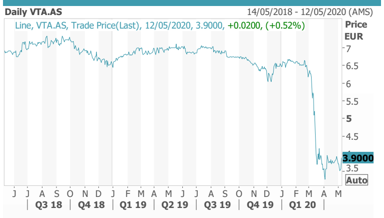
12 May 2020

HARDMAN & CO.

Closed-Ended Investments



Source: Refinitiv

Market data

EPIC/TKR	**VTA.NA, VTA.LN VTAS LN**
Price (p)	3.70/3.77/330p
12m High (p)	6.74/7.04/642p
12m Low (p)	3.20/3.38/285p
Shares (m)	36.6
Mkt Cap (€m)	135
Div. Yield (%)	11%
Discount to NAV (%)	27%
Market	AEX, LSE

Description

Volta is a closed-ended, limited-liability investment company that pursues a diversified investment strategy across structured finance assets (primarily Collateralised Loan Obligation, CLOs).

Company information

Independent Chairman	Paul Meader
Independent Non-Executive Directors	Graham Harrison Stephen Le Page, Atosa Moini, Paul Varotsis
Fund Managers (AXA IM Paris)	Serge Demay A Martin-Min François Touati
Co. sec./ Administrator	BNP Paribas Securities Services SCA, Guernsey

Key shareholders, 31 July 2019

AXA Group	30%
BBVA Madrid & BNP WM	7%
Ironside Partners & Deutsche	6%

Diary

Mid May	April estimated NAV

Analyst

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VOLTA FINANCE LIMITED

Q&A with Hardman analyst

In this note, we provide investors with a detailed Q&A with Volta's Directors and Manager on the key issues as we see them today. These are structured into risk management (exposed sectors where loans are typically >30% below par make up just 10% of the portfolio, solvency is strong and there appears to still be a liquid market at a modest discount for many assets). We consider Volta's re-investment opportunities and focus on the revised dividend prospects. Volta marks to market most of its assets and thus captures both "real" losses and investor sentiment (ca. two thirds of March's losses), which may reverse over the next year or two.

- **Importance of Cov-Lite documentation:** Investors should not underestimate the importance of the market trend for Cov-Lite documentation. It will allow potentially vulnerable companies to survive materially longer (and potentially through to an economic recovery), a material positive for Volta's performance.
- **Performance:** Volta's March fall in NAV (34%) is better than peers with the same accounting approach. Volta's CLO US equity positions had no April cash diversions (market average 17%). Underlying loans in sectors with prices mainly >30% below par are 10% of the book. The manager continues to outperform the market.
- **Valuation:** Volta trades at a 27% discount to NAV. Peer-structured finance funds, and a range of other debt funds, on average, trade at smaller like-for-like discounts/premiums. Volta has delivered faster-than-peer NAV growth for in-line/lower volatility. It targets an 8% of NAV dividend (11% yield on current s/p).
- **Risks:** Credit risk is a key sensitivity. We examined the valuation of assets, highlighting the multiple controls to ensure its validity, in our *initiation note* in September 2018. We noted the NAV is affected by sentiment towards its own and underlying markets. Volta's long $ position is only partially hedged.
- **Investment summary:** Volta is an investment for sophisticated investors, as there could be sentiment-driven, share-price volatility. Long-term returns have been good: ca.10% p.a. returns (dividend reinvested basis) over five years. The current portfolio-expected cashflow IRR is above this level. The dividend yield (8% of NAV is targeted, 11% on current share price) will be driven by cashflows.

Financial summary and valuation (Hardman & Co adjusted basis)

Year-end Jul (€m)	2015	2016	2017	2018	2019	2020E	2021E
Coupons & dividend	33.7	34.7	33.2	38.5	42.0	42.3	25.5
Operating income	46.0	36.5	35.0	37.0	41.0	41.3	24.4
Inv. manager's fees	-4.5	-4.3	-4.6	-4.6	-4.4	-3.4	-1.5
Adj. performance fees	-3.5	-1.3	-1.2	-1.4	-2.1	-2.6	-1.3
Total expenses	-10.3	-7.2	-7.0	-0.9	-1.0	-1.0	-1.0
Total comp. income	35.7	29.3	28.0	29.7	32.9	33.8	20.1
Statutory PTP	47.6	12.6	38.7	22.7	7.1	-89.7	83.3
Underlying EPS (€)	0.98	0.80	0.77	0.81	0.90	0.92	0.55
NAV	299.2	289.3	305.5	305.7	290.6	186.0	252.6
S/P disc. to NAV	55%	53%	56%	56%	53%	27%	46%
Gearing	9%	12%	12%	14%	12%	0%	0%
Dividend yield	9.5%	9.5%	9.5%	9.5%	9.5%	11.1%	12.4%

Source: Hardman & Co Research.

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Manager Q&A

Risk

What are the worst industries/loans to which Volta is exposed through its CLO positions?

Sectors most affected by crisis vary between US and Europe; US sectors where prices generally below 30% par account for 5% of portfolio

"The industries which are the most sensitive to the COVID crisis are not the same on both sides of the Atlantic. In the US, it is mostly industries like Oil & Gas, Coal, Metal Fabricate/Hardware (that are producing for Energy/Raw materials), Pipelines, semiconductors. Those worst industries represent 5,3% of Volta's underlying exposure from its CLO equity positions.

US sector exposures

Sector	Weight (% portfolio)	Average price
Office Furnishings	0.01	20.8
Oil and Gas	0.46	45.5
Coal	0.24	54.8
Metal Fabricate/Hardware	1.31	59.0
Pipelines	1.75	60.8
Semi-conductors	1.02	63.6
Mining	0.53	67.9

Source: Volta (as at 4 May 2020). Hardman & Co Research

European ones further 4%

In Europe, industries in relation with energy/raw materials are far less present but, because of the length of the containment, there is more issue with some other areas like Lodging, Leisure Time. Those worst industries represent 4,4% of Volta's underlying exposure from its Euro CLO equity positions:

US sector exposures

Sector	Weight (% portfolio)	Average price
Mining	0.03	53.4
Agriculture	0.03	61.5
Home Furnishings	0.31	64.3
Food Service	0.40	66.5
Lodging	0.69	68.1
Leisure Time	2.92	69.2

Source: Volta (as at 4 May 2020). Hardman & Co Research

Although the COVID-19 crisis will clearly generate downgrades and defaults that weren't expected, we noticed that most of the CLO managers we work with are actively managing their books to rearrange portfolios.

