

Dear Unitholders,

The Pender Alternative Arbitrage Fund was down -1.0%¹ in May 2023.

M&A Market Update

Global M&A investment value was just over \$1 trillion through the first five months of the year, down from over \$1.8 trillion in deal value during the same period last year². May saw a significant uptick in North American deal activity with US deal volumes reaching the highest monthly level in over a year, driven by a wave of consolidation that spanned many sectors. North of the border, Canada is experiencing an M&A boom, with deal activity up over 100% from the same time last year. We are seeing a mix of activity driven by cross-border M&A largely with US acquirers or targets as well as strategic M&A deals motivated by realizing synergies and improving organic growth in a high-inflation and high-interest rate environment. Despite increased market volatility and higher funding costs on buyouts, deal activity continues with favourable conditions to increase in our core universe of small- and mid-cap mergers.

May was a tale of two halves with the month seeing a continuation of a regulatory regime hostile to large merger deals, which has been a consistent theme this year. First, with the reverberation of the impact from one of the UK's key regulators, the Competition and Markets Authority's (CMA) blocking Microsoft Corporation's (NASDAQ: MSFT) proposed acquisition of Activision Blizzard Inc (NASDAQ: ATVI). This was followed by the cancellation of Toronto-Dominion Bank's (TSX: TD) deal to acquire First Horizon Bank (NYSE: FHN) due to TD being unable to obtain the necessary regulatory approvals to close the deal—rumoured to be related to TD's anti-laundering practices in the US. Finally, after an already challenging month for merger deals, the FTC sued to block Amgen Inc.'s (NASDAQ: AMGN) proposed acquisition of Horizon Therapeutics Public Ltd Co (NASDAQ: HZNP). In the case of the Horizon/Amgen deal, which is neither a horizontal nor vertical merger with no precedent anti-trust concerns, the FTC is attempting to use a novel approach of harm based on theoretical bundling to challenge the deal. This would be the first FTC lawsuit to block a pharmaceutical deal since 2009. Regulators need to keep to the letter of the law and win in court if challenged on a deal and the majority of market participants believe the FTC has overstepped the mark in this case and is likely to lose in court.

In response to the hostile and unpredictable regulatory environment for merger deals this year and particularly in May, spreads for mergers have widened considerably. Investors are now demanding greater compensation for taking on the risk of a deal successfully gaining approval and closing. Merger arbitrage spreads now offer increasingly appealing returns with average merger arbitrage spreads in North America increasing to double digits from last year³. While regulators have been focused on large and mega merger deals, small- and mid-cap merger deals that are not exposed to the same regulatory risk have also seen their spreads widen, creating an attractive opportunity. Despite tightening financing conditions, the strength in equity markets this year is providing confidence for acquirers to do deals, with the likely targets being small- and mid-cap companies.

¹ This Pender performance data point is for Class F of the Pender Alternative Arbitrage Fund. Other classes are available. Fees and performance may differ in those other classes.

² Refinitiv Investment Banking Scorecard – Deal Intelligence I as of June 1, 2023

³ <https://www.barrons.com/articles/m-and-a-regulators-merger-arbitrage-funds-bb11eceb>

SPAC Market Update

The SPAC sector continues to shrink due to liquidations of maturing SPACs. Nineteen SPACs liquidated in May, returning \$4.6 billion to unitholders⁴. The amount of capital held in trust by SPACs has fallen from \$200 billion in 2021 to less than \$50 billion at the end of May. As the number of SPACs and capital held by SPACs shrinks, so has the size of proposed business combinations. In the last couple of years, it was common to see a SPAC merge with a target at multiple times the size of the value held in trust. In contrast, recent deals have been announced a fraction of the SPAC's original trust value as the vast majority of investors are expected to redeem rather than put their capital into the proposed deal. Deal announcements remain few and far between, and the majority of SPACs are likely to liquidate and return capital back to investors.

Over 100 companies that have merged with a SPAC, which represents nearly a quarter of all De-SPACs since 2018, have experienced a more than 90% share price decline⁵. We have discussed that this year likely represents the conclusion of the SPAC cycle, and a clear sign of the culmination of that end is the dozen of recently filed lawsuits by shareholders who have lost big on SPAC deals and have their pitchforks targeted at the sponsors of these SPACs. The former "SPAC King," Chamath Palihapitiya, who launched nine SPACs, is also being sued by investors for the steep losses realized in many of his SPACs that went public while his two remaining pre-deal SPACs announced they will be liquidating this month. Many sponsors, who, like Palihapitiya, were a driving force during the SPAC boom, have thrown in the towel and wound down their existing SPACs. Depending on the market's memory, we may never see them raise another SPAC again.

