

Palos Equity Income Fund

Financial Statements

December 31, 2022 and 2021
(expressed in Canadian dollars)



Independent auditor's report

To the Unitholders and Trustee of Palos Equity Income Fund (the Fund)

Our opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2022 and 2021 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

What we have audited

The Fund's financial statements comprise:

- the statements of financial position as at December 31, 2022 and 2021;
- the statements of comprehensive income (loss) for the years then ended;
- the statements of changes in net assets attributable to holders of redeemable units for the years then ended;
- the statements of cash flows for the years then ended; and
- the notes to financial statements, which include significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in *the Auditor's responsibilities for the audit of the financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information of the Fund. The other information comprises the Management Report of Fund Performance and the information, other than the financial statements and our auditor's report thereon, included in the annual report.

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Our opinion on the financial statements does not cover the other information, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements of the Fund, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements of the Fund or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers LLP¹

Montréal, Quebec
March 29, 2023

¹ CPA auditor, public accountancy permit No. A124829

Palos Equity Income Fund

Statements of Financial Position

As at December 31, 2022 and 2021

(expressed in Canadian dollars)

	2022 \$	2021 \$
Assets		
Current assets		
Investments at fair value through profit or loss (FVTPL)	26,643,435	29,594,503
Cash	107,456	469,162
Accrued income receivable	100,952	78,817
Subscription receivable	-	5,950
Prepaid expenses	-	2,164
	<u>26,851,843</u>	<u>30,150,596</u>
Liabilities		
Current liabilities		
Distributions payable	17,069	375,698
Accrued liabilities	66,675	46,070
Management fees payable	-	658
	<u>83,744</u>	<u>422,426</u>
Net assets attributable to holders of redeemable units	<u>26,768,099</u>	<u>29,728,170</u>
Net assets attributable to holders of redeemable units per series		
Series A	20,332,452	22,004,759
Series F	6,435,647	7,723,411
	<u>26,768,099</u>	<u>29,728,170</u>
Net assets attributable to holders of redeemable units per series per unit		
Series A	6.51	7.24
Series F	7.05	7.77

Approved by the Manager, Palos Management Inc.

(s) Philippe Marleau, Director

The accompanying notes are an integral part of these financial statements.

Palos Equity Income Fund

Statements of Comprehensive Income (Loss)

For the years ended December 31, 2022 and 2021

(expressed in Canadian dollars)

	Note	2022 \$	2021 \$
Income			
Dividend income		653,414	544,599
Interest income for distribution purposes		148,041	119,027
Net realized gain on sale of investments		428,539	3,197,818
Net change in unrealized appreciation (depreciation) of investments		(3,095,559)	2,356,208
		<u>(1,865,565)</u>	<u>6,217,652</u>
Expenses			
Management fees	7	419,297	419,164
Administration and other professional fees		92,965	95,216
Legal fees		64,687	68,464
Audit fees		49,366	50,400
Transaction cost		44,004	51,379
Bank charges and interest		24,782	18,872
Trustee fees		13,834	13,834
Independent review committee fees		12,001	12,001
Withholding tax expense		768	1,462
		<u>721,704</u>	<u>730,792</u>
Increase (decrease) in net assets attributable to holders of redeemable units		<u>(2,587,269)</u>	<u>5,486,860</u>
Increase (decrease) in net assets attributable to holders of redeemable units per series			
Series A		(1,963,651)	3,903,744
Series F		(623,618)	1,583,116
		<u>(2,587,269)</u>	<u>5,486,860</u>
Increase (decrease) in net assets attributable to holders of redeemable units per unit			
Series A	9	(0.63)	1.39
Series F		(0.66)	1.62

The accompanying notes are an integral part of these financial statements.

Palos Equity Income Fund

Statements of Changes in Net Assets Attributable to Holders of Redeemable Units

For the years ended December 31, 2022 and 2021

(expressed in Canadian dollars)

	Net assets attributable to holders of redeemable units, beginning of year \$	Proceeds from redeemable units issued \$	Redemption of redeemable units \$	Distributions to holders of redeemable units* \$	Reinvestment of distribution to holders of redeemable units \$	Increase (decrease) in net assets attributable to holders of redeemable units \$	Net assets attributable to holders of redeemable units, end of year \$
December 31, 2022							
Series A	22,004,759	1,771,394	(1,431,581)	(310,700)	262,231	(1,963,651)	20,332,452
Series F	7,723,411	450,410	(1,093,524)	(92,848)	71,816	(623,618)	6,435,647
	29,728,170	2,221,804	(2,525,105)	(403,548)	334,047	(2,587,269)	26,768,099
December 31, 2021							
Series A	17,923,956	1,581,179	(1,139,303)	(1,542,506)	1,277,689	3,903,744	22,004,759
Series F	7,251,553	477,540	(1,423,775)	(731,226)	566,203	1,583,116	7,723,411
	25,175,509	2,058,719	(2,563,078)	(2,273,732)	1,843,892	5,486,860	29,728,170

