PATHFINDER

Pathfinder Small Cap

Quarterly Report

June 30, 2023

The Pathfinder Small Cap mandates investment in high-torque, early-stage companies that have the potential to generate superior returns.

Pathfinder Partners' Fund

The Partners' Fund had a net return of 0.1% in the second quarter of 2023. This compares to the TSX Venture Exchange's return of -2.0%. Our annualized 10-year return is 18.3% compared to the TSX Venture Exchange's return of -3.4% over the same period. The table below provides the performance summary.

Performance: June 30, 2023

	3M	6M	1 Yr	3 Yr	5 Yr	10 Yr	Incpt. *
Pathfinder Partners' Fund[1]	0.1%	9.5%	8.6%	16.1%	11.4%	18.3%	7.5%
S&P/TSX Venture	-2.0%	9.0%	0.7%	0.1%	-3.4%	-3.4%	-9.9%

	2022	2021	2020	2019	2018	2017	2016
Pathfinder Partners' Fund[1]	-20.6%	19.6%	50.6%	26.3%	-17.0%	36.6%	40.3%
S&P/TSX Venture	-39.3%	7.3%	51.6%	3.7%	-34.5%	11.6%	45.0%

[1] Performance based on Class C Master series, please see disclosures below

*Inception Date: March 2011

Our top contributors for the quarter were **Eupraxia Pharmaceuticals Inc. (TSX:EPRX)** and **Delcath Systems Inc. (NASDAQ:DCTH)**, while our main decliners were **Imaflex Inc. (TSXv:IFX)** and **Itafos Inc. (TSXv:IFOS)**.

The broader markets were led by large-cap tech stocks and the Nasdaq, which climbed 32% in the first half of the year, partly spurred by continued AI hype. Homebuilders were also strong, defying bearish forecasts and widespread pessimism heading into the year. It is a different picture in Canadian small caps – after a difficult 2022, there is severely limited capital availability and companies that aren't profitable are being punished. Against this backdrop, we are pleased to have capital to take advantage of a distressed small cap environment.

With dozens of companies desperate to raise money, we can pick through the best and dictate attractive investment terms. Readers of this publication will notice that there seems to be a pattern of manic-depressive behavior in the Canadian venture market where participants are either euphoric, bidding prices up to unreasonable levels, or despondent, selling no matter how low the price. The market is currently in a despondent state and our job is to stay patient and wait for great deals to cross our desk. Heading into the fall, we are hoping for a surfeit of buying opportunities.

A sector we've talked about a lot lately, biotech, has recently started to outperform. Our M&A thesis continues to pick up steam as seven $1Bn plus acquisitions were made solely in Q2, with a lot of major pharma participating (Merck, GSK, Astellas, Novartis, and Eli Lilly). The **SPDR S&P Biotech ETF XBI (NYSE:XBI),** a proxy for the biotech sector, was up 9.2% for the quarter, and we can expect more M&A activity as major patents roll-off over the next few years and companies look to backfill their existing pipeline with potential blockbuster candidates. We are optimistic that funds from these acquisitions will flow back into the sector.

Our standout biotech investment over the last 12 months has been **Eupraxia Pharmaceuticals Inc. (TSX:EPRX).** We first invested in Eupraxia last year during the depths of the biotech bear market. We were able to purchase a position at a valuation of less than the capital raised during the IPO. Eupraxia recently hit several milestones, first announcing the FDA had granted EP-104 fast track designation, allowing Eupraxia to meet with the FDA more often, and then publishing positive topline Phase 2 results showing their drug met the primary endpoint of pain relief and three of the four secondary endpoints. This is a fantastic result, so much so that Eupraxia hopes the FDA will allow them to modify their Phase 2 trial into a pivotal study that would eliminate the need for separate Phase 3 trials as well as significantly speed up the timeline to commercialization.

