MAXAM CAPITAL MANAGEMENT

Maxam Arbitrage Fund – Q1 2024 Commentary

Dear fellow investors,

The Maxam Arbitrage Fund[1] gained +0.6% in the first quarter of 2024.

Positive fund performance for the first quarter was driven by 15 successful M&A deal closures but impacted by one deal break. Our SPAC holdings were also positive contributors to performance as they continued to benefit from liquidations, extensions, and the ongoing growth of cash held in-trust.

We have a positive outlook for arbitrage in the current environment. Deal flow is solid – and we think poised to improve – and arbitrage spreads are as attractive as we've seen in several years.

Megadeals and more beneath the surface.

New M&A deal flow in the first quarter was encouraging, especially considering cautious expectations due to higher interest rates, a still challenging regulatory environment, and election year uncertainty.

Several megadeals helped fuel a more than 20% rise in global deal values during the first quarter – there were 10 deals valued at more than US$10 billion, including two over US$30 billion[2].

Let's be cautious about calling *one quarter* a trend, but the uptick in large cap M&A deals is a welcome development. Large deal announcements signify some renewed confidence that buyers are increasingly comfortable with the economic landscape, and that they believe they can navigate what continues to be a challenging regulatory environment. And while interest rates remain elevated, lower rates – when they do come – should help fuel more deal activity, especially from the private equity community that is sitting on piles of uncalled capital.

We continue to see lots of new deal activity beneath the surface of the large caps. During the first quarter we added 63 new definitive deals to our database – with 37 of those transactions being under US$1 billion in market capitalization.

Small and mid-cap deal activity should continue to be plentiful with opportunistic acquirors looking to take advantage of some material valuation dichotomies across the market capitalization spectrum. This is an attractive segment of the arbitrage opportunity set for us to take advantage of because, while there are nuances to every deal, smaller deals tend to trade at wider spreads than larger transactions, face less regulatory scrutiny, and close more quickly → less risk and superior IRRs.

The fund initiated 27 new merger arbitrage positions during the quarter and, as mentioned above, had 15 successful deal closures and one deal break.

Some notable owned deals that successfully closed during the quarter included: StarTek, Logistec, Q4, ImmunoGen, Vanstar Mining, Neighbourly Pharmacy, Harpoon Therapeutics, Sovos Brands, Science 37 Holdings, Textainer Group, Karuna Therapeutics, Cymabay Therapeutics, and Farmers Edge.

Our lone deal break during the quarter was Sequans Communications. Would-be acquiror Renesas Electronics abandoned their purchase of Sequans after the company received an adverse tax ruling. As much as we'd like to avoid them all, deal breaks are a reality of an arbitrage strategy. This was just our fourth deal break since launching the fund three and a half years ago (out of over 330 deals invested in) and our overall deal success rate is over 98%. This deal break occurred in late February and the fund had already recovered the decline by mid-March → highlighting the low-drawdown and typically *quick recovery* nature of the strategy.

At the end of the quarter the fund held 29 merger arbitrage positions.

Still ticking along.

At the end of Q1 there were 235 listed SPACs, down from 270 at the end of 2023 and over 530 at year end 2022. Approximately 70% of the decrease in the quarter came from closed deals, and 30% from liquidations. The decline was partially offset via six new SPAC IPOs, down slightly from nine in Q4 2023.

While the SPAC universe is shrinking, it continues to provide us with an opportunity to earn attractive risk-adjusted returns via liquidations and extensions. SPAC trust account balances grow their capital by investing in T-bills, and we are seeing a healthy number of sponsors offer incentives – topping up trust accounts with additional capital – to compensate shareholders for staying invested another few months while management searches for a deal.

While the traditional IPO market has been slow, if we do see a pick-up in activity it may also portend some optionality coming back into SPACs – namely if investors get excited about announced deals. This optionality is essentially being priced at *zero* across most SPACs that are still searching for deals, which means we are getting paid to wait. A "call option" that we get paid for? Yes please.

SPAC IRR's continue to be healthy with the median around 6%, similar to levels at the end of 2023. At the end of the first quarter the fund was invested in 52 SPACs, down from 72 at year-end.

Looking ahead.

Arbitrage yields that we are deploying capital into are as attractive as we've seen in several years. Relatively straight forward deals trade in the 7-8% annualized range while some off the radar deals, and those with more uncertainty, trade into the *low-to-mid teens*. These arbitrage spreads look particularly attractive on an absolute and risk-adjusted basis.

Maxam Arbitrage Fund has demonstrated its unique value over the last few years – during equity and bond market volatility – providing investors with the ability to diversify risk and create more robust portfolios.

We expect arbitrage to generate positive returns regardless of the market environment – and we think we have a particularly attractive environment in front of us.

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] https://www.bnnbloomberg.ca/megadeals-make-a-comeback-to-power-660-billion-m-a-revival-1.2051649

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