

Manager's Commentary

David Barr, CFA

Fund Performance

The Pender Value Fund continued to perform well in the third quarter, gaining 12.4%¹. This compares with gains of 10.5% in the S&P/TSX Composite Index and 7.9% in the S&P/TSX Small Cap Index. In the US, the Russell 2000 Index (CAD) advanced 8.0% in the quarter. The portfolio has now gained 38.4% so far in 2024 and is up 50.5% over the last year.

Equity markets continued their advance and have been resilient as inflation pressures have faded and the pivot to easing monetary policy was realized. The Federal Reserve cut its benchmark interest rate by half a percentage point in September and signaled more reductions to follow. This marked the first easing cycle from the Fed since the onset of the pandemic. The US central bank's first cut in more than four years left the federal funds rate at a range of 4.75% to 5%.

Looking at economic data, last week's jobs report showed employers added 254,000 jobs in September, significantly above the 150,000 economists expected and it marked the largest monthly increase since March². A reading of consumer sentiment also showed a continued improvement in late September, reaching a five-month high on more optimism about the economy in the wake of the Federal Reserve's interest-rate cut. The University of Michigan's final September sentiment index rose to 70.1 from the 69 preliminary reading released earlier this month and it follows an August index of 67.9³.

Easing monetary policy and resilient data on the economic front has contributed to the narrative that the US economy may be headed towards a soft landing. All this is good news for small and mid-cap companies that are more sensitive to interest rates and economic conditions since they tend to have more debt and rely more on floating-rate debt than large companies.

Portfolio Updates

There were some detractors to portfolio performance in the quarter, with Thinkific Labs Inc (TSX: THNC) as one of our weaker holdings. Having recently completed a Substantial Issuer Bid (SIB), the stock has been trading lower. This occurs as the market reacts to the SIB and we would expect the stock to trade a bit sporadically until business fundamentals regain investor attention.

On the positive side, Kraken Robotics Inc (TSXV: PNG) was the top contributor to performance in the quarter. Kraken is a marine technology company that offers subsea sensors, batteries, remotely operated vehicles and robotics services for defense and commercial applications. Their offering has a very strong product-market fit as one of the few mission-critical

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.

² Source: <https://www.morningstar.com/economy/september-us-jobs-report-254000-rise-payrolls-stronger-than-expected>.

³ Source: University of Michigan..

componentry suppliers in the marine defense technology market. NATO navies are prioritizing the modernization of their fleets amidst heightened geopolitical tensions. In doing so, they are increasingly adopting autonomous and robotic systems given the productivity benefits and significantly lower operating costs. We believe we are in the early innings of growing secular demand and Kraken participating in sizable navy contracts, like autonomous underwater vehicles (AUV).

The company is a great example of a compounder, growing revenues at approximately 60% per annum since 2018, while expanding EBITDA margins into the low 20s. We believe they can continue to grow and further expand margins, which should lead to positive FCF generation. In addition to growth, we also see an opportunity for multiple expansion as revenue and margins materialize and the company consistently generates cash flows. We continue to be happy shareholders and Kraken is a top-15 holding in the portfolio.

Outlook and Positioning

Our weight in Canadian equities stood at 70% at the end of the quarter, with 28% in US equities and a small 3% weight held outside North America. Across these geographies, our small cap weight represented 36% of the portfolio at the end of the quarter, with 45% in mid-caps, 14% in large caps and 4% in micro caps.

This positioning is driven by our fundamental analysis and where we find the best opportunities, with a focus on North American small and mid-sized companies. Despite the recent rally, we believe there still exists an attractive opportunity in this area of the market over the next three to five years. We have high conviction in the companies we own and believe this is an exciting time for small cap investors as the fundamentals in these businesses shine through.

David Barr, CFA

October 22, 2024