Volta Finance

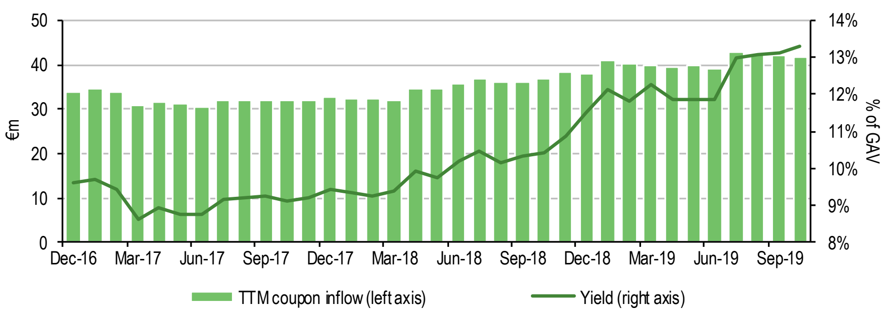
Continued healthy cash yield

Investment companies
Debt – structured finance

4 December 2019

Volta's (VTA's) 12-month NAV total return (TR) at end-October 2019 (-3.5%) is below its five-year average of 11.2%. This mostly comes from the declining prices of collateralized loan obligations (CLOs), with the average price of Volta's USD CLO debt decreasing by 11.5pp of par value y-o-y). The ytd return was mildly positive at 3.1% after a harsh Q418. While market sentiment weighs on valuations, the underlying loan collateral performs well (assisted by record-low default rates), generating strong cash flows (in total, Volta has received €38m in interest and coupons ytd, up 11% year-on-year). Volta's investment manager steadily increases exposure to long-dated equity tranches at the expense of debt tranches in response to the cycle turn.

Volta's cashflow generation on the rise



Source: Volta Finance, Edison Investment Research

The market opportunity

Volta has an active approach to the credit cycle, exploring opportunities across the CLO capital structure. In the current 'end-of-cycle' environment, it favours long-dated equity tranches that offer a high yield as they are currently available at discounted prices. As long as default rates remain constrained, Volta should continue receiving superior cash flows from these investments. While these cash flows may be temporarily redirected to repay more senior tranches or to strengthen loan collateral amid a severe crisis, CLO managers may in the end achieve strong returns for Volta by reinvesting prepayments into new loan collateral at heavily discounted prices to realize capital gains during market recovery.

Why consider investing in Volta Finance?

- Investment manager's proven track record, with 16% average IRR on closed CLO deals (5pp above market average).
- Diversified portfolio among managers minimises risk of collateral overlap.
- Depressed valuations allow Volta to invest at an above-average IRR.
- Prospective returns backed by high cash yield on existing portfolio (with six-month inflow at 15.6% pa of current NAV).

Valuation: Offering a c 9.9% dividend yield

At 2 December 2019, Volta's shares traded at a 16% discount to last reported NAV (as at end-October 2019). The fund has consistently delivered a dividend per share of €0.62 pa and offers a c 9.9% dividend yield.

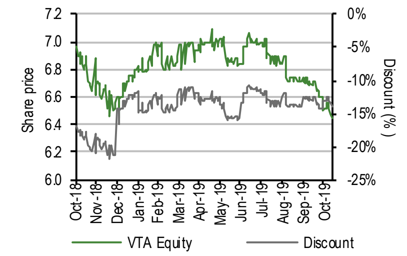
Price	**€6.28**
Market cap	**€229.7m**
NAV	**€274.0m**

NAV* per share	€7.49
Discount to NAV	16.2%

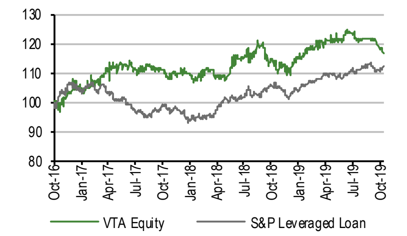
*As at 31 October 2019.

Yield	9.9%
Ordinary shares in issue	36.6m
Code	VTA
Primary exchange	AEX
AIC sector	Debt – structured finance
Benchmark	N/A

Share price/discount performance



Three-year performance vs index



52-week high/low	€7.04	€6.28
NAV high/low	€8.39	€7.49

Gearing

Gross*	14.3%
Net*	13.9%

*As at 31 October 2019.

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Edison profile page

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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.

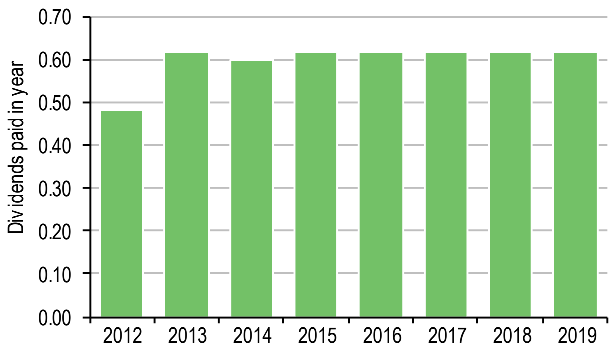
Recent developments

- 13 November 2019: October NAV at €7.49 per share.
- 28 October 2019: FY19 annual report – NAV at €291m, €7.94 per share at end-July 2019.
- 28 October 2019: notice of Annual General Meeting on 6 December 2019.
- 5September 2019: interim dividend paid (ex-div date) at €0.16 per share.

