



THE MANAGER'S COMMENTARY – NOVEMBER 2022

Fellow Unitholders,

As part of the continuous monitoring of our investment strategies, we have analyzed the performance of the Pender Value Fund (PVF). While short-term volatility and drawdowns are an everyday reality for an active, concentrated portfolio, our investment process is designed with the goal of delivering first quartile, risk-adjusted returns to our unitholders over the long term. After reviewing the Fund's performance, we determined that over the past five years, we have not delivered in the PVF.

As lead Portfolio Manager of both the Pender Value Fund and Pender Small Cap Opportunities Fund, I have analyzed the historical performance and decision-making that delivered two different outcomes over the same three-year time period. For the three years ending October 31, 2022, the Pender Small Cap Opportunities Fund has delivered an annualized return of 10.7%¹ while the Pender Value Fund has lagged significantly, delivering -4.7%¹ over the same period. Both funds have faced similar market headwinds, given their partially overlapping focus. We have spoken a great deal about how small caps have underperformed for the last five years and how the technology sector has sold off over the past 18 months. These headwinds have been factors for both funds and have impacted their performance to varying degrees, but we think the divergence in performance that has delivered unsatisfactory results in the Pender Value Fund can be traced to the individual security selection within the Fund.

Looking deeper, it is clear that while some of the holdings overlapped with other Pender funds, some were not held in any other funds. This group of uniquely held companies included both positive and negative contributors, and overall, the contribution to performance by this group was positive for PVF. What was missing, and the key driver of the relative underperformance, were the key investments that were held in Pender Small Cap Opportunities Fund that were significant contributors to the performance of that portfolio. To put it plainly, we did not own the big winners that would have helped offset some of the negative contributors.

When we launched the Pender Value Fund in 2013, our intention was to draw from the pool of "best ideas" from the entire investment team with a goal of driving long-term, risk-adjusted returns for investors. This resulted in a portfolio that was made up of mostly Canadian and almost completely small or mid-cap companies, which aligned with our research focus. This focus drove strong risk-adjusted performance, and by the time the Fund had a five-year track record, the Fund was winning awards for its performance².

As we grew the equity investment team, we expanded the research process to capture a larger opportunity set of businesses to evaluate. We believed that this expanded reach could provide more investment opportunities to draw from, and that this in turn had the potential to drive even stronger returns for the Fund and our clients.

I was driven to keep improving on these strong returns and so we continued to expand our universe, deploying our tried-and-tested investment process to do so. With the benefit of hindsight, we can see

¹ Class F of the Fund. Other classes are available. Fees and performance may differ in those other classes.

² <https://www.penderfund.com/awards/>. The Pender Value Fund won the Fundata Canada Inc. FundGrade A+ Award in 2016 and 2017. The award is given annually to investment funds and managers who have shown consistent, outstanding, risk adjusted performance.

that this did not work. While we still believe our fundamental investment process can transcend borders, the results we delivered have not fulfilled our goals. Something needed to change.

We have therefore begun to narrow the opportunity set of the Pender Value Fund back to North American small and mid-cap stocks with a bias to Canada.

When we looked back on the early success of the Fund, we recognized the approach that helped us realize our goal was focussing on the Canadian small and mid-cap space. We have undertaken a review of each and every holding in the Pender Value Fund and can report that we believe that the opportunity formed by the companies held in the Fund today is very compelling. To begin with, we see many high-quality tech companies trading at a discount greater than 50% of their private market value, but which also have double-digit growth rates. From a fundamental and valuation perspective, this is a strong starting point from which to generate promising five-year returns. Similarly, we see a lot of small-cap tech stocks trading at steep discounts to private market value, and in many cases, these companies have even higher growth rates. Now is not the time to sell.

As larger capitalization or international companies held within the portfolio are sold, you can expect to see the proceeds redeployed into North American small to mid-cap stocks, with an emphasis on Canada. We will not, however, compromise on the potential returns from these companies. We still see these businesses as fundamentally attractive and our investment thesis remains intact, so this transition will happen over time as these companies reach our estimate of intrinsic value. That said, if we see an equal or more compelling opportunity, we will make the switch out of a large-cap or international stock into North American small or mid-cap stock. We have already begun this process, and you will likely have seen evidence of that shift in the last few months. Our weighting in Canada has increased from 36.3% at the end of June to 40.7% at October 31, while our weighting in international holdings has declined from 16.1% to 8.5% over the same period. From a market cap perspective, the small to mid-cap exposure in the portfolio is 46.6% as of the end of October.

One example of a business we have sold is Nintendo Co., Ltd. (TYO: 7974). While this large-cap Japanese business has held up well compared to the broader technology sector, we have sold it in favour of a better opportunity within our North American small and mid-cap focus: Vancouver-based Copperleaf Technologies Inc. (TSX: CPLF). Copperleaf is a company that we have followed closely for many years, having invested in the business when it was a private company and supported it through its IPO in October 2021.

Although we have narrowed the opportunity set for the Pender Value Fund, we will stay true to the underlying investment process that has delivered returns for the Pender Small Cap Opportunities Fund and in PVF's first five years.

While the future is uncertain, our goal is to deliver first quartile results to every single investor at Pender. I am very grateful for your ongoing support and look forward to answering any additional questions you may have.

David Barr, CFA
November 21, 2022



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