EDISON

Volta Finance

Experienced CLO investor with active approach

Investment companies

Volta Finance provides an opportunity to gain leveraged exposure to US and European cash-generative debt assets, in particular through collateralised loan obligations (CLOs). The fund is managed by AXA Investment Managers (AXA IM), a veteran in the structured finance market with a dedicated team that has 17 years of experience across two credit cycles and a proven track record. This expertise (together with Volta's adaptable investment strategy) will be important when we approach the end of the credit cycle and future returns may vary significantly depending on the selected CLO collateral, managers and tranches.

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, %)
31/10/14	11.0	15.1	12.2	5.6	12.6
31/10/15	19.3	10.4	13.9	5.9	14.7
31/10/16	16.8	12.7	7.4	2.6	6.8
31/10/17	11.5	10.3	(1.1)	4.8	(0.9)
31/10/18	2.8	7.2	7.5	2.8	8.1

Source: Thomson Reuters Datastream

Investment strategy: Leveraging scale and expertise

Volta aims at delivering a stable quarterly dividend stream based on a diversified portfolio of structured finance assets, in particular CLO debt and equity tranches making up c 74% of the fund's portfolio at end-October 2018. CLOs performed well throughout the financial crisis and thereafter, with average gross IRR of CLO equity tranches standing at c 10–15% pa. This is because CLOs lack mark-to-market triggers, are mostly backed by senior secured corporate loans and often are actively managed. AXA IM follows an active approach to the credit cycle combined with a constant search for attractively valued tranches and careful selection of CLO managers. Its strong market presence allows it to obtain a majority investor position to control key CLO decisions. All the above allowed AXA IM to outperform the broader US CLO market by an impressive 5pp (average 2001–2007 vintages) and in the case of Volta, to generate a five-year average NAV total return at 11.1% pa.

Market outlook: Nearing the end of the credit cycle?

The global CLO market is experiencing both high investor demand and strong transaction volumes, supported by the search for floating-rate debt exposure amid the ongoing Fed rate hike cycle and the repeal of the risk-retention requirement in the US. Tightening credit spreads remain supportive to CLO equity investors but are accompanied by weakening quality of loan collateral (high proportion of covenant-lite loans). In this context, good selection of CLO managers (on top of market timing and exercising CLO control measures) will constitute an important factor determining future returns.

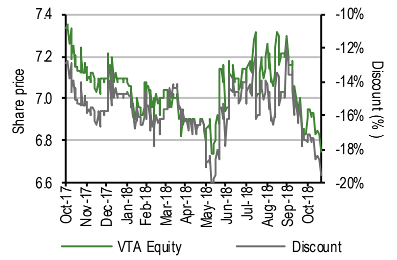
Valuation: Offering a c 9.3% dividend yield

At 20 November 2018, Volta's shares traded at a 20% discount to last reported NAV (as at end-October 2018). The fund has consistently delivered a dividend per share of €0.60–0.62 pa and offers a c 9.3% dividend yield.

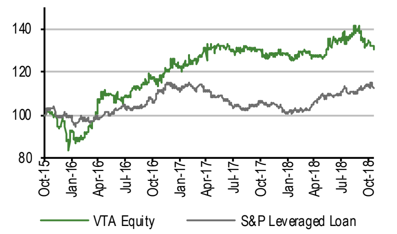
27 November 2018

Price	**€6.75**
Market cap	**€245m**
NAV	**€307m**
NAV per share	€8.39
Discount to NAV	19.5%
Yield	9.3%
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	€7.40	€6.74
NAV high/low	€8.46	€8.18

Gearing

Gross*	116%
Net*	109%

*As at October 2018.

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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

- 12 November 2018: October early estimated NAV at €8.42 per share
- 30 October 2018: 2018 annual report – NAV at €306m, €8.36 per share as at end-July 2018
- 25 October 2018: interim dividend declared at €0.16 per share
- Post reporting events: €10m drawdowns, purchase of CLO tranches for €17m (€6.5m debt, €10.6m equity), redemption of CLO debt tranche for €7.5m

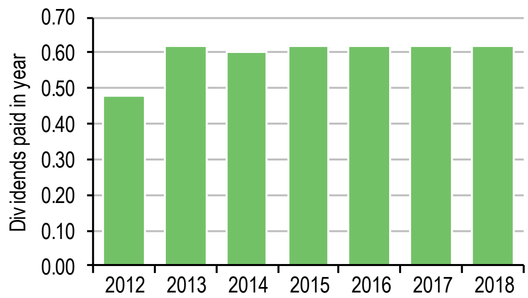
Forthcoming		Capital structure		Fund details	
AGM	30 November 2018	Ongoing charges	1.9%	Group	None
Interim results	N/A	Net gearing	109%	Manager	AXA Investment Managers
Year end	31 July	Annual mgmt fee	1.5%*	Address	BNP Paribas House, St Julian's Avenue, St Peter Port, Guernsey GY1 1WA, Channel Islands
Dividend paid	22 November (ex-date)	Performance fee	20%*		
Launch date	December 2006	Trust life	Indefinite	Phone	+44 (0)1481 750800
Continuation vote	None	Loan facilities	€50m (repo)	Website	http://www.voltafinance.com

Dividend policy and history

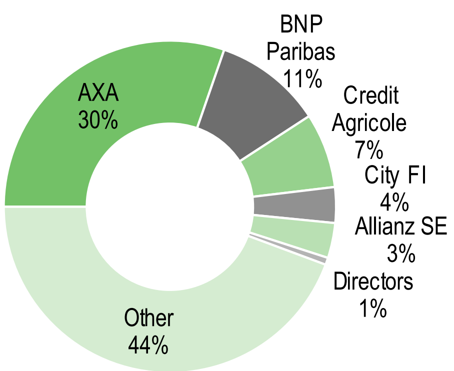
Volta aims at stable dividend distribution to its shareholders. Since 2013 company maintains DPS at an annual level of €0.60–0.62, which has been distributed quarterly since 2016. Dividend declarations usually occur in February, May, August and October and the payments are made in subsequent month.

Share buyback policy and history

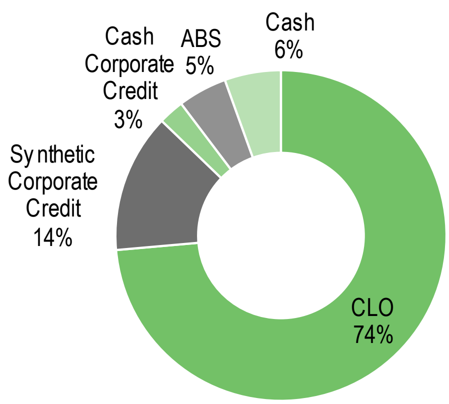
The company has not executed a buyback programme since launch. In the past Volta appointed Kepler to facilitate liquidity on company's shares with a €250k liquidity account provided by and at the risk of Volta. The contract lasted five quarters in 2012/2013.



Shareholder base (as at 15 November 2018)



Portfolio exposure by instrument (as at October 2018)



Top 10 holdings (as at October 2018)

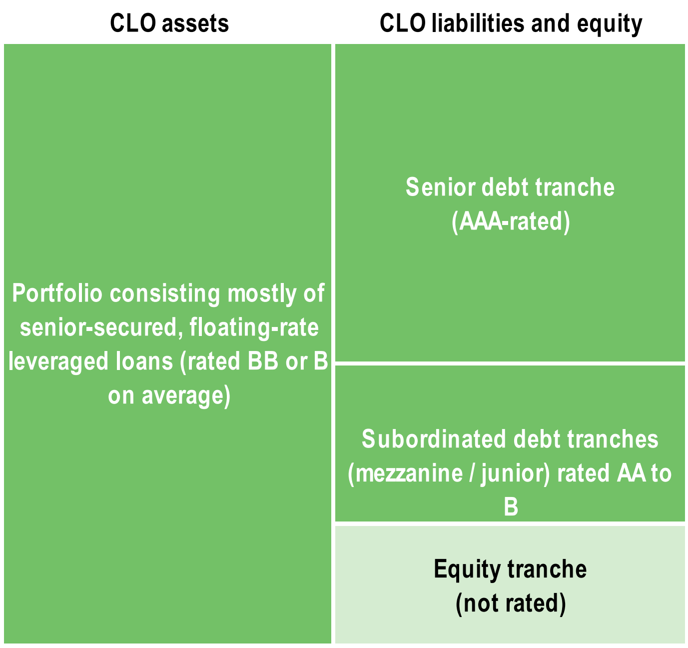
			Portfolio weight %	
Instrument	**Asset Class**	**Manager**	**October 2018**	**October 2017**
Voya 2018-3 Class I Sub notes	CLO equity	Voya	3.1%	0.0%
Bank Deleveraging Opportunity Fund	Synthetic	AXA	2.7%	4.1%
St Bernard Opportunity Fund I	ABS Debt	AXA	2.5%	2.3%
Mountain View 2017-1 - Class E	CLO Debt	Seix	2.3%	0.0%
CMV 1	CMV	N/A	2.3%	1.4%
Neuberger 28 SUBORD	CLO equity	Neuberger Berman	2.2%	0.0%
BBS 2017-1	BBS	N/A	2.1%	2.1%
BILB 1X SUB	CLO equity	Guggenheim	2.1%	0.0%
BBS 2017-2	BBS	N/A	2.0%	2.0%
MP CLO III R - Class E-R Notes	CLO Debt	ACAM	2.0%	1.9%
Top 10 (% of holdings)			**23.2%**	**13.8%**

