EDISON

Volta Finance

Shift towards CLO equity ahead of cycle turn

Investment companies

9 May 2019

Volta's NAV TR performance in recent months was influenced by weaker market sentiment towards the end of 2018, which (despite the subsequent rebound) translated into a marginal (c 1%) negative return in H119 ending on 31 January. Returns in February and March were mildly positive, bringing the ytd performance to 4.0%. Importantly, the cash flows generated by Volta's portfolio remain strong. Moreover, AXA IM used the recent increase in market volatility to deploy the rest of Volta's dry powder and increase its exposure to CLO equity tranches at attractive prices ahead of any potential turn in the credit cycle.

12 months ending	Total share price return (%)	Total NAV return (%)	S&P Leveraged Loan (TR, %)	S&P Euro Leveraged Loan (TR, %)	Credit Suisse Leveraged Loan Index (TR, %)
31/03/15	17.4	15.0	31.6	7.3	32.0
31/03/16	(6.5)	(1.3)	(6.9)	1.8	(6.8)
31/03/17	29.2	23.4	16.9	5.4	16.8
31/03/18	5.7	3.5	(9.2)	3.3	(8.9)
31/03/19	7.2	3.7	12.8	2.3	13.2

Source: Thomson Reuters Datastream

Investment strategy: Active approach to credit cycle

Volta aims to provide a stable quarterly dividend stream based on a diversified portfolio of structured finance assets, in particular CLO debt and equity tranches which made up c 83% of the fund's portfolio at end-March 2019. The dividend payments are currently well covered by interest and coupons from underlying assets, which reached €19.6m on a six-month trailing basis at end-March 2019. AXA IM follows an active approach to the credit cycle and seized the opportunity to deploy the remaining cash during the recent market downturn (it is now fully invested), sourcing new investments with projected IRR of 12.7% in H119. At end-March 2019, CLO equity tranches (including capitalised manager vehicles and warehouses) made up 43.3% of Volta's portfolio, compared to 24.0% a year ago.

Market outlook: Default rates remain low for now

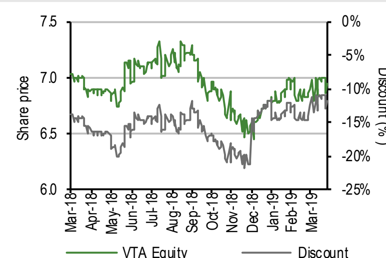
The recent deterioration in market sentiment resulted in an increase in credit spreads (affecting the market prices of CLO tranches), although the spike was partially reversed this year. Corporate default rates remain close to historical lows, assisting cash flows from underlying loan pools. However, this is accompanied by a weakening quality of loan collateral (with the share of covenant-lite loans as high as c 80%). In this context, a good selection of CLO managers (on top of market timing and exercising CLO control measures) remains an important factor determining future returns.

Valuation: Offering a c 8.9% dividend yield

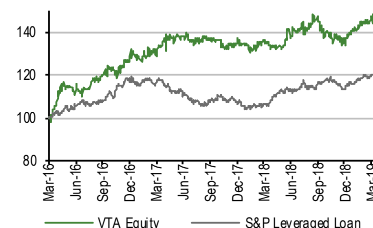
At 7 May 2019, Volta's shares traded at a 12% discount to last reported NAV (as at end-March 2019). The fund has consistently delivered a dividend per share of €0.60–0.62 pa and offers a c 8.9% dividend yield.

Price	**€6.98**
Market cap	**€255m**
NAV	**€288m**
NAV per share	€7.87
Discount to NAV	11.7%
Yield	8.9%
Ordinary shares in issue	36.6m
Code	VTA
Primary exchange	AEX
AIC sector	Specialist Debt
Benchmark	N/A

Share price/discount performance



Three-year performance vs index



52-week high/low	€7.27	€6.56
NAV high/low	€8.46	€7.71

Gearing

Gross*	13%
Net*	18%

*As at March 2019. Net higher than gross due to negative cash.

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Exhibit 1: Volta Finance at a glance

Investment objective and fund background

Volta Finance was established in December 2006 and its investment objective is to preserve capital across the credit cycle and provide a stable income stream to its shareholders through investment in a diversified portfolio of structured finance assets providing leveraged exposure to portfolios composed of a broad range of cash-generative debt assets.

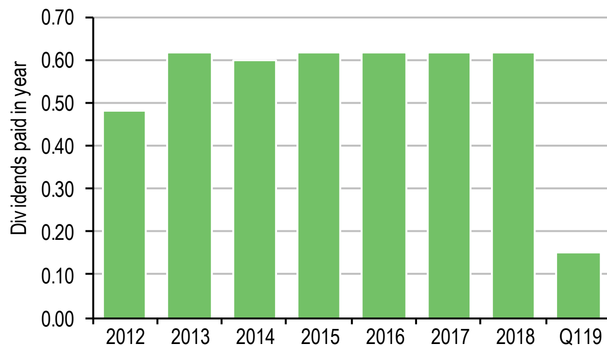
Recent developments

- 23 April 2019: March NAV at €7.87 per share.
- 8 April 2019: H119 interim report – NAV at €291m, €7.95 per share as at end-January 2019.
- 5 April 2019: Change in Directors' remuneration – payment in shares repurchased from market instead of newly issued.
- 7 March 2019: Interim dividend paid (ex-div date) at €0.15 per share.

Forthcoming		Capital structure		Fund details	
AGM	Late 2019	Ongoing charges	1.9%	Group	None
Interim results	N/A	Net gearing	18%	Manager	AXA Investment Managers
Year end	31 July	Annual mgmt fee	1.5%*	Address	BNP Paribas House, St Julian's Avenue, St Peter Port, Guernsey GY1 1WA, Channel Islands
Dividend paid	May 2019	Performance fee	20%*		
Launch date	December 2006	Company life	Indefinite	Phone	+44 (0)1481 750800
Continuation vote	None	Loan facilities	€40m (repo)	Website	http://www.voltafinance.com

Dividend policy and history (financial years)

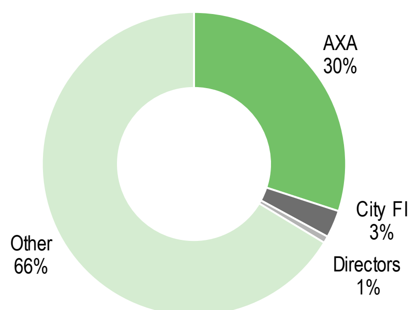
Volta aims at stable dividend distribution to its shareholders. Since 2013, the company maintains DPS at an annual level of €0.60–0.62, which has been distributed quarterly since 2016. Dividend declarations usually occur in February, May, August and October and the payments are made in subsequent month.



