PENDER

CORPORATE BOND FUND

THE MANAGER'S MONTHLY COMMENTARY – APRIL 2019

The Pender Corporate Bond Fund returned 1.1% in April, not a particularly remarkable result within the context of a very well-bid credit market, but nevertheless welcome as a steady progression of unitholder value.

Leading the gains in the Fund were the 2% convertible bonds of Aceto Corp which rallied into the 90s from the 60s as Aceto's liquidation process yielded multiple bids for the company's chemicals business, taking the likely recovery in liquidation close to par. Other strong positions in April included bonds of Navios Maritime Holdings, Calfrac and Venator, all of which rallied on a return of interest in these cyclically depressed industrial issuers.

Offsetting the strength above were selected pockets of weakness, including Dean Foods where negative sentiment, more so than negative events, weighed on the credit. Our small position in Sherritt International bonds was also materially weaker during the month.

For Bedtime Reading…Some Tales of Comfortably Covered Credit

Much of what we write about in our updates concerns the very interesting positions we hold: Distressed credit that is undergoing work-out activity, preferred shares that are emerging from dividend suspension, or bonds of severely out-of-favour companies that we believe should be rated somewhat higher. However, in the interest of full and complete disclosure, it should be noted that the majority of the Fund is invested in far less exotic instruments. For the time being, volatility has been banished from the markets. But should exciting times return, it may be reassuring to be acquainted with this Fund's "Silent Majority," the comfortably covered credits that possess the potential to stand as pillars of calm in the market's periodic storms.

The largest corporate credit in the Fund, from an issuer perspective, is **Microsoft**. Microsoft is a company with impeccable credit credentials. The company has $40B more cash than its total debt. Pre-interest cash earnings cover interest charges 17 times. Our one-year default probability model estimate for "Mr. Softee" is about as close to zero as you can get (0.0002%). We are not getting rich on this AAA-rated credit, whose bonds yield between 2-3% depending on the duration. But this position is an important block in the base of our capital preservation pyramid.

A second key holding, and the Fund's largest individual position, is **Verisign**, specifically the Verisign 4 5/8 notes of May 2023. Like Microsoft, we consider Verisign a modern-day utility. One of the original architects of the internet, Verisign possesses an actual monopoly on the registration and assignment of domains in the ".com" and ".net" root directories. Every website owner in these domains pays $7.85 per year, one way or another, to Verisign, even if the domain is actually marketed to them by another company. Verisign's credit metrics are nearly as hefty as Microsoft, with 7x cash interest coverage and a 1 year default probability we estimate at being less than 0.001%. With the next US Dept of Commerce monopoly review falling after our bond's 2023 maturity, we consider a yield above 4% to be excellent reward for comparatively little risk.

We also hold over $15M of **CF Industries 1st lien bonds**, due in 2020 and 2026 respectively. CF is one of the world's largest producers of nitrogen fertilizer, a critical agricultural input. While prices and margins do vary in this business, we note that net debt, to the 1st lien level, is less than one times cash flow from operations of even CF's worst years dating back through the financial crisis of 2008. Underneath the $1.25B of first lien notes sit more than $13B of equity market capitalization and unsecured credit. Our position here yields approximately 4%, which we feel is attractive for such a senior position.

As a combined weight, our "safety" bucket, which includes all large-issue bonds with an estimated one-year default probability of less than 0.2%, is more than 50% of the Fund. While they don't always drive the bus in terms of returns, these bonds do contribute to total return and provide plenty of ballast when required. Chosen for particular attributes – including prospective growth, decent business 'moats', low net debt, strong profitability and low default risk – we have high confidence in this group of holdings.

New Positions

During April we initiated a position in a series of the junior preferred shares of **Fannie Mae**. Fannie Mae is a U.S. federally chartered mortgage finance organization that has operated under a governmental conservatorship since its bailout at the height of the financial crisis in September 2008. With the recovery in US housing that has occurred since, Fannie Mae has returned to profitability and has delivered more dividends to the US Federal government than it received in bailout. We believe it may not be long before some form of restructuring addresses the $19B of face value of junior preference shares which have suffered from a dividend suspension of more than ten years. With some of the Fannie Mae series trading below 40% of face value, we think there is potential for a large revaluation that may result from any of a variety of restructuring or recapitalization proposals currently under consideration by the US Federal Housing Finance Agency.

April also saw us initiate a position in the convertible bonds of **Paratek Pharmaceuticals Inc**. Paratek was recently successful in receiving FDA marketing approval for Nuzyra, a once-daily intravenous and oral antibiotic. We consider Paratek's business prospects to be strong. Nuzyra is a broad spectrum new antibiotic treatment that may supplant other treatments that have been rendered ineffective by the emergence of resistant bacteria. With cash balances exceeding total debt, and a strong product adoption cycle ahead of it, we like Paratek's chances. Convertible notes priced in the mid 70s yield more than 11% to a 2024 maturity.

Another new issuer initiation was in the credit securities of **Lamar Media**. Lamar is one of four major players in the North American outdoor advertising market. We like Lamar's relatively predictable revenue base that is bolstered by long-term contracts (10-20 years) that cover a large number of its billboard space rentals. Structured as a REIT, Lamar generates healthy levels of free cash flow which are paid out to equity unitholders. Credit enjoys interest coverage in excess of 5x and over $8B of equity value sits below Lamar's $2.9B of debt.

Fund Positioning

The Fund yield to maturity at April 30 was 5.3% with current yield of 4.7% and average duration of maturity-based instruments of 2.4 years. There is a 2.9% weight in distressed securities purchased for workout value whose notional yield is not included in the foregoing calculation. Cash represented 3.0% of the total portfolio at April 30.

Geoff Castle
May 6, 2019

[1] F Class
For full standard performance information, please visit: http://www.penderfund.com/funds-and-performance

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