PENDER
CORPORATE BOND FUND

May 2024

Manager's Commentary

Geoff Castle

The Pender Corporate Bond Fund enjoyed one of its best performing months in May, returning 2.5%[1]. Specific credit catalysts provided a performance boost, and these occurred within the context of a generally positive bond market.

Key contributors for the period included our position in Novavax Inc. convertible bonds that surged 80% on a major sale of business interests to Sanofi SA; a great outcome for the Fund. This item is discussed in more detail below. Our longstanding position in Fannie Mae preferred shares also rallied over 20% in May as investors anticipated renewed progress towards ending the crisis-era conservatorship following the US November elections. Further strength resulted from large rallies in bonds of Lucid Group Inc., Emergent BioSolutions and OPKO Health Inc., each up several points. And finally, numerous Canadian preferred share lines gained more than 5% in May.

Offsetting the general strength, to a degree, was weakness in credit within the EchoStar Corp capital structure. The situation here reflects the trials of an asset-rich but cash-constrained issuer that faces significant near-term maturities. Volatility notwithstanding, we feel confident of a par recovery in our first lien position within EchoStar's profitable Hughes Satellite subsidiary. Our position in the American Tire Distributors Holdings Inc. capital structure was also impacted by lower than anticipated quarterly earnings.

How we made 80% in Novavax Bonds in Less than Six Months

Our striking success in Novavax bonds is worthy of some more detailed explanation. A prior holding of little consequence, Novavax caught our attention again in December 2023 when we noticed the company's 2027 converts offered in the 50s, yielding 20%. We viewed it as probable that Novavax, possessing over $550 million in cash, would be able to pay off its only debt, a $175 million convertible bond due in 2027. At the time the company was under a cloud of bad news. It faced rapidly shrinking demand for its COVID vaccine and was also subject to a $700 million failure-to-deliver legal claim from GAVI (the Global Alliance for Vaccines and Immunisation), an entity that procures vaccines for developing countries. Our assessment in December was that GAVI, an organization started by the Bill and Melinda Gates Foundation, would not be a hard-nosed bargainer against this COVID vaccine pioneer and we felt it was possible that a favourable settlement might emerge. On this somewhat speculative basis we initiated Novavax 2027 notes with a small 0.5% weight.

As it turned out, in February of this year, a settlement was reached between GAVI and Novavax that drastically reduced the cash component of GAVI's claim to a mere $75 million. At this point, it appeared that bankruptcy risk was off the table and we more than tripled the

[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.*

size of our position in the Novavax 2027 notes which still were priced to yield about 20% to their maturity.

What happened next, we did not forecast. But, in the words of our friend, Lee Matheson, good things happen to cheap stocks. And so it was that on May 10, Sanofi and Novavax reached a $1.4 billion deal which essentially transferred Novavax's key product in development, a combined Covid-flu vaccine, to the French multinational. Novavax shares soared from less than $5 to more than $14, which was a level beyond our bond's $12.50 conversion strike price. And so we were able to exit our entire position for somewhat more than par, generating over 80% return versus our cost and more than 1.2% for the Fund overall. Not bad for a few months' work! And this trade is a real feather in the cap of my colleague Parul Garg, who worked tirelessly to understand a complicated and risky file in a way that our numerous competitors in the credit markets clearly missed.

"In May we continued to add in areas where we see the most interesting risk-adjusted return potential, including the recently unpopular rare earths materials sector."

New Positions

As enjoyable as it is to look back on Novavax, we recognize that we work on behalf of holders who are entering the Fund *today*, and so in May we continued to add in areas where we see the most interesting risk-adjusted return potential.

One area we find attractive is the recently unpopular rare earths materials sector and in May we added weight in the 2030 convertible bonds of Nevada-based **MP Materials Corp**. MP mines and refines a variety of rare earths including neodymium, which it processes into magnets that power electric vehicle motors amongst other applications. MP has a strong balance sheet with cash and short term investments of $946 million, slightly more than total debt outstanding. The company is uniquely positioned as the second largest global producer of rare earth materials and the largest in the Western Hemisphere. We anticipate that a recovery in materials prices could deliver a potential double digit return to our converts which were priced near par at month-end.

Another significant addition was more defensive in nature, as we added slightly over 1% weight in **Thomson Reuters** 2025 senior unsecured notes. Thomson Reuters' main business, the provision of mission-critical data and research products for legal, tax, accounting and other professionals is sticky and highly profitable. The company's balance sheet is extraordinarily strong with total debt being less than 4% of market capitalization. Operating income covers interest charges more than nine times. We view one-year default probability as less than 0.01%. The Thomson 2025 Canadian dollar notes yield slightly more than 5% and form a part of the Fund's liquidity reserves.

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Fund Positioning

The Corporate Bond Fund yield to maturity at May 31 was 7.8% with current yield of 5.1% and average duration of maturity-based instruments of 3.6 years. There is a 4.2% weight in distressed securities held for workout value whose notional yield is not included in the foregoing calculation. Cash represented 2.8% of the total portfolio at May 31.

Geoff Castle

June 5, 2024

Standard Performance Information for Pender's Fixed Income Funds may be found here: https://www.penderfund.com/fixed-income/
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