

PENDER

ALTERNATIVE ARBITRAGE FUND MANAGER'S COMMENTARY - MAY 2022

Dear Unitholders,

The Pender Alternative Arbitrage Fund (PAAF) ended the month of May 2022 with a NAV of \$10.23 per unit¹.

M&A activity remains elevated with over \$1.8T of deals announced globally at the end of May, a total that has only been exceeded three times in history². A total of \$377B of merger deals were announced in May, making last month the third-highest May total on record. Technology continues to lead M&A activity by value and volume, with over \$476B of merger deals announced in the sector, which represents 26% of total M&A.

Despite high levels of volatility and merger arbitrage spreads widening in the early weeks of the month, May was a mega-merger month. It was the busiest month of the year for mega-mergers greater than \$10B in size, with seven deals announced in this category³. This was the highest monthly mega-merger deal count since June 2019 when 10 such deals were announced. One of the mega-merger deals announced this month was Broadcom Inc.'s (NASDAQ: AVGO) \$61B proposed offer to acquire VMware, Inc. (NYSE: VMW), making it the largest merger deal of the year and one of the largest tech deals in history. There are currently over 20 M&A deals valued at \$10B or more globally, totalling over \$466B.

While the positioning in the PAAF is focused on small or mid-cap merger deals, this wave of large-cap M&A speaks to the overall environment for activity. While the current backdrop of volatile equity markets, uncertainty due to inflation, supply chain disruptions and rising interest rates could have foreshadowed a dampening of merger activity, that hasn't been the case. There is clearly still significant appetite for mergers with corporations, and private equity firm coffers stacked with cash that is ready to deploy.

May was a tumultuous month for equity markets with high volatility and growing fears that central bank rate hikes may tip the economy into a recession. Merger arbitrage yields widened during the month, likely driven by a mix of four factors: de-risking, widening liquidity premiums as shareholders of target companies sold their positions, arbitrage spreads pricing in higher interest rates and indiscriminate selling driven by elevated equity market volatility. Despite these fears and widening spreads, M&A markets remain healthy with no deal breaks since February.

When merger arbitrage spreads widen without a corresponding increase in duration to completions (extension risk) or a change in the probability of a merger deal being approved and financed (deal risk) then it enhances the forward return of investing in that merger deal. We believe that this is largely the case for the opportunities we are focused on in the PAAF. M&A activity remains strong with several large merger deals announced during the month, as covered above. Strong demand for acquisitions by strategic and financial acquirers, despite volatility in equity markets, suggests a healthy M&A market and robust conditions for merger arbitrage investing.

The wave of negative news for the SPAC industry continued during the month. Many leading Wall Street investment banks, including Goldman Sachs and Citigroup Inc., which were the largest underwriters of SPAC IPOs over the past two years, ended their relationship with SPACs due to the uncertainty created by the SEC's new proposed rules, [discussed in the March commentary](#). Not only are these banks putting a pause on new SPAC issuance, but in many cases, they are ending their advisory relationship with the existing SPACs they took public as underwriters. The loss of these advisory relationships will make it even harder for SPACs to find and successfully close business combinations with targets.

Another factor weighing heavily on the industry is the poor performance for deSPACs, or SPACs that have successfully consummated a merger. 95% of deSPACs completed since 2021 are trading below their NAV and more than 10% of them having issued going-concern warnings in recent months⁴. The oversupply of SPACs, shortening period-to-maturity and these ongoing negative developments have resulted in SPACs continuing to trade lower, widening out SPAC arbitrage spreads. At the end of May, SPACs searching for targets were trading at a discount to trust, which provides a yield-to-maturity in excess of 4.13%⁵. With the capital raised by SPACs held in trust and invested in US treasury bills, we believe SPAC arbitrage provides an attractive low-risk yield.

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

² <https://resourcehub.refinitiv.com/506633dealsintelinsight/506633-May2022MA?lx=Pt1BE>

³ <https://www.spaglobal.com/marketintelligence/en/news-insights/latest-news-headlines/may-total-of-7-global-10b-plus-m-a-deals-marks-most-active-month-since-2019-70653683>

⁴ <https://www.institutionalinvestor.com/article/b1y8sy0mjf32zz/Despite-Market-Rout-Hedge-Funds-Hold-Steady-With-SPACs>

⁵ <https://spacinsider.com/stats/>

Portfolio Update

May was an active month in the Fund as we took advantage of growing fear, high demand for liquidity and equity market volatility to increase the Fund's net exposure by putting excess cash to work. The Fund initiated positions in 11 new or previously announced merger deals with nine deals closing. After a relatively slow April for the Fund, we were quite active in May, initiating positions in new merger deals while also initiating positions in mergers we have been tracking, awaiting an attractive entry point and these came during the month.

