MAXAM
CAPITAL MANAGEMENT

Maxam Arbitrage Fund – Q1 2023 Commentary

Dear fellow investors,

The Maxam Arbitrage Fund[1] gained +1.6% in the first quarter of 2023 whereas the S&P Merger Arbitrage Total Return Index declined -1.5%.

The Maxam Arbitrage Fund's goal is to profit regardless of the behaviour of the markets, and we're pleased that the fund delivered a positive return in each of the first three months of 2023.

Fund performance was generated from the successful completion of 17 merger arbitrage deals during the quarter, and our SPAC arbitrage holdings benefiting from liquidations, extensions, and ongoing accretion to NAV.

An eventful quarter.

Despite a volatile market environment during the first quarter – most notably during March when U.S. regional banks came under significant pressure, impacting the general market – existing and new deals continued to provide us with an attractive arbitrage opportunity set in which to deploy capital.

Merger arbitrage spreads are attractive today – both on an absolute and relative basis. Higher interest rates have historically been a positive for arbitrage returns because, at a high level, arbitrage spreads reflect the prevailing risk-free rate *and* deal risk premia.

We are seeing a bit of a barbell across two broad groups of deals today. While the average merger arbitrage spread across the universe we track is in the low double-digit range, that statistic is pulled higher by some of the riskier transactions with very high yields (think regulatory and financing risks). Conversely, we are seeing an attractive cohort of relatively safer deals with arbitrage yields in the 7-9% range.

The fund invested in 14 new deals during the first quarter, had 17 successful deal closures and experienced no deal breaks. At the end of the quarter the fund held 23 merger arbitrage positions, diversified across market cap, deal type and industry.

Some notable merger arbitrage deals that contributed to gains during the quarter included Shaw Communications receiving final approval, a deal bump for Noranda Income Fund and narrowing of the Activision Blizzard spread.

Owned deals that successfully closed during the quarter included: Sierra Wireless, Freshii, Summitt Industrial Income REIT, STORE Capital, Cowen, Evo Payments, 1Life Healthcare, LHC Group, Noranda Income Fund, Smart Employee Benefits, Nuvo Pharmaceuticals, Waterloo Brewing, Coupa Software, Signify Health, Atlas Corp, and Atlas Air Worldwide.

State of the M&A market.

The types of deals – strategic, leveraged buyouts, opportunistic – and the sectors in which deal activity occurs, tend to vary with the prevailing market and economic environment. While the quantity of new transactions has slowed somewhat from last year, we are encouraged by the ongoing pace and breadth of new deal announcements. Historically there has been sufficient mergers and acquisitions activity through market cycles to construct a diversified portfolio.

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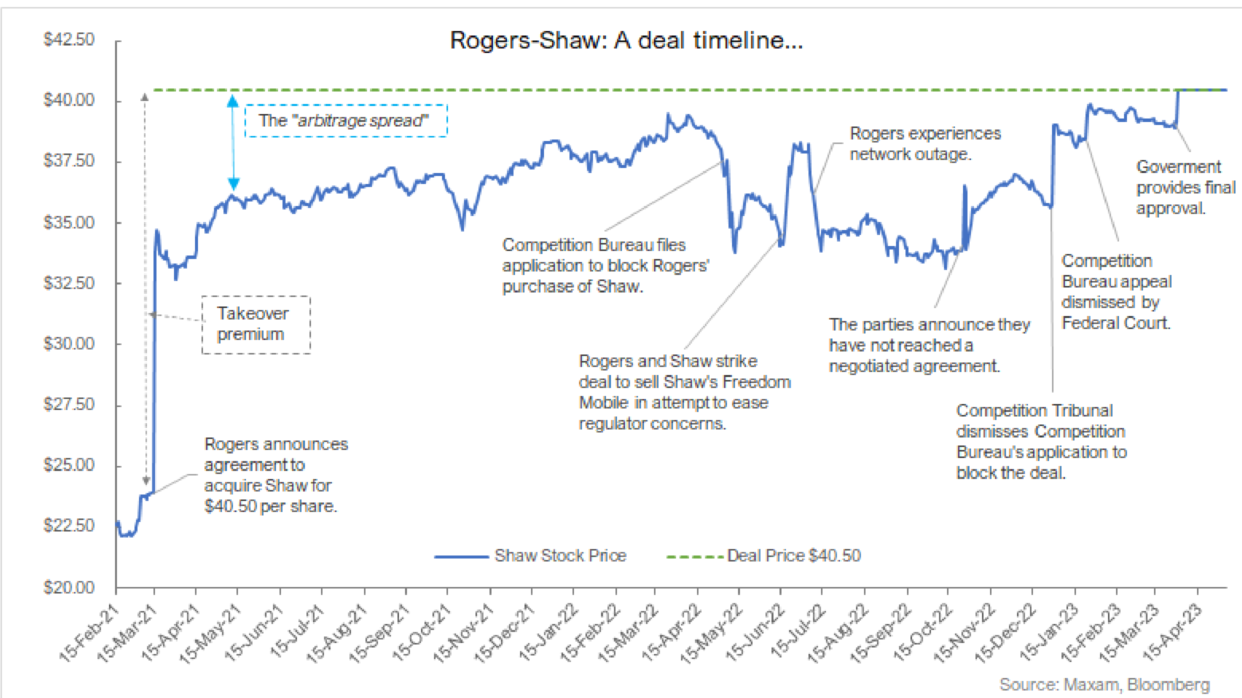
As we've highlighted in recent commentaries, protracted regulatory reviews continue to be common, especially under the Biden administration. Scrutiny has focused on larger cap transactions and industries deemed more sensitive to competition concerns – notably health care, technology, and financial services. While success from the regulators' perspective has been mixed at best, reviews and challenges have resulted in some longer deal timelines.

