March 31, 2015

DK EQUITY GROWTH FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
March 31, 2015

Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	Since Inception March 31, 1993
DK EQUITY GROWTH	**4.8%**	**9.5%**	**13.8%**	**4.0%**	**8.8%**	**16.6%**	**14.4%**	**15.3%**
S&P/TSX Composite Index	2.6%	6.9%	11.4%	7.4%	7.4%	5.6%	8.8%	9.1%
S&P 500 (in U.S. Dollars)	1.0%	12.7%	17.2%	14.5%	8.0%	4.1%	9.4%	9.3%

Our goal is to invest a small portfolio (less than 20) of unique businesses . . . businesses that our clients would not normally be aware of or have access to. Businesses that tick as many of our boxes as possible, such as unique competitive advantage, strong financial position, and a proven and committed management team. We want a business plan that we can understand. And, of course, we want to buy our piece of the business at a fair price. Add a measure of patience, and the long term results will be better than average.

There were a number of important developments among our companies in the recent calendar quarter worthy of reporting.

We began to invest in **Uni-Select Inc.** a couple of years ago. Montreal-based Uni-Select was trading in the $20 per share range at the time and was definitely unloved. Uni-Select has three business units . . . they are the largest distributor of after-market auto parts in Canada; the 6th largest distributor in the U.S.; and the largest distributor of auto paint in North America. It was unloved because the Company was having difficulty with their U.S. division. Because of the distraction with the U.S. operation's poor performance (the smallest division of the Company in terms of profit contribution), the market did not account for the value of the other two units. Subsequent to our initial acquisition, Uni-Select did improve the U.S. margins by closing unprofitable locations and reducing costs. However, the Company is a distant 6th in market share in the U.S. market, and they struggled to compete. Recall the very astute quote from the

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

legendary Jack Welch of G.E. . . . "*when you don't have a competitive advantage, then don't compete!"*. Well, Uni-Select must have heard those words and in February entered into an agreement to sell its U.S. operations to an affiliate of Ichan Enterprises L.P. for $340mm U.S., equivalent to $16 per share. This is a much larger number than we, and the market, thought it was worth. The transaction enables Uni-Select to pay off debt and concentrate on growing the two remaining divisions. We as shareholders have been rewarded with a share price that ended the quarter at $43.68, up 43% on the quarter alone. Our Uni-Select management team, headed by Executive Chair Robert Chevier and CEO Richard Roy, get big kudos from us for execution.

Rona Inc. has seen an improvement in operating results recently. We started buying a position a couple of years ago when the stock was trading in the $10 - $12 range.

Rona is the largest home improvement retailer in Canada. They compete with Home Depot, Lowes, Home Hardware, etc. Rona has a strong national presence in Canada, and a dominant position in Quebec. The Company had been a chronic financial underperformer for many years. In 2012, Rona rejected a takeover offer from Lowes at $14.50 per share, which was intended to give Lowes a quicker and a bigger footprint in Canada. Rona's stock price subsequently declined. A new Executive Chairman was brought in, the same Robert Chevier who turned around the fortunes of Uni-Select. He then recruited a top notch management team. In spite of a sluggish macro environment for home renovations in Canada, Rona's combination of cost cutting; closing or selling money losing locations; and aggressive merchandising has resulted in a positive turnaround in same store sales and profitability.

The stock closed the quarter at $16.20 per share, up 17% over the three month period.

We have been shareholders of **Cott Corporation** for many years. Cott is the world's largest producer of retailer branded (i.e. private label) carbonated soft drinks and juices. Examples are WalMart (Sam's Choice) and Loblaws (President's Choice). Sales of carbonated soft drinks (CSD's) as a category have suffered in recent years because of health concerns. CSD sales in North America (Coke, Pepsi, et al) have been in decline in each of the past 10 years. Jerry Fowden, who had been running Cott's successful U.K. division was appointed CEO in 2009. Jerry impressed us and we have been gradually accumulating more stock. Jerry has been able to generate significant free cash flow from a business whose top line was shrinking. The free cash has been directed to reducing debt, repurchasing stock, and paying a dividend. All the while, Jerry and his team were quietly diversifying the business away from CSD's by building up lines in teas, juices, energy drinks, and other alternative beverages. Moreover, Jerry has been able to utilize excess capacity in Cott's extensive network of U.S. plants to strike co-pack agreements with other beverage manufacturers. Revenues, profits, and free cash flow have begun to grow again.

