

Manager's Commentary – Q3 2024

Dear Investor

Since its inception, the Pender Credit Opportunities Fund (PCOF) has delivered a return of 26.7%, net of all fees and expenses, with a Net IRR of 22.2%. The investment period concluded in July 2024, and on October 1 we distributed 26% of committed capital back to investors, derived from realized investments. Although we have entered the harvesting phase, our focus remains on carefully realizing investments to align with our target return profile, while managing risk effectively.

Recently, we had the opportunity to meet with both our LPAC members and Limited Partners to review the Fund's one-year performance. We appreciate your valuable feedback and continued support. Through various discussions with current and potential investors, we recognize that our strategy is often compared to other alternative credit strategies, particularly private debt.

We believe both price-to-model and price-to-market strategies play a crucial role in diversifying the alternative credit market. The choice between them ultimately hinges on investor preferences. Price-to-model strategies, such as private debt, offer access to a specialized network of private debt underwriting, while price-to-market strategies, like PCOF, provide similar return potential with the added advantages of greater transparency and liquidity through the secondary market. In our view, the mark-to-market approach is particularly well-suited to navigating dynamic economic and policy shifts, as it allows for quicker responses to market changes compared to private strategies, which are often late in response to such fluctuations. While price-to-market models can experience short-term price volatility, we see this as a natural part of their strength in dynamic environments.

From a risk management perspective, our approach goes beyond minimizing volatility. We prioritize acquiring securities with a meaningful margin of safety, ensuring a disciplined and thoughtful approach to managing risk over the long term.

Market Backdrop

As we move into the final quarter of 2024, the short-term outlook remains focused on central banks and their pace of easing lending rates. The key questions revolve around "how far" and "how fast" these adjustments will occur. Additionally, the outcome of the U.S. presidential election in November will have significant implications for both domestic and global markets. Geopolitical risks, once confined to specific regions, are now affecting multiple countries, and the widespread impact cannot be overlooked.

Over a long-term outlook (3-5 years), we may see the widening of credit spreads which are currently in the upper quartile of historical averages. Many companies will soon need to refinance debt originally issued at historically low rates, yet current spreads reflect minimal concern over balance sheet health, shrinking margins, or increased funding costs. This could lead to volatility, particularly for companies reliant on cheap borrowing. Additional concerns include rising credit card delinquencies, increasing auto loan defaults and the overall high number of bankruptcy filings.



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For our current portfolio, credit spreads are being driven more by individual fundamentals than by broader market conditions. As we continue to actively realize positions, we believe the immediate impact on our portfolio will be limited. However, looking ahead to the next 3 to 5 years, we anticipate a cycle of credit spread widening and tightening, which could present an expanded pool of opportunities—potentially revealing clear winners amidst the market dynamics.

Top Contributors

Our position in **Revance Therapeutics Inc.**'s convertible bonds, which rose 45% following a takeover bid, was the top contributor in Q3 2024. Revance, known for its DAXXIFY skincare treatment, competes with AbbVie Inc.'s Botox and has gained significant market share due to its longer-lasting effects. At the time of our investment, we believed the company's value exceeded its \$287 million in debt, which was trading at around 67 and yielding approximately 17%. We exited the position at 97, delivering solid returns for our investors.

Another key contributor this period was **Desktop Metal Inc.**'s convertible bonds, which surged more than 50% after an announced takeover bid. Desktop Metal, a leader in 3D printing, is known for its advanced metal component capabilities. Following the acquisition announcement, the bonds are set to be redeemed at par, and we initiated the position at 58 cents on the dollar, with current prices around 90+. The deal is expected to close in Q4 2024, and we see further upside upon completion.

Top Detractors

Stem Inc.'s convertible bonds were a drag on performance. Despite the company's strong potential in utility-scale battery operating systems, its stretched credit metrics have kept bond prices in the low-30s. Both the stock and bonds of Stem were under pressure following disappointing quarterly sales and earnings, impacted by delays in new utility battery installations caused by funding setbacks in municipal utilities. While this has been a challenging position for us, we remain confident in Stem's long-term value as a leader in battery operating system software, which justifies holding our position through this period of underperformance.

Our position in **Spirit Airlines Inc.**'s distressed securities also detracted from performance. Spirit is on the verge of filing for bankruptcy following the termination of its merger with JetBlue Airways Corporation. We hold an 8% secured note maturing in September 2025, which was initiated at around 60% of par value. Despite its distressed situation, Spirit has some key credit strengths, including \$700 million in cash and 73 owned aircraft, many of which are free of credit liens. We believe this collateral provides a strong foundation for recovery in a reorganization scenario or offers the potential for significant value enhancement should bondholders negotiate an extension of the maturity date.



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In Closing

We are pleased to announce that we are in the process of launching our second fund in early 2025, continuing with the same strategy we have found success with. In our first fund, we approached only close friends and trusted partners of Pender, focusing on building a strong track record and demonstrating the capabilities of our team, infrastructure and, most importantly, the return potential of our strategy. We are proud to be among the first in Canada to introduce a fund dedicated exclusively to this unique asset class.

With the new fund, we are transitioning to an open-ended structure. This will allow us to capture both current and future opportunities without being constrained by a fixed time horizon, with a view to maximizing the potential of our strategy. Based on valuable feedback, we believe this structure will better serve both our existing investors and those who are considering joining us.

Warm Regards,

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