December 31, 2012

DK EQUITY GROWTH FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Report
December 31, 2012

Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs.	15 Yrs	Since Inception March 31, 1993
DK Equity Growth Fund	**6.2%**	**-1.0%**	**-9.1%**	**4.9%**	**16.6%**	**-0.3%**	**15.8%**	**12.6%**	**15.9%**
S&P/TSX Composite Index	1.7%	7.2%	-1.1%	4.8%	11.7%	0.8%	9.2%	6.5%	8.8%
S&P 500 (in U.S. Dollars)	-0.4%	16.0%	8.8%	10.9%	14.6%	1.7%	7.1%	4.5%	8.1%

Not that we believe short term annual returns are relevant nor indicative of long term returns, but it is helpful and instructive to look at them. It helps us, and it helps our clients, keep things in perspective. Our DK Equity Fund annual returns (as distinct from annualized or average annual returns) have been below those of the TSX composite in each of the past two calendar years, 2011 and 2012. This has pulled down the Fund’s annualized returns. For the prior two years, 2009 and 2010, our returns were significantly higher than the TSX composite.

	2012	2011	2010	2009
DK Equity Fund	-1.0%	-16.6%	+39.5%	+60.5%
TSX composite	+7.2%	-8.7%	+17.6%	+35.1%

Our returns are often very different than the broad market index returns, largely because we run concentrated portfolios with 20 company investments, compared with the broad indices, like the TSX, with more than 200 companies. Also, our companies tend to be less followed by others, less understood, and more likely to be mispriced by Mr. Market from time to time.

As long as our businesses are doing what we expect of them to create value for the owner (you) over time, then we all must ignore short term volatility.

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

Have we experienced, in the past 20 years of business, any other period where for two consecutive years our returns have been below the market indices? In fact, there was a period in the late 1990's where the DK Equity Fund returns were below the TSX composite for 4 consecutive years.

	2000	1999	1998	1997
DK Equity Fund	+3.1%	+12.9%	-31.6%	-3.2%
TSX composite	+7.4%	+31.7%	-1.6%	+15.0%

Let's examine why our returns lagged during that period, so that we can draw some parallels to the recent two years. Wind the clock back to 1997/98. Lots of concerns existed. Russia defaulted on its debts. The massive high flying hedge fund, Long Term Capital, imploded and threatened the financial system by bringing down its counterparties. And the Asian crisis, which began in July of 1997 and lasted until late 1999, raised fears of a worldwide economic meltdown due to the ensuing financial contagion. As a result, the market values of economically sensitive companies…oil and gas producers…metals producers…which represented a large portion of our investments, as they do today, were punished severely in the market.

Subsequently, from 1998 until early 2000, we witnessed one of the greatest financial bubbles in recent history…. the technology stock bubble. We did not own any of these companies. We felt the valuations made no sense. Companies with no revenues, no profits, with just a flaky business plan, were accorded enormous values by Mr. Market in his manic state.

Well, when Mr. Market woke up and realized that the world really did need basic services, basic products, raw materials, oil and gas, DK Equity Fund returns trumped the TSX composite returns for the next 6 consecutive years.

	2006	2005	2004	2003	2002	2001
DK Equity Fund	+56.9%	+33.9%	+30.2%	+57.4%	+32.7%	+29.3%
TSX composite	+17.3%	+24.1%	+14.5%	+26.7%	-12.4%	-12.6%

What has occurred in the past two years is somewhat similar to what occurred between 1997-2000. Today, concerns over the Euro zone, the dire U.S. fiscal situation and that China's economic miracle is over, have caused Mr. Market to become depressive with respect to economically sensitive companies…again, particularly oil and gas and basic materials.

Is our strategy a risky strategy? We do not believe it is. Volatility of returns is not, in our opinion, a valid measure of risk. It is a measure of Mr. Market's fickleness, his bipolar condition, and of his obstinance in taking his meds. It is worth noting that in spite of these past periods when our returns lagged the broad market indices, the 20 year annualized return for the DK Equity Fund portfolio has approximated a healthy 16%.

