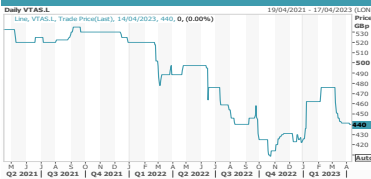




## Closed End Investments



Source: Refinitiv

## Market data

EPIC/TKR	VTA.NA, VTA.LN VTAS LN
Price (€)	5.10/5.00/441p
12m high (€)	6.10/6.08/512p
12m low (€)	4.55/4.60/400p
Shares (m)	36.6
Mkt cap (€m)	187
2023E div. yield	11.5%
Latest NAV (Mar'22, €)	6.04
Discount to NAV	-16%
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. Chairman	Dagmar Kent Kershaw
Independent NEDs	Graham Harrison, Stephen Le Page, Yedau Ogundele
Fund Managers (AXA IM Paris)	Serge Demay, François Touati
Co. sec./	BNP Paribas
Administrator	Securities Services SCA, Guernsey
Website	<a href="http://www.voltafinance.com">www.voltafinance.com</a>

## Key shareholders (Jul'22)

AXA Group	30%
BNP WM	16%
BNP Sec. Serv.	11%

## Diary

Mid-May	Apr estimated NAV
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## Analyst

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## VOLTA FINANCE LIMITED

## An easy guide to the benefits of CLOs

The industry-specific terminology associated with CLOs can give the impression of a complexity to the product that belies reality, and, in our view, is unhelpful to the Volta investment case. Accordingly, in this note, we give investors a simple guide to what CLOs are, the benefits they provide, and how Volta is taking the market opportunities. The core of CLOs is uncomplicated cashflows. They are just a pooling of loans into a vehicle, which funds itself by issuing a range of debt and equity. The pool has diversification and credit-enhancement benefits, which result in investors in debt getting a better-than-average risk/return, and investors in equity getting double-digit returns.

- ▶ **Strong current position:** Volta's current cash receipts are ca.20% of NAV, reflecting low defaults (strong corporate cashflows and profitability, ability to pass on inflation to date), low locked-in CLO borrowing costs, CLOs being floating-rate investments and Volta's portfolio positioning over recent years into CLO equity.
- ▶ **Resilience going forward:** The rating agency's/Volta's/our confidence in a relatively low expected level of defaults reflects i) a strong starting position, including high cash cushions in CLO structures, ii) a preponderance of private equity (PE), iii) inflation still being friend, not foe, iv) covenant-lite documentation, and v) Volta's diversification.
- ▶ **Valuation:** Volta trades at a double discount: its share price is at a 16% discount to NAV, and we believe its mark-to-market (MTM) NAV still includes a further sentiment-driven discount to the present value of expected cashflows. Volta targets an 8% of NAV dividend (11.5% 2023E 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 7.7% p.a. (dividend re-invested basis) since initiation. With above-average returns on recent re-investments, the portfolio's past six-month cashflow (annualised) yield is 21.8%. We estimate 1.5x 2024 dividend cover.

## Financial summary and valuation (Hardman &amp; Co adjusted basis)

Year-end Jul (€m)	2019	2020	2021	2022	2023E	2024E
Coupons & dividends	42.0	39.4	41.8	42.9	45.0	42.6
Operating income	41.0	31.5	44.5	41.6	44.9	42.5
Inv. manager fees (stat.)	(4.2)	(3.9)	(14.2)	(3.9)	(8.1)	(7.6)
Other expenses	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Prof. & tot. comp. inc.	32.9	25.8	35.2	33.4	35.8	33.9
Statutory PTP	7.1	(63.0)	76.8	(17.8)	37.1	35.3
Underlying EPS (€)	0.9	0.7	1.0	0.9	1.0	0.9
NAV per share (€)	7.9	5.7	7.3	6.2	6.6	7.0
S/P prem./disc. (-) to NAV*	12%	23%	17%	-16%	-23%	-27%
Gearing	12%	0%	0%	0%	0%	0%
Dividend (€)	0.62	0.52	0.52	0.61	0.59	0.61
Dividend yield	12.2%	10.2%	10.2%	12.0%	11.5%	11.9%

\*2017-22 actual NAV and s/p, 2023-24E NAV to current s/p; Source: Hardman & Co Research

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- ▶ any partnership or corporation organised or incorporated under the laws of the United States;
- ▶ any estate of which any executor or administrator is a "U.S. person";
- ▶ any trust of which any trustee is a "U.S. person";
- ▶ any agency or branch of a foreign entity located in the United States;
- ▶ any non-discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary for the benefit or account of a "U.S. person";
- ▶ any discretionary account or similar account (other than an estate or trust) held by a dealer or other fiduciary organised, incorporated, or (if an individual) resident in the United States; and
- ▶ any partnership or corporation if:
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# What is a CLO?

