

Engine Capital Sends Letter to Parkland's Board of Directors Outlining Paths to Enhance Shareholder Value

Calls on the Board to Initiate a Strategic Alternatives Process, Including Evaluating a Sale or a Tax-Free Spinoff of Non-Core Assets to Become a More Focused Fuel and Convenience Retailer

Asserts Parkland Could Be Worth \$45 Per Share if the Board Follows Engine's Value-Enhancing Recommendations

NEW YORK--(BUSINESS WIRE)--Engine Capital LP, which owns approximately 2.0% of Parkland Corporation's (TSX: PKI) ("Parkland" or the "Company") outstanding shares, today announced that it has sent the below letter to members of the Company's Board of Directors.

March 22, 2023

Parkland Corporation
240 4th Avenue SW Suite 1800
Calgary, AB T2P 4H4
Attention: Board of Directors

Dear Members of the Board of Directors (the "Board"):

Engine Capital LP (together with its affiliates, "Engine" or "we") is a meaningful shareholder of Parkland Corporation (TSX: PKI) ("Parkland" or the "Company"), with an ownership position of approximately 2.0% of the Company's outstanding shares. Engine is a value-oriented investment fund whose principals have significant experience investing in the convenience retail and fuel marketing industry, including prior investments in CST Brands, Inc., until its sale to Alimentation Couche-Tard Inc. (TSX: ATD), and Casey's General Stores, Inc. (Nasdaq: CASY).

We have followed Parkland closely for many years and initially invested in the Company due to the strength and scale of its global fuel and convenience retail network, its differentiated supply capabilities, the strength of its owned brands and branded partnerships, its very compelling valuation and our belief that there are opportunities readily available within the control of the Board to significantly increase value for shareholders.

Unfortunately, Parkland has been unable to translate its advantaged strategic position and quality assets into adequate returns for shareholders with total shareholder returns ("TSR") trailing relevant benchmarks and peers over every relevant time horizon (as detailed in the below table).¹ It is worth noting that Parkland has underperformed both its convenience retailer and refinery peer groups over the 1-, 3-, 5- and 10-year periods. We are particularly troubled by Parkland's staggering underperformance compared to Canadian convenience retailer champion, Alimentation Couche-Tard Inc. (TSX: ATD).

¹ Total shareholders returns calculated as of the close of March 17, 2023. Convenience retailer peers consist of ATD, CASY and MUSA. Refinery peers consist of MPC, PSX, VLO, DINO, DK, PBF, CVI, PARR and CLMT. We did not include a 10-year TSR for the refinery peer group since Parkland only acquired the Burnaby refinery in 2017.

As a result of this sustained underperformance, Parkland is currently trading at a considerable discount to its retail peers and intrinsic value. The Company has a market capitalization of around \$4.9 billion and an enterprise value of approximately \$10.4 billion, implying a 2023 free cash flow yield of around 15%, a 2023 price-to-earnings multiple of around 12x and a 2023 EV-to-EBITDA multiple of around 6.5x.² These multiples are too low on both an absolute and relative basis. By comparison, Alimentation Couche-Tard trades at a 2023 price-to-earnings multiple of around 16x and a 2023 EV-to-EBITDA multiple of around 9.5x.

Since its creation, Parkland has pursued an aggressive M&A strategy and accordingly, gained significant scale and supply advantages. The Company today considers this vertically integrated supply strategy as one of its core competitive advantages. In its pursuit of this strategy, Parkland has accumulated a range of assets that are not typically owned by pure play fuel and convenience operators. We believe these assets create significant complexity and detract from the Company's underlying valuation leading investors to view Parkland as a conglomerate with disparate assets, instead of a pure play convenience retailer. Conglomerates typically trade at a steep discount to the sum of the parts – and Parkland is no exception.

The reason investors are willing to assign high multiples to pure play fuel and convenience retailers is because these businesses are stable, predictable and cash flow generative. These same investors are not willing to value Parkland in the same way or take the time to analyze Parkland since it also owns several other assets, such as a volatile and more capital-intensive refinery, and low growth commercial assets, such as heating oil and propane distribution businesses. **Therefore, if Parkland wants to be valued like a pure play fuel and convenience retailer, it should simply become a pure play fuel and convenience retailer.**

The complexity of Parkland's business can be best evidenced by the wide list of companies the Company uses in its management information circular to establish its peer group for compensation purposes. The peer group includes (among others) companies as diverse as convenience retailers (Murphy USA, Casey's General Stores), a refiner (Delek USA), pipeline operators (Magellan Midstream Partners, DCP Midstream), utility and energy companies (Emera, Algonquin Power & Utilities, Canadian Utilities), a logistics company (TFI International), a natural gas producer (Keyera) and food retailers (Empire Company, Metro).³

We understand that M&A has historically made sense for the Company in the context of increasing its supply advantage. At this stage of its evolution, however, Parkland has sufficient scale, which is why the Board should now turn its focus to optimizing the Company's structure, simplifying its business and becoming a best-in-class fuel and convenience retailer.