Our positioning in the Fund remains focused on smaller merger deals which, like small-cap securities, tend to be underfollowed and are more likely to be mispriced, particularly in a volatile environment as experienced last month. With expectations of higher interest rates, we are also managing the duration of our holdings by focusing on merger deals in the later stages of their approval process, which we believe have a short period to closing. The barrage of negative developments for the SPAC industry and SPAC share prices has made SPAC arbitrage even more compelling with the average SPAC seeking a target trading at a 4% yield-to-maturity based on its liquidation value upon maturity. We were previously targeting SPAC investments with a duration under 0.5 years trading at a 3% yield-to-maturity but now see a wide set of opportunities amongst relatively large, liquid SPACs which provide a yield to maturity in excess of 4%. We believe that the low-risk nature of SPAC arbitrage with the trust value of SPACs invested in US treasury bills provide a compelling tax-efficient investment opportunity in a volatile market.

Points.com Inc. (NASDAQ: PCOM), ServiceSource International, Inc. (NASDAQ: SREV), Hemisphere Media Group, Inc. (NASDAQ: HMTV), Columbia Care Inc. (CNSX: CCHW), Trecora Resources (NYSE: TREC), Blueknight Energy Partners, L.P. (NASDAQ: BKEP), Natus Medical Incorporated (NASDAQ: NTUS), Biohaven Pharmaceutical Holding Company Ltd. (NYSE: BHVN), Stonemor Inc. (NYSE: STON), Höegh LNG Partners LP (NYSE: HMLP) and GTY Technology Holdings Inc. (NASDAQ: GTYH) were among merger deals initiated in the Fund during the month.

US Ecology, Inc. (NASDAQ: ECOL), Elmira Savings Bank, (NASDAQ: EBSK), Bottomline Technologies, Inc. (NASDAQ: EPAY), Intersect ENT, Inc. (NASDAQ: XENT), Mimecast Limited (NASDAQ: MIME), Zynga Inc. (NASDAQ: ZNGA), IntriCon Corporation (NASDAQ: IIN), American National Group, Inc. (NASDAQ: ANAT) and Ortho Clinical Diagnostics Holdings plc (NASDAQGS: OCDX) were among merger deals that closed in May.

At the end of May, the Fund had 30 investments in small-cap deals under \$2B, with 27 of those deals under \$1B.

Outlook

Equity markets were red across the board in May with the S&P 500 on the verge of entering a bear market during the month but making a sharp recovery through the final weeks to end the month flat at 0.0%. The Nasdaq 100 fared worse, down 1.7% while the S&P TSX Composite gave back some of its gains, driven by the resource sector to end the month down only 0.2%. Inflation rose to 6.8% in Canada, a gain over the previous month, while US inflation of 8.3% declined for the first time in eight months but was still above expectations and at a 40-year high. Recessionary fears may keep equity market volatility high as investors focus on inflation data and the impact from central banks hiking rates. Several prominent corporations including Apple, Microsoft and Tesla announcing layoffs or hiring freezes to cut costs is also weighing on investor expectations of future earnings, adding more uncertainty to equity valuations. Uncertainty remains for bond markets as investors grapple with a series of rate hikes put forth by the Fed, while also reacting to the impact of quantitative tightening as the Fed began reducing its balance sheet, starting on June 1.

With these uncertain market conditions, a non-correlated, event-driven, absolute return alternative strategy like merger arbitrage can be a great compliment to a portfolio. Central banks have signalled a more aggressive pace of rate hikes to tame inflation, creating a further headwind for bonds. Given the wider spreads of both merger arbitrage and SPAC arbitrage, and with merger arbitrage historically exhibiting a positive correlation to interest rates acting as a hedge to rising rates, we believe the strategy provides a compelling alternative to traditional fixed income. Merger arbitrage conditions remain favourable with a high level of M&A activity, even in a volatile market with wide spreads and high success rates of merger deals closing. Alternative strategies have proven to be an effective diversifier for investors so far this year, which we believe justifies a place in portfolios.

Amar Pandya, CFA

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PenderFund Capital Management Ltd.

The Pender Alternative Arbitrage Fund was launched in September 2021. Standard Performance Information for this Fund will be available one year after inception. More information on the Fund can be found here: <https://www.penderfund.com/liquid-alternative-funds/>

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