December 31, 2014

DK EQUITY GROWTH FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Report
December 31, 2014

Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	Your Inception March 31, 1993
DK EQUITY GROWTH	**-5.1%**	**14.4%**	**8.5%**	**6.3%**	**9.6%**	**15.9%**	**14.7%**	**15.3%**
S&P/TSX Composite Index	-1.5%	10.6%	11.8%	7.5%	7.6%	6.2%	8.8%	9.1%
S&P 500 (in U.S. Dollars)	4.9%	13.7%	22.7%	15.4%	7.7%	4.2%	9.8%	9.3%

The year 2014 was a tale of two markets in Canada – energy, and then everything else. With regard to energy, oil prices moved higher in the first six months of the year and took the shares of oil producers higher as well. Oil then did a reversal in the latter part of the year and took the same share prices lower.

Meanwhile, the global economy continued to expand. In particular, the U.S. economy gained significant momentum and took the valuations of our non-energy names higher. Although some value was lost in the latter part of the year, largely with the decline in value of energy companies, we ended the year with a positive return of 14.4%.

The majority of our non-oil & gas investments, which represent roughly 70% of the portfolio at December 31st, did well for the year; particularly those that derive much of their revenues by selling product into the U.S. market. The U.S. economy confounded all expectations by continuing to expand at an accelerating pace throughout the year. In the quarter ending September 30th, the U.S. GDP expanded at a 5% annual rate, the strongest quarter since 2003. A summary of the positive valuation changes of some of our companies (mostly non-energy) during the year is as follows:

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

Company	Price Appreciation in 2014
Velan (Valves)	66%
Linamar (Autoparts)	61%
Winpak (Packaging)	55%
DIRTT Environmental (Office Interiors)	46%
Martinrea (Autoparts)	33%
West Fraser Timber (Forest Products)	28%
Nevsun (Copper)	27%
Shaw Communications (Cable, Broadcasting, Internet)	18%
Parex (Oil)	15%
New Look Eyewear (Purchased June 2014)	15%
Uniselect (After market Autoparts/paint)	8%

We also received a takeover offer this July for our trucking company, **Contrans Group Inc.** We had begun accumulating Contrans during the recession in 2009 when the shares were trading in the $3-$4 range, and continued to build a position over the ensuing few years. By early 2014, we, on behalf of our clients, represented 11% of the company's shares, second only to the Founder/CEO Stan Dunford who owned approximately 15%. Stan, an ex-truck driver, built Ontario based Contrans into the second largest trucking company in Eastern Canada. The largest trucking company in Canada, Transforce Inc., bid for Contrans at $14.60 per share, plus allowed Contrans to distribute a special $0.40 dividend to shareholders … net to us $15 per share. The transaction closed in November, providing the portfolio with roughly 8% cash to reinvest.

The Contrans outcome is typical for our investment strategy. As a general philosophy we try to think like private company owners of publicly traded companies. We have done this throughout our 22 year history. We have avoided making bold market or industry predictions, but rather we have tried to build significant positions in a select number of companies in varied industries. We look for unique companies that: have strong management; with significant management ownership; have established a competitive advantage; have hidden value; and a strong balance sheet. It has been quite common for us to then have the value in these businesses realized when they are sold to a takeout bid. Looking back over the past 22 years, roughly 50% of all sales we have made have been to takeout bids.

During the year, we gradually added to a number of our existing non-energy positions, as shares were available from Mr. Market at attractive prices – **Winpak Ltd., Uni-Select Inc., Héroux-Devtek Inc., Rona Inc., Transat A.T. Inc. & Cott Corporation** for example. We also added a new unique position in **New Look Eyewear Inc.** in June, which we wrote about in detail in our previous report. Late in the year we added a small position in **Lundin Gold Inc.** Lundin is run by Lukas Lundin, who has been one of the best global mining entrepreneurs and operators over

the past 20 years. We have invested alongside him successfully before. Besides our confidence in management, we made the investment because the company has acquired what we consider to be the best undeveloped gold assets in the world. Lundin acquired the Fruta Del Notre deposit in Ecuador from Kinross Gold Corp. for $240 million. Kinross had paid $1.2 billion for the asset 6 years ago. Kinross stayed in the deal with a 20% interest and Lukas Lundin personally invested $100 million.