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

Investing in CLOs

Given that an important part of Volta's portfolio is composed of tranches of CLOs, we decided to outline key aspects of investing in this asset class below. CLOs are one of the most common types of collateralised debt obligations (CDOs) and represent securities providing cash flows in the form of income distributions to investors. These instruments are collateralised by a pool of leveraged bank loans (mostly floating rate and senior secured) consolidated within an securitisation vehicle (SPV), which then issues several tranches of securities with different risk/return profiles (see Exhibit 2). The safest tranche – which offers the lowest returns – is referred to as the senior debt tranche (or AAA-rated tranche). A CLO structure normally also includes several subordinated mezzanine/junior tranches, as well as an equity tranche (also called the residual tranche), which offers the highest return potential, but also bears the highest risk in the whole structure. This is because cash income distribution among the respective debt/equity tranches follows a certain order of priorities (called the payment waterfall), with the equity tranche being entitled to the residual income after all other tranches receive their defined (usually floating-rate) coupon payments.

Exhibit 2: CLO structure



Source: Edison Investment Research

Although CDOs are considered one of the asset classes that triggered the recent financial crisis in 2008/9, it must be noted that this refers to CDOs that were backed by a pool of subprime residential mortgage loans advanced to individual borrowers with low creditworthiness. On the contrary, CLOs predominantly provide exposure to levered corporate loans to sub-investment grade companies and performed well throughout the crisis. According to a performance analysis of US equity tranches issued between 2002 and 2011 conducted by Marble Point, 96% of these tranches (which are considered the most risky component of the CLO structure) generated a positive IRR, half of which provided a particularly attractive return in excess of 15% pa. This solid performance in comparison to the broader loan market may be attributable to several factors, including:

- The vast majority of loans included as collateral are senior secured, which translates into a higher recovery rate in case of a default (80.6% vs 48.4% for senior unsecured bonds according to Moody's data for the period 1987–2016).
- Most CLOs are managed, which means the loan collateral does not represent a static pool of assets and may be subject to turnover or rebalancing until the end of the reinvestment period

(which at present usually lasts for four to five years from the CLO launch). These structures have a dedicated CLO manager, who is responsible for active management of the collateral base. In the past, these managers were often able to offset credit losses during the market downturn by reinvesting the cash flow received from coupon payments, loan prepayments and disposals in performing loans below their par value (becoming providers of liquidity) and thus realize a solid return once loan prices recovered.

- CLOs, unlike some other instruments providing leveraged exposure to corporate debt, do not have direct mark-to-market triggers that would force the investor/manager to conduct a fire sale or respond to a margin call (ie inject additional capital) because of the decline in collateral value. This means that CLO structures can sustain increased market volatility.

Having said that, an investor gaining direct or indirect exposure to CLO investments, in particular the junior debt and equity tranches, should assume a more long-term investment horizon and be prepared for periods when the market value of these instruments deteriorate significantly amid weakening market sentiment and when corporate default rates pick up.

Moreover, despite the fact that CLO equity tranches usually offer high and stable cash dividend distributions (based on coupon payments from the underlying loans) in favourable market conditions, the income streams may become temporarily interrupted. This is due to the above-mentioned payment waterfall, which becomes particularly important when certain internal tests within a CLO are breached. These normally include two coverage tests (overcollateralization and interest coverage) and the interest diversion test for the most junior-rated debt tranche. A test breach usually results in equity distributions being diverted to amortise the senior tranches or for reinvestment into collateral. Once the parameters of the CLO return to pre-defined levels, income distributions to CLO equity tranches can resume. However, the increased defaults might have already reduced the income generation potential of the collateral pool. The CLO manager aims at offsetting this effect through relative value trades as discussed above.

Fund profile: Leveraged exposure to corporate debt

Volta Finance is a Guernsey-registered investment fund listed on the Euronext Amsterdam Stock Exchange, as well as the 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 providing 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, the vast majority of Volta's current exposure (more than 90%) is attributable to corporate debt. Importantly, Volta's exposure to second-lien loans is capped at 10% of gross asset value (GAV) and remains below 5%. Volta does not declare a particular target return pa, but it has highlighted in its monthly reports back in 2016 that it aimed at a return of 9–11% pa (although it also added it was only an indicative target provided for information purposes only). This is confirmed by the recent statement included in its FY18 report that it was able to source investment opportunities with an average projected yield of c 11.2%, which was in line with the fund's target. To achieve its investment goals, Volta is primarily investing in CLOs, synthetic and cash corporate credit and asset-backed securities (ABS).

Volta's policy involves the possibility of investment across the CLO structure, while following a balanced approach to the risk/reward relationship. Historically, the fund had a meaningful exposure to A and BBB tranches at times when they provided an attractive yield (eg A-rated tranches trading at a 15% yield in 2010). At present, Volta's CLO debt exposure represents almost exclusively BB-rated tranches. The fund prefers to avoid the most junior debt (B-rated tranches) and invest in CLO equity tranches instead.

Part of Volta's portfolio is also being invested in CLO equity warehouses, providing equity-like funding for the acquisition of loans before the launch of a new CLO. These investments, while bearing a higher risk, also provide a greater potential return (at c 10–30% pa with average IRR at 20% pa based on the investment manager's four-year track record), as CLO equity tranches are acquired at more favourable terms. The fund is also investing in capitalised manager vehicles (CMVs), which are structures allowing CLO managers to meet the obligations of risk retention while limiting or eliminating the associated capital requirement through the involvement of third-party funding. These represent a minor part of Volta's portfolio (2.3% as at end-October 2018).

Volta's synthetic corporate credit exposure as at end-October 2018 made up 13.6% of GAV. Bank balance sheet transactions (BBST) are the main instruments in this asset class and represent 10.5% of Volta's GAV. These investments are associated with securitisation through credit default swaps (CDS) and credit-linked loans (CLN) conducted by banks to transfer part of their loan exposures. The CLN's are being purchased by investors such as Volta and provide exposure to a portfolio of debt assets (originated by the bank) that continue to be managed by the same bank and in the event of a default, both the bank's and Volta's interests are aligned with respect to maximising the recovered amount and involve full bank workout programmes. There are three major categories of BBST instruments Volta invests in:

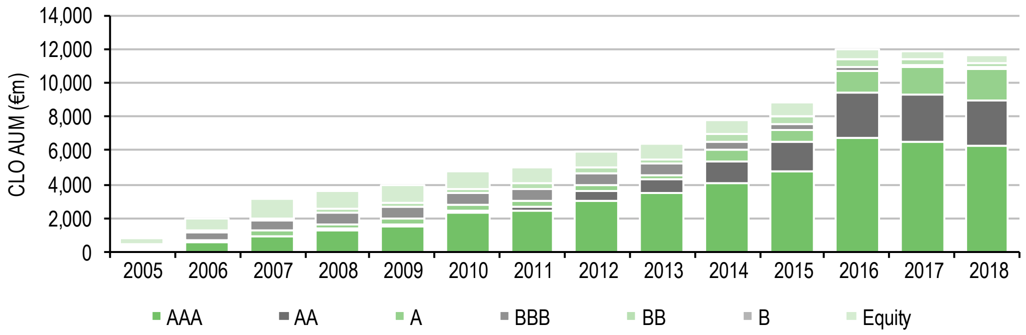
- Contracts with underlying assets representing well-diversified pools (100–150 assets) of predominantly investment grade corporate credit (loans or bonds) that have been reviewed and accepted by AXA IM. As part of the contract, Volta agrees to take on the exposure to the first loss within the portfolio (usually around 6–9% depending on the quality of the underlying assets).
- Instruments exposed to a portfolio of SME loans (usually several thousands), with Volta assuming a second loss position (losses in excess of a certain steady-state level, which is absorbed by the bank).
- Securities with an underlying portfolio of the bank's corporate exposure associated with derivative contracts (eg currency/commodity hedges). Volta and the bank share the risk of default on margin calls associated with these derivatives.