In December of 2014, Cott acquired DS Services. DS is one of America's largest direct to office and home suppliers of water, coffee and other products. The acquisition further diversifies Cott's business. Post the DS acquisition, Cott's revenue attributable to CDS's is down to 19%.

In our discussions with Jerry, it was clear that the acquisition came sooner and was larger than what was ideal at the time for Cott. That said, Cott had to chin themselves to the deal when it was available. Cott leveraged the balance sheet with additional debt and preferred shares. We have the confidence that management will be able to extract enough synergies from the combination and to pay down preferreds and debt quickly. Jerry and his team have proven they can execute. Since the DS acquisition, Cott has been one of the top performers on the Toronto Stock Exchange, up 48% this past quarter.

Our investment with **DIRTT Environmental Solutions** began in early 2008 when it was a private company. At the time of our investment, DIRTT's IPO was imminent. However, along came the Great Recession, and the Company was slower to get traction. The IPO finally took place in late November 2013 at $3 per share. DIRTT is a leading technology driven manufacturer of custom interiors – offices and hospitals. They have manufacturing facilities in Calgary, Savannah and Phoenix.

The Company was founded by Mogens Smed in 2005. We have known Mogens for 20 years. We met when we invested in his previous company, SMED International. SMED was a maker of high-end office furniture and fixtures, which Mogens grew to $300mm in revenue before selling to Michigan-based, privately owned Haworth Inc. in 2000.

Mogens is a legend, and a visionary in the office interiors industry in North America. Since the IPO, DIRTT has reported strong revenue, earnings, cash flow growth and margin improvement. The Company currently has a strong cash position and a very small amount of debt. The market rewarded the stock by pushing up the valuation by 84% to $6.63 per share during the quarter.

Our investment in **New Look Eyewear Inc.**, which we made late last year, is making us look smarter than we really should take credit for. New Look is consolidating the distribution of prescription eyewear in Canada. Since we acquired our stock, New Look made a significant acquisition in Montreal and based on subsequent reports the synergies are beginning to materialize. That said, the market drove the stock price up by almost 25% in the past quarter. Great Company, very strong management group, and a great idea. We plan to stick with them and provide equity financing as they grow.

The global sales of automobiles continues to be strong and our two, tier-one auto parts manufacturers are benefitting. The recent results and the valuations of both **Linamar Corporation** and **Martinrea International Inc.** have been very good. Linamar is up 10% and Martinrea is up 21% in the quarter.

Our commitment to **Winpak Ltd.** (packaging) is working out well. We entered the stock in the low $20 range two years ago. It looked expensive at the time (P/E, P/CF) but it ticked all the other boxes . . . strong competitive position bolstered by strong technology, strong customer relationships and loyalty, strong and committed management team, rich and admirable corporate culture. In the Company's 38-year history they have had only two CEOs. Bruce Berry, who succeeded the founding CEO Bob Lavery, has been with the Company since inception and has been the keeper of the culture. Your author has known Bruce since our college days in Montreal in the 1960's. He is a super capable business leader. This is an "own forever" business. The business results have not disappointed us. This quarter the stock was up 19% to close at $39.80 per share.

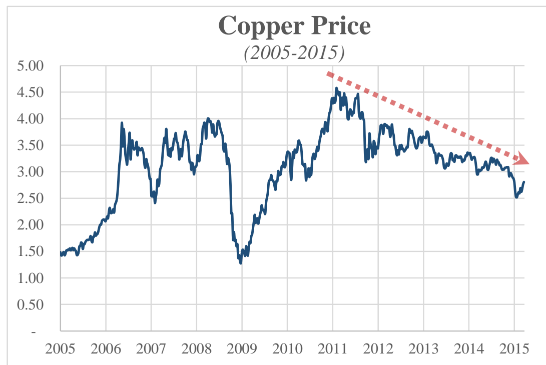
One of our largest commitments in the portfolio is **Heroux-Devtek Inc**. The share price has declined 12% during the quarter. Montreal-based Heroux is the world's third largest manufacturer of landing gear for the aerospace market, serving both the commercial and military sectors. Heroux operates out of 11 facilities in Canada, U.S. and the U.K. Heroux currently generates roughly $350mm of revenue, has a strong balance sheet, a healthy $450mm order backlog, and a very strong management group. Gilles Labbé, the CEO, has been with Heroux since 1989 and owns 10% of the stock. He and his management group have done an outstanding job for us since we first became shareholders in 2006.

