PENDER VALUE FUND   PENDER SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY – SEPTEMBER 2021

Fellow unit holders,

September is a seasonally weak month for stock markets and this year was no different. Major indices ended with losses in September - the S&P 500 Index (in Canadian dollars) had a negative return of 4.3% and the S&P/TSX Composite Index declined 2.2%. On the small cap side, the Russell 2000 Index (in Canadian dollars) and the S&P/TSX Small Cap Index also performed poorly in the month. While the Pender Value Fund was roughly in line with the general markets, losing 2.7%[1], the Pender Small Cap Opportunities Fund outperformed with a strong positive return of 3.8%[1], driven by some idiosyncratic situations such as M&A transactions.

On a year-to-date (YTD) basis, the Pender Small Cap Opportunities Fund has delivered a total return of 24.5%[1], outperforming large cap indices, with the S&P 500 Index (in Canadian dollars) up 15.3% YTD, while the S&P/TSX Composite Index was up 17.5% YTD. The Fund has also outperformed both the Russell 2000 Index (in Canadian dollars) and the S&P/TSX Small Cap Index, which were up 11.8% and 16.8% YTD respectively. The Pender Value Fund has a total return of 3.3%[1] YTD.

Second Lives and End of Public Lives

While most companies only have one successful life, going through a single business life cycle of birth, growth, maturity and decline, businesses that can extend their runway with new acts can become great and compound their growth for much longer. Amazon is a great example of this. The company started as an online book retailer, evolving into a an "everything" store, before turning into a marketplace and hosting third party vendors. Of course they weren't done there and moved on to a fourth act of being a public cloud provider, effectively lengthening its growth cycle. We have invested in several companies that are in similar situations. These companies have already developed a successful initial business with proven technology and wide customer acceptance, and are now investing in a second or third leg of growth to extend the duration of their growth stage. Investing in new acts and reimagining the future often introduces higher uncertainty and price volatility. Some of these companies are well off their 52-week highs, such as Zillow Group, Inc. (NASDAQ: ZG) and Stitch Fix, Inc. (NASDAQ: SFIX). We do not overreact to drawdowns if business momentum is strong. In our experience the stock price will eventually catch up with business growth.

End of public life examples include exactEarth Ltd. (TSX: XCT) and AgJunction Inc. (TSX: AJX) which are being acquired. This really ties in with our commentary of last month where we talked about record level M&A activities. All the themes we discussed last month remain applicable. M&A activities could hit a record of $6T by the end of this year as businesses continue to embrace cheap financing and the pandemic recovery. So far this year, M&A volume has surpassed $4.3T, up from $3.6T in 2020[2]. We expect the robust M&A market to continue to drive performance in the small cap universe.

Portfolio Update

Concurrent with the broader M&A market, we have seen an uptick of M&A activities in our own portfolio. On average, our portfolio has about six take outs each year (2020 was an exception) and this year we have had nine take outs announced so far with another quarter still to play out. Recent examples include: exactEarth Ltd. (TSX: XCT), Alcanna Inc. (TSX: CLIQ) and AgJunction Inc. (TSX: AJX). exactEarth was a top contributor for both the Pender Small Cap Opportunities and Pender Value Funds. The company is being acquired by Spire Global, Inc. for a 153% premium to the previous day's close. Spire recently became public via a SPAC combination and is paying 9x EV/Sales to acquire the company.

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[1] *All Pender performance data points are for Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.*

[2] *https://www.cnbc.com/2021/10/12/kpmg-on-global-ma-market-hitting-record-6-trillion-in-2021.html*

Alcanna and Nova Cannabis Inc. (TSX: NVOC) were also among key contributors to the Pender Small Cap Opportunities Fund. Nova was spun-out of Alcanna and went public in March. There were speculations that Nova was going to be acquired and the stock had a good run, before news emerged that Sundial Growers Inc. (NASDAQ: SNDL), not Nova, is acquiring Alcanna. The good thing is that we own both companies in the same portfolio!

For the Pender Value Fund, other top contributors include Fannie Mae preferred shares, which began bouncing back from severely depressed levels on signs that the Biden administration may eventually recapitalize government-sponsored mortgage entities.

On the negative side, WeCommerce Holdings Ltd. (TSXV: WE) was a key detractor for the Pender Small Cap Opportunities Fund in September. We have discussed WeCommerce multiple times in previous commentaries. Our confidence level in the long-term business fundamentals of the company has not changed a bit and we believe it will garner more interest as investors start to understand it better.

For the Pender Value Fund, Burford Capital Limited (NYSE: BUR) and Dye and Durham Limited (TSX: DND) were two key detractors. Despite the pull back in September, we maintain our positive outlook on Burford's high return litigation investment opportunities and believe there is plenty of pent-up demand due to the pandemic.

Dye and Durham completed a strategic review and decided to stay public as a result of the ongoing UK regulatory review of its acquisition of TM Group and a lack of support from existing shareholders. Concurrently, the company announced a new $1.8B credit facility and a large option grant for its CEO. The stock has been weak following the completion of the strategic review and the announcement of the option plan. We believe DND remains an attractive investment opportunity. The company has identified a significant M&A pipeline with $500M pre-synergy EBITDA and its balance sheet has sufficient capacity with the new credit facility. We have known the management team for a long time and are highly confident in its ability to execute. The option plan further incentivizes the CEO to build the business, with 70% of the options vested based on share-price performance metrics, while the remaining 30% are based on the achievement of certain corporate milestones. DND is currently trading at a discount relative to its peers and the recent IPO of PEXA Group Limited (ASX: PXA) suggests a much higher multiple for DND's business. We believe DND is one of the undervalued stocks in our portfolio that could see both multiple re-rating and business growth.

With strong underlying business fundamentals of our portfolio companies coupled with a robust M&A backdrop providing an additional leg of support, we believe we are well positioned to capitalize on these opportunities in our portfolios.

David Barr, CFA and Sharon Wang
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PenderFund Capital Management Ltd.