March 31, 2016

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
March 31, 2016

Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	Since Inception March 31, 1993
DK EQUITY GROWTH FUND	**5.8%**	**-1.2%**	**4.0%**	**8.5%**	**-0.8%**	**4.9%**	**15.1%**	**11.7%**	**14.5%**
S&P/TSX Composite Index	4.5%	-6.6%	0.0%	5.0%	2.1%	4.0%	6.5%	7.5%	8.4%
S&P 500 (in U.S. Dollars)	1.3%	2.0%	7.2%	11.9%	11.6%	7.0%	6.0%	8.0%	9.0%

We entered 2016 watching the same bearish headlines that dominated the media and global equity markets in 2015. Will the U.S. Federal Reserve raise interest rates? . . . Will the U.S. economy enter a recession? . . . Will China's economy collapse? . . . When will the global oil market recover? The U.S., Canadian, and global markets were weak and wobbly in 2015. With this same sentiment carrying on into the New Year, the dominant headline by mid-January was "U.S. stocks post worst 10 day start to a year in history". By contrast, in early March the dominant headline was "Best U.S. stocks rally since 2014". And nothing had changed in the global macro environment.

It is worth recalling from our 2013, 20th Anniversary book, Lesson #7 . . . "Don't Get Your Investment Advice from the Media".

The Canadian TSX index outperformed the U.S. Indices in the first quarter of 2016 for the same reason it underperformed in the previous year. The Canadian Index is more heavily weighted to oil and natural resource producers than the U.S. counterparts. Oil declined from a peak of $107.00 per barrel (WTI) in mid-2014 to a low of $26.21 per barrel in February of this year. Oil has since bounced back to $38.34 by the end of this quarter. And along with oil, the Canadian dollar rebounded from a January low of $0.69 cents U.S. to $0.77 by quarter end.

We wrote in considerable detail about stock markets and the Canadian dollar in a separate note to our clients dated August 25, 2015. (Letter to Clients August 2015)

[1] Returns are presented gross of management fees.

The most important development for our portfolio in Q1 was the takeover bid by U.S. based Lowe's Companies Inc. for **Rona Inc.** Lowe's is the second largest home improvement chain in the U.S. and Rona is the largest in Canada. On February 3rd it was announced that Lowe's had offered to pay $24 Canadian for all of the outstanding shares of Rona. This represents a 104% premium to Rona's closing share price the previous day, and a substantial premium to our average cost in the portfolio of just over $12 per share.

We had been following Rona for many years. We had visited the previous management. We were interested in the business because of its dominant competitive position in the Canadian home improvement business. Rona has a strong national presence and strong national branding. But prior to 2013 Rona had been a chronic underperformer. In our opinion they were overspending on promotion, with too much head office overhead, and weak merchandising.

In 2012 Lowe's attempted to buy Rona with a $14.50 per share bid. Existing management at that time successfully played the Quebec nationalist card with the then Parti Quebecois Government. Lowe's withdrew its offer.

Subsequently, the Caisse de Dépôt (the behemoth Quebec public pension fund), who is a significant holder of Rona, installed Robert Chevrier as Executive Chairman in January 2013. Robert Chevrier's arrival on the scene at Rona was a signal for us to take notice.

We at Deans Knight were well acquainted with him. He has a well-earned reputation in the Canadian business community as a master strategist and turnaround specialist. In 1993 he had been brought in to improve the fortunes of Westburne Inc., the largest wholesale distributor of plumbing and electrical supplies in North America. United Westburne's shareholders (including ourselves) enjoyed a positive outcome as Mr. Chevrier turned the business around. Westburne was subsequently acquired by Paris based Rexel S.A. in 2000 at a substantial premium.

