PENDER

SMALL CAP OPPORTUNITIES FUND

THE MANAGER'S COMMENTARY – SEPTEMBER 2022

Fellow unit holders,

The Pender Small Cap Opportunities returned -12.5% in September, bringing returns so far this year to -34.8%[1]. This was a challenging period for the Fund, which was up against a difficult market environment, particularly for the small/micro-cap and technology companies that we own in the Fund. In Canada, the broad-based S&P/TSX Composite Index is down about 13% so far this year. The energy sector has been a big driver of returns and is up 15.6.%, while the technology sector is down 57.5% year to date.

We have historically had about 30-40% of the Fund invested in technology companies. While this has often been a positive for the Fund, it has impacted the Fund negatively this year as investor enthusiasm and perhaps some over-extended valuations in the sector have now both receded. Although it is never easy to predict the future, today's investing backdrop is even murkier than usual. With inflation, rising interest rates, recession fears and conflict, there is no shortage of headlines and cross currents to make even seasoned investors scratch their heads. In times of higher uncertainty, like today, it is all too natural for investors to pull back on the reins, reduce risk and wait for a clearer picture of the future to develop. Investment horizons shorten because the goal has shifted from 'which companies can compound over the long-term' to 'what's going to get me through the next few quarters'.

This sentiment is showing up in the market dynamics around some of the companies that we own today. Sangoma Technologies Corporation (TSX: STC) is a company we have highlighted in the past and to which we have been adding to our position in the midst of a significant sell off this year. The sell off has come as the company, along with software communications peers, have seen growth slow in the post-COVID environment. Zoom Video Communications, Inc. (Nasdaq: ZM) and Twilio Inc. (NYSE: TWLO) were both big beneficiaries of the switch to digital communications through the COVID-19 pandemic and are also well off their highs of 2021.

Despite some slowing in their growth, business fundamentals remain healthy and Sangoma has shown that it can grow in different market environments, such as those before the pandemic. Taking a look back at its history, the company has compounded revenues at a 32% CAGR over the last 10 years, growing from $11 million in FY2011 to $231 million in FY2022. While this 20x growth in revenue over the last decade is impressive, it does not come close to matching the 77x growth in enterprise value creation that Sangoma has achieved over the same period.

In its most recent quarter, Sangoma executed well on the integration of Star2Star and NetFortris. These acquisitions expanded its product suite and allowed the company to offer a wider range of solutions to customers. Sangoma recently announced a management team re-alignment, moving the CFO to lead M&A, promoting a Star2Star executive to CFO and assigning a NetFortris leader as its Chief Revenue Officer. We see this as a positive development and an indication that the integration is going well.

We believe that Sangoma can expect to grow revenues at a double-digit rate organically, with EBITDA margins remaining steady in the high teens. This is supported by ~70% of recurring revenues that gives us greater visibility to the company's financial output and less volatility in its fundamentals. Sangoma also has an NCIB in place and has been buying back shares. We see this as prudent and agree that the

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

stock is heavily discounted to intrinsic value. The company is currently trading at 1x projected revenue and 6x NTM EBITDA. This is at the lower end of forward EBITDA multiples that it has traded at historically, despite being a more durable business today.

As investors retreat from small caps and tech stocks, this is a good opportunity to invest in and provide capital to robust businesses that don't require capital to fund their growth. As such, we have been adding to high quality companies that have been left behind, such as Sylogist Ltd. (TSX: SYZ), CopperLeaf Technologies Inc. (TSX: CPLF) and Blackline Safety Corp. (TSX: BLN).

Companies like Aritzia Inc (TSX: ATZ) and Magnet Forensics Inc (TSX: MAGT) are owned in the portfolio and have contributed to performance this year. PAR Technology Corporation (NYSE: PAR) is the largest holding in the portfolio as of the end of September. The company provides point-of-sale technology solutions for the restaurant industry and in other applications. PAR is a good example of a company that has seen a significant de-rating in its multiple, despite strong underlying fundamentals. In its most recent quarter, results showed continued growth in annual recurring revenues and improvement in gross margins. The company's multiple has been cut in half, having traded at over 6x revenue late last year, it was below 3x at the end of August, while fundamentals have been strong and its CEO remains confident in forecasting 30-40% annual recurring revenue growth going forward.

With the severe dislocation in valuations relative to the fundamentals, forward return potential has improved considerably this year. The environment provides a wide opportunity set to filter these businesses and own the companies in which we have the highest conviction in our investment thesis.

Thank you for your continued support.

David Barr, CFA and Sharon Wang
October 17, 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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