PENDER

SMALL / MID CAP DIVIDEND FUND

THE MANAGER'S COMMENTARY – FIRST QUARTER 2023

Dear Unitholders,

A big driver for markets in March was the fallout from the collapse of Silicon Valley Bank (SVB) and Signature Bank, and the forced sale of Credit Suisse, resulting in an expectation that tightening credit standards would impact the availability of liquidity in Canada as well. While the fear of a contagion has subsided, market expectation for a recession remains elevated.

Given the uncertainty, small caps underperformed the large cap index in March, with the Russell 2000 index returning -4.8%, versus 3.2% returns for the Russell 1000. However, small caps have historically outperformed during periods of recession and the ensuing recovery. They are often more nimble in their response to changes in the macro environment and their underperformance leading into these environments. The Pender Small/Mid Cap Dividend Fund ended the quarter down -0.5%[1], while the S&P/TSX Composite Index returned 4.6% and the S&P/TSX SmallCap Index returned 4.5% for the quarter. The indices were helped by their relatively higher weight in commodities, including gold and silver, which benefitted from the deteriorating macro environment and the expectation for a peak in interest rates.

Key contributors for March were the energy names Spartan Delta Corp. (TSX: SDE) and Computer Modeling Group Ltd. (TSX: CMG), along with Guardian Capital Group Ltd. (TSX: GCG). On March 28, Spartan Delta announced the sale of some of its Canadian assets to Crescent Point Energy Corp. (TSX: CPG) for $1.7B, a special dividend of $9.50 per share and the spinout of its remaining Montney assets to a newly created company called Logan Energy as part of the deal. This has helped crystallize the "sum of the parts" value in its assets.

Also during March, Guardian Capital completed the previously announced transaction to sell its wealth subsidiary to Desjardins for $627 million in net proceeds. Post the transaction, Guardian has an estimated $1.2 billion in net liquid balance sheet resources, exceeding its market cap of $1 billion. In addition to that, Guardian has a well-established asset management business generating a consistently positive earnings stream.

In the case of Computer Modeling Group, the recently appointed CEO announced a new strategy, which includes pursuing partnerships to drive double-digit topline growth along with M&A to augment its presence across its traditional markets.

Key detractors for March were Chesswood Group Ltd (TSX: CHW) and Adentra Inc. (TSX: ADEN). Chesswood reported a weak quarter as its commercial equipment financing and consumer finance divisions were impacted by stress in the economy. This resulted in higher net charge-offs and provisions, higher funding costs and increased expenses. Management is focused on repricing risk to reflect current market conditions, which it expects will help with gradual margin improvement. Originations continue to grow, and a medium-term objective of the management team is to grow the portfolio to between $4-6 billion.

Adentra posted weaker-than-expected results for the quarter ended December 2022, in part due to an inventory write-down of $7.6 million. Approximately 40% of Adentra's business is exposed to US new home construction, which is expected to decline year-on-year in 2023. New building starts decreased by

[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.

25% in 2022, but residential construction spending has historically experienced a quick recovery following recessions post-1950, aside from in 2008-9. Another 40% of Adentra's business is exposed to the US repair and remodel market, which is expected to be stable, helped by high levels of home equity and a median age of US housing stock of over 40 years. We believe the stock is very cheap at current levels (6x EV/2023 EBITDA) and see opportunities for Adentra to gain market share (currently 6%), release cash from working capital, buy back stock (having already repurchased >5% of outstanding stock in 2022) and make further accretive acquisitions to achieve its goal of $3.5 billion in revenue by 2026 (a $1 billion increase on 2022 or 9% CAGR).

We also made some portfolio adjustments in March, exiting a couple of names: K-Bro Linen Inc. (TSX: KBL) and Transcontinental Inc. (TSX: TCL/A) in order to redeploy capital to more promising opportunities.

We are always on the lookout for quality compounders trading at reasonable valuations, and one such opportunity presented itself when Trisura Group Ltd. (TSX:TSU), a leading speciality insurance provider, got put in the penalty box by the market on reporting a bad quarter. The company reported an unexpected write-down of $82 million on reinsurance recoverables in its US business. This provided an opportunity for the Fund to initiate a position in a stock that we have been closely monitoring for a few months and have owned in the past. Trisura's management believes the write-down to be a one-time loss since exposure to similar homeowners' insurance is limited to less than 6% of the US gross written premium. Also, management believes remaining reinsurance recoverables are high quality – 83% are represented by rated reinsurers and the remainder are appropriately collateralized.

Trisura operates in a niche market, relying on specialized underwriting knowledge and structuring expertise to offer commercial products not provided by most insurers. It has a 16-year history in Canada, having grown revenue and book value at a CAGR of 29%, over the last eight years, with ROE in the high double digits (30% in each of the last two years). Trisura entered the US market in 2018 and has rapidly grown its fee-based fronting model that originates premiums and cedes the majority of underwriting risk to reinsurance partners for a fee. The US business reported an adjusted ROE (excluding the reinsurance write down) of 14% in 2022 and the ROE has been on an upward trend as the business has gained scale. We expect growth in both the Canadian and US markets to continue as the company expands its distribution relationships in existing lines of business and continues to grow the fronting model.

We are excited about the future potential of Trisura and see compelling value in the portfolio of businesses we own today. Uncertainty in the macro environment has created opportunities at the company level to make attractive investments in high quality compounding businesses in our view. These businesses will again have their day in the sun and we will continue to closely watch their progress along the way.

David Barr, CFA

April 21, 2023

PENDER
PenderFund Capital Management Ltd.