We believe these instruments, although providing returns closer to the lower end or slightly below Volta's targeted range (though still around 9% pa, see Exhibit 18), increase the fund's portfolio diversification while at the same time having a lower risk profile. This is associated with the high degree of underlying collateral diversification (particularly when compared with some of Volta's earlier synthetic positions, see the 'Post-crisis change in portfolio composition' section), limiting the exposure to a single borrower. Moreover, BBST's represent pools of loans which have been carefully reviewed by AXA IM, providing good collateral visibility. The replenishment rules are well defined and in case the collateral base is composed of a more limited number of loans (eg 100-150), AXA IM has a veto right with respect to adding a particular loan which does not meet their quality standards. Finally, the level of portfolio losses which would trigger a complete write-down of these positions is much higher compared to some of Volta's synthetic investments back in 2007-09. It must be noted that they are illiquid contracts entered into through bilateral agreements not available to the wider investor community, where AXA IM has been active for many years.

The fund manager: AXA IM

Volta Finance is managed by AXA IM, a multi-expert asset management company that is part of the AXA Group with more than 17-year track record in the CLO space and good access to CLO managers, arranging banks and brokers. Assets managed by AXA IM stand at €759bn, including €37.9bn in structured finance (data as at end-June 2018). The investment manager completed more than €30bn in CLO investments since 2000 and as at end-June 2018 managed a global book of c €12bn in CLO debt and equity tranches, which has grown at a 10-year CAGR of c 12% (see Exhibit 3).

Exhibit 3: Breakdown of AXA IM's CLO AUM



Source: AXA IM

AXA IM has a dedicated team of structured finance experts, with (what we believe is particularly important) experience across two credit cycles, including 96 professionals covering portfolio management, trading, research and structuring. The team is leveraging a proprietary digital tool to monitor positions, review deals and perform stress scenario analysis. AXA IM covers the full CLO spectrum, ie both the primary and secondary market in US and Europe across the capital structure.

We present a detailed track record of the investment manager with respect to CLO tranches in Exhibit 4. Over the last 10 years, AXA IM has consistently delivered an average return on CLO equity tranches (both US dollars and euros) in excess of 14% pa (reaching even 20–30% pa in some periods). Similarly, AXA IM's performance in the BB-rated tranches stands at an average of c 14%, in USD and EUR, over the last 10 years.

Exhibit 4: AXA IM investments in CLO tranches – annual gross IRR to June 2018

Original rating	Since inception	10 years	5 years	1 year
USD CLO tranches				
AAA	2.5%	2.6%	2.2%	3.0%
AA	3.4%	3.4%	3.0%	3.6%
A	4.1%	6.1%	3.5%	3.4%
BBB	5.8%	12.5%	7.3%	5.5%
BB	13.1%	14.3%	9.0%	11.2%
B	11.6%	11.6%	11.6%	13.9%
Equity	17.7%	38.7%	14.1%	22.1%
EUR CLO tranches				
AAA	2.2%	2.3%	1.6%	0.7%
AA	3.5%	3.3%	2.4%	1.5%
A	3.9%	5.6%	4.1%	2.1%
BBB	5.6%	11.1%	12.7%	4.5%
BB	11.4%	14.3%	13.4%	7.2%
B	11.2%	11.2%	11.4%	10.2%
Equity	7.2%	16.5%	31.2%	27.1%

Source: AXA IM

It is also instructive to examine how AXA IM investments faired against the broader CLO market based on statistics gathered by Wells Fargo for the respective CLO vintages, which represent the timing of the CLO launch (Exhibit 5). When comparing US CLO equity tranches performance for the vintages 2001–2007 with the corresponding AXA IM investments, we can see that Volta's investment manager outperformed the broader space for each vintage, with the lowest excess return for 2005 vintage (0.7pp) and the highest for 2002 vintages (9.9pp). The below figures illustrate that AXA IM's investment approach (which we discuss in more detail in the 'Asset Allocation' section) allowed it to outperform the US CLO equity market by an average 5pp per year in the period 2001–2007. The comparison does not include vintages beyond 2007, as the number of CLO issuances in the period 2008–2010 was very limited and there are very few CLOs from vintages post 2010, which were already terminated (ie there are no realised returns).

Importantly, most of the AXA IM funds that were launched before the onset of the financial crisis were able to meet or outperform their targeted return, as they were able to reinvest the funds in attractively priced CLO equity tranches during the crisis. One case where the target was missed was the Prelude fund launched in 2004 whose reinvestment period ended in February 2008, hindering the fund from investing in attractively valued equity CLO tranches during the financial crisis. Still, this fund was able to generate an IRR at 6.7% pa (vs initial target at 8%). Moreover, it must be noted that due to its evergreen structure, Volta Finance is not subject to these kinds of limitations as there is no defined lock-up period.

Exhibit 5: US dollar CLO tranches – median annual IRR on US terminated deals

Vintage	Wells Fargo Market Data	AXA IM Investments	Relative performance
2001	7.6%	16.2%	8.6%
2002	10.5%	20.4%	9.9%
2003	3.6%	10.9%	7.3%
2004	8.0%	12.2%	4.2%
2005	14.2%	14.9%	0.7%
2006	16.4%	18.4%	2.0%
2007	17.7%	21.2%	3.5%

Source: AXA IM

When investing in CLO equity tranches, AXA IM aims to obtain a meaningful position (ie becoming the majority investor), which allows the investment manager to control the decision of calling the transaction (ie giving the instruction to the CLO manager to liquidate the underlying loan portfolio and repay all the tranches). In fact, the decision to call in deals in 2006–2007 was one of the main reasons AXA IM was able to outperform the market in case of the 2001–2003 vintages. Being a majority investor also provides AXA IM with the option of replacing the CLO manager (although these rights were rarely used).

The manager's view: Preparing for the end of the cycle

For the current financial year ending July 2019, AXA IM is optimistic the performance should be at or above Volta's target returns. This should be driven by the recurring cash flows generated on assets, but also a certain degree of capital gains from its USD CLO equity positions. The latter may be achieved through capital payments or lower cost of debt and/or documentation reflected (most of the time) in the mark-to-market value of the CLO equity tranches. Potential external factors that may lead to increased market volatility include the activity of the US administration having a negative impact on the financial markets, the continuous increase in corporate debt, the possibility of some interest rate volatility and a possible 'hard' Brexit. Other potential risk factors include, among others, the end of the quantitative easing in US and Europe, the threat to classic retail business from online sales and political instability in the Middle East. Volta's performance should be assisted by 1) high portfolio diversification (more than 700 underlying corporate credit issuers); 2) healthy level of cash flows from currently held assets, which may be reinvested at discounted prices in the case 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).

Strategically, AXA IM expects to continue increasing the bank balance sheet transaction (BBST) bucket and the CLO equity bucket (favouring 'controlling positions') and to correspondingly decrease the CLO Debt bucket during the current annual period. With the expected decrease of the CLO debt bucket, AXA IM might reduce the leverage in place on CLO debt tranches, at some point. In aggregate, the investment manager will tend to decrease the number of positions, although maintaining a high level of diversification to increase the value that can be added from deals 'restructuring' (refinancing/resetting/calls/repackaging). CLO warehousing transactions are part of this strategy. This is in line with AXA IM's overall sentiment that we may be approaching the end of the credit cycle.

Market outlook: CLO managers selection becomes key

Conditions in the global (particularly US) CLO market have remained favourable so far this year, fuelled by investors' pursuit of assets that will give them exposure to floating-rate debt investments amid continued Fed interest rate hikes and offer a cushion (through higher interest income) against a potential increase in default rates if the market turns. Simultaneously, the supply side activity was assisted by the recent change of risk retention rules in the US, which reduced the capital requirements for CLO managers. The risk-retention rule is an obligation of the sponsor of an ABS transaction (or its majority-owned affiliate) to retain at least a 5% economic interest in the credit risk associated with the underlying assets. This is aimed at aligning the interests of the sponsor with investors purchasing the ABS. Until recently, this rule was also applicable to CLO managers in both the US (from late 2016) and Europe. However, following the US Court of Appeals ruling from February 2018, the requirement was suspended for CLO managers from May 2018. As a result, some of them have offered the CLO equity tranches they held in their risk-retention vehicles for sale. Moreover, this has lowered the entry barriers and attracted new players to the CLO market. According to a forecast released in May 2018, Wells Fargo was expecting a record US$150bn of new US CLO issues this year (vs US$70bn in H118 and US$120bn in 2017). In Europe as well, CLO activity reached record post-crisis levels, with new issuances at €20.8bn in 9m18 compared to €20.1bn in the whole of 2017.

Amid strong investor demand, CLO spreads reached record-low post-crisis levels (even though they widened somewhat over the last few months), which are supportive to CLO equity tranche buyers such as Volta Finance (as they translate into cheap funding of their positions). At the same time, however, the volume of good quality loans with strong collateral protection has been declining, leading to a growing proportion of covenant-lite loans that currently represent more than 70% of the loan market compared to just 25% in 2006–2007 (according to Thomson Reuters). This leads to lower overall collateral quality in the system and thus potentially elevated default rates and depressed recovery rates during the next economic downturn. It must be noted that the vast majority of CLO collateral normally represent senior secured loans, which were historically characterised by higher recovery rates vs unsecured bonds (80.6% vs 48.4% in the period 1987–2016 according to Moody's Investor Service). However, the current dominance of senior loan-only structures (without the safety margin provided by junior debt such as corporate bonds) may translate into lower rates, with Moody's expecting first-lien loan recoveries to decline to 61% while second-lien loan recoveries might decline to 14% in an economic downturn scenario.