Forthcoming		Capital structure		Fund details	
AGM	6 December 2019	Ongoing charges	1.9% (FY19)	Group	None
Interim results	N/A	Net gearing	14% (Oct 19)	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	September 2019	Performance fee	20%*		
Launch date	December 2006	Company life	Indefinite	Phone	+44 (0)1481 750800
Continuation vote	None	Loan facilities	€40m (repo)	Website	www.voltafinance.com

Dividend policy and history (calendar years)

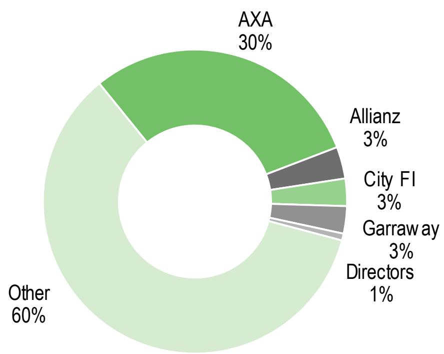
Volta aims for stable dividend distribution to its shareholders. Since 2015, the company has maintained DPS at an annual level of €0.62, which has been distributed quarterly since 2016. Dividend declarations are usually in February, May, August and November and payments are made the subsequent month.



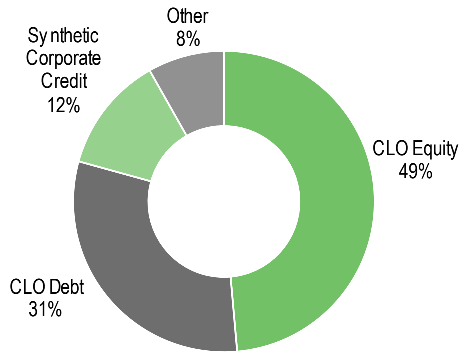
Share buyback policy and history (calendar years)

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 (at 22 November 2019)



Portfolio exposure by instrument (at October 2019)



Top 10 holdings (at October 2019)

			Portfolio weight	
Instrument	Asset Class	Manager	October 2019	October 2018
Bilbao II Equity S-1	CLO equity	Guggenheim	3.8%	-
CMV 1	CMV	Global CLO Manager	3.7%	2.3%
Voya 2018-3 Class I Sub notes	CLO equity	Voya	3.6%	3.1%
Vibrant XI SUBB	CLO equity	Vibrant	3.6%	-
Dryden 2018-70 Subord B	CLO equity	PGIM	3.5%	-
Wind River 2019-1 SUB_I	CLO equity	THL	3.0%	-
BILB 1X SUB	CLO equity	Guggenheim	3.0%	2.1%
St Bernard Opportunity Fund I	ABS Debt	AXA	2.9%	2.5%
BBS 2017-1	Synthetic	European Bank	2.4%	2.1%
BBS 2017-2	Synthetic	European Bank	2.3%	2.0%
Top 10 (% of holdings)			**31.7%**	**24.2%**

Source: Volta Finance, Edison Investment Research, Refinitiv. 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 the Euronext Amsterdam Stock Exchange and the LSE Main Market. The fund invests in a diversified structured finance portfolio that can be composed of a broad range of cash-generative debt assets, including corporate loans, sovereign debt, mortgages, student loans and leases. However, more than 90% of Volta's current exposure represents corporate debt, while its exposure to second-lien loans is capped at 10% of GAV. The fund aims at preserving capital across the credit cycle and delivering a stable quarterly dividend stream.

Volta does not declare a particular target return per year but in its monthly reports in 2016 highlighted that it aimed for a return of 9–11% pa (although it added this was an indicative target for information purposes only). This is confirmed by the recent statements of the investment manager in the FY19 and FY18 reports, which said Volta was able to source investment opportunities in line with target levels at projected yields of 12.8% and 11.2%, respectively. To achieve its investment goals, Volta primarily invests 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: Steady slowdown with episodic volatility

AXA IM acknowledges that it is managing Volta's portfolio in an 'end-of-cycle' environment. The unemployment rate in many countries is at record low levels, but economic growth is more modest than in recent years. The Federal Reserve (Fed) has made its first steps towards monetary policy normalisation, whereas the ECB was unable to start the declared normalisation. The investment manager expects ongoing market volatility to affect both debt and equity markets, as shown in Exhibit 2) amid further economic disappointments. AXA believes a scenario of an abrupt economic downturn is unlikely; however, modest growth and less collaboration among the governments of major economies should translate into default rates returning to historical averages (from current record lows). Given the high corporate leverage and popularity of covenant-lite loans, the manager also expects more loans will see their ratings downgraded in the coming years.

In this environment, AXA favours long-dated CLO equity tranches. These can benefit from the fact that they are still in the investment period, and can source new loans for collateral at attractive prices during market downturns, while the cost of debt tranches is locked. These in turn results in higher residual cashflow in the long term. In this context, it is worth noting AXA focuses on CLO managers that demonstrate an active approach to managing the underlying loan pool. As corporate default rates remain low while risk aversion recently led to a widening of discounts on CLO equity tranches, AXA IM expects it will be able to purchase these at prices facilitating a high level of residual cashflow relative to NAV. In fact, the €42.0m coupon income Volta received during FY19 (ended July 2019) was a multi-year high and represented 13.8% of its opening NAV. This allows Volta to maintain its attractive dividend policy, offering a yield of nearly c 10% currently.