* Detailed distributions to unitholders

	From net investment income \$	From net realized gains on investments and derivatives \$	From return of capital \$	Total distributions to unitholder \$
December 31, 2022				
Series A	-	133,357	177,343	310,700
Series F	-	46,706	46,142	92,848
	-	180,063	223,485	403,548
December 31, 2021				
Series A	-	1,542,506	-	1,542,506
Series F	-	731,226	-	731,226
	-	2,273,732	-	2,273,732

The accompanying notes are an integral part of these financial statements.

Palos Equity Income Fund

Statements of Cash Flows

For the years ended December 31, 2022 and 2021

(expressed in Canadian dollars)

	2022 \$	2021 \$
Cash provided by (used in)		
Operating activities		
Increase (decrease) in net assets attributable to holders of redeemable units	(2,587,269)	5,486,860
Adjustments for non-cash items		
Net realized gain on sale of investments	(428,539)	(3,186,824)
Net change in unrealized (appreciation) depreciation of investments	3,095,559	(2,367,202)
Foreign exchange on cash	(899)	(13,546)
Change in non-cash balances		
Increase in accrued income receivable	(22,135)	(17,982)
Decrease in prepaid expenses	2,164	37
Increase in accrued liabilities	20,605	3,677
Decrease in management fees payable	(658)	(423)
Proceeds from sale of investments	20,489,786	20,646,728
Purchase of investments	(20,205,738)	(20,831,728)
	<u>362,876</u>	<u>(280,403)</u>
Financing activities		
Proceeds from issuance of redeemable units	2,227,754	2,057,218
Amount paid on redemption of redeemable units	(2,525,105)	(2,563,078)
Distributions paid to holders or redeemable units, net of reinvested distributions	(428,130)	(72,747)
	<u>(725,481)</u>	<u>(578,607)</u>
Cash used in financing activities		
	<u>(725,481)</u>	<u>(578,607)</u>
Decrease in cash during the year	(362,605)	(859,010)
Foreign exchange gain on cash	899	13,546
	<u>469,162</u>	<u>1,314,626</u>
Cash – Beginning of year		
	<u>469,162</u>	<u>1,314,626</u>
Cash – End of year		
	<u>107,456</u>	<u>469,162</u>
Supplemental information *		
Interest paid	729	1,095
Interest received	119,646	121,890
Dividends received, net of withholding taxes	644,997	521,786

* Included as a part of cash flows from operating activities

The accompanying notes are an integral part of these financial statements.

Palos Equity Income Fund

Schedule of Investment Portfolio

As at December 31, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
Investments owned (99.53%)				
Equities (96.24%)				
Basic material (7.51%)				
Agnico Eagle Mines Ltd.	CAD	4,061	246,608	285,732
Arizona Metals Corp	CAD	26,900	107,455	115,939
Firs Quantum Minerals Ltd.	CAD	10,500	221,654	297,045
K92 Mining Inc.	CAD	33,300	233,786	255,411
Nutrien Ltd.	CAD	2,662	213,385	263,139
Teck Resources Ltd.	CAD	8,050	273,636	411,919
Wheaton Precious Metals Corp.	CAD	7,200	340,610	380,880
			<hr/>	<hr/>
			1,637,134	2,010,065
Communications (3.37%)				
Shopify Inc.	CAD	6,050	346,380	284,411
TELUS Corp.	CAD	23,640	616,625	617,713
			<hr/>	<hr/>
			963,005	902,124
Consumer, cyclical (4.03%)				
ADENTRA Inc.	CAD	11,500	375,047	325,910
Canadian Tire Corp Ltd.	CAD	1,880	231,363	266,020
Pet Valu Holdings Ltd.	CAD	6,200	193,274	242,606
Pollard Banknote Ltd.	CAD	12,770	321,151	244,162
			<hr/>	<hr/>
			1,120,835	1,078,698
Consumer, non-cyclical (4.46%)				
Dentalcorp Holdings Ltd.	CAD	25,600	259,135	227,840
Green Thumb Industries Inc.	CAD	20,400	226,993	244,392
Neighbourly Pharmacy Inc.	CAD	9,324	256,979	218,088
Park Lawn Corp.	CAD	9,950	280,942	257,208
Savaria Corp.	CAD	17,540	246,771	245,385
			<hr/>	<hr/>
			1,270,820	1,192,913
Energy (18.02%)				
Advantage Energy Ltd.	CAD	10,429	110,424	98,763
Canadian Natural Resources Ltd.	CAD	9,200	419,371	691,748
CES Energy Solutions Corp.	CAD	61,000	140,509	168,360
Freehold Royalties Ltd.	CAD	18,000	191,574	284,940
Headwater Exploration Inc.	CAD	38,000	204,130	224,960
Keyera Corp.	CAD	11,820	335,860	349,754
Parkland Corp.	CAD	10,700	308,634	317,897
PHX Energy Services Corp.	CAD	21,700	137,890	168,609
Precision Drilling Corp.	CAD	2,550	159,158	264,461

The accompanying notes are an integral part of these financial statements.

