Engine Capital Sends Letter to Parkland's Board of Directors Highlighting Additional Opportunities to Unlock Shareholder Value

Believes Leadership Should Announce Additional Value-Enhancing Initiatives and Further Highlight the Value of the Business at Parkland's Upcoming Analyst Day

Recommends Refining Parkland's Capital Allocation Framework, Aligning Management Compensation to Shareholders' Interests and Optimizing Company Operations to Increase Long-Term Value

NEW YORK--(BUSINESS WIRE)--Engine Capital LP, which owns approximately 2.5% of Parkland Corporation's (TSX: PKI) outstanding shares, today announced that it has sent the below letter to members of Parkland Corporation's Board of Directors.

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September 26, 2023

Parkland Corporation

240 4th Avenue SW Suite 1800
Calgary, AB T2P 4H4
Attention: Board of Directors (the "Board")

Dear Members of the Board:

As you know, Engine Capital LP (together with its affiliates, "Engine" or "we") is a meaningful and long-term shareholder of Parkland Corporation (TSX: PKI) ("Parkland" or the "Company"), with an ownership position of around 2.5% of the Company's outstanding shares. We want to commend the Board for taking steps over the last few months that have begun to unlock shareholder value. These steps include:

- **Refreshing the Board** by adding two shareholder representatives and facilitating the departure of the three longest-tenured directors (including the prior Chairman).
- **Simplifying the business** with the announcement to monetize $500 million of Parkland's non-core assets by 2025.
- **Enhancing the profitability of the core business** with the announcement of $100 million of cost savings and efforts to unlock synergies from past acquisitions.
- **Maximizing free cash flow and deleveraging the balance sheet**.

Despite these initiatives, Parkland remains deeply undervalued, trading at an EV-to-EBITDA multiple of 6.5x[1] and a 2024 maintenance free cash flow yield north of 13%.[2] We believe Parkland's upcoming November Analyst Day provides an opportunity for leadership to announce additional value-enhancing initiatives and further highlight the value of the business. The recommendations we detail in today's letter are centered around refining the Company's capital allocation framework, better aligning management compensation with shareholders' interests and further simplifying and optimizing Parkland's operations. We believe the following actions have the potential to unlock significant shareholder value and help the market

[1] Based on management's $2,000 million EBITDA guidance for 2024. As of September 22, 2023.
[2] Maintenance free cash flow is defined as cash flow from operations less maintenance capex, interest on leases and debt and principal payments on leases.

value Parkland more appropriately, and therefore believe they should be addressed by the Company at its upcoming Analyst Day.

1. <u>Communicate Parkland's long-term cash flow opportunity</u>.

Many companies share longer-term free cash flow forecasts, typically over a five-year horizon, during analyst days. Given the stability of Parkland's business, we believe this is something the Company should do. Based on our assumptions, we believe that Parkland will conservatively generate approximately $10.5 billion of Adjusted EBITDA and approximately $5.1 billion of maintenance free cash flow over the next five years (2024 to 2028). Parkland is also projected to receive proceeds of $500 million from non-core asset sales, for a total of $5.6 billion of deployable capital. These are incredibly high numbers for a Company with a market capitalization of $7 billion. We believe it is important for the Board to communicate this longer-term forecast to help the financial community assess the long-term potential of Parkland, and more specifically, its robust and reliable free cash flow available to equity holders.

2. <u>Develop and communicate a precise long-term capital allocation framework</u>.

Given the exceptional free cash flow generation of Parkland's business, we believe the Board needs to be explicit and precise with its capital allocation framework. This clarity will give the market a better understanding of the Board's approach to capital management and should result in enhanced credibility and valuation of the business. We understand the Board's near-term priority is to optimize the current portfolio (synergies and cost savings) while also demonstrating its organic growth potential, which we assume will take two years. During this time, we believe the Board should abstain from M&A. We have developed the following capital allocation framework for Parkland and provide our reasoning and financial assumptions that support this model:

- **In 2024 and 2025, allocate a cumulative amount of around $800 million for share repurchases.** This amount would represent the repurchase of around 12% of the Company's shares outstanding at today's prices, which would be an excellent use of capital given the stock's undervaluation. These share repurchases should be frontloaded in 2024 to take advantage of the stock undervaluation.
- **In 2024 and 2025, pay down debt by a cumulative amount of around $600 million** primarily using proceeds from asset sales to reach the mid-point of the Company's target range.
- **Over the subsequent three years (2026 to 2028), allocate free cash flow to M&A and share repurchases based on external opportunities and relative valuation.**

This framework is based on the following assumptions:

- ***Parkland's undervaluation provides an opportunity for share repurchases beginning in 2024:*** While the Company should continue to deleverage and reach at least the mid-point of its leverage target range, we do not believe it has to be done with the same sense of urgency once the Company's leverage dips below 3x (which will happen shortly). At that point, the Board can be more flexible and prioritize other capital allocation options such as share repurchases, especially considering the stock's undervaluation. The opportunity to repurchase a meaningful amount of outstanding shares at a very attractive price exists now. Conversely, if the Board prioritizes deleveraging first, we suspect it will end up having to repurchase shares at a significantly higher price (as management continues to improve operations and simplify the business). Repurchasing shares only creates value if they are repurchased below their intrinsic value. Therefore, share repurchases should be frontloaded in 2024 while deleveraging can happen in 2025 primarily through the proceeds of the asset sales as they occur. <u>If we assume 2025 EBITDA of $2.1 billion</u>