US market average CLO equity positions: 17% had partial or total cash diversions, Volta had none

As a very simple illustration of the robustness of our positions relative to market, latest statistics we saw on US$ CLO were to mention that, at April payment date, 8.8% of the US$ CLOs suffered a partial diversion of the excess spread payment to the equity tranche and 8.2% a total diversion of such payment. We did not suffer any diversion of payment on Volta CLO equity positions in April."

Hardman & Co comment: using actual market prices for most affected sectors helpful. Only small percentage of book in high-risk sectors to be applauded.

Hardman & Co comment: Volta has used market prices to assess which sectors have been most affected by the COVID-19 crisis. This has appeal to us in that it is using hard factual data rather than the latest news story. We note that less than 10% of the portfolio is in these high-risk areas (where the price is largely under 70% of par).

The prices above represent the underlying loans and CLO structures have gearing to these underlying loans (which is why Volta's overall NAV fell just over 30% in March even though less than 10% of the underlying loans are priced at that level).

What is your current view of how Cov-Lite documentation might affect actual losses both quantum and timing?

Cov-Lite documentation will help companies survive. Lower defaults as a consequence of Cov-Lite is good for Volta.

"Since the early start of the development of Cov-Lite documentation we always said three things: through a given economic recession, with Cov-Lite there is less default, when the default occurs it occurs later with a lower recovery and trading of loans at discount will be more numerous and last longer.

With the COVID-19 crisis, many companies are suffering brutal decreases in revenues. Even taking out the liquidity question of these balance sheets, with full covenant docs, most of these companies would have been forced into default in a few months. Cov-Lite will give far more time to these companies to survive such a drop in revenues; obviously some defaults will occur, but the pace of defaults will be spread through years. Recovery will probably be lower, but we clearly avoid a brutal increase in defaults. Loans from companies in a painful situation will trade for quarters and probably years for some of them at discount before defaulting (or not) giving more time and more re-investment opportunities to CLO managers that have solid credit skills and trading capabilities.

This time, it is clear that Cov-Lite have been a good thing for CLO equity positions."

Hardman & Co comment: we would also highlight sentiment benefit from defaults lower than they would otherwise have been

Hardman & Co comment: The fact that many companies without revenue would have breached "full" covenants and gone into default is indisputable. We concur with management that the "cycle" will be extended significantly because of Cov-Lite documentation. We also believe that investor sentiment, and so the share price, will be driven by the number of defaults and if these do not materialise in the short term to the extent they would have in the past, we do not expect the same sentiment-driven downward pressure on the share price as has been seen then.

To what extent is the portfolio value at risk from changes in actual cash payments and to what extent from rating agency changes?

ca.20% loans already downgraded

"For the moment, rating agencies acted massively and relatively promptly regarding corporate ratings. Depending on which rating agency you consider, ca.20% of the loans have already been downgraded. At this point in time, almost no CLO debt tranches have been downgraded and rating agencies assign Neg Watch or Neg outlook to 20 to 80% of BB CLO tranches (depending on the rating agencies and on region (US/Europe)).

Further downgrades to be expected. While no cash diversions made in April, Volta expects them in July and October.

Like every three months, April is a month during which most of our CLO positions are receiving cash (coupons from the debt, excess cashflows from equity). Despite an already massive wave of downgrades in the loan markets, with a significant increase in CCC bucket (+5% for US$ CLOs, +3% for EUR CLOs) none of Volta's positions suffered a diversion of payments. Unfortunately, we expect to see more downgrades in loan markets and it might happen that in July some but a few of Volta's equity positions suffer a partial or full diversion of payments. We expect, having in the meantime some defaults materialising, that there will more of this in October."

Already built into valuation

Hardman & Co comment: Volta's portfolio has clearly outperformed the market in terms of cash diversion in the short term. It cannot be immune from market trends and so more cash diversion may be expected during the course of 2020. There is no reason to believe that Volta will not continue to outperform the market as a whole. We believe the cash diversion is expected by investors and so built into the prices.

It appears that all the expected cashflows were received in April. That is a highly credible performance. You noted some were at lower levels than historically given prevailing interest rates. Can you give more colour on the reduction?

CLO equity positions carry basis risk as CLO structures typically receive one-month LIBOR-related payments but pay three-month LIBOR. Should reverse as a more normal yield curve is re-established in the future.

"Most CLOs were paying in April for the period from mid-January to Mid-April. Interest payments due to CLO debt holders were basically depending on three-month LIBOR rates around mid-January, but most of the interest payments received from underlying loan pools are depending on one-month LIBOR rates determined in January/February and March. With the decrease in one-month LIBOR rates since mid-January US$ CLO suffered from this mismatch. The impact was estimated, on average, to be in the area of 20% of the equity payments.

In the future, if/when rates will increase again, CLO equity position will benefit from the hike."

Hardman & Co comment: The basis risk between paying three-month but receiving one-month LIBOR is a known exposure for CLO equity holders. Over time, a reversion to a normal yield curve will see the losses in cashflow this time around reverse. There is unlikely to be exact offset (future cashflows will be different from current ones) but any difference is unlikely to be material.

Can you explain the mechanics behind your comment in the March 2020 monthly statement that "CLO equity positions will start suffering partial diversion of cash flows as early as July and that this might become more pronounced in October due to the likely increase of the excess CCC bucket in CLOs". Do you think such a profile is fully built into CLO equity prices?

