BULLETIN # 128 – April 23 2013

Parkland Fuel Corporation – PKI-TSX; PKIUF-OTC

Parkland is the largest independent marketer and distributor of refined fuels in Canada. They are simply the middle man between the refinery market and the energy consumer client. Think of them as the guys who take oil from big tanks into little tanks. They also operate retail and wholesale fuels and convenience stores.

The Canadian fuel market is fragmented, and the majors are divesting assets—so there is lots to consolidate in the market. Parkland's goal is to buy up assets and grow organically to double market share in 5 years.

QUICK FACTS:

Trading Symbols:	PKI-TSX (PKIUF-PINK)
Share Price:	$16.50 (my price $17.50)
Current Dividend:	$1.04 paid annually
Shares Outstanding:	68.6 million shares
Market Cap:	$1,132 million
Net Debt:	$277 million
Enterprise Value:	$1,409 million

POSITIVES

- Stable market demand even during recessionary times
- Fragmented fuel sales market gives PKI a consolidation opportunity
- Low payout ratio of 50% underpins an attractive dividend of ~6.3%

NEGATIVES

- A recessionary economy translates into lower commercial fuel sales
- Rising fuel prices may dampen demand reducing Parkland's sales
- Warm winter temperatures directly impact heating fuel sales

- Rig Utilization rates directly impact diesel and propane sales to the oil and gas industry.

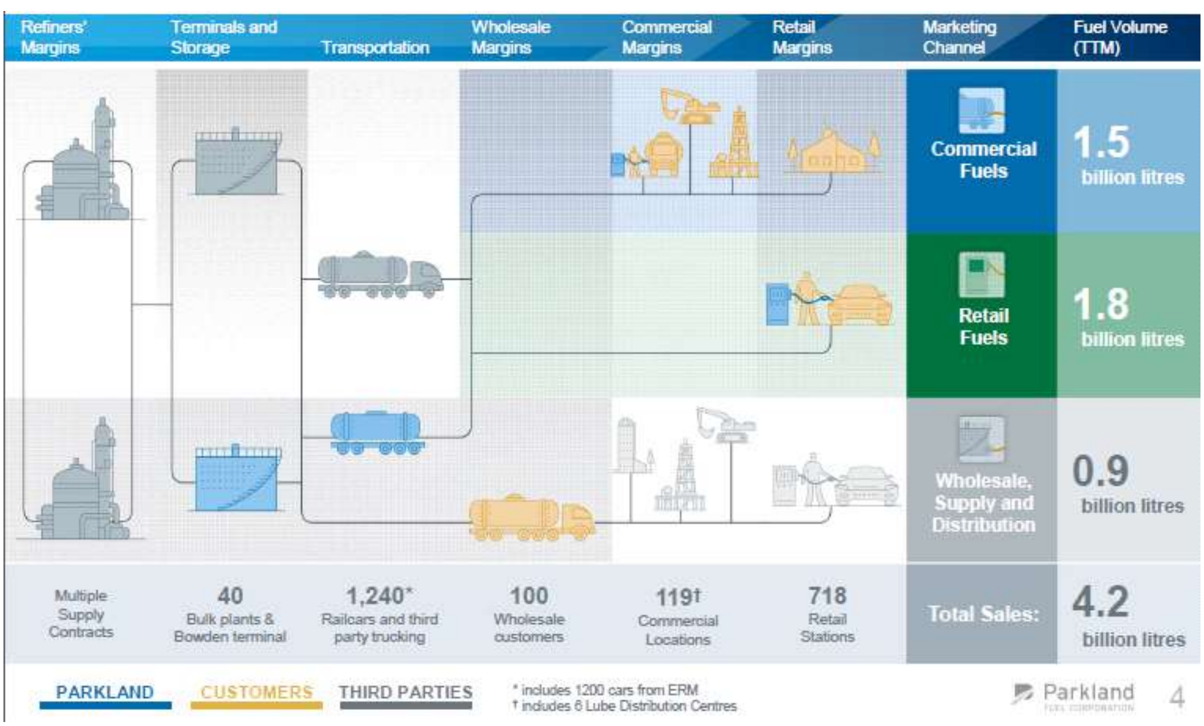
BUSINESS SEGMENTS

Parkland Fuel Corporation is Canada's largest independent distributor and marketer of fuels to retail, commercial and wholesale customers. The company markets almost 5 billion litres annually of gasoline, diesel and light fuel oil through a vast distribution network across Canada.

