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VOLTA FINANCE LIMITED

Putting the discount into perspective

Volta's share price discount to NAV (26%) is now back to the levels seen in the early stages of the pandemic. This appears anomalous with 6.3% total shareholder return in 1Q'24, the annualised cashflows in excess of 20%, the consensus outlook, as well as the structured debt finance and all investment company averages (11% and 6%, respectively). In our view, any discount reflects investor concerns that either the current NAV is unrealistic or that it cannot be achieved in the future. In this note, we examine what may drive such concerns, concluding they are more sentiment- than reality-driven; as such, they may be less likely to be sustained.

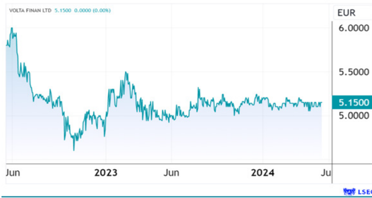
- **Why the current NAV is realistic:** Volta adopts a mark-to-market approach. The NAV should be real unless the pricing sources are inaccurate, which appears unlikely. The MTM approach captures sentiment risk in the asset valuation. In our view, the risk of yet-to-be-identified losses affecting the current NAV materially are low. There are multiple checks and reviews to ensure the process is robust.
- **Resilience:** In previous notes, we have outlined why CLO structures have incremental risk controls and that the expected losses from such vehicles are well below corporate credit markets as a whole. We further outlined that AXA IM has consistently picked CLO managers with below-average losses.
- **Valuation:** Volta trades at a double discount: its share price is at a 26% discount to NAV, and we believe its MTM NAV still includes a further sentiment-driven discount to the present value of expected cashflows. Volta targets an 8% of NAV dividend (10.2% 2024E yield on current share price).
- **Risks:** Credit risk is a key sensitivity. In this note, we examine the valuation of assets, highlighting the multiple controls to ensure its validity. 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 both the NAV and the discount to NAV may be volatile over time. Fundamental long-term returns have been robust: 8.0% p.a. (dividend reinvested basis) since inception. Volta's performance relative to that of its peers has been strong, and returns for investments made after the financial crisis were double those in prior years.

Financial summary and valuation (Hardman & Co adjusted basis)

Year-end Jul (€m)	2020	2021	2022	2023	2024E	2025E
Coupons & dividends	39.4	41.8	42.9	47.0	39.7	46.3
Operating income	31.5	44.5	41.6	44.1	55.2	51.9
Total inv. manager fees (stat.)	(3.9)	(14.2)	(3.9)	(5.6)	(10.1)	(9.4)
Other expenses	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Total comp. inc.	25.8	35.2	33.4	35.2	44.0	41.5
Statutory PTP	(63.0)	76.8	(17.8)	27.0	45.3	42.8
Underlying EPS (€)	0.7	1.0	0.9	1.0	1.2	1.1
NAV per share (€)	5.69	7.28	6.22	6.45	7.16	7.77
S/P prem./disc. (-) to NAV*	-23%	-17%	-16%	-21%	-28%	-34%
Gearing	0%	0%	0%	0%	0%	0%
Dividend (€)	0.52	0.52	0.61	0.51	0.53	0.57
Dividend yield	10.3%	9.9%	11.1%	9.9%	10.2%	11.0%

**2020-23 actual NAV and s/p, 2024-25E NAV to current s/p; Source: Hardman & Co Research*

Closed End Investments



Source: Refinitiv

Market data

EPIC/TKR	VTA.NA, VTA.LN VTAS LN
Price (€)	5.15/5.04/430p
12m high (€)	5.32/5.30/468p
12m low (€)	4.92/4.78/404p
Shares (m)	36.6
Mkt cap (€m)	188
2024E div. yield	10.2%
Latest NAV (Mar'24, €)	6.98
Discount to NAV	-26%
Country of listing	NL/UK
Currency of listing	€/€/GBP
Market	AEX, LSE

Description

Volta is a closed-ended, limited liability investment company that aims to provide a steady stream of quarterly dividends, pursuing exposure, predominantly, to Collateralised Loan Obligations (CLOs) and similar asset classes.