Palos Equity Income Fund
Schedule of Investment Portfolio ...continued
As at December 31, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
Secure Energy Services Inc.	CAD	51,900	310,269	364,857
Spartan Delta Corp.	CAD	16,000	85,144	239,200
Surge Energy Inc.	CAD	23,000	209,533	209,530
Tamarack Valley Energy Ltd.	CAD	79,000	287,673	352,340
Topaz Energy Corp.	CAD	18,200	328,369	384,566
Tourmaline Oil Corp.	CAD	6,620	216,051	452,278
Trican Well Service Ltd.	CAD	68,900	205,422	252,174
			3,650,011	4,824,437
Financial (29.31%)				
Alaris Equity Partners Income	CAD	13,500	198,907	216,540
Bank of Montreal	CAD	11,108	1,164,110	1,362,507
Boardwalk Real Estate Investment Trust	CAD	5,467	212,247	270,234
Brookfield Asset Management Ltd.	CAD	3,000	120,500	116,310
Brookfield Corp.	CAD	6,200	237,646	263,996
BSR Real Estate Investment Trust	USD	13,600	221,437	239,807
Crombie Real Estate Investment Trust	CAD	18,260	295,698	289,604
Dream Industrial Real Estate Investment Trust	CAD	25,305	334,321	295,815
EQB Inc.	CAD	4,650	216,437	263,795
Flagship Communities REIT	USD	11,600	220,783	254,931
InterRent Real Estate Investment Trust	CAD	25,500	324,538	326,400
National Bank of Canada	CAD	6,610	421,565	603,030
Royal Bank of Canada	CAD	8,540	715,023	1,087,142
StorageVault Canada Inc.	CAD	40,820	118,654	245,736
The Bank of Nova Scotia	CAD	13,930	972,108	924,116
The Toronto-Dominion Bank	CAD	12,399	613,583	1,087,020
			6,387,557	7,846,983
Funds (6.59%)				
BMO Short Corporate Bond Index ETF	CAD	67,127	866,912	874,665
BMO Short Federal Bond Index ETF	CAD	67,130	887,245	890,144
			1,754,157	1,764,809
Industrial (11.04%)				
ATS Corp.	CAD	4,900	212,881	206,241
Badger Infrastructure Solution	CAD	3,000	74,717	79,980
Canadian National Railway Co.	CAD	2,640	304,067	424,618
Canadian Pacific Railway Ltd.	CAD	4,415	214,070	445,694
Cargojet Inc.	CAD	2,210	305,352	257,134
CCL Industries Inc.	CAD	3,760	180,916	217,478
GFL Environmental Inc.	CAD	7,200	229,568	284,688
H2O Innovation Inc.	CAD	30,000	64,852	77,100
Mullen Group Ltd.	CAD	19,100	214,953	277,905
NanoXplore Inc.	CAD	34,200	130,415	88,920
TFI International Inc.	CAD	2,255	198,987	305,801

Palos Equity Income Fund
Schedule of Investment Portfolio ...*continued*
As at December 31, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares	Average cost \$	Fair value \$
WSP Global Inc.	CAD	1,830	205,043	287,475
			<u>2,335,821</u>	<u>2,953,034</u>
Technology (5.89%)				
CGI Inc.	CAD	2,270	210,756	264,932
Constellation Software Inc.	CAD	125	240,269	264,245
Kinaxis Inc.	CAD	1,910	258,970	290,148
Magnet Forensics Inc.	CAD	8,450	274,832	313,918
Nuvei Corp.	CAD	6,960	365,752	239,494
Open Text Corp.	CAD	5,091	236,047	204,251
			<u>1,586,626</u>	<u>1,576,988</u>
Utilities (6.02%)				
AltaGas Ltd.	CAD	9,800	226,232	229,124
Brookfield Infrastructure Corp.	CAD	4,175	184,011	219,897
Brookfield Renewable Partners LP	CAD	8,650	324,399	296,522
Capital Power Corp.	CAD	6,120	211,028	283,540
Innergex Renewable Energy Inc.	CAD	17,100	314,383	277,020
Northland Power Inc.	CAD	8,218	294,185	305,134
			<u>1,554,238</u>	<u>1,611,237</u>
Total Equities			<u>22,260,204</u>	<u>25,761,288</u>