Volta positions itself to capture opportunities through reinvestments in CLO tranches at a discount when higher volatility occurs. It aims at maximising received cashflows while decreasing exposure to less liquid investments. Consequently, it reduced its exposure to the relatively illiquid Bank Balance Sheet (BBS) transactions to 12.5% at end-October 2019 from 15% at the beginning of FY19 (ie August 2018). Moreover, it has downsized its repo facility (used to lever up CLO debt investments) in March 2019 to US$40m from US$50m to limit its liquidity risk (ie risk associated with a potential margin call). AXA IM focuses on CLO equity tranches, but still actively trades in

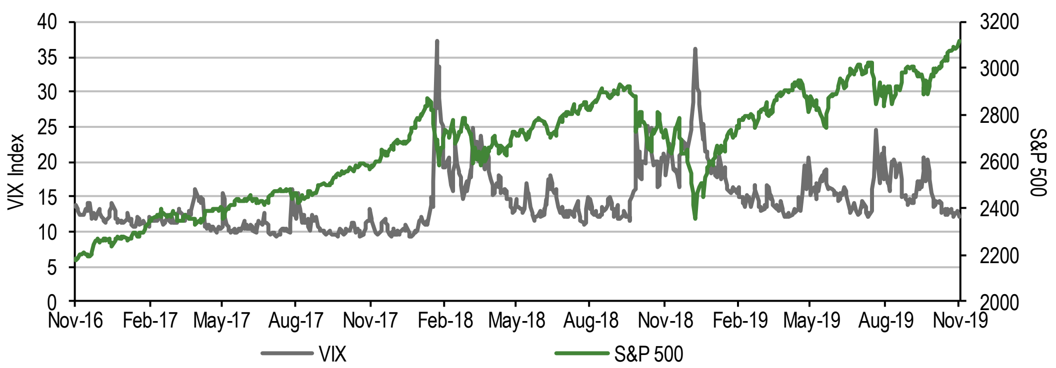
CLO debt tranches – it exits positions when they trade close to par and tends to purchase debt at a discount to maximise the potential gains that could come from any pre-payment at par. Importantly, realised losses on transactions were minimal during FY19, and most negative performance came from mark-to-market. Ahead of Brexit, European CLO debt exposure was reduced to the current 0.8%.

For the current financial year ending July 2020, AXA IM remains optimistic that Volta should perform near its target returns. Given the current economic slowdown and muted investor sentiment, this should be driven mainly by income from ongoing cash flows rather than tighter discounts (and thus higher prices) of CLO tranches. That said, AXA underlines that most of Volta's assets are already priced at a discount (creating some room for pull-to-par). Volta's overall 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).At end-October 2019, Volta was fully invested.

Market outlook: Likely mean reversion of default rates

The slowdown in GDP growth that is unfolding in major economies may continue into 2020, with the ECB expecting the euro area to post 1.1% and 1.2% growth in 2019 and 2020 respectively, while the Fed forecasts 2.2% and 2.0% growth in the US in 2019 and 2020.This has put pressure on both the ECB and Fed to delay or abandon monetary tightening. Recession concerns coupled with multiple geopolitical triggers (most notably US-China tensions and Brexit) increased volatility?

Exhibit 2: Recent volatility spikes in the S&P500 index



Source: Refinitiv, Edison Investment Research

Despite persistently low interest rates, the weaker macro environment may result in corporate default rates returning closer to historical averages from the current record lows. Fitch expects US leveraged loan defaults to rise to 3% in 2020 from the current 1.7% (LTM at September 2019). Similarly, S&P forecasts US corporate debt default rate to reach 3.4% by mid-2020. In the European market, S&P expects the default rate for speculative grade issuers to reach 2.8% by mid-2020. It is worth noting this is slightly ahead of the 2.0% default rate assumed for calculating the projected yield of Volta's CLO Equity tranches (15.7% and 11.2% for US and euro tranches at end-July 2019, respectively).At the same time, however, it recently reduced its recovery rate assumption by 10pp to 65%. We also underline that Volta's investment manager seeks to outperform the market through careful selection of CLO managers. At present, a severe spike in default rates is not expected by any rating agency (which we believe is underpinned by, among others, cheap money and loose covenants), and with widening discounts on CLO equity tranches there are opportunities to acquire high-yielding assets. Moreover, tightening of spreads on CLO AAA debt tranches may create solid ground for the refinancing of CLO structures to the benefit of CLO equity tranches.

Beyond the short term, S&P recently became wary of growing risks that could lead to a further default spike (up to 10%) beyond mid-2020. These include the recent yield curve inversion, as well as an uptick in credit spreads for speculative-grade debt. Furthermore, we note the deterioration in debt quality is already visible in issuer ratings. S&P Global Intelligence reports that over the 12 months ending September 2019, the ratio of US corporate ratings downgrades to upgrades was 2.9x compared to 2.1x and 1.6x in 2018 and 2017, respectively. At the same time, the number of sub-investment grade issuers rated B- or lower reached c 27% in June 2019, which is considerably higher than the 15% seen in June 2007 (ie close to the peak of the cycle before the global financial crisis).

The worsening of credit quality is especially visible among first-time issuers – during the LTM period ending July 2019, c 34% of speculative grade new issuers were rated B- or below. We note that the last time we saw these levels was in 2000 (c 25%). Both now and back then, the high-tech sector led the way with respect to new issuers with weak ratings. Importantly, the share of outstanding US loans rated CCC currently stands at 7.5%. This is crucial for CLOs (which held 62% of outstanding US leveraged loans at end-2018 according to Moody's and absorb an even larger share of new leverage loans issued), as most structures are contractually limited to keeping no more than 7.5% of their assets in debt rated CCC or lower. This may result in some CLO structures being forced to sell their lowest-grade debt, with limited number of potential buyers. However, we understand that although CCC-rated loans above the 7.5% limit are deducted for the purpose of the over-collateralization test for junior CLO tranches, this does not have to translate into a test failure (which would divert cash flows from equity and junior tranches to be reinvested in collateral or to pay down the most senior tranches). Hence, 7.5% does not constitute an immediate trigger point in this respect.