Parkland currently controls 5.2% share of a market estimated at 78 billion litres annually with more than 10,000 retail service stations and commercial locations.

The company operates mostly in non-urban markets across Canada through 3 business segments:

- Commercial Fuels
- Retail Fuels
- Wholesale Supply & Distribution



Commercial Fuels

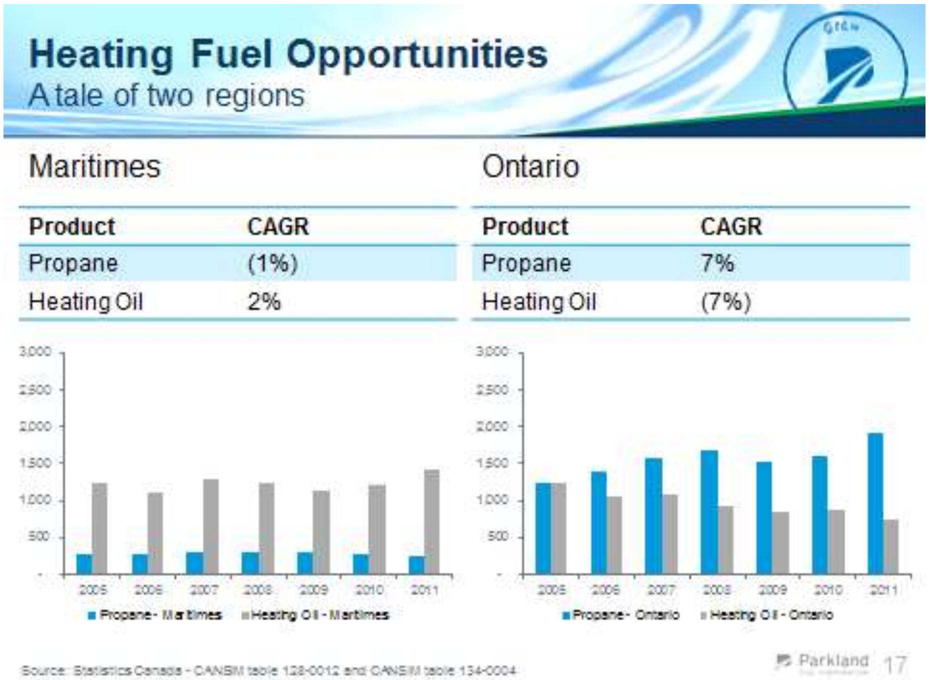
The Commercial Fuels division counts 113 locations servicing commercial, industrial and residential customers. It delivers ~1.5 billion litres of fuel, propane, heating oil, lubricants and other products through an extensive transportation network spanning the country.

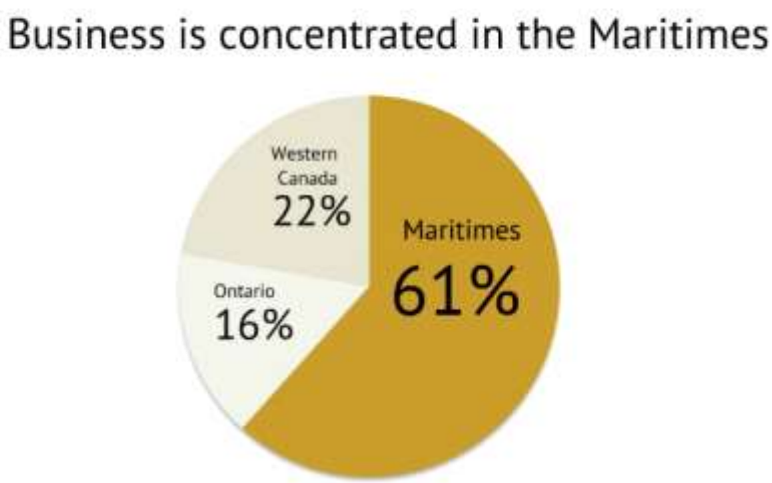
The division is dominated by sales to oil and gas, mining, forestry and other commercial industries. It has assets all over the country, which helps with cash flow stability.

Heating Oil

Parkland has 14% market share in Canada with most of the business concentrated in the Maritimes. This leaves lots of room for expansion in markets with low or no penetration.

