

# **Palos Equity Income Fund**

Interim Financial Statements (unaudited)

**June 30, 2020 and 2019**

(expressed in Canadian dollars)

# Palos Equity Income Fund

## Notice

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The following Palos Equity Income Fund semi-annual Financial Statements have not been subject to a review by the Fund external auditors.

# Palos Equity Income Fund

## Statements of Financial Position (unaudited)

As at June 30, 2020 and December 31, 2019

	June 30, 2020	December 31, 2019
<b>ASSETS</b>		
<b>Current assets</b>		
Investments at fair value through profit or loss (FVTPL)	\$ 20,657,969	\$ 24,572,008
Cash	134,589	1,288,990
Receivable from investments sold	487,720	-
Accrued income receivable	50,538	60,063
Prepaid expenses	2,275	2,275
	<u>21,333,091</u>	<u>25,923,336</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Securities sold short	-	272,000
Payable for investments purchased	230,453	-
Accrued liabilities	51,394	46,479
Distributions payable	19,303	84,473
Redemptions payable	1,310	-
Management fees payable	23	-
	<u>302,483</u>	<u>402,952</u>
<b>Net assets attributable to holders of redeemable units</b>	<u>\$ 21,030,608</u>	<u>\$ 25,520,384</u>
<b>Net assets attributable to holders of redeemable units per series</b>		
Series A	\$ 15,024,157	\$ 17,011,039
Series F	<u>6,006,451</u>	<u>8,509,345</u>
	<u>\$ 21,030,608</u>	<u>\$ 25,520,384</u>
<b>Net assets attributable to holders of redeemable units per series per unit</b>		
Series A	\$ 5.09	\$ 5.72
Series F	5.52	6.17

Approved by the Manager, Palos Management Inc.

(s) Charles Marleau

Director

# Palos Equity Income Fund

## Statements of Profit or (Loss) and Comprehensive Income (unaudited) For the periods ended June 30, 2020 and 2019

	2020	2019
<b>Income</b>		
Dividend income	\$ 292,934	\$ 355,620
Interest income for distribution purposes	64,592	79,914
Net realized loss on sale of investments	(905,432)	(564,127)
Net change in unrealized appreciation (depreciation) of investments	(1,929,084)	3,154,718
	<u>(2,476,990)</u>	<u>3,026,125</u>
<b>Expenses</b>		
Management fees (Note 7)	157,276	187,382
Administration and other professional fees	50,029	69,812
Transaction cost	31,537	26,388
Legal fees	31,737	22,082
Audit fees	22,061	25,885
Trustee fees	6,898	8,023
Independent review committee fees	5,984	5,951
Bank charges and interest	1,891	1,592
Withholding tax expense	1,377	2,026
	<u>308,790</u>	<u>349,141</u>
<b>Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units</b>	<u>\$ (2,785,780)</u>	<u>\$ 2,676,984</u>
<b>Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per series</b>		
Series A	\$ (1,695,225)	\$ 1,679,995
Series F	(1,090,555)	996,989
	<u>\$ (2,785,780)</u>	<u>\$ 2,676,984</u>
<b>Increase (decrease) in Net Assets Attributable to Holders of Redeemable Units per Unit (Note 9)</b>		
Series A	\$ (0.57)	\$ 0.56
Series F	(0.87)	0.62

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

## Statements of Changes in Net Assets Attributable to Holders of Redeemable Units (unaudited)

For the periods ended June 30, 2020 and 2019

	Net assets attributable to holders of redeemable units, beginning of period	Proceeds from redeemable units issued	Redemption of redeemable units	Distributions to holders of redeemable units*	Reinvestment of distributions to holders of redeemable units	Decrease in net assets attributable to holders of redeemable units	Net Assets attributable to holders of redeemable units, end of period
<b>June 30, 2020</b>							
Series A	\$ 17,011,039	\$ 280,483	\$ (545,662)	\$ (146,963)	\$ 120,485	\$ (1,695,225)	\$ 15,024,157
Series F	8,509,345	44,584	(1,443,940)	(61,477)	48,494	(1,090,555)	6,006,451
	<u>\$ 25,520,384</u>	<u>\$ 325,067</u>	<u>\$ (1,989,602)</u>	<u>\$ (208,440)</u>	<u>\$ 168,979</u>	<u>\$ (2,785,780)</u>	<u>\$ 21,030,608</u>

	Net assets attributable to holders of redeemable units, beginning of period	Proceeds from redeemable units issued	Redemption of redeemable units	Distributions to holders of redeemable units*	Reinvestment of distributions to holders of redeemable units	Increase in net assets attributable to holders of redeemable units	Net Assets attributable to holders of redeemable units, end of period
<b>June 30, 2019</b>							
Series A	\$ 15,862,490	\$ 238,853	\$ (566,663)	\$ (592,720)	\$ 480,719	\$ 1,679,995	\$ 17,102,674
Series F	9,040,057	467,506	(419,165)	(321,627)	276,924	996,989	10,040,684
	<u>\$ 24,902,547</u>	<u>\$ 706,359</u>	<u>\$ (985,828)</u>	<u>\$ (914,347)</u>	<u>\$ 757,643</u>	<u>\$ 2,676,984</u>	<u>\$ 27,143,358</u>

