September 30, 2013

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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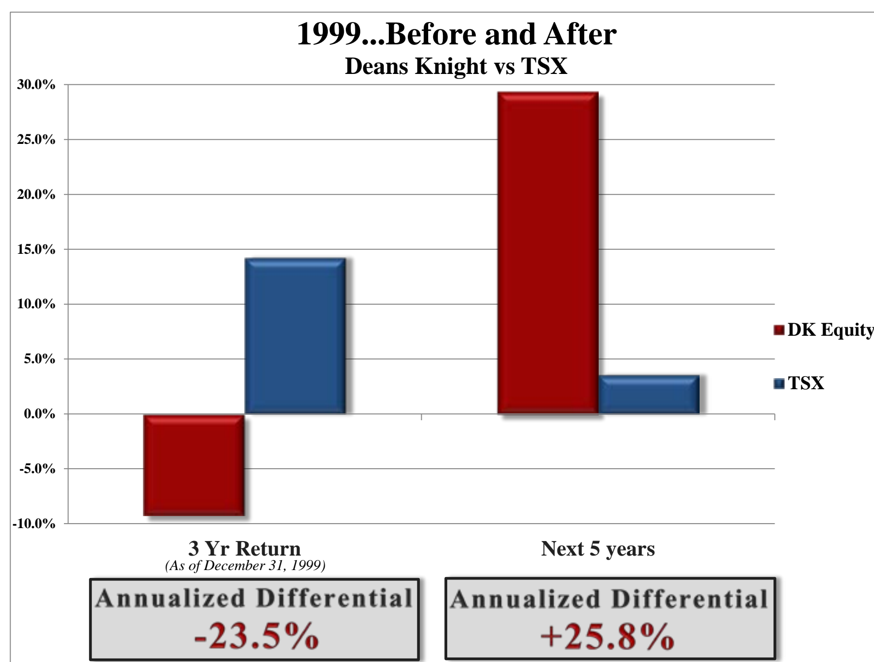
Quarterly Report
September 30, 2013

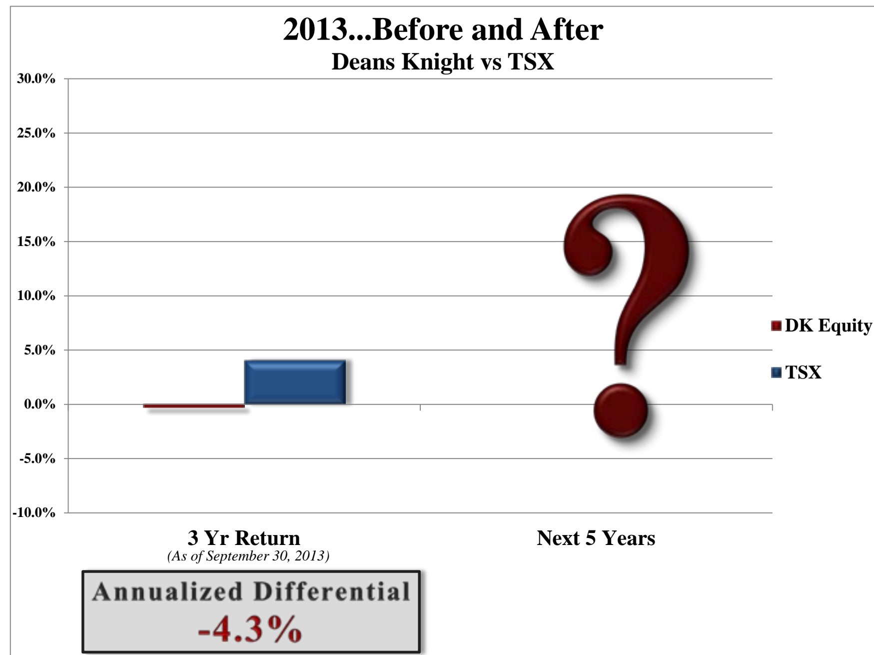
Rates of Return[1]

	3 Mths	YTD	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs.	15 Yrs	20 Yrs	Since Inception March 31, 1993
DK Equity Growth Fund	**7.9%**	**-2.9%**	**3.1%**	**0.2%**	**-0.2%**	**6.4%**	**5.5%**	**12.4%**	**15.8%**	**14.3%**	**15.2%**
S&P/TSX Composite Index	6.2%	5.3%	7.1%	8.1%	4.1%	5.9%	4.8%	8.4%	8.1%	8.4%	8.8%
S&P 500 (in U.S. Dollars)	5.2%	19.8%	19.3%	24.7%	16.3%	14.7%	10.0%	7.6%	5.3%	8.8%	8.7%

In the most recent calendar quarter, our overall portfolio valuation improved significantly. While our returns over the past three years have not lived up to our expectations, or surpassed the TSX, we have been in this situation before and are confident our returns will be strong again (see below).