Part of our biotech analysis' checklist includes ensuring a company has a "robust pipeline". This simply means the company has multiple drugs or indications that are being developed, mitigating the value destruction should a trial fail – if a drug is being used in two trials and one trial fails, then there is still one shot left on net. Eupraxia's second indication is Eosinophilic Esophagitis (EoE) and uses the same technology as EPI-104. We think the Osteoarthritis trial has a strong readthrough into the EoE trial because of their similarities, meaning a better chance of success. With EoE, Eupraxia has an opportunity to be granted an orphan drug designation which would secure higher pricing and increased patent protection. Eupraxia closed Q2 at $8.65/share, up 137% YTD, and 104% in Q2 alone, but it still has tremendous upside potential on the success and commercialization in Osteoarthritis and in EoE, in our opinion.

While we are optimistic about our investments, the volatility and uncertainty around rate hikes, recession potential, and a company's ability to access capital is a real concern. However, it is during times of increased volatility that smart investments will limit downside risks while laying the foundation for future outperformance. During times of uncertainty, companies can trade at large discounts to their intrinsic value and we look to take advantage of these cheap valuations that normally wouldn't exist. We can confidently take these risks knowing that we pick companies with strong management teams, cash to fund operations, and a business plan with catalysts that we believe in.

Pathfinder Resource Fund

The Resource Fund had a net return of −6.0% in the second quarter of 2023. This compares to the benchmark which had the same net return of −6.0%. Since inception (July 16, 2018), the Resource Fund has returned +13.8% annualized versus the benchmark's return of +5.6%. The table below provides the performance summary.

Performance: June 30, 2023

	3M	6M	1 Yr	3 Yr	Incpt. *
Pathfinder Resource Fund[1]	-6.0%	9.2%	5.8%	16.4%	13.8%
Benchmark	-6.0%	-2.0%	7.5%	13.0%	5.6%

	2023 YTD	2022	2021	2020	2019
Pathfinder Resource Fund[1]	9.2%	-18.7%	23.6%	69.9%	15.6%
Benchmark	-2.0%	12.0%	19.8%	6.0%	19.0%

Benchmark: 75% S&P/TSX Capped Materials Index, 25%, S&P/TSX Capped Energy Index *Inception Date: July 16, 2018

[1] Performance based on Class C Master series, please see disclosures below

Our top contributors for the quarter were **Ophir Gold Corp. (TSXv:OPHR), Arizona Sonoran Copper Corp. (TSX:ASCU) and Calibre Mining Corp. (TSX:CXB).** The main detractors were our fertilizer companies, **Itafos Inc. (TSXv:IFOS)** and **Fox River Resources Corp. (CSE:FOX)**.

The long-term outlook for commodities remains favourable despite the lingering volatility seen over this last quarter. China has shown some economic weakness with lower than anticipated manufacturing demand and a softening housing market, affecting industrial metals such as iron and steel. That said, the push for decarbonization through electrification still bodes well for base metals, namely copper. The story of the year in resources has been de-stocking of inventories driven by higher interest rates, which increases the cost of maintaining inventory stockpiles. Faced with higher costs and the prospect of softer demand due to economic weakness, suppliers previously interested in maintaining stockpiles have instead elected to "de-stock", adding additional supply to the market.

The agricultural sector has seen lower demand in fertilizer application, following the Russia/Ukraine war, due to higher prices which has incentivized farmers to reduce application to save money. Application can only be delayed for so long until diminishing crop yields force the use of fertilizer. Adding to the reduced demand was a double-whammy of inventory drawdowns throughout the supply chain. Similarly, base metals inventories are being exhausted to unprecedented levels, while new mines may not be able to backfill the increasing demand. The on-going "de-stocking" and underinvestment in commodities signals a potential supply constraint in the long-term which we believe will eventually lead to higher prices to incentivize supply to meet the demand. When demand recovers, we anticipate a concurrent increase in inventory levels, spurring price increases.

