DEANS KNIGHT
CAPITAL MANAGEMENT LTD

DK EQUITY GROWTH FUND
Quarterly Review
December 31, 2004

Rates of Return

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs
DK Equity Growth Fund	**9.6%**	**30.2%**	**43.1%**	**39.6%**	**36.9%**	**29.4%**	**19.9%**
Nesbitt Burns Small Cap Index (Unweighted)	9.6%	12.6%	28.4%	17.1%	13.7%	9.9%	8.0%
S&P/TSX Composite Index	7.2%	14.5%	20.4%	8.3%	2.7%	3.6%	10.1%
DJIA	7.6%	5.3%	16.2%	4.7%	2.1%	0.7%	13.1%
S&P 500	9.2%	10.9%	19.5%	3.6%	-0.5%	-2.3%	12.1%

As we reflect back on another year in financial markets, we are inundated with the usual pundits, waxing about where the stock market will go in 2005 and beyond. We urge our clients to pay no attention.

A wise man once said "the best way of predicting the future is to invent it".

Better in our opinion to look back, learn from what we see, and with this knowledge search for companies that may be trading below their potential longer term value.

Looking back over 2004, the most watched U.S. market indices showed moderate gains with the S&P 500 and Dow Jones industrials up 10.9% and 5.3% respectively. The S&P/TSX composite on the other hand showed a gain of 12.5%. The main reason for the larger advance for the TSX is the heavier weighting of oil and gas in the Canadian index.

The rising price of oil was one of the big surprises in 2004. The price of benchmark West Texas Intermediate crude rose 33.6% to finish the year at $ 43.35 per barrel, after reaching a high of roughly $55 in the latter part of October. The price rise was due to a strong year over year surge in demand of 3%, butting against world supply constraints. As we have written on more than one occasion in the past two years, we believe that there is very little excess capacity in the world oil market.

Although we cannot predict what the price of oil will be at any point in the future, we feel comfortable repeating our previously stated view that the average price of crude oil will be higher in the next 5 years, than the average price of $31 of the last 5 years. That said, we believe that investing in oil and gas companies today will not be as profitable as it has been for us over the

past 5 years. The capital appreciation that we have enjoyed resulted from investing heavily in Canadian oil and gas companies, when oil traded as low as $11 per barrel and company valuations were historically low. Now the scene is very different. The rising price of oil and natural gas, and the rise in valuation of most oil and gas companies has attracted attention. The valuations are now no longer as attractive as they once were. The easy money has been made.

The overlooked, undervalued oil and gas company is getting difficult to find. The last really good value situation we found was **Paramount Resources**, and it turned out to be one of the top performing oil and gas companies listed on the TSX last year. We purchased shares in late 2003 following a meeting with the CEO. The shares were at roughly $8 and Jim Riddell greeted us with "you guys are the first investors to visit me in 2 years". Music to our ears. The Company and its CEO were in the doghouse because things were not happening fast enough for the market. However, here was a company that had been around for over 20 years, was producing nearly 30,000 boepd, had great management, significant management ownership, and a proven track record of creating shareholder value. Based on a conservative outlook for 2004 cash flow of $3 per share we were able to begin purchasing stock at less than 3 times cash flow. In the end, with rising production and strong commodity prices, it looks like 2004 cash flow will come in at $5 per share. In retrospect, we were acquiring the shares at an incredible 1.6 times. This, in a market where hot brand-name junior companies have been trading at 8 – 10 times. Furthermore, late in the 2004 year Paramount announced the intention to spin off certain assets into an oil and gas trust, giving the shares a further valuation boost.

We must lower our expectations regarding returns from this sector in the future. We do have a positive longer run view of oil and gas prices, but remember in the last 6 years the price of oil has quadrupled. We would not place a bet on that happening in the next five years. Value creation in the oil and gas business going forward must come from the drill bit, i.e. rising production. This entails more risk.

In addition to the price of oil, the other big surprise in 2004 was the magnitude of the increase in the value of the Canadian dollar. Since a low point of 62¢ on January 18, 2002, the CDN dollar appreciated 34% to finish 2004 at 83¢ U.S. This was great if you vacationed in the U.S., but bad news if you were a non-resource sector Canadian manufacturer. The manufacturers essentially have had to deal with a 34% increase in production costs due to the currency appreciation alone, but with no power to increase product pricing. Profits and cash flows of these companies have suffered significantly as costs have risen at a much faster rate than companies have been able to make adjustments. Many of our holdings have been negatively affected including **Winpak, Velan Engineering, Shermag, CAE Inc**., and **CFM International**.