Palos Equity Income Fund
Schedule of Investment Portfolio ...continued
As at December 31, 2022

(expressed in Canadian dollars)

Description	Currency	Number of shares/ Nominal value	Average cost \$	Fair value \$
Fixed income (3.10%)				
Basic material (2.08%)				
Chemtrade Logistics Income Fund, 6.5% / Oct. 31, 2026 / CONV \$15.80	CAD	250,000	250,000	245,818
North American Construction Group Ltd., 5.5% / June 30, 2028 / CONV \$24.75	CAD	300,000	300,000	312,000
			<u>550,000</u>	<u>557,818</u>
Consumer cyclical (1.01%)				
Exchange Income Corp. 5.25% / Jan. 15, 2029 / CONV \$59.99	CAD	300,000	300,000	296,700
			<u>850,000</u>	<u>854,518</u>
Warrants (0.01%)				
Flow Beverage Corp. \$10 / June 29, 2023	CAD	5,220	5,220	26
The Lion Electric Co. \$2.80 / Dec. 13, 2027	USD	25,000	–	23,678
Star Royalties Ltd. \$1 / Feb. 19, 2024	CAD	85,000	7,565	2,125
Tidewater Midstream and Infrastructure Ltd. \$1.44 / Aug. 16, 2024	CAD	15,000	1,500	1,800
			<u>14,285</u>	<u>27,629</u>
Total investments owned			23,124,489	26,643,435
Commissions and other portfolio transaction costs			<u>(26,425)</u>	<u>-</u>
Net investments owned (99.53%)			<u>23,098,064</u>	<u>26,643,435</u>
Other assets, net (0.47%)				<u>124,664</u>
Net assets attribute to holders of redeemable units (100%)				<u>26,768,099</u>

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

1 General information

Palos Equity Income Fund (the Fund) was formed on January 3, 2008 under the laws of the Province of Quebec pursuant to a trust agreement, as amended for the last time on August 26, 2013, between Computershare Trust Company of Canada (the trustee) and Charles Marleau (the settlor). The address of the Fund's registered office is 1 Place Ville-Marie, Suite 1670, Montréal, Quebec, H3B 2B6 Canada. The Fund is an open-ended mutual fund, is qualified as a unit trust and is a registered investment fund under Section 204.4 of the Income Tax Act (Canada).

Series A opened on January 3, 2008, and Series F opened on February 24, 2012.

The Fund acts as an investment holding unit trust for the benefit of unitholders by acquiring, investing in, holding, transferring, disposing of, or otherwise dealing with such investments as the trustee and the investment fund manager determine, at their discretion, in accordance with the investment objectives of the Fund, which are to preserve capital, to provide an attractive and steady stream of income and to deliver trading-enhanced returns.

The investment fund manager and portfolio advisor is Palos Management Inc. (the Manager).

These financial statements have been authorized for issue by the Board of Directors of the Manager on March 24, 2023.

2 Basis of presentation

These financial statements have been prepared in compliance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board.

3 Summary of significant accounting policies

Financial instruments

Classification

IFRS 9, Financial Instruments, sets out a classification and measurement model for financial assets to determine whether a financial asset should be classified at amortized cost, at fair value through profit or loss (FVTPL) or fair value through other comprehensive income (FVOCI). This model is based on the contractual cash flow characteristics of the financial asset and the business model under which the financial asset is held. The Fund manages its investments in financial assets with the objective of realizing cash flows through both the sale of the assets and income generated from those assets. The Manager makes decisions based on the assets' fair values and manages the assets to realize those fair values.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

IFRS 9 requires that an entity recognize a loss allowance for expected credit losses on financial assets which are measured at amortized cost or FVOCI. Financial assets held by the Fund which are measured at FVTPL will not be subject to the recent impairment requirements.

With respect to receivables, the Fund considers both historical analysis and forward-looking information in determining any expected credit loss. As at the statement of financial position dates, all receivables are due to be settled within the short term. The Fund considered the probability of default to be close to zero as these instruments have a low risk of default and the counterparties have a strong capacity to meet their contractual obligation in the near term. Given the limited exposure of the Fund to credit risk from financial assets recorded at amortized cost, no loss allowance has been recognized as any such impairment will not have a significant impact on the financial statements.