Detailed review of mechanism by which cash diversion takes place

"All CLOs are built with mechanisms that are in place to protect the debt holders (in some way protecting debt holders also means avoiding debt prepayment and maintaining intact through time the leverage that benefits to CLO equity positions). The first level of defence is an over-collateralisation test usually named "Re-investment test". At inception of the CLO, this test has generally a 3.5% cushion (meaning that the size of the underlying portfolio of loans exceed by 3.5% the amount requested to stay in compliance). The way this cushion is consumed is through trades that generate losses, loans in defaults or loans being rated CCC/Caa1 or lower in excess of 7.5% (loans in excess of the CCC bucket are considered as if they were in default).

If and when a CLO breach the "re-investment test", the rule is simple; at the payment date, 50% the excess cashflow that should have been paid is reinvested in new loans and not paid to the equity tranche. If by diverting a lower amount the test is back into compliance, the lower amount is diverted.

Then, if there is more par erosion, a second test, generally the distance is 1% from the re-investment test, exist to protect the BB tranche of the CLO. Once breached, diversion is 100% of the excess cashflows that might have been paid to the equity (or lower if it's enough to be back into compliance), and the amount that is diverted is used to prepay the AAA tranche of the CLO.

Here you can touch one of the significant benefits of having defaults spread through time (thanks to Cov-Lite). If you have every quarter 1% of default causing 0,5% erosion of the test and you are at the limit of breaching the re-investment test, diverting a portion of the payments to the equity combined with some re-investments at discount should permit maintaining this type of test in compliance. Having no reduction of the leverage that benefit the equity and maintaining re-investment capabilities is key for the performance of CLO equity through time.

CLO equity at the end of March are priced for the situation in which we are: the possibility exists that some diversion of cashflow may happen. But, if the defaults are really spread through time, it is also possible to avoid diversion of cashflows before many years or to suffer only partial diversion of cashflows. The question is thus more about credit selection and trading from CLO managers in order to mitigate downgrade risk as well as ability to seize the right opportunities to rebuild par."

Hardman & Co comment: important to recognise that Cov Lite deferring defaults helps cash diversion

Hardman& Co comment: The structure to divert cash from equity holders reflects risk. As outlined above, Cov-Lite documentation generates a lower risk of default (albeit higher loss in the event of default later on). The lower up-front risk should mean less cash diversion than would otherwise have been seen.

You increased the CLO equity positions up to 45% of the portfolio in early 2020 against 31% in January 2019. In March 2020, the local currency monthly performance was down 36.9% while the debt positions fell 41.3%. Why did equity outperform debt?

US$ CLO equity average prices of Volta moved from 59.85% in February 2020 to 43.50% as of March 2020, US$ CLO debt moved from 89.97% to 54.34%.

"First, it isn't a surprise, historically speaking price reaction of CLO debt (the Original BB tranches) and CLO equity are not so different. The reason for the outperformance of CLO equity in March is mainly the fact that the starting point was far higher for CLO debt. US$ CLO equity average prices of Volta moved from 59.85% in February 2020 to 43.50% as of March 2020, US$ CLO debt moved from 89.97% to 54.34%.

One of the reasons for the outperformance is also our positioning regarding CLO equity. Most of them are from recent deals, having cleaner-than-average underlying portfolios and more time to benefit from the re-investment opportunity. Both rating agencies and the market (through price hierarchy) clearly stated that having more time for re-investment/rearrangement of underlying loan portfolio is considered as a positive feature."

Hardman & Co comment: Volta has long said its risk-adjusted returns favoured equity as their prices had already built in much of a downside

Hardman & Co comment: Volta has re-iterated many times in the past that its investment philosophy is a risk-adjusted return. Because CLO equity positions started so lowly priced, they had less to fall when the crisis hit. Management had not predicted COVID-19, but this recessionary downside protection had been communicated well in advance. The positioning in terms of recent versus old deals reflects AXA IM's expertise and experience in this field.

How much of the portfolio do you think could be liquidated over the timescale of say a week and what discount would you have to accept for such a sale?

Volta will not be a forced seller at distressed prices. Even in current markets, it could sell tens of millions at discount of 5%-10%.

"The first thing to say is that Volta already acts to avoid being forced sellers. We have enough cash to reduce the repo, we are just waiting for having a bit more cushion, in terms of cash, before acting.

However, if we were to sell some of Volta's assets, we would suffer a discount. This discount should be in the area of 5%-10% on CLO debts, but is much more difficult to ascertain in current market on CLO equity positions. Accepting this kind of discount permits selling few tens of millions in a week."

Hardman & Co comment: net liabilities €4m and solvency thus strong. Selling tens of millions at 5%-10% discount can be compared with 27% share price discount to NAV.

Hardman & Co comment: Not being a forced seller is a core message Volta has again been communicating for many years and should not come as a surprise. "Tens of millions" can be compared with an end-March Gross Asset Value of €197m, CLO positions of €136.8m and total liabilities (including fees due of €13m). End-March cash was €9m as well. A material element of the book would appear to be sellable at the 5%-10% discount. Volta's share price is currently at a 27% discount to NAV.

How much have bid-offer spreads widened and is this a constraint on positioning the portfolio/re-investment?

Bid offers spread widened to ca.5%

"In normal market conditions bid-offer are in the area of 1% for Original BB CLO tranches and 2% for CLO equity. Nowadays, we are around 5% for both of them. Managing the cost of portfolio re-positioning has always been part of our management duty; obviously, this time it is more costly but is rewarded given current outlook uncertainty when willing to reposition a portfolio. At the end, the difference in performance between a good or an average CLO equity position or between CLO BB and CLO equity merits suffered such bid-ask. It is only and mainly a question of conviction and of market opportunity.

We tend to purchase first and sell after as it is always very speculative to bet on ability to purchase quality paper we are looking for. In this market you depend on offers."

Hardman & Co comment: spread widening modest relative to re-investment returns

Hardman & Co comment: The wider bid-offer spreads is not a surprise and we would expect cash received in the short term to be used to build solvency rather than for re-investment. Before this crisis, Volta has been looking at mid-teens annual cash returns on its re-investments and we would expect this to have improved materially. In that context, an extra few percent in bid-offer spread is perfectly acceptable for the right re-investment.

