JANUARY 2018

KeyStone's

Canadian Income/Dividend Stock Research

Independent Equity Advisors

Editor: Ryan Irvine, BBA (Finance)
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Parkland Fuel Corp
Moderate-Risk/Hybrid Portfolio
Price: $28.85
Symbol: PKI:TSX
Near Term: ▲ BUY
Long Term: ▲ BUY

Summary

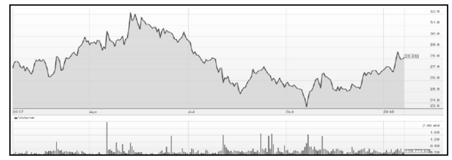
Headquartered in Calgary, Alberta, Parkland is Canada's largest and one of North America's fastest growing independent marketers of fuel and petroleum products. Parkland delivers refined fuels and high quality petroleum products through three channels: Retail Fuels, Commercial Fuels and Supply and Wholesale. As the nation's second largest convenience store operator, Parkland prides itself on being able to deliver competitive product offerings to customers in the retail segment. As the owner of the Burnaby Refinery, Parkland also maintains a portfolio of supply relationships, storage infrastructure, and third-party rail and highway carriers to ensure security of supply to customers.

Parkland Fuel Corp (PKI: TSX)

Recommendation: BUY

Current Price (January 31, 2018)..........$28.85

Fair Value..........$32.40



INVESTMENT RECOMMENDATION

We are initiating coverage on Parkland Fuel Corp (PKI: TSX) with a rating of BUY and a fair value assessment of $32.40 per share. Parkland Fuel will be added to our Moderate-Risk and Hybrid portfolios.

COMPANY DESCRIPTION

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INVESTMENT HIGHLIGHTS

- Substantial growth in free cash flow expected over next 2 to 3 years.
- Relatively stable financial performance through economic cycles.
- Attractive yield and consistent low single digit dividend growth.
- Reasonable value relative to expected free cash flow.

FINANCIAL OVERVIEW

Recent Performance: PKI reported solid performance in the third quarter of 2017 with strong growth from the base business and contribution from its newly acquired assets. Q3 revenue increased 59% to $2.6 billion and adjusted EBITDA increased 60% to $96.4 million. Distributable cash flow per share increased 21% to $0.35 and adjusted distributable cash flow per share increased 43% to $0.50. Adjusted distributable cash flow excludes acquisition, integration and other costs. The payout ratio in the third quarter was 59% compared to 83% in the same quarter last year.

For the first 9 months of 2017, revenue increased 37% to $6.2 billion and adjusted EBITDA increased 25% to $220 million. Distributable cash flow per share for the first 9 months declined 1% to $0.94 and adjusted distributable cash flow per share increased 16% to $1.33. The decline in distributable cash flow per share was the result of acquisition related expenses. PKI's payout ratio for the first 9 months of the year was 66% of adjusted distributable cash compared to 75% in the same period of 2016.

Segmented Results: Retail Fuels adjusted EBITDA grew 80% to $73.7 million for the third quarter of 2017 and grew 30% to $136.5 million for the first nine months of 2017. Growth in Retail Fuels was primarily the result of contributions from newly acquired assets and overall company C-Store same

TABLE 1: MARKET DATA

Symbol	PKI: TSX
Yield	4.03%
Market Capitalization	$3.65 B
Shares Outstanding (basic)	130,700,000
Shares Outstanding (diluted)	130,500,000
Average Daily Trading Volume	318,631

TABLE 2: QUARTERLY FINANCIAL DATA

	Q3 2017	Q3 2016	Change
Revenues	$2,600,600,000	$1,638,100,000	59%
EBITDA	$96,400,000	$60,300,000	60%
Free Cash Flow	$46,200,000	$27,800,000	66%
FCF per Share	$0.35	$0.29	21%
Total Debt	$2,364,900,000	$770,327,000	207%
Shareholder's Equity	$1,515,800,000	$812,950,000	86%

TABLE 3: ANNUAL FINANCIAL DATA

	9M 2017	9M 2016	Change
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Price-to-FCF	11.8
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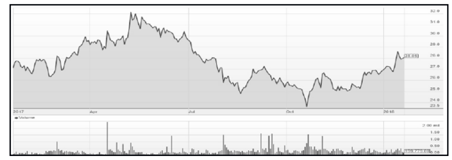


store sales growth (SSSG) of 4.1% for the third quarter and 3.5% for the first 9 months of the year.