CLOs are just portfolios of loans

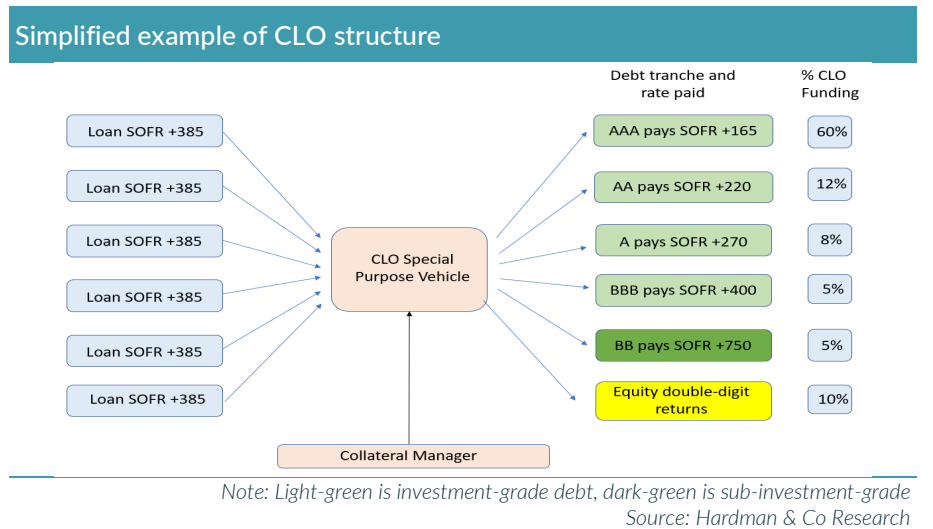
Individual loans are pooled, and different tranches of debt at different interest costs are issued as funding

in principle the same portfolio diversification seen in bank

As illustrated in the chart below, CLOs are, at their heart, very simple cashflows. A portfolio of loans is acquired by a special purpose vehicle (SPV), which funds the purchase by issuing a mix of different tranches of bonds (CLO debt tranches) and "income notes" (CLO equity tranches). The interest received from the loan portfolio is used to pay, firstly, the coupons on the CLO debt tranches, and then all the excess cashflow is for the profit of the equity tranche.

The example below is simplified to illustrate how a CLO works.

- ▶ The starting point is when a CLO SPV acquires 100-200 loans (to simplify the chart below, we have used just six). The rate that the loans pay is based off their individual credit risk, and, in our example, again to simplify matters, we have assumed that they all pay SOFR +385bps.
- ▶ To finance itself, the SPV mainly issues bonds, but, as even the riskiest bond investors want some protection, there is an equity tranche to the SPV. It is the equity holders who bear initial losses beyond any income generated in the period. In our example, the SPV has a 10% equity cushion to give the bond holders the desired protection. On the assumptions below, the equity holders earn a return of 21%, based off SOFR at 3%, and before any costs and defaults. The latter can be variable, but marketwide, we believe expectations are for long-term double-digit returns from CLO equity tranches, and we note that AXA IM, Volta's manager, typically outperforms the market.
- ▶ Bonds that incur the first loss after equity are likely to be sub-investment-grade, and the rate that they pay reflects this higher risk (in our example, the BB bonds have a spread of 750bps). Sub-investment-grade bonds typically account for 5%-10% of the SPV funding.
- ▶ Portfolio diversification means that the probability of all the loans going into default simultaneously is low. Consequently, the SPV can issue the majority of its bonds with investment-grade status, and carrying a much lower coupon than the loans incur individually. The AAA tranche may typically be 55%-65% of the stack, the AA 10%-15%, and the A 5%-8%. There is nothing unusual in CLOs using this standard portfolio diversification. In principle, the structure of a CLO SPV is the same as that of a bank, in that it takes a broad portfolio of credit risk and has a broad range of funding, carrying different interest costs.



## Benefits of a CLO structure

A CLO structure has advantages for all the interested parties:

### Loan originators have additional sources of funding

- ▶ The originators of the loans (usually, but not necessarily, banks) have access to alternative finance, and can manage the credit risk on their books. They will often service the loans in the SPV (for a fee), and keep their relationship with the borrower. This is capital-efficient for the originators, as they do not need to hold capital against the loans sold to the SPV, but still earn origination fees.

