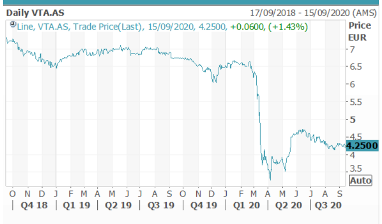
15 September 2020

HARDMAN & CO.

Closed-Ended Investments



Source: Refinitiv

Market data

EPIC/TKR	VTA.NA, VTA.LN VTAS LN
Price (€)	4.24/4.30/382.5p
12m High (€)	6.74/7.04/642p
12m Low (€)	3.20/3.38/285p
Shares (m)	36.6
Mkt Cap (€m)	155
2021E div. yield	12%
Discount to NAV	25%
Market	AEX, LSE

Description

Volta is a closed-ended, limited-liability investment company that pursues a diversified investment strategy across structured finance assets (primarily Collateralised Loan Obligation, CLOs).

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

Key shareholders

AXA Group	30%
BBVA Madrid & BNP WM	7%
Ironside Partners & Deutsche	6%

Diary

Mid Sep'20	Aug estimated NAV
Oct'20	FY'20 results

Analyst

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VOLTA FINANCE LIMITED

Value added by active portfolio management

In this note, we explore Volta's portfolio positioning, increasing its CLO equity weight and reducing the CLO debt proportion. We show how this has helped deliver relative resilience amid the COVID-19 crisis to date, with AXA IM selecting investments i) whose price already reflected a downturn, ii) of recent vintage, and iii) in defensive sectors. Volta marks to market its investments, and has suffered from sentiment-driven effects. Annualised received cashflows, though, represent 17% of July NAV, and market conditions have been improving. We examine the upside optionality that Volta's portfolio provides to any further recovery.

- **Relative resilience to Jul'20:** Volta has been increasing its CLO equity weighting since summer 2018. It bought positions where prices already reflected a downturn, which were recent structures and in defensive sectors. These positions showed less volatility than debt positions, and Volta has outperformed its peers.
- **Upside optionality:** Potential upside could come from i) improving trends in CLO markets, with rising asset prices, greater volumes and widening spreads, ii) normalisation of sentiment discounts on both assets and Volta's shares, iii) Volta shares aligning with other corporate debt vehicles, and iv) a rising dividend.
- **Valuation:** Volta trades at a double discount. Its share price is at a 25% discount to NAV. Furthermore, its mark-to-market NAV, we believe, includes a further sentiment-driven discount (10%-15%) to the present value of expected cashflows. Volta targets an 8% of NAV dividend (12% yield on current share price).
- **Risks:** Credit risk is a key sensitivity. We examined the valuation of assets, highlighting the multiple controls to ensure its validity, in our *initiation note,* in September 2018. The NAV is exposed to 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. Long-term returns have been good: ca.10% p.a. returns (dividend-reinvested basis) over five years pre-crisis. The portfolio's cashflow yield is currently ca.17%, more than 2x the cost of the dividend (8% of NAV, giving an 12% yield on the current share price).

Financial summary and valuation (Hardman & Co adjusted basis)

Year-end Jul (€m)	2015	2016	2017	2018	2019	2020E	2021E
Coupons & dividend	33.7	34.7	33.2	38.5	42.0	42.3	28.3
Operating income	46.0	36.5	35.0	37.0	41.0	41.3	27.3
Inv. manager's fees	-4.5	-4.3	-4.6	-4.6	-4.4	-3.6	-1.5
Adj. performance fees	-3.5	-1.3	-1.2	-1.4	-2.1	-2.6	-1.5
Total expenses	-10.3	-7.2	-7.0	-0.9	-1.0	-1.0	-1.0
Total comp. income	35.7	29.3	28.0	29.7	32.9	33.6	22.7
Statutory PTP	47.6	12.6	38.7	22.7	7.1	-67.7	86.1
Underlying EPS (€)	0.98	0.80	0.77	0.81	0.90	0.92	0.62
NAV	299	289	306	306	291	208	276
S/P disc. to NAV	48%	46%	49%	49%	47%	25%	44%
Gearing	9%	12%	12%	14%	12%	0%	0%
Dividend yield	14.6%	14.6%	14.6%	14.6%	14.6%	9.7%	12.1%

Source: Hardman & Co Research.