How did you pick the specific four positions for sale at a loss in March 2020?

Asset sold in March on a mix of risk and solvency basis

"Two of them were sold for risk management, being amongst the positions we considered as the weakest in our portfolio (and the bids were correct). The two others were sold because they were amongst the less costly to be sold".

Hardman & Co comment: This appears a sensible balance of managing market and liquidity risk.

Having reduced hedges and margin calls, what is your current forex exposure?

"At the end of March, US$ assets were representing close to 61% of the portfolio. After hedge the US$ exposure was in the area of 45%."

Hardman & Co comment: In volatile markets, the probability of there being margin cash calls on forex hedges rises. There is thus a need to balance forex risk, which may reverse over the course of the medium and long term against the need to hold solvency against margin calls. We regard this as a core part of the management of the portfolio.

Opportunity

You have previously indicated that the returns made immediately post the GFC were ca.2x those of the years immediately before. Is that the type of upside you would expect this time around?

While quantum of upside cannot yet be judged, the same factors that drove out strong returns post financial crisis are in place again.

"CLO equity positions from vintages 2006/07 were purchased with the assumption that projected returns should be in the area of 12/14%. With the GFC, these CLO equity positions, on average, suffered some diversion of cashflows during 2009 and then benefited from the re-investment mechanism in CLOs. It took time but after a few years, cashflows from these positions were in the area of 35% per year, almost twice what those positions were paying before the GFC thanks to a significant increase in the Weighted Average Spread (WAS) of the underlying portfolios. Thanks to that, they finally performed 16% to 20%, almost 50% more than originally thought.

Every crisis is different but, like in 2009, loans are trading at discount, new loans are issued with significant higher spread and some loans are and will continue to default. Like for 2009, some CLO equity will suffer from partial or total diversion of cash flows and CLO managers will be able to rotate portfolios, to increase WAS, trying to avoid defaults.

It is also true that this crisis is different from the previous one, being a global shutdown affecting most industries and not only a liquidity crisis. Both are still systemic in their nature. Also, the market reaction is different because the 2009 crisis changed the reactions of market players to the current environment: banks have been providing more support in dealing CLO paper than in 2009, investors were less levered investing in loans or CLO and rating agencies moved swiftly in downgrading loan collateral. As a result, loan downgrades are impacting CLO structures quicker while prices for quality loans moved up even quicker. As a result, fundamental stress in CLO measured by prices and downgrades looks very different based on your perspective. This provides area for conviction.

As a result, it is impossible to make any statement regarding the final answer to this question, but the mechanisms in place are the same and a positive output cannot be excluded."

Hardman & Co comment: In the middle of the night, it is rather unfair to ask management how sunny the next day will be. However, it is clear that the underlying reasons for outperformance are the same as post the financial crisis even if the precise quantum of benefit cannot, at this stage, be judged.

If Volta marked to model, fall in NAV in March would have been ca.10%, not the 34% reported. The gap reflects sentiment and should be recovered over the next year or two.

By marking to market, you capture both the "real" economic effects but also swings in market sentiment. Your end-March NAV was €5.06 down from €7.69 at end-January – a fall of 34%. If you marked to model, what do you think the fall would be and would it be fair to expect most of this return to be re-captured over the next year?

"We believe that, with a mark-to-model approach, CLO equity positions would be valued 30% higher on a relative basis. We have no mark to model in place for CLO debt, but for the moment we do not have any strong evidence that most of our CLO debt positions shouldn't recover par. A mark to model of Volta assets will have led to a decrease in the area of 10% and the difference between -34% and -10% should be re-captured.

The reason for a decrease in CLO mark-to-model prices is that a proper mark-to-model approach would have to take into account the stress that already occurred (many loans being downgraded, increase in below 80% price loans). Mark-to-model prices can be higher later on when it is possible to better account for potential good news (ability of manager to avoid losses and benefit from re-investment opportunities)."

Volta's accounting is mark to market. Its theoretical mark-to-model impact is consistent with numbers by BGLF, which uses this approach and so is credible. Recovery in a reasonable period also seems the most likely outturn.

Hardman & Co comment: Management's indication that the portfolio would fall by ca.10% if the sentiment element is removed is consistent with the monthly performance of BGLF, which uses a mark-to-model approach. It appears to us a split of about one third fundamental and two thirds sentiment in an extreme market is not unreasonable. We also believe that as markets normalise, the sentiment factor should return to zero. In good times, market prices may well be above modelled prices, but that is for the future not now.

Given the relative pricing of European against US CLO positions appears to reflect greater sentiment issues, should we expect a re-allocation to the former from the latter?

Too early to assess best market opportunities

"For the moment, we have no clear view regarding rebalancing between US CLO equity and the European ones.

The US are more exposed to the crisis than Europe. It has been clearly outlined by rating agencies and confirmed by a lower volume of downgrades in Europe. However, US CLO managers benefit from a deeper loan market, being far more liquid and, hence, having a higher ability to reshape portfolios. In Europe, there is, as well, always the risk that a form of European crisis could resume. We will address that through time."

Hardman & Co comment: AXA IM's scale in structured markets gives it a whole market insight, which is invaluable in picking off the most optimal parts of the market at any given time. We would expect an evolution in the portfolio from here rather than a fundamental revolution.

From 2017-19, you typically generated ca.€150-€160m p.a. from coupons and sales of financial assets. How much cash do you expect to be generated in the next year, which may be available to re-invest at potentially higher returns?

Base case scenario would be ca.€60m cash proceeds

"From March 2020 to March 2021, we will not have a lot of prepayments. We have one position that is going to be reimbursed for $9m and we have some Bank Balance Sheet positions that are amortising from which we can expect some principal payments. Taking into account all of that, interest, coupons and principal payments, quarterly cashflows are in the area of €15m by the end of 2020. Depending on the severity of the crisis, it may be divided by two by the end of 2021 if we reach a point where diversion of equity payments became the norm."

