PENDER
CORPORATE BOND FUND

March 2024

Manager's Commentary

Geoff Castle

Highlights

- Large positive moves came from some deeply discounted bonds including Esperion's 2025 notes, Lucid Group's 2026 convertible bonds, and 2028 bonds of Emergent BioSolutions. Convertible bonds in Equinox Gold (2029) and OPKO Health (2029) provided further gains.
- The wide valuation divergence between certain pockets in the credit markets and the tight spreads in the high-yield bond index highlight the potential benefits of an active investing approach.

The Pender Corporate Bond Fund returned 2.8% in March[1], as the Fund benefited from numerous specific catalysts that drove very strong performance.

Some of the Fund's deeply discounted bonds made large moves during the month. Our holding in Esperion Therapeutics, Inc's 2025 notes gained 11% as long-awaited label expansions for Nexletol/Nexlizet were approved by the FDA. The Fund's position in 2026 convertible bonds of Lucid Group, Inc. rose more than 17% as an entity affiliated with Saudia Arabia's Public Investment Fund (PIF) invested $1 billion into the electric car maker, re-affirming our view that the company's debt enjoys implicit support from the PIF. Due in part to the enthusiasm on the appointment of an accomplished pharmaceutical industry veteran, new CEO Joseph Papa, our position in deeply discounted 2028 bonds of Emergent BioSolutions gained more than 15%.

Another area of strength for the Fund was in near-the-money convertible bonds that rose with significant movement in the underlying equities. Equinox Gold's 2029 converts rose 19% as the Canadian gold miner advanced towards opening its Greenstone mine. And OPKO Health's 2029 convert burst above par on the company's surprise sale of a portion of its money-losing laboratory business for over $200 million.

The Tide is Turning...But it's Still Early

In the latter half of 2023 we noticed an extraordinary divergence developing between some pockets of the credit market that we viewed as extremely cheap in comparison to a high yield bond index that was quite tightly priced versus the government bond benchmarks. We noted that these cheap pockets were difficult to approach passively because often the issues were unrated, or because their return potential came partly in equity-linked revaluation.

[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.*

Although it is starting to feel as if the tide is turning, we believe the valuation anomalies have only recovered a small portion of their full potential. Let us elaborate, using the examples of this month's key performance drivers:

Lucid Group, Inc: Our position in Lucid 2026 notes represents a holding of that company's only debt securities. March's gain saw the securities price up from $43.75 per $100 of face value to $51.60. That was a nice mark-up, but we believe that it is reasonable to consider full par repayment by 2026 as an ultimate target. After all, the company, proforma its latest cash infusion, has more than $4 billion in cash and short-term investments compared to only $2 billion in borrowings. In addition, Lucid has fixed assets valued at over $3 billion and inventories of nearly $700 million. The ongoing commitment of the Saudi PIF only adds to the solid case for the Lucid notes.

Esperion Therapeutics, Inc: Regular readers of this commentary would be amongst a very small group of market participants who would have instantly grasped the importance of the FDA label extension to this company's future prospects. But the word is quickly getting out. In essence, the addressable market for Esperion's cholesterol lowering therapy has been expanded by more than five times. Street estimates for revenue for Esperion in 2025 now represent more than triple the company's 2023 total. In our view, the company's 2025 notes, which still yield more than 16%, are now truly "cream puffs", providing extraordinary potential return for little fundamental risk.

Equinox Gold: We have regularly reminded our readers of the record low price ratio that has existed between that of gold miners' valuation to the price of the yellow metal itself. However, in the last six months we have seen miners like Equinox outperform bullion by a factor of approximately 2:1. Gold stocks are just beginning to outperform bullion. We note that recently the gold price has surpassed its 2011 high water mark, yet Equinox Gold shares are still trading at *less than half* the level they were in 2011. Were Equinox to regain its 2011 high, the intrinsic value of our call-protected 2029 convertible note would increase from the current level of $116 to over $200. (And note that since 2011, the tangible book value per Equinox share has expanded by more than three times).

OPKO Health: There are few companies as out-of-favour as OPKO. Yet, the company's diminished value seems to be at odds with a growing supply of good news and improvements in its financial position. Last June, OPKO and its marketing partner Pfizer received FDA approval for its weekly growth hormone therapy, Somatrogon. Subsequently, the company successfully refinanced its 2024 convertible bond maturity, extending its nearest debt maturity to 2029. Furthermore, it recently sold off a piece of its money-losing laboratory business for a sum that exceeded the company's total debt. If OPKO's equity can merely achieve the average valuation it held back in 2019 (a year it was undergoing the phase 3 trial of Somatrogon), the intrinsic value of our non-callable convertible bonds could increase by more than 100%.

To state the case simply, we are value players. We spent the better part the past year loading up the Fund with value opportunities that had a lot of "legs" from the return potential point of view of. After suffering a bit while we were waiting for catalysts to materialize, the last few months have seen encouraging developments. Potential returns have begun to be realized. But there is a long way to go. Buckle up!

"The tide is turning yet valuation anomalies have only recovered, in our view, a small portion of their full potential."

Portfolio Activity

In March, we initiated a position in the 8.25% 2027 bonds of **Centrus Energy Corp**. The company has, essentially, a monopoly on the enrichment of uranium for use in nuclear power plants in the United States. The entity is profitable, with operating income covering gross interest charges by 6x in the past year. December 31 cash balances of $201 million was more than 2x total debt outstanding. Yield to maturity of the bonds which trade at a slight discount to par, was more than 8.5%. We view one-year default probability for this unrated issuer at less than 0.25%.

Also in March, we significantly expanded our weighting in the 13.5% notes of **PGS ASA**, a Norwegian geotechnical company engaged in offshore seismic information. Last October the company agreed to be acquired by its larger competitor, TGS ASA, also of Norway. We expect the acquisition to be completed later this year and the acquiror has declared its intent to redeem these bonds at the earliest call date which is March 31, 2025. The bonds closed the month priced to yield 8.9% to the 2025 call.

Fund Positioning

The Corporate Bond Fund yield to maturity at March 31 was 8.0% with current yield of 5.6% and average duration of maturity-based instruments of 3.8 years. There is a 5.6% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 1.7% of the total portfolio at March 31.

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