PENDER
ALTERNATIVE ARBITRAGE FUND

MANAGER'S COMMENTARY – MARCH 2023

Dear Unitholders,

The Pender Alternative Arbitrage Fund was down -0.3%[1] in March.

M&A Market Update

Global M&A investment totalled $575 billion through the end of Q1 2023, down from the $1.1 trillion in deal value during the same period last year[2]. Rising interest rates, elevated market volatility and growing recession fears have caused some dealmakers to put a pause on M&A. The banking crisis during the month, which included the collapse of Silicon Valley Bank and Signature Bank as well as the forced sale of Credit Suisse, added further volatility and uncertainty to markets and impacted deal flow. Despite the overall slowdown in global M&A activity, pockets of deal activity continue to occur as well-capitalized, opportunistic acquirers take advantage of dislocated valuations. Even on the Monday following the closure of Silicon Valley Bank and the appointment of the FDIC as receiver of all deposits, there were several M&A deals announced, including the largest deal of the year thus far: Pfizer Inc's (NYSE: PFE) $41 billion offer to acquire Seagen Inc. (NASDAQ: SGEN).

An encouraging development in the month was the return of banks to offer buyout debt financing. Banks paused buyout lending activity after suffering some heavy losses in committed financing for notable LBO deals last year, including Citrix Systems, Inc. and Nielsen Holdings plc. The March banking crisis mainly impacted regional banks with larger banks deemed safer or at least "too big to fail" with some investors moving their deposits to larger banks during the month. Regional banks are not typically major advisors or lenders on M&A deals, so with the impact of the banking crisis appearing contained, bank-led buyout financing could remain. Private equity firms have ample dry powder for acquisitions, and for the past few months many deals have occurred without the use of leverage. However, as one of the key drivers of private equity is the ability to enhance returns through the use of leverage (through leveraged buyouts) and with banks willing to step back in and provide financing, we think private equity-led M&A could be on the rise.

SPAC Market Update

At the end of March, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 5.1%[3]. With SPAC arbitrage effectively equating to acquiring a treasury bill at a discount, SPACs currently provide nearly a similar yield as US Corporate Investment Grade Bonds[4] with lower credit risk, shorter duration and a tax advantage, as SPAC returns are primarily capital gains.

March was the peak month of SPAC maturities for 2023, with the industry now fully lapping the peak of the 2020/21 SPAC bubble by the typical two-year maturity date. Dozens of SPACs liquidated during March, returning nearly $11 billion dollars to investors. Many SPACs with looming maturities have elected to extend their maturities for a few quarters, but this requires unitholder approval and gives investors the right to elect to redeem their units to receive the cash held in trust rather than remain invested in the SPAC. Like many investors, we have elected to redeem back for the cash value, leaving these "redeemed" SPACs now holding only a fraction of their initial cash value. With SPAC sponsors having already sunk the millions of dollars required to set-up, fundraise and manage the SPAC, kicking the can down the road may

[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] https://www.reuters.com/markets/deals/global-dealmaking-sinks-lowest-level-over-decade-2023-03-31/
[3] https://spacinsider.com/stats/
[4] https://fred.stlouisfed.org/series/BAMLC0A4CBBBEY

be perceived as the best option. However, the prospect of these redeemed SPACs finding and successfully closing a merger is no better than it was prior to redemption, and could arguably be worse, given their smaller cash balance. With a smaller float, less liquidity, poor prospects of finding a target and the new maturity date quickly approaching, we believe redeemed SPACs are likely to provide arbitrage investors another investment opportunity in a few quarters' time.

As at March 31, 2023, there were just under 450 active SPACs in the market with roughly 290 SPACs searching for targets[5]. The majority of these SPACs are maturing this year, which should provide a continued tailwind of SPAC liquidations for the next few quarters. As the size of the SPAC sector and the number of SPACs in the industry shrinks, there will likely be a corresponding decline in our SPAC exposure in the Fund, but we are still finding plenty of opportunities today. With the market oversupplied with active SPACs, SPAC IPO activity remains depressed with only 11 SPAC IPOs completed through March 2023, compared to the 86 successful SPAC IPOs in the calendar year 2022 and the 613 completed in 2021. The SPAC IPOs of 2023, though fewer in number, have exhibited strong performance out the gate on average, so there remains appetite in the market for new SPACs. Our strategy remains focused on targeting SPACs trading at a discount to trust value that offer an attractive yield held through liquidation, but we will continue to monitor the sector for new opportunities.