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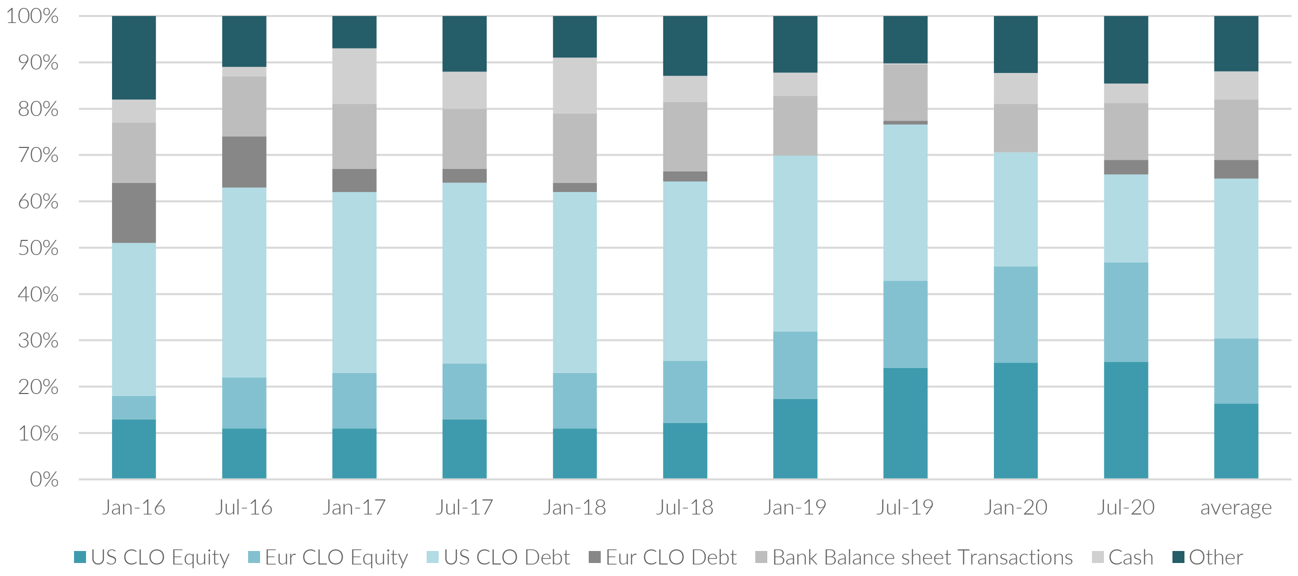
Changes in Volta's portfolio

CLO equity increasing proportion of book

As the chart below shows, Volta doubled the proportion of its book in US CLO equity positions between July 2018 and July 2019 (from 12% to 24%). European CLO equity positions increased from 13% to 19% over the same period, and CLO debt (US and European combined) fell from 41% to 35%, with cash falling by 5%.

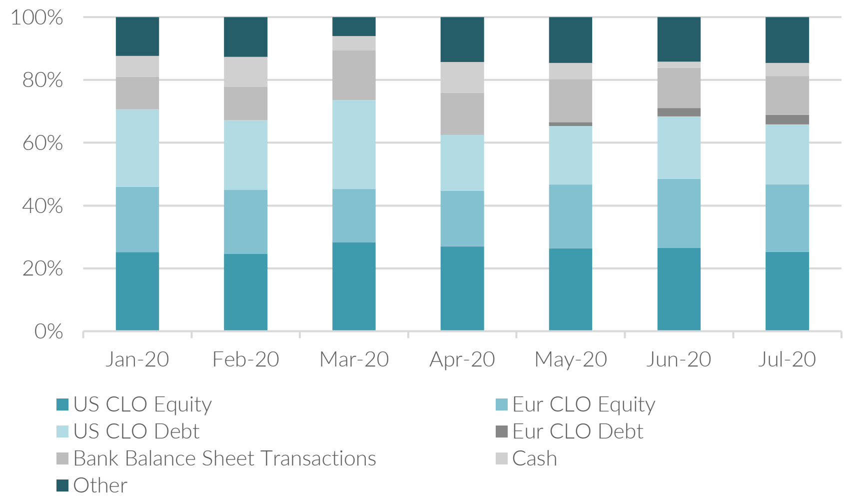
Proportion of portfolio by asset class from 2016



Source: Volta Monthly reports, Hardman & Co Research

In the past six months, the manager's reacting speed can be seen in the changes made between February and April, with a jump in cash and lower-risk Bank Balance Sheet transactions. Volta has recently started to build a small European CLO debt exposure through recently issued BB positions that are offering a superior risk/reward return.

