

PALOS

CONTENTS

Weekly Commentary

Issue No. 12 | MARCH 22, 2021

Bro Linen Inc. – Wash, Rise & Repeat the Dividend!	1
Palos Funds vs. Benchmarks (Total Returns)	3
Disclaimer & Contacts	4

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K-Bro Linen Inc. – Wash, Rise & Repeat the Dividend!

K-Bro Linen Inc. (TSX: KBL) is the largest provider of laundry and linen cleaning services in Canada. Founded in 1954 as Stork Diaper Service, the company has expanded its market to include healthcare, hospitality (hotels), and commercial operators. The Mississauga, ON based company operates facilities in metropolitan centers from Victoria to Quebec City. In November 2017, K-Bro entered the U.K. market (United Kingdom) with its acquisition of Fishers Topco Ltd., a leading laundry business with operations in Scotland and Northern England.

On March 19, 2020 KBL reported record annual revenue and EBITDA (*Earnings Before Interest, Taxes, Depreciation & Amortization*) for 2019. However, in tandem with the positive revenue news the company also announced that the Covid-19 pandemic would likely have a negative impact on the hospitality business. Little did we know how significant the impact on the hospitality sector would be. As investors began to digest the potential impact of Covid, shares in KBL stumbled from a post-earnings four year high to lows not seen since 2012 - a peak to trough correction of approximately 44 percent in a mere two weeks!

Clearly, the selloff was sparked by fear of the unknown which subsequently inspired an irrational wave of panicked selling. While the pandemic-related fear led many to conclude that the hospitality business would suffer, what was overlooked was the potential boost to the healthcare segment. Although some non-essential surgeries were postponed, increased demand for reusable personal protective equipment (PPE), higher hospitalization rates, and strong pricing softened the blow being felt in hospitality.

On March 18, 2021 KBL released its Q4 and full year 2020 results. On the company's earnings call with analysts, it was confirmed that reduced hotel occupancies and restricted travel led to unprecedented weakness in the hospitality segment. For Q3/2020 revenues were down by 63% from Q3/2019 and Q4/2020 revenues were lower by 70%. So far in 2021, hospitality related activity is down by 80%. Conversely, the healthcare segment saw revenues up by about 12% in Q3/2020 and higher by 18% in Q4/2020. So far in 2021, healthcare activity is comparable to levels seen in Q4/2020. Overall, in 2020 healthcare accounted for

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approximately 83% of consolidated revenues versus 57% in 2019, with much of this attributed to weakness in hospitality.

During the company's earnings conference call, Linda McCurdy (Director, President and CEO) commented that management was "very pleased with how quickly K-Bro adapted to an unprecedented crisis". For 2021, improvement is being anticipated in both segments and management is confident that the healthcare segment will continue to benefit from a trend towards outsourcing, reusable PPE, and an acceleration in delayed medical procedures. As the global vaccine rollout continues to gather momentum it is reasonable to expect that the hospitality segment will begin to recover in the latter half of this year. Overall, the company executed well in adapting to pandemic-related challenges in 2020.

K-Bro remains laser focused on maintaining their reputation as a best-in-class laundry business. The company has paid consistent monthly dividends (currently C\$0.10/month, 2.9% yield) for over fifteen years without reduction or interruption. From our perspective we value K-Bro as a dominant player in an industry characterized by recurring revenue streams and longer-term contracting. The industry is poised for consolidation and K-Bro's balance sheet strength and ample liquidity allows for the possibility of making opportunistic acquisitions.

On the heels of the March 18 earnings release shares in KBL rose by 2.6% to close at \$42.38, their highest close since March 11, 2020 and up 9.3% on the year. Shares have fully recovered from last spring's correction; yet another example that patience and discipline will always outperform fear and irrational selling. The **Palos Equity Income Fund** and the **Palos Income Fund LP** have held shares in KBL since our initial investment in January 2018. We consider KBL to be a core holding in our income generating portfolios.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.63	10.06%
Palos Equity Income Fund - RRSP	PAL101	\$7.02	9.92%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	\$24.47	53.29%
Palos-Mitchell Alpha Fund ³	PAL300	\$13.27	11.50%
S&P TSX Composite (Total Return with dividends reinvested)			8.78%
S&P 500 (Total Return with dividends reinvested)			4.54%
S&P TSX Venture (Total Return with dividends reinvested)			13.79%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.72%
Canadian Government 10-Year			1.59%
Crude Oil Spot			US \$61.42
Gold Spot			US \$1741.70
US Gov't10-Year/Moody BAA Corp. Spread			215 bps
USD/CAD Exchange Rate Spot			US \$0.8001

¹ Period ending March 19, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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