

PALOS

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Weekly Commentary

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Capital Power Corp. – Set to Capitalize on Carbon Capture Technology

Capital Power Corporation (TSX: CPX) operates a diversified portfolio of power generating facilities located in Canada (approx. 70%) and the United States (30%). Power is generated from both thermal and renewable sources; however, the company aspires to achieve carbon neutrality by 2050. To reach its lofty goals, CPX is focusing on developing innovative technologies that extend well beyond wind and solar alone.

Thermal power generating facilities, which includes natural gas fired turbines, produce a carbon footprint that is largely unavoidable. To offset this the company is committed to investing in technologies like carbon capture and sequestration. CPX has invested over C\$40 million in carbon capture research. Recognizing that reducing carbon emissions is not a single solution problem, the company believes that a mix of solutions that combines renewables, carbon capture, emissions reducing technologies, and higher efficiency is the optimal course to long term sustainability.

Carbon capture, utilization, and storage (CCUS) is at the forefront. In simple terms, CCUS involves the capture of carbon dioxide (CO₂) that is created during the fossil fuel combustion process. Once captured, CO₂ can be physically transported by pipeline or ship and deployed as a resource for other industrial uses or buried underground. Thus, the removal of carbon from the atmosphere is achievable and capable of generating “negative emissions”. As governments around the world increase their efforts to battle climate change, CCUS is seeing a significant rise in capital allocation, research, and deployment.

Capital Power released Q1/2021 numbers on April 30 and results exceeded expectations. EBITDA was 29% higher compared to 2020 as a February cold snap led to elevated demand and strong pricing in Q1. Regarding the renewables portfolio, development and construction of seven new projects are on budget and on time. Commercial operations are scheduled to begin in the first quarter of 2022. The company also reported that the repowering of the Genesee 1 and 2 facilities, which are being converted to natural gas fired turbines from coal, is targeted for late 2023 and 2024, respectively.

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CPX also reported on CO2 reduction initiatives that are currently underway. The Genesee Carbon Conversion Center is expected to be operational by mid-2022. The first phase of this C\$ 1.6 billion project will apply CCUS technologies at Genesee 1 and 2. This initiative should deliver 3 million tonnes of carbon emission reductions per year; viewed as a significant amount. Well documented in the news of late is our government's urgent desire to significantly reduce carbon emissions by 2030. As the cost of carbon will surely rise, so too will government commitments to incentivizing carbon capture and storage.

The Biden and Trudeau administrations are signaling an aggressive approach to carbon reduction and this will be extremely supportive of CCUS. Bottom line: government will continue to throw cash at carbon reduction and the development of renewable energy sources. In our opinion, a win-win for Capital Power. The company has a market capitalization of C\$ 4.4 billion and currently pays an attractive monthly dividend of C\$0.5125 per share (5.13% yield). Following the earnings release the stock closed at an all-time high of C\$39.19 on the TSX. The **Palos Income Fund LP** and the **Palos Equity Income Fund** have held shares in CPX since June 2019.

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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	12.43%
Palos Equity Income Fund - RRSP	PAL101	\$7.09	12.37%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL210	\$23.62	52.61%
Palos-Mitchell Alpha Fund ³	PAL300	\$11.84	13.76%
S&P TSX Composite (Total Return with dividends reinvested)			10.64%
S&P 500 (Total Return with dividends reinvested)			11.83%
S&P TSX Venture (Total Return with dividends reinvested)			9.17%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.63%
Canadian Government 10-Year			1.55%
Crude Oil Spot			US \$63.58
Gold Spot			US \$1767.70
US Gov't10-Year/Moody BAA Corp. Spread			199 bps
USD/CAD Exchange Rate Spot			US \$0.8137

¹ Period ending April 30, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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