Hardman & Co comment: at a third of NAV cash generation means Volta is in position to take re-investment opportunities

Hardman & Co comment: A base case of ca.€60m p.a. down 60% from pre-crisis levels appears credible with the extra risk should conditions worsen. Again. this can be compared with an end-March Gross Asset Value of €197m, CLO positions of €136.8m and total liabilities (including fees due of €13m). End-March cash was €9m as well. The key message is that there should be sufficient cash generated to mean that reinvestment at higher rates should be visible.

Would you expect the cash diversion re increase in excess CCC buckets to be temporary and, if so, on what timescale would you expect the cash to be released?

"We expect defaults to spread through years and CCC bucket to stay high for years. The uncertainty regarding diversion of cashflows is whether defaults jointly with CCC will be high enough to reach the point at which diversion starts. For sure, we will have some diversion within our portfolio but the situation isn't the same as 2009. There was a severe spike in defaults and then after one year, at least in the US, we were almost back to normal."

Hardman & Co comment: We still have to wait and see how the crisis evolves but, again, Cov-Lite documentation gives a better position than seen during the financial crisis.

You now have enough cash to repay the Repos facility. Whilst prudent through the crisis, would you have appetite to increase gearing in due course to maximise the re-investment opportunity?

Conservative approach to gearing in company given there is underlying gearing in the vehicle

"The Repo facility was not initiated for general gearing but for a very specific opportunity which was, some years ago, to gear CLO debt and reduce CLO equity exposure. Over the last year or so, this successful investment strategy was reversed as CLO debt was reduced, the Repo gradually repaid and investment in CLO equity increased once again. The COVID-19 situation simply accelerated the last step of this process. It is quite possible that selective, similar strategies could be followed in the future. However, the company already has significant embedded leverage in most of the structures into which it invests and so the Board does not consider it appropriate to have a general, long-term, structural level of gearing at the company level in addition to the gearing embedded in our investments."

Hardman & Co comment: There is clear focus on both the company's and the underlying leverage. This has been stated many times in the past and should not come as surprise to investors.

In the summer of 2007, your share price was around €9. It then fell to a low of 34c in January 2009 before increasing tenfold to €3.4 in November 2010. What type of share price profile do you expect this time around?

Recovery in sentiment losses (both on underlying and Volta discount) plus some extra re-investment return means a share price return of 100% in few years is credible

"Our view is still that, through re-investment, there is chance to bring back the NAV to pre-COVID-19 levels but, as we expect this crisis to have consequences for years, such outcome cannot come before a few years."

Hardman & Co comment: Taking the NAV back to the pre-crisis levels (January 2020 €7.69), and removing the current discount, would represent a roughly doubling of the share price. A significant element of this could be achieved by a change in sentiment (see earlier question regarding mark to market against marked to model). The residual recovery represents just over 10% incremental NAV accretion over a few years, which, given the re-investment returns are likely to be well above pre-crisis levels, appears demanding but credible.

Dividend

A key attraction for the shares had been the high dividend yield. On *11 May*, you announced a dividend of €0.10 per share having received all the cashflows in April (albeit some at lower than prior periods solely because of the lower level of prevailing interest rates). You also said that, after repaying the Repos, you will be left with €8m of surplus cash against the €3.7m cost of the dividend. Can you add some colour on what led you to set the dividend at the level it was and the factors which lead you to say in the announcement "Allowing for a sensible buffer for working capital, this remaining cash will be deployed, at highly attractive expected returns, into current commitments and new investments."

Dividend at 8% of NAV has been a long-run average

"For a long time, Volta has paid a dividend of around 8% of NAV which, historically, represented 62 cents per annum per share. We indicated prior to the current crisis that should the NAV fall materially then we would seek to maintain a dividend at around that 8% level, which is what our latest announcement has sought to do. It is inevitable that the very conditions that cause a material mark-to-market reduction in the NAV will also cause some reduction in cashflows, so this approach felt sensible and prudent to the Board. We are likely to continue to seek to achieve this, although we will have to wait for future quarterly cashflows to be sure that this level is appropriate and achievable.

Embedded IRRs in CLO tranches are very attractive at present, even accounting for the ratings agencies' central case expectations of rising defaults. So, we have sought to balance shareholders' understandable and clear desire for attractive dividends with the opportunities that may present themselves to profit from any recovery. The Board believes that allocating approximately 50% of cashflows to re-investment, as we have done here, is a good balance."

Dividend determination appears driven by actual cashflows rather than sentiment and appears to us the right approach

Hardman & Co comment: Volta suspended its dividend in early April as there was limited visibility at the time on what would actually be received. Having now seen the actual cashflows for that month (which were as expected allowing for rate changes), it is paying a reduced dividend. We believe this reflects sensible prudence in both this dividend but also, more fundamentally, it shows an approach driven by reasoned decision based off actual data rather sentiment (or regulatory constraint). No certainty can be gained for the level of future dividends but there should be more confidence in the approach taken to setting them.

In the past, you emphasised the sustainability of the dividend from the long-term cash cover generated by a broad portfolio of diversified loans. While current conditions are exceptional, what needs to change for the historical level of dividend restored?

Dividend re-instatement will be driven by actual cash received – should be more visible in few months – with target 8% NAV yield

"We recognise that dividends are important to our shareholders but, as you rightly say, conditions are exceptional at present. The company's cashflows from underlying investments are concentrated in January, April, July and October and the dividend historically was paid later in each of those months. The dividend was initially cancelled by the company because there was a fair degree of uncertainty around the likely level of cashflows to be received in April and beyond. In the end, we were pleased to see that the receipts for April were not impacted by downgrades and defaults, in contrast to the wider CLO equity market. However, as time passes, further downgrades and defaults are inevitable and so, whilst we do not see cashflows drying up, we do expect them to be reduced in July and the autumn. In the past, including in economic downturns, it was easier to predict the cashflows with greater accuracy than we can today and so our basic premise is that we should only pay dividends when we have the received the cash flows to support them. So, in summary, we pay dividends as soon as we can and when it is prudent in light of the overall liquidity of the company. That is unlikely to be at 15.5 cents per share per quarter in the short term. We have indicated previously that we would anticipate that this would be more likely to be set at 8% of NAV should the NAV move materially, as it has."