### Different CLO debt tranches meet different investor appetite

- ▶ With the diversification benefits of pooling multiple loans and with the credit enhancements we detail below, relatively safe instruments can be created. While they pay lower interest rates, they are designed to appeal to conservative investors, such as pension funds. The structure also creates riskier tranches, which appeal to higher-risk-appetite investors by offering higher yields. The overall pool of potential investors is thus increased.

### Flexibility in managing portfolio

- ▶ Investors also benefit from having multiple assets in the SPV, which can be sold if market conditions change. CLOs are actively managed by portfolio managers, who will trade in and out of assets, just like any other loan fund. In addition, Axa is actively managing its portfolio of CLO investments, and also trades in and out of those CLO securities, based on value and credit risk, creating flexibility in the management of the portfolio.

### Higher yield to investors

- ▶ CLO investment returns for investors include not only the perceived credit risk, but also complexity and illiquidity premiums. The structures are not always easy to analyse, and the market for structured debt is smaller, and more specialist, than that for corporate loans. The spread advantage over investment-grade credit typically widens in periods of uncertainty, and increases with higher-risk tranches, but, through-cycle for the AA-AAA tranches it may be around 70bps, rising to up to 200bps for BBB and 500-700bps for B).

### Limited interest rate exposure

- ▶ The underlying loans and CLO debt are typically floating-rate, and so there is limited interest rate sensitivity or exposure to a rising rate environment (other than through credit risk).

### Non-correlated asset class

- ▶ The correlation to other fixed-income asset classes has been low. Against government 10-year benchmark indices, Volta's share price has minimal correlation (correlation co-efficient to 10-year government bond benchmark index June 2015 to end-March 2023: Germany 0.05, US 0.06, France 0.17, Italy 0.24, Spain 0.34), nor is it correlated to investment-grade benchmarks (Europe 0.11, US 0.28).

### Cheaper finance for borrowers

- ▶ The overall cost of finance to borrowers does not reflect these higher investor returns, as the CLO structure broadens the range of lenders (creating demand from both conservative and risk-taking lenders), and it shares some of the benefits of diversification.

## Risk enhancement within CLOs

The attractive credit profile of CLOs is not just about diversification and pooling benefits. CLO creditworthiness is enhanced by a series of risk controls/features, including:

Cash is retained in SPV/used to repay investment-grade debt if the level of collateral or interest cover falls below set levels

- ▶ “Cash diversion” tests mean that, when a covenant is broken, cash must be retained within the SPV (or used to repay the investment-grade debt), and not paid out to equity holders. These are sometimes referred to as re-investment tests, as they constrain how a CLO structure can re-invest the cash it has received from its loan assets. The tests enhance the position for higher-quality bond holders, while reducing cash distributions for equity holders. Typical covenants triggering cash diversion include:
  - over-collateralisation: the market value of outstanding loans has to exceed the value of non-equity liabilities by a set proportion. The structures usually define how assets are valued as a further constraint on higher-risk loans. So, for example, defaulted loans may have to be valued at the lower of the market price or net assumed recovery; and
  - interest cover in order to provide a cushion for the debt holders’ interest payments.

Early in the pandemic ca. 20% US CLOs saw cash diversion. Volta had none.

- ▶ In its 2022 Report and Accounts, Volta emphasised that it did not expect any cash diversion tests to be breached (see page 7). In its 2020 Report and Accounts, Volta (page 4) noted “Although early in the COVID crisis, almost 20% of the overall USD CLO universe suffered a partial or total diversion of cashflows due to a breach of the Reinvestment Test. None of Volta’s CLO equity positions breached that test”. This number of market-wide cash diversions shows that the controls are effective in times of stress. We detail how Volta achieved its market-beating performance in the section below.

Other tests maintain that ongoing risk profile of SPV is within known parameters

- ▶ We show, in the section on *Lifecycle of a CLO* below, that, once a CLO has been created, there is a period when it is actively managed, with loans both bought and sold to optimise returns. Other tests are in place to ensure that the ongoing metrics of the CLO are within known parameters, rather than triggering a more draconian cash diversion, and these include:
  - The weighted average risk factor (WARF) is a numeric calculation, which applies scores to the different ratings of the assets in the portfolio. The overall average indicates the creditworthiness of the portfolio as a whole.
  - There are usually limits on the proportion of the SPV that can be held in higher-risk loans (e.g. a cap of 7.5% on CCC or lower-rated).
  - To ensure diversification, CLOs build in concentration limits typically to individual names (1%-2% normal cap) and sectors (typically 10%-12%).
  - There may be limits on factors like the percentage of a covenant-lite (cov-lite) portfolio or borrower size, in order to enhance the liquidity of the underlying assets. A cov-lite loan is a type of financing with fewer restrictions (covenants) on the borrower, and consequently fewer protections for the lender, and is often used in leveraged buyouts. The easing may be financial (e.g. interest cover), or it may be operational (e.g. on sales of subsidiaries).
  - A weighted average spread (WAS) must typically be maintained.
  - The weighted average life of the loans (WAL) is also typically limited.