Demand for heating oil is largely driven by the weather. Seasonal temperatures have a direct relationship with heating oil sales for homes and businesses.





Bulk Fuel & Propane

The bulk fuel segment delivers diesel to drilling rigs in oil and gas, mining and heavy machinery in construction.

Parkland is the 3rd largest distributor of propane in Western Canada where 60% of business is oil and gas. Canada wide, the company only holds 2% market share. The company's strategy is to grow the business through cross selling and acquisitions. As a one-stop-shop with multi-product offerings, the company caters to customers with diesel run drilling rigs and propane run pump jacks.

Western Canada's oil and gas sector is their market for diesel sales volumes. As the rig count goes up or down, so does Parkland's sales.

Lubricants

Lubricants are an oily or greasy substance used to minimize friction in engine components. Canada is the world's 5th largest market for lubricants with most of the demand coming from the resource sector (oil and gas, mining etc).

In the world of lubricants, Shell is globally recognized as #1. Parkland is Shell's top branded distributor in North America for lubricants – in some cases on exclusivity basis. So it's another high quality product they can market across their network. And where they're exclusive, they have an edge over the competition.

The company markets its products directly to transport, industrial and commercial branches and indirectly through resellers, like automotive repair centers, fast lube shops, auto and heavy truck parts retails and other commercial fuel resellers.

Retail Fuels

Parkland Retail fuels division is composed of 718 retail service gas stations across Canada, selling 1.845 billion litres of gasoline and diesel to Canadian drivers.

Demand is driven by a growing population with consumption growing even after accounting for improvements in engine efficiency (unlike the USA). Retail demand is underpinned by a sparsely populated country, people need to drive and they can only go so far with spending cuts.

Operations are focused on non-urban areas where competition is less fierce. The retail service stations are associated with national brand names; mainly Fas Gas, RaceTrac and Esso. The variety of brand names allows the company to capture a wider audience, both geographically and demographically.

Parkland operates this segment under 2 business models:

- Parkland Retailers & Independent Dealers

Parkland Retailers

Through its 137 Parkland retailers, the company sells its fuel directly to customers. Under this model, Parkland owns or controls the retails gas stations and contracts out the local management of the station to independent entrepreneurs.

The operators make sure the station is well maintained, kept clean and manage the convenience store inventories. These entrepreneurs receive profits from the convenience store and a small margin on the fuel volumes sold.

It’s like working on a commission.

This model allows the company to generate better gross profit margins of 6-8 cents per litre.

Independent Dealers

Independent dealers are gas stations owned or controlled by third parties who contract fuel supply from Parkland. This model earns Parkland 2-3 cents of profit per litre from the fuel volumes sold.

These are typically sold under long term contracts ranging from 5 to 10 years. These dealers are provided with branding options such as Fas Gas, Race Trac or Esso. There are 581 service locations operating under the independent dealers’ model.

This model suits areas with high competition as it provides margin stability through long term contracts and reduces overhead expenses.

Wholesale, Supply and Distribution

The Supply and Wholesale division manages Parkland’s fuel supply contracts and purchasing obligations from refiners. PKI buys almost 5 billion litres of fuel every year or the equivalent of 75,000 bbls/d of refining capacity. Parkland sources fuel from multiple sources for stability/security.

This segment includes the recently completed Bowden facility at Bowden, Alberta. This terminal facility has 250,000 barrels of oil storage capacity. It allows the company to take advantage of arbitrage during seasonal volatility in sales as well as gain negotiation leverage with refiners on supply agreements.

Wholesale fuel customers pick up the fuel from a terminal or a refinery. They could be resellers, grossers or simply independent fuel marketers.

Elbow River Marketing

Elbow River is Parkland's biggest addition to the Wholesale, Supply and Distribution division so far this year; the acquisition closed on February 15, 2013. This segment was acquired for $80M in cash and $15M in assumed debt from AvenEx Energy Corporation (AVF-TSX).

Elbow River is a North American transporter, supplier and marketer of petroleum products including liquefied petroleum gases (butane, propane and condensate), crude oil, heavy fuel oil, and a growing portfolio of refined fuel and bio-fuel products.