Hardman & Co comment: The chairman has outlined a clear path to returning dividends based on cash received and the target level which may be achieved. An 8% of NAV yield is likely to still leave considerable solvency to re-invest at high returns and, on current prices, is a yield of more than 10% on the share price.

I note your 11 May comment that "Should income levels in the coming quarters exceed the company's current central case, then additional income may well be distributed as an enhanced dividend later in the year." Does this mean you anticipate making up the dividend shortfall when conditions improve and how will the board balance the higher expected return from re-investment against dividend payments?

Will balance dividend against re-investment

"We need to balance the payment of dividends against the opportunities available to reinvest in assets at attractive prices and that will be the ongoing discussion. I know that we would be sympathetic to making up dividend shortfalls should conditions permit. But it is premature in the current environment for the board to be making any commitments one way or the other. If we were to do this, then the first obvious point would probably be in the dividend paid in October 2020, which would be the final dividend payment for the financial year ending 31 July 2020."

Hardman & Co comment: We interpret this as we would like to but wait and see what conditions we come out from the crisis.

Peer comparison

Volta has been outperforming peers and, as noted earlier, the CLO equity market

Volta's end-March NAV was €5.06 down from €7.69 end-January – a fall of 34%. Fair Oaks in contrast fell from $0.77 to $0.36, down 53% while Marble Point fell 45%. Against these comparators, we note the 20% Volta has outside CLOs may have limited the downside. Additionally, Volta's equity positions may have more re-investment periods than those in peers' portfolios. We note that Volta has delivered market-beating returns over the long term and so manager value-added could be another factor. Additionally, there are some delays in reporting valuations (in Volta's case ca.15% assets), which could distort inter-company comparisons.

Blackstone GSO Loan Financing has a mark-to-model approach (its € NAV fell 14% in March). As noted above, Volta estimates on the same approach its NAV would have fallen by 10%. TwentyFour Income Fund's (with a greater proportion of residential mortgages) saw its £ NAV fall by 16%.

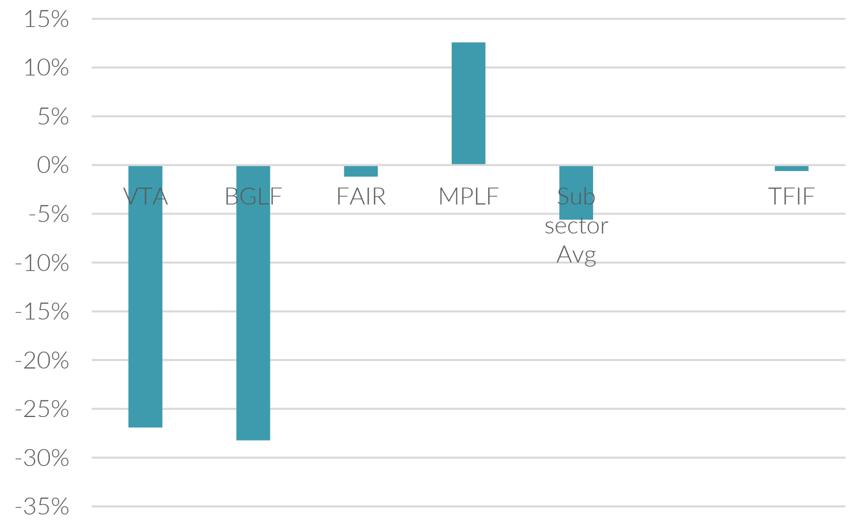
Valuation

Discount to NAV

Discount materially larger than peers on same accounting basis

Compared with its structured debt peers, on market price to NAV, Volta is trading at a material discount. Given the historical performance, risk profile and portfolio mixes identified in the sections below, this relative discount appears anomalous.

Current share price discount to May NAV for Volta and peers



Source: Hardman & Co Research Monthly reports for Volta (VTA), TwentyFour Income Fund (TFIF), Fair Oaks Income Fund (FAIR), Blackstone/GCO Loan Financing Ltd (BGLF) and Marble Point Loan Financing; priced 11 May 2020

Triggers for market re-evaluation of discount

Historically, dramatic reductions in discount to NAV generated by share price increases; these have been driven by a mix of market sentiment and company-specific issues

The share price discount to NAV is wider than peer average levels. This could reflect a number of possible drivers, each of which we discuss below. We believe that the most likely driver of long-term share price growth, and a reduction in the discount to NAV, is the delivery of the expected total shareholder returns and the market having greater confidence in their sustainability over the medium term. Looking at the portfolio as it stands, the most critical feature will be delivery of returns as credit default increases. In the near term, a modest deterioration of credit is likely to see much greater opportunities for higher-return re-investment, as the yield of all loans will increase. In addition to this macro development, we note the following.

Broadening awareness of Volta

- The board has taken several steps to broaden knowledge of the company and so ensure that there is a better understanding of the real (NAV) volatility. The UK listing (VTA) was partially to do this, and saw a positive reaction. On 3 September 2018, Volta added a sterling listing (VTAS) to its euro listing on the UK exchange. We note that Volta has engaged multiple sponsored research houses to distribute the message to the widest possible audience. We sense that the board has an appetite to expand the fund, which should materially assist with the limited share price liquidity and, with that, we expect an active engagement with existing and potential shareholders in a range of forums. Improving awareness and the associated liquidity should help reduce the discount.

On 11 December 2018, Volta announced it believed it was an excluded security under NMPI rules

On 11 December 2018, Volta announced that it was the opinion of the board that the company's shares qualified as an "excluded security" under the rules; the company is therefore excluded from the FCA's restrictions that apply to non-mainstream pooled investments (NMPIs).