At the end of May, there were just under 411 active SPACs in the market with assets over \$48 billion, 240 of which were searching for targets. As the SPAC sector shrinks, so has the SPAC exposure in our Fund. We believe our focus on acquiring SPACs at a discount to trust value offers an attractive yield through redemption or liquidation. At the end of May 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 5.7%. With SPAC arbitrage effectively equating to acquiring a Treasury Bill at a discount, SPACs currently provide an almost-similar yield to US Corporate Investment Grade Bonds with lower credit risk, shorter duration and a tax advantage, as SPAC returns are primarily capital gains.

Portfolio Update

May saw elevated levels of spread volatility in the merger arbitrage sector as the reverberations from several of the large deal-breaks and regulatory responses resulted in a widening of spreads. While our small- and mid-cap focused exposure allowed us to avoid much of the regulatory risk experienced by large cap merger deals, the Fund had a small position in First Horizon Corporation (NYSE: FHN), which saw its merger with Toronto-Dominion Bank (TSX:TD) terminated during the month. The FTC's lawsuit to challenge the proposed acquisition of Horizon Therapeutics Public Ltd Co (NASDAQ: HZNP) also drove a widening of spreads for biotech deals, where the Fund holds several positions. In response to these events, arbitrage spreads widened considerably and, in most cases, indiscriminately led to attractive opportunities across the sector. The HFRI ED Merger Arbitrage Index was down 4.0% year-to-date through to the end of May, but with the index exhibiting only two years of negative performance since 1990, as with other prior years with weaker performance to start, arbitrage investors quickly repriced risk and demand higher returns, which has historically resulted in positive absolute performance through the year⁶.

⁴ <https://www.spacresearch.com/>

⁵ <https://www.bloomberg.com/news/articles/2023-06-01/spacs-fuel-new-boom-lawsuits-are-piling-up-in-courts-across-us>

⁶ <https://www.hfri.com/indices/hfri-ed-merger-arbitrage-index>

We were active in the month, taking advantage of dislocated and mispriced arbitrage deals driven by the greater dispersion in spreads, and we expect to benefit from these opportunities in the coming weeks and months. We continue to position the Fund in small- and mid-cap merger deals and we seek to take advantage of the higher spread environment while avoiding the deal risk and duration risk, which has been elevated for larger deals throughout the year. At the end of May 2023, the Fund had 31 investments in small-cap deals under \$2 billion, 19 of which were valued at under \$1 billion.

The Fund initiated positions in 15 new or previously announced merger deals during May, and five merger deals held within the Fund also closed during the month. Through the month there has been a myriad of new high-quality small-cap merger deals announced trading at attractive spreads and high single-digit to low double-digit implied yields, which are unlikely to face regulatory pushback with upside to their expected duration. Some of these small-cap merger deals initiated in the Fund during May include: Ruth's Hospitality Group Inc (NASDAQ: RUTH), CTI BioPharma Corp (NASDAQ: CTIC), Home Point Capital Inc (NASDAQ: HMPT), Absolute Software Corp (NASDAQ: ABST), VectivBio Holding AG (NASDAQ: VECT) and Greenhill & Co., Inc. (NYSE: GHL).

Outlook

After a more challenging start to the year for the merger arbitrage sector, elevated regulatory risk appears to be priced into new and existing merger deals while deal activity looks to be increasing, which provides a favourable forward setup for merger arbitrage performance. The yield environment for merger arbitrage deals is attractive, having expanded on both a relative and absolute basis, while there has also been a steady stream of high-quality small and mid-cap deals announced in recent weeks. With AI, VR, automation and electrification being key technology trends with significant runway, we could see M&A activity increase in the technology, industrial and materials sector as supply chains with exposure to those emerging technologies benefit from increased demand.

As valuations in the small- and mid-cap space continue to trade at dislocated levels, the opportunity and incentive for acquirers to target these businesses look attractive, with activists and shareholders of potential target companies actively seeking to close these discounts.

*Amar Pandya, CFA
June 20, 2023*



PENDER
PenderFund Capital Management Ltd.

All dollar figures are in USD unless otherwise indicated.

Standard Performance Information for the Pender Alternative Arbitrage Fund may be found here:
<https://www.penderfund.com/pender-alternative-arbitrage-fund/>

This commentary is subject to the Disclaimer found here: <https://www.penderfund.com/disclaimer/>

© Copyright PenderFund Capital Management Ltd. All rights reserved. June 2023.