Company information

Ind. Chair	Dagmar Kent Kershaw
Ind. NEDs	Stephen Le Page, Yedau Ogundele, Joanne Peacegood
Fund Manager	AXA IM
Co. sec./ Administrator	BNP Paribas Securities Services SCA, Guernsey
BNP:	+44 (0)1481 750853
Website:	www.voltafinance.com

Key shareholders

AXA SA Bank	21.75%
BNP Paribas	15.28%
AXA Framlington IM	8.23%
BNP Wealth Mgt.	5.50%

Diary

Mid-May	April estimated NAV

Analyst

Mark Thomas
mt@hardmanandco.com

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The discount in absolute and relative perspectives

Absolute

Huge discount appears anomalous with long-term track record, recent performance and the outlook

The 26% discount to NAV implies that investors believe that the trust is destroying, or is likely to destroy, value. This appears anomalous with the track record since inception, recent performance and the manager's stress scenario testing.

To put this into a context, as at March 2024:

- the annualised share price total return since inception was positive 8.0%;
- no month in the past year has seen a negative total return; and
- the annualised past six months' cash received was 21% of the March 2024 NAV.

Even in extreme stress scenario, manager still expecting 9% IRR (base case 17%).

The manager provided the results of its portfolio stress tests in the January 2024 Interim Report and Accounts, which indicate a 17%+ projected yield in the base case and a 9% CLO IRR, even in the worst of its two stress tests. The latter reflects an instantaneous 6% increase in CCC bucket (all CLOs will then exceed the classic 7.5% authorised CCC bucket) and defaults to materialise in relation with such CCC bucket and current WARF. Looking through the technicalities, it implies this would cause an average 6.2% default rate every year for the next two years, roughly double the current consensus expectation and, in aggregate, greater than the GFC. We note i) in all scenarios, a positive yield is expected, ii) the sensitivity of the equity positions is, as expected, materially higher than the debt, iii) the latest numbers cannot be compared with ones provided in previous reports due to changes in assumptions (current assumptions are more conservative than previous ones), and iv) bearing in mind the discount to the share price, the yield to shareholders is roughly a quarter higher than the NAV.

Projected yield (from NAV value)

	Base case	Stress	Extreme stress
USD equity	21.6%	7.2%	2.6%
Euro equity	21.2%	13.1%	9.6%
USD debt	14.6%	14.5%	12.6%
Euro debt	11.3%	11.4%	11.2%
Average for CLOs	17.3%	11.5%	9.0%

Source: Volta January 2024 Interim Report and Accounts, Hardman & Co Research

Relative

We consider a number of relative comparisons below:

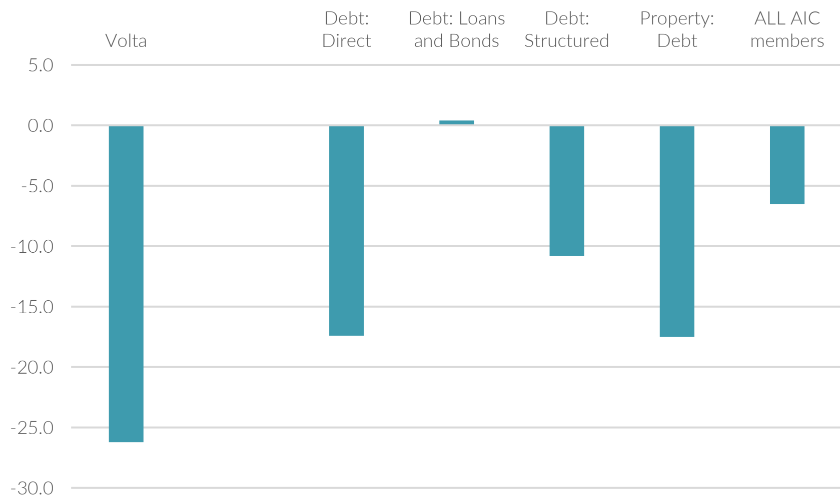
Discount back to peak of COVID-19 levels, despite outlook being much better

- The current discount is close to the March 2020 level of 27%. Investors should consider whether the current outlook is as bad as at the peak of the sentiment crisis of COVID-19. Despite the -32.4% NAV return performance in March 2020, the full-year NAV return was just -5.7%, followed by +17.9% in 2021.
- The chart below shows Volta's discount relative to a range of debt investment company sectors.