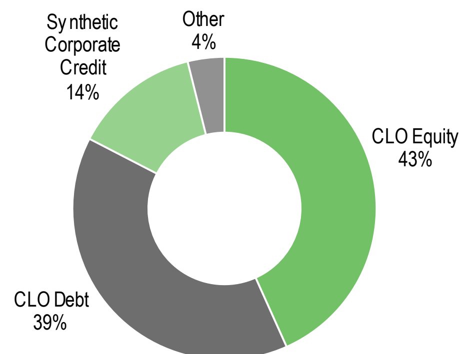
Share buyback policy and history

The company has not executed a buyback programme since launch. In the past Volta appointed Kepler to facilitate liquidity on the company's shares with a €250k liquidity account provided by and at the risk of Volta. The contract lasted five quarters in 2012/2013.

Shareholder base (as at 30 April 2019)



Portfolio exposure by instrument (as at March 2019)



Top 10 holdings (as at February 2019)

			Portfolio weight %	
Instrument	**Asset Class**	**Manager**	**March 2019**	**March 2018**
Dryden 2018-70 Subord B	CLO equity	PGIM	4.0%	-
Bilbao II Equity S-1	CLO equity	Guggenheim	3.9%	-
Voya 2018-3 Class I Sub notes	CLO equity	Voya	3.2%	-
Wind River 2019-1 SUB_I	CLO equity	THL	3.2%	-
CMV 1	CMV	Global CLO Manager	2.9%	1.6%
St Bernard Opportunity Fund I	ABS Debt	AXA	2.7%	2.3%
Bank Deleveraging Opportunity Fund	Synthetic	AXA	2.7%	4.1%
Mountain View 2017-1 - Class E	CLO Debt	Seix	2.4%	2.2%
BBS 2017-1	BBS	European Bank	2.3%	2.2%
BBS 2017-2	BBS	European Bank	2.2%	1.9%
Top 10 (% of holdings)			**29.5%**	**23.1%**

Source Volta Finance, Refinitiv, Edison Investment Research. Note: *Please see the 'Capital structure and fees' section for further details.

Fund profile: Leveraged exposure to corporate debt

Volta Finance is an investment fund registered in Guernsey and listed on both the Euronext Amsterdam Stock Exchange and LSE Main Market. The fund aims at preserving capital across the credit cycle and delivering a stable quarterly dividend stream through investing in a diversified portfolio of structured finance assets, which provide leveraged exposure to portfolios composed of a broad range of cash-generative debt assets. These include corporate loans, sovereign and quasi-sovereign debt, residential and commercial mortgage loans, automobile loans, student loans, credit card receivables, leases, as well as debt and equity interests in infrastructure projects. However, more than 90% of Volta's current exposure represents corporate debt. Importantly, Volta's exposure to second-lien loans is capped at 10% of gross asset value (GAV).

Volta does not declare a particular target return pa, but has highlighted in its monthly reports back in 2016 that it aimed at a return of 9–11% pa (although it also added that this was only an indicative target for information purposes only). This is confirmed by the recent statements of the investment manager in the FY18 and H119 reports, that Volta was able to source investment opportunities in line with target levels at a projected yield of 11.2% and 12.7%, respectively. To achieve its investment goals, Volta is primarily investing in CLOs, synthetic and cash corporate credit and asset-backed securities (ABS). For an in-depth description of the structured finance instruments in Volta's portfolio see our initiation note.

The fund manager: AXA IM

The manager's view: Harvesting the volatility

For the next six-month period ending July 2019, AXA IM remains optimistic that Volta should deliver returns at or above target. This should be driven mainly by ongoing cash flows generated by assets as well as some appreciation on portfolio components given that current asset prices in Volta's portfolio are visibly below par. Although the investment manager acknowledges that we are most likely approaching the end of the credit and economic cycle, it does not foresee any significant deterioration in the coming quarters. Potential risk factors that could translate into higher volatility include US administration, the continuous increase in corporate debt and the difficulty in finalising the Brexit deal. However, AXA IM does not expect a disorderly Brexit to translate into material losses for Volta, as currently its exposure to UK market is limited to 6% of underlying credits.

Volta's performance should be assisted by: 1) high portfolio diversification (more than 700 underlying corporate credit issuers); 2) a healthy level of cash flows from currently held assets, which may be reinvested at discounted prices in the event of increased market volatility; and 3) a combination of long-term assets that may be held throughout the whole credit cycle (CLO equity tranches with long reinvestment periods) and short-term, liquid positions (eg some of the CLO debt tranches). AXA IM also notes that maturity and credit curves are very steep (the same rating assets are yielding far more with a long maturity than with a mid- to short-term maturity), which illustrates the high level of investor caution with respect to capital deployment. This limits the risk of an extreme rise in volatility and encourages AXA IM to deploy cash at depressed prices. As at end-March 2019, Volta is fully invested.

Strategically, AXA IM intends to continue increasing the CLO equity bucket and correspondingly to decrease the CLO debt bucket over the next six months. With the expected decrease of the CLO debt bucket, AXA IM might also further reduce the leverage in place on CLO debt tranches at some point. In aggregate, the investment manager will target a reduction in the number of positions, favouring 'controlling positions' to increase the value that can be added from deal restructuring (refinancing/resetting/calls/repackaging). CLO warehousing transactions are part of this strategy.

Market outlook: Lower prices create opportunities

Global markets experienced elevated volatility in recent months, both in equity and credit markets, and also translated into lower valuations of structured finance instruments. The spreads on US AAA debt tranches widened to a two-year high of 138bp in February and remained at similar levels in March, according to Refinitiv. However, the levels seem to be acceptable for equity tranche investors, as there are still CLOs being set up with US$39.4bn sold ytd until 19 April in the US, which is even slightly ahead of the US$38.7bn in the same period of 2018. On the back of recent issues, the US CLO market crossed the record-high US$600bn mark. At the same time, the wider spreads dampened the refinancing and reset volume (Q119: US$9.1bn, -71% y-o-y).

