

PALOS

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Weekly Commentary

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Mullen Group Ltd. – Earnings and M&A Update

Mullen Group Ltd. (TSX: MTL) consists of a group of transportation companies that operate in three distinct business segments: **Less-than-Truckload (LTL)**, **Logistics & Warehousing (L&W)**, and **Specialized and Industrial Services (S&IS)**. While we wrote about Mullen in our February 19 Weekly Commentary (Issue No. 7), we are following up on the heels of Mullen’s Q1/2021 earnings call that was held last Thursday (April 22). In January, Mullen management disclosed their intention to pursue strategic acquisitions in the **LTL** and **L&W** segments. True to their word, Mullen moved forward with two acquisitions in the first quarter.

On March 8, MTL announced their intention to acquire Mississauga based **APPS Transport Group Inc. (APPS)**, a well-established and highly regarded operator located in the Greater Toronto Area (GTA). The company also operates five locations in Western Canada making for a good fit with MTL’s existing network. APPS focuses on its commercial supply chain business (food, beverage, retail) and has expertise in both business-to-business (B2B) and business-to-consumer (B2C). The dramatic shift towards “direct-to-consumer” delivery, an obvious byproduct of the growth in digital commerce, shows no signs of diminishing.

On April 16, Mullen confirmed it was acquiring B.C. based **Bandstra Group**. Established in 1955, Bandstra is a family run business with a long history in servicing the transportation and logistics needs of Northern B.C. The acquisition includes **Bandstra Transportation (BT)**, and **Babine Truck & Equipment Ltd.** Babine operates as an OEM (Original Equipment Manufacturer) trucking dealership offering Volvo and Mack truck sales, maintenance, and repair services. Considered a non-core business, Babine will slide into the Mullen Group’s **S&IS** segment. The senior management team at Bandstra, which includes members of the Bandstra family, has agreed to remain with the business. In the words of Murray Mullen (President, CEO and Chairman), “no one knows the Bandstra Group better than the Bandstra family”.

Mullen Group reported first quarter results on April 22 and Earnings per Share (EPS) that beat consensus estimates. This despite a year-over-year revenue decline of 8.7% (C\$291 million vs. C\$318 million in Q1/2020). Reduced business activity due to Covid-19 was cited as the main reason. The strongest performing segment was **LTL** as demand for trucking and transportation was robust while the weakest results came from **S&IS**. Despite the rebound in oil prices, S&IS revenues were impacted by muted drilling and exploration activity in Western Canada.

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Our expectation is that infrastructure activity should increase as the impact of Covid-19 restrictions diminish. Pipeline completions (Trans Mountain and Coastal Gas link) have been pushed out to 2023. However, once the much-needed export infrastructure is completed, we expect to see a resurgence in exploration and drilling activity. The pipelines will need to be filled and this bodes well for the **S&IS** segment. At the same time, the oil & gas industry is undergoing rapid change as climate change and decarbonization have become hot political issues. In response, MTL is preparing for the future by developing new technologies designed to reduce the environmental impact of the oil industry. Let's not kid ourselves: the oil industry isn't vanishing any time soon.

With vaccination rates accelerating and many regions of the U.S. economy re-opening, activity in the U.S. transportation sector is rapidly picking up steam. Bottlenecks and pricing pressures have already begun to appear. The **Baltic Dry Index (BDI)**, a widely followed leading indicator of global marine shipping prices, recently hit its highest level since 2010. The **Dow Jones Transportation Average**, another leading indicator, is making new all-time highs. The "transports" are up 21% year-to-date and a remarkable 124% from the March 2020 low. Increasing demand for transportation and logistics services puts pricing leverage in the hands of suppliers – good news for Mullen Group.

We believe management will continue to hunt for attractively valued assets while remaining conservative and prudent in their approach to making acquisitions. The company continues to buy back its own stock as management shares our view that its shares are undervalued. Always looking to the future, the company is expanding on its commitment to ESG best practices. For example, Mullen has already begun transitioning its short-haul delivery fleet to electric or hybrid-electric vehicles, scoring valuable points on the ESG front. Positive ESG scores have become an important screening criterion for many institutional investors.

The future looks bright for Mullen. The **Palos Income Fund LP**, the **Palos Equity Income Fund**, and the **Palos-Mitchell Alpha Fund** are currently invested in MTL shares.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$9.56	11.58%
Palos Equity Income Fund - RRSP	PAL101	\$7.09	11.44%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	\$23.62	47.99%
Palos-Mitchell Alpha Fund ³	PAL300	\$11.84	12.41%
S&P TSX Composite (Total Return with dividends reinvested)			10.56%
S&P 500 (Total Return with dividends reinvested)			11.79%
S&P TSX Venture (Total Return with dividends reinvested)			6.35%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.56%
Canadian Government 10-Year			1.52%
Crude Oil Spot			US \$62.14
Gold Spot			US \$1777.00
US Gov't10-Year/Moody BAA Corp. Spread			202 bps
USD/CAD Exchange Rate Spot			US \$0.8016

¹ Period ending April 23, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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