While we patiently wait for these scenarios to play out, we continue to "weather the storm." We maintain a diversified core portfolio to mitigate downside while investing in select torquey junior names at disciplined weights to capitalize on the potential for upside in the resource sector. As operating margins for producers shrink due to higher costs (inputs, smelter, and freight charges), we have focused on strengthening our positions in companies that are resistant to inflation. This inflation protection comes in several forms. For example, we have increased our weighting in royalty companies where we get a percentage of top-line revenues but aren't exposed to operating cost inflation or capital expenditures. We have also invested directly in physical commodities such as uranium where we expect the price to increase over the long run to levels that incentivize much-needed new production.

Altius Renewable Royalties (TSX:ARR) is one such royalty company focused on investing in renewable power developers, capitalizing on the shift towards de-carbonization and clean energy. ARR has established financing relationships with top-tier developers, providing them with exposure to a robust pipeline of U.S.-based wind and solar projects. Royalty companies provide financing to companies in return for an economic interest in the project by receiving a percentage of production or in ARR's case, the top line revenue generated from renewable power generation projects. Since going public, ARR has generated a modest revenue stream but is poised for substantial growth in the future. The company has aligned itself with strategic partners such as Great Bay Renewables who is associated with two of the largest renewable developers in the US with an established pipeline of projects. With ARR's recent US$45M investment in Hexagon Energy, they gained exposure to over 73 wind and solar projects in the United States representing approximately 16.5 GW of renewable energy production. Altius Renewable Royalties has invested +US$300 M over the last few years and is poised for strong revenue growth in the future without exposure to cost inflation.

Another part of our strategy is to invest in mining companies with limited downside risk. Typically, as mining companies advance, the downside risk is decreased but the valuations increase as well. **Aurion Resources (TSXv:AU)** is one such company that we believe has the relatively limited downside risk while still being attractively valued with a strong management team that continues to unlock value through strategic partnerships. Aurion is a Canadian exploration company focused on exploring their 100% owned Risti and Launi projects in Finland while advancing their Helmi discovery through a joint venture agreement with B2Gold. Through the joint venture agreement, AU has been able to steadily advance their project through B2Gold's expenditures of +C$15 M on exploration while retaining a 30% interest in the property. Through this exploration work, the Helmi prospect was discovered and is strategically located next to and on trend of Rupert Resources (TSX:RUP C$860 M MC) multi-million ounce Ikkari development project. In our opinion, Helmi is a natural extension of Rupert's Ikkari deposit and consolidation of the two projects is inevitable.

Both companies above are examples of strong management teams that have executed strategic partnerships while protecting capital allowing them to "weather the storm" yet advance their projects. While we expect volatility in the near-term, by diversifying our portfolio and investing in companies that offer disciplined capital allocation, we continue to mitigate the potential downside risks of the current market. As inventories continue to decrease and underinvestment intensifies supply constraints, the potential for a commodity "super cycle" continues to gain favour. In the meanwhile, we will continue to stick to our investment criteria of investing in companies with strong management teams, tight capital structures, and strategic assets.

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Disclosure

National Instrument 31-103 requires registered firms to disclose information that a reasonable investor would expect to know, including any material conflicts with the firm or its representatives. Doug Johnson and/or Pathfinder Asset Management Limited are an insider of companies periodically mentioned in this report. Please visit www.paml.ca for disclosures.

* All returns are time weighted and net of investment management fees. Returns from the Pathfinder Partners' Fund are presented based on the Class C Master series except prior to its inception in July 2011 when the Class A Master series was used. Inception returns include the 10 months from inception in March 2011. Returns greater than one year are annualized. Returns from the Pathfinder Resource Fund are presented based on the Class C Master series since its inception in July 16, 2018. The S&P/TSX Venture Composite Index (C$), the S&P/TSX Venture Composite Index, the S&P/TSX Capped Materials Index and the S&P/TSX Capped Energy Index provide general information and should not be interpreted as a benchmark for your own portfolio return. Further details of the Partners' Fund are available on request.

Changes in Leverage. We are increasing the liabilities ceiling to 2.0 times the market value of equity for Pathfinder International Fund and Pathfinder Real Fund to be consistent with Pathfinder Partners' Fund and Pathfinder Resource Fund.

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