However, concerns around a slowing economy and political turmoil were not accompanied by higher corporate default rates, which have remained at low levels over the last 12 months in both the US and the European loan markets. According to Moody's, the default rate in advanced economies fell to 1.6% in 2018 from 2.3% in 2017. This creates an opportunity to invest in CLOs at lower prices to facilitate par building while retaining the solid cash flow profile of the portfolio. Nevertheless, we are wary that we may be approaching the end of the credit cycle and at some stage default rates are likely to increase. Some assurance in the future performance of Volta's assets is provided by the fact that projected returns and valuations assume default rates at 2% pa, which have not been seen in the portfolio over the last 10 years, and that Volta's positions experienced default rates below the market average on an LTM basis.

Although the Q418 uptick in credit spreads was rapid and led to some disruptions in the market (eg difficulties in converting some of the warehouses into CLOs), they remain at historically low levels. US high-yield credit spreads reached a local peak at 535bp (523bp in Europe) at the beginning of 2019 (visibly below peak levels from early 2016) and have been narrowing recently. Currently, high-yield credit spreads stand at around 375bp in the US, and 363bp in Europe. Even though we acknowledge that high-yield bond spreads may exhibit some differences versus corporate loan spreads (which are relevant to the structured finance products in which Volta invests), we still believe that they are a good illustration of the general trends in the credit markets.

Exhibit 2: BofAML US high-yield credit spread

Source: Refinitiv

Exhibit 3: BofAML Euro high-yield credit spread

Source: Refinitiv

According to Moody's, LTM default rates in the US high-yield debt area are expected to reach 3.4% by the end of 2019 from 2.8% in December 2018. This is still a relatively moderate level if we compare it with over 5% in 2017. The rating agency expects that by end-2019, default rates in both Europe and the US could post the largest percentage point increase over a three-month span since late 2015, which could lead to a visible increase in corporate credit spreads and in turn put pressure on CLO equity valuations. Still, as long as default rates remain relatively constrained, the widening spreads on underlying loan collateral should improve cash flows distributed to CLO equity tranches.

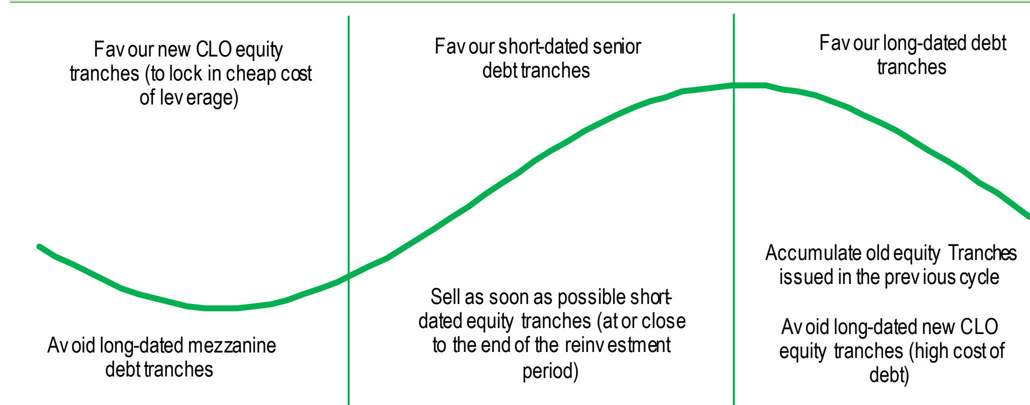
Having said that, we believe that one of the reasons behind the historically low default rates may be the high proportion of covenant-lite loans (currently c 80% of leveraged loans in the US according to S&P), of which only a small part is maturing over the next 2-3 years. This translates into a limited number of technical defaults at the moment. However, the low covenant protection may at the same time translate into lower credit quality of these loans. If they mature in an economic downturn, this may lead to lower recovery rates (as discussed in detail in our initiation note). The quality of the collateral can also be challenged by high demand for CLOs as 50% of the US$1.2tn leveraged loan market in the US is already packed into CLOs, based on Refinitiv estimates.

Asset allocation

Investment process: Active approach to the credit cycle

AXA IM's focus is on long-term value investments to provide consistent excess returns with special emphasis on income generation and capital preservation. It aims at identifying opportunities based on constant reassessment of the relative value across the CLO capital structure. The fund manager's active portfolio approach is presented in Exhibit 4. Investment decisions are aligned with the respective phases of the credit market cycle. During an expansion phase, characterised by low debt cost (and thus low CLO debt spreads), AXA IM aims to lock in the cheap cost of leverage through investing in new CLO equity tranches, while at the same time avoiding mezzanine debt tranches with long maturities, as these offer limited returns (due to low spreads) while exposing the investor to a higher risk. Once the expansion phase nears its end, AXA IM's emphasis gradually shifts to safer, short-dated senior debt tranches and away from short-dated equity tranches at or close to the end of the reinvestment period (when the collateral pool becomes static and the CLO manager is not able to reinvest cash into new, more attractively priced loans). Finally, during a market downturn, AXA IM favours debt tranches with longer maturities and is progressively accumulating old equity tranches issued during the prior cycle at attractively low CLO debt spreads, while avoiding long-dated CLO equity tranches due to the high cost of debt embedded in them. At the bottom of the cycle and as market conditions improve, AXA IM will increase its exposure to mezzanine debt tranches.

Exhibit 4: AXA IM's active investment approach throughout the credit market cycle



Source: AXA IM

AXA IM targets an alpha at around 4pp pa from investments in CLO equity tranches, which compares with an average actual alpha at 5pp for the US$ CLO equity tranches 2001–2007. It intends to achieve this based on a number of competitive advantages, including: 1) the ability to negotiate better deal terms with arranging banks and CLO managers through its strong relationships and scale of operations; 2) a well-defined process for selecting a diversified pool of top-performing US and European CLO managers; and 3) leveraging its majority investor position to

decide on the optimal exit strategy (call, amortisation or sale), as well as to control the manager replacement rights.