Proportion of portfolio by asset class in 2020



Source: Volta Monthly reports, Hardman & Co Research

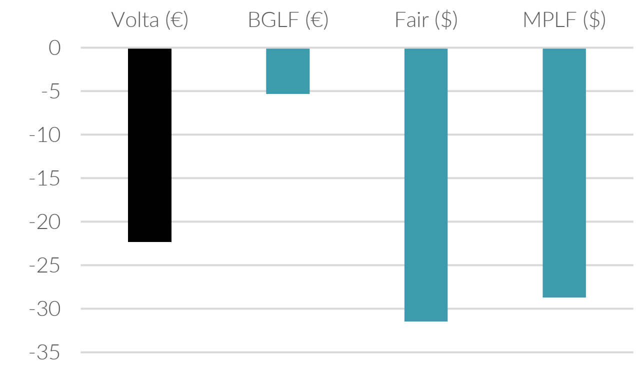
Result: relative resilience to date

Performance relative to peers/market

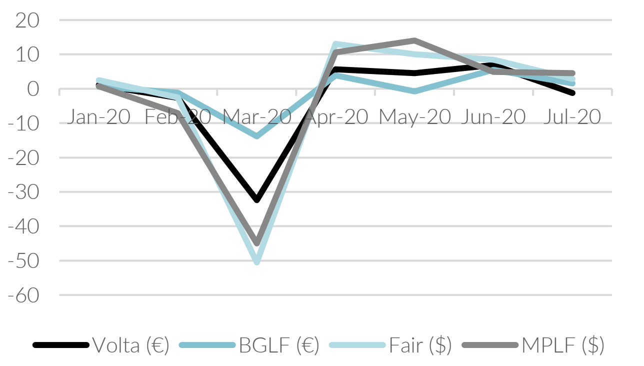
Volta been less volatile than peers and seen smaller fall in NAV, COVID-19 crisis to date

Compared with peers who mark-to-market their portfolios (Fair Oaks (Fair) or Marble Point (MPLF)), Volta has continued its long-term performance of delivering superior returns with lower volatility. Its NAV YTD to end-July was down 22%, while Fair and MPLF's were down 31% and 29%, respectively. In its most recent report and accounts, Volta highlighted that its annual volatility was two thirds of the level of Fair in the prior year. In March 2020, the fall in Volta's NAV was around two thirds of these peers, and there was little FX effect end-March on end-February.

Cumulative NAV performance, January to July 2020 (%)



Monthly performance (%)



Note: While Volta reports in € and Fair/MPLF report in $, the effect of the 5% depreciation of the $ to € YTD is unclear, as it also depends on underlying asset mixes and hedges. Source: Monthly reports for each company, Hardman & Co Research

Good asset selection has fed through to an above-market proportion of the portfolio continuing to make cash payments to Volta

The actual cashflows and performance of the portfolio throughout the crisis have been much better than its accounting NAV. In July, as in the first month of every quarter, most CLO positions receive their coupon payments. According to Wells Fargo research quoted by Volta in its July report, 24% of US$ CLOs were suffering a breach of the interest diversion test as at the end of the month[1]. Only one US$ CLO position in Volta did not receive any cashflows (and that was due to an interest coverage test breach). Except for this position, all CLO equity and CLO debt held by Volta paid their coupons in July, and only three out of 46 were close to breaching conditions, but all three saw improvements in May and June, and now have larger cushions. This performance reflects asset selection by AXA IM, and having a more resilient portfolio will feed through to achieving a more resilient NAV.