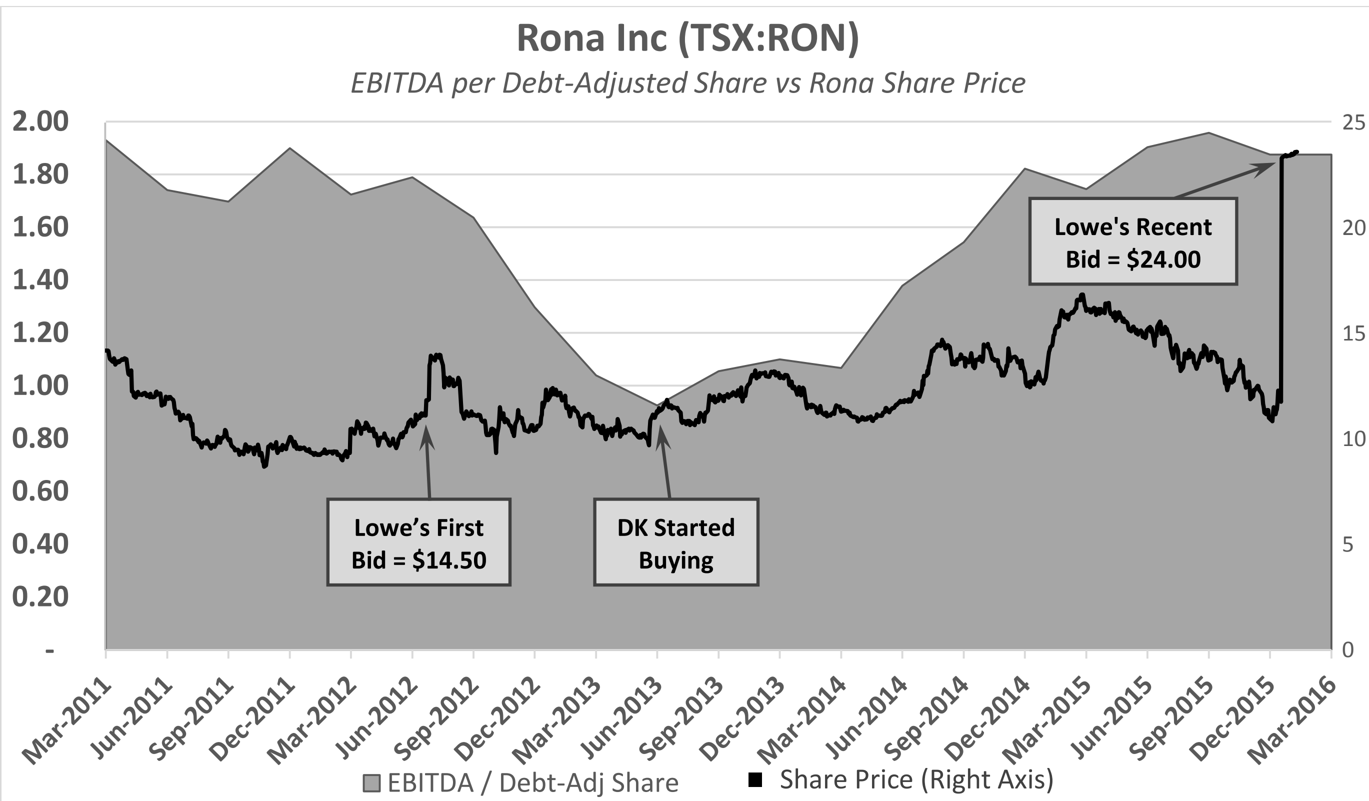
Mr. Chevrier had also appeared on the scene as Executive Chair at auto parts aftermarket distributor **Uni-Select Inc.** in 2012. At Uni-Select his influence resulted in a noticeable improvement in operations. In 2015 Uni-Select sold their U.S. auto parts division to Carl Ichan. The sale unlocked significant value. As a result Uni-Select was the best performing stock on the TSX in 2015, with appreciation of 124%. We are investors in Uni-Select and enjoyed significant value creation for our clients.

At Rona, Chevrier brought in two key merchandising stars . . . Robert Sawyer from Metro Richelieu and Alain Brisebois from Alimentation Couche-Tard. Although there are many boxes we are looking to tick before buying a company, management is the most important one. We do want to be involved with companies where we have identified unrealized value or unrecognized growth potential. However, we also want to be partnered with management we trust, we respect, and who share similar values to ours. The new Rona fit the bill. We were buying the number one branded, biggest home improvement chain in Canada, run by a very best-in-class management team.