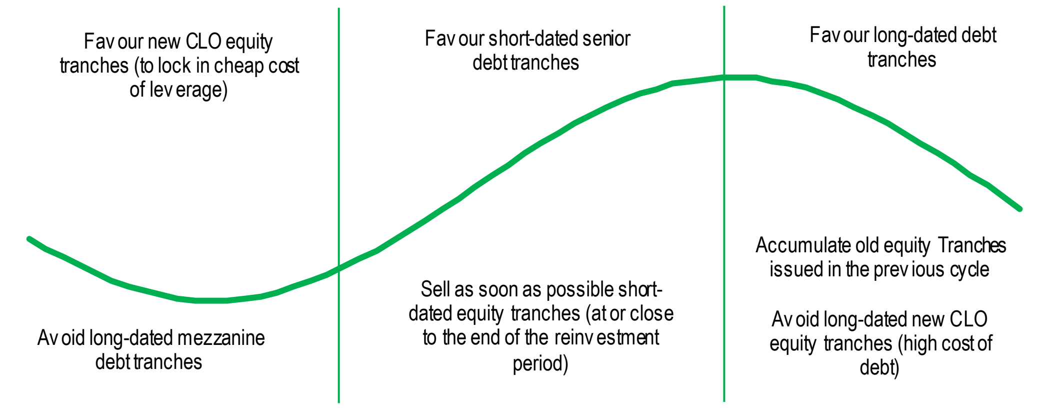
While we acknowledge the deteriorating debt quality, we also note the prevalence of covenant-lite debt (c 80% of newly issued leveraged loans in the US), of which only a small part will mature over the next two to three years, should translate into a contained number of technical defaults in the short term. Still, once these mature in an economic downturn, this may lead to lower recovery rates (as detailed in our initiation note).

Asset allocation

Investment process: Active approach to the credit cycle

AXA IM focuses on long-term value investments to provide consistent excess returns with emphasis on income generation and capital preservation. It aims at identifying relative value opportunities across the CLO capital structure, distinguishing between seniority and the age of the CLO structure. The fund manager's active portfolio approach is presented in Exhibit 3. 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 avoiding mezzanine debt tranches with long maturities, as these offer limited returns (due to low spreads) and expose the investor to a higher risk. As the current 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). It has also already started to accumulate equity tranches with attractive CLO debt spreads. Finally, during market downturns, AXA IM favours debt tranches with longer maturities and proceeds with the accumulation of old equity tranches issued during the prior cycle at attractively low CLO debt spreads, while avoiding new 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 3: 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 dollar CLO equity tranches over 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) and control the manager replacement rights.

Current portfolio positioning

Volta's GAV at end-October2019 was €313.3m, with c79% invested in CLOs. In line with its strategy, Volta continues to increase its exposure to CLO equity positions, which as a percentage of GAV (and including CMV's and warehouses) went up by 13.8pp y-o-y to 48.6%. This represents a record high level and compares to an average post-crisis allocation of 26.7%. We note that c 60% of the CLO equity bucket represent long-dated issuances (vintages 2017 to 2019), which can purchase new loan collateral at depressed prices in an economic downturn while they are still in a reinvestment period. Consequently, although the current risk-averse market sentiment weighs on the pricing of equity tranches (and in turn Volta's NAV), it allows the investment manager to enter secondary positions at significant discounts. As a reminder, equity tranches that underperform when the market turns are normally those with short maturities, facing the risk of redemption in unfavourable market conditions. A significant tightening in spreads on European CLO AAA tranches (as part of the recently experienced 'flight to quality' in credit markets) may constitute an opportunity for Volta to refinance the CLO structures and, as a result, improve the cash flows to equity tranches.

Exhibit 4: Portfolio GAV breakdown

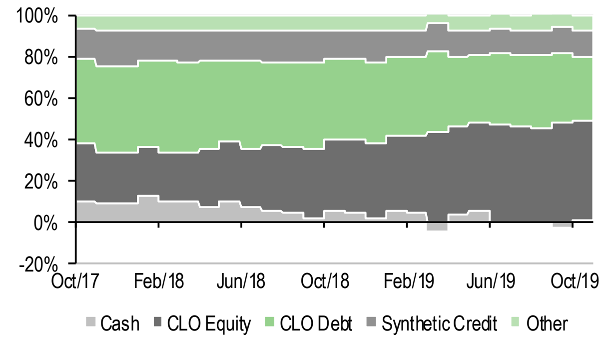
	Portfolio end-Oct 2019 (€m)	Structure end-Oct 2019	Portfolio end-Oct 2018 (€m)	Structure end-Oct 2018	Change (€m)	Change (pp)
CLO	**248.7**	**79.4%**	**260.3**	**73.4%**	**-11.6**	**6.0**
US$ equity	74.9	23.9%	52.1	14.7%	22.8	9.2
EUR equity	65.8	21.0%	55.0	15.5%	10.8	5.5
US$ debt	93.7	29.9%	135.1	38.1%	-41.4	-8.2
EUR debt	2.5	0.8%	2.5	0.7%	0.0	0.1
CMV	11.6	3.7%	8.2	2.3%	3.4	1.4
Warehouse	0.0	0.0%	8.2	2.3%	-8.2	-2.3
Synthetic Corporate Credit	**39.3**	**12.5%**	**48.4**	**13.6%**	**-9.1**	**-1.1**
BBS transactions	39.2	12.5%	48.4	13.6%	-9.2	-1.1
Cash Corporate Credit	**6.4**	**2.0%**	**8.9**	**2.5%**	**-2.5**	**-0.5**
Equity	6.4	2.0%	8.9	2.5%	-2.5	-0.5
ABS	**17.7**	**5.6%**	**17.1**	**4.8%**	**0.6**	**0.8**
Residual positions	8.8	2.8%	8.2	2.3%	0.6	0.5
Debt	9.1	2.9%	8.9	2.5%	0.2	0.4
Cash	**1.2**	**0.4%**	**19.8**	**5.6%**	**-18.6**	**-5.2**
GAV	**313.3**	**100.0%**	**354.5**	**100.0%**	**-41.2**	**-**