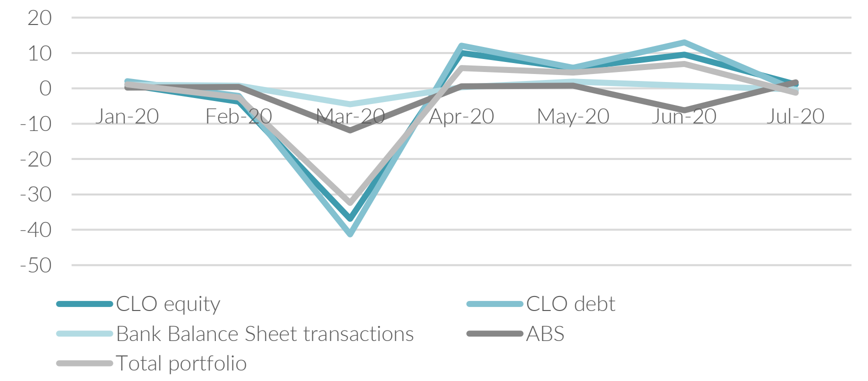
Asset class performance

CLO equity positions shown less volatility and similar performance to bond ones

The chart below shows the performance of each asset class throughout the COVID-19 crisis to date. The surprise to some investors may be that the CLO equity positions have shown slightly less overall volatility than the CLO debt ones, with an overall performance over the period broadly in line. We explore the reasons for this resilience in the section below.

[1] The interest diversion test requires the value of the loans a CLO holds to exceed the value of the bonds it issued by a sufficient amount. Failing that test requires the deferral of interest (and principal) payments on the bonds, and cuts them off to equity. Instead, the "diverted" funds pay down the safest notes issued by the CLO.

Monthly performance of portfolio by asset class through initial stages of COVID-19 crisis (%)



Source: Volta Monthly reports, Hardman & Co Research

Impact of mark-to-market approach

Volta's mark-to-market approach captures sentiment volatility in its NAV

Volta sticks to a mark-to-market approach and so captures sentiment volatility, as well as volatility in the underlying expected cashflows. In contrast, Blackstone/GCO Loan Financing Ltd (BGLF) adopts a mark-to-model approach, and its fall in March was around a third of Volta's. BGLF subsequently has seen a much slower level of recovery than those adopting a mark-to-market approach. We estimate that, should Volta be using a mark-to-model approach, its NAV would be ca.10%-15% higher than the reported number (at its peak in March, we believe the effect was closer to 20%).

Mark-to-market may not reflect real value of company, as Volta's strong balance sheet means it should not be a forced seller at distressed prices

The primary advantage of the mark-to-market approach is that it reflects the current realisable value of the portfolio, and it is a much more transparent practice for investors who do not have the necessary tools or the experience to fully understand the pertinence of any given model. Its weakness is that it assumes that the company has to sell the assets at what may be very distressed prices and well below the expected present value of future cashflows. A business such as Volta, with a strong balance sheet (zero debt, with the REPOS facility re-paid earlier this year and cash of €8.7m at end-July), will not be in such a position and can wait for a time when the market value of the assets better reflects expected cashflows.

Sentiment affects not only NAV but also discount

Adverse sentiment to the perceived complexity of CLO securities not only has an impact on their prices (and so Volta's NAV) but it also affects the rating given to Volta itself. We discuss below how differently Volta has performed from some global corporate bond funds, despite the fact that all have exposure to the debt of huge numbers of corporates with wide diversification.

Cashflows

In July, Volta received "only" the equivalent of €3.9m from its CLO equity positions, relative to €5.7m in April. The decline is almost evenly split between the two technical effects, one of which will reverse in October, when cashflows are expected to be approximately €1m higher than previously forecast. The factors were:

- Since April, ca.40% of the European loans elected to pay their coupon on a six-month basis, instead of the classic three-month basis. This effect will unwind with higher cashflows in October.

- Interest payments due to CLO debt holders are based off three-month LIBOR rates, but most of the interest payments received from underlying loan pools have more recently been driven by one-month LIBOR rates. With the decrease in one-month LIBOR rates since mid-January, US$ CLO suffered from this mismatch. Additionally, re-pricing more frequently means that steady falls in rates have a greater impact. If and when rates go up, Volta will benefit from the opposite technical effect.

In the six months ending July 2020, Volta received the total cash equivalent of €17.7m. This represents a 17% annualised yield on the end-July NAV, despite the previously mentioned technical impacts.

Reasons for relative resilience

AXA IM's asset selection, and so the resulting portfolio resilience, reflect:

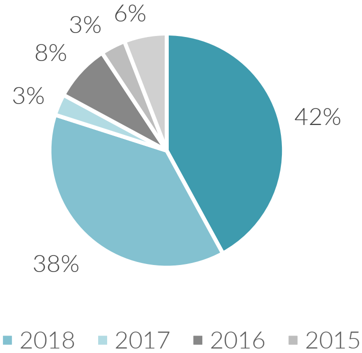
CLO equity acquisition prices already reflected downturn

- When Volta was building its CLO equity portfolio, it already had a downturn in mind, and factored this scenario into the prices it was willing to pay. In the FY'18 Report and Accounts, in October 2018, the Chairman noted "*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*." In February 2020, its US$ CLO equity had average prices of just 59.9% of par. These fell to 43.6% as of March 2020, a relatively modest decline, as the downturn scenario was already built into the price.