### June 30, 2020

	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
*Detailed Distributions to unitholders				
Series A	\$ -	\$ -	\$ (146,963)	(146,963)
Series F	-	-	(61,477)	(61,477)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (208,440)</u>	<u>(208,440)</u>

### June 30, 2019

	From net investment income	From net realized gains on investments and derivatives	From return of capital	Total distributions to unitholders
*Detailed Distributions to unitholders				
Series A	\$ -	\$ -	\$ (592,720)	(592,720)
Series F	-	-	(321,627)	(321,627)
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (914,347)</u>	<u>(914,347)</u>

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

## Statements of Cash Flows (unaudited) For the periods ended June 30, 2020 and 2019

	2020	2019
<b>Cash provided by (used in):</b>		
<b>Operating Activities</b>		
Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units	\$ (2,785,780)	\$ 2,676,984
Adjustments for non-cash items		
Net realized (gain) loss on sale of investments	905,432	(3,154,718)
Net change in unrealized depreciation of investments	1,929,084	564,127
Foreign exchange (gain) loss	7,358	(986)
Change in non-cash balances		
(Increase) decrease in accrued income receivable	9,525	(88,364)
Increase in prepaid expenses	-	(14,346)
(Decrease) increase in accrued liabilities	4,915	(16,448)
(Decrease) increase in management fees payable	23	(29,135)
Proceeds from sale of investments	15,224,348	9,202,430
Purchase of investments	<u>(14,674,092)</u>	<u>(8,827,853)</u>
Cash provided by operating activities	<u>620,813</u>	<u>311,691</u>
<b>Financing Activities</b>		
Proceeds from issuance of redeemable units	325,067	645,791
Amount paid on redemption of redeemable units	(1,988,292)	(958,997)
Distributions paid to holders or redeemable units, net of reinvested distributions	<u>(104,631)</u>	<u>(157,960)</u>
Cash used in financing activities	<u>(1,767,856)</u>	<u>(471,166)</u>
Decrease in cash during the period	(1,147,043)	(159,475)
Foreign exchange gain (loss) on cash	(7,358)	986
Cash, beginning of period	<u>1,288,990</u>	<u>524,906</u>
<b>Cash, end of period</b>	<b>\$ <u>134,589</u></b>	<b>\$ <u>366,417</u></b>
<b>Supplemental information *</b>		
Interest paid	\$ 96	\$ 247
Interest received	29,923	68,020
Dividends received, net of withholding taxes	282,847	331,256

\*Included as a part of cash flows from operating activities

# Palos Equity Income Fund

Schedule of Investment Portfolio as at June 30, 2020 (unaudited)

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
<b>Investments owned (98.23%)</b>				
<b>Equities (89.92%)</b>				
<b>Basic Materials (7.62%)</b>				
Argonaut Gold Inc.	CAD	77,460	90,243	198,298
Dundee Precious Metals Inc.	CAD	23,770	158,560	212,504
Equinox Gold Corp.	CAD	13,940	154,575	211,609
Lundin Mining Corp.	CAD	48,240	281,052	351,187
Major Drilling Group International Inc.	CAD	2,700	11,293	11,583
Nutrien Ltd.	CAD	4,512	302,198	196,813
Sandstorm Gold Ltd	CAD	5,500	58,829	71,665
Sociedad Quimica y Minera de Chile SA	USD	4,000	210,425	141,977
Teck Resources Ltd.	CAD	14,550	287,883	206,901
<b>Total Basic Materials</b>			<b>1,555,058</b>	<b>1,602,537</b>
<b>Communications (5.86%)</b>				
Quebecor Inc.	CAD	13,540	413,606	394,962
Shopify Inc.	CAD	410	203,445	528,806
Telus Corp.	CAD	13,590	323,544	309,444
<b>Total Communications</b>			<b>940,595</b>	<b>1,233,212</b>
<b>Consumer, Cyclical (8.29%)</b>				
Alimentation Couche-Tard Inc.	CAD	5,690	173,699	242,223
BRP Inc.	CAD	3,770	100,706	218,283
Canadian Tire Corp Ltd	CAD	2,350	229,623	276,454
Dollarama Inc.	CAD	5,180	218,389	233,929
Goodfood Market Corp.	CAD	22,000	103,001	102,520
Pollard Banknote Ltd	CAD	9,920	188,312	169,632
Restaurant Brands International Inc.	CAD	3,160	258,672	233,492
Wal-Mart Stores Inc.	USD	1,640	197,137	267,452
<b>Total Consumer, Cyclical</b>			<b>1,469,539</b>	<b>1,743,985</b>
<b>Consumer, Non-cyclical (9.27%)</b>				
Badger Daylighting Ltd	CAD	6,520	218,301	193,774
Boyd Group Income Fund	CAD	1,060	199,541	214,194
Curaleaf Holdings Inc.	CAD	20,490	150,480	169,862
Green Thumb Industries Inc.	CAD	9,920	145,822	134,416
Jamieson Wellness Inc.	CAD	5,130	89,617	182,525
K-Bro Linen Inc.	CAD	9,380	320,315	248,101
Park Lawn Corp.	CAD	7,850	208,399	175,997
People Corp.	CAD	22,560	130,603	203,717
Premium Brands Holdings Corp.	CAD	3,000	240,910	259,800
Savaria Corp.	CAD	13,340	167,341	166,216
<b>Total Consumer, Non-cyclical</b>			<b>1,871,329</b>	<b>1,948,602</b>

