PENDER
SMALL CAP OPPORTUNITIES FUND

## THE MANAGER'S COMMENTARY – MAY 2022

Fellow unit holders,

Equity markets continued to be volatile in May as investors focused on the macro dynamics of rising inflation, rising interest rates and the potential impact on future economic growth. Sentiment has weakened as the prospect of a possible recession on the horizon grew. Central banks remained focused on tamping down inflation, which has remained stubborn, and have continued to raise rates this year. This action has reset valuations, with multiples compressing across equities, and in the technology sector in particular.

The Pender Small Cap Opportunities Fund was down -6.9% in the month, bringing its year-to-date return to -20.9%.[1] This compares to the Russell 2000 Index that is down -16.6% so far this year, and the S&P/TSX Information Technology sector that is down -34.5% in 2022. The resources-heavy S&P/TSX is slightly lower this year, down -1.2% with energy companies giving it some buoyancy so far this year.

The portfolio's modest exposure to energy-tied companies and better performing parts of the market were not enough to offset the magnitude of the losses in the portfolio. We saw a continued sell-off in unprofitable technology companies in the month as they dramatically underperformed the technology sector and the overall market. Some of these unprofitable companies will find it difficult to fund their growth plans with capital markets effectively closed to them. Nevertheless, we have identified some companies with strong balance sheets and well-funded business plans that we believe can withstand a tough environment and capture long-term growth opportunities.

Key detractors in the portfolio during the month included Sangoma Technologies Corporation (TSX: STC) and Thinkific Labs Inc. (TSX: THNC). These are both top holdings in the fund and are among our highest conviction positions in the portfolio. In both cases, multiple compression has driven their stock prices lower, but we believe the fundamentals of the businesses remain strong and that the shares offer compelling value on conservative assumptions relative to the robust growth of the last couple years. Sierra Wireless, Inc. (TSX: SW), PAR Technology Corporation (NYSE: PAR) and Spartan Delta Corp. (TSX: SDE) contributed to performance during the month, but not enough to offset the losses in the overall portfolio.

Our portfolio activity was focused on adding high-quality businesses where we have higher confidence in their long-term ability to grow. The silver lining in a volatile market is that selling can be indiscriminate. As fundamental investors, we spend our time analyzing business models and their economics. We have a deeply researched and robust idea of the intrinsic value of a business and take a longer-term view than the market – which tends to be very short term, particularly when the storm clouds roll in.

While some of these companies we own are not generating much in earnings today (or are even losing money), we have confidence in the unit economics of their business models and that their management teams are making growth investments in high-return opportunities. Their actions will drive revenue growth and eventually lead to profits and cash flow over time in our opinion, but we need to be patient and think long-term as investors.

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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*

In the portfolio, we have been selling portfolio holdings that were smaller in weight and market cap. We have also been reducing or eliminating our positions in companies that have performed well in recent months. We were active in adding higher quality businesses to the portfolio. When we define business quality, we look at several attributes – unit economics, growth runway, competitive advantage and execution. Our new positions are in names we have followed for a long time and which have been on sale at what we believe to be attractive prices.

Magnet Forensics Inc. (TSX: MAGT) is an example of a new addition to the portfolio. The company provides a digital investigation software platform for the public and private sectors. It is a high-growth, profitable company with a solid recurring revenue base and strong customer retention. Magnet Forensics boasts a strong balance sheet in a net cash position that gives it optionality to deploy capital into M&A or accelerate its internal growth initiatives in a tough environment. The company's competitive advantages include multiple device compatibility and a large artifact library that is hard to replicate. We have followed the company for many years. It is a stable growth company, with a long runway, and is now available at an attractive price, in our opinion.

While investing in times of uncertainty can be challenging, we believe the rewards are available for long-term investors who have the patience to stay the course. Despite the drawdown in equity markets and compression in multiples, we are optimistic about the prospect for each of the companies we own in the portfolio. The opportunity to upgrade to high-quality growth companies trading at attractive prices does not present itself often. The opportunity today in small-cap stocks is compelling for investors focused on the long-term. Thank you for your support.

*David Barr, CFA and Sharon Wang*
*June 23, 2022*

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PenderFund Capital Management Ltd.

*Standard Performance Information for the Pender Small Cap Opportunities Fund may be found here:* *https://www.penderfund.com/pender-small-cap-opportunities-fund/*

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