(normalized for turnarounds), the Company needs to allocate less than $600 million for debt repayment to reach the midpoint of its leverage target.[3]

- ***$1.4 billion in excess cash should be deployed opportunistically:*** Over the next two years (2024 and 2025), Parkland will generate approximately $1.8 billion of maintenance free cash flow, as well as $500 million from asset sales for a total of $2.3 billion of deployable cash. Around $500 million of this amount will go to paying dividends and $400 million will go to growth capex, leaving around $1.4 billion of excess cash available to deploy. As mentioned, the Company needs to use less than $600 million to get to a leverage of 2.5x and can therefore use the remaining $800 million for share repurchases.
- ***Consider M&A only after Parkland's operations have been optimized:*** From 2026 to 2028, Parkland will generate around $3.3 billion in maintenance free cash flow. It will pay around $800 million in dividends and $600 million in growth capex, leaving $1.9 billion available for capital deployment. At that point, the Company could consider M&A again. By then, the operations will be more optimized, the Company's profitability will be meaningfully higher, the leverage will be in check, and we suspect the stock may trade at a more reasonable valuation, making share repurchases potentially less attractive. At that point, Parkland will be in an ideal position to consider M&A and take advantage of its supply advantage to maximize potential synergies.
- ***Raise return threshold for growth capex:*** We have assumed around $200 million in growth capex annually. We believe Parkland needs to raise its return threshold for growth capex to continue raising its ROIC. Whether for growth capex or M&A, Parkland needs to evaluate these investments by comparing their attractiveness to repurchasing shares as an alternative. For illustration, at the current share price, repurchasing Parkland shares is likely to result in an IRR north of 15% (and meaningfully above the Company's cost of capital). Therefore, the Board needs to make sure that any growth capex or M&A results in an IRR superior to that 15% alternative.

Formalizing and quantifying a long-term capital allocation framework will be an important step to providing more transparency to Parkland's investors and can help the market more accurately value the business.

3. Further refine Parkland's compensation framework to better align management incentives with shareholders' interests.

Parkland's compensation structure is fundamentally flawed and has the potential to incentivize bad behavior. One major flaw of the current framework is that management gets credit for the EBITDA and distributable cash flow ("DCF") from acquired businesses as part of its annual incentive plan. Management can simply make an acquisition, acquire EBITDA and max out its short-term bonus. This does not create the right incentive structure and can lead to significant value destruction, as management should not be incentivized to simply make acquisitions and increase EBITDA.

One can argue that the mess Parkland got itself into last year is a result of its own compensation framework: make acquisitions, stress the balance sheet, increase EBITDA and max out on bonuses. This dynamic may have also played a role in 2022 when management earned 148% of its target payout for the EBITDA component of its bonus, despite poor operating performance (particularly in Q3). We believe that the acquisition of the 25% of Sol Investments Limited that Parkland did not own and its associated EBITDA played a large role in management getting to this 148% payout.

This structure is flawed and needs to be immediately corrected. Acquisitions must be excluded when considering annual incentive compensation. Additionally, instead of using EBITDA or DCF as a metric, we believe the Compensation Committee needs to start using per share metrics (instead of absolute numbers).

[3] We assumed that all excess cash flow in Q3 and Q4 2023 is used to pay down debt.

Management's job is to increase EBITDA per share or DCF per share, not necessarily EBITDA or DCF in an absolute sense.

Finally, we believe DCF should have a higher weight than its current 10% for the bonus calculation. We would therefore suggest the following weight be assigned for the annual incentive compensation, using Bob Espey's compensation framework as a reference, with the caveat that acquisitions are no longer included in the numbers.

Annual Incentive Framework
Illustrative Example for Mr. Espey, Chief Executive Officer

Metric	Weighting
Adjusted EBITDA per share	*45%*
Distributable Cash Flow per share	*20%*
Safety	*10%*
Diversity and Inclusion	*5%*
Balance Sheet	*10%*
Decarbonization	*10%*

4. <u>Announce an additional $100 million of cost savings by 2025 and commit to higher ROIC target.</u>

While we commend the Company on its recent announcement and implementation of a $100 million cost restructuring, we believe there are opportunities to further streamline the cost structure, especially as the Company continues to integrate prior acquisitions and dispose of non-core assets. Based on our own benchmarking and discussions with management, we believe an additional $100 million of cost savings is available to Parkland. We believe it would be helpful for management to give the financial community visibility into these opportunities at its upcoming Analyst Day. This will help investors better understand the normalized level of profitability of the business. Increasing Parkland's profitability as well as raising the return threshold for growth capex will be key levers to further increase Parkland's ROIC which remains too low even at the recently announced target of 11%.

5. <u>Continue to focus on simplifying the business and divesting non-core assets</u>.

While we are pleased the Company has initiated the process to monetize $500 million of non-core assets, we believe Parkland needs to go further. After years of prodigious M&A activity, there are additional non-core assets that can be monetized. As an example, the heating oil business does not seem core to Parkland because it does not reinforce the core business. From our perspective, it should therefore be sold.

In conclusion, we continue to believe that the value creation opportunity at Parkland is significant. While we are encouraged by recent value-enhancing actions leadership has taken, we firmly believe additional steps need to be taken. We look forward to expanding our ongoing dialogue with the Board and management to help increase long-term value for the benefit of all Parkland stakeholders.

Sincerely,

Arnaud Ajdler
Managing Partner

Brad Favreau
Partner

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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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