

# PALOS

## CONTENTS

## Weekly Commentary

Issue No. 12 | MARCH 21, 2022

Birchcliff Energy Ltd. – Well on the way to Returning Cash to Shareholders	1
Palos Funds vs. Benchmarks (Total Returns)	3
Disclaimer & Contacts	4

*By Charles Marleau CIM<sup>®</sup> and William Mitchell CIM<sup>®</sup>*

## Birchcliff Energy Ltd. – Well on the way to Returning Cash to Shareholders

**Birchcliff Energy (TSX: BIR)** is a Calgary-based Canadian energy company with production weighted in natural gas. Operations are focused in two areas of the B.C./Alberta Montney play: the “Pouce Coupe” and “Gordondale” areas of Alberta. Unconventional natural gas accounts for approximately 81% of production with condensates accounting for 8%, natural gas liquids 8% and light oil 3%.

The company reported its Q4/2021 and full year 2021 results on March 16. Production was pre-released on March 9. In Q4, cash flow generated from operations was \$193.7 million (\$0.70 per fully diluted share) which was a 176% increase from the same quarter in 2020. Full-year cash flow was an impressive and record-setting \$539.7 million (\$1.93 per fully diluted share). Production for the full year averaged 78,580 barrels of oil equivalent per day (BOE/D) which was in line with estimates.

Debt reduction remains a priority. Birchcliff ended the year with roughly \$500 million in net debt, a reduction of 22% for the quarter and 34% for the full year. BIR currently pays a dividend of \$0.01 per quarter (0.42% yield) which was doubled in Q3/2021. While the current yield is small, management has signalled that if pricing and cash flows stay consistent with recent levels there is significant potential for a dividend hike in 2022. Given current strip pricing there is the potential for a material increase in yield. We believe it’s fair to speculate that down the road a “special” dividend could be in the cards.

Capital expenditures in 2022 are expected to be in the neighborhood of \$250 million. Drilling will focus on bringing new wells online at Pouce Coupe (natural gas focused) and Gordondale (light oil and condensates). With the goal of maintaining annual production at a level comparable to 2021, the drilling program can be fully funded even if current prices were to be cut in half.

Over the past 12 months, U.S. natural gas prices, as measured by Henry Hub natural gas futures, have doubled since last spring and are higher by 30% year to date. European prices have been significantly more volatile with prices recently up by more than 10-fold since last summer. Natural gas prices have made headlines

*By Charles Marleau CIM<sup>®</sup> and William Mitchell CIM<sup>®</sup>*

recently as the conflict in Ukraine is likely to impact future Russian gas supplies to markets in Western Europe. The turmoil in energy markets has put future natural gas supply chains in focus around the globe.

Currently under development is the massive LNG Canada (liquified natural gas) project located on the western coast of B.C. The \$40 billion project passed its construction mid-point in January and while delays have occurred its hopeful that LNG exports will commence sometime in 2025. The LNG Canada facility has the potential to export over 2 billion cubic feet/day of LNG to markets in Asia, where pricing is much stronger than in North America. The Montney play, where Birchcliff operates, is located in close proximity to the B.C. coast. This bodes well for all Canadian producers over the long term given our vast resources, reputational stability and reliability.

In our view, Birchcliff is one of the best natural gas “pure plays” in Canada. Reserves are vast, the company owns infrastructure, and the management team that’s led by industry veteran Jeff Tonken is highly experienced. In addition, BIR has a policy of not hedging future prices which offers the flexibility to sell into whichever markets have the best pricing. The balance sheet is in great shape as debt is essentially “melting away”. The **Palos-Mitchell Alpha Fund** and The **Palos WP Growth Fund** are currently invested in shares of Birchcliff.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) <sup>1</sup>	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$10.11	2.76%
Palos Equity Income Fund - RRSP	PAL101	\$7.40	2.14%
Palos Merchant Fund L.P. (Dec 31, 2021) <sup>2</sup>	PAL500	\$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	\$17.73	-6.43%
Palos-Mitchell Alpha Fund <sup>3</sup>	PAL300	\$9.42	-8.34%
S&P TSX Composite (Total Return with dividends reinvested)			3.36%
S&P 500 (Total Return with dividends reinvested)			-6.05%
S&P TSX Venture (Total Return with dividends reinvested)			-9.06%
Chart 2: Market Data <sup>1</sup>			Value
US Government 10-Year			2.15%
Canadian Government 10-Year			2.19%
Crude Oil Spot			US \$104.70
Gold Spot			US \$1,929.30
US Gov't 10-Year/Moody BAA Corp. Spread			220 bps
USD/CAD Exchange Rate Spot			US \$0.7934

<sup>1</sup> Period ending March 18th, 2022. Data extracted from Bloomberg

<sup>2</sup> Fund is priced annually

<sup>3</sup> 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

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[www.palos.ca](http://www.palos.ca)