We have made a point of shying away from predictions. We have been around long enough, and we have studied the learned literature and the track record regarding predictions enough, to know that we would be wasting our time. Although we do not know what 2013 will bring, we do know that in the latter half of 2012 the market began to recognize our companies and our returns over the 6 month period were substantially greater than that of the TSX composite, being 17.1% versus 8.9%, respectively. This is in spite of a lack of economic growth in Europe, the continued concerns regarding the fiscal imbalances in the U.S. and worries about the slowing of economic growth in China.

Also it is worth noting that a number of our current investee companies, and in fact many of our past companies, are project driven. That is to say, they are projects that are under development and will be in production in the coming months or over the next few years. Some of our notable development investments are **Coalspur Mines** (thermal coal)…**Northland Resources** (iron ore)…**Detour Gold**. And, although now producing, **Mirabela Nickel** was still ramping up to full production and driving down costs in 2012. Development companies are often treated poorly in the market during the development phase and then value is recognized when production is fully commissioned. We have invested in many such development projects over the past 20 years and many, with patience, have provided us with outsized returns. Our current development companies have world class projects and are managed by what we believe to be exceptional people.

One of our investee companies that had the biggest drop in valuation last year was **Niko Resources**. This is a situation where every possible obstacle that could have been thrown at them, was thrown at them in 2012. Niko's main asset is a 10% interest in the gas producing D6 field, offshore India. Their partners are British Petroleum (30%), and Reliance Industries (60%). The sale of the gas from this field is contracted to the Indian government at $4.20 per mcf until 2014. Niko and their partners have been trying to convince the government to raise the price closer to the market prices the government is currently paying for imported gas…closer to $12. With a lack of positive response from the government, and as a way of putting pressure on them, the partners have not invested new capital into the field. As a result, production and reserves are declining. Moreover the geology of the field is proving to be more complicated than originally thought.

That said, in February 2011 BP paid $7.2 billion to Reliance for a 30% interest in the field. This implies a value of $2.4 billion for Niko's 10%. Niko's current market capitalization is just over $700 million.

In addition to the India assets, Niko has high impact oil and gas plays in Bangladesh, Indonesia, Madagascar, Pakistan and Trinidad. In Indonesia alone, Niko has working interests ranging from 20% to 100% in 22 offshore exploration blocks.

We continue to hold the position, expecting at some point, a higher price for gas sold from the D6 block. In addition we get a free option on the high impact exploration wells that will be drilled this coming year, particularly in Indonesia.

Looking at other investments in the portfolio at the end of 2012…Our main forest products investment, **West Fraser Timber**, is benefitting from the turnaround in the U.S. housing market. Toward the end of the year, annualized U.S. housing starts approximated 850,000 units. This is well below the 1.5 million units that we feel is necessary to house the formation of families in the U.S., but well above the low point of approximately 500,000 units during the 2008/2009 recession. Our auto parts companies, **Linamar** and **MartinRea**, are beginning to benefit from the recovery in the U.S. auto industry. U.S. auto production by year end was running at roughly 15 million units versus a recession low of 9 million units. Our airplane parts manufacturer, **Heroux-Devtek**, is doing record business on the back of a resurgence of orders for airliners and private jets. Heroux also sold their industrial division this year, roughly 50% of the company, for a value that was equal to the entire market cap of the company at that time. They paid us a $5 cash dividend with the proceeds.

As we enter 2013, the market mavens still worry about the same old saws that caused the consternation in the past 2 years. Slow European growth, sub-par U.S. growth, the fiscal imbalances in the U.S. (which will dominate the headlines over the next few months), the change of leadership and uncertain economic future for China. And while the pundits and mavens worry about the same old stuff, many will miss some great investment opportunities as a result.

As so well-articulated in a year end article in the London Spectator, we live in a world that is in better shape by almost any measure than it has ever been before…less hunger, less disease, and more prosperity. Perhaps much of the West is experiencing relatively slow economic growth, but most developing countries are accelerating. People are being lifted out of poverty at the fastest rate ever recorded. Death from war and natural disaster is the lowest on record. Life expectancy rates globally show that humans are living longer.

As the world continues to prosper, demand for basic materials continues to grow. For example, global oil consumption in the past two calendar years has been running at record levels. The pundits are always worried about slowing demand for basic materials. That is not the issue. As the world grows, the issue will be supply. For patient investors who own supply (world class assets) the returns will come.