PALOS

Weekly Commentary

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By Charles Marleau CIM® and William Mitchell CIM®

Whitecap Resources – Impressive Cash Flow, a Sustainable Dividend, and ESG

Whitecap Resources Inc. (TSX: WCP) is a Calgary-based Canadian energy company with operations focused on high quality oil and natural gas producing assets in Eastern B.C./Western Alberta, Central Alberta, and Saskatchewan. In addition to oil and gas production and marketing, Whitecap is rapidly evolving to become a world leader in carbon capture, utilization and storage (CCUS). The company has a strong commitment to sustainability and strives for excellence in ESG (environmental, social, governance). WCP is a "net negative" producer of CO2 and we believe this uniquely differentiates WCP from many of its peers.

Whitecap released its Q4/2021 results on February 24. The company generated record cash flows in 2021 with Funds Flow of $1.1 billion (+72% year-over-year) and Free Funds Flow of $670 million (+92% year-over-year). Average production was 120,000 barrels of energy per day (boe/d), approximately three-quarters light oil and one-quarter natural gas. Strong prices for oil and gas bolstered the company's strategy to enhance the return of capital to shareholders.

On the earning call, management reiterated its plans to return capital through additional share buybacks and dividends as management announced a 33% dividend increase. This lifts the dividend yield to around 4% on an annual basis which according to management is sustainable at a WTI crude oil price of USD$45 per barrel, well above recent prices that are currently about USD$90 to USD$95/boe. With strength in prices expected to continue, the dividend is sustainable and has the potential to grow. Management further commented that hedging strategies can be used to ensure dividend sustainability. The current hedging book has 16% hedged in 2022 and 12% in 2023.

The balance sheet is in great shape with net debt of approximately $1.2 billion and over $800 million borrowing capacity. Recently, WCP arranged a sustainability-linked loan (SLL) credit facility. The loan is tied to meeting emissions reduction targets including a 15% reduction in scope 1 and scope 2 greenhouse emissions, and a 30% reduction in methane emissions by 2025. This creates a financial incentive to meet targets which should be viewed positively by investors who favor positive ESG initiatives.

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The day prior to the earnings release (Feb. 23), a multi-partner joint project to develop a world class CCUS “hub” in Fort Saskatchewan, AB was announced. The project’s partners include Wolfstream, North America’s largest private infrastructure operator and owner of the Alberta Carbon Trunk Line. Other partners include **Air Products and Chemicals Inc. (NYSE: APD)**, the First Nations Capital Investment Partnership (FNCIP) and Whitecap. The FNCIP includes four First Nations and is intended to incorporate indigenous rights, provide a beneficial economic interest, and enshrine environmental stewardship in infrastructure projects on indigenous lands.

In his closing remarks on the earnings call, Whitecap President and CEO Grant Fagerheim stated Whitecap is positioned to be a “world leader as the world transitions to a lower carbon economy”. We have met with management on several occasions over the past few years. In our view, Whitecap is a perfect example of a company that recognizes the importance of incorporating sustainability and ESG principles into its corporate culture. Executive compensation is tied to climate-related performance goals and Whitecap is a world leader in CO2 storage technology, currently sequestering 2MT (mega tons) of CO2 annually. Global demand for oil and gas will continue to rise and the transition to “green energy” will take decades to materialize. As we transition, many Canadian companies are paving the way for a more environmentally friendly way to produce and consume fossil fuels. In our view, Whitecap is a great “made in Canada” story that fits the bill.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$9.80	-0.41%
Palos Equity Income Fund - RRSP	PAL101	$7.20	-0.65%
Palos Merchant Fund L.P. (Dec 31, 2021) [2]	PAL500	$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	$17.33	-8.57%
Palos-Mitchell Alpha Fund [3]	PAL300	$9.76	-5.08%
S&P TSX Composite (Total Return with dividends reinvested)			-0.22%
S&P 500 (Total Return with dividends reinvested)			-7.80%
S&P TSX Venture (Total Return with dividends reinvested)			-10.95%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			1.96%
Canadian Government 10-Year			1.90%
Crude Oil Spot			US $91.59
Gold Spot			US $1,887.60
US Gov't10-Year/Moody BAA Corp. Spread			224 bps
USD/CAD Exchange Rate Spot			US $0.7873

[1] *Period ending February 25th, 2022. Data extracted from Bloomberg*

[2] *Fund is priced annually*

[3] *Fund is priced weekly on Tuesdays*

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