PENDER

SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY – MARCH 2022

Fellow unit holders,

The first quarter of 2022 came to a close with mixed performance to start the year. Investors were focused on macro events on several fronts, including the ongoing conflict in Ukraine, rising commodity prices that underpin already strong inflation, and the start of an interest rate hiking cycle that could dampen growth expectations. These developments all contributed to increased uncertainty, with broad markets posting mixed results.

In March, the S&P 500 Index (CAD) was up 2.0%, while the Russell 2000 index (CAD) fell 0.4%, bringing the first quarter results to -6.0% and -8.9% respectively. In Canada, the S&P/TSX Composite Index gained 4.0% in March and is up 3.9% year to date (YTD), largely on the strength in energy prices following the invasion of Ukraine. Against this backdrop, the Pender Small Cap Opportunities Fund was down 1.6%[1] on the month and down 9.4%[1] so far this year.

We saw a continuation of a trend we have seen for several months now as multiples continued to compress, particularly in growth-oriented technology firms and small cap companies. This impacted the performance of the Fund in March and YTD. This was particularly evident in high-growth firms as the market's appetite for these companies has shifted compared to a year ago. Companies that went public and raised capital, with the intention of aggressively growing their business have not been rewarded in this environment where concerns about cash burn and current free cash flow generation are top of mind.

This dynamic has created compelling buying opportunities. When we dig in and analyze some of these businesses, we are finding that the growth runway is not being rewarded and the long-term cash flow generation potential of the business is being ignored, in our view. The pullback, driven by rising interest rates, geopolitical risk, inflation, or economic growth concerns, has created attractive entry points where we can underwrite the quality of the business by understanding which businesses are self-sustaining and which require additional capital. We see parallels in this environment to 2002/2003 where technology businesses that were not dependent on third party capital to grow their business prospered in the years (even decades) that followed. These businesses were proven to be very profitable, cash flow generative and outstanding companies for long-term investors to own.

Thinkific Labs Inc. (TSX: THNC) is a new addition to the Fund that fits this description. We liked the business and have followed its progress for years. We knew it as a private company and watched as it went public, although we never invested as we thought the valuation was too rich. The macro pullback, driven by multiple compression, has now given us the opportunity to own what we believe is a great business at an attractive price, with the multiple having slipped from 10x forward revenue at the time of IPO, to 1.1x now. This is despite continued strong fundamentals with the business growing revenues 80% over the last year and having about $2/share in cash on their balance sheet (or about 66% of their market capitalization with the equity trading at about $3/share).

Management has also acted proactively to right size their business and reduce cash burn in this new environment. Understanding that access to capital markets to finance growth plans has dried up, they reduced headcount by about 20% last quarter. While making these changes was not easy, the company has tried to support their former colleagues in finding new roles by sharing their names publicly and helping them make connections. We believe this speaks to the culture of the company and how they treat their employees and as the saying goes, "culture eats strategy for lunch". This gives us confidence that Thinkific Labs can self-sustain their growth into the future.

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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.*

Another development we have seen in our portfolio is with companies that have historically grown through acquisitions – **Sangoma Technologies Corp (TSX: STC), Wishpond Technologies Ltd (TSXV: WISH) and WeCommerce Holdings Ltd (TSXV: WE)** – all completed tuck-in acquisitions recently.

This flurry of activity occurred as valuation multiples came down and companies have become active again, looking for M&A opportunities. Several of our holdings have made acquisitions in the past month. Notably Sangoma announced its acquisition of NetFortris Corporation on March 29 for US$68M, implying an attractive 1.3 EV/Sales multiple. This acquisition expands Sangoma's Managed Service Provider capability and strengthens its competitive position as a one-stop-shop solution provider creating significant cross selling opportunities. Wishpond completed its acquisition of Viral Loops Limited, a referral marketing software platform, effective April 1. This is the fifth acquisition for Wishpond since it went public, and the acquisition provides the company with good opportunities to upsell Viral Loops to its 3,000 SME customer base. WeCommerce announced in early March its acquisition of Kno Technologies Inc. ("KnoCommerce"), a customer survey and insights app. KnoCommerce is a small tuck-in acquisition for WeCommerce that is unlikely to have a material financial impact this year, but it provides merchants with a better understanding of their customers' journey and thus enhances customer engagement.

It is a good environment for these companies that can grow revenues and cash flows organically, while opportunistically enhancing their growth by acquiring complementary product sets, geographies or technology teams. This period in small caps is reminiscent of 2020 or 2009 – periods where we experienced a sharp sell-off in equities that presented an attractive buying opportunity for long-term investors. Coming out of these periods, the following 3-5-year periods were impressive, as seen in the following table:

	March 2020 plus 1 year	June 2009 plus 1 year	June 2009 plus 3 years	June 2009 plus 5 years
Pender Small Cap Opportunities Fund (Class F[1])	149.3%	14.3%	18.7%	22.2%

Source: PenderFund

While investing in times of uncertainty can be challenging, the rewards are attractive for long-term investors who have the patience to stay the course. Despite the challenges in the world today, we are optimistic about the prospect for each of the companies we own in the portfolio. The opportunity to own a portfolio of high quality, compounding companies at attractive prices does not present itself often. We are convinced that the long-term opportunity for small-cap stocks is compelling. Thank you for your support.

David Barr, CFA and Sharon Wang
April 20, 2022

[Standard Performance Information for the Fund]

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PenderFund Capital Management Ltd.