Portfolio Update

March was a tough month in the merger arbitrage space, as the regulatory environment remained unpredictable and challenging to navigate, and elevated market volatility from the banking crisis caused spreads to widen for several deals. Several moves from US regulators have added uncertainty to the evaluation of deal risk. These included the unprecedented action of the Federal Communications Commission to block the merger of Tegna (NYSE: TGNA), and ongoing efforts by the Federal Trade Commission (FTC) and the Department of Justice to block other mergers from a more politicized perspective. With these regulators being focused on large merger deals, our small and mid-cap deal positioning may benefit from wider spreads without correspondingly higher deal risk. For the occasional larger deal held in the Fund, the letter of the law still matters, so while regulators can try to block a merger, if challenged, they also need to win in court and there have been several victories against the FTC in the past year. In response to an increasingly hostile regulatory environment, we intend to reduce our already small exposure to large-cap merger deals with ample small and mid-cap M&A activity, and we expect activity in that part of the market to remain robust. At the end of March 2023, the Fund had 25 investments in small-cap deals under $2 billion, 14 of which were valued at under $1 billion.

The Fund initiated positions in 15 new or previously announced merger deals during March, and 20 merger deals held within the Fund also closed during the month. The volatility and dispersion in merger spreads during the month provided ample opportunities for the Fund to initiate and add to many positions at highly attractive yields. While merger arbitrage spreads may widen in periods of stress, without a corresponding change in the deal risk or a lengthening in the expected time to close, the widening of a spread provides a higher forward expected return. Elevated selling activity in periods of stress may widen spreads in the short-term but will subsequently close upon achievement of the discreet and non-correlated factors like regulatory approvals required for a merger deal to close.

First Horizon Bank (NYSE: FHN), which has an acquisition offer from Toronto-Dominion Bank (TSX: TD) was a key detractor to the Fund during the month. The acquisition, which was announced in February 2022, appeared to be in the later stages of approval while trading at a wide spread that provided an attractive expected yield. In early March, the company announced that a pending regulatory approval delay could push out the closing date potentially past the current May 27 deadline requiring a negotiation to extend the deadline. The banking crisis, which occurred in the weeks following this announcement, added

[5] https://www.spacresearch.com/

further uncertainty to the deal, with the market implying a high probability of a deal break or the deal being repriced at a lower level. We cut our exposure to the deal upon the initial announcement of the delay while subsequently adding to our position after a sell-off in the share price in the weeks following the banking crisis. TD currently has a definitive agreement obligating it to do what is required to close the deal up to its current close date, and while a reprice or termination could occur, in the current regulatory environment, walking away from the merger or pushing too hard to reprice the deal might not be in its best interests for their long-term US expansion. We maintain a small position in the deal today as we believe there is a favourable risk/reward opportunity, but continue to monitor the deal closely.

Within our limited exposure to larger merger deals, we did see some positive developments during the month. Notably, the highly topical merger between Shaw Communications Inc. (TSX: SJR.B) and Rogers Communications Inc. (TSX: RCI.B) received final regulatory approval after a process lasting over two years with considerable regulatory hurdles, delays and tribunal hearings. While we reduced our exposure to the deal earlier in the year after the companies were successful in preventing the Competition Bureau from blocking the deal, we maintained a sizeable position going into this final approval to close. Given an increasingly hostile regulatory environment, we expect to focus an even greater portion of the Fund to small- and mid-cap merger deals going forward, and we expect to avoid larger mergers with elevated deal risk.

Outlook

We believe the widening of merger arbitrage spreads in March implies a more favourable forward outlook for returns going forward. Arbitrage yields expanded considerably during the month and new merger deals announced in the past few weeks traded at attractive yields, compensating investors for higher interest rates, elevated regulatory risk, and higher volatility with a meaningful risk premium over the risk-free rate. This is a welcome change from the first months of the year where spreads were relatively tight given underlying deal risk and higher interest rates. Part of this may be explained by the significant amount of arbitrage capital that had to be redeployed at the start of the year given the wave of SPAC liquidations in December and many merger deals closing prior to year-end.

In our opinion, we see favourable tailwinds for a pick-up in M&A activity, particularly in our core area of focus in small and mid-cap merger deals. Smaller merger deals and private equity buyouts with low anti-trust and competitive risk are ideal opportunities in the current environment. This merger arbitrage positioning along with the low-risk, low volatility and tax-efficient returns provided by our SPAC arbitrage exposure, we believe, could provide investors with an attractive non-correlated investment stream in an uncertain and volatile market environment.

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April 25, 2023

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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/*](https://www.penderfund.com/pender-alternative-arbitrage-fund/)