Recent deals vast majority of book

- Most positions are in recently structured deals, which have cleaner-than-average underlying portfolios and more time to benefit from the re-investment opportunity. Both rating agencies and the market (through price hierarchy) clearly indicate that having more time for re-investment/rearrangement of an underlying loan portfolio is considered a positive feature. In the chart below, we have looked at all CLO equity positions, which individually account for more than 1% of gross asset value (GAV). In total, these 16 positions account for 41% of Volta's GAV (with no debt, it is 41% of July net asset value too). As can be seen in the chart, 42% of these positions by amount were 2019 vintages and a further 38% 2018 vintages.
- The weighting to recent vintages is even more pronounced in Volta's larger positions. The average 2019 position was 2.9% of NAV; in 2018, it was 2.6%, while, in 2015, 2016 and 2017, they were 1.4%, 1.1% and 1.2%, respectively.

Equity tranches over 1% of GAV: percentage by vintage



Source: Volta Finance July portfolio composition disclosure on website, Hardman & Co Research

High-risk sectors a small proportion of the book

- In Europe, industries related to energy/raw materials are far less present but, because of the length of the containment, there is more issue with some other areas, like Lodging and Leisure. Those worst industries represent ca.44% of Volta's underlying exposure from its Euro CLO equity positions.

Upside optionality going forward

CLO market conditions improving

Calling a sustained recovery may be premature, but there are some encouraging signs: i) in July, both US and European loans experienced net upgrades for the month for the first time in 2020; ii) with the recovery in prices of average CCC-rated debt held in CLOs, there is less pressure on the diversion tests noted above; iii) total monthly issuance of CLOs increased in July, to $9.1bn in the US and €2.6bn in Europe, compared with $7.9bn and €2.4bn, respectively, in June; iv) spreads of European new issue CLOs tightened across the capital stack; and v) in the European CLO secondary market, bids wanted in competition ("BWIC") activity reached record levels, reflecting elevated secondary market trading activity. Accordingly, for Volta, we believe it is appropriate to consider the potential upside optionality going forward.

Factors driving upside

CLO equity has more potential upside than other elements of capital stack

CLO equity positions are especially geared to the factors driving upside, as:

- They take the residual cashflows, so an increase in income from higher re-investment spreads feeds through to equity holders. In the section on risk below, we highlight the manager's IRR scenario test, which clearly demonstrates this benefit.
- A reduction in the sentiment discounts on CLO assets will see rising prices of existing investments and less risk of cash diversions, as asset coverage test ratios improve.
- Volta's investments are at much lower prices, giving a geared upside effect to capital movements. Should investments return to par value in due course, when the economy normalises, it would see debt values double, but equity prices treble.
- Part of this is because we believe equity CLO tranches have "suffered" a greater degree of sentiment-driven discount than debt tranches, reflecting their higher-risk nature in uncertain times. When the economy normalises, and sentiment risk discounts reduce, the equity tranches will see more benefit.
- Somewhat less positively, the lower NAV price means that the same nominal cash return generates a higher IRR. This has been painful for long-term shareholders, but critically, from here, there are greater returns to be made.

AXA IM core competency is spotting price anomalies. Bought equity positions ahead of potential downturn. Dipping toe in European debt tranches.

As always, these generic issues may or may not be reflected in the price of specific securities. A core part of AXA IM's skill is identifying when there are pricing anomalies. It did so by buying equity tranches ahead of a potential downturn because the price more than reflected the incremental risk. Even with the drivers favouring equity positions, we note that Volta has been dipping its toe back into the European CLO debt market (July 3% of GAV its highest proportion since early 2017), as it believes the risk/reward is selectively attractive in that market.

Global corporate bond funds comparison

Volta's ultimate exposure is 700 corporate borrowers, but it fell 3x or more than global corporate bond funds

Volta has a flexible mandate and so can invest in the whole range of different tranches of CLO securities. It can thus optimise returns by picking whichever instrument offers the best risk/reward outcome. However, the bottom line is that its exposure is to ca.1,400 corporate credits, spread broadly by geography, sector and economic exposure. It is worth considering, therefore, how Volta has performed relative to a range of global corporate bond funds. Rather than taking an index, we have looked at some specific alternative investments to give investors a flavour of the relative returns.

