PENDER
ALTERNATIVE ARBITRAGE FUND

MANAGER'S COMMENTARY – APRIL 2023

Dear Unitholders,

The Pender Alternative Arbitrage Fund was up 0.1%[1] in April 2023.

M&A Market Update

Global M&A investment totalled over $900 billion through the end of April, down from the $1.5 trillion in deal value during the same period last year[2]. While M&A activity has declined in 2023 due to the uncertainty in markets and the steep increase in borrowing costs through rising interest rates, there have been notable sectors that have bucked the trend and where deal activity remains strong, including the healthcare, industrials and materials sectors. Higher inflation, the reshoring of supply chains driven by geopolitical uncertainties and the scarcity of material resources driven by the electrification and urbanization trends occurring globally are all driving consolidation in the mining, energy and infrastructure sectors. Private equity firms continue to be active dealmakers in the public market, representing a leading share of deal flow. These firms have so far announced the majority of the largest deals throughout the year[3]. With nearly a trillion dollars of capital in PE firms needing to be deployed, appealing public versus private valuations, a return of bank led debt financing and general partner incentives to do deals, the environment for buyouts is attractive.

The healthcare sector has seen a significant spike in activity this year, with deal volumes surpassing levels from the same time last year by nearly 50%. The pharmaceuticals and biotech industries have seen dozens of deals announced in the past few months, providing a high-quality source of deal flow for merger arbitrage investors. This spike in activity has been driven by a multitude of market and industry-specific factors, which have created an ideal environment for M&A. A biotech company is typically focused on a single drug or therapy and raises millions of dollars in funding to research, develop and submit a drug for approval to the FDA where the ultimate timing and outcome is uncertain. This makes biotech companies a highly speculative investment. With higher interest rates, increased market volatility and lower investor risk appetite for these speculative investments, many biotech companies have been left capital starved and trading at steep valuation discounts. With large pharmaceutical companies maintaining strong balance sheets and cash positions, they can acquire a drug developer with promising or successful clinical results and leverage their marketing, distribution and overheads justifying a steep premium to add a new drug to their portfolio. While Big Pharma and Big Insurance are increasingly targets for regulators, the new drugs and therapies developed in the biotech sector have less overlap with existing drugs and face far fewer hurdles in an acquisition. As biotech acquisitions are typically financed with available liquidity and structured as a tuck-in to a larger pharmaceutical company, biotech acquisitions tend to close in a shorter period of time, thus providing attractive returns to arbitrage investors.

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[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] Refinitiv Investment Banking Scorecard – Deal Intelligence I as at May 11, 2023

[3] Take-Private Dealmaking Continues at a Record Pace, Institutional Investor, May 3, 2023

SPAC Market Update
At the end of April 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 5.4[4]. With SPAC arbitrage effectively equating to acquiring a Treasury Bill at a discount, SPACs currently provide an almost-similar yield to US Corporate Investment Grade Bonds[5] with lower credit risk, shorter duration and a tax advantage, as SPAC returns are primarily capital gains.

The SPAC sector continues to shrink due to liquidations of maturing SPACs. Fourteen SPACs liquidated in April, returning $3.6 billion to unitholders[6]. The environment for existing SPACs to find and close a business combination remains as challenging as it has been for the majority of the last two years. Thirteen months after the SEC released a draft of new proposed rules for SPACs, it is still not clear what the impact of these rules may be, which has caused underwriters and bankers to exit the SPAC business, making it increasingly difficult for existing SPACs to close a merger with a target. A recent analysis by the Wall Street Journal, which looked at companies that competed a merger with a SPAC between 2020 and 2022, determined that over a quarter of these de-SPACs were now 'penny stocks' trading below $1[7]. With uncertainty in the amount of capital a SPAC will actually provide at deal closure, poor performance of de-SPACs and a lack of clarity on regulatory rules, the prospects for existing SPACs completing deals remain grim.

At the end of April, there were just under 430 active SPACs in the market with assets over $65 billion, 270 of which were searching for targets[8]. 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. We still see many SPACs with upcoming maturities seeking an extension, pushing out the maturity by a few quarters while offering existing unitholders the right to redeem back for trust value. We will continue to redeem these SPACs and monitor them post-redemption as they will potentially provide another arbitrage opportunity in the future.