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

Schedule of Investment Portfolio as at June 30, 2020 (continued) (unaudited)

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
<b>Energy (8.45%)</b>				
AltaGas Ltd	CAD	8,400	134,059	131,460
CES Energy Solutions Corp.	CAD	38,200	47,336	41,256
Enbridge Inc.	CAD	7,017	326,793	289,662
Keyera Corp.	CAD	14,520	415,171	300,128
Pembina Pipeline Corp.	CAD	8,949	345,059	303,729
Precision Drilling Corp.	CAD	40,300	40,350	41,509
Secure Energy Services Inc.	CAD	40,100	62,581	66,967
Suncor Energy Inc.	CAD	16,750	678,604	383,408
Tourmaline Oil Corp.	CAD	18,420	188,331	218,645
<b>Total Energy</b>			<b>2,238,284</b>	<b>1,776,764</b>
<b>Financial (26.30%)</b>				
Bank of Montreal	CAD	9,204	812,803	665,081
Boardwalk Real Estate investment Trust	CAD	9,717	354,120	288,692
Brookfield Asset Management Inc.	CAD	4,600	161,965	205,528
Crombie Real Estate Investment Trust	CAD	16,160	226,947	206,848
Dream Industrial Real Estate Investment Trust	CAD	18,480	237,931	197,366
Equitable Group Inc.	CAD	2,910	241,176	207,745
InterRent Real Estate Investment Trust	CAD	13,300	194,845	190,589
National Bank of Canada	CAD	7,460	470,638	458,939
Royal Bank of Canada	CAD	9,990	810,577	920,179
StorageVault Canada Inc.	CAD	56,620	128,044	180,618
The Bank of Nova Scotia	CAD	14,080	983,815	791,014
The Toronto-Dominion Bank	CAD	13,064	599,867	791,548
Tricon Capital Group Inc.	CAD	24,010	255,473	219,692
WPT Industrial Real Estate Investment Trust	USD	11,800	206,042	207,248
<b>Total Financial</b>			<b>5,684,243</b>	<b>5,531,087</b>
<b>Funds (1.96%)</b>				
iShares 1-5 Year Laddered Government Bond Index ETF	CAD	22,470	407,785	411,650
<b>Total Funds</b>			<b>407,785</b>	<b>411,650</b>
<b>Industrial (12.05%)</b>				
Aecon Group Inc.	CAD	11,820	174,821	174,465
Canadian National Railway Co.	CAD	3,500	395,316	420,385
Canadian Pacific Railway Ltd.	CAD	1,120	252,799	386,758
Cargojet Inc.	CAD	1,160	119,281	185,600
CCL Industries Inc.	CAD	5,160	241,901	226,421
GFL Environmental Inc.	CAD	11,120	243,192	283,449
Mullen Group Ltd	CAD	16,000	104,026	116,320
NanoXplore Inc.	CAD	80,700	133,155	130,734
TFI International Inc.	CAD	5,390	218,986	259,744
Transcontinental Inc.	CAD	8,900	116,022	134,390
WSP Global Inc.	CAD	2,600	223,600	216,476
<b>Total Industrial</b>			<b>2,223,099</b>	<b>2,534,742</b>

The accompanying notes are an integral part of these financial statements.



# Palos Equity Income Fund

Schedule of Investment Portfolio as at June 30, 2020 (continued) (unaudited)

Expressed in Canadian Dollars

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
<b>Technology (5.03%)</b>				
CGI Inc.	CAD	2,970	275,747	254,024
Kinaxis Inc.	CAD	1,070	82,606	207,644
Lightspeed POS Inc.	CAD	10,350	357,972	335,651
Open Text Corp.	CAD	4,520	230,831	260,578
<b>Total Technology</b>			947,156	1,057,897
<b>Utilities (5.08%)</b>				
Brookfield Renewable Partners LP	USD	3,500	227,812	228,255
Capital Power Corp.	CAD	12,420	355,779	347,512
Innergex Renewable Energy Inc.	CAD	8,550	143,301	163,305
Northland Power Inc.	CAD	9,718	229,577	330,218
<b>Total Utilities</b>			956,469	1,069,290
<b>Total Equities</b>			18,293,557	18,909,766
<b>Fixed Income (8.20%)</b>				
<b>Basic Materials (2.41%)</b>				
Chemtrade Logistics Income Fund, - 6.5% / Oct 31, 2026	CAD	250,000	250,000	194,730
North American Construction Group Ltd, 5% / Mar 31, 2026	CAD	350,000	350,000	311,500
<b>Total Basic Materials</b>			600,000	506,230
<b>Energy (0.96%)</b>				
Parkland Fuel Corp., - 5.50% / May 28, 2021	CAD	200,000	200,000	200,876
<b>Total Energy</b>			200,000	200,876
<b>Financial (1.80%)</b>				
Fiera Capital Corp., - 5.00% / Jun. 30, 2023	CAD	375,000	374,692	378,750
<b>Total Financial</b>			374,692	378,750
<b>Utilities (3.04%)</b>				
Innergex Renewable Energy Inc. - 4.75% / June 30, 2025	CAD	600,000	579,000	639,144
<b>Total Utilities</b>			579,000	639,144
<b>Total Fixed Income</b>			1,753,692	1,725,000