## Volta Finance Limited

Less maturity mis-match, with interest and principal repayments from assets matching CLO liabilities

Assets backed by good-quality security

Creditworthiness shown by absence of any CLO investment-grade defaults over 2012-21...

...and losses under Fed stress test scenario were just 1/35<sup>th</sup> level of corporate loans

▶ While major corporations have highly sophisticated treasury functions to manage their debt, they need to finance large bullet repayments by either building cash balances in advance (with significant cash drag costs) or issuing new debt (into what may or may not be favourable markets). In a CLO, there is a clear alignment between the maturity of debt that it issues and the loan assets held within the SPV. It does not face the same maturity mis-match as a corporate, as the principal repayments are aligned to the CLO's own.

▶ The vast majority of the corporate loans are senior-secured (typically over 90%), with first liens over specified assets. Investors benefit because they are investing in a structure that is secured, with specific assets backing the debt. A typical corporate loan is a general claim against the borrower, and may not have specific income-generating assets assigned to it.

With diversification, credit enhancement and cash diversion mean that CLO debt has attractive risk characteristics compared with single company corporate credits, and this is not always reflected in the ratings, but it is in defaults. Athene noted, in its April 2022 report, *Understanding Structural Credit*, that there had been no defaults in investment-grade CLO debt in the previous decade (see chart below), and a BlackRock report projected that, using the Fed's bank holding company stress test scenario, investment-grade corporate loans would see projected losses of 7.0%, against 0.2% for CLOs.

### Historical credit impairments pre-/post-2008 by type



Source: Athene<sup>1</sup>, Hardman & Co Research

<sup>1</sup> The Athene report notes: Represents the average annual default rate of U.S. products for all categories, except CLOs. CLOs represent the average of US CLO trailing 12-month impairment rate. However, 2001-2010 CLO B impairments were based the average of Moody's trailing 12-month impairments rates from Feb 2010-Dec 2010 as 12-month impairment data was not available prior to Feb 2010. 2001 - 2010 includes a discounted buyback of a pre-GFC CLO tranche (current CLO documents prohibit such activity); the related CLO transaction performed as expected and repaid all of its debt at par with no underlying impairment. Source: Moody's Annual Default Study (February 2022). S&P Annual Global Structured Finance Default and Rating Transition Study (May 2021). Moody's Impairment and loss rates of Global CLOs (June 2021).

## Changes since the GFC

CLO market fundamentals different from during GFC, with changes including:

Fewer originate and distribute models, which did not align originators with CLOs

More robust investor base, including pension funds (from 6% of issuance in 2007 to 42% now)

Tightening in all aspects of regulation

The Global Financial Crisis (GFC) saw investor appetite for all structured credit vehicles, including CLOs, wane, even though the highest losses were concentrated in non-CLO vehicles. Since then, the overall CLO market has changed significantly, which should help sentiment. The main changes include:

- ▶ Before the GFC, a market feature was originate and distribute (often through securitisation) business models. In our view, this created a much greater moral hazard, as the originator of loans was not aligned with the end-investors, and, consequently, some asset classes had fundamentally weak asset-backing. CLOs invest in corporate debt that has been originated for real, fundamental reasons, and there is much more alignment between originators and investors.
- ▶ The investor base in CLOs is now much less incestuous, creating lower contagion risk. In 2007, 37% of securitisation debt was purchased by other securitisations and SPVs, and a further 28% by banks. This has changed fundamentally, not least due to regulation, but the portion of new issuances purchased by pension funds and insurers has increased from 6% in 2007 to over 42% today.
- ▶ The regulatory environment has been strengthened significantly. Changes have included higher capital requirements for banks and insurers, risk retention (in Europe, since 2010, CLO managers have had to hold 5% of the original value of the assets to ensure that their interests are aligned to the CLO), and the Volcker rules enacted in the US (which originally meant that banks were prohibited from purchasing the notes of any CLO that held any assets other than loans and cash equivalents). These latter were eased somewhat in 2020 (the details of which are summarised in the Loan Syndications and Trading Association [report](#)).