Discount above AIC debt sectors, despite the credit enhancement in CLO structures and AXA IM's record of investing in below-average loss CLO managers

- As we outlined on our pages 4-8 of our note, *An easy guide to the benefits of CLOs*, CLO structures have multiple incremental risk mitigation practices and reported significantly lower historical losses 2001-20 than the equivalent corporate rated instruments. Our note highlights that projected losses are also well below corporate debt; it is anomalous, therefore, to have Volta on a higher discount than all these debt investment trust averages.

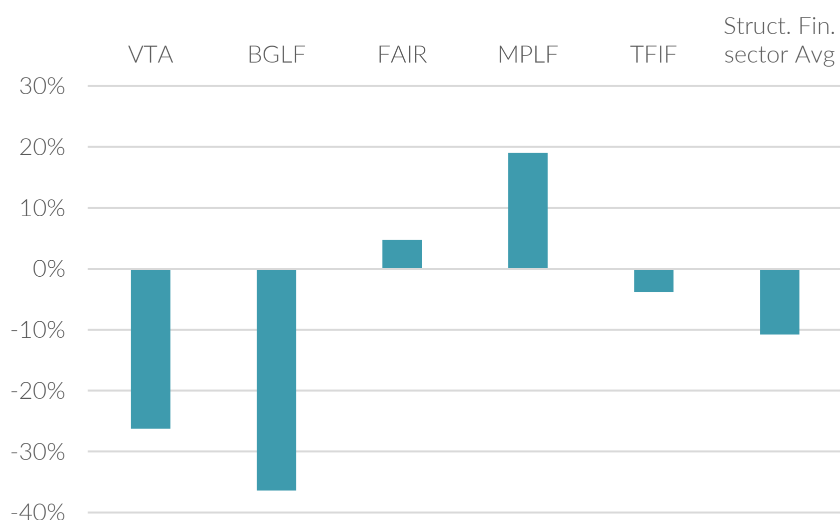
Volta and AIC sector discounts to NAV (%)



Source: AIC accessed 16 May 2024, Hardman & Co Research,

- We detail the discount relative to others in the Debt Structured subsector in the chart below. Company-specific issues mean comparisons need to be treated with caution (e.g. BGLF in wind down); however, as our note, *The benefits of having AXA IM as the manager* published 7 December 2023, highlighted, AXA IM has a proven track record of choosing CLO managers with below-average loss experiences.

Current share price discount to latest 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 at 16 May 2024

Why the current NAV is realistic

Summary

Discount justified if investors do not believe the current NAV is realistic

One factor that could drive any investment trust to trade at a discount to NAV is if investors do not believe the current NAV is a realistic reflection of what the assets may be sold for, should the trust wish to sell today.

In considering this risk for Volta, we note:

Volta's portfolio primarily marked to market with data from credible source, there is a conservative culture, and three layers of checks and reviews

- The approach is mark to market, with nearly 90% of prices sourced from the reputable JP Morgan PricingDirect. Across its platform, AXA IM's experience is that the vast majority of its trades are consistent with the pricing indicated by this source.
- AXA IM and Volta have conservative cultures.
- Valuations are checked and reviewed at the CLO structure level, by AXA IM teams and by Volta itself, bringing a depth and breadth of review that is unusually high for an investment trust.
- While there may be "unknown unknowns" creating losses in the current book, which have yet to be identified, Volta's track record would suggest that they are unlikely to be material, and certainly well below anything implied by the discount.

Valuation approach

Vast majority of assets valued off market prices

We believe there has been increased focus on the valuation methodologies of investment trusts investing in what may be perceived as illiquid, complex assets. Volta's approach is detailed on pages 49-51 of the *2023 Report and Accounts*. We note i) 82% of the fair value is taken directly from JP Morgan PricingDirect or other market participants, and ii) a range of the residual assets also uses market-price-driven methodologies, including CLO_CMV (5% fair value, which is valued under a sum-of-the-parts method with all CLO equity investments valued based on JP Morgan PricingDirect) and the CLO Warehouse (3% fair value, which is valued at the lower of: (a) the principal amount invested plus accrued income net of financing costs; and (b) the mark-to-market value of the relevant proportion of the underlying portfolio).

We further note:

- The data provider is credible.
- The prices obtained from JP Morgan PricingDirect are derived from observed traded prices, where these are available, but may be based upon non-binding quoted prices received by JP Morgan PricingDirect from arranging banks or other market participants or a combination thereof, where observed traded prices are unavailable. AXA IM's experience, across its platform, has been that trades are consistent with this pricing.

