

June 30, 2007

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK EQUITY GROWTH FUND

Quarterly Review

June 30, 2007

Rates of Return¹

	<u>3 Mths</u>	<u>YTD</u>	<u>1 Yr</u>	<u>2 Yrs</u>	<u>3 Yrs</u>	<u>4 Yrs</u>	<u>5 Yrs</u>	<u>10 Yrs</u>	<u>Since Inception March 31,1993</u>
DK Equity Growth Fund	10.9%	15.8%	61.7%	47.8%	43.0%	44.9%	38.3%	20.2%	24.0%
S&P/TSX Composite Index	6.3%	9.1%	22.7%	21.2%	20.1%	21.2%	16.6%	9.9%	12.1%
DJIA	9.1%	8.8%	23.0%	16.9%	11.2%	13.0%	10.2%	7.8%	12.4%
S&P 500	6.3%	7.0%	20.6%	14.5%	11.7%	13.5%	10.7%	7.1%	10.8%

The **LionOre Mining Intl.** saga drew to a close during the past three months. This is a story that we and our clients have been very involved in since 1996. We have witnessed LionOre grow from a small operation, producing nickel from one mine in Botswana, to the world's largest publicly traded pure nickel producer with expanded operations in Botswana, and additional mines in South Africa and Western Australia. The Company also acquired, developed, and proved the patented Activox technology, which permits the extraction of nickel from sulphide deposits more efficiently and cost effectively. With soaring global nickel demand, particularly from China, and a run up in nickel prices, a wave of consolidation in the industry has gathered steam in the past two years.

LionOre became the most recent target when, on March 26th, Swiss-based Xstrata initiated a "friendly" cash bid of \$18.50 per share. The deal was termed "friendly" because it had the support of management, the directors, and a small group of shareholders, including ourselves. The group agreed to lock up their shares with Xstrata, but had the right to withdraw from the lock up if another bid was received that the LionOre Board of Directors deemed to be superior.

Subsequent to this initial bid, nickel prices continued to spike higher, eventually reaching \$22 per pound, causing LionOre's cash flow to balloon. Bear in mind, we were invested in LionOre when nickel was trading as low as \$1.75 per pound in 1999.

On May 3rd Norilsk entered the picture with a cash bid of \$21.50 per share. Russian-based Norilsk is the world's largest nickel producer. Xstrata countered on May 15th with \$25, and Norilsk came back at \$27.50 on May 23rd. To put the valuation in perspective here, just the increase in the market value of LionOre between the time of the initial Xstrata bid and the final Norilsk bid, a mere 58 days, was 1.5 times greater than LionOre's entire market cap one year ago.

¹ Returns longer than one year are annualized.

The lock up proved to be a potent value creating strategy. It drew the first bid to the table and created the auction that we feel resulted in a very attractive price for the Company. The \$27.50 Norilsk bid was deemed superior to Xstrata's bid and our shares were released from the lock up.

Rather than wait and tender our shares to the Norilsk bid, we elected to sell in the market at a small discount, thereby avoiding the potential risk, albeit small in our view, of an unforeseen development that could have derailed the Norilsk bid. By the end of June, the LionOre stock had been turned into cash, which represented roughly 20% of the portfolio. This cash is now available for other opportunities that may emerge over the next few months. As a footnote, during the month of June the price of nickel declined by 25%.

It is also worth noting that our commitment to resources has come down a long way over the past year with the sale of **First Quantum Minerals**, **Paladin Resources**, and now LionOre. This is a natural process after a massive 6 to 7 year run-up in metal prices.

In our last quarterly, we reported on the not-so-positive developments at **Menu Foods**. Menu Foods is the largest private label manufacturer of wet pet food in North America. On March 16th the Company announced a recall of roughly 60 million pouches and cans of cuts and gravy style dog and cat food following the deaths of 14 animals. It was subsequently discovered that the source of the contamination was wheat gluten (protein) that was produced in China. A number of other pet food companies were using the same wheat gluten and the recall was eventually expanded to include roughly a dozen other manufacturers.

