PENDER
ALTERNATIVE ARBITRAGE FUND

September 2023

Manager's Commentary

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Dear Unitholders,

Highlights

- The Fund initiated positions in 14 new or previously announced mergers while five merger deals held within the Fund closed during the month.
- At the end of September, the Fund had 41 investments in small-cap deals under $2 billion, 32 of which were valued at under $1 billion.
- Deal activity in Canada through the third quarter ending September 30 reached $46.6 billion up from $41.2 billion at the same period last year.

The Pender Alternative Arbitrage Fund was up 0.4%[1] in September 2023.

M&A Market Update

Global M&A activity totaled $2 trillion through the first three quarters of 2023, a 27% decline from the same period last year[2]. This level represents the slowest nine-months for global deal activity in a decade as merger and acquisition activity globally remains in a slump. Rising interest rates, persistent inflation, elevated market volatility and flaring geopolitical conflicts have resulted in higher levels of uncertainty for dealmakers making it harder to get a deal across the line. Despite the depressed levels of deal activity, there are signs that it is set to increase with financing conditions improving, bankers becoming more creative in how they structure deals and, increasingly, relying on private credit providers for financing.

While M&A activity in the US has declined, it has fared much better than the rest of the world with the US accounting for a 44% share of worldwide M&A up from 42% a year ago. Deal activity in Canada remains strong with volumes up 13% in the quarter as financing conditions improved despite the impact of high interest rates[3]. Deal activity in Canada through the third quarter ending September 30 reached $46.6 billion up from $41.2 billion at the same period last year. This represents a level more in-line with pre-pandemic and long-term average levels. The boost to higher deal-flow in Canada can be partly explained by the country's unique market exposure to hard assets benefiting from higher pricing and increased demand.

Another potential sign of improving confidence in capital markets has been the return of "IPOs" or initial public offerings. IPO activity has remained muted in 2023 with 120 IPOs completed in the US through the end of September down from the 163 deals completed at

[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.

[2] Source: Refinitiv - Deals Intelligence

[3] Source: Reuters (https://www.reuters.com/markets/deals/canada-ma-volumes-rise-dealmakers-cautious-about-near-term-pickup-2023-10-05/)

the same time last year. In addition to a decline in IPO volumes, the size of IPOs this year has also lagged until September which witnessed some sizeable and well-known debuts. Arm Holdings PLC (NASDAQ: ARM), Instacart (NASDAQ: CART) and Klaviyo Inc (NYSE: KVYO) all had their IPOs in September with strong initial reactions with subsequent wobbles with share prices moving closer to or below their IPO price. Bankers, would-be issuers and private equity firms looking at exit opportunities will be watching the market reception to these IPOs closely, weighing if the market is signaling whether they should join them.

"Unlike their large- and mega-cap counterparts, small-cap companies benefit from a larger pool of buyers including strategic buyers, management buyouts, private equity funds, pension/sovereign funds and industry consolidators."

Similar to the M&A market where the spread between the buyer and seller valuation expectations remains a key determinant for a deal to get done with sellers generally having to accept a decline in valuations, the IPO market is signaling a similar reduction in valuation is necessary to bring buyers to the table. Instacart's IPO raised $660 million, valuing the company at roughly $10 billion making it one of the largest IPOs of the year but deputing at a fraction of its $39 billion valuation set in a fundraising round in 2021. In this new market environment with profitability, pricing power and persistency of growth weighted with much higher relevance, sellers of businesses— whether to an acquirer in an M&A transaction or in an IPO selling shares to new investors in the public markets— need to be realistic in their expectations. Within the small-cap sector in Canada and the US we have followed several strategic review processes where sellers remained anchored to high historical valuations and buyers offers overweighted the worst-case outlook for a business. This stubbornly wide gap between expectations has impeded deal activity this year but as frustrated shareholders pressure boards to seek out ways to unlock value and buyers weight the risk of overpaying vs losing a competitive advantage, this gap should narrow. As we see buyers and sellers of businesses analyze and incorporate new information and data points into their valuation expectations, there should be more opportunities where an equilibrium is found, and a deal can get done.