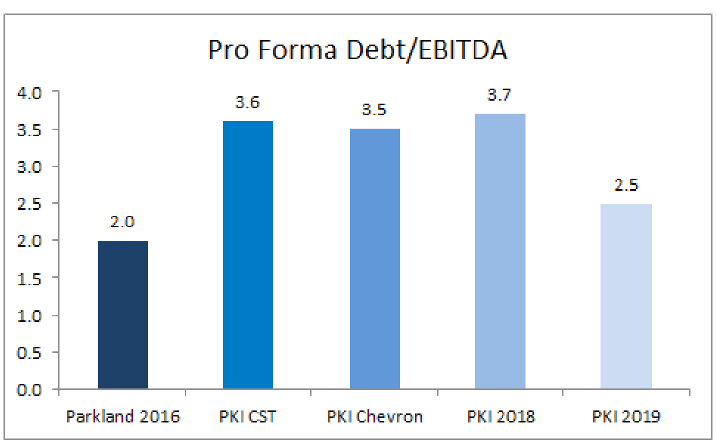
Commercial Fuels adjusted EBITDA for the third quarter of 2017 grew 85% and 27% for the first nine months of 2017, primarily due to contributions from newly acquired assets. Excluding the impact of new assets, the Commercial Fuels Base Business saw strong results for the 3 and 9 months periods driven by organic growth efforts and the impact of recent customer wins.

Parkland USA adjusted EBITDA remained stable for the third quarter of 2017 as a result of new customer wins and strength in lubricant volume, offset by the foreign exchange. Adjusted EBITDA increased 11% for the first nine months of 2017 primarily due to growth in the lubricants business which saw improved margin year-over-year, growth in the retail division with the addition of three new sites in Wyoming, as well as organic growth at existing sites.

Supply and Wholesale adjusted EBITDA for the third quarter increased 4% to $24.4 million, primarily driven by improving supply economics and partially offset by softer performance in the crude and LPG businesses. For the first 9 months, adjusted EBITDA grew 4.3% to $65.5 million.

Financial Position: PKI ended the third quarter with total debt of $2.36 billion. Based on management's 2018 adjusted EBITDA guidance ($660 million), the debt-to-EBITDA leverage ratio is 3.6 times which is above the target range of 2.0 to 3.5 times.

Recent acquisitions have resulted in a significant increase in debt leverage. PKI's plan is to reduce the leverage ratio to 2.5 times by 2019, based on the realization of synergies from recent acquisitions and debt principle payments.



