

PALOS

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Weekly Commentary

Issue No. 43 | OCTOBER 25, 2021

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By Charles Marleau CIM[®] and William Mitchell CIM[®]

LNG Canada: Securing Markets for Canadian Natural Gas Producers

In October 2018, a consortium led by **Royal Dutch Shell Plc (RDS)** announced a final investment decision (FID) to proceed with plans to build a massive liquified natural gas (LNG) processing and exporting facility on Canada's west coast. The 'mega-project', located at Kitimat B.C., is thought to be the largest privately funded venture in Canada's history. Through its ownership of **Shell Canada**, RDS will hold a 40% interest and include partners Petronas (25%), PetroChina (15%), Mitsubishi Corporation (15%), and Korea Gas Corporation (5%).

To safely export natural gas, it must first be transformed from a gas to a liquefied state. The liquification process requires the gas to be cooled to a temperature of at least -162°C. Once liquified, the volume is reduced to roughly 1/600th of its gaseous state. This facilitates the storage and transport of massive volumes of LNG on specially designed vessels. Given the locations where project partners are located, the destinations for LNG exportation will obviously be Asian markets (China, Japan, Korea, and Malaysia) where pricing power is significantly higher than in North America. It's important to note the competitive advantage versus U.S. Gulf Coast exporters. The distance and time (re: cost) of transporting LNG from B.C. to Asia will be reduced by approximately 50 percent compared to U.S. Gulf Coast LNG which currently routes via the Panama Canal.

Feedstock natural gas will be transported by a pipeline infrastructure system called the Coastal Gas Link (CGL). **TC Energy (TSX/NYSE: TRP)** is leading the transportation system project which includes private equity partner KKR and the Alberta Investment Management Corporation (AIMCO). CGL has agreements in place with First Nations agreements which in turn will provide indigenous peoples with community-based business opportunities and thousands of jobs during and after the construction phase. For the Canadian gas industry, the bottom line will be better prices compared to current pricing power which is constrained by the fact that Canadian gas exports are sold entirely to North American markets.

According to the International Energy Agency (IEA), global demand for natural gas is expected to increase 45% by 2040 (source:). While environmental interests are generally opposed to growing our dependence on hydrocarbons, proponents argue that cleaner burning natural gas will serve as an important 'transitional' fuel as the world transforms from fossil fuels to renewables. Further highlighting Canada's exceptional

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commitment to reducing the carbon footprint of our energy sector, LNG Canada is committed to using hydro and efficient natural gas turbines for electricity consumption.

Once feedstock is transported to Kitimat, the process of transforming natural gas to LNG includes the removal of impurities and other fuels called ‘condensates’, or liquids. This includes propane, butane, and pentane. Liquids can be stored and resold to market for commercial use. Each processing terminal is called a ‘train’ and once the project is commissioned (mid-2025), there will be two operational trains with expansion capability that could double LNG production capacity and accommodate roughly one LNG vessel per day.

On October 6, LNG Canada announced that the \$40 billion project was 50 percent complete. When operational, the facility will put Canada in a position to capitalize on growing demand as natural gas displaces coal as a power generation feedstock. The benefit to Canada’s economy and social programs will be significant as the project could contribute \$23 billion in new government revenues over the next four decades and inject \$3.7 billion in GDP and \$475 million in annual tax revenues to B.C. coffers. Over the coming weeks we will turn our focus to identifying companies who stand to benefit as Canada transforms to become an important player on the global LNG stage.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$10.22	24.16%
Palos Equity Income Fund - RRSP	PAL101	\$7.86	24.36%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL213	\$26.32	64.87%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.75	28.95%
S&P TSX Composite (Total Return with dividends reinvested)			24.34%
S&P 500 (Total Return with dividends reinvested)			22.38%
S&P TSX Venture (Total Return with dividends reinvested)			8.48%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.63%
Canadian Government 10-Year			1.65%
Crude Oil Spot			US \$83.76
Gold Spot			US \$1795.50
US Gov't10-Year/Moody BAA Corp. Spread			170 bps
USD/CAD Exchange Rate Spot			US \$0.8086

¹ Period ending October 22, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188

F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110

F. +1 (647) 343-7772

www.palos.ca