December 31, 2016

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
December 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	**0.9%**	**22.7%**	**9.6%**	**11.2%**	**7.0%**	**3.6%**	**15.0%**	**11.0%**	**14.8%**
S&P/TSX Composite Index	4.5%	21.1%	5.4%	7.1%	8.2%	4.7%	7.4%	7.3%	8.8%
S&P 500 (in U.S. Dollars)	3.8%	12.0%	6.5%	8.9%	14.6%	6.9%	6.7%	7.7%	9.1%

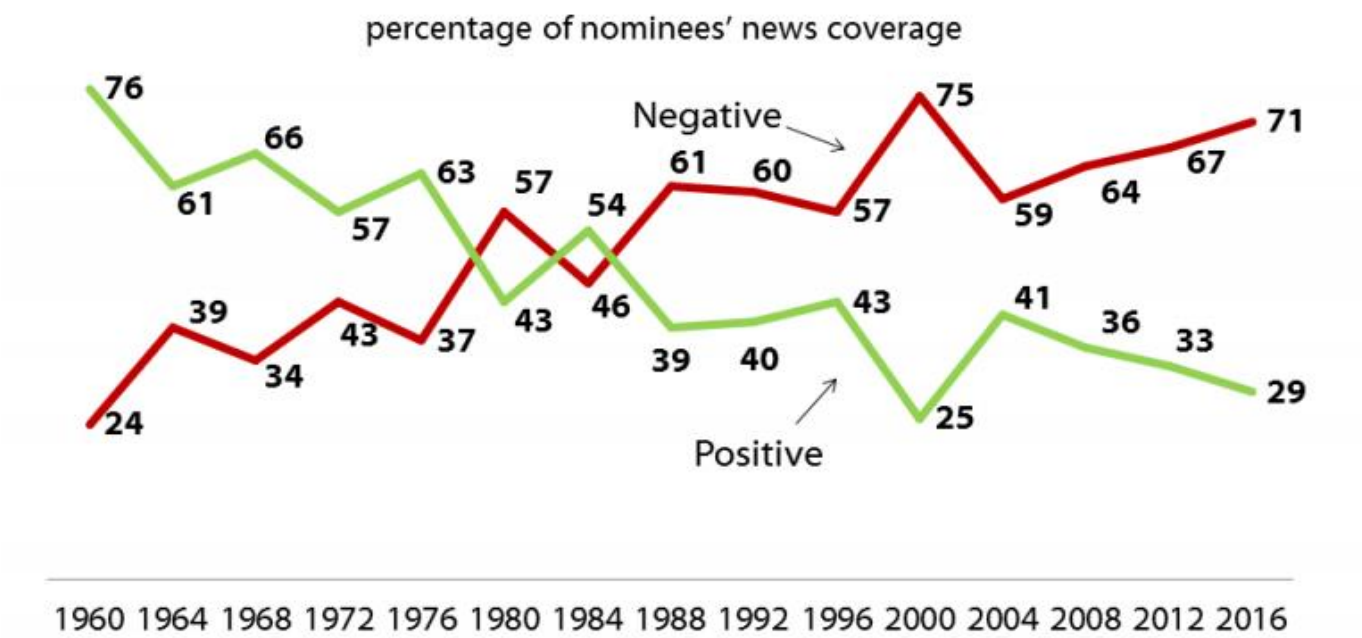
Looking back on 2016, it is remarkable that North American stock markets fared as well as they did, given the alarming headlines and dire prognostications of so many pundits that dominated the year. The list of negative headlines thrown at us as we began 2016, and then throughout, was indeed a long one. However, none of the warnings played out.

> "Collapsing commodity prices . . . more commodity price weakness ahead!!"
> Oil reached a low of $26.21 per barrel in February, but then closed the year at $53.72. Natural gas reached a low of $1.64 per mcf in March and finished 2016 at $3.72.
>
> "World worried over China's economic collapse . . . dread infects global markets."
> China's economy expanded at a 6 ½-7% annual rate throughout 2016.
>
> "Threat of a U.S. recession . . . could the economy tank in 2016?"
> The U.S. economy continued to expand and growth accelerated to an annual rate of 3.5% in the third quarter.
>
> "Fed will raise interest rates in 2016 . . . higher rates are the biggest threat to the global economy."
> They did raise the Fed Funds rate by ¼% in December 2015 and again in December 2016. The global economy continued to expand.

[1] Returns are presented gross of management fees.

"Brexit. The U.K. voted to leave the Euro . . . I.M.F. lays out grave consequences of Brexit." The global economy continued to expand and stock markets moved higher.

