DK EQUITY GROWTH FUND

Quarterly Report
September 30, 1999

Rates of Return

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	6Yrs
DK Equity Growth Fund	**1.4%**	**21.7%**	**29.9%**	**-17.0%**	**-4.8%**	**8.0%**	**12.1%**	**13.0%**
Nesbitt Burns Small Cap Index (Unweighted)	5.1%	13.1%	20.0%	-11.9%	-1.2%	4.3%	4.5%	4.3%
TSE 300	-0.4%	8.5%	25.9%	1.0%	11.4%	13.3%	11.9%	11.9%

For the first time in a number of years we have seen a change in returns in favour of small company stocks. Looking at the table above, the Nesbitt Burns Small Cap unweighted index has generated roughly a 13% return for the 9 months ended September 30 compared to 8.5% for the larger capitalization dominated TSE 300. The return on your portfolio over the same period has been a respectable 21.65%.

We stated in previous reports that we intended to stay with those areas of the market that have been out of favour and underpriced i.e. smaller company stocks and resource-based stocks. Both had been ignored over the previous two years. Resource stocks in particular had fallen from favour subsequent to the Asian crisis in late 1997.

We pointed out in our June report that interest in out of favour securities is often rekindled as a result of takeover activity. As the valuation gap widens we see larger cap companies acquiring smaller ones, or taking significant share ownership positions, particularly in the resource sector. This has happened to six of our companies in the past 12 months and we expect there will be more of this activity over the next 12 months.

We have a large commitment to oil and gas stocks at this point in time (roughly 30% of the portfolio). Rarely have we seen the environment for the industry so positive, and yet the stocks so cheap. The valuations still seem to be suffering a hangover from the longest and steepest decline in oil prices in history that occurred between mid 1997 and the end of 1998.

By mid December of 1998 oil traded below $11 per barrel (using WTI benchmark). These depressed prices had the effect of shutting-in higher cost production and virtually shutting down exploration. As a result, the ability to supply oil was curtailed, while global demand continued to grow. This combined with the natural decline rates of existing producing basins and OPEC production cuts, had the effect of pushing oil prices back up above $20 per barrel by this summer.

It is instructive to recall that last December some observers were predicting $5 oil. Such predictions disregard the facts and fundamentals of the oil industry. Oil is the world's most important commodity by value of daily trading. Oil is a depleting resource for which there is currently no known economically viable substitute. The world oil industry does not function at $12 per barrel, let alone $5.

Matt Simmons, of Simmons and Co. of Houston, Texas, did an analysis late last year of the 10 biggest and best run oil companies (Amoco, Arco, Chevron, Conoco, Exxon, Mobil, Phillips, Royal Dutch Shell, Texaco, and Unocal). He concluded that $12 oil "essentially snuffs out the lifeblood of these companies". At these levels, by his estimation, they collectively are in a negative cash flow position of approximately $30 billion per year. Surely these companies will not continue to sell a depleting, non-renewable resource at prices that cause them to hemorrhage red ink. The point that we want to make clearly here is that non-OPEC and OPEC suppliers of oil will not continue to supply the product or explore for additional product at prices that are non-economic.

Another key point to remember is that oil and natural gas wells deplete i.e. production from existing wells declines over time, and must be replaced with further exploration. Total non-OPEC sources of oil (roughly 45% of global supply) are entering a net depletion mode. Some of the decline rates are surprisingly high. For example, we have seen estimates of current depletion rates for the Gulf of Mexico of 26% per annum for oil and 38% per annum for natural gas. Furthermore, global decline rates are accelerating as newer, more rapidly depleting wells are brought on-stream to replace older production.

A third important point regarding world oil supply is that excess daily productive capacity as a percentage of the daily world oil demand is at a historical low. According to Simmons & Co. analysis, the world had approximately 20 million barrels per day of shut-in supply in 1986, representing 32% of daily demand. Today, estimates of shut-in capacity range from 3 – 6 million barrels or 4 – 8% of current daily demand of 75 million barrels.

The fundamentals of oil are very attractive right now, but the natural gas fundamentals for Canadian producers are even more compelling. We are currently in the strongest natural gas market that Canada has ever experienced. Over the past 12 months, Canadian natural gas prices surged by over 100%. This has been driven by soaring U.S. production decline rates and the availability of pipeline takeaway capacity for delivery of Canadian gas to the lower 48 states. Furthermore, Henry Groppe, of Groppe Long and Associates of Houston, Texas recently pointed out to us that for the first time in U.S. history, all electric generating facilities currently under development are natural gas driven – adding further demand to dwindling supplies.

In spite of healthy industry fundamentals, energy companies, particularly the junior and intermediate exploration and production companies, are being valued at historically low price / cash flow ratios. There are many companies in the portfolio today that are trading around 3 times conservatively forecasted Year 2000 cash flow, and at substantial

discounts to net asset values and to where these companies were valued in the market two years ago.

Vermilion Resources is a typical example. Vermilion's share price peaked in late 1997 at $9.70. The stock is currently trading at $4.40, or 45% of its earlier high, even though oil and natural gas prices are higher today and the company produces 12,000 Boepd versus 6,000 Boepd in 1997. At $4.40 per share, the company is valued at roughly 3.3 times Year 2000 cash flow, and roughly 68% of its $6.50 net asset value. The Year 2000 projected debt / cash flow ratio is a comfortable 1.6 times.