Current portfolio positioning

Volta's gross asset value (GAV) at end-March 2019 stood at €326.3m, of which around 83% was invested in CLOs, including 39.3% in debt tranches and 43.3% in equity tranches including capitalised manager vehicles (CMVs) (see Exhibit 5).

Exhibit 5: Portfolio GAV breakdown

	Portfolio end-Mar 2019 (€m)	Structure end-Mar 2019	Portfolio end-Mar 2018 (€m)	Structure end-Mar 2018	Change (€m)	Change (pp)
CLO	**269.3**	**82.5%**	**231.5**	**67.6%**	**37.9**	**15.0**
US$ equity	70.5	21.6%	31.8	9.3%	38.7	12.3
EUR equity	61.3	18.8%	40.7	11.9%	20.7	6.9
US$ debt	127.3	39.0%	141.6	41.3%	-14.4	-2.3
EUR debt	1.0	0.3%	7.8	2.3%	-6.8	-2.0
CMV	9.5	2.9%	5.4	1.6%	4.0	1.3
Warehouse	0.0	0.0%	4.1	1.2%	-4.1	-1.2
Synthetic Corporate Credit	**44.2**	**13.5%**	**52.6**	**15.3%**	**-8.4**	**-1.8**
BBS transactions	44.2	13.5%	52.6	15.3%	-8.4	-1.8
Cash Corporate Credit	**8.0**	**2.5%**	**9.1**	**2.6%**	**-1.0**	**-0.2**
Equity	8.0	2.5%	9.1	2.6%	-1.0	-0.2
ABS	**18.0**	**5.5%**	**15.8**	**4.6%**	**2.2**	**0.9**
Residual positions	9.1	2.8%	7.9	2.3%	1.2	0.5
Debt	8.8	2.7%	7.9	2.3%	0.9	0.4
Cash	**-13.3**	**-4.1%**	**33.7**	**9.8%**	**-46.9**	**-13.9**
GAV	**326.3**	**100.0%**	**342.6**	**100.0%**	**-16.3**	**-**

Source: Volta Finance, Edison Investment Research. Note: Subtotals do not sum up due to rounding.

Volta's recent portfolio developments are an illustration of the consistent execution of its strategy, aimed at locking in cheap cost of leverage in new long-dated CLO equity issuances (2017–2019 vintages now represent c 64% of the CLO portfolio), and by taking advantage of the lower prices of existing CLO equity tranches following the recent market downturn. It is important to note that equity tranches which underperform when the market turns are normally those with short maturities, facing the risk of redemption in unfavourable market conditions. At the same time, those with longer maturities can profit on deal restructuring (refinancing/resetting/calls/repackaging) by reinvesting in loans at lower prices.

Consequently, Volta's exposure to CLO equity (including warehouses and CMVs) increased greatly by 19.3pp from 24.0% at end-March 2018 to an all-time high of 43.3% at end-March 2019 (see Exhibit 6) vs an average post-crisis allocation of 25.1%. Volta is currently fully invested compared to 10% of GAV held in cash a year ago, and a five-year average cash position of 6%.

At the same time, the allocation to CLO debt went down moderately by 4.3pp to 39.3%. This was accompanied by Volta downsizing its credit facility (used to enhance returns in the CLO debt bucket) to €40m from €50m in March 2019. Importantly, Volta's EUR CLO debt bucket is now close to zero as it has reduced its position since the EU referendum in 2016 (12% of portfolio in June 2016). Although Volta expects to further increase the CLO equity bucket, it does not intend to completely replace the CLO debt bucket with equity positions.

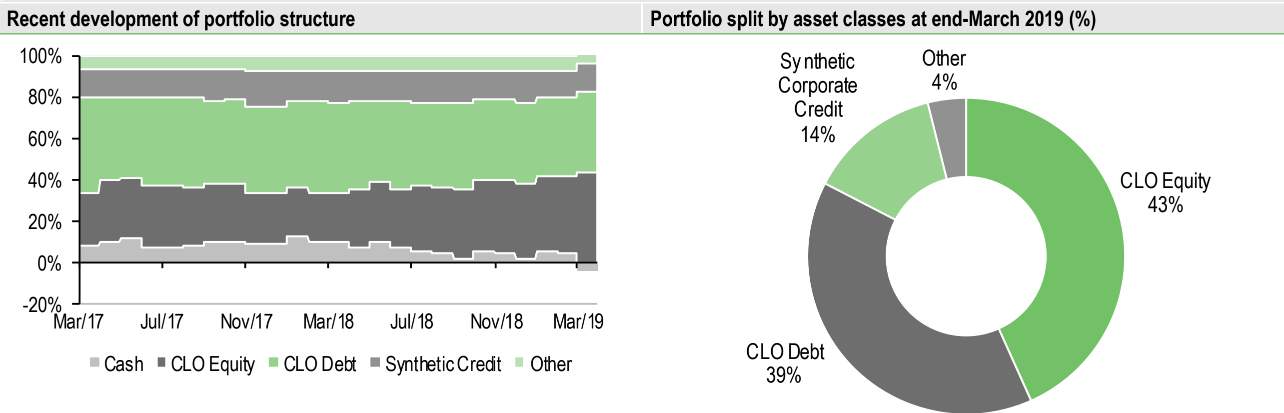
Volta presents its portfolio on a trade date basis and due to transactions concluded in March that were settled in April, it showed a negative cash position at the reporting date. We believe that the settlements were financed by a combination of cash inflows from coupons/interest and some investment disposals.

We have also examined Volta's developments in the higher-risk CLO warehouse bucket. Since July 2018, Volta has successfully closed four CLO warehouses, which were able to deploy capital at depressed loan prices in late 2018 and resulted in an attractive IRR in the range of 14-27%. At the same time, Volta was able to avoid involvement in warehouses that invested at elevated prices and,

amid the market downturn, faced difficulties converting into CLOs due to a gap between the yield expectations of CLO investors and the spread on the underlying loan pool. As at end-March 2019, Volta had exposure to one CLO warehouse, but this had already been priced (being thus free of credit risk) and categorized as CLO equity. This warehouse should yield an IRR at 25–30% (final return to be confirmed post settlement in April). Even if these investments are usually short-dated and represent a small part of Volta's portfolio, we believe it is worth noting Volta's expertise in appropriate management of these positions.