As a result, we believe a critical factor determining future returns for CLO investors will be the ability to effectively identify those CLO managers who 1) follow a prudent loan selection process to secure a good quality CLO collateral base (and thus stable cash flow once markets deteriorate); and 2) will be able to conduct reinvestments (using proceeds from principal pre- and repayments or earlier loan sales) at attractive loan price levels to improve portfolio returns by means of relative value trades (for instance, amid heavy redemptions experienced by loan mutual funds/ETFs). Active portfolio trading plays an important role as most CLOs are managed so do not represent static loan pools. In this context, we believe AXA IM's strong expertise in the CLO market (including the selection of CLO managers) represents an important competitive advantage.

It is also instructive to look at the long-term context of the CLO market from the perspective of the standard parameters of these structures. Generally, CLOs issued after the financial crisis (broadly referred to as CLO 2.0) are characterised by more conservative parameters to reduce the risk of a strong downgrade and erosion of market value. This includes a higher level of subordination or lower leverage (providing greater protection to senior tranches while limiting the return of the equity tranche), shorter non-call and reinvestment periods, as well as higher minimum weighted average spreads (of performing floating-rate securities in the portfolio over LIBOR) and CLO AAA spreads, ie spreads attributable to the most senior CLO debt tranche. In case of post-crisis CLO issuances, the weighted average spread covenant amounts to c 400bp; this is close to double versus to pre-crisis issuances. Currently in Volta's portfolio, the majority of CLOs are 2016–18 vintages, which are characterised by a CLO AAA spread of 85–115bp; in the pre-crisis era a spread of AAA usually came to c 30bp. The reinvestment period lasts four to five years, compared to CLO 1.0 at up to seven years. This may provide some relief in a distressed scenario.

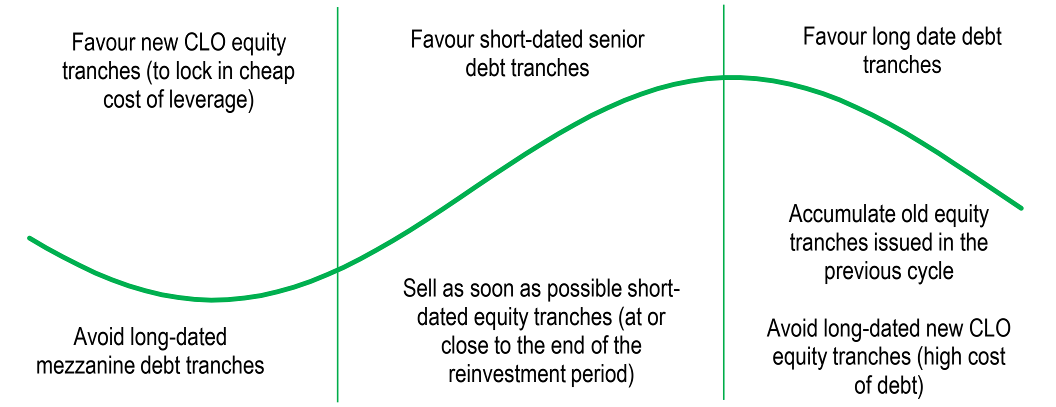
Although it seems we may be approaching the end of the credit cycle, we believe the risk of a significant credit crunch materialising over the next 12 months is relatively limited and the threat may be more medium term, in our view. At present, the overall healthy macroeconomic and corporate credit fundamentals continue to translate into a low credit default rate, which stands below or close to the long-term average of c 3% (based on S&P LCD data). This should be supported by the maturity profile of loans included as collateral in CLOs, with c 1% of European loans maturing until 2019 and only a further c 5% maturing by 2020 (calculations based on Fitch Ratings data). The corresponding numbers for the US market as at March 2018 (illustrated by the S&P/LSTA Leveraged Loan index) stood at 2.7% and 5.2%, respectively (with a minor proportion of loans maturing in 2018). This is the result of favourable credit market conditions, which translated into high refinancing activity, allowing borrowers to extend loan maturities. Moreover, the higher proportion of covenant-lite loans should translate into a lower number of technical defaults in the near term.

Asset allocation

Investment process: Active approach to the credit cycle

AXA IM is focused on long-term value investments to provide consistent excess returns with special emphasis on income generation and capital preservation. Its investment philosophy involves identifying opportunities based on constant reassessment of the relative value across the CLO capital structure. The fund manager's active portfolio approach is illustrated in Exhibit 6. Investment decisions depend on the phase of the credit market cycle. During a recovery 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 avoiding mezzanine debt tranches with long maturities, which offer limited returns (due to low spreads) and expose the investor to a higher risk. As the recovery phase turns into an advanced expansion phase, the 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 gradually accumulating old equity tranches issued during the previous 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 be more interested in mezzanine debt tranches.

Exhibit 6: AXA IM's active investment approach throughout the credit market cycle



Source: AXA IM

AXA IM aims at generating an alpha at around 4pp pa with respect to investments in CLO equity tranches (vs actual alpha at an average of 5pp for the USD CLO equity tranches 2001–2007 as highlighted above) through a number of factors. Firstly, it is able to negotiate better deal terms with arranging banks and CLO managers through its strong relationships and scale of operations. Secondly, the investment manager follows a well-defined process for selecting top-performing US and European CLO managers. This involves the requirement for the manager to display a solid track record coupled with an asset management style aligned with the investment manager's views on the CLO equity space. AXA IM prefers managers who focus on one of the following investment styles: 1) highly diversified portfolio of large caps or defensive constituents and an investment philosophy based on capital preservation; 2) generating trading gains through portfolio turnover; 3) exposure to non-standard loans and story credits (distressed assets); and 4) credit focus – loss avoidance and origination strength.

Importantly, AXA IM intends to have a diversified pool of CLO managers (usually selecting around 10–15 with the highest ranking, see Exhibit 12 for current Volta portfolio) and assure diversified CLO collateral to mitigate the idiosyncratic risk. This should also lead to an improved 'stretch', ie the proportion of collateral that has the least overlap between CLOs and is usually responsible for a considerable part of the distributions to holders of CLO equity tranches. Generally, the degree of collateral overlap between two CLOs of different managers and with different vintages stands at c 30% in the US and c 40% in Europe. This compares with around 60–70% in the case of two CLOs with the same manager and similar vintages, in general. The above aspects should be further assisted by the option to control the transaction call and the manager replacement rights (as discussed earlier), as well as the selection of an optimal exit strategy (call, amortisation or sale).

AXA IM's investment process may be divided into four stages. Firstly, it starts with a review of the general macroeconomic and credit outlook in each of the main target regions by the CLO investments team leveraging both in-house analytical capabilities and external research. Based on the outcome of the analysis, AXA IM defines the preferred portfolio allocation ranges for the respective credit investment types (eg CLO tranche types) and identifies appropriate monitoring parameters and applicable hedging proxies. Secondly, the investment manager identifies CLO opportunities in the primary and secondary markets through its origination network including investment banks, brokers, CLO investors and other CLO managers. Thirdly, AXA IM finalises the CLO selection and investment based on both qualitative and quantitative factors, which involve several participants, including portfolio managers and investment analysts (who examine the assets, structure and collateral manager), structurers and a dedicated trader. The investment idea is subsequently presented to the investment committee (for primary investments) or portfolio managers (for secondary investments) who make the final decision whether to invest in a given asset. At the final stage of the investment process, the fund manager embarks on the regular monitoring, involving quarterly and ad-hoc assessment of the portfolio by senior portfolio managers, which may result in adjustment to allocation ranges or parameters and portfolio rebalancing. Moreover, individual CLOs are subject to monthly asset reviews. The monitoring process also covers the review of monthly portfolio reports from the fund's administrator, ad-hoc cash-flow simulation and price comparisons, which are the basis of making the decision whether to keep, sell or hedge the individual investments.

Even though portfolios managed by AXA IM (including Volta Finance) are usually highly diversified in terms of sector, the fund manager tends to avoid certain exposures that it perceives are highly risky or unattractive. At present, the fund manager is particularly sceptical about the new technologies and retail sectors. The manager believes its strict portfolio selection criteria allowed him to avoid meaningful exposure to sectors, market segments and investments that were strongly affected by the credit crisis.

Current portfolio positioning

Volta's GAV at end-October 2018 stood at €354.5m, broadly in line with the prior year as the fund's return was distributed to investors through dividends. Around 74% of the assets were invested in CLOs, including 38.8% in debt tranches and 30.2% in equity tranches, with the rest being invested in warehouse investments and CMVs.

