), which funds the purchase by issuing a mix of different tranches of bonds (CLO debt tranches) and an "Income notes" (CLO equity tranche). The interest received from the loan portfolio is used to pay the coupons on the CLO debt tranches and any excess cash flow is for the profit of the "equity" tranche.

Simplified example of a CLO structure



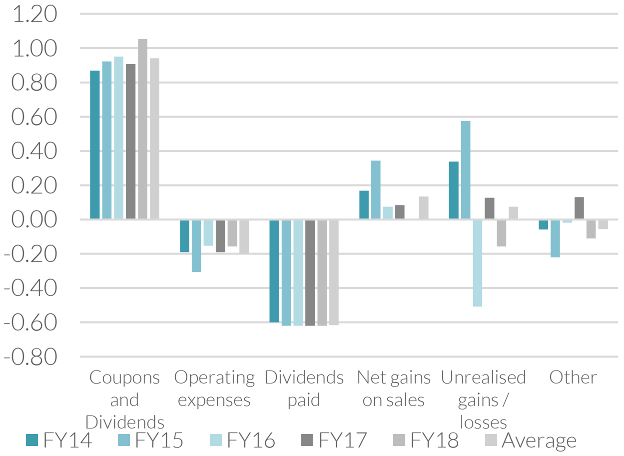
Source: Hardman & Co Research

Investment manager (AXA IM) must show exactly the same skills as any other – identifying risks and rewards from different opportunities

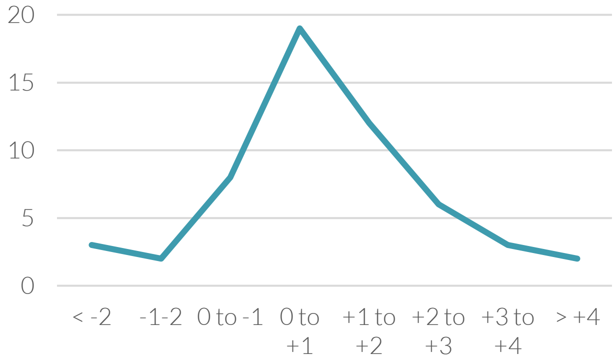
The skills of the fund manager in the CLO space are the same as any other fund manager: i) analysing where it can get the best returns by asset class – the risk/reward for an equity tranche is different from each of the debt tranches; ii) identifying which CLO have risks, for example credit or interest rate; and iii) spotting CLOs with opportunities, from say re-financing its own debt. AXA IM is huge in structured debt allowing Volta access to origination (bigger deals at lower fees), risk controls, and timely market information. Its track record has been better than the market average.

Predictability of income streams

Impact on NAV of different P&L lines (€ per share)



Number of months since August 2014 by %



Source: Volta, Hardman & Co Research

We believe that, for some investors, the terminology of CLOs can make them concerned that it is a complex and opaque market. There are technical terms, as there are in any other industry, so we suggest rather than focus on them, investors look to what are the key drivers and outturns from the business. Looking at the drivers, the left-hand chart above shows the profit and loss for 2014-2018. The key messages here are: i) coupons and dividends more than cover expenses and dividends and Volta is not dependent on unpredictable capital gains; and ii) there has been remarkable stability in these income lines. The graph below on the right-hand side shows the numbers of months since August 2014 by monthly performance. NAV gains of 0-1% were evident for 19 months, and gains of 1-2% in a further 13. This distribution of return, with most months delivering a steady gain, is reflective of good risk controls.

Predictable income streams cover expenses and dividend

With market concerns that the credit cycle might turn, in our note, *Investment opportunities at this point of the cycle*, published 14 January 2019, we explored 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.

Current portfolio

Recently been increasing weighting in CLO equity tranches

Volta produces monthly reports details its exposures. In its *April report,* its portfolio was 33% in US CLO debt tranches, 21% in US CLO equity tranches, 19% in Europe CLO positions and 13% in bank balance sheet transactions (the latter has the same economic exposure as a CLO debt tranche and is formed of loans originated by a bank). Serge Demay, from Fund Manager AXA IM, recently gave an investor presentation, which we reviewed in our note, *Manager's March 2019 presentation,* published on 21 March. Key takeaways were: i) Flexible mandate means it can exploit whichever element of the CLO market offers the best opportunity. This is likely to see further allocations to CLO equity tranches in the near term. ii) The credit cycle is likely to turn but this should be gentle and create re-investment opportunities. iii) The flexible mandate means the portfolio can be quickly re-positioned if market conditions change. The management and board both experienced the financial crisis.

Valuation

Asset sales at prices at or above book cost gives confidence in valuation approach

We discussed in our initiation note, *Delivering the structured finance opportunity*, the checks and balances Volta has in place to ensure its valuation is realistic. This includes external pricing and verification of pricing and consideration of market prices to model. To us, the critical test is that actual asset sales prices have been at or above the latest valuation

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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