As can be seen in the chart below, the March fall in the price of these investments was in the range of 11%-15%, which is consistent with the end-February to end-March fall reported by the mark-to-model approach of BGLF. In contrast, Volta's share price fell from €6.62 on 21 February to €3.28 on 6 April, a decline of 50%.

It has also responded much less to stimulus packages, and remains well below pre-crisis levels, while corporate bond funds are at or above the pre-crisis levels

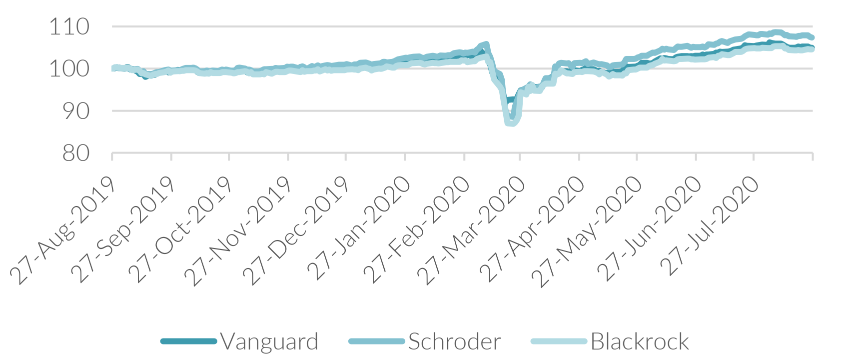
The corporate bond funds all appear to have responded quickly to fiscal and monetary stimulus packages recovering to their pre-crisis levels within a few months. Now they are trading at or above the pre-crisis levels, while Volta's share price is still down 36%.

Volta's sharper and more sustained fall could imply that:

There are some differences but the overall trends appear anomalous with fact that Volta's ultimate exposure is huge numbers of corporate borrowers

- Volta's underlying exposure is materially different – unlikely to be significant, given the number of positions and global diversity;
- the capital stack differential gives it a different outcome on the same underlying risk – historically, Volta has actually delivered long-term outperformance;
- the accounting and legal structure is different (see section above) and, for some reason, investors have not followed the underlying risk;
- corporate bond funds are including a recovery that has not been assumed within Volta; and
- the cost of complexity remains high in uncertain times – possible.

Indexed price performance of range of global corporate bond funds



Source: Refinitiv, *Vanguard Global Corp Bd Idx Inst USD Hdg (UCITS), Schroder ISF Global Corporate Bond S Acc* (SICAV), *MIL BlackRock Global Corporate Bond Fund* (UCITS), *Hardman & Co Research*

Sentiment double whammy hitting CLO investment values and Volta's rating. The unwind of this implies significant recovery potential.

We believe the key driver is sentiment, which has adversely affected both i) the accounting value of investments (and hence the difference between a mark-to-market and mark-to-model approach), and ii) the rating applied to Volta, so its discount relative to the discounted NAV has widened. Critically, the reversal of these factors could lead to material outperformance by Volta relative to corporate bond markets.

GFC re-investment experience as example

Same factors that drove out strong returns post financial crisis are in place again

CLO equity positions from vintages 2006/07 were purchased with the assumption that projected returns should be in the area of 12%/14%. With the Global Financial Crisis (GFC), these CLO equity positions, on average, suffered some diversion of cashflows during 2009, and then benefited from the re-investment mechanism in CLOs. It took time, but, after a few years, cashflows from these positions were ca.35% per year, almost twice what those positions were paying before the GFC, thanks to a significant increase in the Weighted Average Spread (WAS) of the underlying portfolios. Thanks, in turn, to that, they finally returned 16% to 20%, almost 50% more than originally thought.

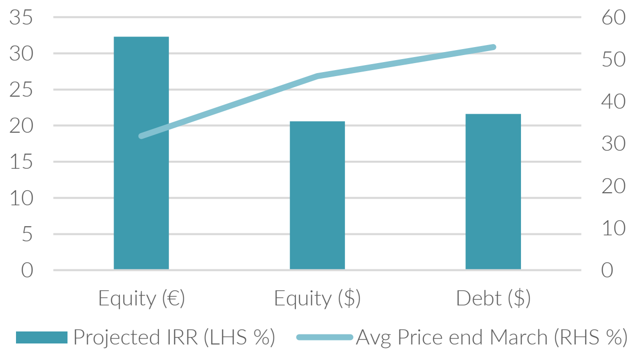
Every crisis is different but, as in 2009, loans are trading at a discount, new loans are issued with significantly higher spreads, and some loans are defaulting, and will continue to do so. Like for 2009, some CLO equity will suffer from partial or total diversion of cashflows, and CLO managers will be able to rotate portfolios, to increase WAS, trying to avoid defaults.