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

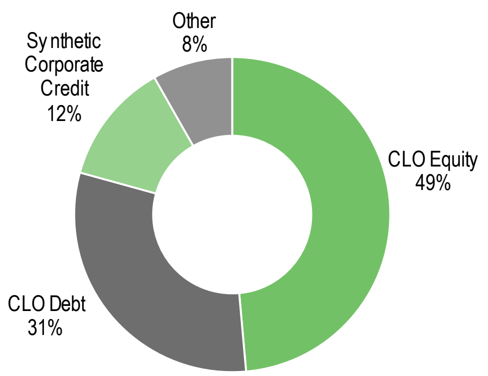
The increase in the CLO equity bucket was at the expense of exposure to CLO debt (which was reduced by 8.1pp to 30.7%) and BBS transactions (which fell 1.1pp to 12.5%). AXA IM notes that the risk profile of the most junior CLO debt (B tranches) is similar to residual positions, while they do not provide the upside potential from improving cash flows from the underlying loan collateral or the flexibility to refinance the CLO structure. In contrast, senior tranches trade close to par and thus offer limited returns. Ahead of Brexit, Volta has kept its EUR CLO debt bucket below 1% of GAV. BBS positions are synthetic transactions that permit banks to transfer part of their exposures and are illiquid relative to other components of Volta's portfolio. As part of its efforts to enhance the liquidity profile of its portfolio, the company has recently also reduced the repurchase facility (used to lever up its CLO debt exposure) from US$50m to US$40m.Volta is currently fully invested, while its five-year average cash position is5%.

Exhibit 5: Volta's exposure – debt vs equity tranches

Recent development of portfolio structure



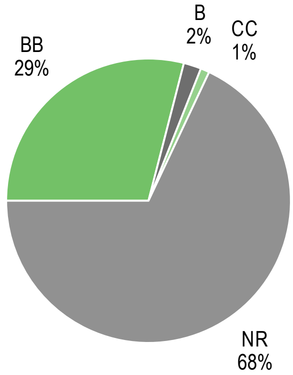
Portfolio split by asset classes at end-October 2019 (%)



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

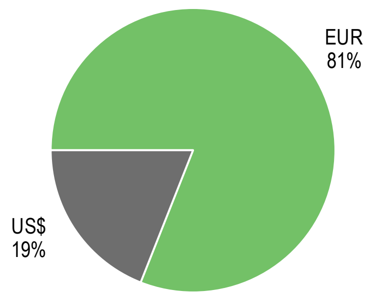
The fund's portfolio remains highly diversified across borrowers and sectors. Its top 10 underlying exposures (making up only 3.9% of Volta's NAV at end-October2019) come from 10 different sectors, with Volta's largest exposure to a single security equalling 3.8% of GAV at end-October 2019.As Volta invests a considerable part of its portfolio in the US, it has a high exposure to the US dollar, with c 62% of its GAV representing US securities at end-October 2019 (flat y-o-y). Volta intentionally does not fully hedge US dollar exposure to limit the liquidity required to fund potential margin calls. Interestingly, its residual US dollar position decreased to 19% from 33% at October 2018 (see Exhibit 7). Given that Volta's exposure to US assets remained stable over the period, we suspect the investment manager has decided to take advantage of the US dollar strengthening to increase hedging. Since inception, the overall FX impact on Volta's performance has been modest. We also note that Volta's UK exposure at end-July 2019 stood at 6%.

Exhibit 6: Volta's direct investments by rating breakdown at end-October 2019



Source: Volta Finance, Edison Investment Research

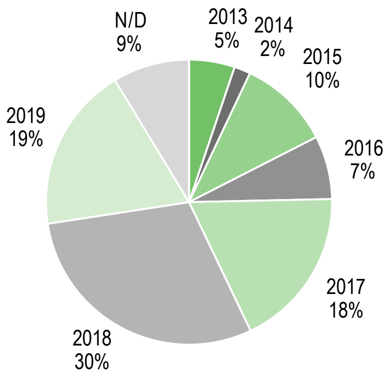
Exhibit 7: Residual currency exposure (after hedging) % of NAV at end-October 2019



Source: Volta Finance, Edison Investment Research

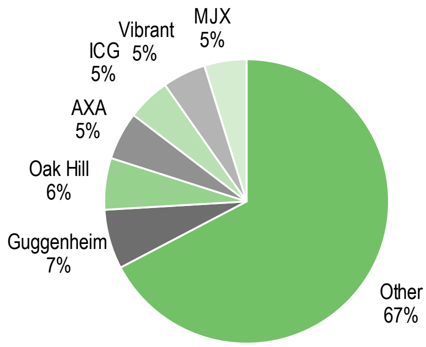
Volta's diversification in terms of CLO managers in its portfolio remains relatively high (see Exhibit 9), allowing for lower concentration risk (most notably lower collateral overlap) and providing AXA IM with more flexibility to pursue its active approach to the credit cycle. At the same time, its split by vintages is skewed towards newer issuances and 48% of CLO exposure comes from 2018–2019 vintages.

Exhibit 8: Volta's CLO portfolio by vintage at end-October 2019



Source: Volta Finance, Edison Investment Research

Exhibit 9: Volta's CLO portfolio by manager at end-October 2019



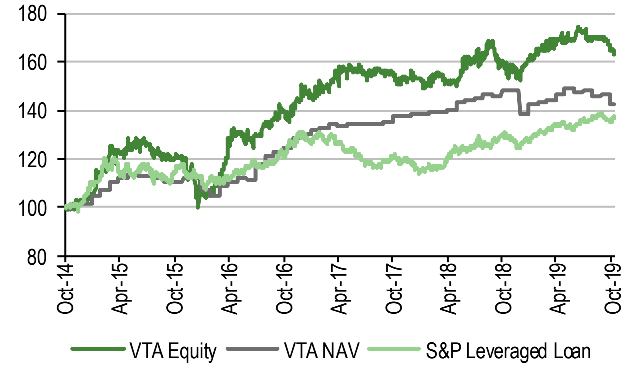
Source: Volta Finance, Edison Investment Research