SPAC Market Update

There were eight SPACs that liquidated in September, returning $2.3 billion to unitholders.[4] With no SPAC IPOs, the total amount of capital held in trust by all SPACs declined to just over $24 billion. September was the first month in over a year where no new SPACs went public. This is in sharp contrast to only a couple years ago where it was normal to see dozens of SPACs raise hundreds of millions every month. Through the first three quarters of 2023, only 22 SPACs have gone public raising $2.8 billion down 95% from the 613 SPACs which raised $163 billion in the peak of the SPAC bubble in 2021. The decline of new SPACs is a return to a more normalized environment for the industry where the supply of SPAC capital

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

and the demand for that capital by businesses seeking to go public is at an equilibrium. With the IPO window showing some signs of opening up this month, there are likely more private businesses not suitable for a traditional IPO or direct listing who may find a merger with a SPAC a preferential way to go public. While the Fund's exposure to SPACs has declined to the low single-digits, a return to a more balanced market could make new SPAC IPOs an attractive arbitrage opportunity and a potential investment for the Fund.

At the end of September, there were just under 330 active SPACs in the market with assets just over $24 billion, with less than 171 actively searching for targets. At the end of September 2023, SPACs searching for targets were trading at a discount to trust value, which provided a yield-to-maturity of 4.6%.[5] With SPAC arbitrage effectively equivalent to acquiring a Treasury Bill at a discount, SPACs currently provide an almost-similar yield to US Corporate Investment Grade Bonds with lower credit risk, shorter duration and a tax advantage, as SPAC returns are primarily capital gains.

Portfolio Update

Through the month of September, the Fund initiated positions in 14 new or previously announced mergers while five merger deals held within the Fund closed during the month. September saw a continuation of elevated deal activity spanning a diverse number of sectors and industries with a healthy mix of strategic and financially motivated transactions. One of the deals initiated in the portfolio during the month included the Pender Corporate Bond Fund holding Intercept Pharmaceuticals Inc. (NASDAQ: ICPT) which is being acquired by Italian pharmaceutical company Alfasigma S.p.A. Merger arbitrage spreads remain wide with many small-cap deals trading at attractive spreads. 2023 has proven to be a challenging year for merger arbitrage investors but a pick-up in M&A activity, particularly within small-cap companies, wider merger arbitrage spreads and the short duration of the strategy, we are seeing promising signs with a favorable setup for forward returns.

At the end of September 2023, the Fund had 41 investments in small-cap deals under $2 billion, 32 of which were valued at under $1 billion. A key benefit of our focus on small- and mid-cap merger deals is our ability to take advantage of organic deal flow from Pender's equity portfolio and leverage Pender's existing insights, analysis and trade execution competencies in small- and mid-cap equities. We had an example of this during the month with the Fund initiating a position in Avantax Inc (NASDAQ: AVTA) which was a holding in the Pender Alternative Special Situations Fund (PASSF). Avantax which is a registered investment advisor sold a key tax software business segment in November 2022 with its remaining business being subscale in an industry that has been experiencing significant consolidation. The PASSF initiated a position in the company during the summer when an activist investor was pushing the company to explore strategic alternatives including a sale and Pender's analysis suggested there was a high probability of a take-out with a private market value well above the share price at that time. On September 11, 2023, Avantax announced that they had accepted an offer to be acquired by wealth management software firm Cetera Financial Group for $26 per share. We were able to quickly leverage our

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

research and analysis on the company, identifying the deal as high quality with the potential to close in a shorter time than indicated by management and generating a potentially attractive return.

Outlook

September was marked by the resurgence of government bond yields and further pressure on equity markets which experienced sizeable declines during the month. The one sector that has exhibited persistent strength has been Energy with higher oil prices and the rising cost of gasoline further adding to inflationary pressures. The material rise in longer-term treasuries indicates the market is realizing that central banks could keep rates higher for longer and that the first rate cut could be further away than expected. In an environment wrought with uncertainty, portfolio diversification and holding non-correlated investments is a favorable strategy.

The risk-off market in September saw a decline in equity prices especially among small-cap companies, thus expanding the already wide valuation gap with large cap companies. With this widening disconnect between market value and intrinsic value, we believe conditions are ripe for an increase in M&A activity within small caps as frustrated shareholders are more receptive to offers at a premium to the current market price. Unlike their large- and mega-cap counterparts, small-cap companies benefit from a larger pool of buyers including strategic buyers, management buyouts, private equity funds, pension/sovereign funds and industry consolidators. The end-market for small-cap businesses is also typically domestic or trans-border which is an attractive characteristic in an uncertain geopolitical environment where governments are promoting reshoring supply chains. While financing conditions remain challenging, smaller acquisitions are much easier to finance with flexible financing options available to many buyers. Given these conditions we see an environment which could see a rise in small-cap deal activity and a highly attractive source of deal-flow for the Fund.

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