Like Parkland, Elbow River connects buyers and sellers of energy products—mostly through their 1200 rail cars, which is a booming business in the energy sector now. But they have a higher risk, higher reward culture and will remain separate. Elbow also has a terminal storage capacity of 377,694 barrels similar to the Bowden terminal.

Parkland expects Elbow River to contribute 2 billion liters in sales volumes *on top of* its current 7 billion liters fuel sales target in 2016. The acquisition adds $20M in EBITDA and an experienced marketing and logistics team.

CONSOLIDATING THE MARKET—A ROLL-UP STORY

The oil and gas industry is usually divided into three major sectors: upstream (production of oil and gas), midstream (pipelines) and downstream. The downstream sector commonly refers to the refining of crude and the processing of natural gas, as well as the marketing and distribution of refined products.

While the majors refocus on their upstream operations, Parkland is perfectly placed to absorb and optimize downstream marketing assets.

The majors like Imperial Oil, Shell and Suncor make up 60% of the market leaving the rest in the hands of smaller players. Parkland is Canada's largest independent distributor with 5.2% market share. The second player in line is a private company with 2.5% market share according to management.

So not only does Parkland buy smaller companies, they bid for assets that the majors are divesting.

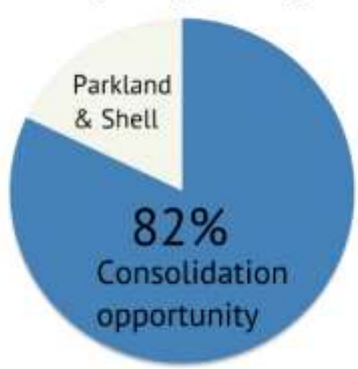
Parkland is very active in buying large regional brands. It recently announced the acquisition of TransMontaigne Canada Marketing, a leading wholesale fuel marketer in Quebec and Ontario. The deal is expected to add 0.5 Billion liters in annual wholesale fuel volumes.

Prior to that, Parkland acquired Sparling's Propane, the second largest propane retailer in Ontario growing its volumes in excess of 120 million liters of fuel annually.

The company also improved its strategic position in the Canadian propane market by announcing plans to lease terminal storage in both Montreal and Quebec City.

All of these arrangements are expected to contribute an incremental ~$6.5 million in EBITDA bringing its annual sales volumes close to 5 billion litres. It also bumps the company closer to its anticipated fuel volumes target of 7 billion liters by 2016.

Opportunity to consolidate through organic growth



FINANCES AND VALUATION

Parkland began 2013 with a debt to cash flow ratio of 1.4:1; a major improvement from 2.26:1 from YE 2011.

The company's Q4 missed analyst expectations following an 11% drop in commercial fuel volumes. According to management, analysts had frothy expectations to begin with since they did not account for a softening in general economic activity.

The ensuing conference call saw analysts focused on the upcoming expiration of a 1 billion liter fuel supply contract with Suncor Energy. Parkland manages its supplies with anywhere from 30 to 50 contracts in their portfolio with different refineries in order to mitigate supply risk.

But the Suncor contract was special as it allowed the company to partake in the refiner's profits. The confidential formula provided Parkland with a cut from the margins realized from buying Canadian discounted crude and selling the refined product at world pricing.