Exhibit 6: Volta's exposure – debt vs equity tranches

Recent development of portfolio structure | **Portfolio split by asset classes at end-March 2019 (%)**

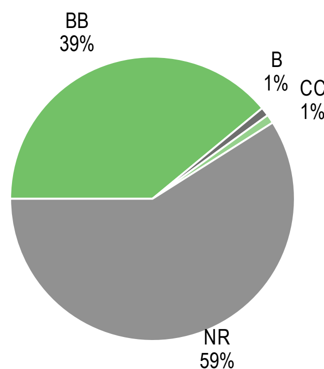


Source: Volta Finance, Edison Investment Research. Note: Equity exposure includes CLO equity tranches, but also warehousing investments and CMVs, which predominantly offer exposure to equity tranches.

The fund's portfolio remains highly diversified across borrowers and sectors. Its top 10 underlying exposures (making up only 3.7% of Volta's NAV according to the latest available data at end-February 2019) come from eight different sectors, while Volta's largest exposure to a single security equals 4.0% of GAV as at end-March 2019.

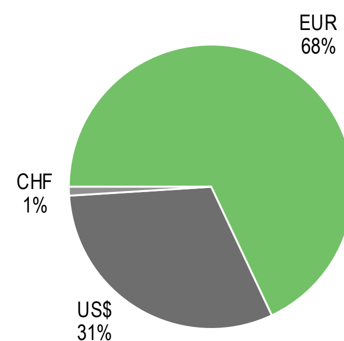
As Volta invests in CLOs issued in Europe and in the US, it has a considerable exposure to the US dollar, with c 65% of its GAV representing US securities at end-February 2018. The currency position is only partially hedged, leaving the fund with a residual US dollar exposure of 31% (see Exhibit 8). Volta intentionally does not fully hedge US$ exposure to limit the liquidity required to fund potential margin calls. Since inception, the overall FX impact on Volta's performance has been modest, given the historical pattern of the euro/US dollar rate reverting to the mean.

Exhibit 7: Volta's direct investments by rating breakdown*



Source: Volta Finance, Edison Investment Research. Note: Latest data available at end-February 2019.

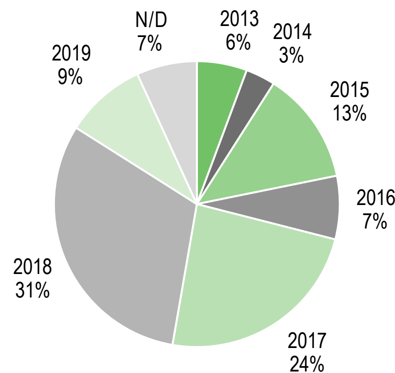
Exhibit 8: Residual currency exposure (after hedging) % of NAV*



Source: Volta Finance, Edison Investment Research. Note: Latest data available at end-February 2019.

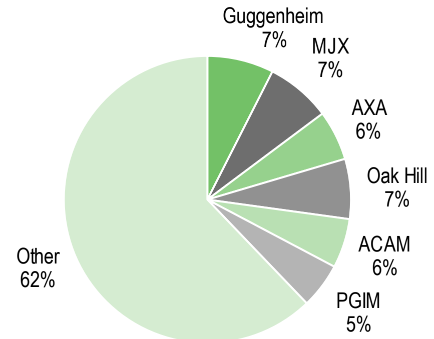
Volta's diversification in terms of CLO managers in its portfolio also remains relatively high (see Exhibit 10), allowing for lower concentration risk (most notably lower collateral overlap) and providing AXA IM with more flexibility to pursue its active approach to the credit cycle.

Exhibit 9: Volta's CLO portfolio by vintage



Source: Volta Finance, Edison Investment Research

Exhibit 10: Volta's CLO portfolio by manager



Source: Volta Finance, Edison Investment Research

Even though the value of CLO tranches is subject to the mark-to-market approach, CLOs do not have embedded triggers that would force the investor in the case of an internal test breach resulting from lower market value of the underlying collateral to conduct a 'fire sale' or inject additional capital to improve the collateral. Nevertheless, if the financial performance of underlying borrowers deteriorates (translating into an increased default rate), Volta's cash inflows will be impaired as well. In a recessionary environment, US default rates have gone from a long-term average of 3% up to 8% or even 10%. In valuing its CLO tranches, Volta assumes an average default rate of 2%. In Exhibit 11, we present scenarios of company estimations of GAV change with a default rate hike to 3% and 4%.

Exhibit 11: Sensitivity of GAV on assumed default rates as at January 2019

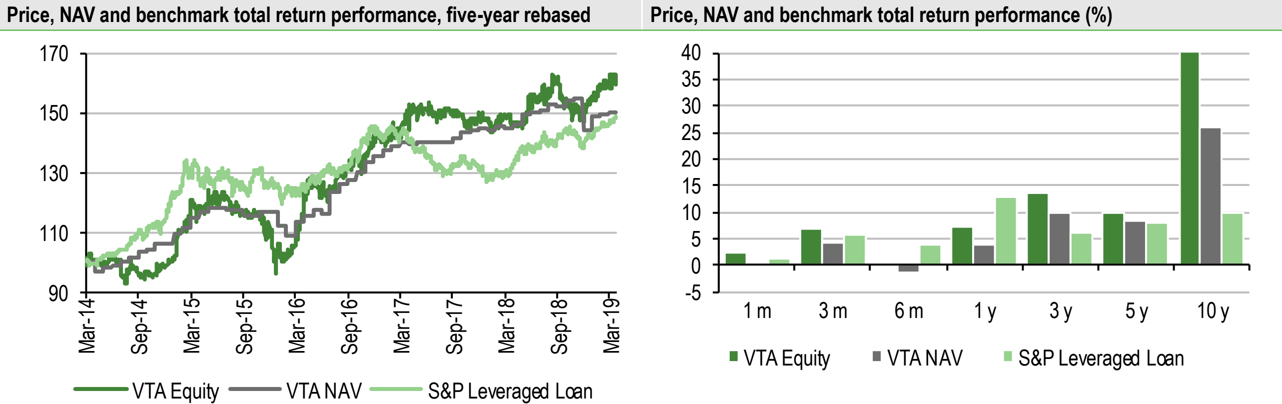
		Default rate of 3%		Default rate of 4%	
	% of GAV	Price impact	GAV impact	Price impact	GAV impact
US$ CLO equity	17.3	(11.0%)	(1.9%)	(22.8%)	(3.9%)
EUR CLO equity	14.2	(7.3%)	(1.0%)	(16.3%)	(2.3%)
US$ CLO debt	37.6	0.0%	0.0%	0.0%	0.0%
EUR CLO debt	0.0	0.0%	0.0%	0.0%	0.0%

Source: Volta Finance

Performance: 5-year NAV returns ahead of benchmark

Over the last 10 years, coinciding with the culmination of the financial crisis, Volta's shares achieved an average annual total return (TR) of 43.6% (see Exhibit 12), while its five-year performance shows a more normalised rate of return at 10.0% pa, according to our calculations. We also estimate Volta's five-year NAV TR performance at 8.5% per year, which is above our selected benchmark of 7.9% pa.

