PENDER
CREDIT OPPORTUNITIES FUND

Manager's Commentary – Q2 2024

Parul Garg
July 19, 2024

Dear Investor

We sincerely appreciate your continued support of Pender Credit Opportunities Fund I (PCOF I). Since its launch, the Fund has delivered an impressive return of 19.8%, net of all fees and expenses, outperforming both the High Yield Market (ICE BofA US High Yield TR USD returned 8.9%) and the CCC index (ICE BofA CCC & Lower US High Yield TR USD returned 10.7%). Our investment period will conclude on July 27, 2024 and returns from realized investments will be distributed to investors starting in September 2024.

It's hard to believe that almost a year has passed since we launched PCOF I. Our strategy focuses on stressed and distressed credits of small to mid-sized companies where we see an underlying business with improving fundamentals and which is trading below our view of intrinsic value. Our portfolio remains unique, exploring numerous opportunities with the agility to adjust quickly and capitalize on these mispriced securities. Terms like distressed, restructuring, or bankruptcy often deter investors, however this is an asset class that offers asymmetric risk-to-reward opportunities. Our ability to capture these opportunities is underpinned by our team's experience, diverse backgrounds, and robust investment process. This process emphasizes intensive, fundamental research through disciplined quantitative and qualitative analysis.

As substantial investors in the Fund ourselves, our interests are closely aligned with yours, and we benefit from significantly more operational freedom compared to larger, policy-driven competitors. **Thank you** for being an investor!

We firmly believe that the next five years will be highly favorable for this asset class. Currently, high-yield and leveraged loans are trading at exceptionally narrow credit spreads, but there are several warning signs emerging that could upset this trend. Inflation has remained higher than expected, putting pressure on household cash flows. As a result, credit card delinquencies are steadily rising, surpassing 10-year highs. Despite seemingly stable unemployment numbers, record numbers of workers are holding multiple jobs, indicating underlying stress in making ends meet. Consumers are under growing financial strain and will eventually need to boost their liquidity. The yield curve has been inverted since March 11, 2022—the longest period of inversion in history, surpassing the 1978 record of 624 days. When the yield curve normalizes, as history would indicate it will, a recession is likely. Additionally, the upcoming U.S. presidential election will likely impact markets as the year progresses. By focusing on small to mid-sized company credits, we continue to discover ample investment opportunities, as we have over the past nine years of investing in these assets. **However, the next five years may experience a cycle of spread widening and tightening, potentially offering an even larger pool of opportunities, including some clear winners.**

© Copyright PenderFund Capital Management Ltd. All rights reserved. July 2024.

All dollar amounts quoted are US dollars.

Parul Garg
July 19, 2024

Top Contributors and Detractors in the Quarter

Top Contributors:

Novavax: We started building up the position in December 2023 when Novavax 2027 convertible bonds were trading in the 50s, yielding 20%. With over $550 million in cash and only $175 million in convertible debt due in 2027, we saw ample balance sheet liquidity which created a significant opportunity to invest in their debt. Despite negative news, including declining demand for its COVID vaccine and a $700 million legal claim from GAVI (the Global Alliance for Vaccines and Immunization), we believed a favorable settlement was possible. By February, GAVI reduced its claim to $75 million, mitigating the risk of severe financial strain. We tripled our position in Novavax 2027 notes, which were still yielding around 20% at the time. In May, Novavax reached a $1.4 billion deal with Sanofi, causing shares to soar and allowing us to exit our position with an 80% return.

Emergent BioSolutions: Emergent BioSolutions' 3.875% notes maturing in 2028 plummeted into the 30s early this year and were completely overlooked by investors. Despite challenges, including issues in its contract manufacturing division and the death of its founder, Emergent' s strengths, such as its role in providing emergency medications for the US government and producing Narcan, were evident. This year, the company made progress in turning around the business – the appointment of a new CEO, a $250 million government contract, and the sale of a loss-making CDMO site has resulted in the equity rising from lows of approximately $1.50 to above $10 year to date, and bond prices climbed from 35 to 72.

Top Detractors:

Stem Inc.: Stem Inc.'s convertible bonds detracted from performance last quarter. Despite the company's strong potential in utility-scale battery operating systems, its stretched credit metrics have kept bond prices in the low-40s. We continue to own the debt and believe that as Stem's financial results strengthen, bond prices will improve significantly.

Emerging Opportunities:

Lucid Group: Early 2024 presented an intriguing opportunity with Lucid Group's 2026 convertible notes trading at less than 40 cents on the dollar, yielding over 35% to maturity. Despite Lucid's lack of profitability, we find it unlikely that its majority owner, the Saudi Public Investment Fund (PIF), would abandon its investment, considering its $26.4 billion stake in Lucid. With more than $4 billion in cash, Lucid's financial position is strong. By early July, bullish sentiment on Lucid's credit began to emerge, with bonds beginning the month of July at 58 cents on the dollar.

In Closing

We are proud to be one of the first asset managers in Canada to introduce a fund solely dedicated to this unique asset class. While this strategy has already gained traction among major institutional investors in the U.S., we are pioneering its adoption here. Our approach

© Copyright PenderFund Capital Management Ltd. All rights reserved. July 2024.

All dollar amounts quoted are US dollars.

offers a return profile comparable to private debt assets, with the added benefits of greater transparency and liquidity in the underlying investments through our focus on public debt. We are confident that this asset class, combined with our process and capabilities, has the potential to deliver superior results and set a new standard in the Canadian investment landscape.

Warm Regards,

Parul Garg
Portfolio Manager, Pender Credit Opportunities Fund I
pgarg@penderfund.com

© Copyright PenderFund Capital Management Ltd. All rights reserved. July 2024.

All dollar amounts quoted are US dollars.