Volta's KID disclosure not driven by business performance. Greater understanding of the business could see less share price volatility.

- The Key Information Document (KID) disclosure may be a relative dis-incentive to potential investors, with Volta having a longer hold period and greater sensitivity than peers. As noted above, the historical NAV performance does not justify the historical share price volatility. As the market gets a broader appreciation of how Volta's multi-manager approach has delivered, and is likely to deliver, returns, there might be less share price volatility and KID disclosure more in line with peers.

Checks and balances in place to ensure validity of monthly NAV. Less reliant than some on mark-to-model due to both portfolio mix and valuation approaches.

- The discount could reflect concerns that the NAV is not truly representative of the value of the business, because the modelling/valuation assumptions do not reflect a realisable value. We detailed in our initiation note of September 2018 why we believe Volta adopts appropriate valuation techniques. It is worth noting that the most illiquid assets, for which modelling is important, form a lower proportion of the group than is the case for most of Volta's peers.

Buyback possible but only as part of long-term programme

- The board is active in its consideration of a tender at NAV/repurchases in the market (which would be at a significant discount to NAV if executed at current prices). It says it will use such discount control measures if it believes them to be in the best interests of shareholders, noting "these mechanisms can be a double-edged sword". On the upside, it creates a buyer for the shares, and it could be perceived as putting a cap on the discount, which the market might then close itself. It is likely to reduce the discount in the short term. On the downside: i) it could create liquidity problems; ii) the capital could be better deployed in the fund (subject to the level of discount); iii) it shrinks the business, and so worsens the total expense ratio; and iv) it sends a very mixed message, especially if, as seems likely over the medium term, Volta has new investment opportunities and comes to market for further equity funding. Accordingly, we note that the policy is to make the company more attractive to new investors. We believe the board would use a buyback as part of a long-term strategy, rather than a short-term "sticking plaster".

Increased market confidence regarding sustainability of returns through weaker credit market conditions

- We believe that performance over the past five years (10.5% p.a.) reflects the favourable macroeconomic environment, with limited credit defaults, CLO debt, which had been purchased at a discount being redeemed at par, and positive sentiment towards CLO investment generally. Looking forward, while Volta has accessed high-return re-investments, it might take delivery of NAV to convince all in the market that such returns are sustainable. This might take more time (and effort) than Volta benefiting from the rising sentiment in good markets.

Financials

We assume no material change in markets to July 2020 and that, by July 2021, half of the losses seen this year will have been recovered. We have not changed our re-investment rate yet (currently 13%) but this provides upside to coupon and dividend income should the re-investment rate increase. We assume no further dividend this financial year and 8% of NAV in 2021.

Profit and loss account (statutory)

Year-end Jul (€m)	2013	2014	2015	2016	2017	2018	2019	2020E	2021E
Coupons and dividends received	**0.0**	**31.4**	**33.7**	**34.7**	**33.2**	**38.5**	**42.0**	**42.3**	**25.5**
Net gains on sales	0.0	6.1	12.6	2.7	3.1	0.0	0.5	0.5	0.5
Unrealised gains and losses	0.0	12.2	21.0	-18.5	4.7	-5.7	-18.2	-125.0	65.0
Net gain on fin. assets at FV through P/L	**79.2**	**49.7**	**67.2**	**18.9**	**40.9**	**32.7**	**24.4**	**-82.2**	**91.0**
Net FX	-0.5	1.6	-8.2	0.3	5.6	-2.0	-11.6	0.0	0.0
Net gain on IR derivatives	2.3	-0.3	0.0	0.0	0.4	-0.9	1.6	0.0	0.0
Interest expense on repo	0.0	0.0	-0.2	-0.9	-1.1	-1.4	-1.6	-1.6	-1.6
Net bank int. & charges	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.1	0.1	0.1
Operating income	**81.0**	**50.9**	**58.8**	**18.2**	**45.7**	**28.4**	**12.8**	**-83.7**	**89.4**
Inv. manager's fees	-2.6	-3.6	-3.9	-4.1	-4.1	-4.2	-4.2	-4.5	-4.6
Inv. manager's performance fees	-7.7	-1.9	-5.0	0.0	-1.5	0.0	0.0	0.0	0.0
Directors' renumeration & expenses	-0.4	-0.4	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Other expenses	-1.1	-1.0	-1.8	-0.9	-0.8	-1.0	-1.0	-1.0	-1.0
Total expenses	**-11.8**	**-6.9**	**-11.2**	**-5.6**	**-6.9**	**-5.7**	**-5.7**	**-6.0**	**-6.1**
Profit and total comp. income	69.2	44.0	47.6	12.6	38.7	22.7	7.1	-89.7	83.3
Avg. no shares for EPS calculation (m)	32.8	36.1	36.5	36.5	36.5	36.56	36.59	36.61	36.61
Statutory EPS (p)	2.11	1.22	1.31	0.34	1.06	0.62	0.19	-2.45	2.27
Total dividend (p)	0.62	0.60	0.62	0.62	0.62	0.62	0.62	0.41	0.46

Source: Volta, Hardman & Co Research

To derive our adjusted profit and loss, we strip out the capital movements, including: i) unrealised gains/losses; ii) FX movements; and iii) net gain of IR derivatives. We have left in realised gains, which, although volatile, have been converted into cash, and some capital gains might be expected to form part of the normal course of business. We have also backdated the current management fee structure and adjusted it to the new level of profitability.