As we wrote in our last report, we are in the "unenviable position of not having enough information to predict the outcome of this very difficult situation". Three months later it is still difficult to assess the potential damage to Menu's relationships with customers and credibility with the North American consumer.

However, since our last report, Menu has successfully negotiated a deal with their creditors to provide the necessary near term liquidity to see the Company through the cost of the product recall, now estimated to be roughly \$45 million. However, in a negative development, Proctor & Gamble cancelled all orders with Menu for their Iams Cuts and Gravy product, which represented 11% of Menu's 2006 sales. In our opinion, it will take until the late Fall to have a better understanding about the condition of the business. At that time, we expect the Board of Directors will have enough information to be able to evaluate the options and make a decision as to how to best move forward.

Following the sale of LionOre we are sitting with considerable cash balances. In addition to continuing to evaluate new opportunities, we are gradually adding to our holdings in **Loblaws**. Due to fears of increased competition from Wal-Mart and various operational difficulties, the market has punished Loblaws' stock, valuing the company today at \$17 billion, a 40% decline from two years ago.

Loblaws owns much of the real estate where the stores are located. Analyzing this real estate in the context of precedent transactions, we can build a case that it could be worth roughly \$6.5 billion. In addition to this, Loblaws owns the very successful President's Choice brand of household products. President's Choice has revenues of roughly \$6.4 billion and we estimate the brand has a value of roughly \$4.5 billion.

If we back out the real estate and the President's Choice business, we are paying about 5.5 times for the \$1.1 billion in cash flow that Loblaw's produced last year. We believe the cash flow is at a low point, and with a successful turnaround cash flows will increase, which would add significant value to shareholders.

We have also been gradually building a position in **Canwest Global Communications**. Canwest is an international media company with three primary assets; Australian TV (Ten Networks), Canadian newspaper & online assets (Canwest MediaWorks Income Fund) and the Canadian Global TV network held directly under Canwest Global.

In June Canwest ended talks to sell Ten Networks because they felt they were not being offered enough for the business. If we value Ten Networks at the price that they turned down then Canwest's share of the company is worth about C\$1.3 billion. If we value the MediaWorks subsidiary at similar prices to other recent newspaper transactions, the subsidiary would be worth about \$2.8 billion. Based on these values we are getting the Canadian TV assets for free at today's stock price.

The Canadian TV assets are expected to generate about \$60 million in cash flow this year. Furthermore, in January Canwest entered a deal with Goldman Sachs to buy the Alliance Atlantis specialty TV channels to compliment their conventional Canadian TV assets. Canwest paid \$200 million for a 29% stake in the specialty channels and can earn a larger share depending on how the conventional TV network performs between now and 2011.

In the December report we expressed our opposition to the government's announcement to begin taxing income trusts in 2011. An unforeseen and unintended consequence of this legislation has been a wave of takeovers of the trusts following the decline in valuations in the past 6 months. Since the announcement a total of 26 income trusts, representing a total value of \$8 billion, have been taken over. These transactions will result in job losses and reduced tax revenue to the government. Furthermore, 50% of these transactions were done by foreign groups, resulting in potential further tax leakage.

BCE's potential conversion to a trust last fall was one of the major factors in the government's decision to tax trusts citing losses in tax revenue and a lack of reinvestment of capital. On July 2nd, Ontario Teachers, along with two U.S. based private equity funds, successfully bid to take BCE private financed largely with debt. Since interest is tax deductible, BCE will pay little to no tax and Ottawa stands to lose more than \$1 billion in annual tax revenue. In addition, the large interest payments will restrict the amount of capital BCE can invest back in to the Company. BCE as a private company is worse for Canada than BCE would have been as a trust.

None of this should have happened. In our view the government was not losing tax dollars to the trust structure. The trust structure gave these businesses a relative competitive advantage, made them stronger, and it resulted in larger personal income tax revenues to the government. Rather than imposing a tax on the trust, a better course of action would have been to stop meddling, allow more corporations to convert to trusts, or even better, eliminate corporate income taxes entirely, which are a punitive and unnecessary form of double taxation of individual Canadians.