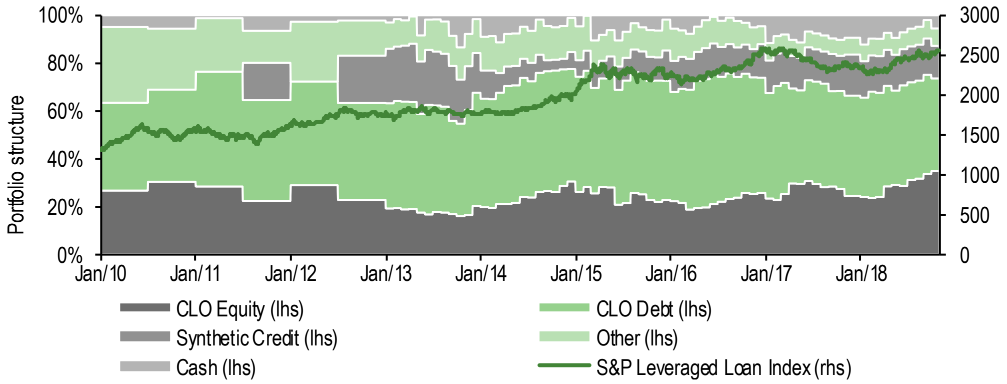
Exhibit 7: Portfolio GAV breakdown

	Portfolio end-Oct 2018 (€m)	Structure end-Oct 2018	Portfolio end-Oct 2017 (€m)	Structure end-Oct 2017	Change (€m)	Change (pp)
CLO	**260.3**	**73.4%**	**240.0**	**68.3%**	**20.3**	**5.1**
USD equity	52.1	14.7%	39.3	11.2%	12.8	3.5
EUR equity	55.0	15.5%	37.0	10.5%	18.0	5.0
USD debt	135.1	38.1%	138.3	39.3%	-3.2	-1.2
EUR debt	2.5	0.7%	5.3	1.5%	-2.8	-0.8
CMV	8.2	2.3%	5.0	1.4%	3.2	0.9
Warehouse	48.4	13.6%	51.9	14.8%	-3.5	-1.1
Synthetic Corporate Credit	**48.4**	**13.6%**	**51.9**	**14.8%**	**-3.5**	**-1.2**
BBS transactions	8.9	2.5%	8.9	2.5%	0.0	0.0
Cash Corporate Credit	**8.9**	**2.5%**	**8.9**	**2.5%**	**-0.1**	**0.0**
Equity	17.1	4.8%	14.6	4.1%	2.5	0.7
ABS	**8.2**	**2.3%**	**6.5**	**1.8%**	**1.7**	**0.5**
Residual positions	8.9	2.5%	8.1	2.3%	0.8	0.2
Debt	19.8	5.6%	36.1	10.3%	-16.3	-4.7
Cash	**260.3**	**73.4%**	**240.0**	**68.3%**	**20.3**	**5.1**
GAV	**354.5**	**100.0%**	**351.4**	**100.0%**	**3.1**	**-**

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

Over the 12 months ended October 2018, Volta's combined exposure to CLO equity (including warehouses and CMVs) increased visibly by 7.3pp from 27.5% at end-October 2017 to an all-time high at 34.8% vs average post-crisis allocation of 25.2% (see Exhibit 8), while the allocation to CLO debt went down slightly by 2.0pp from 40.8%. The increased exposure to CLO investments has been accompanied by a reduction in Volta's cash position from €36.1m to €19.8m (currently 5.6% - in line with post-crisis average). This highlights AXA IM's belief that we are nearing the end of the credit cycle (see Exhibit 6 for reference). The attractive cost of debt (CLO debt spreads at post-crisis lows) allows Volta to lock in a cheap cost of leverage in new CLO equity issuances (2017–2018 vintages represent c 49% of the CLO portfolio) while still benefitting from low default rates (a significant part of CLO returns transferred to equity tranches). This approach is also illustrated by Volta's exposure to warehousing and CMV structures. It is important to note equity tranches that underperform when the market turns are normally those with short maturities, facing the risk of redemption in unfavourable market conditions. As of July 2018, c 88% of Volta's financial assets had a maturity over five years.

Exhibit 8: Volta's CLO exposure – debt vs equity tranches

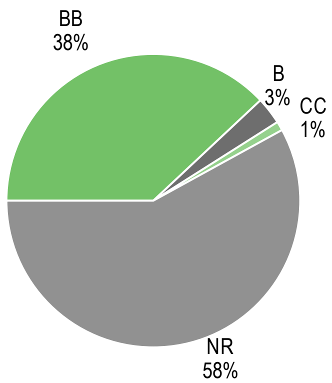


Source: Volta Finance, Edison Investment Research. Note: Equity exposure includes CLO equity tranches, but also warehousing investments and CMVs, which predominantly offer exposure to equity tranches.

The fund's portfolio is highly diversified across borrowers and sectors. Its top 10 underlying exposures (making up only 3.7% of Volta's NAV as at end-October 2018) come from seven different sectors, while Volta's largest exposure to a single security equals 3.1% as at end-October 2018.

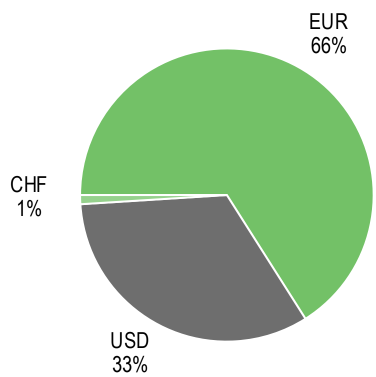
As Volta invests in CLOs issued in Europe and in the US, it has a considerable exposure to the US dollar, with c 62% of its GAV representing US dollar-denominated securities at end-October 2018. The currency position is only partially hedged, leaving the fund with a residual US dollar exposure of 33% (see Exhibit 10). Volta intentionally does not fully hedge USD 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 mean-reverting pattern of the euro/US dollar rate.

Exhibit 9: Volta's direct investments by rating breakdown



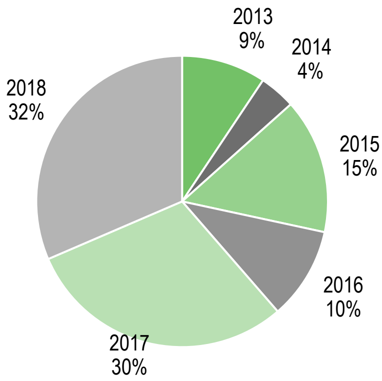
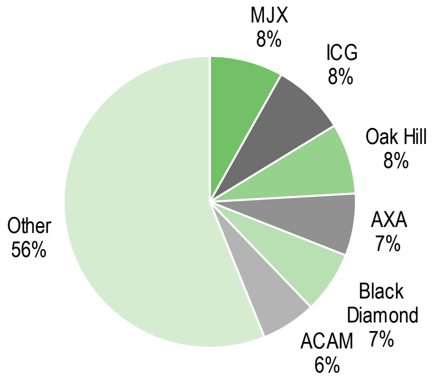
Source: Volta Finance, Edison Investment Research

Exhibit 10: Residual currency exposure (after hedging) % of NAV



Source: Volta Finance, Edison Investment Research

Volta's diversification in terms of CLO managers in its portfolio is relatively high (see Exhibit 12). This translates into lower concentration risk (particularly lower collateral overlap), providing AXA IM with more flexibility of pursuing its active approach to the credit cycle.

Exhibit 11: Volta's CLO portfolio by vintage	Exhibit 12: Volta's CLO portfolio by manager
	
Source: Volta Finance, Edison Investment Research	Source: Volta Finance, Edison Investment Research

Asset valuation method

Volta's portfolio is carried at fair value with the exception of assets acquired within a period of one month where up-to-date market prices are not available. These assets are valued at cost plus accrued interest (3.7% of Volta's portfolio as at end-July 2018). The majority of investments (64.9% as at end-July 2018) are valued based on prices received from PricingDirect (an independent pricing source) or from arranging banks and other market participants. This includes: 1) CLO debt tranches, which are valued based on observed traded prices obtained from PricingDirect, or if these are not available, on non-binding quoted prices received by PricingDirect from arranging banks and/or other market participants; and 2) CLO equity tranches that are valued based on third-party non-binding quoted market prices. The non-binding quoted market prices received from third parties are based on subjective assumptions related in particular to default and recovery rates, which quite often are not disclosed. Consequently, Volta reviews the prices against its in-house valuation models and adjusts them accordingly if it considers they represent unreliable fair value estimates. However, as at end-October 2018, there were no such adjustments applied. Furthermore, Volta's board engages an independent third party to verify and ensure proper valuation of CLO debt and equity tranches on a semi-annual basis.

