Maxam Arbitrage Fund – Q3 2023 Commentary

Dear fellow investors,

The Maxam Arbitrage Fund[1] gained +1.0% in the third quarter, +3.8% through the first nine months of 2023 and +6.0% over the last year.

Positive fund performance for the quarter was driven by the successful completion of 17 M&A deals and our SPAC holdings benefiting from liquidations, extensions, and the ongoing growth of cash held in-trust due to higher interest rates.

Rates and Regulators.

For several quarters now we have been highlighting the more hostile regulatory environment that many large capitalization mergers and acquisitions have faced, most notably from the FTC and DOJ in the U.S. We have recently seen some key setbacks and losses for regulators attempting to block deals – notable transactions where regulators were unsuccessful included: Black Knight/Intercontinental Exchange, Activision/Microsoft, and Horizon Therapeutics/Amgen.

These developments are encouraging for dealmakers and arbitrageurs, not just for the success of these specific deals but because established precedent and competition law is being upheld, and regulators may be deterred from readily challenging so many deals going forward.

In addition to more frequent regulatory challenges, higher interest rates have also been influencing the arbitrage environment. Constructively, higher interest rates have historically had a positive influence on arbitrage returns because arbitrage spreads typically reflect the prevailing risk-free rate *plus* a deal risk premia. And the low duration nature of the strategy helps us quickly take advantage of those attractive spreads as deals complete.

We have a tailwind at our backs today for future returns. We own, and are investing in, solid deals with arbitrage yields in the ~8-12% range.

The flow.

The recent market environment has been characterized by rising interest rates, tightening credit conditions, recession fears and geopolitical tensions. You wouldn't be alone in questioning if these factors were problematic for deal flow.

Despite these factors, and a volatile market environment, we added over 60 new M&A deals to our arbitrage database in the third quarter alone (and we've already added 15 more in October so far).

We discussed reasons for the *ebb and flow* of deal activity in both our Q1 and Q2 commentaries. The quantum of deals, types of buyers, and the sectors that activity may be more concentrated in all tend to vary with the prevailing market and economic conditions – but historically we have always had sufficient deal flow to actively maintain our risk management framework.

In particular, with many quality small and mid-cap companies trading at material discounts to their larger peers, plus numerous busted IPOs and de-SPACs struggling to garner attention from investors, we foresee an environment where opportunistic acquirers are increasingly likely to step-up, enhancing deal flow.

The fund invested in 31 new or existing deals during the quarter, had 17 successful deal closures and experienced no deal breaks. Owned deals that successfully closed during the quarter included: US Xpress, Diversey Holdings, Berkshire Grey, Absolute Software, Univar Solutions, Reunion Neuroscience, Uni-Select Inc, Arconic Corp, Franchise Group, Focus Financial Partners, Conformis Inc, Home Capital, Quotient Technology, Radius Global Infrastructure, Reata Pharmaceuticals, Syneos Health and Liminal Biosciences.

At the end of the third quarter the fund held 33 merger arbitrage positions.

Special Purpose? How about *Shrinking Pool* of Acquisition Companies.

There were 330 publicly listed SPACs at the end of the quarter, down from over 530 at the end of 2022 – and similar to what has been transpiring for several quarters now most of this decrease came from liquidations rather than closed deals[2]. Also, the pace of new SPAC IPOs has largely ground to a halt, with September marking the first month in over a year without an offering[3].

SPAC arbitrage is a shrinking opportunity set, but one that continues to provide us with an opportunity to earn very attractive risk-adjusted returns via liquidations and extensions. Recall that SPAC trust accounts are invested in T-bills and that SPAC sponsors are faced with either liquidating at maturity – and returning capital plus interest to investors – or offering incentives to shareholders, such as topping up trust accounts, to compensate them for staying invested for another few months. This risk/reward strikes us as quite attractive, especially when you consider that these returns are largely taxed as capital gains.

At the close of Q3, the fund was well-diversified across 76 SPACs.

Tailwinds.

As discussed above, higher interest rates have historically been a tailwind for arbitrage returns – this is evident in the attractive arbitrage yields available to us today. In addition to the current robust opportunity set of deals, we foresee an environment that is conducive to a continuation of healthy deal flow.

The Maxam Arbitrage Fund achieved its three-year track record milestone at the end of the third quarter. We are pleased with the fund's strong results so far and look forward to continuing to deliver value-add with consistent performance that exhibits low correlation with traditional equities and bonds.

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

[2] SPAC stats from www.spacresearch.com

[3] https://www.bnnbloomberg.ca/zero-spac-offerings-since-august-with-market-gone-cold-1.1979731

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