Hardman & Co adjusted profit and loss account (€m)

Year-end Jul (€m)	2014	2015	2016	2017	2018	2019	2020E	2021E
Coupons and dividends received	31.4	33.7	34.7	33.2	38.5	42.0	42.3	25.5
Net gains on sales	6.1	12.6	2.7	3.1	0.0	0.5	0.5	0.5
Net gain on fin. assets at FV through P/L	**37.5**	**46.2**	**37.4**	**36.2**	**38.5**	**42.5**	**42.8**	**26.0**
Interest expense on repo	0.0	-0.2	-0.9	-1.1	-1.4	-1.6	-1.6	-1.6
Net bank interest & charges	0.0	0.0	-0.1	-0.1	-0.1	0.1	0.1	0.1
Operating income	**37.5**	**46.0**	**36.5**	**35.0**	**37.0**	**41.0**	**41.3**	**24.4**
Inv. manager's fees	-4.1	-4.5	-4.3	-4.6	-4.6	-4.4	-3.4	-1.5
Inv. manager's performance fees	-2.5	-3.5	-1.3	-1.2	-1.3	-2.1	-2.6	-1.3
Directors' renumeration & expenses	-0.4	-0.5	-0.6	-0.5	-0.5	-0.5	-0.5	-0.5
Other expenses	-1.0	-1.8	-0.9	-0.8	-0.9	-1.0	-1.0	-1.0
Total expenses	-7.9	-10.3	-7.2	-7.0	-7.2	-8.0	-7.5	-4.3
Profit and total comp. income	**29.5**	**35.7**	**29.3**	**28.0**	**29.7**	**32.9**	**33.8**	**20.1**
Adjusted EPS (€)	**0.82**	**0.98**	**0.80**	**0.77**	**0.81**	**0.90**	**0.92**	**0.55**
Dividend cover (x)	**1.36**	**1.58**	**1.29**	**1.24**	**1.31**	**1.45**	**2.25**	**1.20**

Source: Volta, Hardman & Co Research

Balance sheet									
@ 31 Jul (€m)	2013	2014	2015	2016	2017	2018	2019	2020E	2021E
Financial assets at FV through P/L	238.7	256.3	307.3	324.1	321.3	325.7	325.5	195.8	263.0
Derivatives	1.6	0.0	0.0	1.2	0.7	1.3	0.8	0.8	0.8
Trade and other receivables	0.0	0.0	38.1	5.0	0.3	12.9	5.5	5.5	5.5
Cash and cash equivalents	9.7	19.5	0.4	10.9	37.1	20.5	14.5	3.7	3.1
Total assets	250.1	275.8	345.8	341.3	359.4	360.4	346.2	205.7	272.3
Loan financing under repos	0.0	0.0	27.3	40.3	38.1	42.7	35.9	0.0	0.0
Interest payable on loan financing	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Derivatives	0.0	0.2	0.3	0.0	0.0	0.1	0.3	0.3	0.3
Trade and other payables	3.8	2.0	19.0	11.6	15.6	11.7	19.2	19.2	19.2
Total liabilities	3.8	2.1	46.6	52.0	53.8	54.7	55.7	19.7	19.7
Net assets	246.3	273.6	299.2	289.3	305.5	305.7	290.6	186.0	252.6
Period-end no. shares (m)	35.3	36.5	36.5	36.5	36.5	36.6	36.6	36.6	36.6
NAV per share (€)	6.97	7.50	8.20	7.92	8.36	8.36	7.94	5.08	6.91
Total debt to NAV	0%	0%	9%	12%	12%	14%	12%	5%	4%

Source: Volta, Hardman & Co Research

Cashflow									
Year-end Jul (€m)	2013	2014	2015	2016	2017	2018	2019	2020E	2021E
Total comprehensive income	69.2	44.0	47.6	12.6	38.7	22.7	7.1	-89.7	83.3
Net gain on financial assets at FV in P/L	-79.2	-49.7	-67.2	-18.9	-40.9	-32.7	-24.4	82.2	-91.0
Net movement in unrealised gain on revln. derivatives	-2.3	0.3	0.1	-1.5	0.5	-0.5	0.7	0.3	0.3
Interest expense on repos	0.5	-1.6	0.2	0.9	1.1	1.4	1.6	1.6	1.6
FX losses on re-translation repos	0.0	0.0	-0.9	-0.3	-2.2	0.4	2.0	0.0	0.0
(Increase)/decrease in trade receivables	-1.3	-1.8	0.0	0.0	-0.1	0.1	-3.2	0.0	0.0
Increase/(decrease) in trade payables	0.1	0.1	2.0	-1.5	1.6	-1.7	0.1	0.0	0.0
Directors/other fees paid in cash	5.4	0.0	0.2	0.1	0.1	0.2	0.1	0.1	0.1
Net cash inflow/(outflow) from op activities	-7.6	-8.6	-18.0	-8.5	-1.0	-10.3	-15.9	-5.6	-5.7
Cashflow from investing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Coupons and dividends recd.	32.7	31.4	33.3	33.6	34.4	38.0	42.2	42.3	25.5
Change in margin/deriv. sett.	1.7	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Purchase of financial assets	-46.5	-71.5	-99.3	-127.0	-109.0	-138.8	-117.8	-90.0	-120.0
Proceeds from sales of financial assets	24.2	72.2	96.9	84.9	125.5	114.2	118.2	95.0	118.0
Net cash outflow from investing activities	12.1	33.6	30.9	-8.5	50.9	13.4	42.7	47.3	23.5
Cashflows from financing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends paid	-15.3	-17.0	-22.3	-22.6	-22.7	-22.7	-22.3	-15.0	-16.7
Net sales of shares	15.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from repos	0.0	0.0	28.2	13.3	0.0	4.2	-8.8	-35.9	0.0
Interest paid on repos	0.0	0.0	-0.1	-0.8	-1.1	-1.3	-1.7	-1.6	-1.6
Net cash inflow from financing activities	0.6	-16.8	5.8	-10.2	-23.7	-19.7	-32.8	-52.6	-18.4
Net increase in cash and cash equivalents	5.1	8.2	18.7	-27.2	26.2	-16.6	-6.0	-10.8	-0.6
Opening cash and cash equivalents	5.2	9.7	19.5	38.1	10.9	37.1	20.5	14.5	3.7
Effect of FX	-0.5	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Closing cash and cash equivalents	9.7	19.5	38.1	10.9	37.1	20.5	14.5	3.7	3.1

Source: Volta, Hardman & Co Research

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