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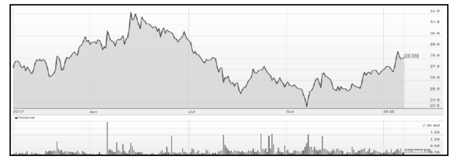
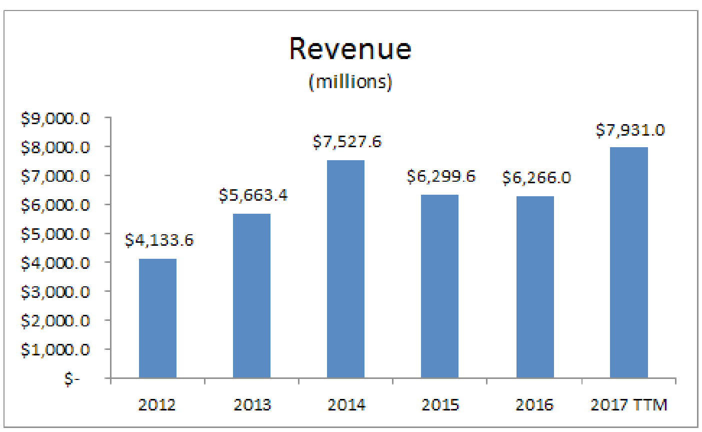
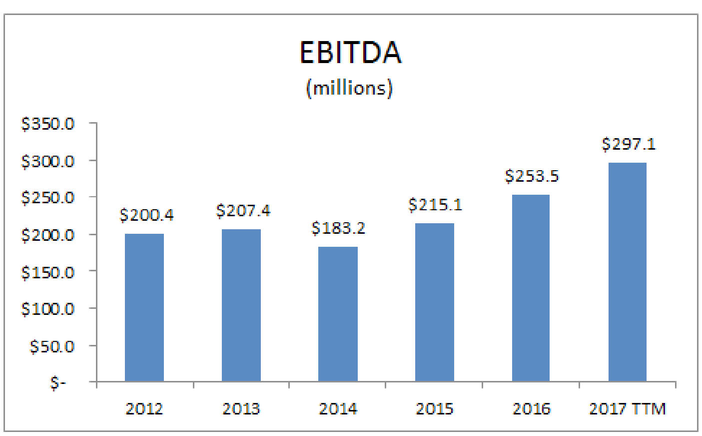


Outlook: In the near term, we expect costs associated with the recent acquisitions to create some noise in the financial reporting. In Q1, the company will be completing a major maintenance turnaround at the Burnaby refinery. A turnaround of this magnitude generally occurs once every 10 years and the estimated cost is approximately $100 million. The company will also incur non-recurring expenses associated with the integration of recent acquisitions.

Historical Performance: The charts below illustrate PKI's financial performance from 2012 to the end of Q3 2017. There was a decline in adjusted EBITDA and adjusted distributable cash flow in 2014 which was the result of the conclusion of a multi-year supply contract the company had with Suncor. From 2014 to 2016, adjusted distributable cash per share was relatively flat. The lack of growth in per share cash flow has been the main reason we have refrained from setting a buy recommendation on the stock. Consistent performance in the base businesses coupled with contributions from recent acquisitions are both expected to support significant growth in cash flow per share over the next 2 to 3 years.





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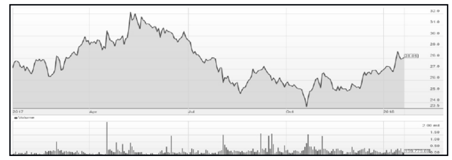

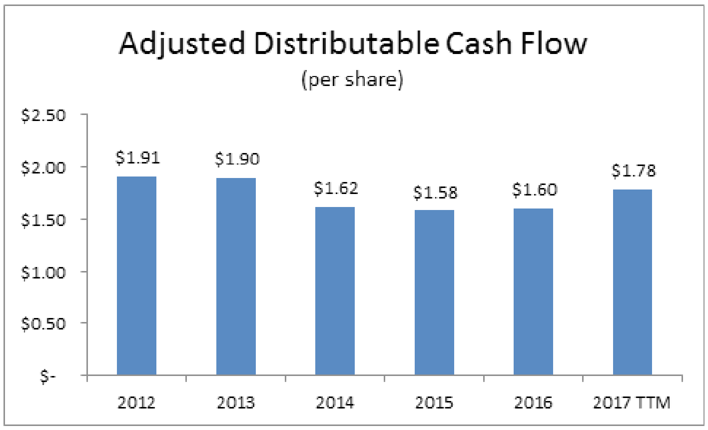

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OPERATIONS

PKI's business is comprised of 4 segments:

Retail Fuel: Parkland Retail Fuels sells fuel to the retail public through company owned retail gas stations and sells fuel as a wholesale fuel supplier to independent dealer owned gas stations that subsequently sell fuel to the retail public. Fuel is sold either on a branded or unbranded basis. Parkland owns four proprietary brands: Fas Gas Plus, Race Trac, Pioneer and On the Run/Marché Express, and is a branded wholesaler for both Esso and Chevron. Parkland's multi-brand strategy provides a robust offering to satisfy many fuel market segments. The Retail Fuel segment is currently comprised of 1,841 fuel sites.