Manager sensitivity scenarios

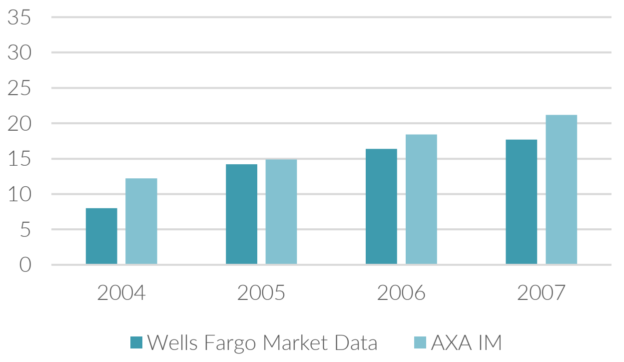
Manager sensitivity analysis based off rating agency scenarios indicate similar IRR in US CLO as post GFC

On page 9 of the January *Half Year Report* (actually published on 30 April 2020), Volta presented scenarios in line with rating agencies' scenarios from the end of March. The detailed assumptions are in that report but, in summary, we believe they are credible, assuming over 10% default rates, material increases in CCC buckets and re-investment spreads at 450bps for two years. As can be seen in the left-hand chart below, it generates projected IRRs of 20%-32%, based off March NAVs. We estimate that CLO positions are ca.28% higher and debt 33% since March, so the IRRS on July NAVs would be commensurately lower.

Projected IRR and average price at end-March (%)



IRR by year for the market and AXA IM (%)



Source: Volta Half Year Report, Hardman & Co Research

March $ equity position implied IRRs were in line with actual returns from that market in 2007 tranches

On page 12 of the January *Half Year Report*, Volta also presented the returns earned from US CLO equity positions in the years running up to the GFC. The returns actually earned from the 2007 vintages, at 21.2%, are very much in line with the 21.6% that Volta's scenario test implies for the March 2020 US CLO equity positions.

Dividend at 8% NAV planned. Given share price discount to NAV, equates to 10.8% dividend yield.

Dividend

In *early April*, Volta cancelled the dividend payment due on 28 April until there was more visibility on likely cash receipts. On *11 May*, a reduced dividend was declared (€0.1 vs. €0.155), to be paid in June. On *30 June*, a dividend of €0.11, to be paid at end-July, was also declared. Looking forward, the intention is to pay a dividend equivalent to 8% of NAV, which, with the group at a 25% discount, implies a 2021E dividend yield to shareholders of 12.1%.

If sentiment does improve, investors will benefit not only from the capital appreciation in the NAV, but also from a reduced discount to NAV, and also a higher dividend.

Past six months' actual cashflow equivalent to annualised 17% yield on July NAV

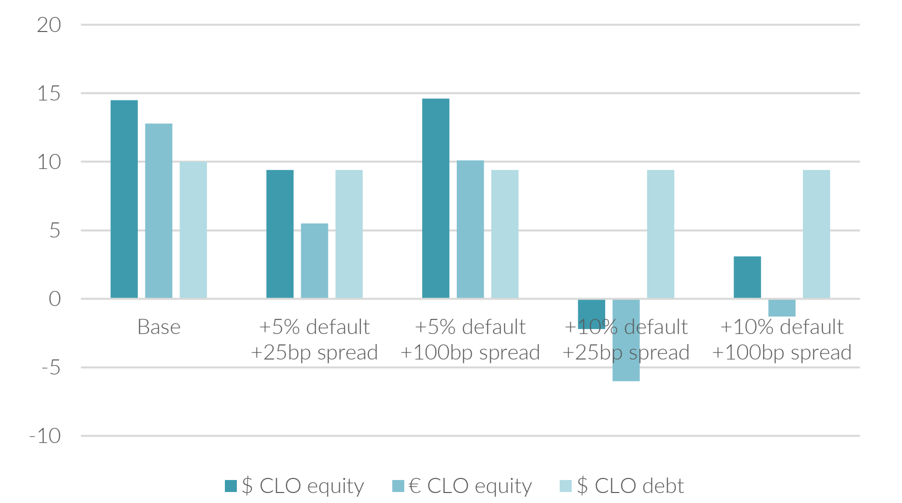
The value investors will give to the dividend will also reflect its cover. In the six months to July, Volta received €17.7m of coupons/interest from its investments. The annualised equivalent is a 17% annualised yield on the end-July NAV. This cash receipt is after €1m of technical effects, which are known to reverse in October, and €1m of effects, which will reverse at some stage, when interest rates normalise. Adjusting just for the former implies €37.4m of annualised cash receipts, which takes the yield up to 18%. While we cannot be certain of future cashflows (see *Risks* section below), it does suggest 2x or more coverage of the currently planned dividend level of 8% NAV.

