

PALOS

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Weekly Commentary

Issue No. 45 | NOVEMBER 8, 2021

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

ARC Resources – Reports a Strong Earnings Beat

ARC Resources (TSX: ARX) is a leading Canadian energy company based in Calgary, AB. ARC owns a diverse portfolio of assets in the prolific Montney play, located in Alberta and Northeastern B.C.

ARC reported third quarter/2021 results on November 5. On the earnings call, President and CEO Terry Anderson highlighted the quarter's record production and free cash flow (FCF) per share, which topped the previous high mark set in 2006. Anderson also remarked that exceptional operational efficiencies and strong commodity prices provided tailwinds. ARC generated over \$500 million in FCF during Q3 (\$0.69/share), with most of the proceeds used to pay down debt and return capital to shareholders. The dividend was boosted by 52% to \$0.10 per share. Management also confirmed that beginning in September, a \$200 million NCIB (Normal Course Issuer Bid) was instituted, this based on management's conviction that the value of the business is underappreciated by the market. The NCIB permits ARC to repurchase approximately 3% of the float via the public market.

Last February, ARC announced its all-stock merger with **Seven Generations Energy Ltd. (TSX: VII)**, an \$8.1 billion merger that created Canada's sixth largest energy company. The merger created the Montney play's biggest operator, Canada's largest producer of condensates, also known as 'liquids', and the third-largest producer of natural gas in the country. In Q3, ARC produced more than 340,000 boe/day. The merger is roughly 90% complete and anticipated synergies of \$25 million are expected to be 'double' that amount by year end, clearly reflecting the success of the Seven Generations integration.

Management also commented on the Sunrise expansion project, a facility located in the Montney near Dawson Creek B.C. The project is designed to be amongst the lowest GHG (greenhouse gas) emitters in the Canadian energy space. Sunrise is connected to the BC Hydro grid which substitutes clean, renewable hydro for natural gas that would normally be used to fire energy generating turbines. This creates a 97% reduction in absolute emissions. Further enhancing the zero-emissions initiative, ARC built a water reservoir with a capacity of 200,000 cubic meters which reduces the impact of transporting water using gas powered trucks. Sunrise is recognized as the most efficient and profitable of ARC's assets and clearly demonstrates that environmentally responsible projects can create value.

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Of note, management announced that an agreement to supply feedstock into LNG Canada's pipeline network, called the **Coastal Gas Link (CGL)**, had been reached. While the counterparty in the agreement remains confidential, the deal is viewed as advantageous in terms of access to better pricing in overseas markets and capitalizes on Sunrise's relative proximity to pipeline infrastructure and the export facility under construction on the B.C. coast. The long-term agreement will feed 150 million cubic feet of gas into LNG Canada which equates to about 12% of ARC's natural gas volumes, with the potential to grow.

In our view, ARC is an attractive investment due to its presence in the world-class Montney, operational expertise that positions ARC amongst the lowest cost producers, and a strong balance sheet that offers sustainable returns to shareholders. Further, we see value in ARC's impactful ESG commitment that encompasses an environmentally responsible approach to meeting the world's long-term energy needs, and the company's acknowledgement that recognizes the importance of improving community-based relationships and building inclusive business partnerships with Indigenous Peoples.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$10.25	24.59%
Palos Equity Income Fund - RRSP	PAL101	\$7.88	24.69%
Palos Merchant Fund L.P. (Dec 31, 2020) ²	PAL500	\$1.35	-21.15%
Palos WP Growth Fund - RRSP	PAL213	\$25.97	62.71%
Palos-Mitchell Alpha Fund ³	PAL300	\$10.96	31.44%
S&P TSX Composite (Total Return with dividends reinvested)			25.86%
S&P 500 (Total Return with dividends reinvested)			26.54%
S&P TSX Venture (Total Return with dividends reinvested)			12.64%
Chart 2: Market Data ¹			Value
US Government 10-Year			1.45%
Canadian Government 10-Year			1.59%
Crude Oil Spot			US \$81.27
Gold Spot			US \$1,816.80
US Gov't10-Year/Moody BAA Corp. Spread			173 bps
USD/CAD Exchange Rate Spot			US \$0.8029

¹ Period ending November 5th, 2021. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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