The 'big daddy' of media fiascos in 2016 was the coverage of the U.S. Presidential election. With the negative headlines, the S&P 500 index declined for 9 consecutive days leading up to the election . . . the longest losing streak in 36 years. Looking at the recent graph published by the Shorenstein Center[2], it shows the very high negative tone of the media coverage, and low positive tone since the recent election campaign began. The graph also shows an astonishing trend over the 56 years.



The negative coverage of the election was a consistent concern of the media throughout the year. The coverage of Trump was particularly negative. The surprise outcome was a Trump victory . . . and a Trump rally from November 8 to year end.

The Trump post-election rally has been much ballyhooed, again by the media. This too, in our opinion, is overplayed. As much as the negative press about his campaign was exaggerated, so too is the stock market rally that has ensued.

The post-election rally has not been as broadly based as advertised. Looking at Canada, for example, the TSX Composite index rose 4.5% in the fourth quarter of the year. However, the Canadian Financials Index rose 11.5% accounting for 90% of the entire index increase. Our portfolio valuation changed very little post-election, and frankly, why should it?

[2] The Shorenstein Center was established at Harvard University in 1987. Its research is focussed on studies of the media, politics and policy.

We initiated a few changes to the portfolio during 2016. We sold our position in Canada's largest home improvement retailer, **Rona Inc.**, to the Lowe's Inc. takeover bid early in the year. The sale made a substantial profit for the portfolio. The Rona cost base was roughly $12 per share, and the sale price was $24. The holding period was approximately 2 years. Over our 24 year history we have sold over 40 companies to takeover bids.

We eliminated two positions during the year . . . the junior forest products company **Conifex Timber Inc.**, and auto parts maker **Martinrea International Inc.** With the cash that was provided by the sales of Rona, Conifex, and Martinrea, we added to certain of our existing positions and added one new company to the portfolio.

We added to our holding in **West Fraser Timber Co. Ltd.**, consolidating our focus in the forest products industry to just one company. West Fraser is the low cost producer in the sector, and we identify closely with their corporate culture. Also, with the expiration of the softwood lumber agreement between Canada and the U.S., and with the likelihood of tariffs being applied to exports of lumber from Canada to the U.S., West Fraser will be less impacted than some other Canadian producers because roughly 40% of their production comes from the U.S.

West Fraser Timber also continued to generate free cash flow throughout 2016. They paid a dividend yield of 1%, paid down debt, and repurchased outstanding common stock. Since 2014 West Fraser has repurchased close to 8% of the outstanding shares using free cash.

With the sale of auto parts manufacturer Martinrea, we consolidated our holdings in the sector to one holding, **Linamar Corporation**. As the automobile industry enters a period of significant change . . . lighter, more fuel efficient cars . . . more electric powered vehicles . . . perhaps driverless cars . . . Linamar is a technology leader in supporting their auto company clients in making the transitions to the changing environment.

Also, during the year, we added to a number of our existing holdings, when we could do so at advantageous prices . . . **AutoCanada Inc.**, **Paramount Resources Ltd., New Look Vision Group Inc., Cott Corporation, Transat A.T. Inc.**, **Asanko Gold Inc.** and **Pine Cliff Energy Ltd.**

We completed the addition of one new position this year . . . **Sleep Country Canada Holdings Inc.**, Canada's largest specialty mattress retailer. Throughout 2016, Sleep Country reported strong quarterly performance . . . strong year-over-year revenue, EBITDA, and earnings increases, and an impressive 13 consecutive quarters of positive same-store sales increases.

In 2016, some of our companies benefitted from tailwinds, and some faced challenging headwinds. Our 5 oil and gas companies (**Parex Resources Inc.**, Pine Cliff, Paramount, **Whitecap Resources Inc.** and **Tourmaline Oil Corp.**) benefitted from the strong recovery in oil and gas prices. More importantly, all of them proved that they were well-managed, were low cost operators, and financially strong enough to not only survive the two year weakness in oil and gas prices, but to prosper during this period. Likewise, our 2 base metals producers (**Nevsun Resources Ltd.** and **Lundin Mining Corporation**) benefitted from a better climate for copper, nickel and zinc. Both companies are generating free cash flow and paying us quarterly dividends.

Our producing gold company, Asanko, poured its first gold early in the year and by year-end the plant was running at better than design throughput, and was producing at an annual rate of just over 200,000 ounces of gold.

Our gold development company, **Lundin Gold Inc.** released a bankable feasibility study on its robust deposit in Ecuador early in the year. In late December they also signed an exploitation agreement with the government that establishes all fiscal, operational and commercial terms, and paves the way for project financing and the start of construction.

Uni-Select Inc., the largest distributor of aftermarket auto parts in Canada, and the largest supplier of auto paint in North America, made a number of tuck-in acquisitions over the year. With free cash flow that they generate they continue to buy back stock and to pay a dividend.