Recognition

Regular-way purchases and sales of financial assets are recognized at their trade date. Transaction costs are expensed as incurred in the statements of comprehensive income (loss). The Fund's investment assets and liabilities are measured at FVTPL, including certain investments in debt securities which have been designated at FVTPL. The Fund's derivative and non-derivative investments are classified as FVTPL upon initial recognition. The Fund's obligation for net assets attributable to holders of redeemable units is classified as a financial liability at the redemption amount, which approximates fair value. The redemption amount is determined as the net difference between total assets and all other liabilities for which accounting policies are described herein. Under this method, financial assets and financial liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract's effective interest rate. The Fund's accounting policies for measuring the fair value of its investments and derivatives are identical to those used in measuring its net asset value (NAV) for transactions with unitholders.

Income recognition

The interest income for distribution purposes shown on the statements of comprehensive income (loss) represents the contractual interest accounted for on an accrual basis. The Fund does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds and loans which would be amortized on a straight-line basis. Dividend income is recorded on the ex-dividend date.

Realized gain on sale of investments and unrealized appreciation (depreciation) of investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial assets and financial liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Fund uses the last traded market price for both financial assets and financial liabilities where the last traded price falls within that day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, the Manager determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances.

The fair value of financial assets and financial liabilities that are not traded in an active market, including over-the-counter derivatives, is determined using valuation techniques. The Fund uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques include the use of comparable recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option-pricing models and others commonly used by market participants and which make the maximum use of observable inputs.

Investment entities

The Fund meets the definition in IFRS 10, Consolidated Financial Statements, for investment entities and accounts for its investments in underlying at FVTPL.

Structured entities

The Fund may invest in other investment funds (underlying funds) by holding redeemable shares of the underlying funds which entitle the holder to an appropriate share of the underlying funds' net assets. The Fund does not invest in underlying funds for the purpose of exercising management control. Such investments expose the Fund to the risk that underlying funds may not perform as expected and indirectly to all of the risks applicable to investments in underlying funds.

The carrying value of investments in underlying funds is included in Investment at fair value though profit or loss (FVTPL) in the statement of financial position and also represents the maximum exposure to losses. Changes in fair value of investments in underlying funds are included within net change in unrealized appreciation (depreciation) of investments in the statement of comprehensive income.

Classification of redeemable units

The Fund's outstanding redeemable units are in different series which do not have identical features. Consequently, the Fund's outstanding redeemable units are classified as financial liabilities and recorded as net assets attributable to holders of redeemable units, in accordance with the requirements of International Accounting Standard (IAS) 32, Financial Instruments: Presentation.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

Foreign currency translation

The Fund's subscriptions and redemptions are denominated in Canadian dollars, which is also its functional and presentation currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates that transactions occur. Foreign currency assets and liabilities denominated in a foreign currency are translated into the functional currency using the exchange rate prevailing at the measurement date. Foreign exchange gains and losses relating to cash and to other financial assets and financial liabilities are presented as net realized gain on sale of investments and net change in unrealized appreciation (depreciation) of investments in the statements of comprehensive income (loss).

Offsetting financial assets and financial liabilities

Financial assets and financial liabilities are offset in the Fund's statements of financial position when and only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. The Fund has a legally enforceable right to offset a financial asset and financial liability when such right is enforceable in the normal course of business and in the event of default, insolvency or bankruptcy.

Over-the-counter derivatives, securities lending, repurchase agreements and receivable for investments sold and payable for investments purchased are subject to master netting or similar agreements that do not meet the criteria for offsetting in the statements of financial position as they give a right to set-off that is enforceable only in the event of default, insolvency or bankruptcy.

Cash

Cash comprises deposits with financial institutions and bank overdraft.

Increase (decrease) in net assets attributable to holders of redeemable units per unit per series

The increase (decrease) in net assets attributable to holders of redeemable units per unit of each series is calculated by dividing the increase (decrease) in net assets attributable to holders of redeemable units of each series by the weighted average number of units outstanding during the year.

Taxation

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada). All of the Fund's net income for tax purposes and sufficient net capital gains realized in any period are required to be distributed to unitholders such that no income tax is payable by the Fund. As a result, the Fund does not record income taxes. Since the Fund does not record income taxes, the tax benefit of capital and non-capital losses has not been reflected in the statements of financial position as a deferred income tax asset.

The Fund currently incurs withholding taxes imposed by certain countries on investment income and capital gains. Such income and gains are recorded on a gross basis and the related withholding taxes are shown as a separate expense in the statements of comprehensive income (loss).

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

New standards, interpretations and amendments not yet adopted

There are no new standards, interpretations or amendments that have not yet been adopted, that would affect the Fund's financial statements.

