

PALOS

CONTENTS

Weekly Commentary

Issue No. 23 | JUNE 7, 2021

| | |
|---|---|
| Topaz Energy Corp. – Sustainable Dividend Growth in Energy | 1 |
| Palos Funds vs. Benchmarks (Total Returns) | 3 |
| Disclaimer & Contacts | 4 |

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Topaz Energy Corp. – Sustainable Dividend Growth in Energy

Topaz Energy (TPZ: TSX) is a Canadian royalty and energy infrastructure company focused on free cash flow generation and sustainable dividend payments to shareholders. Topaz was established in 2019 through a strategic partnership and asset acquisition from Tourmaline Oil. The initial acquisition was comprised of a gross overriding royalty interest (GORR) on approximately 90% of Tourmaline’s developed and undeveloped lands, a non-operating joint interest in 45% of Tourmaline’s natural gas producing facilities (including long term “take-or-pay” commitments), and an interest in third-party processing and handling agreements.

Topaz’ approach to growth centers on the pursuit of high-quality acquisitions that offer compelling long-term contracting and stable revenue streams. The business model is highly scalable. Key to the strategy is the ability to offset operational responsibilities which allows management to remain focused on building revenue streams, identifying accretive opportunities and managing non-operational financial risk.

TPZ announced Q1/2021 results on May 6. Revenue and other income showed a 66% improvement over Q1/2020. Improved performance was driven by 13% royalty production volume growth, 75% higher processing revenues, and improvements in Canadian natural gas prices pricing (+55% AECO). A dividend of \$0.20/share was paid in Q1/2021 which equates to a payout ratio of 65% versus a payout ratio of 77% in Q1/2020. Topaz is well-funded to execute on its growth strategy with \$95 million in cash and access to a \$300 million credit facility. Acquisitions will be disciplined with a focus on top quality, long-life resources with stable income potential.

Looking to the future, TPZ is well situated in the heart of Canada’s prolific reserves in the Montney and Alberta Deep Basin. The region’s proximity to Canada’s burgeoning liquified natural gas project (LNG Canada) being developed at Kitimat, BC bodes well for capitalizing on infrastructure and transportation needs tied to LNG Canada. The \$18 billion project is expected to be operational by late 2023.

On the ESG front, natural gas is widely accepted as the cleanest fossil fuel. With the well documented transition from coal-fired to natural gas power production, future demand should be robust. Further, recent

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declines in U.S. supply capabilities combined with significant drawdowns in storage is a tailwind for natgas pricing. Tourmaline is recognized as Canada's premier natural gas operator and the strong relationship with Topaz is clearly a mutual benefit.

The **Palos Income Fund LP** and the **Palos Equity Income Fund** currently hold shares in Topaz Energy. The company has a market cap of C\$1.65 billion and a sustainable dividend yield of 5.5%. We initialized our position in TPX on April 27, 2021 at \$14.30 per share. At the close of trading last Friday (June 4), TPZ shares were trading at \$14.66 for a modest short-term gain of gain of 1.6%. Since the company's reorganization in Q1 2019, shares are higher by 16% including dividends.

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| Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹ | FundServ | NAVPS | YTD Returns |
|--|----------|---------|--------------|
| Palos Income Fund L.P. | PAL100 | \$9.87 | 15.26% |
| Palos Equity Income Fund - RRSP | PAL101 | \$7.35 | 15.53% |
| Palos Merchant Fund L.P. (Dec 31, 2020) ² | PAL500 | \$1.35 | -21.15% |
| Palos WP Growth Fund - RRSP | PAL210 | \$24.01 | 50.42% |
| Palos-Mitchell Alpha Fund ³ | PAL300 | \$12.39 | 17.70% |
| S&P TSX Composite (Total Return with dividends reinvested) | | | 16.21% |
| S&P 500 (Total Return with dividends reinvested) | | | 13.34% |
| S&P TSX Venture (Total Return with dividends reinvested) | | | 11.78% |
| Chart 2: Market Data ¹ | | | Value |
| US Government 10-Year | | | 1.55% |
| Canadian Government 10-Year | | | 1.46% |
| Crude Oil Spot | | | US \$69.62 |
| Gold Spot | | | US \$1889.80 |
| US Gov't10-Year/Moody BAA Corp. Spread | | | 197 bps |
| USD/CAD Exchange Rate Spot | | | US \$0.8275 |

¹ Period ending June 4, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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