The remaining investments (31.4% at end-July 2018) are valued as follows:

- **Bank Balance Sheet Transactions (12.3%)** – using AXA IM's discounted projected cash flow models based on in-house assumptions with respect to discount rates (8–12% in FY18), constant default rates (0.2–2.4%), prepayment rates (0–10%) and recovery rates (50–60%). -
- **ABS Residual positions (2.9%)** – AXA IM's discounted projected cash flow models using a discount range of 9–11%.
- **CLO Warehouse (3.5%)** – the lower of: 1) principal amount invested plus accrued income net of financing costs; or 2) the mark-to-market value of the relevant proportion of the underlying portfolio (taking into account the probability of success/failure of the CLO issuance) plus accrued income net of financing costs.
- **Investments in funds (10.7%) and CMVs (2.0%)** – based on the most recent NAV or capital account statement provided by the respective underlying administrators, adjusted for any cash flows received/paid from the date of this statement.

Valuation of Volta's portfolio is not straightforward, given most of its investments are traded in markets with a limited number of participants pricing these securities (which may translate into a higher bid/ask spread). However, the CLO market is relatively transparent, with details of each CLO position, including CLO manager activity are publicly disclosed each month using automated systems such as INTEX. Still, it cannot be ruled out that under extreme market conditions, market participants could cease to provide pricing for the respective instruments Volta has invested in (similar to what happened in 2008/09). Moreover, there is a certain set of investments that lack an agreed industry standard approach to valuing them and no active market participants are willing to provide valuations on a monthly basis. As a result, these are valued by Volta on a mark-to-model basis. As illustrated above, these instruments constituted c 15% of the portfolio at end-July 2018 and included BBS transactions, as well as ABS residual positions. It must be also noted that due to existing reporting schedules, a small part of Volta's NAV may be outdated. For example, as at end-October 2018, investments for which prices were determined with a one- and four-month lag represented 5.6% and 3.6% of GAV, respectively. As a result, there may be instances where the value of at least part of Volta's investments are miscalculated.

Post-crisis change in portfolio composition

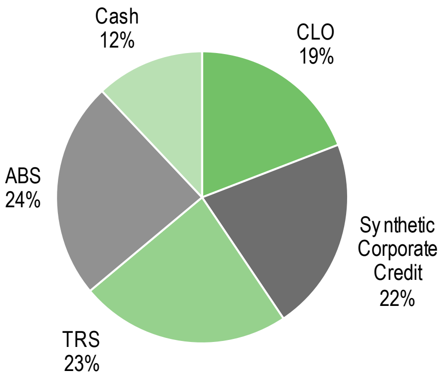
It is instructive to look at the asset allocation of Volta's current portfolio in the context of a potential financial crisis similar to what the financial markets (in particular the structured finance market) experienced in 2008–09, given that both the fund's NAV and share price were strongly affected at the time. Volta's IPO proceeds raised in December 2006 were broadly allocated equally between equity CLOs (19%), residual ABS positions (24%), corporate credit (21%) and a total return swap (TRS) (23%), with the balance kept in cash (12%). During the market downturn, the instruments that contributed the most to the reduction of Volta's NAV and income stream were either highly leveraged or exposed to corporate credit through synthetic contracts. Volta had a particularly high exposure to two positions during the crisis, a TRS transaction and ARIA II, which we describe in detail below.

In the first months after launch at the end of 2006, Volta entered into a TRS transaction and as a result, gained exposure of up to €450m to European leveraged loans by providing an initial collateral of €71m. As it was a non-recourse TRS, it required Volta to either post additional collateral or sell assets amid declining prices to avoid termination and liquidation of the swap. Subsequently, a considerable decline in the value of the underlying assets forced the deleveraging of the TRS and sale of the underlying loans at depressed prices, leading to the swap's termination in April 2008. Volta received cash from the liquidation of a mere €17m, which translated into a net cash outflow on this transaction of €54m (ie 18% of IPO proceeds).

The second position that Volta had particularly high exposure to during the last financial crisis was ARIA II. This was a bespoke CDO tranche managed by AXA IM. It had exposure to synthetic credit positions (ie actively managed portfolio of credit default swaps) and Volta invested a significant part of IPO proceeds in this single instrument in April 2007 (representing 18% of portfolio at July 2007, implying a valuation at €51m with €69m nominal value). Volta held a junior tranche with the detachment point at 2.61%, which was triggered as ARIA II suffered a considerable number of defaults in the underlying portfolio, including in particular, Lehman Brothers, Quebecor, Tribune and IDEARC. As a result, Volta's position was written down to nil.

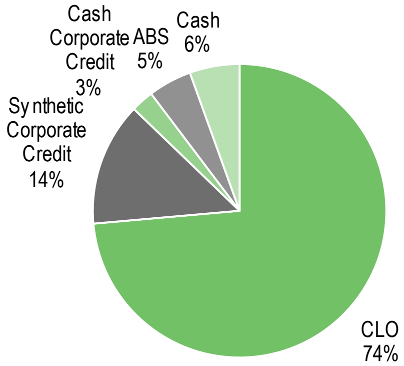
Since the financial crisis, Volta has reorganised its portfolio structure and we believe that even market conditions similar to those during the financial crisis should not affect Volta's income streams to the same extent as they did in the past. Currently Volta's portfolio is dominated by CLO tranches, which represent 69% of GAV as at end-October 2018 or 74% including CLO warehouses and CMV's compared with just 19% in the pre-crisis portfolio (see Exhibit 13).

Exhibit 13: Volta's portfolio at end-July 2007



Source: Volta Finance, Edison Investment Research

Exhibit 14: Volta's portfolio at end-October 2018



Source: Volta Finance, Edison Investment Research

Even though the value of CLO tranches is subject to the mark-to-market approach (as discussed earlier), 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. Still, 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 15, we present scenarios of company estimations of GAV change with a default rate hike to 3% and 4%.

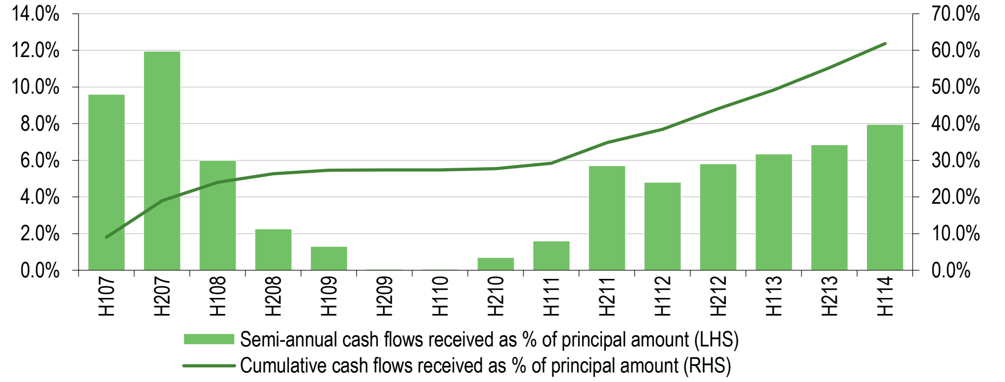
Exhibit 15: Sensitivity of GAV on assumed default rates as on July 2018

		Default rate of 3%		Default rate of 4%	
	% of GAV	Price impact	GAV impact	Price impact	GAV impact
USD CLO equity	10.4	-6.8%	-0.7%	-21.7%	-2.3%
EUR CLO equity	14.3	-10.9%	-1.6%	-25.9%	-3.7%
USD CLO debt	38.7	0.0%	0.0%	-0.2%	-0.1%
EUR CLO debt	2.2	0.0%	0.0%	0.7%	0.0%

Source: Volta Finance

As Volta is mainly exposed to CLO mezzanine debt (in particular the more junior BB-rated tranches) and equity tranches at present, its income streams depend on the result of internal tests conducted within the CLO (as discussed on page 3). However, even during the 2008–09 financial crisis, income streams from residual positions that Volta held throughout the downturn resumed in the market recovery phase, as illustrated by the positions from the five UK non-conforming mortgage ABS transactions (see Exhibit 16). Moreover, the impact on Volta's future portfolio returns was enhanced by the deployment of cash into CLO tranches at attractive prices.

Exhibit 16: History of payments on the five UK non-conforming residual positions held by Volta since 2006/2007



Source: Volta Finance

Currently, Volta's portfolio is much more diversified. The biggest single asset in Volta's portfolio (Equity tranche of CLO managed by Voya) is only 3.1% of Volta's GAV at end-October 2018; top 10 underlying exposures (in terms of individual borrowers) are 3.7% of the fund's NAV. This is also true for sector exposure, which is more diversified, as opposed to the pre-crisis portfolio that, for instance, had a high proportion of UK non-conforming mortgage pools. Furthermore, positions with exposure to synthetic corporate credit make up a significantly lower part of Volta's present portfolio, in comparison to the pre-financial crisis portfolio. Also, Volta's initial portfolio included only CLO equity tranches, whereas the current portfolio also consists of the perceived less risky CLO debt tranches. Finally, the portfolio exposure labelled as synthetic differs considerably from synthetic instruments held by Volta in 2007–09 (please refer to the 'Fund profile' section for details).