We believe the Board needs to take the following actions in the near-term to enhance long-term shareholder value:

- 1. Immediately start exploring all strategic alternatives for Parkland, including evaluating the sale or spinoff of non-core assets with the goal of becoming a more focused fuel and convenience retailer.**
- 2. Adhere to best corporate governance practices by refreshing the Board and adding directors with convenience merchandising and capital allocation experience.**
- 3. Improve the Company's compensation framework to better align management's incentives with shareholder's interests.**

² P/E and EBITDA multiples per CapitalIQ.

³ Complete list of peers can be found in the Company's 2022 Management Information Circular.

The following sections of this letter detail our views on these different topics.

1. Immediately start exploring all strategic alternatives for Parkland, including evaluating the sale or spinoff of non-core assets with the goal of becoming a more focused fuel and convenience retailer.

The long-term underperformance of Parkland compared to its pure play convenience retailer and refinery peers over every relevant time horizon should convince the Board that the status quo can no longer persist. This underperformance compared to pure play peers of Parkland's convenience retailer and refinery businesses is typical of a conglomerate's underperformance and is the reason why investors prefer to invest in pure plays that can allocate capital more effectively, optimize the capital structure and incentivize management more appropriately. We would also note that Parkland's multiple has steadily contracted since shortly after the purchase of Chevron Canada, which came with the Burnaby refinery.

Given these dynamics, we believe the Board should immediately start exploring all strategic alternatives for Parkland, including monetizing or separating the Burnaby refinery and the heating oil and propane distribution businesses. We are aware of several parties interested in these different assets. We acknowledge that such a sale is complicated by the need to structure a long-term contract since Parkland's fuel retail operations will continue to be a major customer of the refinery. We also acknowledge that there is potential tax leakage that must be evaluated.

Given these potential concerns, in addition to the consideration of the outright sales of these assets, the Board may want to evaluate a potential tax-free spinoff of the refinery and/or the commercial distribution businesses into a separate public company that could optimize its own capital allocation strategy and capital structure. In such a scenario, Parkland would become two public companies:

- *Parkland RemainCo* would be a higher growth pure play fuel and convenience retailer that would continue growing through M&A with a particular focus on improving and growing its merchandising operations. *Parkland RemainCo* would trade at a much higher multiple than the current Parkland multiple especially as its merchandising mix increases. This entity (with its higher multiple) would have a lower cost of capital and the currency to fuel its acquisitions.
- *Parkland SpinCo* would be a lower growth company with the refinery and/or the distribution businesses. This business could return most of its cash flows to shareholders through dividends. The close ties between the two companies could be maintained through contractual agreements or through other types of governance structures.

While it is difficult as outsiders to opine whether a sale or a spin will maximize the most value for shareholders, it is something that the Board and its investment bank should immediately start exploring.

While we acknowledge that there are some arguments that could be made as to why these businesses should stay together, it is clear to us that considering the complexity, the conglomerate discount and the long-term underperformance of Parkland's stock that Parkland in its current form does not work as a standalone public entity. We believe that Parkland does not need to own all these assets under one corporate umbrella in order to achieve most of the vertical integration or scale benefits that it enjoys today. Instead, Parkland could rely on contractual agreements or other forms of control to achieve the best of both worlds – optimizing the value of the business, while keeping the benefits of scale and vertical integration.

The Board may want to consider Marathon Petroleum Corporation (NYSE: MPC) ("Marathon") as an interesting case study. Marathon was a complicated conglomerate with retail, refining and midstream businesses. Like Parkland, Marathon operated a vertically integrated business model and believed the business model created scale and synergies. Like Parkland, Marathon's stock was a perennial

underperformer. In August 2020, under pressure from shareholders, Marathon announced the sale of its retail operation (Speedway) to a large competitor. As part of the deal, it entered into a long-term supply agreement with the buyer to provide fuel as well as logistics and transportation services to the Speedway business, and used the proceeds of the sale to paydown debt and return capital to shareholders. More importantly, it simplified and refocused the business. Since announcing this sale in August 2020, Marathon's share price has increased by around 258% and outperformed its peers by around 150%.⁴

2. Adhere to best corporate governance practices by refreshing the Board and adding directors with convenience merchandising and capital allocation experience.