What will trigger a revaluation of these stocks? In our opinion the main catalyst will be the third quarter earnings reports. The Q3 year over year comparison of revenues, cash flows, and earnings for most exploration and production companies will show huge increases. In most cases these companies are producing more oil and gas and are selling it at much higher prices than a year ago. Furthermore, companies have reduced their cost structures during the previous year of low commodity prices. The year / year comparisons for Q4 will show even greater improvements because Q4 1998 was the low point for oil prices.

The fundamentals are similarly attractive for base metal stocks. The price of nickel for example, has soared from a low of $1.70 per pound in late 1998 to roughly $3.50 per pound. However, despite the improvement, the shares of many of the producers still trade at huge discounts to their 1997 highs. The market has not awakened to the rapidly improving fundamentals of these companies and the dramatic turnaround that is occurring in the earnings. **Lionore Mining** is a low cost nickel producer that remained cash flow positive even in the worst of the nickel market last year. Lionore will begin to report escalating earnings and cash flows from their Tati nickel mine. Furthermore, Lionore is involved in two advanced stage, low cost nickel deposits in Australia that will be brought into production over the next two years. The company is debt free, has cash and marketable securities of roughly $5 million, and in addition they have recently made a significant gold discovery. The company is a stronger and more profitable company today when trading at $1.40 per share, than it was in 1997 when it was trading at $5.00.

Outside of the resource sector our portfolio of consumer and industrial products companies continue to trade at attractive prices when compared to many of the big cap growth and technology stocks. We continue to buy back **Cinram** (prerecorded audio and video) which we sold last year at much higher valuations. Cinram traded as high as 35 times earnings in late 1997. We are buying it today at roughly 12 times earnings. If anything, the company is stronger now than it was then. We continue to add to **Premdor** (world's largest door maker) at levels that represent 10 times 1999 earnings. We added to **Western Star Trucks** at $23 during this quarter. The CEO of Western Star bet us a case of "Opus One" (retail value approximately $2,000) that he will earn $4 per share in the fiscal year ended June 30, 2000. Even if he is wildly optimistic (and we don't think he is) and only earns $3, we still bought the stock at only 7 times earnings. We bought more **Velan Engineering** (valve manufacturer) in the low $20 range, down from a 52

week high of $40. Velan is the "Cadillac" of the global valve industry, and it has been punished by fund managers simply because of two sluggish quarters. Velan has been in business for over 40 years and has never had a money-losing year. The company consistently, year after year, outperforms every other global manufacturer. At $20, Velan trades at roughly 13 times this year's earnings. We know that if the Velan family were willing to sell their control block, there would be a buyer for the company well north of $30 per share – a much better indication of the value of the business.

We could go on and on with such examples. The bottom line is, in a world where the broad market indices (TSE 300, S & P 500, Dow Industrials, NASDAQ) are being carried upward by a very small number of extraordinarily highly valued stocks, we feel way more comfortable where we are placed.

Take the TSE 300 index as a case in point. Roughly 17% of the index in now made up of two stocks, BCE Inc. and Nortel. However, BCE owns 40% of Nortel and BCE's stock price is driven by Nortel. So in essence, Nortel's shares drive 17% of the TSE 300 Index and the rise in Nortel stock accounts for roughly 70% of the gain in the TSE 300 index year-to-date. What is Nortel's price/earnings ratio? Based on the latest 12 months it didn't have one because it didn't have any earnings. Go Figure!

An interesting saga that is playing out as we write is that of **OSF Industries** (store fixtures). The story began this past summer with the stock trading in the $4.50 - $5.00 range. Along came Centre Partners, a New York-based buy out firm, with a cash bid for all the shares at $9.50. RBC Dominion Securities was hired by OSF's Board to do a fairness opinion and came up with a range of $10.50 to $13. Even though OSF's overall business is strong, they did have a lousy third quarter. Centre Partners subsequently changed their bid. Centre Partners now want 24.9% via a treasury issue of convertible preferred stock at $7. We are not "over the moon" regarding the revised transaction, but we are evaluating the situation. This story is not over yet. The bottom line is that the company is worth more than $4.50 per share.

The 10 largest holdings are:

Western Star Trucks	3.8%	trucks, buses
UCAR International	3.6%	graphite electrodes
Unican	3.5%	locks and keys
Winpak	3.5%	packaging
Genesis Exploration	3.2%	oil and gas
Lionore Mining	3.0%	nickel
Merit Energy	2.8%	oil and gas
Premdor	2.8%	doors
Ensign Resource Service	2.7%	oil driller
West Fraser Timber	2.6%	forest products
	31.5%	

As of September 30th the portfolio breakdown by industry group stood as follows:

Metals	11%
Oil & Gas	30%
Forest Products	6%
Total Resource	47%
Consumer Products	14%
Industrial Products	19%
Transportation	2%
Communications	3%
Merchandising	7%
Financial Services	3%
U.S & International	5%
	100%