[1] Returns longer than one year are annualized gross of management fees.



Similar to the three years ended in 1999, our most recent three year returns have been impacted by declining valuations in mining and energy companies. While the macro picture is different today, the results are similar. However, as is often the case with our strategy, periods of low returns are often followed by periods of significantly higher returns, as was the case from 2000 – 2005. Did we do anything dramatic in 2000 to change our fortunes? NO. However, we did address mistakes made, and worked hard to find new opportunities, just as we are doing now. During the quarter, we made some changes to the portfolio… some sales, and the introduction of a few new companies to the portfolio.

On the sell side we sold all of our shares in **Mirabela Nickel**. In our June letter we reported in some detail on Mirabela. As a brief refresher, the Company has a world class nickel sulphide deposit in Brazil; producing roughly 20,000 tonnes of nickel per annum with relatively low production costs; a solid management team; and a first-class processing plant. The problem has been the unrelenting slump in nickel prices. With the benefit of hindsight, the very strong nickel prices that crested in 2007, and from which we benefited through our ownership and sale of **LionOre Intl. Mining** at that time, also had the effect of bringing on new nickel production capacity. This led to slumping prices and rising inventories. Very few producers are making money today. Mirabela, even though they could be cash flow positive at the mine site, were cash flow negative after administrative and debt servicing costs.

Also in the most recent quarter, we reduced our holding in **Niko Resources**. Again, we had written about Niko extensively in our previous report. Again, with the benefit of 20/20 hindsight, it is clear why our experience has been disappointing. This is a company that became involved at an early stage in the largest gas find in energy-starved India. Everything is right about Niko's key assets and their very strong partners, Reliance Industries and BP. The problem is that management took the cash flow from the main producing arm and instead of hoarding it, paying it to shareholders, or buying back stock, they embarked on unsuccessful high impact exploration

wells in Southeast Asia. There is still value in the company's assets that may well far exceed the current market value, but we felt better by reducing our exposure. When in a leaking boat, sometimes it is better to stop bailing and switch boats.

OK . . . we took our lumps in Canadian oil and gas and mining in the past few years. As Yogi Berra said . . . *"we made too many wrong mistakes"*. That said, we have written a fair bit about it in recent letters and we have concluded that it's not time to abandon these areas. Both have underperformed the broad market indices in North America for the past two years, the mining group dramatically so. It will not last forever.

For 20 years, our strength at Deans Knight has always been to provide clients with unique investment opportunities across a wide range of industries. Three such investments, which are new to the portfolio in the past quarter, are outlined below.

Winpak Ltd. is a leading Canadian-based (Winnipeg) packaging firm providing high-tech packaging materials and machinery for the production of perishable foods, beverages, and healthcare products. They operate out of ten facilities in North America, with 74% of their sales based in the United States. Wihuri Oy, a privately owned Finnish conglomerate owns 52% of Winpak's shares, in addition to Wipak, a European/Asian packaging company. Winpak has an exemplary track record of corporate governance, with no additional share or stock option issuances, since their IPO in 1986. The Company has identified a niche market within the food and healthcare industry that has high barriers-to-entry and has allowed them to grow consistently. Over the past 20 years, Winpak has generated a compounded sales growth rate of over 9% per annum. With its current opportunities, Winpak is positioned for a period of accelerated growth and has a very healthy balance sheet position with just over $2 per share of cash, and no debt.

Rona Inc. is Canada's leading home-improvement retailer. In recent years the Company has faced increased competition from Home Depot, Lowe's, and a host of smaller operators. Rona recently installed a new Executive Chairman and a new management team. The team includes the former COO from Metro Inc., who took the CEO seat, and the number three person from Alimentation Couche-Tarde, who took over the Chief Operating role; both very respected operators in Canadian retailing. With a fresh look at the business, this new management team has laid out a definitive transformational strategy that would see $110 million in cost savings, $200 million in debt repayment and cash flow growth of 50% to nearly $300 million. The business trades at 6.5x cash flow after debt repayment while competitors trade between 9 – 11x. During the quarter we initiated a position on behalf of our clients. We keep in regular contact with management; as they continue to execute on their strategy we will continue to build our position at a reasonable price.