Exhibit 12: Volta Finance's performance to 29 March 2019

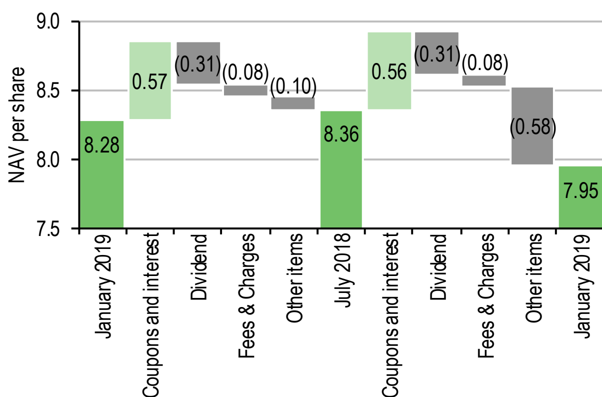


Source: Thomson Datastream, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Volta's NAV TR in H119 (until end-January 2019) was -1.2%, while the slight compression in discount translated into a minor positive share price total return at 0.2%. However, it must be noted that the negative result is mostly attributable to unrealized losses (which contributed -6.6pp to the NAV performance), while the net loss on closed transactions had an effect of just -0.4pp. This was largely offset by coupon/interest inflows (with a 6.7pp positive impact on NAV performance). The ongoing charges were in line with previous years, reducing NAV by c 0.9pp in H119.

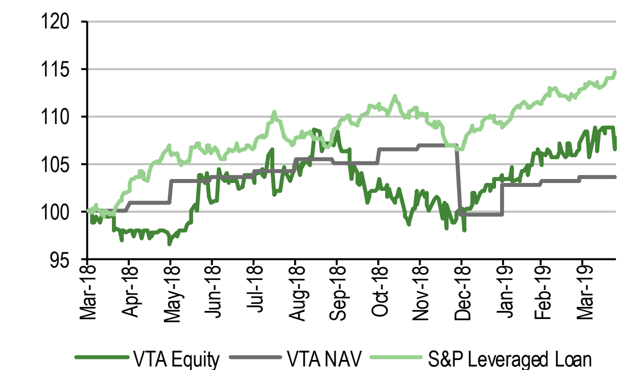
As at end-March 2019, Volta's ytd NAV TR performance was 4.0%, including €0.15 DPS paid in March. This was predominantly driven by CLO debt tranches, which posted a ytd return of 5.1% (we estimate c 1.9pp contribution to the ytd NAV performance) and CLO equity tranches at 3.9% (estimated contribution of c 1.3pp), particularly on the back of the January rebound. Bank balance sheet transactions, which are the only main asset class valued using in-house models (rather than the mark-to-market approach), posted a ytd return of 2.9% and contributed c 0.4pp to total ytd NAV performance (Edison estimate). Volta's LTM NAV TR as at end-March 2019 was positive at 3.7%, but below the LTM TR of the S&P Leveraged Loan Index at 12.8% (see Exhibit 14).

Exhibit 13: One-year NAV per share performance



Source: Volta Finance

Exhibit 14: One-year NAV and share price performance against S&P Leveraged Loan Index



Source: Volta Finance, Refinitiv

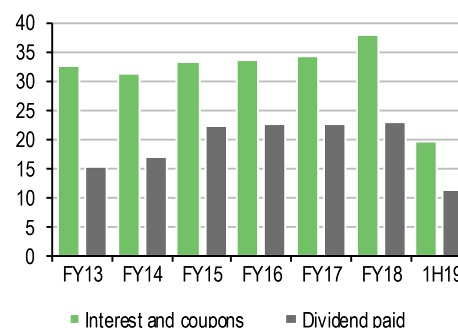
When examining Volta's NAV performance, it is important to distinguish between the negative impact from mark-to-market of asset prices and the fund's ability to generate a continued strong level of cash flows from the underlying loan pool. In recent months, these cash flows increased considerably, reaching c €19.6m on a six-month trailing basis (see Exhibit 15), mainly on the back of higher coupons from CLO positions (both debt and equity). Interestingly, underlying loan spreads widened for the first time in recent years, improving the cash distributions to CLO equity tranches held by Volta. The solid inflows were subsequently used to distribute dividends and deploy capital,

at more attractive market valuations. Volta's dividend payout is well covered from a recurring cash flow perspective, in line with prior periods (see Exhibit 16).

Exhibit 15: Six-month trailing inflow from interest and coupons* (€m)

Source: Volta Finance. Note: *Net of repo costs.

Exhibit 16: Cash inflow from interest and coupons and dividends paid (€m)



Source: Volta Finance, Edison Investment Research

As the negative price performance of CLO tranches was not accompanied by deteriorating credit quality, Volta seized the opportunity to source investments at an average projected IRR of 12.7% in H119. Importantly, as the US$ CLO debt bucket (which represented 39% of Volta's assets as at end-March 2019) was priced at 96% of par on average, future performance may be assisted by pull to par. Consequently, Volta estimates its projected returns at portfolio level at 12.5% pa, which is above the 10.8% pa in July 2018. This already accounts for the fact that part of Volta's CLO debt investments are leveraged, which is expected to improve the projected yield of the whole portfolio by 0.8pp. After accounting for financing/hedging costs and ongoing charges, we estimate that all the above may translate into a NAV TR of c 10% pa. An additional return of 1-2pp may come from active trading in the portfolio, according to AXA IM.