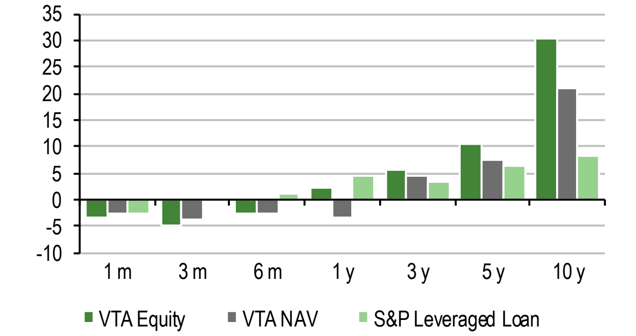
Performance: Five-year NAV return above benchmark

Over the last 10 years Volta's shares achieved an average annual TR of 30.3% (see Exhibit 10). However, this was largely driven by the strong rebound during the recovery phase in 2009–12 after the 2008/09 global financial crisis. Five-year performance shows a more normalised rate of return at 10.5% pa. We estimate Volta's five-year NAV TR performance is 7.4% pa, which is above our selected benchmark S&P Leveraged Loans Index (LLI) of 6.3% pa.

Exhibit 10: Volta Finance's performance to 31 October 2019

Price, NAV and benchmark TR performance, five-year rebased	Price, NAV and benchmark TR performance (%)





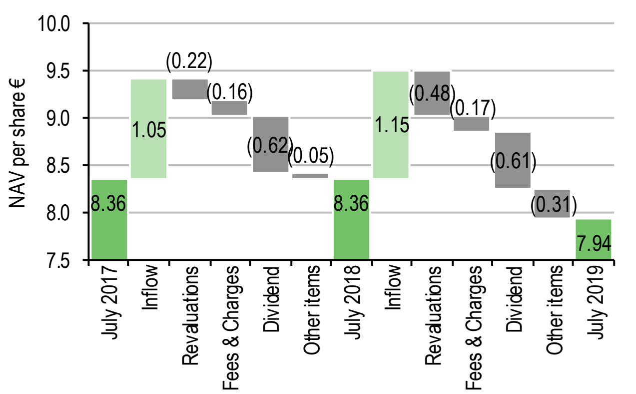
Source: Thomson Datastream, Euronext Amsterdam, Edison Investment Research. Note: Three- and five-year performance figures annualised.

The weaker ytd results (3.1% at end-October 2019 vs benchmark at 8.9%)are largely a function of the risk-off attitude coupled with a global shift from floating rate to fixed rate debt assets negatively affecting the pricing of junior debt and equity CLO tranches (as these are normally floating-rate instruments).Valuation of these investments held in Volta's portfolio is largely subject to mark-to-market, translating into a lower reported NAV. However, we should stress that CLOs do not have embedded mark-to-market triggers that would force the investor to conduct a 'fire sale' or inject additional capital to improve the collateral (explained in detail in our initiation note).Instead, CLOs have certain internal tests in place where quality deterioration in underlying loans (ie an increase in default rates)may trigger a temporary redirection of coupon cash flows attributable to CLO equity (and possibly junior debt) tranches to strengthen the loan collateral (as was the case in 2009/2010). However, current default rates are at record lows globally (see the Market outlook section above for details); if they remain at moderate levels, Volta should be able to harvest significant cashflows from assets acquired at discounted prices. In fact, Volta set a new record of monthly distributions from its portfolio at €11.0m net of repo costs in July 2019,while its current six-month rolling cash inflow (as at end-October 2019) reached a healthy €21.5m (see Exhibit 11), translating into an annualised yield on its portfolio at 15.6% of the end of month NAV. As a result, Volta's dividend cover at end-October 2019 stood at 1.8x.

Exhibit 11: Six-month trailing inflow from interest and coupons* (€m)

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

Exhibit 12: One-year NAV per share performance

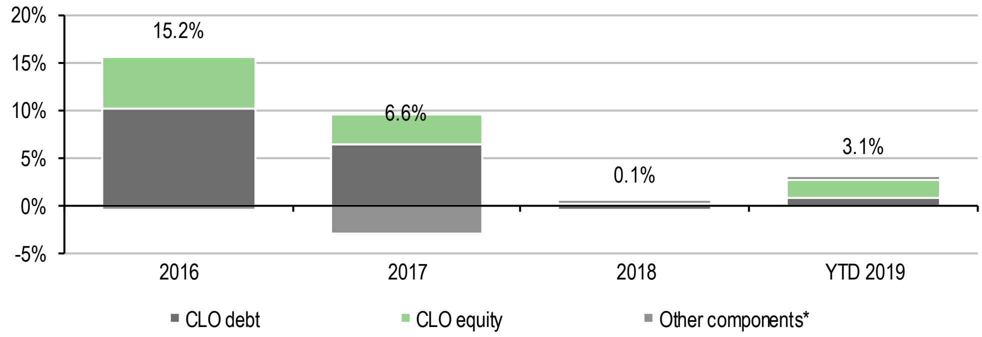


Source: Volta Finance, Refinitiv

Volta's NAV TR in FY19 (to end-July 2019) was 2.5%. Although remarkably below long-term averages, it still constitutes a considerable uplift in H219, after the company posted a 1.2% NAV decrease in H119 (ending January 2019). While investor caution towards more risky and complex investments (such as CLOs) results in depressed market prices, coupons and interest from the underlying loan pool continue to contribute positively to NAV at 13.8pp in FY19 (ending 31 July). This was mostly offset by revaluations, but it must be noted that unrealised losses contributed -9.3pp, whereas the net loss on closed transactions had an effect of just -0.4pp. Ongoing charges were in line with previous years at 1.9% of the opening NAV in FY19. In April, Volta unified its pricing source of CLO Equity tranches to JP Morgan Pricing Direct, which increased NAV by 0.2% at the time. Previously, pricing from corresponding arranging banks was mostly used. The NAV return falls short of the 9.3% TR posted by our selected benchmark S&P LLI.

