Manager's Commentary

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The Pender Small / Mid Cap Dividend Fund (PSMDF) ended September 2023 with total returns of 0.4% for the quarter, outperforming the S&P TSX Composite Index total return of -2.2% and the S&P TSX Small Cap Index total return of -0.8%[1].

The quarter saw some unusual volatility, with the price of oil up 29% to end the quarter at $90.8/bbl (WTI) and the US 10-year Treasury yield up 73 bps to end the quarter at 4.57%, the highest since the summer of 2007 and a sharp increase from the recent lows of < 1% in the summer of 2020. Comments from the US Federal Reserve indicating higher for longer rates were further reinforced by the recalibration of inflation expectations driven by the increase in crude oil prices. Higher rates impacted equity markets from a combination of lower economic growth expectations as well as the increase in discount rate to reflect the higher risk-free rate.

This short-term volatility does not influence the way we think about the businesses we own and in fact reinforces our belief in the investment framework focused on quality companies with capable management and growth tailwinds. We continue to engage with management teams and actively manage the Fund to ensure the portfolio is well positioned for the medium to long term (three to five years).

30-Sep-23	**PSMDF**	**Benchmark (IShares S&P/TSX SmallCap Index ETF)**
Market Cap (mm)	1,295	1,348
Dividend Yield (TTM)	2.61	2.74
Dividend CAGR (trailing 10-years)*	7.2%	3.6%
Active Share	99.03	-
# of Securities	32	253
Return on Equity	17.8%	8.0%
Forward P/E (NTM)	15.8	16.7

*Dividend paying securities held within the fund have a history of attractive long-term dividend growth. The Fund also offers a higher return on equity at lower valuation than the benchmark index. *Excludes companies with less than 5-year dividend paying track record in 2022, with adjustments made to the weights to account for these exclusions.*

Top Contributors / Detractors

The top contributor in the month was Computer Modeling Group, a technology company in the oil and gas industry engaged in the development and licensing of reservoir simulation software. The company reported strong results for the June quarter, continuing a trend of improving topline growth over the last several quarters driven by healthier end markets and growing exposure to the energy transition theme. Pramod Jain, appointed CEO in May 2022, has made significant organizational changes, refocusing the business on growth 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.*

empowering senior management with a results-driven culture and at being intentional about customer segmentation and value-based pricing to improve competitiveness, especially in conventional energy end markets. He has reduced headcount at the Calgary HQ, including in the R&D function (set up lower cost R&D center in India), to make the organization more accountable. Following a period of no mergers and acquisitions in the company's 45-year history, the company has already made two acquisitions in the last 12 months that provide it with access to new technology and markets that should generate an attractive return on investment in the future.

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Other leading contributors in the quarter were Saturn Oil & Gas and Spartan Delta, both energy companies that benefitted from the rebound in oil prices. Also, NFI Group closed its equity and second lien debt refinancing package in August, which will allow management to now focus on recovering from COVID-driven supply chain challenges. The company is on track to ramp up production to meet strong demand as its customers seek to transition its internal combustion engine fleet to zero-emission buses over time.

Amongst top detractors was Chorus Aviation, which provides contract flying and charter services through its Regional Aviation Services business segment and aircraft leasing and maintenance, repair and overhaul services through its Regional Aircraft Leasing business segment. The market was disappointed to learn about a further delay in the launch of Fund III of its regional aircraft asset management business. We exited our position in the company during the month of September.

Another detractor was Trisura Group, a specialty insurance company, which was impacted by the news of a fintech company in the US being investigated for using fraudulent letters of credit towards reinsurance collateral. While Trisura is not known to have any relationship with the fintech in question, this revelation sparked investor concern related to uncertainties about potential exposure to other parties. On the other hand, the company posted yet another strong quarterly earnings, with 31.5% year-on-year topline growth in Canada and 48.5% year-on-year growth in the US. The growth is supported by expanding distribution relationships in existing lines of business and growth of the hybrid fronting model (fee-based model originates insurance premiums and cedes majority of underwriting risk to reinsurance partners). Adjusted ROE for the consolidated business was 19%, maintaining the high double-digit trend of the last several quarters. Trisura also announced the acquisition of a small US Surety company that will enhance the recently launched Surety practice in the US and expand distribution relationships.

Portfolio Changes

We used recent volatility in the market to initiate two new holdings during the quarter. Canacol Energy is Columbia's largest independent natural gas producer with a track record of exploration and development success. Over 85% of its natural gas sales volumes are under long-term fixed price take or pay contracts, providing it with a source of stable revenue and cash flow that allows it to maintain its dividend (9.1% yield). High profit margin (85% EBITDA margin) and return-focused capital allocation together contribute low double digit returns on invested capital. The commissioning of a new gas pipeline expected within the next 18 months will provide Canacol access to the much larger interior market accounting for 60% of Colombia's natural gas demand (vs the much smaller coastal market where Canacol now accounts for >50% of gas supplies), helping it boost sales volume by a projected 45% in 2025 (vs 2023 sales volume). In the near term, Canacol is focusing on infill development drilling and workover opportunities to meet anticipated high gas demand (gas fired generation will make up for lower hydro) during the El Niño season, which is anticipated to start in fourth quarter 2023.

Another new holding is Aecon Group Inc that provides construction and infrastructure development services. Since the new CEO Jean-Louis Servranckx joined the company in late 2018, Aecon has taken several steps to derisk the business and to recycle cash into higher return businesses that we believe is not yet reflected in the share price due to the overhang of four legacy fixed price lump-sum turnkey contracts on which it has had to book charges due to cost overruns over the last several quarters. The company's growth initiatives are primarily directed towards businesses with lower risk profiles, including long-term operation and maintenance concessions, renewable energy and decarbonization and other projects linked to sustainability initiatives (60% of 2022 revenue was tied to sustainability projects). Higher margin nuclear is currently at 15% of construction segment revenue, but likely to increase to 20% over next three to five years as recent contract wins for small modular reactors get booked into revenues.

Outlook

We have recently seen a pickup in buy-out activity by private equity of small to midcap listed companies. For example, on Oct 3, Ember Infrastructure made an offer to take Quebec City-based H2O Innovation private at a 68% premium to pre-deal price and Persistence Capital Partners put in an offer for Neighbourly Pharmacy at a 69% premium to pre-deal price. This clearly reflects the discounted valuation some of these small-mid cap companies are trading at, since the deals were done at substantial premiums, despite the higher cost of capital.

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