

PALOS

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Palos Weekly Commentary

Issue No. 5 | JANUARY 31 2019

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Palos Funds

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Stop Loss on SNC-Lavalin Group Inc.

On January 28, 2019, SNC-Lavalin Group Inc (TSX:SNC) dropped another bomb on investors. A few years ago, SNC was being investigated for corruption and also had a failed IPO for Highway 407. This kept the valuation on SNC attractive, and the company made some strategic acquisitions that diversified their business. My investment thesis was based on valuation and management's ability to regain investor confidence by diversifying their business.

I attended multiple meetings with the President and CEO Neil A. Bruce and had many calls with SNC's investor relations department. I was under the impression that SNC was on a new path, where management was making the appropriate changes to gain investor confidence. Boy was I wrong! On January 28, 2019 the negative news would not stop:

- SNC cuts 2018 forecast
- Serious problem with a mining contract
- SNC takes a \$1.24 billion impairment charge
- SNC won't be able to meet its 2020 profit goal
- SNC sees lower Oil & Gas revenue in 2019

To say the least, the news was exhausting. As a previous investor of SNC, I no longer have any confidence in this company. Especially since we spoke to the company a few months ago about Saudi Arabia and the possible effect from the geo-political risk between Canada and Saudi Arabia. The company was confident and explained to me that SNC's Kentz and Atkins subsidiary works in Saudi Arabia and is viewed as British and would therefore not be impacted. The company is now saying that exiting Saudi Arabia is a possibility.

SNC is now trading at a very attractive valuation versus its peers. However, I view this name as a value trap that will take many years to regain any confidence from investors. I took the loss and moved on to better investment opportunities. When hope becomes your only investment thesis, it is time to move on.

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) ¹	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	\$8.46	7.19%
Palos Equity Income Fund - RRSP	PAL101	\$5.68	6.22%
Palos Merchant Fund L.P. (Dec 31, 2018) ²	PAL500	\$1.82	6.59%
Palos WP Growth Fund - RRSP	PAL210	\$7.65	8.15%
S&P TSX Composite (Total Return with dividends reinvested)			8.30%
S&P 500 (Total Return with dividends reinvested)			7.07%
S&P TSX Venture (Total Return with dividends reinvested)			10.43%
Chart 2: Market Data ¹			Value
US Government 10-Year			2.68%
Canadian Government 10-Year			1.91%
Crude Oil Spot			US \$54.23
Gold Spot			US \$1,309.90
US Gov't10-Year/Moody BAA Corp. Spread			237 bps
USD/CAD Exchange Rate Spot			US \$0.7604

¹ Period ending Jan 30, 2019. Data extracted from Bloomberg

² Fund is priced annually

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