AXA IM's scale means, even in volatile markets, it can access liquidity and finer pricing

- In illiquid markets, even in normal conditions, the bid-offer spread can be wide. In general, Volta takes the mid-price for valuation purposes. As we noted in our report, The benefits of having AXA IM as the manager, published 7 December 2023: "*AXA IM leverages on its scale to minimise bid offer spread and achieve best execution. It has a team of two product-dedicated traders while three portfolio managers also have an extensive trading background. As a result, AXA IM's execution tends towards mid-market levels, not bid-side.*"

- In uncertain markets, the bid offer spread widens, sometimes materially. We believe the macroeconomic and geopolitical environment means that current conditions present such uncertain conditions. AXA IM notes that it has executed all the deals it wants to at acceptable prices and, again, as our December 2023 report noted, "*due to the long-standing partnerships established with brokers over the years, AXA IM accesses liquidity, even in volatile markets*".

Illogical to apply a further discount of Volta's share prices to NAV when the asset valuation already captures adverse sentiment

- By marking to market, Volta captures investor sentiment to its assets. In uncertain times, prices fall and so the asset valuations and the NAV fall too. There is an illogicality to applying a further discount of Volta's share prices to NAV when the asset valuation already captures adverse sentiment.

Conservative culture

We have previously highlighted the importance of culture and that, in our view, financial reports are an art not a science. They reflect the company's interpretation and choice of assumptions within the overall guidelines provided by the accounting rules. In our view, AXA IM is a conservative organisation as a whole and the independent board of Volta is also conservative by nature. We believe this is not only reflected in the choice of assets (we outline in the section, below, Volta's below-average loss experience) but also in the way it interprets the accounting rules.

Checks and reviews

Valuations reviewed at CLO, AXA IM and Volta levels

Volta's valuations are subject to an unusually high degree of checks and reviews.

- At the CLO structure level, there are audit and internal management reviews, ensuring the realism of the valuation for each asset within the CLO structure.

- AXA IM then overviews and, being a large player,
  - is in a position to sense check prices for the CLO valuations for realism;
  - can see if different CLO mangers are valuing the same assets differently. This allows it not only to assess the value of specific assets but also goes into the consideration of which CLO managers to invest in.

- At the Volta level, there are
  - audit checks by external auditors (KPMG Channel Islands Limited – see pages 36-41 of the 2023 Report and Accounts).
  - the dedicated Board Audit committee (see page 31-32 of the 2023 Report and Accounts)
  - The whole board signing off on published financial statement.

There may be losses in current portfolio yet to be identified, but scale is unlikely to be material

"Unknown unknowns"

To quote Donald Rumsfeld, there are "unknown unknowns", which may result in losses in the existing portfolio and which have yet to be identified in each monthly factsheet. In periods of macro-uncertainty, they present a greater risk than in normal trading conditions. By way of example, Altice France is owned by ca.95% of the European CLO market[1] and, in March 2024, it unexpectedly announced that it was looking for lenders to take some of the pain of its re-financing. It is logical to factor in some "unknown unknowns" discount, especially in uncertain times, but this needs to be put into perspective.

- One of the core attractions of CLO structures is that they diversify risk. Even a large player like Altice France only represented 1.6% of the average European CLO portfolio (it was owned by ca.95% of the European CLO market). It is also held by ca.77% of US CLOs, with an 0.5% average holding. As we outlined in our note, *The benefits of having AXA IM as the manager,* AXA has a track record of investing in below-average risk investments. For Volta, Altice France only represented 0.8% of its average underlying portfolio (with 46.9% of the portfolio in European CLO assets and 39.4% in US assets, on a market-average holding, it would have been ca.1.1%). Even a material haircut would have a minimal impact on the NAV and Volta commented it "*is not expected to suffer any diversion of cashflow as a result of Altice's downgrade*".

- Arguably, of course, the unknown unknowns should be factored in the market prices of its assets and thereby into Volta's NAV calculation. Again, applying a double discount appears, to us, illogical.

[1] Source: Volta March Factsheet

NAV resilience

Could also justify a discount if there will be a decline in value in the future

Any investment company's discount to NAV would also be justified if the current valuation was real but, by the time the assets could be sold, they did not achieve the current price. A discount would also be justified if investors believed the manager would sell existing assets and replace them with ones that would fall in value. For Volta, we believe this "sustainability" of the NAV is more likely to be the key driver for the level of discount rather than concerns over whether the current NAV is real.

