

PALOS

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Palos Weekly Commentary

Issue No. 19 | MAY 9 2019

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Palos Funds

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The Strong gets Stronger

The portfolio is invested in what we believe to be the strongest Canadian E&P in the TSX. Our approach for the past few years has been sticking to companies with strong management teams, strong balance sheets, low decline rates, and with controlled production growth. I continue to stay away from the highly levered, high oil sensitivity companies, as the risk to reward remains high.

I don't see why investors would invest in over levered names when quality names are trading at the same multiples. For example, on May 8th, 2019, Torc Oil & Gas Ltd (TSX: TOG) announced its Q1 2019 results, and they delivered strong numbers. Production came in at 28.3MBOE/d, which was better than consensus. Additionally, their operating costs were below consensus. Many analysts on the street padded their lifting costs as they expected the extreme cold weather to have a significant impact. That was not the case, and as a result TOG was able to keep costs well below \$13 per BOE. TOG's operating efficiency permitted the company to have stronger cash flows, improved production, reduced debt, and a 14% increase in dividends.

What is strange is that the market is not distinguishing the superior companies. For example, TOG is trading at 0.9x D/CF and 3.9x EV/DACF, versus its peers at 2x and 4x respectively. My opinion remains, that it's just a matter of time before the market starts to reward quality names over those that are distressed. Meanwhile, I am very content with the 6% dividend, as I see it as a safe return.

Disclaimer: Palos Funds are shareholders of TOG.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.69	12.69%
Palos Equity Income Fund - RRSP	PAL101	\$5.80	10.39%
Palos Merchant Fund L.P. (Dec 31, 2018) ²	PAL500	\$1.82	6.59%
Palos WP Growth Fund - RRSP	PAL210	\$7.88	11.44%
Palos-Mitchell Alpha Fund (Fund Initiated on Jan 29, 2019)	PAL300	\$10.44	4.38%
S&P TSX Composite (Total Return with dividends reinvested)			15.63%
S&P 500 (Total Return with dividends reinvested)			15.61%
S&P TSX Venture (Total Return with dividends reinvested)			7.47%
Chart 2: Market Data ¹			Value
US Government 10-Year			2.48%
Canadian Government 10-Year			1.71%
Crude Oil Spot			US \$62.12
Gold Spot			US \$1,281.40
US Gov't10-Year/Moody BAA Corp. Spread			216 bps
USD/CAD Exchange Rate Spot			US \$0.7419

¹ Period ending May 8, 2019. Data extracted from Bloomberg

² Fund is priced annually

³ Fund is priced weekly on Tuesdays

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