Microsoft's January 2022 agreement to acquire Activision Blizzard for US$69 billion is being challenged by the Federal Trade Commission and other regulators. Two deals in the financial services sector – TD Bank's acquisition of First Horizon Corporation and Madison Dearborn Partners' acquisition of MoneyGram International – were both announced in February 2021 and have yet to receive their respective regulatory approvals over a year later.

Up here in Canada, Rogers Communications' acquisition of Shaw Communications was announced in March 2021 and took just over two years to complete. The transaction received final approval on March 31st after a lengthy challenge from Canadian regulators that included an unsuccessful attempt by the Competition Bureau to block the merger.

Regulatory-challenged deals present both risk and opportunity – spreads are typically wider, however there can be greater risk of a deal break, or of lower annualized returns. These deals can present opportunity for active arbitrageurs as time passes and developments occur. For example, below is a chart of Shaw's stock price through the duration of the deal timeline.



Beneath the surface.

While the largest M&A transactions get all the headlines, we often see more attractive risk-adjusted returns in small/mid cap deals. This is an opportunity set within the arbitrage universe that we actively allocate to.

Regulatory risks can be lower, or even non-existent, in smaller capitalization deals where competition concerns are much less significant and therefore may not meet review thresholds for anti-trust regulators. Not only do these deals tend to close more quickly than larger cap transactions, but they can also trade at higher gross spreads due to larger pools of capital not being able to allocate efficiently to them.

Small/mid cap deal flow can also be more consistent than their large cap brethren because, owing to their smaller size, they are often less dependent on the availability of external financing – if any is required.

We also observe greater upside optionality in the form of deal bumps and competitive situations in the small and mid-cap deal space. Case in point, diversified natural resources giant Glencore PLC recently increased its bid to acquire Noranda Income Fund from an initial price of $1.42 to $1.98 – a 39% bump – in response to some shareholders who asked for greater value. We were pleased to be long Noranda.

We believe we will continue to have the opportunity to allocate to attractive small/mid cap arbitrage situations in the current and approaching market environment. With many smaller cap companies trading at steep discounts to their larger and better capitalized peers, plus numerous busted IPOs and de-SPACs getting no love from investors, opportunistic acquirers are likely to step-up, as we are already seeing.

SPAC landscape.

While the environment for SPACs continued to evolve in the first quarter of 2023, we were still presented with opportunities to harvest attractive returns with very low risk exposure.

The SPAC universe continues to largely be in *run-off* with the large number of SPACs that came public via IPOs in 2021 now coming towards the end of their lives. SPAC sponsors are faced with either liquidating and returning capital or offering incentives for SPAC shareholders to stay long for another few months by topping up trust accounts. Both scenarios provide opportunities for arbitrageurs.

Our systematic and quantitative approach to SPAC arbitrage has enabled us to take advantage of both liquidations and extensions at attractive yields in the 6-7% range and sometimes higher. And, as a bonus, the higher interest rates earned by funds held in trust provides ongoing growth in SPAC NAVs.

We've also seen a small uptick in new SPAC issuance of late. New SPAC IPOs are typically coming with attractive features such as over-funded trust accounts and greater warrant coverage.

The prospect of earning annualized returns in the mid-to-high single digit range with T-bill level risk, taxed as capital gains, strikes us as attractive – especially relative to similar return alternatives.

As of March 31 the fund was well-diversified across 62 SPACs.

Looking ahead.

Merger arbitrage and SPAC arbitrage yields both benefit from higher interest rates, and we continue to see and deploy capital into a diversified portfolio of attractive risk-adjusted return opportunities across the capitalization spectrum.

Regardless of deal size, we are always focused on transactions that we believe will reach successful completion, bolstered by our systematic and risk management focused process.

Thank you for your trust and confidence. Please don't hesitate to reach out with any questions.

Sincerely,

Travis Dowle, CFA
President & Fund Manager
Maxam Capital Management Ltd.

[1] Maxam Arbitrage Fund, Class F, net of fees and expenses. Inception date October 1, 2020. Please contact us regarding other series of fund units or visit our website www.maxamcm.com