We have written multiple times on the resilience of the portfolio

Portfolio resilience has been the subject of multiple reports we have written on Volta, with the overall conclusion that the cashflows of the business should prove robust. We list below a selection of our reports, which cover the portfolio's resilience.

- Our *initiation report* (5 September 2018).
- *9%+ yield in uncertain times* (7 October 2019).
- *Follow the money* (3 February 2020).
- *Value added by active portfolio management* (15 September 2020).
- *Cash is king and the king is rocking and rolling* (16 September 2022).
- *R&A shining light on 20%+ IRR base-case scenarios* (11 January 2023).
- *An easy guide to the benefits of CLOs* (18 April 2023).
- *The benefits of having AXA IM as the manager* (7 December 2023).
- *Insights from the Report and Accounts* (24 January 2024).

In summary, the key points are:

CLO market has multiple risk enhancement features and AXA IM has track record of investing with below-average risk CLO managers

- As noted above, CLO structures have multiple risk enhancement features – see *An easy guide to the benefits of CLOs*. AXA IM's scale, expertise and market presence mean that it has a proven track record of investing with CLO managers who have below-average risk (see *The benefits of having AXA IM as the manager)* as well as actively managing the portfolio *to the risk outlook (see* the benefits report and *Value added by active portfolio management).*

Sensitivity to rising rates managed

- We believe sensitivity to rising rate environment is a key issue for all investors in debt investment companies. As noted above, Volta, to date, has performed exceptionally well through a combination of asset class allocation, variable rate debt positions, and CLO equity positions, benefitting from CLO debt refinancing – see our notes, *Re-Set, Re-Fi, Re-Light my Fire* (published 5 May 2021) and *R&A shining light on 20%+ IRR base-case scenarios* (published 11 January 2023) – and the low default rates.

Manager's view is for base case IRR of 17% and 9% in extreme stress scenario

As noted above, the manager provided the results of its portfolio stress tests in the Interim Report and Accounts, with 9% expected IRR, even in an extreme stress scenario. As our recent notes highlight, we, and Volta, expect defaults to rise from their unusually low post-COVID-19 stimulus levels but for the increase to be well within manageable levels. CLO managers have been preparing for credit deterioration and, as the manager noted in the March 2024 factsheet, no cash diversion is expected from the Altice France situation.

Financials

Our estimates are unchanged

To derive our adjusted profit and loss, we strip out the capital movements, including i) unrealised gains/losses, ii) FX movements, and iii) net gains of IR derivatives. We have left in realised gains, which, although volatile, have been converted into cash, and some capital gains may 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 & Co adjusted profit and loss account

Year-end Jul (€m)	2017	2018	2019	2020	2021	2022	2023	2024E	2025E
Coupons and dividends received	33.2	38.5	42.0	39.4	41.8	42.9	47.0	39.7	46.3
Net gains on sales	3.1	0.0	0.5	(7.0)	2.7	(1.3)	(3.4)	15.0	5.0
Net gain on fin. assets at FV through P/L	**36.2**	**38.5**	**42.5**	**32.4**	**44.5**	**41.7**	**43.6**	**54.7**	**51.3**
Interest expense on repo	(1.1)	(1.4)	(1.6)	(0.8)	-	-	-	-	-
Net bank interest & charges	(0.1)	(0.1)	0.1	0.0	(0.0)	(0.0)	0.5	0.5	0.5
Operating income	**35.0**	**37.0**	**41.0**	**31.5**	**44.5**	**41.6**	**44.1**	**55.2**	**51.9**
Inv. manager fees	(4.6)	(4.6)	(4.4)	(3.6)	(3.3)	(3.9)	(3.3)	(3.5)	(3.9)
Inv. manager performance fees	(1.2)	(1.3)	(2.1)	(0.6)	(4.6)	(3.0)	(4.3)	(6.3)	(5.1)
Directors' remuneration & expenses	(0.5)	(0.5)	(0.5)	(0.5)	(0.3)	(0.4)	(0.3)	(0.3)	(0.3)
Other expenses	(0.8)	(0.9)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Total expenses	(7.0)	(7.3)	(8.0)	(5.7)	(9.3)	(8.3)	(8.9)	(11.2)	(10.4)
Profit and total comp. income	**28.0**	**29.7**	**32.9**	**25.8**	**35.2**	**33.4**	**35.2**	**44.0**	**41.5**
Adjusted EPS (€)	**0.77**	**0.81**	**0.90**	**0.71**	**0.96**	**0.91**	**0.96**	**1.20**	**1.13**
Dividend cover (x)	**1.24**	**1.31**	**1.45**	**1.36**	**1.85**	**1.49**	**1.89**	**2.28**	**2.00**

Source: Volta, Hardman & Co Research

Glossary

When looking at Volta, investors are likely to come across a number of technical terms summarised below.