Impact from the risk-retention requirement repeal in the US

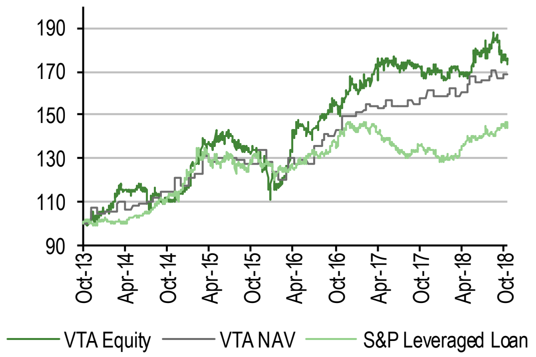
The recent change of the risk-retention rules may impact the scope of investment opportunities laid before Volta. The fund can only participate in deals that are compliant with EU law, which means the recent repeal of risk-retention rules in the case of CLO managers in the US will affect the availability of Volta's US CLO investments (according to the company, c 45% of US CLO issues in 2017 were compliant with European law). We believe the repeal will not disable Volta's presence on this market, as originators willing to attract European investors will have to be compliant with European law despite the repeal. The second implication of the risk retention rules repeal in the US is the lower availability of CMV investments. As discussed, CMVs are structures which allowed CLO managers to meet the obligations of risk retention without engaging the required capital, thus the need of creating new CMVs in the US will be more limited. However, Volta's portfolio exposure to CMVs is minor, as the fund invested in only one CMV structure in August 2017, which represents 2.3% of Volta's GAV (as at end-October 2018).

Performance: Five-yr NAV returns ahead of benchmark

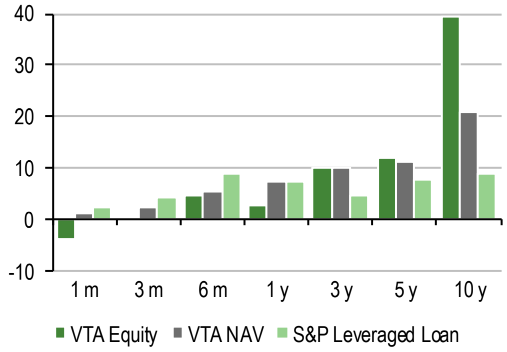
Even though Volta was established on the eve of the financial crisis (December 2006) and its share price declined significantly during the market turmoil (from €7.75 in July 2007 to €0.34 in February 2009), the fund's shares posted an annualised total return since inception at c 10% in euro terms compared to the S&P Leveraged Loan Index TR performance at c 7%. This is partially attributable to dividends being reinvested at depressed price levels. Over the last 10 years, coinciding with the culmination of the financial crisis, Volta's shares achieved an average annual total return of 39.5% (see Exhibit 17), while its five-year performance showing a more normalised rate of return, stood at 12.1% pa, according to our calculations. We also estimate Volta's NAV TR performance since inception at c 6.2% pa and its five-year performance at 11.1% per year (the latter being clearly above our selected benchmark at 7.8% pa). One should note that Volta managed to rebuild its NAV without significant capital injections, as the 2013 private placement with €16m proceeds was the only capital raise to date.

Exhibit 17: Volta Finance's performance to 31 October 2018

Price, NAV and benchmark total return performance, five-year rebased



Price, NAV and benchmark total return performance (%)



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

Volta's NAV total return in FY18, at end-July 2018 was 7.8%. The estimated contribution to its NAV performance of the respective asset classes (before FX and hedging impact but after accounting for the leverage effect from its repo facility) to date in FY18 is presented in Exhibit 18. Net FX and hedging impact had a minor positive effect (0.1%), financing costs and other hedging costs represented a negative impact of 0.8%, while operating expenses reduced the NAV performance by 1.9%.

Exhibit 18: Volta portfolio performance FY18 (ending July 2018)

Asset class	Estimated annual performance	Average weight
USD CLO debt	11.2%*	39.3%
Bank balance sheet transactions	9.2%	14.7%
USD CLO equity	7.7%	12.7%
EUR CLO equity	12.2%	12.4%
ABS	7.0%	4.4%
CLO Warehouses	14.1%	3.1%
Cash corporate credit	5.4%	2.5%
EUR CLO debt	4.0%	2.3%

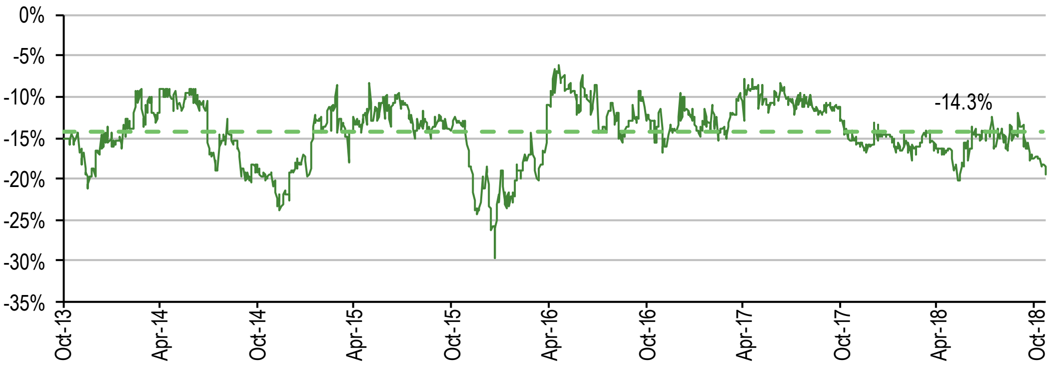
Source: Volta Finance; Note: *Includes the gearing effect of the repo facility.

As at end-October 2018, Volta's shares generated an LTM total return at 2.8% (see Exhibit 17), which is below its LTM NAV total return at 7.2%. This divergence is the result of a widening discount to NAV, which currently stands at c 20% compared to 15% a year ago and its five-year average of 14%. This compares with the LTM TR performance of the S&P Leveraged Loan Index at 7.5%. Currently Volta's gross projected IRR at portfolio level (based on AXA IM estimates) stands at 10.8% pa of which 0.8% pa is attributable to leverage related to its repurchase agreement. We estimate that this may translate (after accounting for financing/hedging costs and ongoing charges) into an NAV total return at c 8–9% pa. However, Volta aims at outperforming this projected return by 1–2pp pa through additional gains from active trading in its portfolio components.

Discount: Trading at a low double-digit discount

Volta's shares have traded at a visible discount to NAV over the last several years (usually in the range of 5–20%, see Exhibit 19). Currently the shares trade at a c 20% discount compared to a 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 19: 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 €306.7m as at end-October 2018. The management fee is subject to reduction with respect to investments in products managed by AXA IM (10.4% of Volta's NAV as at end-October 2018) to avoid double charging. The investment manager is also receiving 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 (set at €7.7389 at end-July 2018) and a cap of 4.99% of NAV. The current fee structure was introduced effectively from 1 August 2017 and replaced the former structure where AXA IM was entitled to a management fee of 1.5% of NAV up to €200m and 1.75% pa beyond this amount. The performance fee was lowered from 25%, and the investment manager no longer receives part of the fees in Volta's shares. Over the last five years, recurring ongoing charges (including management fee but excluding performance fee) were broadly stable at around €5.0–5.7m per year, which represented c 1.8–1.9% of NAV. Directors' remuneration amounted to c €0.5m per year of which 30% was payable in new shares. The Volta investment company has a perpetual life and there is no defined timing of continuation votes.

Share capital was technically increased multiple times, but a capital increase to raise new funds has been conducted only once, in May 2013, when Volta raised €16m in a private placement of 2.6m class C shares (out of 3.2m offered) issued at €6.18 per share (broadly in line with the market price at that time). Since inception, Volta issued 6.6m shares: 2.6m in FY13 share issue; 2.2m from scrip dividends (FY11–14) with roughly 20% of shareholders electing new shares over cash; 1.2m to AXA IM representing 50% of incentive fees (issued in FY11–13) and 0.5m as 30% of directors' remuneration. Since August 2013, incentive fees to AXA IM have been payable entirely in cash. The number of shares issued to directors as remuneration is calculated based on last estimated NAV (until February 2017 it was based on Volta's share price). AXA is Volta's main shareholder, with a stake of c 30%. AXA also holds a single class B convertible ordinary share, which allows it to elect one director to Volta's board. In total, 94% of Volta's shares are held by nominees, with 58% by Euroclear Nominees.