We started accumulating stock in mid-2013. Rona demonstrates the need for patience when investing. With new management in place in 2013 shareholder value was steadily increased, but it went unrecognized by the market price of the stock.

New management cut costs and closed unprofitable locations. In each quarter, we witnessed improved same store sales, profits and cash flow. Rona paid us a dividend, bought back shares in the market, and paid down debt. In July of last year Rona executed a very important accretive deal to buy its 20 franchise stores, making Rona 100% corporate stores, and more valuable to a takeover bid.

The graph below shows clearly that value per share (the grey area) was being created with the arrival of new management, but the share price (black line) was flat lining until the Lowe's bid was announced.



The takeover of Rona was not an unusual outcome for us. The Rona transaction was the third such occurrence in the last 1½ years. In late 2014, we sold **Contrans Group Inc.** (our trucking Company), and last year, our U.S. division of Uni-Select, to buyouts. In fact, roughly 50% of the value of the shares that we have sold in our 23 year history have been to takeout bids. As a reminder, we found this paragraph in our December 31, 2001 report to clients:

> "In the year 2001 we continued to lose what we felt were undervalued and overlooked companies to takeover bids. Early this year we sold **Encal** (oil & gas) to a bid from U.S. based Calpine Corporation. We also sold our long held position in **Unican Security Systems** following a bid from a Swiss lock manufacturer, Kabba Holdings. Unican fit our selection criteria to a tee.

> Aaron Fish, a Montreal locksmith, started the company in the 1950's and gradually built the company into the largest key manufacturer in the world. The Company was also a major player in security entry systems (hotels & offices) and a major manufacturer of many types of locks. In the summer of 2000 the stock was languishing in the low $20 range. Kabba paid $36 cash for the company in a transaction that closed in April 2001. From the time Unican became a public company in 1967 until the Kabba purchase, Aaron Fish delivered his shareholders an annualized return of just over 15%. This is the way it is supposed to work. As Warren Buffet once said "It takes three things to be successful in business – brains, energy and character. Without the third, the first two will get you into trouble."

In our previous report (December 31, 2015) we reviewed in some detail, the major developments that occurred in 2015 in our stable of companies. Year to date, there have been a few more developments worth noting. **Asanko Gold Inc.** poured its first gold in January, well ahead of schedule. Asanko and **Lundin Gold Inc.**, both enjoyed the tailwind of stronger gold prices in Q1, and the improved investor sentiment for the precious metal, and for shares of gold companies.

Tourmaline Oil Corp., one of our natural gas producers, made more small acquisitions in the quarter. **Paramount Resources Ltd.** entered into an agreement in March to sell their Musreau processing plant and related infrastructure to Pembina Pipeline Corporation for $600 million. This enables Paramount to reduce debt.

In early March, **Lundin Mining Corporation** (base metals) announced that it had entered into an agreement to acquire an interest in Freeport-McMoRan Inc.'s Serbian high grade copper project. Lundin has been taking advantage of their strong balance sheet to acquire high quality assets in what has been the longest, deepest base metal slump in history.

We added to some of our existing holdings on share price weakness during Q1 . . . notably Paramount, **New Look Eyewear Inc., Sleep Country Canada**, **AutoCanada Inc.**, **Pine Cliff Energy Ltd.**, Lundin Mining and **Transat A.T. Inc.**

Paramount and Pine Cliff shares had been under pressure because of continuing weak natural gas prices . . . and Paramount because of too much debt which they addressed with their Musreau divestiture. New Look dipped on no news and we were able to acquire a small amount of additional stock. Transat shares have been lower because of the weak Canadian dollar, which negatively affects their profit margin because much of their costs are denominated in the stronger U.S. dollar. AutoCanada has been weak because 50% of their dealer sales are in Alberta and new car sales in that province have taken a beating because of the oil & gas induced contraction in Alberta's economy. We will continue to look for opportunities to purchase our businesses at what we believe to be attractive prices. We have more potential buying power in reserve as the Rona shares can easily be converted to cash as needed.