Commercial Fuel: Parkland Commercial Fuels delivers bulk fuel, bulk and cylinder exchange propane, heating oil, lubricants and other related products and services to commercial, industrial and residential customers in Canada through an extensive delivery network. Parkland Commercial Fuels uses a variety of trade names, service marks and trademarks for use in its business, which Parkland regards as having significant value and as being important factors in the marketing of its products. The brands in this segment includes Bluewave Energy; Columbia Fuels; Sparlings Propane; Island Petroleum, Propane Nord-Ouest (PNO) and PNE.

Supply & Wholesale: Parkland's Supply and Wholesale segment manages fuel supply by contracting and purchasing fuel from refiners and other suppliers, distributing through third party rail and highway carriers, storing fuel in owned and leased facilities and serving wholesale and reseller customers in Canada and in the United States.

Parkland USA: Parkland USA is an independent fuel marketer headquartered in Minot, North Dakota. Parkland USA supplies and distributes refined petroleum products throughout North Dakota, Montana,

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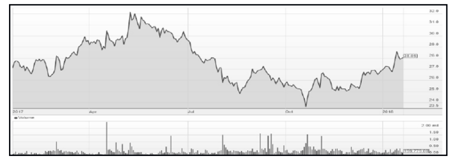


Minnesota, South Dakota and Wyoming. Parkland USA is a platform for growth in the Northwest United States and provides Parkland with export opportunities for product from Western Canada. Additionally, this segment enhances supply capabilities by leveraging Parkland's rail assets. The brands in this segment include Farstad Oil and Superpumper.

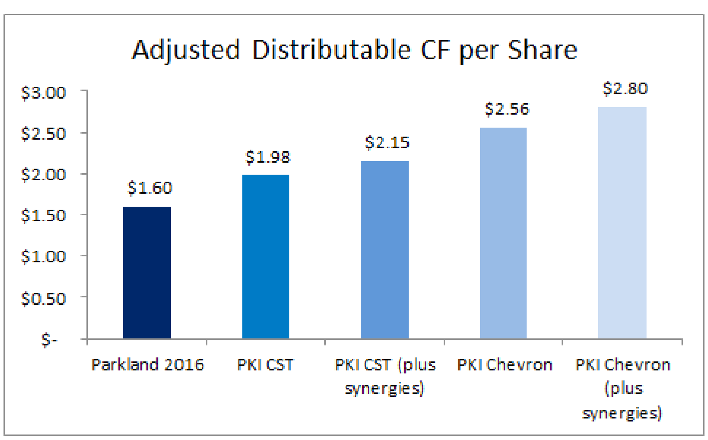
AREAS OF GROWTH

PKI's strategy is to grow organically and to pursue prudent acquisition opportunities. The company has set an organic growth target of 3% to 5% per year. The plan to achieve this is to focus on the effective deployment of growth capital back into the business by identifying opportunities to increase gross margin and continuously improve efficiencies.

In the last half of 2017, PKI completed the two largest acquisitions in its history which are expected to drive significant growth in cash flow per share over the next 2 to 3 years.

1. **Chevron Canada's Downstream Assets:** On October 1st, PKI acquired downstream fuel assets from Chevron Canada for a price of $1.46 billion. The acquisition adds more than 2.5 billion litres of annual volume, 166 retail service station and commercial cardlock sites, and a 55 thousand barrel per day refinery in Burnaby, BC. The transaction is expected to be immediately accretive to free cash flow per share and add $230 million in annualized EBITDA plus annual run-rate synergies of $35 to $50 million over 2 to 3 years.

2. **Majority of CST Brands, Inc.'s Canadian Business and Assets:** On June 28th, PKI completed the acquisition of the majority of CST Brands' Canadian Business for a price of $945 million. The transaction adds 589 fuel sites to PKI's portfolio and 3.0 billion litres of fuel volume. The assets are also expected to add $105 million and $115 million in estimated annual adjusted EBITDA and be 20% accretive to distributable cash flow per share plus additional synergies which would be realized over the following 36 months.