4 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgments and estimates that the Manager has made in preparing the financial statements:

a) Classification and measurement of investment and application of the fair value option

In classifying and measuring financial instruments held by the Fund, the Manager is required to make significant judgments about whether or not the business of the Fund is to manage its portfolio of investments and evaluate performance on a fair value basis and that the portfolio of investments is neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets. The most significant judgments made include assessing and determining the appropriate business model that enables the decision that the Fund's investments are classified as FVTPL.

5 Risks associated with financial instruments

Risk factors

The Fund's activities expose it to a variety of risks associated with financial instruments, as follows: credit risk, liquidity risk, market risk (including currency risk, interest rate risk and price risk) and concentration risk. The Fund's overall risk management program seeks to maximize the returns derived for the level of risk to which the Fund is exposed and seeks to minimize potential adverse effects on the Fund's financial performance. All investments result in a risk of loss of capital. These risks are moderated through careful selection of securities and other financial instruments within the Fund's investment guidelines. The risks are measured using a method that reflects the expected impact on the results and net assets attributable to unitholders of the Fund from reasonably possible changes in the relevant risk variables.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

Credit risk

The Fund is exposed to credit risk, which is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The majority of the credit risk to which the Fund is exposed arises from its investments in debt securities. In selecting fixed income securities for the Fund, the Manager considers factors such as the debt security's yield, risk of interest rate fluctuation, credit risk, the issuer's capital structure, credit spread and duration. As at December 31, 2022, all investments in fixed income were non-rated (2021 – non-rated).

All portfolio transactions in securities are settled or paid for upon delivery using approved brokers. The risk of default is considered minimal as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities are received by the broker. The trade will not settle if either party fails to meet its obligation. In addition, the Fund lodges its cash with quality institutions. Credit risk with respect to accrued income receivable is limited as the receivables are derived from a portfolio of diversified investments.

The Fund's maximum exposure to credit risk is equal to the carrying value of the assets presented on the statements of financial position. The Fund does not anticipate any significant losses from the non-performance of counterparties.

Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. The Fund is exposed to daily cash redemptions. Financial liabilities that potentially subject the Fund to liquidity risk consist of payable for investments purchased, redemptions payable, distributions payable, accrued liabilities and management fees payable. The Fund's investment approach focuses on investing in highly liquid securities and moderately liquid securities, which are therefore readily saleable to meet liquidity needs.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

The Fund may invest in debt securities and unlisted equity investments that are not traded in an active market. As a result, the Fund may not be able to quickly liquidate its investments in these instruments at amounts which approximate their fair values, or be able to respond to specific events such as deterioration in the creditworthiness of any particular issuer. In accordance with the Fund's policy, the Manager monitors the Fund's liquidity position on a daily basis. The tables below analyze the Fund's financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. The amounts in the tables are the contractual undiscounted cash flows.

	2022		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Distributions payable	-	17,069	17,069
Accrued liabilities	-	66,675	66,675
Redeemable units	26,768,099	-	26,768,099

	2021		
Financial liabilities	On demand	< 3 months	Total
	\$	\$	\$
Distributions payable	-	375,698	375,698
Accrued liabilities	-	46,070	46,070
Management fees payable	-	658	658
Redeemable units	29,728,170	-	29,728,170

Redeemable units are redeemable on demand at the holder's option. However, the Manager does not expect that the contractual maturity disclosed above will be representative of the actual cash outflows, as holders of these instruments typically retain them for a longer period.

Market risk

The Fund's investments are subject to market risk which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. To monitor the risk, the Fund's Manager uses stress testing to examine the impact that abnormally large swings in market factors and periods of prolonged inactivity might have on trading portfolios. The stress testing is designed to identify key risks and ensure that the losses from abnormal events are not above the Fund's risk tolerance.

The following tables include sensitivity analyses that show how the net assets attributable to holders of redeemable units would have been affected by a reasonably possible change in the relevant risk variable at each reporting date. In practice, the actual results may differ and the difference could be material.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

a) Currency risk

The Fund invests in monetary assets denominated in currencies other than Canadian dollar. These investments result in currency risk, which is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The table below indicates the foreign currencies to which the Fund had significant exposure as at December 31, 2022 and 2021, in Canadian dollars. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the Canadian dollar had strengthened or weakened by 5% in relation to each of the other currencies, with all other variables held constant. The monetary exposure presents the impact on cash and the non-monetary exposure presents the impact on investments. Non-monetary items are investments in equity securities and are classified based on the currency in which they were purchased.