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

Schedule of Investment Portfolio as at June 30, 2020 (continued) (unaudited)

Expressed in Canadian Dollars

Description	Currency	Number of shares	Average cost \$	Fair value \$
<b>Warrants (0.11%)</b>				
Cresco Labs Inc., - \$12.50 / Sept. 24, 2022	CAD	8,500	18,360	6,078
Drone Delivery Canada Corp., - \$1.5 / Mar. 25, 2021	CAD	35,000	5,390	4,375
Dundee Precious Metals Inc., - \$8 / May 13, 2021	CAD	4,500	–	4,230
Sherritt International Corp. \$1.95 / Jan 25, 2021	CAD	48,000	–	120
Yamara Gold Inc. \$13.5 / Jan. 15, 2021 RSTD	CAD	5,000	–	8,400
<b>Total Warrants</b>			23,750	23,203
<b>Total investments owned</b>			20,070,999	20,657,969
Commissions and other portfolio transaction costs			(20,996)	–
Net investments owned (98.23%)			20,050,003	20,657,969
Other assets, net (1.77%)				372,639
<b>Net Assets Attributable to Holders of Redeemable Units (100%)</b>				<b>21,030,608</b>

The accompanying notes are an integral part of these financial statements.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

## 1 General information

Palos Equity Income Fund (the “Fund”) was formed in January 3, 2008 under the laws of the Province of Quebec pursuant to a trust agreement (the agreement), as amended for the last time on August 26, 2013, between Computershare Trust Company of Canada (the trustee) and Charles Marleau (the settlor). The address of the Fund’s registered office is 1 Place Ville-Marie, Suite 1670, Montréal, Québec, H3B 2B6, Canada. The Fund is an open-ended mutual fund, is qualified as a unit trust and is a registered investment fund under Section 204.4 of the Income Tax Act (Canada).

Series A opened on January 3, 2008 and Series F opened on February 24, 2012.

The Fund acts as an investment holding unit trust for the benefit of unitholders by acquiring, investing in, holding, transferring, disposing of, or otherwise dealing with such investments as the trustee and the investment fund manager determine, at their discretion, in accordance with the investment objectives of the Fund, which are to preserve capital, to provide an attractive and steady stream of income and to deliver trading-enhanced returns.

The investment fund manager and portfolio advisor is Palos Management Inc. (the Manager).

These financial statements have been authorized for issue by the Board of Directors of the Manager on August 7, 2020.

## 2 Basis of presentation

These financial statements have been prepared in compliance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Boards (IASB).

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

## 3 Summary of significant accounting policies

### Financial instruments

#### Classification

IFRS 9, Financial Instruments, sets out a classification and measurement model for financial assets to determine whether a financial asset should be classified at amortized cost, at fair value through profit or loss (“FVTPL”) or fair value through other comprehensive income (“FVOCI”). This model is based on the contractual cash flow characteristics of the financial asset and the business model under which the financial asset is held. The Fund managed its investments in financial assets with the objective of realizing cash flows through both the sale of the assets and income generated from those assets. The Manager makes decisions based on the assets’ fair values and managed the assets to realize those fair values.

IFRS 9 requires that an entity recognize a loss allowance for expected credit losses on financial assets which are measured at amortized cost or FVOCI. Financial assets held by the Fund which are measured at FVTPL will not be subject to the recent impairment requirements.

With respect to receivables, the Fund considers both historical analysis and forward looking information in determining any expected credit loss. As at the statements of financial position date, all receivables are due to be settled within the short term. The Fund considered the probability of default to be close to zero as these instruments have a low risk of default and the counterparties have a strong capacity to meet their contractual obligation in the near term. Given the limited exposure of the Fund to credit risk from financial assets recorded at amortized cost, no loss allowance has been recognized as any such impairment will not have a significant impact on the financial statements.

#### Recognition

Regular way purchases and sales of financial assets are recognized at their trade date. The Fund’s investment assets and liabilities are measured at fair value through profit or loss (FVTPL), including certain investments in debt securities which have been designated at FVTPL. The Fund’s derivative and non-derivative investments are classified as FVTPL upon initial recognition. The Fund’s obligation for net assets attributable to holders or redeemable units is classified as a financial liability at the redemption amount, which approximates fair value. The redemption amount is determined as the net difference between total assets and all other liabilities for which accounting policies are described herein. All other financial assets and financial liabilities are classified as subsequently measured at amortized cost and other financial liabilities respectively and are measured at amortized cost. Under this method, financial assets and financial liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract’s effective interest rate. The Fund’s accounting policies for measuring the fair value of its investments and derivatives are identical to those used in measuring its net asset value (“NAV”) for transactions with unitholders.