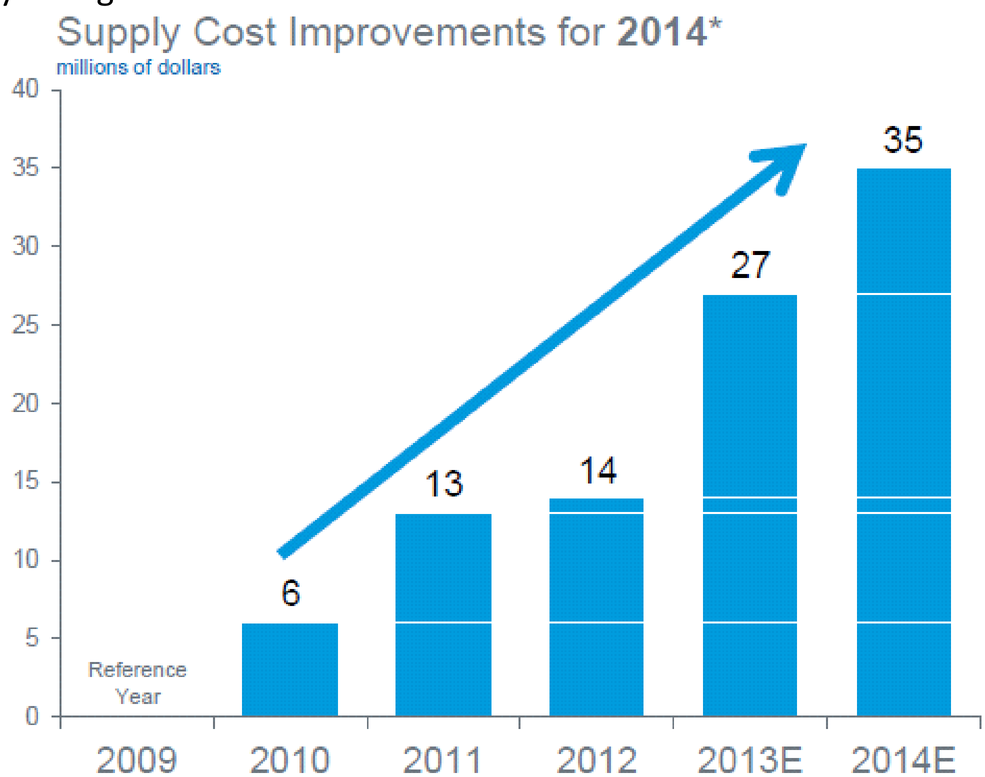
This contract proved very profitable in the past 2 years thanks to the wide differentials in Canadian oil pricing. This explains why analysts remain focused on its expiration at the end of 2013.

And there's no doubt it will make a difference to the financials—look at how EBITDA per share is dropping—even with all of management's cost cutting and new acquisitions:

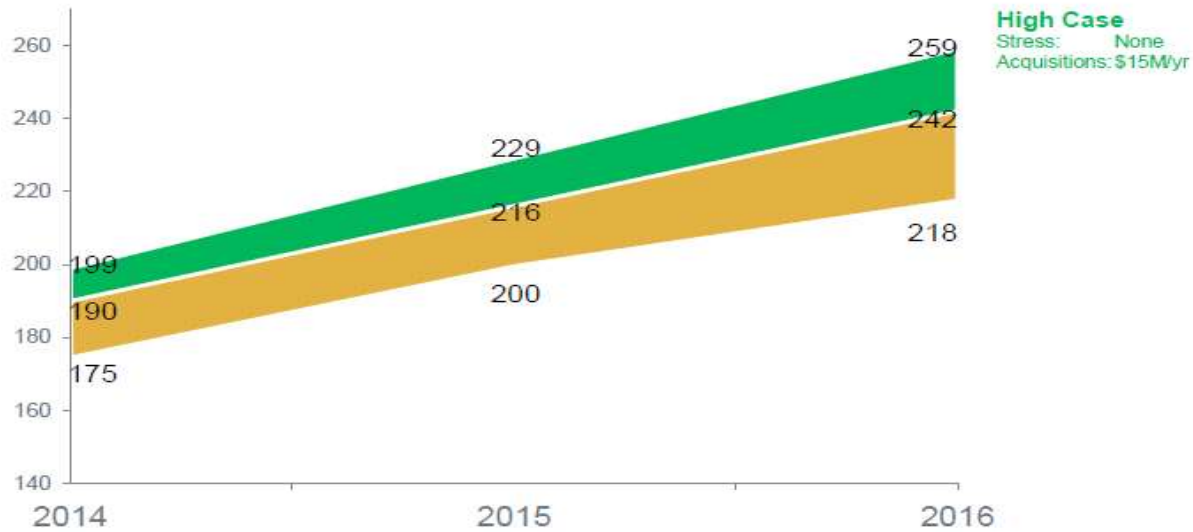
	2008A	2009A	2010A	2011A	2012A	2014E	2015E	2016E
EBITDA/Share	1.63	1.80	1.89	2.34	2.92	2.42	2.69	2.96

EBITDA is dropping 50 cents a share from 2012-2014, which is why the stock is in corrective mode here. The question for investors is—has the stock corrected ENOUGH that the market sees value, and it can begin to base for awhile. The stock clearly needs to do that before resuming an uptrend.