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary \$	Non-monetary \$	Total \$	Monetary \$	Non-monetary \$	Total \$
December 31, 2022						
US dollar	(113,120)	518,416	405,296	(5,656)	25,921	20,265
% of Net assets attributable to holders of redeemable units	(0.4)	1.9	1.5	0.0	0.1	0.1

Currency	Exposure			Impact if CAD strengthened or weakened by 5% in relation to other currencies		
	Monetary \$	Non-monetary \$	Total \$	Monetary \$	Non-monetary \$	Total \$
December 31, 2021						
US dollar	(22,717)	1,043,757	1,021,040	(1,136)	52,188	51,052
% of Net assets attributable to holders of redeemable units	(0.1)	3.5	3.4	-	0.2	0.2

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Fund holds securities with fixed interest rates that expose the Fund to fair value interest rate risk. The Fund also holds cash that is subject to variable interest rates which exposes the Fund to cash flow interest rate risk.

The Fund mitigates interest rate risk by monitoring interest rates and the maturities of its portfolio of interest-bearing financial instruments. The following table summarizes the Fund's exposure to interest rate risk. It includes the Fund's interest-bearing financial assets at fair value, categorized by the earlier of contractual interest rate reset dates or maturity dates. The table also illustrates the potential impact on the net assets attributable to holders of redeemable units if the prevailing levels of market interest rates changed by 1%, assuming a parallel shift in the yield curve with all other variables held constant.

Terms to maturity	2022 \$	2021 \$
1–5 years	245,818	634,736
5–10 years	608,700	628,050
Total	854,518	1,262,786
Impact on net assets attributable to holders of redeemable units	26,750	29,103
Impact on net assets attributable to holders of redeemable units (%)	0.1%	0.1%

c) Price risk

Price risk is the risk that the value of an investment will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual investment or its issuer, or by factors affecting all securities traded in the market. The Fund is exposed to price risk through its equity investment portfolio, which includes a variety of common shares in a wide range of industries. Other assets and liabilities are monetary items that are short term in nature, and as such are not subject to price risk.

As at December 31, 2022, the expected increase or decrease in net assets attributable to holders of redeemable units of the Fund if the S&P/TSX composite index had increased or decreased by 5%, with all other variables held constant, would amount to \$1,318,850 and would represent 4.9% of the net assets attributable to holders of redeemable units of the Fund (2021 – \$1,346,550 representing 4.5%).

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

Concentration risk

Concentration risk arises as a result of the concentration of exposure within the same category, whether it is geographical location, product type, industry sector or counterparty type. The following is a summary of the Fund's concentration risk by market segment over the total investments market value:

Market segment	% of portfolio	
	2022	2021
Basic materials	7.5	7.4
Communications	3.4	3.9
Consumer, cyclical	4.1	6.4
Consumer, non-cyclical	4.4	6.5
Energy	18.1	10.8
Financial	29.5	31.0
Funds	6.6	6.2
Industrial	11.1	12.9
Technology	5.9	5.0
Utilities	6.1	5.5
Bonds	3.2	4.3
Warrants	0.1	0.1
	<hr/> 100.0	<hr/> 100.0

Market segment	% of portfolio	
	2022	2021
Bonds	3.2	4.2
Common stock	96.2	95.3
Warrants	0.1	0.1
Other net assets	0.5	0.4

Fair value measurement

The carrying amounts of accrued income receivable, subscription receivable, prepaid expenses, accrued liabilities and management fees payable approximate their fair values due to the short-term nature of these financial instruments.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 – Valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

				2022
	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Assets				
Equity	25,761,288	-	-	25,761,288
Fixed income		854,518	-	854,518
Warrants	27,629	-	-	27,629
	25,788,917	854,518	-	26,643,435
				2021
	Level 1*	Level 2	Level 3	Total
	\$	\$	\$	\$
Assets				
Equity	28,316,745	-	-	28,316,745
Fixed income		1,262,786	-	1,262,786
Warrants	14,972	-	-	14,972
	28,331,717	1,262,786	-	29,594,503

* The comparative figures previously reported as at December 31, 2021 have been adjusted in the table above in order to conform to the December 31, 2022 financial statement presentation. The corporate bonds have been reclassified from Level 1 to Level 2. The impact is isolated to the disclosures noted here.

All fair value measurements above are recurring. Fair values are classified as Level 1 when the related security or derivative is actively traded and a quoted price is available. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1. In such cases, the instruments are reclassified into Level 2, unless the measurement of its fair value requires the use of significant unobservable inputs, in which case it is classified as Level 3.

There was no change in levels during the years ended December 31, 2022 and 2021.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

Equities and convertible bonds

The Fund's equity and convertible bond positions are classified as Level 1 when the security is actively traded and a reliable price is observable. All equities and convertible bonds are classified as Level 1 investments.

Bonds and short-term investments

Corporate bonds are valued using models with inputs including interest rate curves, credit spreads and volatilities. The inputs that are significant to valuation are generally observable, and therefore the Fund's bonds and short-term investments have been classified as Level 2.