# Palos Equity Income Fund

## Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

### Income recognition

The interest income for distribution purposes shown on the statements of profit or (loss) and comprehensive income (loss) represents the contractual interest accounted for on an accrual basis. The Fund does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds and loans which would be amortized on a straight-line basis. Dividend income is recorded on the ex-dividend date.

Realized gain (loss) on sale of investments and unrealized appreciation (depreciation) of investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds.

### Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial assets and financial liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Fund uses the last traded market price for both financial assets and financial liabilities where the last traded price falls within that day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, the Manager determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances.

The fair value of financial assets and financial liabilities that are not traded in an active market, including over-the-counter derivatives, is determined using valuation techniques. The Fund uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques include the use of comparable recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and others commonly used by market participants and which make the maximum use of observable inputs.

### Investment entities

The Fund meets the definition in IFRS 10, Consolidated Financial Statements, for investment entities and accounts for its investments in underlying at FVTPL.

### Structured entities

The Fund may invest in other investment funds ("underlying funds") by holding redeemable shares of the underlying funds which entitle the holder to an appropriate share of the underlying funds' net assets. The Fund does not invest in underlying funds for the purpose of exercising management control. Such investments expose the Fund to the risk that underlying funds may not perform as expected and indirectly to all of the risks applicable to investments in underlying funds.

The carrying value of investments in underlying funds is included in "Investments" in the statements of financial position and also represents the maximum exposure to losses. Changes in fair value of investments in underlying

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

funds are included within “Net change in unrealized appreciation (depreciation) of investments” in the statements of profit or (loss) and comprehensive income.

## **Classification of redeemable units**

The Fund's outstanding redeemable units are in different series which do not have identical features. Consequently, the Fund's outstanding redeemable units are classified as financial liabilities and recorded as net assets attributable to holders of redeemable units, in accordance with the requirements of International Accounting Standard (IAS) 32, Financial Instruments: Presentation.

## **Foreign currency translation**

The Fund's subscriptions and redemptions are denominated in Canadian dollars, which is also its functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates that transactions occur. Foreign currency assets and liabilities denominated in a foreign currency are translated into the functional currency using the exchange rate prevailing at the measurement date. Foreign exchange gains and losses relating to cash and to other financial assets and financial liabilities are presented as “Net realized loss on sale of investments” and “Net change in unrealized appreciation (depreciation) of investments” in the statements of profit or (loss) and comprehensive income (loss).

## **Offsetting financial assets and financial liabilities**

Financial assets and financial liabilities are offset in the Fund's statements of financial position when and only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The Fund has a legally enforceable right to offset a financial asset and financial liability when such right is enforceable in the normal course of business and in the event of default, insolvency or bankruptcy.

Over-the-counter derivatives, securities lending, repurchase agreements and receivable for investments sold and payable for investments purchased are subject to master netting or similar agreements that do not meet the criteria for offsetting in the statements of financial position as they give a right to set-off that is enforceable only in the event of default, insolvency or bankruptcy.

## **Cash**

Cash comprises deposits with financial institutions and bank overdraft.

## **Increase (decrease) in net assets attributable to holders of redeemable units per unit per series**

The increase (decrease) in net assets attributable to holders of redeemable units per unit of each series is calculated by dividing the increase (decrease) in net assets attributable to holders of redeemable units of each series by the weighted average number of units outstanding during the period.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

## Taxation

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada). All of the Fund's net income for tax purposes and sufficient net capital gains realized in any period are required to be distributed to unitholders such that no income tax is payable by the Fund. As a result, the Fund does not record income taxes. Since the Fund does not record income taxes, the tax benefit of capital and non-capital losses has not been reflected in the statements of financial position as a deferred income tax asset.

The Fund currently incurs withholding taxes imposed by certain countries on investment income and capital gains. Such income and gains are recorded on a gross basis and the related withholding taxes are shown as a separate expense in the statements of profit or (loss) and comprehensive income.

## New standards, interpretations and amendments not yet adopted

There are no new standards, interpretations or amendments that have not yet been adopted, that would affect the Fund's financial statements.

## 4 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgments and estimates that the Manager has made in preparing the financial statements:

- a) Fair value measurement of derivatives and securities not quoted in an active market

The Fund may hold financial instruments that are not quoted in active markets, including derivatives. Fair values of such instruments are determined using valuation techniques and may be determined using reputable pricing sources or indicative prices from market makers. Broker quotes as obtained from the pricing sources may be indicative and not executable or binding. Where no market data is available, the Manager may value positions using its own models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. The models used to determine fair values are validated and periodically reviewed by experienced personnel of the Manager. The models used for private equity securities are based mainly on earnings multiples adjusted for a lack of marketability as appropriate.

Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require the Manager to make estimates. Changes in assumptions about these factors could affect the reported fair values of financial instruments. The Manager considers observable data to be market data that is readily available, regularly distributed and updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

- b) Classification and measurement of investment and application of the fair value option

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

In classifying and measuring financial instruments held by the Fund, the Manager is required to make significant judgments about whether or not the business of the Fund is to manage its portfolio of investments and evaluate performance on a fair value basis and that the portfolio of investments is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The most significant judgments made include assessing and determining the appropriate business model that enables the decision that the Fund's investments are classified as FVTPL.

## 5 Risks associated with financial instruments

### Risk factors

The Fund's activities expose it to a variety of risks associated with financial instruments, as follows: credit risk, liquidity risk, market risk (including currency risk, interest rate risk and price risk) and concentration risk. The Fund's overall risk management program seeks to maximize the returns derived for the level of risk to which the Fund is exposed and seeks to minimize potential adverse effects on the Fund's financial performance. All investments result in a risk of loss of capital. These risks are moderated through careful selection of securities and other financial instruments within the Fund's investment guidelines. The risks are measured using a method that reflects the expected impact on the results and net assets attributable to unitholders of the Fund from reasonably possible changes in the relevant risk variables.

### Credit risk

The Fund is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The majority of the credit risk to which the Fund is exposed arises from its investments in debt securities. In selecting fixed income securities for the Fund, the Manager considers factors such as the debt security's yield, risk of interest rate fluctuation, credit risk, the issuer's capital structure, credit spread and duration. The analysis below summarizes the credit quality of the Fund's debt portfolio as at June 30, 2020 and December 31, 2019.

	<u>June 30, 2020</u>	<u>December 31, 2019</u>
<b>Credit rating</b>	<b>Total fixed income %</b>	<b>Total fixed income %</b>
BB	11.6	8.7
Non-rated	88.4	91.3
	<u>100.0</u>	<u>100.0</u>

Source: Standard & Poor's



# Palos Equity Income Fund

## Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

All portfolio transactions in securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities are received by the broker. The trade will not settle if either party fails to meet its obligation. In addition, the Fund lodges its cash with quality institutions which have credit ratings of A or above as at June 30, 2020 and December 31, 2019. Credit risk with respect to accrued income receivable is limited as the receivables are derived from a portfolio of diversified investments.

The Fund's maximum exposure to credit risk is equal to the carrying value of the assets presented on the statements of financial position. The Fund does not anticipate any significant losses from the non-performance of counterparties.

### Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. The Fund is exposed to daily cash redemptions. Financial liabilities that potentially subject the Fund to liquidity risk consist of payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management fees payable. The Fund's investment approach focuses on investing in highly liquid securities and moderately liquid securities, which are therefore readily saleable to meet liquidity needs.

The Fund may invest in debt securities and unlisted equity investments that are not traded in an active market. As a result, the Fund may not be able to quickly liquidate its investments in these instruments at amounts which approximate their fair values, or be able to respond to specific events such as deterioration in the creditworthiness of any particular issuer. In accordance with the Fund's policy, the Manager monitors the Fund's liquidity position on a daily basis. The tables below analyze the Fund's financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. The amounts in the tables are the contractual undiscounted cash flows.

	<b>June 30, 2020</b>		
<b>Financial liabilities</b>	<b>On demand</b>	<b>&lt; 3 months</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Payable for investments purchased	–	230,453	230,453
Accrued liabilities	–	51,394	51,394
Distributions payable	–	19,303	19,303
Redemptions payable	–	1,310	1,310
Management fees payable	–	23	23
Redeemable units	21,030,608	–	21,030,608

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# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

Financial liabilities	December 31, 2019		
	On demand \$	< 3 months \$	Total \$
Securities sold short	–	272,000	272,000
Distributions payable	–	84,473	84,473
Accrued liabilities	–	46,479	46,479
Redeemable units	25,520,384	–	25,520,384

Redeemable units are redeemable on demand at the holder's option. However, the Manager does not expect that the contractual maturity disclosed above will be representative of the actual cash outflows, as holders of these instruments typically retain them for a longer period.

## Market risk

The Fund's investments are subject to market risk which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. To monitor the risk, the Fund's Manager uses stress testing to examine the impact that abnormally large swings in market factors and periods of prolonged inactivity might have on trading portfolios. The stress testing is designed to identify key risks and ensure that the losses from abnormal events are not above the Fund's risk tolerance.

The following include sensitivity analyses that show how the net assets attributable to holders of redeemable units would have been affected by a reasonably possible change in the relevant risk variable at each reporting date. In practice, the actual results may differ and the difference could be material.