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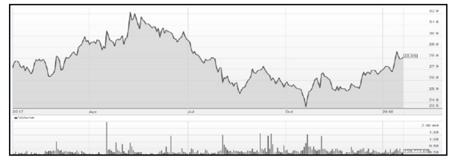

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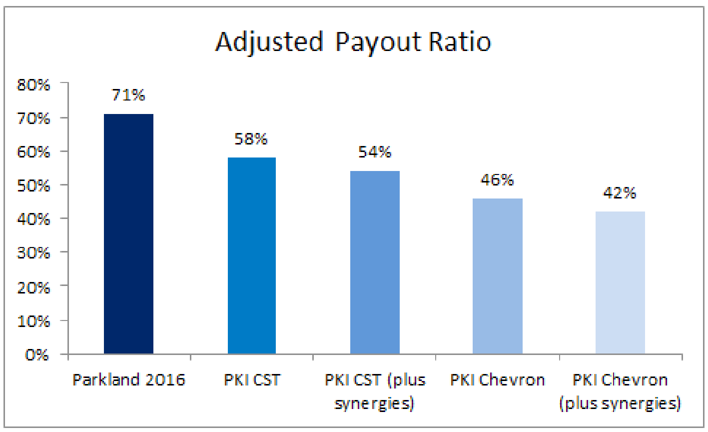
DIVIDEND POLICY

PKI currently pays a monthly dividend of $0.0962 ($1.15 annualized) which equates to a yield of 4.03%. The company reported a payout ratio to adjusted cash flow of 71% for 2016. The payout ratio is expected to decline meaningfully as a result of contributions from the recent acquisitions and realized synergies.



PKI has been a dividend growth stock with the most recent increase of 1.8% in March of last year. The company has increased the dividend for 5 straight years at an average compound rate of 2.5% per year.

VALUATION AND FAIR VALUE ASSESSMENT

We are estimating 2018 adjusted distributable cash flow of approximately $2.40 per share which is based on a full year of contribution of the CST and Chevron acquisitions and does not include synergies. Based on this estimate, PKI is currently trading at a price-to-distributable cash multiple of 11.8 times. Our fair value assessment of $32.40 is based on a justified price-to-distributable cash flow multiple of 13.5 times.

The recently completed acquisitions are expected to generate significant growth in distributable cash per share as the new assets contribute and synergies are realized. PKI expects both deals to be immediately accretive (per share growth) with synergies adding to additional accretion over a 2 to 3 year period. The caveat in the near term is that PKI anticipating significant one-time expenses and maintenance costs associated with the recent acquisitions. These include a major maintenance turnaround at the newly acquired Burnaby refinery in Q1, and integration costs for the CST and Chevron assets in Q1 and Q3, respectively.

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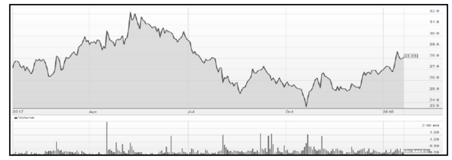

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KEY RISK SENSITIVITIES

1. **Exposure to Refiner's Margins:** The acquisition of the Burnaby refinery will expose the company's refinery margins which can more-or-less be quantified by the 3-2-1 crack spread. The Burnaby refinery has a maximum capacity of 55,000 barrels per day. Based on capacity utilization of approximately 85%, we would estimate a sensitivity of $17 million (in EBITDA) for every $1 change in the 3-2-1 crack spread.

2. **Long-Term Electric Vehicle Adoption:** PKI is a fuel distribution business and in direct competition with electric forms of transportation and heating. The long-term adoption of electric transportation is a threat to the company. PKI states that they are monitoring these trends closely but do not expect to see a meaningful decline in fuel volumes over the next 10 years. PKI is exploring strategies to position the company to benefit from ongoing trends in transportation such as the adoption of electric vehicles.

3. **Transportation Activity:** As a fuel distribution business, the main demand driver to the company is transportation activity. This includes both personal and commercial transportation which is indirectly linked to general economic activity in each of the company's regional markets.