We are concerned that three of Parkland's directors have served on the Board for twelve years or more, including Chairman Jim Pantelidis who has served on the Board for **24 years**, and Mr. Spencer and Mr. Bechtold who have been on the Board for 21 and 17 years, respectively. Directors who have served for more than 12 years are deemed "stale" and non-independent based on criteria set by leading institutions and proxy advisors. CalPERS, which manages the largest public pension fund in the U.S., suggests that this length of service is around twelve years.⁵ While ISS does not currently have a voting policy relating to director tenure, its views on the topic are clear through its QuickScore governance rating system, which states that *"limiting director tenure allows new directors to the board to bring fresh perspectives. A tenure of more than nine years is considered to potentially compromise a director's independence and as such QuickScore will consider tenure > 9 years excessive."*

We are also concerned by the extensive interrelationships among certain directors. Mr. Pantelidis and Bechtold were senior executives and colleagues at Petro Canada for years before working on the Parkland Board together for more than 17 years. Mr. Pantelidis and Richardson also served together on the Board of Rona Inc. for years until its sale in 2016. Subsequently, Mr. Richardson joined the Parkland Board in 2017. Mr. Spencer, who has been on the Parkland Board since 2002, was considered a "non-independent director" until 2020 because he was a partner at Bennett Jones LLP, the Company's law firm. Such interrelationships call into question whether these directors are capable of acting independently.

We also note that Chairman Pantelidis is also the Chair of the Strategic Initiatives & Corporate Development Committee and that two of the four members of that committee include Mr. Pantelidis and Mr. Bechtold, who together have served on the Board for a cumulative total of **41 years**. Given the necessary changes we highlight in this letter, we are concerned by the outsized influence of these long-tenured and interconnected directors have on the capital allocation and strategic direction of the Company.

Given the long tenure and the interconnections of certain Board members and the fact that the vast majority of directors have energy and petroleum experience, we believe that the Board needs to be strengthened through the addition of new directors with more diverse skillsets. It is our view that investors would benefit by having shareholder-designated directors with convenience merchandising backgrounds, as well as financial and capital allocation experience added to the boardroom.

3. Improve the Company's compensation framework to better align management's incentives with shareholder's interests.

⁴ Peers consist of PSX, VLO, DINO, DK, PB and CVI.

⁵ "Director Tenure: Boards should consider all relevant facts and circumstances to determine whether a director should be considered independent – these considerations include the director's years of service on the board – extended periods of service may adversely impact a director's ability to bring an objective perspective to the boardroom. We believe director independence can be compromised at 12 years of service – in these situations a company should carry out rigorous evaluations to either classify the director as non-independent or provide a detailed annual explanation of why the director can continue to be classified as independent." Source: "Governance and Sustainability Principles", California Public Employees Retirement System, September 2019. <https://www.calpers.ca.gov/docs/forms-publications/governance-and-sustainability-principles.pdf>

We believe Parkland's executive compensation framework could be significantly improved by making the following changes:

- A. Financial "per share" metrics should be used to determine the annual incentive plan targets and should exclude the impact of acquisitions.** For example, if the Board wants to continue using EBITDA as a financial metric, it should instead switch to EBITDA per share, which would incentivize management to think more broadly about capital allocation since there may be times when repurchasing shares are a better use of capital than M&A. We would also suggest the Board deemphasize subjective and non-quantitative metrics such as "supply advantage" or "low carbon strategy." We would also suggest the Board reintroduce free cash flow per share as a metric. We note that this was a metric used by the Board prior to 2021 but was unfortunately removed. Free cash flow per share is a critical measure as the Board takes into account capital expenditures and working capital.
- B. We do not believe executives should earn any TSR-related performance share units ("PSUs") unless Parkland's relative TSR is at or above the 50th percentile.** A significant portion of executives' long-term compensation is tied to PSUs. The number of PSUs earned is determined by measuring Parkland's relative TSR and relative ROIC compared to a peer group. Based on our understanding of the current plan, executives would earn half of their target PSUs if Parkland's relative TSR is at the 25th percentile. We believe the current TSR threshold is simply too low.
- C. The peer group selected by the Board is comprised of companies significantly larger than Parkland, leading to executive compensation being potentially artificially too high.** Given Parkland's business and the low margins of fuel retailing, we do not believe revenue is a good proxy to consider when establishing the peer group. Instead, we believe that market capitalization and enterprise value are the more relevant proxies. We also note the peer group has consistently outperformed Parkland, which should be reflected in compensation as well. The below table highlights that Parkland is around the 25th percentile of the peer group when considering market capitalization and enterprise value and is significantly below the 25th percentile when considering TSR, raising significant questions around the validity of this peer group.

In conclusion, we believe that the value creation opportunity at Parkland is significant and that there are meaningful levers for the Board to significantly enhance shareholder value in the public market. If we assume an 8.5x EBITDA multiple for the fuel and convenience retail assets and a 5x EBITDA for the commercial and refining assets (both conservative multiples), we believe the stock would be worth around \$45 per share, a premium of around 55% to Parkland's recent price.

If the Board is unwilling to optimize the business in the public market, we believe the Board should consider a sale of the entire Company to either private equity or strategic buyers.

We request a meeting with members of the Board as soon as possible to discuss the matters and initiatives set forth in this letter. On behalf of Engine, we look forward to working cooperatively with you to increase long-term shareholder value.

Sincerely,

Arnaud Ajdler
Managing Partner

Brad Favreau
Partner

About Engine Capital

Engine Capital LP is a value-oriented special situations fund that invests both actively and passively in companies undergoing change.

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