

PALOS

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Weekly Commentary

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By Charles Marleau, CIM

ATS - Powering the Transition to an Automated World

ATS Automation Tooling Systems Inc. (ATA: TSX) is a Cambridge, Ontario based company that designs and furnishes automated manufacturing equipment for the automotive, electronics, pharmaceutical, chemicals, and energy industries. ATS has more than 50 offices worldwide and 22 manufacturing facilities located in North America, Europe, China, and Southeast Asia. European operations account for roughly half of the company's revenues. The company specializes in high precision and customized solutions that are designed to meet each customer's specific needs.

ATS Life Sciences, which provides and services high-quality systems to the pharmaceuticals, medical device, diagnostics, and containment equipment industries, accounts for roughly 50% of revenues. The **ATS Mobility, Nuclear, and Specialty Automation** segment, based in Germany, is an "end-to-end" automated assembly and test solutions provider with high level expertise in EV battery production for the electric mobility industry. The company also provides after-sales services which includes training, technical support, and maintenance. Management recognizes that servicing is a high-margin, recurring source of revenues that reduces sensitivity to the business cycle.

Since late 2018, ATS has made several key acquisitions which will serve to complement existing expertise. In 2018, ATS bought German company KMW, a supplier custom assembly systems and components used in EV technology. In early 2019, ATS acquired Italian company Comencer S.p.A, a business that designs and manufactures components for the radiopharmaceuticals market. Comencer's mission is to continuously improve the accuracy and safety of its systems. Late last year, ATS purchased German company iXLOG, a Germany based consulting company that specializes in analytics, optimization, and cloud-based solutions for business data processing.

The company released its Q1 results on Aug. 12. Like many companies in the industrial sector, Covid-19 had an impact on ATS' operations and production efficiency. Compared to the same quarter in 2019, revenues fell 4% to \$324.9 million, operating margin fell 6%, order bookings were 23% lower, and order backlog decreased 7% to CAD\$ 909 million from CAD\$982 million a year ago. Services revenues declined 19%, largely due to travel restrictions and temporary closures of some client facilities. On the earnings call, CEO Andrew Hider commented that "the presence of a healthy backlog, strong balance sheet, and resilient workforce provides an advantage for ATS."

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In response to Covid-19, attentiveness was paid to facility cleansing, physical distancing of employees, flexible work hours, and remote work capabilities. These measures allowed all global facilities to remain open, although admittedly less efficient. Revenues generated by ATS Life Sciences rose 6% as some customers ramped up production of personal protective equipment (PPE) and other health related products that are needed to fight the pandemic. The ATS business model (ABM) has adjusted to recent challenges by making improvements to virtual capabilities in remote operations, training, and on-demand programs.

Looking forward, international trade disputes and Covid-related supply chain disruptions will likely hasten a shift to a repatriation of manufacturing and a localization of supply chains. ATS is well positioned to capitalize on such a transition, and I maintain a positive outlook. Following a strong rally off the March lows, ATA made a new 18 month high on May 26 (\$23.07). However, the stock sold off during June and July, bottoming at \$16.96 on July 30. At this point, we viewed the selloff as unwarranted and we began accumulating shares for The Palos Income Fund.

Disclaimer: Palos Funds are shareholders of ATA.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$7.74	-3.19%
Palos Equity Income Fund - RRSP	PAL101	\$5.54	-1.82%
Palos Merchant Fund L.P. (Dec 31, 2019) ²	PAL500	\$1.71	20.15%
Palos WP Growth Fund - RRSP	PAL210	\$8.99	17.35%
Palos-Mitchell Alpha Fund ³	PAL300	\$9.10	-12.31%
S&P TSX Composite (Total Return with dividends reinvested)			-1.11%
S&P 500 (Total Return with dividends reinvested)			6.46%
S&P TSX Venture (Total Return with dividends reinvested)			26.70%
Chart 2: Market Data ¹			Value
US Government 10-Year			0.63%
Canadian Government 10-Year			0.54%
Crude Oil Spot			US \$42.34
Gold Spot			US \$1934.60
US Gov't10-Year/Moody BAA Corp. Spread			268 bps
USD/CAD Exchange Rate Spot			US \$0.7589

¹ Period ending August 21, 2020. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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