Manager's Commentary

Aman Budhwar, CFA

The first quarter of 2024 was marked by economist's growing confidence in a soft landing for the Canadian economy. After going through a soft patch in the summer of 2023, growth expectations have been revised higher, with Q1 2024 GDP growth expectations revised from 0.5% to 1.0% in the most recent survey of economists conducted by Bloomberg. Similarly, growth expectations for US GDP in the first quarter of 2024 were revised to 2.0%, up from 1.8% previously.

This growing sense of optimism was reflected in the stock market, with the more domestic focused small caps in particular posting strong returns in the quarter. The performance of the S&P TSX Small Cap index, with an >50% weight in energy / materials, was also helped by a recovery in commodity prices, with the price of crude (WTI) up 16% to end the quarter at US$83 per barrell and gold up 8% to end the quarter at US$2,230 per oz amongst others.

Q1 2024

The Pender Small Mid Cap Dividend Fund posted total returns of 9.6% for the quarter ended March 2024, outperforming the S&P/TSX Small Cap Index total return of 7.9% and the Fund's benchmark, the S&P/TSX Composite Index, return of 6.6%[1].

The Fund participated in the rally in crude prices through our exposure to energy service companies that are expected to benefit from higher equipment utilization rates as well as prices. We also took the opportunity to initiate a position in a low-cost copper producer that is expected to see meaningful growth in production as a new mine comes on stream in 2024.

Top Contributors / Detractors

The top contributor during this quarter was Aecon Group Inc. (TSX: ARE), a relatively recent addition to the portfolio that was also a top contributor for the quarter prior. Aecon Group is up over 50% from our acquisition price in early Q4 2023. While the market has been fixated on losses on a few legacy projects, our due diligence was focused on the quality of the underlying business which has seen significant improvement under the leadership of the CEO Jean-Louis Servranckx since 2018. Aecon has recycled capital out of low return businesses like road construction into areas like nuclear and utilities where it has a sustainable competitive advantage. The underlying EBITDA margin (excluding legacy projects, property sales and business dispositions) was 9.6% in 2023, highest in over a decade. Also, as a result of disposition, the balance sheet improved to end the year with almost zero net debt.

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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.

Other top contributors during the quarter included Total Energy Services Inc. (TSX: TOT) and Adentra Inc (TSX: ADEN).

- **Total Energy's** Canadian operations are expected to benefit from the narrowing differentials between the Western Canadian Select & West Texas Intermediate (WCS-WTI) crude price as new egress capacity through the Trans Mountain expansion comes on stream. As well, its Australian business will nearly double in size giving it scale advantages post the closing of a recent acquisition.
- **Adentra**, a wholesale distributor of building products, reported better than expected results for Q4 2023 with gross profit margins 40bps ahead year-on-year despite the tough industry environment due to higher interest rates impacting home construction / renovation. As the business took a step down, the company utilized cash generated from release in working capital during 2023 to pay down debt. Management is targeting $3.5 billion in revenue and 10% EBITDA margin for 2028, or almost 90% EBITDA growth over 2023, through a combination of $500 million organic growth and $800 million of acquired revenue.

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Amongst top detractors during the quarter was Jamieson Wellness (TSX: JWEL). A recent addition to the portfolio, it is a growing global health and wellness company with a leadership position in the Canadian vitamin, mineral and supplement (VMS) marketplace. The company reported underwhelming results for Q4 2023 and guidance for 2024/25 included a step up in brand investments to accelerate growth, particularly in China. While topline is expected to grow in double digits over the next few years, the increase in sales and marketing expense as well as mix shift to lower margin international regions will depress EBITDA margins, expected to be down 350bps to 19.1% in 2024 vs. the pre-international expansion high of 22.6% in 2022. As long-term investors, we believe these brand building investments as foundational for long term growth and market expansion and expect to see attractive returns on these investments over time. We used the sell-off as an opportunity to add to our position.

Portfolio Changes

We added three names to the portfolio during the quarter.

- **Dye and Durham Limited** (TSX: DND): We re-initiated a position during the quarter by participating in the secondary equity offering. We had previously exited the position due to its high debt load, some of which has been repaid through the capital raise. We believe the underlying business has the potential to generate substantial cash flows which has been overshadowed over the past few years by their exposure to the cyclicality of the real estate markets, various one-time cash costs and higher cash interest payments. To address this, management has increased exposure to practice management software – a one-stop solution for law firms – and substantially increased annual recurring revenue. They are also working to further reduce leverage and cost of debt.

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- **Calian Group Ltd.** (TSX: CGY): A diverse company providing innovative healthcare, communications, learning and cybersecurity and technology solutions. Its business diversification provides it a unique opportunity to capitalize on growth in the aforementioned markets. In addition to organic growth, Calian is looking to deploy between $250 million to $300 million over the next few years to make strategic acquisitions that would contribute significantly to the 90% growth in EBITDA expected over FY23-FY26 ($66 million EBITDA in FY23 to $125 million guidance for FY26. Source: Investor Day presentation, Feb 15, 2024). Given the free cash flow generated by the business and management’s M&A track record (11 transactions in two years with revenue and EBITDA growth of 31% and 53% respectively), we believe future acquisitions should also be a good use of capital.
- **Ero Copper Corp.** (TSX: ERO): A low-cost producer of copper as well as gold / silver as by-product with operations in Brazil. It is in the process of commissioning a new mine that will see its copper production more than double in 2025 (vs. 2023) while at the same time further reducing cash production costs. We are bullish on the long-term outlook for copper as it stands to benefit from incremental demand from the global energy transition, be it EVs, renewables or grid reinforcement / expansion even while the lackluster outlook for growth in new mine supply points to growing deficits and higher production costs.

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