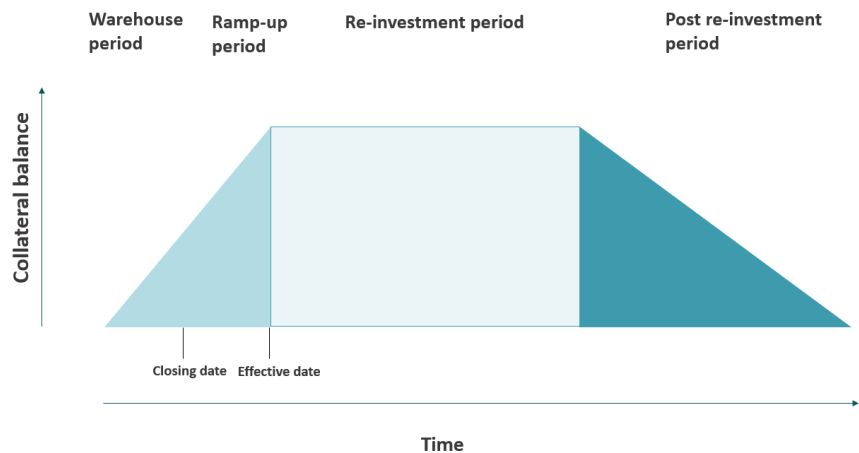
## Lifecycle of a CLO

Warehouse used to buy up to 40% of assets pre-CLO formation

Once active, a CLO can then trade assets to optimise returns

A typical lifecycle for a CLO is shown in the chart below. In the initial stages, the collateral manager acquires assets on behalf of the CLO, using a warehouse facility financed by a bank (Volta may provide capital at this stage). The warehouse stage may continue until ca.40% of the target portfolio has been bought. Once a closing date has been reached, loans previously warehoused are transferred to the CLO, and the CLO moves into the “ramp-up period”, when further assets are acquired. The size of the CLO is set shortly after. For a set period, the cash generated from borrowers may be re-invested in new loans, with the collateral manager trading assets on behalf of the CLO. This active management helps to maintain or improve the credit quality of the portfolio, and optimise returns. After a set period, the CLO goes into a wind-down phase, and any cash is no longer re-invested, but used to repay the CLO debts and, ultimately, the equity holders.

### Simplified example of CLO lifecycle



Source: Hardman & Co Research

## Characteristics of CLO equity vs. debt

Volta can invest in CLO equity and debt – so investors should appreciate opportunities from both

As noted above, CLOs give an end-investor a wide choice of risk/return options from low-yielding, low-risk debt, through higher risk tranches of loans to equity-like instruments. CLOs operate as financing companies: every quarter, the CLO receives income from the loan portfolio, pays the interest due on the financing and expenses, and also pays any remaining available cash (effectively, its post-loss funding margin) over time to investors in its equity. CLO equity can take the form of preference shares, income notes or subordinated bonds. In the section below, *How Volta exploits opportunities*, we show how its allocation between CLO equity and debt tranches has changed over time.

CLO equity sees:

Higher returns when defaults are low

Upside if the CLO debt can be re-priced when the underlying loans are not

Small benefit from rising rates

Default expectations remain low (and we expect Volta's portfolio to outperform the market)

Higher trading spreads than debt, with less liquidity

CLO equity gives investors a different risk profile. In particular:

- ▶ It sees the upside from CLO structures being more profitable than expected. Current credit losses are below those built into initial pricing assumptions, and it is the equity elements that capture this benefit. CLO equity bears the first risk of loss, and so is more sensitive to credit deterioration, should that happen.
- ▶ Market conditions have recently meant that CLO debt tranches can be re-financed at lower rates, improving the CLO profitability. This has been happening at a time when the underlying loan market has not seen re-pricing. The overall profitability of the CLO rises to the benefit of the equity holders. We explored this issue in detail in our notes, *Re-Set, Re-Fi, Re-Light my Fire* (published in May 2021) and *Yield (10%, covered and growing) + capital growth* (July 2021). For several years, the benefit has been 1%-1.5% incremental returns.
- ▶ The interest rate risk environment affects CLO equity investments in a number of ways:
  - The underlying floating-rate loans held by the CLOs should generate more income in a higher-rate environment, and, with up to 10% of SPV funding coming from non-interest rate equity, there is a small leverage gain.
  - As noted above, higher defaults will initially be borne by CLO equity. In our view, there will be only modest, company-specific defaults until short-term rates exceed 4% for a sustained period, at which stage the problems become more marketwide. Given that this is the level in many countries,



we are close to an important point of inflection. We, Volta and rating agencies believe that the whole market is expecting defaults to rise from their current very low levels (Volta *February factsheet* reports that “the rolling 12-month default rate increased by 0.2% (from 0.8% to 1%) in the US, while decreasing by 0.2% for European loans (from 0.4% to 0.2%)”. However, in our view, we are not yet at a point of stress-type losses. We note another point from Volta’s latest factsheet: “Current levels are significantly below the level projected by the rating agencies, with defaults expected to reach 2.5% to 4.5% for 2023. We are still being more constructive than that, and expect default rates to stay at the bottom of this range”. The relative outperformance by Volta is an important consideration.

