PENDER

SMALL / MID CAP DIVIDEND FUND

PENDER SMALL/MID CAP DIVIDEND FUND – ONE YEAR ANNIVERSARY

What an eventful first year it has been for the Pender Small Mid Cap Dividend Fund. Starting the Fund amid bleak circumstances in the early days of the pandemic, we feel fortunate when we reflect on the past twelve months for the fact that we and our loved ones are in good health in contrast to the loss, pain and disruption which impacted so many in the world. While the Fund was not immune to the doldrums of the pandemic last spring, we were able to take meaningful action, exiting positions that had catastrophic risk and increasing exposure to high quality companies positioned to grow and benefit in this environment. We have capped off the first year of the Fund with strong performance for the 12 months since inception to January 31, 2021 of 41.5%[1]. We are pleased to have compounded capital for our investors and remain humble after such an unusual year, as we remain in unusual times.

Small cap stocks with large-cap ambitions

Small cap companies have continued to see positive performance in the new year and are finally having their moment in the sun, experiencing price appreciation and attracting growing interest from both retail and institutional investors. With small caps having been out of favour for so long and still trading at what we view as attractive levels, we believe that we are still in the early innings of a recovery for those companies. Our positive view is supported by smaller companies being generally more sensitive than larger ones to changes in the economy and, as the economy opens back up through the year, there is potential for stronger earnings momentum. Smaller companies also tend to be more domestically focused than their larger counterparts, so as economic activity increases in Canada and the US, smaller companies should see a greater benefit than larger globally exposed peers. The majority of our holdings include companies with strong balance sheets and management teams who have exhibited a track record of prudent capital allocation. While abundant fiscal stimulus has supported equity valuations broadly, many smaller, niche, illiquid and pandemic-impacted businesses continue to trade at low valuations in our view. This is an advantage for smaller companies that have capital to deploy with a large number of attractive acquisition targets.

While we remain cautious of certain parts of the market where valuations appear frothy, we continue to find attractive investment opportunities among smaller cap companies. Our holdings are well positioned in the event that a recovery takes longer than expected due to vaccination delays or potential virus mutations, while also being well positioned for further stimulus by governments.

While markets soar, we're positioning for both risk and reward

After a significant appreciation in many of our holdings over the past year, we have positioned the portfolio with a balanced approach, focusing on risk mitigation to preserve capital while the portfolio has meaningful upside potential to an eventual recovery and economic expansion. To this end, we have reduced our exposure to some of our more cyclically exposed holdings that have experienced substantial multiple expansions, as well as companies that have benefited from lockdowns and the changes in activity due to the pandemic but are likely to see those tailwinds turn into headwinds as the economy normalizes. We started the year with a large cash position and have taken advantage of volatility and quarterly earnings to add to and initiate positions in new holdings. We continue to find quality small and mid-cap companies with niche businesses, compelling fundamentals and growth outlooks trading at attractive high single-digit and double-digit free cash flow (FCF) yields.

New additions

Hamilton Thorne, a company we previously owned and subsequently sold last spring was reinitiated in the Fund. The company is a leading global supplier of lab equipment, consumables, software and services to the Assisted Reproductive Technology (ART) industry, including in vitro fertilization (IVF) and related procedures. Hamilton Thorne is a great example of the kind of niche, underfollowed but high-quality business, with the long growth runway that we seek for the Fund. With the maternal age of first pregnancies increasing in the developed world as the people are waiting longer to get married and have kids, it is estimated that one in six families have fertility issues. IVF demand is expected to grow significantly as developing countries increase funding and insurance reimbursements for the procedure, with an emerging middle class in developing countries now being able to afford and access IVF technology. The company is well

[1] Class F; PenderFund

positioned to grow organically as they develop new products and services, and expand into new clinics where there is ample room for growth. The company has a management team who have proven to be adept capital allocators, employing a disciplined acquisition strategy in a heavily fragmented industry to help bolster growth, adding new capabilities and cross-selling products and services to new clinics. The company has delivered profitability and positive cash-flow over the last five years and maintains a strong balance sheet; yet the shares trade at a steep discount to peers. As the company grows and continues to execute on their strategy, we expect market awareness to increase, driving a multiple expansion.

Corus Entertainment Inc., a media and content company, was another new addition to the Fund. We believe the company is misunderstood by the market as it is perceived entirely as a traditional media business facing structural headwinds, which overlooks the meaningful advances in new marketing technology, content production and subscription streaming that are driving growth within the company. Their legacy broadcasting business of bundling and selling television channels was impacted by advertising revenue declining during the pandemic but there has been a steady recovery as companies want to engage with consumers so their brands remain top of mind. Overlooked by the market are the new growth opportunities Corus has been focused on. The company's StackTV subscription video streaming service on Amazon Prime Video was launched in mid-2019 and has grown to over 400k monthly subscribers. This a meaningful and highly profitable stream of recurring revenue which we do not believe is reflected in the share price. Corus, which is well known for developing children's television content, has also expanded into developing original animated feature films, a venture which is well positioned to benefit from continued demand for new children's content by streaming leaders Netflix and Disney+. Corus trades at >25% FCF yield which would imply that the market expects cashflows to materially decline, yet the company is actually growing sales and earnings. With a ~4.5% dividend and a low ~20% payout the company has plenty of excess capital to pay down debt and invest in the business. With growth inflecting higher while leverage decreases, the market has started to take notice of the company and we don't expect its valuation to remain dislocated for long.

Small caps over the long-term outperform; our focus is on investors getting paid to wait

The Pender Small/Mid-Cap Dividend Fund was designed to provide a combination of dividend income and capital appreciation to investors. Finding companies that pay a sustainable dividend is a key characteristic we look for but it is not the only characteristic. We can and do own non-dividend paying companies in the Fund. Our focus is to find quality businesses that generate positive cash-flow and are operated by management teams who can maximize long-term shareholder value in the deployment of that capital. We believe this approach will serve investors well over time.

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PenderFund Capital Management Ltd.