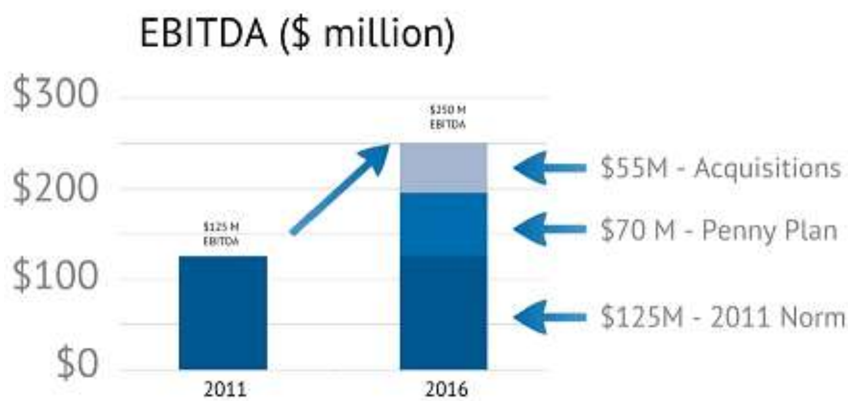
The reality is that now, in the spring of 2013, that those refinery margins have come in hard and fast, making that contract not as lucrative as before—so losing it should not mean any more damage than it has already had on the stock. But it definitely changed the emotion around the stock.



This chart above essentially says their COGS—Cost of Goods Sold—will go down \$35 million between 2009-2014. The chart below estimates their EBITDA growth on top of that—out to 2016.



The plan includes $55 million in incremental EBITDA through major acquisitions with an estimated $27 million in EBITDA achieved so far in 2013 leaving $28 million to be acquired through other opportunities.



The company currently has a 70% DRIP participation rate. DRIP stands for Dividend Re-Investment Plan. It means that 70% of the shareholders have chosen to receive their dividend in new shares, not cash.

This preserves cash, but the downside of a high DRIP rate is the dilution—estimated annually at just over 5%. This means the number of shares outstanding increases that amount. Another way of looking at it is through non-participating shareholders, their shares end up losing 5% of their weighting every year.

But the DRIP does raise equity cheaply, that funds their growth program. This greatly reduces the need to turn to the market for money. According to management, the DRIP program would be cancelled in the absence of growth opportunities—but in such a fragmented Canadian market, there are LOTS of opportunities.

COST REDUCTION—THE PARKLAND PENNY PLAN

On top of its growth pipeline, the company wants to reduce one penny per liter off its costs, organically generating $70M in free cash in 2016 – that's $0.01 X 7 billion liters. They call it the Parkland Penny Plan.

The plan is implemented using 3 levers:

Negotiate better discounts with suppliers.

Find more synergies across their operations—merging outlets that may sell different products in the same area, for example.

Using storage terminals to hold lots of oil, in case of refinery outages. Having a secure product supply means a lot, and is a great edge against smaller competition.

The company hosted its annual investor day on April 15, 2013 in Toronto providing a detailed progress summary on its Parkland Penny Plan.

Since its launch in May 2012, the plan has delivered $27 million in new EBITDA from the acquisitions of Elbow River, Sparling's and TransMontaigne. They expect to add another $7 million in EBITDA through acquisition synergies and $11 million from costs savings. This represents 36% of the targeted $125 million in new EBITDA Parkland is targeting by 2016.

The company expects to grow organically over the 2014-2016 period between 2-4% per year. Income investors stand to benefit from modest dividend increases mirroring the company's growth rate.

WHAT THE ANALYSTS SAY

FIRM	12 MONTHS TARGET PRICE
PI Financial	$19.00
National Bank	$19.00
Canaccord	$20.50

STOCK CHART

CONCLUSION

Parkland is a defensive stock that provides investors both growth and yield. The stock currently yields about 6.3% with a strong case for dividend growth. The company is implementing a plan that would see its fuel sales volumes grow to 7 billion liters annually doubling cash flow by 2016.

PLEASE UNDERSTAND SOMETHING HERE. I'm telling you about the growth the company is hoping to have, and the cost cutting activities it's doing to improve EBITDA—but the reality is that here in April 2013 the stock is still correcting from its Q4 miss, and the time to buy it is after it starts basing for a couple months.

Parkland offers income oriented investors with an attractive investment opportunity thanks to a sustainable high yield and multiple growth opportunities in multiple business divisions.