### a) Currency risk

The Fund invests in monetary assets denominated in currencies other than Canadian dollar. These investments result in currency risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The table below indicates the foreign currencies to which the Fund had significant exposure as at June 30, 2020 and December 31, 2019, in Canadian dollars. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the Canadian dollar had strengthened or weakened by 5% in relation to each of the other currencies, with all other variables held constant. The monetary exposure presents the impact on cash and the non-monetary exposure presents the impact on investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary	Non-Monetary	Total	Monetary	Non-Monetary	Total
<b>June 30, 2020</b>						
U.S. Dollar	\$ (202,924)	844,932	642,008	(10,146)	42,247	32,101
	\$ (202,924)	\$ 844,932	\$ 642,008	\$ (10,146)	\$ 42,247	\$ 32,101
% of Net Assets						
Attributable to Holders						
of Redeemable Units	(1.0)	4.0	3.0	0.0	0.2	0.2

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary	Non-Monetary	Total	Monetary	Non-Monetary	Total
<b>December 31, 2019</b>						
U.S. Dollar	\$ 38,606	\$ 429,509	\$ 468,115	\$ 1,930	\$ 21,475	\$ 23,405
	\$ 38,606	\$ 429,509	\$ 468,115	\$ 1,930	\$ 21,475	\$ 23,405
% of Net Assets						
Attributable to Holders						
of Redeemable Units	0.2	1.7	1.9	0.0	0.1	0.1

## b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Fund holds securities with fixed interest rates that expose the Fund to fair value interest rate risk. The Fund also holds a limited amount of cash subject to variable interest rates which exposes the Fund to cash flow interest rate risk.

The Fund mitigates interest rate risk by monitoring interest rates and the maturities of its portfolio of interest-bearing financial instruments. The following table summarizes the Fund's exposure to interest rate risk. It includes the Fund's interest-bearing financial assets at fair value, categorized by the earlier of contractual interest rate reset dates or maturity dates. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the prevailing levels of market interest rates changed by 1%, assuming a parallel shift in the yield curve with all other variable held constant.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

	Total exposure	
	June 30, 2020 \$	December 31, 2019 \$
<b>Terms to maturity</b>		
Less than one year	200,876	508,164
1-5 years	1,017,894	1,228,970
5-10 years	506,230	594,970
<b>Total</b>	<b>1,725,000</b>	<b>2,332,104</b>
<b>Impact on net assets attributable to holders of redeemable units</b>	<b>53,848</b>	<b>60,783</b>
<b>Impact on net assets attributable to holders of redeemable units %</b>	<b>0.3%</b>	<b>0.2%</b>

c) Price risk

Price risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment or its issuer, or by factors affecting all securities traded in the market. The Fund is exposed to price risk through its equity investment portfolio, which includes a variety of common shares in a wide range of industries. Other assets and liabilities are monetary items that are short term in nature, and as such are not subject to price risk.

As at June 30, 2020, the expected increase or decrease in net assets attributable to holders of redeemable units of the Fund if the S&P/TSX composite index had increased or decreased by 5%, with all other variables held constant would amount to \$946,032 and would represent 4.5% of the net assets attributable to holders of redeemable units of the Fund (December 31, 2019 – \$1,129,950 representing 4.4% of the net assets attributable to holders of redeemable units of the Fund).

## Concentration risk

Concentration risk arises as a result of the concentration of exposure within the same category, whether it is geographical location, product type, industry sector or counterparty type. The following is a summary of the Fund's concentration risk by market segment over the total investments market value:

# Palos Equity Income Fund

## Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

Market segment	Percentage (%) of portfolio	
	June 30, 2020	December 31, 2019
Basic Materials	7.8	9.1
Communications	6.0	1.8
Consumer, Cyclical	8.4	7.2
Consumer, Non-cyclical	9.4	13.0
Energy	8.6	16.0
Financial	26.7	25.6
Funds	2.0	1.0
Industrial	12.3	8.9
Technology	5.1	3.2
Utilities	5.2	4.5
Bonds	8.4	9.6
Warrants	0.1	0.1
	100.0	100.0

Asset class weighting	Percentage (%) of Net Assets	
	June 30, 2020	December 31, 2019
Bonds	8.2	9.1
Common stock	89.9	86.0
Warrants	0.1	0.1
Other net assets	1.8	4.8

### Fair value measurement

The carrying amounts of receivable from investments sold, accrued income receivable, prepaid expenses, payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management fees payable approximate their fair values due to the short-term nature of these financial instruments.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

June 30, 2020	Level 1	Level 2	Level 3	Total
<b>Assets</b>				
Equity	\$ 18,909,766	\$ –	\$ –	\$ 18,909,766
Fixed Income	1,524,124	200,876	–	1,725,000
Warrants	10,573	12,630	–	23,203
	\$ 20,444,463	\$ 213,506	\$ –	\$ 20,657,969
<b>Assets</b>				
Equity	\$ 22,224,779	\$ –	\$ –	\$ 22,224,779
Fixed Income	2,128,854	203,250	–	2,332,104
Warrants	15,125	–	–	15,125
	\$ 24,368,758	\$ 203,250	\$ –	\$ 24,572,008
<b>Liabilities</b>				
Equities	\$ 272,000	\$ –	\$ –	\$ 272,000

All fair value measurements above are recurring. Fair values are classified as Level 1 when the related security or derivative is actively traded and a quoted price is available. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1. In such cases, the instruments are reclassified into Level 2, unless the measurement of its fair value requires the use of significant unobservable inputs, in which case it is classified as Level 3.