Portfolio Update
April saw a return to a more normalized merger arbitrage market after a volatile March, which was fraught with regulatory pushback and increased uncertainty due to the regional banking crisis. A benefit of the elevated volatility and regulatory risk witnessed in the market last month was a widening of arbitrage spreads as investors repriced deal risk and demanded higher compensation in the form of risk and liquidity premiums. In a market environment like that experienced last month, there tends to be greater dispersion in spreads or a greater mispricing of deal risk, which allows arbitrage investors to adjust exposure to various deals and optimize a Fund for the benefit of risk-adjusted returns. We were active in the Fund during the month, trimming and adding exposure to various deals and taking advantage of this dispersion in spreads. We continue to position the Fund in small and mid-cap merger deals and we seek to take advantage of the higher spread environment while avoiding the deal risk and duration risk, which has been elevated for larger deals throughout the year. At the end of April 2023, the Fund had 23 investments in small-cap deals under $2 billion, 13 of which were valued at under $1 billion.

The Fund initiated positions in 13 new or previously announced merger deals during April, and 10 merger deals held within the Fund also closed during the month. As discussed in the M&A Market Update above, the biotech sector has seen a surge of activity, providing arbitrage investors with a

[4] https://spacinsider.com/stats/
[5] https://fred.stlouisfed.org/series/BAMLC0A4CBBBEY
[6] https://www.spacresearch.com/
[7] More Than 25% of the Companies That Merged With SPACs During the Boom Are Penny Stocks Now, Wall Street Journal, April 21,2023
[8] https://www.spacresearch.com/

plethora of high-quality, low-risk and potentially high-yielding investment opportunities. New positions initiated in the Fund during the month included the proposed acquisitions of several biotech companies including: Heska Corporation (NASDAQ: HSKA), Prometheus Biosciences Inc. (NASDAQ: RXDX), Satsuma Pharmaceuticals, Inc. (NASDAQ: STSA), BELLUS Health Inc. (NASDAQ: BLU), Spectrum Pharmaceuticals, Inc. (NASDAQ: SPPI) and IVERIC bio, Inc. (NASDAQ: ISEE).

One of the more attractive features of biotech mergers is the potential short period to closing, especially when the deal is structured as a tender offer. A tender offer typically doesn't require approval from the board of directors or a shareholder vote to approve the proposal, which enables a substantially faster completion time than a merger. An example of this type of deal held by the Fund was the acquisition of Provention Bio, Inc. (NASDAQ: PRVB) by Sanofi S.A. (EPA: SAN), with Sanfoi seeking to add Provention's TZIELD, a first-in-class therapy in Type 1 diabetes to its general medicines asset portfolio. On March 13, 2023, Sanofi announced an agreement to acquire Provention. According to the terms of the merger agreement, Sanofi would commence a cash tender offer to acquire all outstanding shares of Provention for $25 per share. Provention's shares were priced at $24.10 when the acquisition offer was announced, and the merger completed only 46 days later on April 28, 2023. Buying that merger deal at the closing share price on the date of announcement and holding through to completion would have provided a return a 3.7% and an annualized yield of over 33%, which highlights the attractiveness of this type of deal structure. While we will continue adding to new biotech deals we deem attractive, we will also continue to find opportunities across various industries and structures and manage the risk profile of the Fund by diversifying and limiting exposure on a deal-specific, sector-specific and industry-specific basis.

Outlook

We expect the wider merger arbitrage spreads experienced in April to continue for the foreseeable future as investors reprice risk to a new and less predictable regulatory regime and demand a higher premium over the risk-free rate for the liquidity and duration exposure of investing into a merger deal. We continue to see favourable conditions for deal activity in the small and mid-cap space with valuations dislocated in that part of the market, buyers—whether strategic or financial—having ample capital to do deals with the right conditions and incentives in place for buyers and sellers to come together and find an agreement that works for all sides. With investor activism on the rise, if sellers don't come to the table willingly, it is an ideal environment for hostile offers to form. Selling shareholders are often receptive to a higher in-hand offer than to holding out for a higher share price at some point in the future.

The path of interest rates remains uncertain thanks to declining but persistent inflation, a strong labour market, rising geopolitical tensions and the stresses of rapidly rising interest rates as seen in the regional banking sector showing signs of spreading to the commercial real estate market. A low-risk, low-volatility and non-correlated investment strategy like merger arbitrage can be a highly complementary addition to an investment portfolio in this environment. The tax efficient returns of merger and SPAC arbitrage are primarily in the form of capital gains, which compares well to the income interest returns received in a typical bond investment.

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May 19, 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/

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