- Re-financing activity triggered by rate moves can be mixed. Re-financing, which is beneficial to the underlying borrowers, is initially adverse for CLO equity holders, although re-sets, by extending the duration of cashflows, might see some long-term benefit. CLOs’ restructuring of their debt is generally beneficial to the equity holders, with improved terms/cheaper rates.
- The difference between one-month and three-month benchmark rates can be a short-term factor. A bigger gap is negative for CLO equity investors, as loan borrowers can typically opt to switch from three-month to one-month fixes, while CLOs’ liabilities typically do not have this flexibility, and continue to pay interest based on the three-month rate.
- ▶ The investment manager advises that the trading spreads on equity are somewhat higher (“normal trading: bid-ask spread is 0.2%-0.4% on best-quality debt, ranging up to 1%-1.5% on CLO equity; stress scenario 1%-2% and 4%-6%, respectively”).

## CLO opportunities in the real world

### Risk/reward optimisation

The different tranches of CLO debt mean that investors can select how much risk they want, and for what reward, from a portfolio of CLO securities with distinct risk/reward characteristics. It also creates arbitrage opportunities where specific tranches of loans might be mis-priced for the reasons identified in the section below.

### Mis-pricing opportunities in CLO market

In a world with perfect information and transparency, each tranche of CLO funding would price perfectly to reflect the risk in the underlying assets. In the real world, this is not the case, and we highlight below several potential sources of mis-pricing. We do not believe investors should be concerned about mis-pricing, although, for a trust using an MTM valuation, rather than mark-to-model, it introduced volatility to the reported NAV. In principle, the factors driving mis-pricing are identical to those of most other (non-CLO) investments, and they create the opportunities for Volta to earn superior returns.

### Sentiment to whole debt market

- ▶ Sentiment can be both positive and negative. For credit markets where there is an uncertain economic outlook, there could be a flight to safety, creating a potential investment opportunity where specific company risk is not priced in. If there is the view that retail is having a bad time, all retailers can be marked down.

## Volta Finance Limited

### Lack of understanding of specific credit risk

- ▶ The lack of understanding of a specific credit risk is often related to sentiment towards a broader sector or market. Investors need to appreciate both the probability of default and the degree of recovery in the event of default. In the CLO market, there are opportunities to identify CLOs that might do well in a challenging market.

### Rating constraints affect demand

- ▶ Rating constraints can distort some investor behaviours. Insurance companies generally cannot buy tranches below BBB, and this creates a mis-pricing between BBB and BB tranches. If investors try, for example, to anticipate a rating downgrade, significant pricing mis-matches might occur.

### Illiquidity premium

- ▶ As noted above, trading in many CLO instruments is generally thin, creating illiquidity-driven price opportunities. Non-mainstream elements of the market, like warehouse and capitalised manager vehicles, can offer a higher return, due partially to their illiquidity. It is also worth noting that illiquidity will affect different markets, to varying degrees, over time.

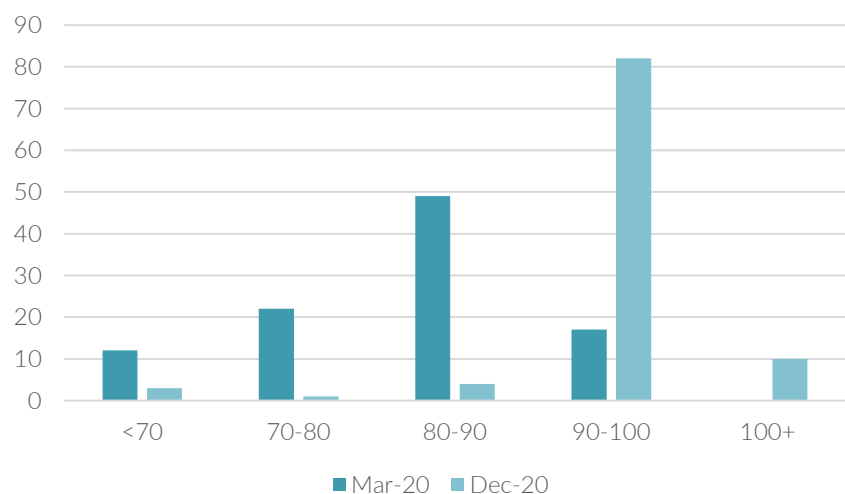
### Less price transparency

- ▶ There is less price transparency in private markets than in public ones. This can create adverse sentiment to Volta's own valuation in times of uncertainty. It can also create a double discount, with both the underlying assets trading at a discount to long-term value and then investors discounting Volta's NAV again. However, in terms of Volta making investments, the lower transparency creates opportunities.