Glossary

Term	Meaning
ABS	Asset-backed securities.
ABS residual positions	Residual income positions, which are a sub-classification of ABS, being backed by any of the following: residential mortgage loans; commercial mortgage loans; automobile loans; student loans; credit card receivables; or leases.
Bank Balance Sheet Transactions (BBST)	Synthetic transactions that permit banks to transfer part of their exposures, such as exposures to corporate loans, mortgage loans, counterparty risks, trade finance loans, or any classic and recurrent risks that banks take in conducting their core business.
Cash Corporate Credit (CCC)	Deal-structured credit positions, exposed predominantly to corporate credit risks by direct investments in cash instruments (loans and/or bonds).
Cash diversion	In periods of stress (typically measured by a specific deterioration in the proportion of the portfolio with worse-quality ratings), cash is diverted from being distributed to equity holders, and is retained to provide additional protection for bond holders.
Cash waterfall	The clear priority in which income from the SPV is allocated to stakeholders.
CLOs or CLO	A collateralised loan obligation (CLO) is a single security backed by a pool of debt. CLOs are often corporate loans with low credit ratings, or loans taken out by PE firms to conduct leveraged buyouts.
CLO 1.0	The first vintage of modern CLOs (issued from mid- to late 1990s). It included some high-yield bonds, as well as loans, and was the standard CLO structure until the financial crisis struck in 2008. Now under 1% of CLOs in issue.
CLO 2.0	Issued 2010-14, in response to the financial crisis, by strengthening credit support and shortening the period in which loan interest and proceeds could be re-invested into additional loans.
CLO 3.0	Began in 2014, and aimed to further reduce risk by eliminating high-yield bonds and adhering to the post-GFC regulatory changes. Currently, few CLOs allow for investments into high-yield bonds, and those that do generally limit the exposure to 5%-10%. To compensate for the exposure to high-yield bonds, these CLOs have increased levels of subordination to better protect debt tranches.
Capitalised Manager Vehicle (CMV)	A CMV is a long-term, closed-ended structure, which is established to act as a CLO manager and to also provide capital in order to meet risk retention obligations when issuing a CLO, and also to provide warehousing capabilities.
CPR	Constant prepayment rate.
Refi	Consists in refinancing part, or all, of the debt tranches of a CLO, while operating very modest changes in the CLO documentation.
Reset	Consists in calling all the debt tranches of a CLO, re-marketing a full new debt package, with new CLO documentation, almost as if it were a new CLO.
Synthetic Corporate Credit (SCC)	Structured credit positions predominantly exposed to corporate credit risks by synthetic contracts.
Underlying assets	The assets in which the company may invest, either directly or indirectly, include, but are not limited to, corporate credits, sovereign and quasi-sovereign debt, residential mortgage loans, commercial mortgage loans, automobile loans, student loans, credit card receivables, leases, and debt and equity interests in infrastructure projects.
Warehouse	A warehouse is a short-term structure put in place before a CLO happens in order to accumulate assets, in order, in turn, to facilitate the issue of the CLO. A warehouse is leveraged, and can be marked to market.
Weighted average life of the loans (WAL)	The average length of time that each dollar of unpaid principal on a loan or an amortising bond remains outstanding.
Weighted average risk factor (WARF)	The WARF measure aggregates the credit ratings of the portfolio's holdings into a single rating. The credit rating letter rating corresponds to a numerical rating factor, which, in turn, corresponds to the 10-year probability of default. The WARF is determined by calculating the weighted average of these numerical factors.
Weighted average spreads (WAS)	A percentage equal to i) the Aggregate Funded Spread, divided by ii) the Aggregate Eligible Collateral Obligation Amount (excluding any interest that has been deferred and capitalised on any Deferrable Collateral Obligation).

Source: Hardman & Co Research

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