

PENDER PENDER

VALUE FUND SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY – JUNE 2020

Fellow Unitholders,

We hope you and your families are safe and healthy.

Q2 ended on a much more positive note than Q1, when COVID-19 threw the entire stock market into unprecedented turmoil in March. While COVID-19 is still here with us, stock markets seem to be ignoring it and are continuing on an upward pricing trend. Small cap indices such as the Russell 2000 (CAD) and Russell Microcap (CAD) outperformed large cap indices like the S&P500 (CAD) and the S&P/TSX Composite with total returns of 21.0% and 25.9% vs. 16.3% and 17.0%, respectively. Similar to small cap markets, our funds delivered impressive performance in Q2, with the Pender Value Fund up 23.4% and Pender Small Cap Opportunities Fund up 28.3%¹.

Looking back, June was the third consecutive month that stock markets had advanced since March. The S&P 500 (CAD) was up by 0.6% and the S&P/TSX Composite was up by 2.5% while the Pender Value Fund generated a total return of 3.4% and the Pender Small Cap Opportunities Fund generated a total return of 3.5%¹ in the month. We are happy to see that our funds have rebounded nicely from the troughs in March, but we are fully aware that the global economy is not out of the woods yet and there are many uncertainties still ahead of us.

Portfolio Updates

Cloudera was a key contributor to the Pender Small Cap Opportunities Fund for the month. Its stock price surged up over 18% on June 9 amid media reports of a possible sale. Cloudera provides data management and data analytics solutions for large enterprises based on open source platforms and their data solutions support on-premise, cloud or hybrid environments with a consistent layer of governance and security standards. We have long believed that the company trades at a discount to its intrinsic value and now the potential transaction could be a catalyst to close the discount. That being said, we like the strengthened competitive positioning of the company (after merging with their competitor Hortonworks), its blue-chip customer base, and its growth trajectory. We'd be happy to hold the position for the foreseeable future even without a transaction.

Athabasca Oil Corp. (debt) was once again a top contributor for both the Pender Value Fund and the Pender Small Cap Opportunities Fund. As we mentioned in [our previous commentary](#), we like the risk/reward profile of the distressed debt compared to the company's equity and our flexible fund mandate provides us with the option to invest in the asset class we believe has better upside potential by leveraging the knowledge of the business from our fixed income team.

Another top contributor for both funds was Leaf Group. Leaf Group operates a portfolio of media properties and ecommerce marketplaces in the lifestyle and fitness category. The marketplaces segment has seen strength due to more online buying caused by COVID-19. A group of activist shareholders representing approximately 40% of shares outstanding filed 13D forms and sent public letters to the company expressing their concerns regarding management, the Board and the business. We have held the shares for a long time as we believe that the assets are priced at a deep discount to their value, even

¹ F Class; source - PenderFund

with conservative valuation assumptions. We are disappointed with the performance in the last couple of years and we share the same concerns as the activist investor group. At the end of June, we filed our own 13D form indicating that in our opinion changes need to be made at the company to unlock shareholder value.

We mentioned in [our last commentary](#) that many technology companies are the beneficiaries of the accelerated digitization trend due to COVID-19 and have seen their fair share of stock price appreciation. On the flip side, more traditional companies in the industrial sectors seem to be lagging on performance, at least for the month of June. Winpak and CCL industries were key detractors for the Pender Value Fund and Terravest Industries was a key detractor for the Pender Small Cap Opportunities Fund during the month of June. In our opinion, the fundamentals of these businesses remain sound and solid and we believe the setback in stock price is temporary.

This dichotomy of old business and new technology continues to widen as “boring old companies” remain mainly out of favour and “exciting technology companies” are touching new highs. How does this translate in our portfolio? First, we are holding and looking at adding names, particularly in the tech sector, that have seen their intrinsic value increase as a result of the changes the world has witnessed, where we believe they are mispriced. Second, we continue to hold more traditional businesses that are being punished by the market in this period, but in our opinion, overly so. Third, we are looking at asset classes with potentially lower correlation to major indices (such as SPACs, special situations, and securities higher up the capital structure) so that if volatility does rear its ugly head, they could dampen volatility in the funds, and provide potential sources of cash to take advantage of other opportunities.

Half of the year 2020 has already passed. Most of us would probably like to fast forward to 2021. It has been quite a roller coaster ride. We’ve had our highs and lows. Now it feels like we are riding on an upward track, but we don’t know at what point the downward part of the ride starts. Like a good roller coaster, the stock market generally plunges when you are least expecting it, generating the highest amount of “excitement”. The good thing is we have something to hold on to – our investment process. We cannot stress enough the importance of having an investment process and sticking to it, especially in times of uncertainty. Our goal has always been to understand the quality of a business, to find opportunities that have a favorable risk/reward profile, to obtain more value than we are paying for, and to mitigate downside risks. The market is providing a bumpier ride than we are used to, but our aim is for the businesses we own to drive the returns that make us forget how bumpy the ride was.

David Barr, CFA

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PenderFund Capital Management Ltd.

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