### 2020 pricing shows how mis-pricing can be extreme in stress scenarios

These factors are most evident in periods of stress. As the chart below shows, in March 2020, on average, 83% of secondary market bids were at prices below 90% of par, but, by the year-end, this had fallen to just 8%.

Mix of US CLO secondary average bid price, Mar'20 and Mar'21 (%)



Source: Refinitiv, Hardman & Co Research

## How Volta exploits opportunities

Starting point is AXA-IM having the resources, expertise and experience to conduct in-depth due diligence

Volta’s investment approach is to optimise risk/reward through detailed analysis and market knowledge. The manager, AXA-IM, is a huge player in the structured markets, and has the resources to conduct due diligence in a way in which smaller players cannot. The time spent in understanding the extent to which the risks are credit, re-financing, illiquidity, structuring, interest rate or any other type of risk is critical to delivering its target returns. In addition to analysis, having AXA-IM as the manager gives Volta a competitive advantage in CLO documentation and deal structuring scrutiny (especially in the primary market).

Considers both top-down and bottom-up

Volta’s investment approach is both bottom-up and top-down. The type of assets it purchases, and the portfolio construction, are bottom-up, while selection of trades and specific ideas are top-down. When purchasing a CLO position in the secondary market, the company looks carefully to the underlying portfolio (with the focus on industry and name-by-name exposure).

Focus on manager selection

The focus is actively on CLO manager selection. Volta believes that part of what makes a good CLO manager is its ability to manoeuvre within the CLO constraints (and anticipating them). The fund manager spends considerable time on its due diligence and follow-up processes with CLO managers (in exactly the same way as a good fund manager behaves).

Volta typically a long-term investor, not a trader

Achieving such returns makes Volta typically a long-term investor, although, when the market is offering specific opportunities (say oil and gas stress in the US), it might purchase assets for the short run (i.e. a few quarters). It will only purchase assets that it would be comfortable holding for the long run. Trading is not a driver to performance, and we understand that the active sales of positions is normally 10%-20% of NAV, and the cost of churning the portfolio is very limited.

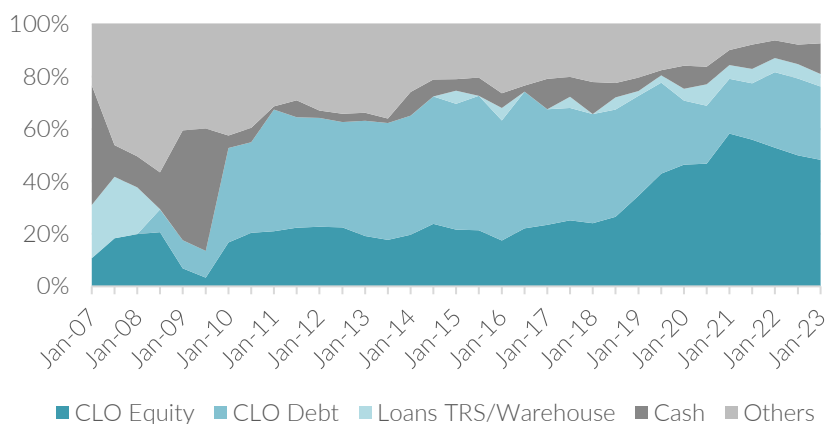
Evidence of superior performance is fewer cash diversion tests than the market

In our view, the proof of the pudding is in delivery in downside scenarios. As noted above, in the early stages of COVID-19, Volta’s investments did not see cash diversion tests triggered, while 20% of the US CLO market did.

### How the portfolio has evolved

The chart below shows how AXA-IM has managed the portfolio, most notably in 2019-21, by increasing the weight to equity positions (since reduced somewhat).

Volta’s portfolio mix by key asset categories, Jan’07 to Jan’23 (%)



Source: Refinitiv, Hardman & Co Research

## Type of borrower

There is a perception among some investors that CLO borrowers are, in some way, distressed or non-standard corporates. This is not the case. The chart below gives examples of some of the largest underlying borrowers currently in the Volta portfolio. The examples below show the household, mainstream nature of underlying borrowers. It is not in the interests of CLO managers to have problem accounts.