CONCLUSION

PKI is a company we had under active coverage from 2013 to 2015. The rating was changed to a short-term: SELL after we generated a 52% gain and the company has since been rated a long-term: HOLD. We have decided to upgrade the rating to BUY based on recent acquisition activity and growth projections.

PKI's business model has been attractive to us due largely to its relative resilience which was tested with the energy market downturn in 2014. What has discouraged us from a BUY recommendation was the lack of per share growth (notably in cash flow) from 2014 to 2016, in spite of the size of the overall company increasing substantially. This lack of per share growth was mostly attributable to strength in some areas of the business being offset by weakness in other areas of the business which were impacted by weaker energy markets.

In 2017, PKI completed 2 major acquisitions (the largest in its history) which are expected to contribute significant growth over the next 2 to 3 years. The company has provided pro-forma projections which provide for $2.80 in distributable cash flow per share (compared to $1.60 in 2016) with the full integration of both acquisitions and realization of synergies.

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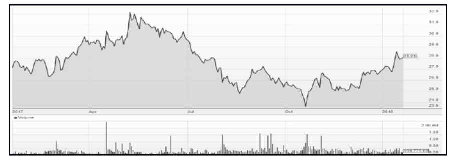

PKI expects synergies to be realized over a 2 to 3 year period post-closing of the acquisitions (around 2020).

There will be some noise in the financial performance in 2018 with a major turnaround occurring at the Burnaby refinery in Q1 and integration expenses occurring throughout the year. For this reason, we would look to the 2019 results as more reflective of the cash flow generating power of the business.

A key risk to consider with PKI is the long-term future of gas stations and fuel distribution in a world with increasing electric vehicle (EV) penetration. Management states that they are monitoring risks associated with EV trends as well as potential opportunities to provide EV services to locations. Over the very long term, EV and driverless technology will reduce and eventually eliminate the need for gas stations. However, we do not believe that this will start to have a meaningful impact on the company for at least 10 years. Management also notes that most of their retail fuel stations are located in strategic, high-traffic areas which are well positioned to compete for fuel volumes and provide additional services.

We see a good opportunity in PKI over the next 2 to 3 years. Our investment thesis is based on the embedded growth from the recent acquisitions and stable performance (with modest growth) in the base business. There may be some volatility in 2018 as integration and refinery turnaround costs weigh on cash flow. In 2019, we should see full contribution from the acquired assets with additional growth from synergies in 2020. Even on a trailing (last 12 months) basis, the company is trading at a reasonably attractive valuation of 16 times distributable cash flow. Factoring in the cash flow potential over the next 2 to 3 years, we believe that PKI truly offers a compelling mix of growth, value and income, which has become rare in the current market environment.

We are initiating coverage on Parkland Fuel Corp (PKI: TSX) with a rating of BUY and a fair value assessment of $32.40 per share. Parkland Fuel will be added to our Moderate-Risk and Hybrid portfolios.

TABLE 1: MARKET DATA

Symbol	PKI: TSX
Yield	4.03%
Market Capitalization	$3.65 B
Shares Outstanding (basic)	130,700,000
Shares Outstanding (diluted)	130,500,000
Average Daily Trading Volume	318,631

TABLE 2: QUARTERLY FINANCIAL DATA

	Q3 2017	Q3 2016	Change
Revenues	$2,600,600,000	$1,638,100,000	59%
EBITDA	$96,400,000	$60,300,000	60%
Free Cash Flow	$46,200,000	$27,800,000	66%
FCF per Share	$0.35	$0.29	21%
Total Debt	$2,364,900,000	$770,327,000	207%
Shareholder's Equity	$1,515,800,000	$812,950,000	86%

TABLE 3: ANNUAL FINANCIAL DATA

	9M 2017	9M 2016	Change
Revenues	$6,191,300,000	$4,526,000,000	37%
EBITDA	$220,000,000	$176,400,000	25%
Net Earnings	$107,200,000	$91,000,000	18%
EPS	$0.95	$0.96	-1%

TABLE 4: FINANCIAL RATIOS

	2018e
Price-to-FCF	11.8
EV-to-EBITDA	9.1
Debt-to-EBITDA	3.6
ROE	9.6%
Payout Ratio	48%

2008a; 2009e
The term (a) refers to the actually results that a company has posted on its financial statements. The term (e) refers to analyst estimates of future results.