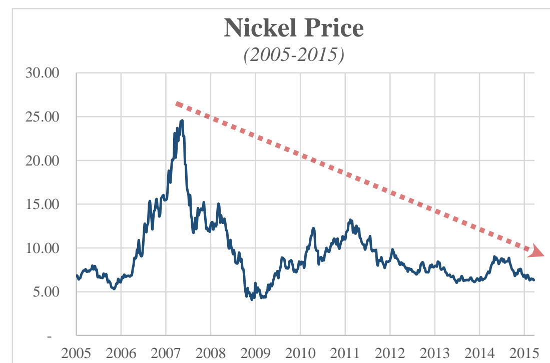
We like the Company and we like the industry.

Demand for airplanes mirrors population and economic growth. As the world economy expands, which we assume it will over the next 10 years, more people will travel and we will need more airplanes. Airplanes cannot take off and land without landing gear. Moreover, landing gear must be inspected and rebuilt on a regular basis by the manufacturer. A good business to be in with the right team.

In December 2013, Heroux was awarded a long-term contract with Boeing to supply complete landing gear systems for the Boeing 777 and 777X programs. The 777 is the world's most successful twin engine long haul airplane. In February, we were invited to attend the official inauguration of a new 100,000 square foot, $50mm manufacturing facility in Cambridge, Ontario, dedicated to producing major structural parts for this new program. Senior Boeing personnel were in attendance. In discussions with both Boeing and Heroux executives, it is clear that awarding this contract to Heroux is a significant event for both entities, and a very big endorsement for Heroux from Boeing. This new business alone plus existing contracts will take Heroux's revenue to at least $500mm over the next 4 – 5 years . . . and this does not assume any new contract wins over the period. We do not think Heroux's current market value reflects the potential value creation going forward.

We added one new position to the portfolio this quarter . . . **Lundin Mining Corporation** (distinct from our position in Lundin Gold). In the beat-up base metal sector, Lundin Mining has one of the best portfolios of assets, best balance sheets, and management groups. Lundin produces copper, zinc, lead and nickel from projects in Chile, Portugal, Sweden, Spain, and the U.S.A. All of these metals, along with most other basic commodities, have been in a bear market since 2008. That said, the world needs these basic products to enable growth. We may not be buying a piece of Lundin at the bottom of the base metals cycle, but it certainly is not at the top of the cycle.





The key for us here is that Lundin has opportunistically acquired additional projects . . . the Eagle Nickel project in Michigan from Rio Tinto in 2013, and the Candelaria Copper project in Chile in 2014 from Freeport MacMorran. We should note that since purchasing Eagle in 2013, the Company has built out the mine and brought it into production both on-time and on-budget; a rare feat in the mining space. Both Eagle and Candelaria are among the world's lowest cost producers of their respective metals; Eagle around $2.00/lb of nickel and Candelaria near $1.50/lb of copper. In our conversations with Lukas Lundin he admits that he is not bottom fishing by acquiring these projects but rather he is taking advantage of opportunities that arise because the commodities complex has been under pressure. That is typically when opportunities to acquire first class assets do occur.

The price of crude oil and the TSX Energy Index remained under pressure this past quarter. WTI oil reached a low of $45.19 per barrel in March and the Index was down 2% in the quarter. The media is beating this story to death, but it is yesterday's story. As we wrote in our last report . . . too much production equals too much supply equals lower pricing. A prolonged period of lower pricing results in lower production. Lower prices eventually lead to higher demand and a resurgence in prices. When does this happen? Don't know. Recall the old saying "*in the investment business it is not difficult to foresee what will happen, but it is impossible to foresee when it will happen"*. What is critical here is that our core energy holdings are low cost producers and are not starved for capital. In a tough commodity price environment they will not only survive, but perhaps even prosper at the expense of weaker players. In the quarter **Whitecap Resources Inc.** and **Tourmaline Oil Corp.** each made acquisitions. We also saw some appreciation in valuations . . . Whitecap (26%), **Paramount Resources Ltd.** (11%), **Parex Resources Inc.** (6%).