Since end-FY19 (July 2019) Volta posted a NAV TR of -3.7%, with CLO debt and equity tranches posting returns of -3.9% and -3.1% respectively during the period. After taking into account their respective portfolio weights, this translates into a contribution to NAV TR of -2.6pp (-1.3pp each) according to our calculations. The ytd NAV TR performance (calendar year) was 3.1% vs 8.9% SP LLI. The main contributor to ytd performance was CLO equity tranches delivering 1.9pp (5.5% ytd performance) according to our calculations.

Exhibit 13: NAV TR performance attribution of main asset classes



Source: Volta Finance monthly reports, Edison Investment Research calculations. Note: *Includes synthetic corporate credit, cash corporate credit, ABS and FX impact.

A combination of continued solid income generation and falling prices of riskier tranches translated into a rise in the projected IRR of Volta's portfolio to 11.6% at end-July 2019 (12.5% including leverage), which compares to 10.0% (10.8%) a year earlier. It also allowed the investment manager to seize the opportunity to source new investments at an average projected IRR of 12.75% in FY19, as per company announcements. These calculations are conducted under the assumption of a fixed default rate of 2% per year, which is ahead of the market's current default rate (1.03% globally in 2018 according to S&P). After accounting for financing and hedging costs and ongoing charges, we estimate all the above may translate into a NAV TR above10% pa. An additional return of 1–2pp may come from active trading in the portfolio, according to AXA IM.

Exhibit 14: Projected IRR on Volta's portfolio by asset classes at end-July 2019

Asset Class	%GAV	Projected IRR	Price Jul-19	Price Jul-18
US$ CLO equity	24.1%	15.7%	76%	73%
EUR CLO equity	18.8%	11.2%	72%	80%
US$ CLO debt	33.7%	9.9%	94%	100%
EUR CLO debt	0.8%	9.4%	96%	99%
CMV/CLO warehouses	2.8%	15.0%	87%	101%
Bank balance sheet trans.	12.2%	10.7%	88%*	96%
Cash corp. credit	2.1%	8.0%	64%	N/A
ABS residual	2.6%	11.0%	78%	N/A
ABS debt	2.7%	10.0%	101%	N/A
Total	**99.8%****	**11.6%*****		**-**

Source: Volta Finance, Edison Investment Research. Note: *Average. BBS priced at 88%, REO at 100%. **Remaining c 0.2% represents Volta's cash position at end-July 2019. ***Excluding the impact of leverage.

Volta estimates the impact of an increase in default rates above its base scenario on their asset prices and portfolio value. Although the assumed 2% rate pa may seem conservative given the current environment, it is also worth noting that during past economic recessions, the US default rate has gone from a long-term average of 3% up to 8% or even 10%. In Exhibit 15, we present Volta's scenarios for GAV change based on a default rate hike to 3% and 4%.

Exhibit 15: Sensitivity of GAV on assumed default rates at January 2019

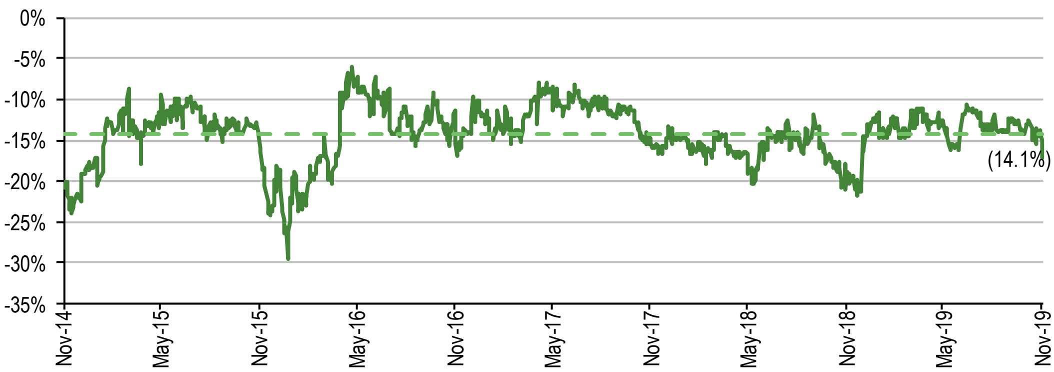
		Default rate of 3%		Default rate of 4%	
	% of NAV	Price impact	NAV impact	Price impact	NAV impact
US$ CLO equity	27.0%	(11.2%)	(3.0%)	(23.9%)	(6.4%)
EUR CLO equity	21.3%	(12.9%)	(2.7%)	(26.8%)	(5.7%)
US$ CLO debt	37.6%	0.0%	0.0%	0.0%	0.0%
EUR CLO debt	0.9%	0.0%	0.0%	0.0%	0.0%

Source: Volta Finance

Discount: Trading at a low-double digit discount

Volta's shares have traded at a discount to NAV over the last few years (usually in the range of 5–20%, see Exhibit 16). We believe that to some extent this may be the result of relatively low stock liquidity, overall investor caution over structured finance investments and inherent uncertainty related to the valuation of some portfolio holdings. However, the discount has narrowed from 20% towards the end of 2018 and the shares now trade close to the five-year average discount of c 14%.

Exhibit 16: Share price discount to NAV over five years (%)



Source: Euronext Amsterdam, 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 (the last reported NAV stood at €274.0m at end-October 2019). The management fee is subject to reduction in investments in products managed by AXA IM (10.6% of Volta's GAV at end-October 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 in FY19 were in line with this and amounted to €5.7m, representing 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; repurchased from the market since then). Volta has a perpetual life and there is no defined timing of continuation votes.