6 Redeemable units

During the years ended December 31, 2022 and 2021, the number of units issued, redeemed and outstanding were as follows:

	Redeemable units – Beginning of year	Redeemable units issued	Redemption of redeemable units	Reinvestments of units	Redeemable units – End of year
December 31, 2022					
Series A	3,038,038	255,512	(209,866)	40,048	3,123,732
Series F	994,079	58,525	(149,901)	10,156	912,859
December 31, 2021					
Series A	2,808,470	215,255	(161,867)	176,180	3,038,038
Series F	1,042,356	60,548	(181,497)	72,672	994,079

Capital structure

Units issued and outstanding are considered to be the capital of the Fund. The Fund does not have any specific capital requirements.

The Fund is authorized to issue an unlimited number of redeemable unit series, as well as an unlimited number of redeemable units within each series. Each series unit enables its bearer to participate equally in the allocations the Fund completes for the given series. Unit fractions may also be issued.

The Fund is composed of more than one redeemable unit series; each redeemable unit series may feature different structures regarding management fees, performance fees and brokerage. As a result, each redeemable unit entitles its holder to one vote and to participate equally in the allocations the Fund completes and, in the case of Fund liquidation, in the allocation of the redeemable unit series' net assets attributable to holders of redeemable units after all current liabilities have been paid.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

7 Related party transactions

Management fees and performance fees

The Manager provides management and advisory services to the Fund in accordance with the agreement. In return for these services, the Manager is paid a management fee and a performance fee. The Series A units of the Fund are subject to a monthly management fee equal to 1/12 of 1.5% of the NAV of the Series A units. The Manager will pay a trailer fee of 0.75% out of the management fees collected from the Fund with respect to Series A units.

Series F is similar to Series A, but no trailer fee is included in the management fee. Series F charges a monthly management fee of 1/12 of 0.75% of the NAV of Series F.

Based on the agreement amended and restated on August 26, 2013, the performance fee is 20% of the amount by which the Fund outperforms its benchmark, the S&P/TSX Composite Index. Performance fees are paid annually.

The total management fees and performance fees for the year ended December 31, 2022 amounted to \$419,297 and nil respectively (2021– \$419,164 and nil respectively), with nil in outstanding fees due to the Manager as at December 31, 2022 (2021– \$658).

The Manager may waive or absorb the operation of management fees of the Fund. The decision to do so is reviewed regularly and is determined at the sole discretion of the Manager. During the year, the Manager did not waive any fees (2021– did not waive any fees).

Independent Review Committee fees

The total remuneration paid to members of the Independent Review Committee during the year ended December 31, 2022 amounted to \$12,001 (2021– \$12,001) and consisted only of fixed fees.

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

8 Brokerage commissions and soft dollars

The total commissions paid by the Fund to brokers in connection with portfolio transactions for the years ended December 31, 2022 and 2021, together with other transaction charges, are disclosed in the statements of comprehensive income of the Fund. Brokerage business is allocated to brokers based on the best net result for the Fund. Subject to these criteria, preference may be given to brokerage firms which provide (or pay for) certain services (arrangements referred to as “soft dollar”), which may include investment research, analysis and reports, and databases or software in support of these services. The ascertainable soft dollar value received as a percentage of total brokerage commissions paid during the years ended December 31, 2022 and 2021 is disclosed below.

	2022	2021
Soft dollars	\$5,234	\$5,637
Percentage of total transaction costs (%)	12%	11%

9 Increase (decrease) in net assets attributable to holders of redeemable units per series per unit

The increase (decrease) in net assets attributable to holders of redeemable units per series per unit for the years ended December 31, 2022 and 2021 is calculated as follows:

	Increase (decrease) in net assets attributable to holders of redeemable units per series \$	Weighted average of redeemable units outstanding during the year	Increase (decrease) in net assets attributable to holders of redeemable units per unit \$
December 31, 2022			
Series A	(1,963,651)	3,096,748	(0.63)
Series F	(623,618)	944,443	(0.66)
December 31, 2021			
Series A	3,903,744	2,813,689	1.39
Series F	1,583,116	974,276	1.62

Palos Equity Income Fund

Notes to Financial Statements

December 31, 2022 and 2021

(expressed in Canadian dollars)

10 Taxes

The Fund qualifies as a mutual fund trust under the Income Tax Act (Canada).

All or substantially all of the net income for tax purposes and net taxable capital gains realized in any period, after use of loss carry-forwards, are distributed to unitholders such that no income taxes are payable by the Fund.

Capital and non-capital losses determined for tax purposes as at December 31, 2022 were nil (2021 – nil).