### Selection of largest underlying borrowers in Volta's portfolio (March 2023)



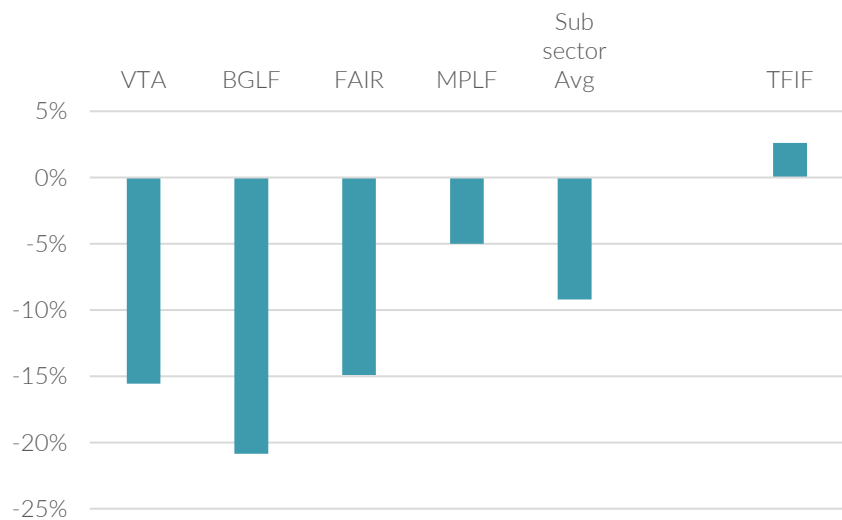
Source: Volta, Hardman & Co Research

# Valuation and financials

## Valuation

Given the historical performance, risk profile and portfolio mixes identified in previous reports, Volta's discount to NAV appears anomalous.

### 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 April 2023

## 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)	2016	2017	2018	2019	2020	2021	2022	2023E	2024E
Coupons and dividends received	34.7	33.2	38.5	42.0	39.4	41.8	42.9	45.0	42.6
Net gains on sales	2.7	3.1	0.0	0.5	(7.0)	2.7	(1.3)	-	-
<b>Net gain on fin. assets at FV through P/L</b>	<b>37.4</b>	<b>36.2</b>	<b>38.5</b>	<b>42.5</b>	<b>32.4</b>	<b>44.5</b>	<b>41.7</b>	<b>45.0</b>	<b>42.6</b>
Interest expense on repo	(0.9)	(1.1)	(1.4)	(1.6)	(0.8)	-	-	-	-
Net bank interest & charges	(0.1)	(0.1)	(0.1)	0.1	0.0	(0.0)	(0.0)	(0.0)	(0.0)
<b>Operating income</b>	<b>36.5</b>	<b>35.0</b>	<b>37.0</b>	<b>41.0</b>	<b>31.5</b>	<b>44.5</b>	<b>41.6</b>	<b>44.9</b>	<b>42.5</b>
Inv. manager fees	(4.3)	(4.6)	(4.6)	(4.4)	(3.6)	(3.3)	(3.9)	(3.4)	(3.6)
Inv. manager performance fees	(1.3)	(1.2)	(1.3)	(2.1)	(0.6)	(4.6)	(3.0)	(4.4)	(3.6)
Directors' remuneration & expenses	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)	(0.3)	(0.4)	(0.4)	(0.4)
Other expenses	(0.9)	(0.8)	(0.9)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Total expenses	(7.2)	(7.0)	(7.3)	(8.0)	(5.7)	(9.3)	(8.3)	(9.2)	(8.6)
<b>Profit and total comp. income</b>	<b>29.3</b>	<b>28.0</b>	<b>29.7</b>	<b>32.9</b>	<b>25.8</b>	<b>35.2</b>	<b>33.4</b>	<b>35.8</b>	<b>33.9</b>
<b>Adjusted EPS (€)</b>	<b>0.80</b>	<b>0.77</b>	<b>0.81</b>	<b>0.90</b>	<b>0.71</b>	<b>0.96</b>	<b>0.91</b>	<b>0.98</b>	<b>0.93</b>
<b>Dividend cover (x)</b>	<b>1.29</b>	<b>1.24</b>	<b>1.31</b>	<b>1.45</b>	<b>1.36</b>	<b>1.85</b>	<b>1.49</b>	<b>1.66</b>	<b>1.53</b>

Source: Volta, Hardman & Co Research

## Glossary

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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