Exhibit 17: Projected IRR on Volta's portfolio asset classes at end-January 2019

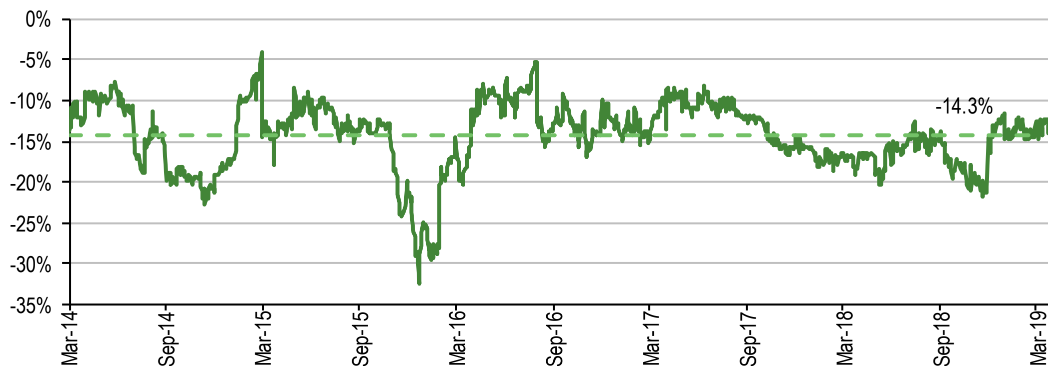
Asset Class	%GAV	Projected IRR	Price Jan-19	Price Jul-18
US$ CLO equity	17.4%	14.3%	77%	73%
EUR CLO equity	14.5%	18.2%	72%	80%
US$ CLO debt	38.0%	9.8%	93%	100%
CMV/CLO warehouses	4.6%	15.0%	95%	99%
Bank balance sheet trans.	12.8%	11.1%	90%	96%
Cash corp. credit	2.4%	8.0%	69%	N/A
ABS	5.2%	10.5%	91%*	N/A
Total	**94.9%****	**11.8%*****		**-**

Source: Volta Finance, Edison Investment Research. Note: *Average. Residual positions priced at 81%, debt tranches at 101%. **Remaining c 5% represents Volta's cash position at end-January 2019. ***Excluding the impact of leverage.

Discount: Trading at a low-double digit discount

Volta's shares have traded at a visible discount to NAV over the last few years (usually in the range of 5–20%, see Exhibit 18). Currently, the shares trade at a c 12% discount, close to the five-year average discount of c 14%. We believe this may be to some extent the result of the relatively low stock liquidity, overall investor caution over structured finance investments and inherent uncertainty related to the valuation of some portfolio holdings.

Exhibit 18: Share price discount to NAV over five years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

The investment manager is entitled to a management fee paid in semi-annual intervals, which on an annualised basis is equal to 1.5% of NAV up to €300m and 1.0% per year beyond this amount (the last reported NAV stood at €287.8m as at end-March 2019). The management fee is subject to reduction with respect to investments in products managed by AXA IM (10.2% of Volta's NAV as at end-March 2019) to avoid double charging. The investment manager also receives a performance fee calculated as 20% of NAV outperformance over a hurdle rate of 8% in any financial year, subject to an absolute high-water mark and a cap of 4.99% of NAV. Over the last five years, recurring ongoing charges (including a management fee but excluding a performance fee) were broadly stable at around €5.0–5.7m per year, which represented c 1.8–1.9% of NAV. Ongoing charges on an LTM basis were in line with this and amounted to €5.8m, and represented 1.9% of average NAV. The investment manager has not been entitled to a performance fee since FY17. Directors' remuneration amounted to c €0.5m per year, of which 30% is payable in shares (new issues until April 2019; in the future, this will be based on shares repurchased from the market). Volta has a perpetual life and there is no defined timing of continuation votes.

As per Volta's investment policy, its portfolio investments may be levered up to 95% with the exception of residual positions, where the leverage cap is set at 30%. Volta's actual leverage level stood at c 12% of GAV at end-March 2019 (enhancing its returns) and represents the loan financing received under a repurchase agreement with Société Générale for €40m (reduced from €50m in March 2019). The debt bears an interest rate of Libor 3M +1.5% and is secured against a portfolio of US$ CLO debt securities. The repo is overcollateralized (on the last reporting date in January 2019, the €50m was secured against assets with market value of €78.9m and final maturity in December 2022). The agreement may be terminated by either party, with repayment becoming due within one year (in three equal installments after six, nine and 12 months).

Moreover, Volta has several funding commitments on its current portfolio associated with funding vehicles that are in the ramp-up stage. At end-January 2019, commitments not yet called for amounted to €22.0m, of which €7.8m was related to a recently closed CLO warehouse. Over the last semi-annual period, outstanding commitments were reduced from €55.4m at end-July 2018.

Dividend policy and record

Although Volta has no strict dividend policy in terms of defined payout ratio or dividend yield at the moment, the fund's general intention is to provide a stable income stream in the form of dividends

paid every quarter (every six months before September 2016). Since 2013, it has been able to deliver a dividend per share of around €0.60–0.62 on an annualised basis. Having said that, the amount of dividend payments is dependent on the general level of interest rates as well as credit spreads prevailing in the markets; default/recovery rates in the underlying collateral affecting income streams; and the scope of investment opportunities available to Volta. Any negative impact on the income streams should be less pronounced than during the last financial crisis due to the changes in portfolio composition and potentially offset by well-timed investments in line with AXA IM's active investment approach throughout the credit cycle. As Volta's shares are trading at a meaningful discount to NAV, they offer a dividend yield of around 8.9%. The company has recently paid out an interim dividend of €0.15 per share, which is in line with historical levels.