Book value (BV)
The total value of a company's assets, on its Balance Sheet, less any liabilities. Also referred to as Shareholder Equity. (The value of a companies assets, on its Balance Sheet, does not necessarily reflect the true value of assets).

Cash Flow from Operations (CFO; Operating Cash Flow)
The cash inflow that a company recieves during a period, resulting from operating activities (does not include Cash Flow from Investing or Financing).

Current ratio
One of many ratios designed to evaluate short-term liquidity of a company. Calculated as current assets divided by current liabilities, this ratio gauges the level of cash resources relative to current liabilities as a measure of cash obligations (the ratio should be greater than 1).

D/E: Debt-to-equity ratio
A measure of a company's financial leverage calculated by dividing long term debt by shareholders equity. It indicates what proportion of equity and debt the company is using to finance its assets (a lower ratio indicates lower relative debt ratios).

EBITDA
Earnings before interest, taxes, depreciation, and amortization. EBITDA is calculated as revenue minus expenses (excluding tax, interest, depreciation, and amortization).

EPS: Earnings per share
A company's earnings available to common shareholders, also known as net income or net profit, divided by the number of shares outstanding.

Fair Value
The price at which an analyst believes a companies stock should be priced. Although this value is based on intelligent analysis, it in no way is a representation of what the companies share price will be trading at given any period of time. The analysis used to determine Fair Value is based on numerous assumptions and uncertainties. Fair Value should be used only as a general guide to investing and should not be depended upon.

FCFE: Free cash flow to equity
Cash flow from operations less working capital requirements, sustaining capital expenditures and scheduled debt repayments. FCFE consists of cash inflows that are available to the shareholders of the company.

Net working capital surplus (deficiency)
A measure of the company's ability to carry on its normal business comfortably and without financial stringency, to expand its operations without the need of new financing, and to meet emergencies and losses. Calculated by deducting current liabilities from the current assets (as positive figure is a surplus, whereas a negative figure is a deficiency).

P/B: Price-to-book ratio
Calculated as a stock's market value (current closing price) divided by its latest quarter's book value. While a lower P/B ratio could mean that the stock is undervalued, it could also serve as a sign of weak fundamentals, and as with most ratios, this varies a fair amount by industry.

P/CF: Price-to-cash flow ratio
Calculated as a company's current share price divided by its cash flow per share (i.e., free cash flow divided by the number of company's shares outstanding) over the last four quarters (called "TTM," or "trailing 12 months" calculation). It is a measure of the market's expectations regarding a firm's future financial health.

P/S: Price-to-sales ratio
It is calculated as a stock's current market price divided by its sales (revenue) per share. When calculating this ratio, we use the company's revenue from its latest four quarters, or on a TTM basis.

ROE: Return on equity
A measure of a corporation's profitability, calculated as net income divided by shareholder's equity. ROE is often useful in comparing the profitability of a company to other firms in the same industry.

Tangible Book Value (TBV)
The total value of a company's assets, on its Balance Sheet, less any liabilities and intangible assets such as goodwill. Also referred to as Shareholder Equity. (Also true asset values likely differ from Balance Sheet Values, Tangible Book Value is generally considered a more accurate representation of value).

Times Interest Earned
The multiple of Net Income (before interest and taxes) to interest payments during the period. This assesses a companies ability and margin of safety, with respect to meeting its interest obligations (a higher number is more attractive).

Yield
The investment return resulting from income distributions. Calculated as the annual or annualized interest or dividend distribution, divided by the cost of the original investment.

Disclosure					
Stock Holding				Other	
Companies	KeyStone	KeyStone Employees	Related Companies	Investment Banking Client	Related Company Business Relationship
Parkland Fuel Corp	NO	NO	NO	NO	NO