Risks

Volta cannot be immune from both fundamental and sentiment drivers. Risk aversion may return.

The 32% fall in Volta's NAV in March shows that it is not immune to the economic outlook and, we believe, to a greater degree, sentiment. The variability in the latter can be hard to predict, although, over time, actual interest and principal payments should moderate its effect. In its January interim report, the manager gave some scenario impacts looking at changes in defaults (from the normal 2% assumption), with a range of related spread widening. A 5% increase in defaults, with only a modest spread widening, would see the book earning an IRR close to the 8% target dividend yield. A spread widening of 50bps, rather than 25bps, sees IRRs comfortably above this level.

IRR (%) across asset classes with different assumptions



Source: Volta Finance January 2020 Half-yearly financial report, Hardman & Co Research

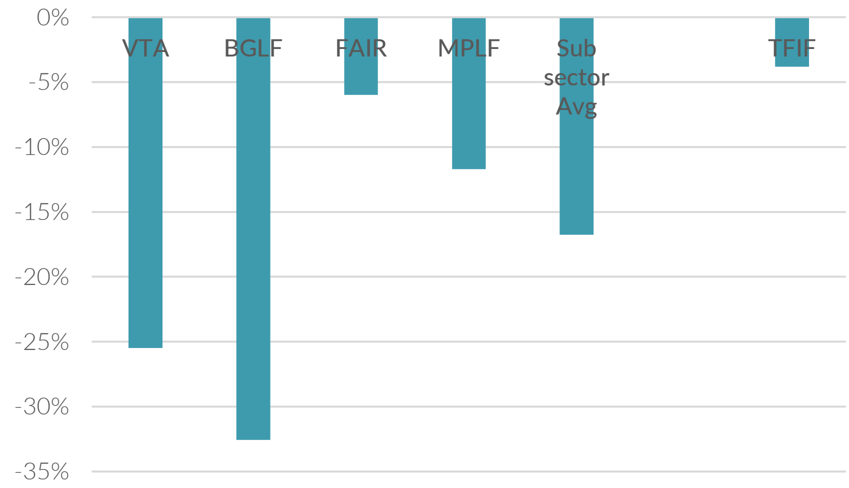
As outlined through the Monthly Reports, although more defaults are expected to start to materialise, they are spread through time, and are likely to come through over two to three years. Such an outturn may be expected to lead to almost no diversion of payments on Volta CLO equity positions and, in AXA IM's view, this situation is far better than the types of scenarios that were used for illustration purposes above (simulating an instantaneous shock corresponding to 5% or 10% defaults). On both sides of the Atlantic, loan market spreads are between 50bps and 75bps wider than pre-COVID-19 levels, and the delay in default occurrence has been clearly pointed out by AXA IM as a favourable situation, giving more time to CLO managers re-arranging portfolios and benefiting from reinvestment opportunities.

Valuation and financials

Discount slightly larger than peers on same accounting basis

Compared with its structured debt peers, on market price to NAV, Volta is trading at a small discount. Given the historical performance, risk profile and portfolio mixes identified in the sections below, this relative discount appears anomalous.

Current share price discount to July 2020 NAV for Volta and peers



Source: Hardman & Co Research, Monthly reports for Volta (VTA), TwentyFour Income Fund (TFIF), Fair Oaks Income Fund (FAIR), Blackstone/GCO Loan Financing Ltd (BGLF) and Marble Point Loan Financing (MPLF); priced 15 September 2020

Financials

Our financial assumptions reflect the NAV stated in Volta's July monthly report. The detail of the results will be announced in October.

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