a) Equities and convertible bonds

The Fund's equity and convertible bond positions are classified as Level 1 when the security is actively traded and a reliable price is observable. All equities and convertible bonds are classified as Level 1 investments.

b) Bonds and short-term investments

Corporate bonds are valued using models with inputs including interest rate curves, credit spreads and volatilities. The inputs that are significant to valuation are generally observable and therefore the Fund's bonds and short-term investments have been classified as Level 2.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

## 6 Redeemable units

During the periods ended June 30, 2020 and 2019 the number of units issued, redeemed and outstanding were as follows:

	Redeemable Units, beginning of period	Redeemable Units Issued	Redemption of Redeemable Units	Reinvestments of Units	Redeemable Units, end of period
<b>June 30, 2020</b>					
Series A	2,976,153	52,485	(104,681)	25,870	2,949,827
Series F	1,379,500	7,626	(309,631)	9,721	1,087,216
<b>June 30, 2019</b>					
Series A	2,966,368	41,773	(98,164)	84,128	2,994,105
Series F	1,587,495	75,438	(68,267)	45,289	1,639,955

## Capital structure

Units issued and outstanding are considered to be the capital of the Fund. The Fund does not have any specific capital requirements.

The Fund is authorized to issue an unlimited number of redeemable unit series, as well as an unlimited number of redeemable units within each series. Each series unit enables its bearer to participate equally in the allocations the Fund completes for the given series. Unit fractions may also be issued.

The Fund is composed of more than one redeemable unit series; each redeemable unit series may feature different structures regarding management fees, performance fees and brokerage. As a result, each redeemable unit entitles its holder to one vote and to participate equally in the allocations the Fund completes and, in the case of Fund liquidation, in the allocation of the redeemable unit series' net assets attributable to holders of redeemable units after all current liabilities have been paid.

## 7 Related party transactions

### a) Management fees and performance fees

The Manager provides management and advisory services to the Fund in accordance with the agreement. In return for these services, the Manager is paid a management fee and a performance fee. The Series A units of the Fund are subject to a monthly management fee equal to 1/12 of 1.5% of the net asset value of the Series A units. The Manager will pay a trailer fee of 0.75% out of the management fees collected from the Fund with respect to Series A units.

# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

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(expressed in Canadian dollars)

Series F is similar to Series A, but no trailer fee is included in the management fee. Series F charges a monthly management fee of 1/12 of 0.75% of the NAV of Series F.

Based on the agreement amended and restated on August 26, 2013, the performance fee is 20% of the amount by which the Fund outperforms its benchmark, the S&P/TSX Composite Index. Performance fees are paid annually.

The total management fees and performance fees for the period ended June 30, 2020 amounted to \$157,276 and \$0 respectively (June 30, 2019 – \$187,382 and nil respectively), with \$23 in outstanding fees due to the Manager as at June 30, 2020 (December 31, 2019 – nil).

The Manager may waive or absorb the operation of management fees of the Fund. The decision to do so is reviewed regularly and is determined at the sole discretion of the Manager. During the period, the Manager did not waive any fees (2019 – did not waive any fees).

b) Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the period ended June 30, 2020 amounted to \$5,984 (June 30, 2019 – \$5,951) and consisted only of fixed fees.

## 8 Brokerage commissions and soft dollars

The total commissions paid by the Fund to brokers in connection with portfolio transactions for the periods ended June 30, 2020 and 2019, together with other transaction charges, are disclosed in the statements of comprehensive income (loss) of the Fund. Brokerage business is allocated to brokers based on the best net result for the Fund. Subject to this criteria, preference may be given to brokerage firms which provide (or pay for) certain services (arrangements referred to as soft dollar), which may include investment research, analysis and reports, and databases or software in support of these services. The ascertainable soft dollar value received as a percentage of total brokerage commissions paid during the periods ended June 30, 2020 and 2019 is disclosed below.

	<b>2020</b>	<b>2019</b>
Soft dollars	\$1,738	\$2,408
Percentage of total transaction costs (%)	6%	9%



# Palos Equity Income Fund

Notes to financial statements (unaudited)

As at June 30, 2020

(expressed in Canadian dollars)

## 9 Increase in net assets attributable to holders of redeemable units per series per unit

The increase in net assets attributable to holders of redeemable units per series per unit for the periods ended June 30, 2020 and 2019 is calculated as follows:

	Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Series	Weighted Average of Redeemable Units Outstanding During the Period	Increase (Decrease) in Net Assets Attributable to Holders of Redeemable Units per Unit
<b>June 30, 2020</b>			
Series A	\$ (1,695,225)	2,959,031 \$	(0.57)
Series F	(1,090,555)	1,255,552	(0.87)
<b>June 30, 2019</b>			
Series A	\$ 1,679,995	2,973,812 \$	0.56
Series F	996,989	1,600,210	0.62

## 10 Taxes

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada).

All or substantially all of the net income for tax purposes and net taxable capital gains realized in any period, after use of loss carryforwards, are distributed to unitholders such that no income taxes are payable by the Fund.

Capital and non-capital losses determined for tax purposes as at December 31, 2019 are nil.