CFM International, which manufactures gas and electric fireplaces and barbeques, got hit with the double whammy, a rising Canadian dollar and rising raw materials costs (steel). The shares were one of the biggest losers on the TSX in 2004, declining 78% to close the year at $2.43 as profits evaporated. CFM is currently struggling to restructure its operations.

Things look grim in the short run for these types of companies. On the other hand, these companies are available at low valuations, such as price/book and price/sales. Although the risk is high, if management is successful in making adjustments to operations and/or if they get a

break from the rising CDN dollar, or other input costs such as steel, these companies will turn out to be our best investments over the next few years.

As we wrote in our last report, record high steel prices resulted in a significant lift in the valuation of our holdings in **Algoma Steel**. Surging profits and cash flow made Algoma one of the biggest gainers on the exchange in 2004, and one of the major contributors to your returns. The stock has gone from $1 per share 18 months ago to almost $30. It has gone from trading at a fraction of book value and revenues to 1.5 times book and 0.6 times revenue. By year-end 2004 we had sold 75% of our Algoma shares as we gradually reduce our position.

One of our holdings benefited handsomely from the appreciation of the Canadian dollar: **Transat A.T**. Montreal-based Transat is Canada's largest tour operator. We visited the Company in late 2003 when the shares were trading at less than $10. The Company was busy cutting operating costs following a period of declining profitability. Transat's main business is package tours, mainly to U.S. warm weather destinations. As the CDN dollar was appreciating, their cost of goods was declining and margins widening. Furthermore, with a higher CDN dollar, Canadians could better afford the trips and bookings increased. One year later the shares trade at $24.10. More important however, earnings have soared to $1.75 per share and Transat has $7.60 per share in free cash on the balance sheet. We expect to receive either a special dividend or a share buy back, or a combination of both in 2005.

Again looking back, resource companies in general, not just oil and gas, have been very much in vogue. Base metal producers also enjoyed improving valuations and contributed to your returns. As human beings our predictions are heavily influenced by our most recent experiences. Consequently market experts are predicting great things for metals producers in 2005. Again our view is more sanguine. Like oil, base metal prices have risen dramatically from their lows of 4 – 5 years ago. Nickel from $1.75/lb. to $6.50/lb. and copper $0.50/lb. to $1.30/lb. The share prices of producing companies have also risen dramatically and are not as attractive as they were a few years ago.

As a result, in 2004 we sold some shares in companies that have surged in value, and we have added investments in junior companies that have a better chance of adding value going forward with increases in production. To find investments we have gone to the Australian market. Australia is a country with a strong mining culture. However we find that emerging mining companies trade at lower valuations than in North America or Europe. As a result we have begun investing in **Paladin Resources** (uranium) and **Anvil Mining** (copper).

Our investments in forest products companies also contributed to returns in 2004. Because of the concerns about the U.S. countervailing duties, lumber producers such as **Canfor** and **West Fraser Timber** were initially acquired at a fraction of book value and revenues. Valuations improved dramatically. We still have a positive longer term view for the industry but again valuations are much higher and investment returns going forward will be lower.

Our message to clients . . . it is more difficult today to find opportunities as numerous and as attractively priced than it was 3 – 5 years ago. As a consequence, we expect that future rates of return will likely be lower than those experienced in the recent past.

As of December 31st, the portfolio breakdown by industry group stood as follows:

Industry Group	%
Energy	46.2%
Industrials	19.5%
Base Metals & Minerals	15.2%
Consumer Discretionary	8.2%
Other Materials	4.3%
Healthcare	2.8%
Paper & Forest Products	2.2%
Precious Metals	0.7%
Utilities	0.6%
Cash & Miscellaneous	0.3%
	100%

As of December 31st, the 10 largest equity holdings were:

Holding	%	Industry
LionOre Mining International	6.8%	Nickel Mining
Paramount Resource Ltd.	5.5%	Oil & Gas
West Energy Ltd.	5.0%	Oil & Gas
Transat A.T. Inc.	4.6%	Tour Operator
Ketch Resources Ltd.	4.5%	Oil & Gas
Bonterra Energy	4.3%	Oil & Gas
Mustang Resources Inc.	4.3%	Oil & Gas
Linamar Corporation	4.3%	Auto Parts
CAE Inc.	4.0%	Aerospace Equipment & Services
Meridian Energy Corp.	3.9%	Oil & Gas
	47.2%	