

Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund returned 2.2% in November¹, an impressive result that was largely due to some positive moves in key distressed credit positions.

The largest move, by far, was in our holdings of preferred shares in the Government-Sponsored Enterprise (GSE) entities, **Fannie Mae** and **Freddie Mac**. In the wake of the November US election, these positions gained over 100%, which amounted to a benefit of slightly more than one percent to the Fund. A Republican victory was widely viewed to be a catalyst for the exit of these entities from their 15 year conservatorship by the US Federal Housing Finance Authority. We sold down the position considerably in November.

In addition, the Fund benefited from a successful outcome in the debt restructuring of **Spirit Airlines Inc** that was announced on November 18 in conjunction with a bankruptcy filing. In this case, the holders of Spirit's 8% secured loyalty bonds emerged with ownership rights to 76% of this aircraft-rich discount airline. Our position in the loyalty notes, a top ten holding in the Fund, gained over 25% in the month.

We also enjoyed notable gains in our position in **Porch Group Inc** secured notes, as that entity received approval to divest itself of a money-losing insurance operation. And, in the latter part of the month, we started to benefit from a recovery in our **American Tire Distributors Inc** term loan position, as detailed below.

The portfolio also held positions in entities that declined in the wake of the election, including our position in the distressed bonds of **STEM Inc**, a software-focused entity serving the market for utility-scale battery systems. We believe that STEM's value is deeply understated, and we added to the position in convertible notes below 30c on the dollar.

American Tire Distributors ... Fighting and Winning

On the morning of October 22, we awoke to discover that American Tire Distributors (ATD) had filed for Chapter 11 bankruptcy. That fact, in and of itself, was not entirely unexpected, as our position in the company's term loan had been recently quoted around 45c on the dollar. What caught us by surprise, however, was that the filing came together with an unusually aggressive Debtor-in-Possession (DIP) financing package agreed to between the company and a majority group of term loan lenders. Under the terms of the proposed DIP facility, all but \$74 million of the \$1B ATD term loan, would be "rolled up" into the DIP facility, leaving our position at the very bottom of the debt stack. Suddenly, our 45c loan position was 5c bid. Our value, essentially, had been stolen.

Finding ourselves on the receiving end of what is known in the trade as "debtor on debtor violence," we realized that we had to quickly engage in battle in an attempt to recover our

¹ All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.

lost value. So, together with a handful of other institutions, we engaged counsel, and filed an objection to the “roll-up” feature of the DIP in the Delaware bankruptcy proceeding. Our case was clear cut. The prejudicial “roll up” was at odds with the equity requirements of the credit agreement which governed our ATD term loan. The judge agreed.

The ultimate financial recovery in our position is, at the time of writing, uncertain. That depends on the outcome of an auction for the ATD business currently in process. However, we rejoice in having recovered our rights in this security. And we are pleased that “the system” still works in preventing insiders and large holders from abusing other market participants. Long may it be so.

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New Positions

In November we underwrote a position in the newly issued 12% 2029 senior notes of **Tenaz Energy Corp.** Calgary-based Tenaz recently acquired operating North Sea natural gas assets from a European consortium that included Royal Dutch Shell and Exxon. This \$140MM bond issuance enabled the refinancing of the bank bridge loan that facilitated the deal. We like the credit profile of this issuer, with Tenaz’s total debt less than 1X our estimate of annual cash from operations for the North Sea field, and cash balances approximately equal to its debt load. We expect that Tenaz will be able to refinance us out of this bond once the market sees more operating history from its European acquisition.

Also in November, we took advantage of the post-election spike in longer-end yields to add to our holdings of Canadian perpetual preferred shares. With running yields in the 6.1% range, we calculate a tax-equivalent yield for the perpetual lines of **Canadian Utilities Ltd**, **Great-West Lifeco Inc** and **Power Corp of Canada** to be approximately 8%. We believe Canadian investors will soon come to realize the relative scarcity of such income from high quality issuers, and we expect a tightening spread between the perpetual preferred tax equivalent yield and longer-dated corporate yields.

Fund Positioning

The Corporate Bond Fund yield to maturity at November 30 was 7.0% with current yield of 5.4% and average duration of maturity-based instruments of 3.5 years. The Fund holds a 3.4% weight in distressed credit instruments where positions are held for a target value lower than par, and therefore the headline yields of these securities are not included in the foregoing calculation. Cash represented 1.8% of the total portfolio at November 30.

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December 10, 2024