Uni-Select is a major distributor of automotive aftermarket parts, tools, equipment, paint, and body shop accessories. They are the market leader in Canada and the 6th largest distributor in the United States. They also are the leading distributor of automotive paint and related products in North America. Uni-Select's stock price came under pressure in 2012 due to deteriorating margins in their U.S. parts division. The stock fell from just under $30 per share in 2012 to $19 per share in 2013. In May 2012, Uni-Select brought in a new Executive Chairman, who had previously been the President of Uni-Select from 1983 to 1990 and had a long track record of

creating shareholder value. The new Chairman and the Board of Directors concluded a strategic review process in July and came forward with an "action plan". The plan focused on improving margins and set out to save $30 million annually by 2015. With execution of their "action plan", Uni-Select potentially could generate $120 million in EBITDA which would be significantly more than it generated when it was a $30 stock. Furthermore, we believe the three business units, Canadian parts distribution, U.S. parts distribution, and the paint business, if sold separately could realize $30 per share net of debt. At the current stock price ($23.32 at quarter end) Uni-Select has been purchasing its own shares in the public market, as they feel it is a prudent use of cash. We bought Uni-Select in the $20 per share range.

We began buying **Paramount Resources Limited** earlier this year and continued to add to the position, on weakness in the share price, this past quarter. Paramount is a Canadian energy company primarily focused on liquids rich natural gas in the Alberta Deep Basin. The Company was created by, and is run by, the Riddell family, with whom we have a great relationship, and who we would regard as one of the most respected oil and gas producers in Canada. The Riddell family, along with company insiders, own over 50% of Paramount which truly allows them to run their business with an owner type mentality and long-term perspective. Paramount has assembled a significant resource base in one of the most economic natural gas basins in North America. Management is focused on being a low cost producer and is currently building their own gas plant which will allow them to double production from this year to next. We believe Paramount has assembled an asset base that can continue to grow in a low gas price environment and would be an ideal fit for a potential LNG operator.

There were some noteworthy developments regarding existing holdings during the past quarter. In mid-September, **Heroux-Devtek Inc.**, which manufactures landing gear and components for aircraft, announced a major new contract with Boeing to supply complete landing gear systems for the Boeing 777, and contingent on the launch, the 777X. This is a major breakthrough for the Company. Heroux is the third largest manufacturer of landing gear components in the world. This is the first time they have been awarded an order to supply the complete landing gear assembly.

Our two auto parts companies, **Linamar Corporation** and **Martinrea International Inc.,** have been doing well as auto sales and manufacturing of autos have picked up globally since the 2008/09 recession. On September 26th an ex-Director of Martinrea filed a statement of claim against a few of the other Directors and Officers of Martinrea alleging that certain of these executives misused their position at the Company for personal gain. Serious allegations for sure. That said we must be mindful not to over react. Martinrea has done a remarkable job of navigating through the troubled times in the auto business in 2008/09. Moreover, the Company emerged from that period as a stronger company, in a stronger competitive position. While the market valuation may be affected by this "cloud", we must keep in mind that this is a very good business, in a very good industry, with strong growth opportunities going forward. This current situation provides Martinrea with an opportunity to strengthen its corporate governance practices to ensure they are best in class. Enclosed is a letter we sent to the Chairman of Martinrea, Rob Wildeboeur outlining this opportunity.

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CAPITAL MANAGEMENT LTD

September 30th, 2013

Rob Wildeboeur
Executive Chairman
Martinrea International Inc.
3210 Langstaff Road
Vaughan, ON L4K 5B2

Dear Rob,

We have read the Statement of Claim, dated Sept 26, 2013, filed by Nat Rea, Rea Holdings, and Edward Sorbara. It is a curious action, to say the least. It raises many questions of Mr Rea, his motives and his intentions. Far be it for us, from our vantage point, to understand these.

We have also, this morning, read Martinrea's response to the claim and of your intention to file a Statement of Defense.

As you well know, we have been long standing shareholders of Martinrea on behalf of our clients. You and your executive team have done a terrific job of building this company into a major player in the auto parts industry internationally. Furthermore, you should be commended for navigating the company through the very difficult times of the financial crisis and deep recession of 2008/2009, and emerging from that time as an even stronger competitor in the industry.

That said, this action by Mr Rea et al, besides the obvious problems it raises and the distractions it creates, does present an opportunity. That opportunity is to look closely at strengthening Martinrea's Board and examining closely, the Company's governance practices to ensure they are the strongest in the industry.

Sincerely,

Wayne Deans

SUITE 1500 999 WEST HASTINGS STREET VANCOUVER BC V6C 2W2 604 669 0212