As per Volta's investment policy, its portfolio investments may be levered up to 95% with the exception of residual positions (eg CLO equity tranches and ABS residual positions), where the leverage cap is set at 30%. Volta's actual leverage level stood at c 13% of GAV at end-October 2018 (enhancing its returns) and represents the loan financing received under a repurchase agreement with Société Générale for €50m (of which €44.4m had been drawn at end-October 2018). The debt bears an interest rate at LIBOR 3M +1.5% and is secured against a portfolio of USD CLO debt securities with a total value of €68.7m and final maturity in December 2022. Consequently, the repo is overcollateralised and Volta may experience a near 20% decline in collateral value without triggering a margin call. 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). Before entering into the repurchase agreement in 2015, Volta did not use any bank debt facilities. It is important to note that leverage guidelines do not trigger any passive breach (eg due to price volatility within Volta's investment portfolio) and in such cases only limit Volta's ability to incur new debt.

Moreover, Volta has several funding commitments on its current portfolio associated with funding vehicles that are in the ramp-up stage. At end-July 2018, commitments not yet called for (mostly related to warehouses and CMVs) amounted to €55.4m. Accounting for events after reporting date, we estimate the amount stands at c €45.4m.

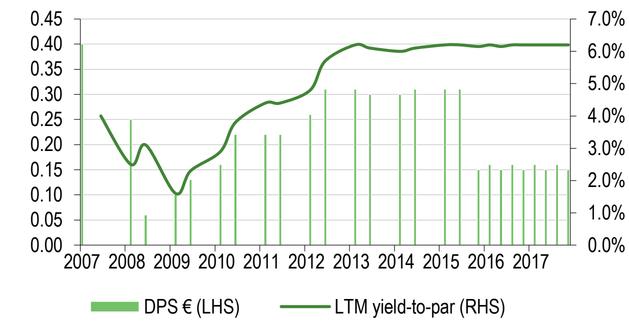
Dividend policy and record

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 at around €0.60–0.62 on an annualised basis.

Having said that, the amount of dividend payments are 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. Historically, the fund's targeted dividend yield announced during its IPO in 2006 was 10% on NAV. However, during the financial crisis, Volta missed one of its semi-annual payments to take advantage of market opportunities in early 2009. At the same time, losses incurred on certain assets (in particular a TRS and the bespoke CDO tranche ARIA II described earlier), coupled with an increase in default rate of CLOs collateral, impaired Volta's income streams and led to a decline in dividend payments (as illustrated by the fall in yield at par, see Exhibit 20). Even though the fund subsequently returned to an 8–10% yield on its NAV (see Exhibit 21), this was partially a function of Volta's NAV remaining visibly below par. As discussed above, Volta's current portfolio composition differs substantially from the portfolio it held during the crisis, thus any negative impact on the income streams should be less pronounced and potentially offset by well-timed investments in line with AXA IM's active investment approach throughout the credit cycle.

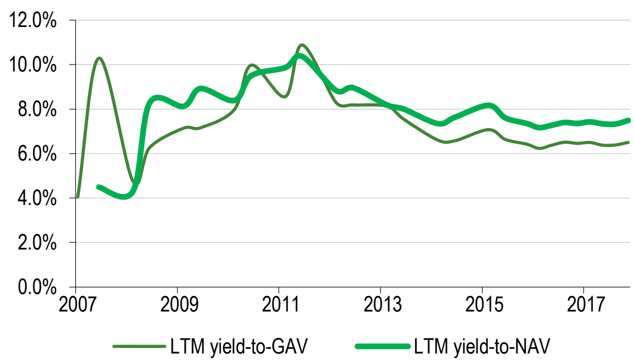
In 2013, Volta suspended its earlier dividend yield target and declared it will pay dividends that will correspond with yields achieved on the underlying collateral, reflecting the low interest rate environment (given the vast majority of the portfolio was, and still is, based on a floating rate). Since then, Volta's LTM dividend yield vs NAV has hovered around 7.2–8.0% and stands at 7.4% (the fund's yield at par remained stable over the last years at c 6.0–6.2%). As Volta's shares are traded at a meaningful discount to NAV, they offer a dividend yield to share price at around 9.3%. Given that volatility in valuing the fund's investments may be substantial during periods of stress (much higher than the volatility of the income stream these generate), Volta's dividend yield to share price ratio may also be quite volatile.

Exhibit 20: Volta's dividend payment track record



Source: Volta Finance accounts, Edison Investment Research

Exhibit 21: Volta's historical LTM yield to GAV/NAV



Source: Volta Finance accounts, Edison Investment Research

Peer group comparison

The peer group we used consists of funds exposed predominantly to CLO investments (Exhibit 23). 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-September 2018, at least 90% of their portfolios were invested in CLO equity tranches, which is considerably ahead of Volta (33.6% 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-September 2018).

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 case of Volta as at end-October 2018. 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 21.4% at end-September 2018, according to the company. Importantly, in the case of investments in CLOs or other products managed by an entity from the same group, these kinds of funds normally only pay 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 22). However, this is achieved at the expense of CLO manager diversification.

TwentyFour Income invests primarily in UK (c 45–50% of portfolio) and European ABS characterised by lower liquidity but higher yields. This includes a broad asset spectrum, such as non-confirming residential mortgage-back securities (NC RMBS), consumer ABS, prime RMBS, buy-to-let RMBS, commercial MBS and auto and student loans. At end-September 2018, CLOs represented c 31% of the fund's portfolio. Consequently, it should be treated as Volta's more remote peer.

Exhibit 22: 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	75	34	61% USD, 36% EUR	N/A, but most likely around 9–11% pa (net return)
Carador Income Fund	Blackstone	Diversified	95	90	100% USD	N/A
Blackstone/GSO Loan Financing	Blackstone	100% of CLOs managed within the capital group	79	79	52% USD, 48% EUR**	N/A
Marble Point Loan Financing	Marble Point	100% of CLOs managed within the capital group	70	62	100% USD	8% dividend yield target
Chenavari Toro Income Fund	Carne Global	Diversified (although meaningful exposure through Taurus to CLOs managed by Chenavari)	60	~50**	95% EUR, 5% GBP	Net return of 9–11% pa, DPS of at least 8c pa
Fair Oaks Income 2017	Fair Oaks	Diversified	100	90+	99% USD, 1% EUR	Target return at 12–14% pa
TwentyFour Income	TwentyFour	Diversified	31	31%	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, **Edison estimates.

Volta has historically outperformed the peer average based on one, three and five-year NAV returns at 7.2%, 33.2% and 69.2% respectively. This is despite Volta's higher ongoing charges than the peer group average (although they are comparable with Carador) and a lower proportion of CLO equity in the portfolio. It is the only fund within the peer group that has a 10-year performance history, with an NAV TR at 557.6% (or 39.5% per year). MPLF was launched in February 2018, so no performance data before that is available. It is also important to note that Blackstone/GSO Loan Financing uses a mark-to-model rather than mark-to-market approach for NAV valuation. Volta's dividend yield of 9.3% is below the peer average of 11.6%. This may be attributable to the lower allocation to CLO equity tranches vs peer group, which under favourable market conditions provides better income streams (but also bears more risk). Volta's discount to NAV is at the higher end of the peer group range (with only Chenavari Toro trading at a deeper discount)

Exhibit 23: Peer group comparison at 20 November 2018

% 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	**245.0**	**7.2**	**33.2**	**69.1**	**557.6**	**(18.8)**	**1.9**	**Yes**	**109**	**9.3**
Carador Income Fund USD Ord	222.8	5.9	22.0	62.8	N/A	(9.4)	2.0	Yes	113	17.0
Fair Oaks Income 2017 Ord	345.6	10.1	37.7	N/A	N/A	(5.2)	0.7	No	92	17.6
Blackstone/GSO Loan Financing	338.9	8.6	21.6	N/A	N/A	(6.2)	0.5	No	98	11.9
Marble Point Loan Financing Ord	183.9	N/A	N/A	N/A	N/A	8.0	N/A	No	155	8.0**
Chenavari Toro Income Fund Limited	251.0	7.0	21.5	N/A	N/A	(19.7)	2.8	Yes	102	8.8
TwentyFour Income Ord	529.3	3.2	(4.3)	32.1	N/A	4.2	0.9	No	99	5.2
Average	**302.4**	**7.0**	**21.9**	**54.7**	**557.6**	**(6.7)**	**1.4**	**-**	**110**	**11.6**
Fund rank in sector	**5**	**3**	**2**	**1**	**-**	**6**	**3**	**-**	**3**	4

Source: Morningstar, Edison Investment Research. Note: Performance to 31 October 2018. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. Note: *Edison estimates; **company target

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. He has over 30 years of experience in financial markets and is an independent director of other investment companies, insurers and investment funds. Volta's senior director Paul Varotsis has been a board member since the fund's inception. He specialises in structured credit and was a partner at Reoch Credit Partners until 2011. Graham Harrison is co-founder and has been group managing director of ARC Group since 1995. He has extensive fund board experience across a wide variety of assets. Stephen Le Page was a partner at PwC in the Channel Islands in 1994–2013 and effectively carried out the role of chief executive, currently holds a number of non-executive roles. Atosa Moini retired as Goldman Sachs' head of origination and distribution of asset-backed products and loans in EMEA in late 2016 and joined Volta.

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