

# PALOS

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## Weekly Commentary

Issue No. 11 | MARCH 15, 2021

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## Tourmaline Oil – Canada’s Kings of Natural Gas

**Tourmaline Oil Inc.** (TSX: TOU) is a senior oil and gas exploration and production company and Canada’s largest producer of natural gas. Tourmaline’s portfolio of operations focuses on the Western Canadian Sedimentary Basin and includes three core areas. The Alberta Deep Basin is regarded as Alberta’s largest natural gas field. Assets in the play includes ownership interests in thirteen natural gas plants. The company’s goal is to optimize cost management to become one of the major natgas producers in the area. The Montney complex in North Eastern B.C. is rich in gas and condensates. TOU is one of the largest producers in the Montney with current production around 135,000 boepd and a 2021 production target of 155,000 to 160,000 boepd. The Peace River/Charlie Lake holds lands and infrastructure that includes a working interest in 21 gas plants (14 are 100% owned), 19 compressor stations, storage facilities and oil processing.

TOU released Q4 and full-year 2020 results on March 11 and the results were impressive. The company achieved record production having exceeded 400,000 barrels of energy per day (boepd). Fourth quarter cash flow was C\$377 million (\$1.44/diluted share) and cash flow for the full year came in at C\$1.185 billion (\$4.36/diluted share). At prevailing market prices, management expects 2021 cash flow to increase to \$2.2 billion. The quarterly dividend was raised to \$0.16 per share from \$0.14 per share marking the fourth dividend hike since the first dividend was declared in March 2018. The dividend was fully funded from free cash flow.

Despite the challenges faced by the pandemic and plummeting prices last spring, the company had an excellent year. In October, **Topaz Energy Corp.** (TSX: TPZ) was spun off in an IPO that raised CAD\$230 million for Tourmaline. The TPZ spinoff was the biggest Canadian energy patch IPO since 2017 and TOU retained an ownership interest of 51.7%. In November TOU also announced the acquisitions of two Deep Basin producers. **Modern Resources** was acquired for \$73.75 million cash, 1.5 million TOU shares and the assumption of debt. **Jupiter Resources** was acquired for \$626 million in stock. The combined transactions added lands, infrastructure, and additional production of 76,000 boepd which was immediately accretive to cash flow.

There is plenty of reason for optimism. Tourmaline scores well on the ESG front (environmental-social-governance) having the lowest GHG emissions intensity amongst its senior Canadian peers. The company achieved a 46% reduction in CO2 emissions between 2013-2018 and is also targeting a 25% reduction in methane emissions by 2027. Scoring well on ESG has become an important consideration as institutional

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investors have increased scrutiny on ESG metrics. A continuous commitment to technological and engineering advances has realized operating cost reductions of +50% since 2012.

TOU has become a top six, gas focused North American supplier and we believe this trend will continue. Management is committed to a gradual organic growth strategy and a pledge to only acquire assets if deemed attractive and accretive. The balance sheet is in excellent shape and the company has a BBB rating by DBRS (Dominion Bond Rating Service). We initially invested in TOU on September 24, 2019 and we hold shares in both **The Palos Equity Income Fund** and the **Palos Income Fund LP**. Since our initial purchase TOU shares have increased by an impressive 97.2 % including dividends. Shares jumped 7.2% following the earnings announcement and closed at \$26.08 on Friday. Analyst price targets were raised across the street with TD raising to \$28 from \$24, CIBC to \$30 from \$28, National Bank to \$37.50 from \$30, and Canaccord Genuity to \$32.50 from \$24 (*source: Bloomberg*).

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) <sup>1</sup>	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.63	10.06%
Palos Equity Income Fund - RRSP	PAL101	\$7.03	10.17%
Palos Merchant Fund L.P. (Dec 31, 2020) <sup>2</sup>	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	\$24.82	55.49%
Palos-Mitchell Alpha Fund <sup>3</sup>	PAL300	\$13.17	10.70%
S&P TSX Composite (Total Return with dividends reinvested)			8.73%
S&P 500 (Total Return with dividends reinvested)			5.32%
S&P TSX Venture (Total Return with dividends reinvested)			12.23%
Chart 2: Market Data <sup>1</sup>			Value
US Government 10-Year			1.62%
Canadian Government 10-Year			1.59%
Crude Oil Spot			US \$65.61
Gold Spot			US \$1719.80
US Gov't10-Year/Moody BAA Corp. Spread			218 bps
USD/CAD Exchange Rate Spot			US \$0.8015

<sup>1</sup> Period ending March 12, 2021. Data extracted from Bloomberg

<sup>2</sup> Fund is priced annually

<sup>3</sup> Fund is priced weekly on Tuesdays

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