New Look Vision Group, the largest eyewear distributor in Canada, made a number of small acquisitions during 2016, including their first foray into Western Canada with the addition of a chain of 10 retail locations in British Columbia.

Winpak Ltd., our North American high tech packaging company, continued to generate free cash flow and pile up cash on the balance sheet (currently $200 mln or $3 per share) for its owners. Winpak is debt free, pays a small dividend, and from time to time pays shareholders a special dividend out of cash stockpiles.

The shares of our consumer products company, Cott Corporation, were weaker in the latter part of the year, declining from a high of $22.42 in August to a year-end price of $15.20. In our opinion the decline is unwarranted and temporary. Cott is the world's largest producer of private label carbonated soft drinks and juices (roughly 18% of revenue) and one of the largest distributors of water & coffee to homes and offices in North America and Europe. Moreover, using its network of 60 manufacturing plants in the U.S., Mexico and the U.K., and 180 distribution facilities, Cott has also developed a profitable and growing business of co-packing and distributing beverages for other manufacturers. Cott has been successfully transitioning the business away from the declining soft drink and juice categories to a more diversified and higher margin beverage company with four acquisitions in the coffee and water delivery business in the past three years. Margins have been expanding, free cash flow is increasing, and in the latest quarter new customer additions on its Water and Coffee Solutions business were up 20%.

There were notable developments with our two value investments . . . Transat and **Maxim Power Corp.** Montreal-based Transat is one of North America's largest fully-integrated travel providers. In the fourth quarter of the year Transat concluded the sale of its French and Greek assets for proceeds of $93 million. What the shareholders own, following the closing of the sale, is the following:

	Conservative Per Share value
The North American Integrated Tour Operator	
2x average EBITDA of the last 3 years of $65 mln	$3.25
Oceans Hotels	
Current book value $100 mln	$2.75
Excess unrestricted cash	$4.00
	$10.00
Year-end share price	$5.50
Unrealized value (80%)	$4.50

This past September, Calgary-based Maxim Power announced the sale of their 32 natural gas fired French power generating facilities for net proceeds of 47 mln Euros. Subsequently, Maxim announced the settlement of litigation with the Federal Energy Regulatory Commission and then, just before year-end, announced the sale of wholly owned Maxim Power U.S.A. for $84 mln U.S., net of debt and transaction costs. Moreover, the Alberta Utilities Commission owes Maxim an estimated $40 mln following a decision last year to compensate Maxim for underpaying the company for power from 2006 to the present time. It is anticipated that these proceeds will be received some time in 2017. The result of these transactions will generate, for Maxim, roughly $3 cash per share, net of debt. The year-end price for Maxim was $2.95. This implies that the shareholders get the remaining Alberta assets for free. These consist of the existing Milner 80 MW coal fired power production, the metallurgical coal reserves of roughly 18 mln tons, the 946 MW of permitted, but not yet developed, natural gas fired power generation, and 200 MW of permitted, but undeveloped, wind power facilities. The stated objective of management (who own 40% of the outstanding shares) is to ultimately maximize the value of the assets and return the proceeds to the shareholders.

Our two small biotechnology investments, **Fio Corporation** and **Xbiotech Inc.**, which together represent roughly 1.5% of the portfolio assets, continue to work towards profitable commercial operations. These investments are much like doing a home renovation project . . . "takes twice as long and costs twice as much to get the end result". Toronto-based Fio is a medical diagnostic device company. Their Fionet handheld diagnostic tool is designed to diagnose, provide treatment protocol, and capture data regarding infectious diseases in less developed countries. Fio has made significant progress in moving toward a financially sustainable business model. 2017 will be a pivotal year for the company.

Austin, Texas' Xbiotech is a drug development company that is focused on producing true human antibodies targeted at fighting a variety of conditions. The company has ongoing clinical trials ranging from phase I to phase III in a number of areas . . . cancer, arthritis, staph infections, psoriasis, inflammatory bowel disease, acne and a number of other inflammatory conditions. Both Fio and Xbiotech are run by first class people who are financially committed to their businesses.

Our message to clients again at each year-end does not vary . . . ignore the media and ignore the predictions of the market mavens. Instead, focus your attention on the way our investee companies are being run, and on their valuations. It has been proven, in a vast number of studies, that we mere mortals are hopeless when it comes to predicting the future.

Our recommended reading for 2017 is Michael Lewis' new book, "The Undoing Project", which was released in early December. It focuses on the behavioural work done by Amos Tverksy and Nobel Prize winner Danny Kahneman. The book provides us with scientific background on why we humans fail to predict accurately and why we tend to act in irrational ways. Their work impresses upon us that we humans often think we know more than we do know. It is not just that people don't know what they don't know . . . but that they don't bother to factor their ignorance into their judgements. The book goes a long way in helping us to understand our biases and hopefully to enable us to become better investors as a result.