Peer group comparison

The peer group we used consists of funds exposed predominantly to CLO investments (Exhibit 19). It is important to highlight that these funds obtain this exposure through a variety of structures. We believe Carador Income Fund and Fair Oaks Income Fund 2017 are the most comparable peers, with high portfolio diversification across instruments, CLO managers, sectors and borrowers. Both funds invest primarily in CLOs. However, at end-March 2019, at least 90% of their portfolios were invested in CLO equity tranches, considerably ahead of Volta (43.3% including warehouses and CMVs). It must be also noted that Fair Oaks Income Fund 2017 has a definite life, covering a two-year investment period ending in June 2019, which may be extended by up to two years, and a fixed life of five years from the end of the investment period. This fund is mostly exposed to the US market (91% of portfolio as at end-March 2019). Moreover, following the November vote, Carador Income Fund is in a process of managed wind-down and converts its assets to cash (17% of NAV at end-March 2019), as 14.8% of its existing dollar shares will be redeemed.

Blackstone/GSO Loan Financing (BGLF) and Marble Point Loan Financing (MPLF, primarily investing in US dollar-denominated CLOs) operate as risk retention vehicles and as such are mainly investing in CLO equity tranches, CLO warehouse investments and directly held loans not yet securitised. Consequently, all instruments in their portfolios are managed by their respective investment managers vs c 10% in the case of Volta as at end-March 2019. Chenavari Toro Income Fund (established in 2015) is EU focused and its strategy differs to Volta's approach in that around half of its current portfolio represents a direct origination strategy, involving investments in originators of securitisation vehicles that also act as risk retainers. The indicative, forward-looking return of this higher-risk strategy stood at 17.6% at end-March 2019, according to the company. Importantly, in the case of investments in CLOs or other products managed by an entity from the same group, these kind of funds normally pay only management and performance fees at the underlying product level. As these investments represent 100% of BGLF's and MPLF's portfolio, these funds do not pay any fees to their investment manager at portfolio level. This translates into lower charges to investors in comparison to funds investing primarily in CLOs managed by external managers, such as Volta Finance or Carador Income Fund (see Exhibit 20). However, this is achieved at the expense of CLO manager diversification.

TwentyFour Income invests primarily in UK (c 45% of portfolio) and European ABS characterised by lower liquidity but higher yields. This includes a broad asset spectrum, such as non-conforming residential mortgage-back securities (NC RMBS), consumer ABS, prime RMBS, buy-to-let RMBS, commercial MBS, and auto and student loans. At end-March 2019, CLOs represented c 34% of the fund's portfolio. Consequently, it should be treated as Volta's more remote peer.

Exhibit 19: Comparison of Volta's fund structure vs peers

Company	Investment manager	CLO manager pool	% of CLO in portfolio	% of CLO equity in portfolio*	FX exposure (unhedged)	Target return/ dividend yield
Volta Finance	AXA IM	Diversified	83	43	65% US$, 31% EUR**	N/A, but most likely around 9–11% pa (net return)
Carador Income Fund	Blackstone	Diversified	83	76	100% US$	N/A
Blackstone/GSO Loan Financing	Blackstone	100% of CLOs managed within the capital group	80	80	56% US$, 44% EUR***	N/A
Marble Point Loan Financing	Marble Point	100% of CLOs managed within the capital group	68	61	100% US$	8% dividend yield target
Chenavari Toro Income Fund	Carne Global	Diversified (although meaningful exposure through Taurus to CLOs managed by Chenavari)	62	~50**	93% EUR, 7% GBP	Net return of 9–11% pa, DPS of at least 8c pa
Fair Oaks Income 2017	Fair Oaks	Diversified	100	95	99% US$, 1% EUR	Target return at 12–14% pa
TwentyFour Income	TwentyFour	Diversified	34	34	59% EUR, 41% GBP	Net return of 6–9% pa and dividend yield of at least 6% pa

Source: Company filings, Edison Investment Research. Note: *Includes CLO warehouse investments. **As at end-February 2019. ***Edison estimates.

Volta has slightly outperformed the peers in the long term, with a five-year return of 50.3%. In the most recent period, Volta moderately underperformed the peer average based on one-year NAV return at 3.7%. However, we again underline the differences in portfolio allocation and investment strategies discussed above. Volta has a relatively high ongoing charge (although comparable with Carador and Chenavari), due to a considerable part of the portfolio being managed by external investment managers. It is also important to note that Blackstone/GSO Loan Financing (which was the top performer over a one-year period) uses a mark-to-model rather than mark-to-market approach for NAV valuation. Volta's dividend yield of c 8.9% (although quite healthy) is somewhat below the peer average of 11.0%. The company's discount to NAV is at the higher end of the peer group range (with only Chenavari Toro and Blackstone/GSO Loan Financing trading at a deeper discount).

Exhibit 20: Peer group comparison at 6 May 2019

% unless stated	Market cap €m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum-fair)	Ongoing charge	Perf. fee	Net gearing*	Dividend yield
Volta Finance	**255.3**	**3.7**	**32.5**	**50.3**	**903.4**	**(11.7)**	**1.9**	**Yes**	**118**	**8.9**
Carador Income Fund USD Ord	97.9	(4.0)	29.8	38.0	366.2	(7.4)	1.8	Yes	96	13.0
Fair Oaks Income 2017 Ord	336.3	14.7	60.8	N/A	N/A	(0.5)	0.7	No	173	18.1
Blackstone/GSO Loan Financing	332.9	18.5	28.9	N/A	N/A	(11.1)	0.4	No	113	12.2
Marble Point Loan Financing Ord	150.8	2.2	N/A	N/A	N/A	(2.2)	1.3	No	102	6.9
Chenavari Toro Income Fund Limited	251.3	5.3	26.2	N/A	N/A	(20.4)	2.5	Yes	98	10.2
TwentyFour Income Ord	602.5	9.2	25.5	29.0	N/A	1.8	0.9	No	99	5.4
Peer average	**295.3**	**7.6**	**34.2**	**33.5**	**366.2**	**(6.6)**	**1.3**	**-**	**114**	**11.0**
Fund rank in sector	**4**	**5**	**2**	**1**	**1**	**6**	**2**	**-**	**2**	**5**

Source: Morningstar, Edison Investment Research. Note TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets, 100 = ungeared. NAV performance as at end-March 2019. *Edison estimates

The board

Volta's management board consists of five directors, all of whom are independent and non-executive. Paul Meader joined Volta in 2014 and has been chairman since 2016. Volta's senior director, Paul Varotsis, has been a board member since the fund's inception. The other directors are Graham Harrison (appointed in 2015), Stephen Le Page (appointed in 2014) and Atosa Moini (appointed in 2017).

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