At end-October 2019 Volta's leverage stood at 12.5% (down from 13.5% at end-October 2018) and consisted of a repurchase agreement from Société Générale. The investment manager reduced the size of the repurchase agreement to US$40m (from US$50m) to limit the risk of liquidity issues in anticipation of higher volatility. The debt bears an interest rate of Libor 3M +1.5% and is secured against a portfolio of US dollar CLO debt securities. The repo is over-collateralised (on the last reporting date in July 2019, the €40m was secured against assets with market value of €63.2m and final maturity in December 2022). The agreement may be terminated by either party, with repayment becoming due within one year (in three equal instalments after six, nine and 12 months).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 has several funding commitments in its current portfolio associated with funding vehicles that are in the ramp-up stage. At end-July 2019, commitments not yet called for amounted to €30.5m, up from €22m at end January 2019, and significantly lower than €55.4m at end July 2018. At end FY18 most commitments stemmed from CLO warehouses, which have been closed during the year. Currently, the largest commitment (€12.5m) is associated with the real estate-owned (REO) transaction 2019-1. This is a synthetic credit position that Volta entered in July 2019 by investing €3m initially. The asset has a relatively short term (two years weighted average life) and offers an IRR of close to 13% (according to Volta).

Dividend policy and record

Although Volta has no strict dividend policy in terms of defined payout ratio or dividend yield, 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 2015 it has been able to deliver a dividend per share of €0.62 on an annualised basis. However, the amount of dividend payments depends 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 (see our initiation note) 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 9.9%. The company recently paid an interim dividend of €0.16 per share, in line with historical levels.

Peer group comparison

The peer group we used consists of funds exposed predominantly to CLO investments (Exhibit 17). It is important to highlight these funds obtain this exposure through a variety of structures. We believe Fair Oaks Income Fund 2017 is the most comparable peer, with high portfolio diversification across instruments, CLO managers, sectors and borrowers. However, it has considerably higher exposure to CLO equity tranches (95% of portfolio at end-June 2019) than Volta (48.6% including warehouses and CMVs). It must be also noted that Fair Oaks Income Fund 2017 has a definite life, with investment period ending in June 2020 (and may be extended by another year at the general partner's discretion). Following the end of investment period, the fund will have a fixed life of five years. Carador Income was excluded from the peer group due to a managed wind-down process.

The remaining funds' structures and strategies differ from that of Volta materially. Blackstone/GSO Loan Financing (BGLF) and Marble Point Loan Financing (MPLF) are risk-retention vehicles and as such their investments include directly held loans not yet securitised alongside CLO Equity and Warehouses. All instruments in their portfolios are managed by their respective investment managers vs c 10% in the case of Volta at end-October 2019.This may result in higher collateral overlap and may enhance returns for investors, as typically these kinds of funds only pay management and performance fees at the underlying product level. The latest ongoing charge at BGLF and MPLF stood at 0.4% and 1.4% of NAV respectively, compared to 1.9% for Volta.

Chenavari Toro Income Fund's 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 16.8% at end-September 2019, according to the company.

TwentyFour Income's main focus lies in UK-based assets (c 47% of portfolio and residential mortgage-backed securities (50% of the portfolio). It does have material exposure to CLOs (33% of the portfolio) and should be treated as Volta's more remote peer.

Exhibit 17: 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	79	49	62% US$, 34% EUR	N/A, but most likely around 9–11% pa (net return)
Blackstone/GSO Loan Financing	Blackstone	100% of CLOs managed within the capital group	82	82	56% US$, 44% EUR**	N/A
Marble Point Loan Financing	Marble Point	100% of CLOs managed within the capital group	89	77	100% US$	8% dividend yield target
Chenavari Toro Income Fund	Carne Global	Diversified (although meaningful exposure through Taurus to CLOs managed by Chenavari)	69	~30**	95% EUR, 7% GBP	Net return of 9–11% pa, DPS of at least €8c pa
Fair Oaks Income 2017	Fair Oaks	Diversified	100	95	93% US$, 7% EUR	Target return at 12–14% pa
TwentyFour Income	TwentyFour	Diversified	33	N/D	53% EUR, 47% 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 recently underperformed its peers, ranking fifth in one- and three-year NAV return. The five-year NAV TR of 42.7% is slightly below the peer group average. We underline the differences in portfolio allocation and investment strategies discussed above. 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 has a higher ongoing charge compared to some peers due to a significant part of portfolio being managed by external managers as discussed above. Volta's dividend yield of c 9.9% (although quite healthy) is somewhat below the peer average of 11.5%. The company's discount to NAV is at the higher end of the peer group range (with only Chenavari Toro trading at a deeper discount).

Exhibit 18: Peer group comparison at 2 December 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	229.7	**(3.5)**	**14.2**	**42.7**	**570.1**	**(16.2)**	**1.9**	**Yes**	**114**	**9.9**
Fair Oaks Income 2017 Ord	277.0	(2.4)	18.7	76.8	N/A	(9.2)	0.3	No	100	22.0
Blackstone/GSO Loan Financing*	323.9	10.4	25.3	48.9	N/A	(10.1)	0.4	No	102	12.4
Marble Point Loan Financing Ord	143.1	(11.7)	N/A	N/A	N/A	3.6	1.4	No	100	7.2
Chenavari Toro Income Fund*	245.9	9.1	28.2	N/A	N/A	(20.0)	2.5	Yes	100	10.1
TwentyFour Income Ord	659.7	9.8	29.8	16.4	N/A	1.3	1.0	No	100	5.5
Peer average	**329.9**	**3.0**	**25.5**	**47.4**	**-**	**(6.9)**	**1.1**	**-**	**100**	**11.5**
Fund rank in sector	**5**	**5**	**5**	**3**	**1**	**5**	**2**	**-**	**1**	**4**

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

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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