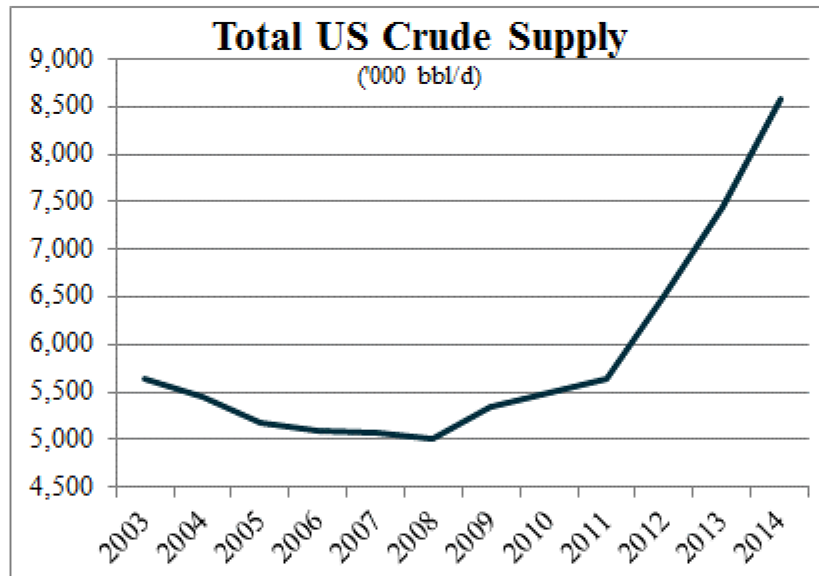
The funds for these purchases were made available from the sale of oil weighted investments during the first 9 months of the year, from some profit realization sales of small amounts of **Linamar Corporation** and **West Fraser Timber Co. Ltd.** and from the previously noted takeover of Contrans.

The price of oil (WTI) peaked at $101.18 per barrel in June and declined to a low of $53.61 in December, a decline of 47%. That took valuation of shares in many oil producers down by 40%-50% in the last 4 months of the year.

The decline in oil has been the major media event of the latter part of 2014. It has attracted a significant amount of coverage and analysis and has garnered the majority of business news air time.

Let's cut through all the media hype - oil price volatility is not something new. Predicting short term trends in oil prices is impossible to do with any degree of accuracy. If you believe the media, the recent decline in the oil price is the result of politically motivated conspiracies … the OPEC cartel driving the price down to punish the U.S. shale producers … the Saudis and the U.S. driving the price down to punish Russia for their actions in Crimea … the Saudis driving the price down to punish Iran for developing nuclear armament capabilities. There may be kernels of truth to all of these but let's forget the conspiracy theories. The fact of the matter is, no one can drive down the price of oil unless there exists an excess of supply. That is what we currently have. It is not a first time occurrence. It has happened before.

The global 90 million barrel per day oil market is suffering from moderating demand growth, which is being swamped by a surge in supply. By most estimates, the global oil market is oversupplied by 2% or 1.5 million barrels per day. The supply surge has primarily come from the rapid increase in production from U.S. shale reservoirs over the past 5-6 years, and to a lesser extent from a recovery of production in Iraq. The following graph shows the increase in U.S production from 5 million barrels per day to current production of 8.6 million barrels per day.



Source: U.S. Department of Energy

As often occurs with a dramatic shift in direction in oil, the price typically overshoots to the downside or upside. In the current case, the likely outcome will be a reduction in supply growth as producers forgo higher cost development. Moreover, some producers may decide not to sell these non-renewable resources at today's depressed prices, but to shut in current production, with a view to selling at higher prices at some point in the future. Also, we should not rule out a potential increase in consumption, spurred on by lower prices.

During 2014, we did reduce the value of our investments in oil. We sold roughly 30% of our holdings in **Parex Resources Inc.** at higher valuations during the third quarter. We also reduced our exposure by selling **Athabasca Oil Corporation** and **Torc Oil & Gas Ltd.** Within the energy sector we shifted the holdings toward natural gas production … **Tourmaline Oil Corp., Paramount Resources Inc., and Pinecliff Energy Ltd.** These three companies, and their management teams, are the very best among the top gas producers in Western Canada. Although their share prices have declined along with the energy group in the latter part of 2014, these companies, in our view are likely to be long term beneficiaries of today's depressed energy environment. They are low cost operators, they are proven value creators, and they are well financed.

Although we avoid market predictions, the long term prospects for the North American natural gas, to us, looks positive. Natural gas is a clean/green preferred energy source. North American natural gas prices are deeply discounted from global gas prices and this is not likely to persist. Gas exports via pipelines from the U.S. to Mexico are rapidly growing. In addition, in the U.S. there is roughly 15 billion cubic feet of liquefied gas export capacity currently in advanced stages of consideration. And, we should not forget the wild card … liquefied gas exports from the west coast of Canada, which could become a reality over the balance of this decade. All of the above, combined with the continued trend to using natural gas instead of coal for electricity generation, will serve to increase the demand for North American natural gas. Moreover, much of the current

gas production in the U.S. is from shale formations with high decline rates. Many of the prolific U.S shale plays have already reached peak production in the last three years and others, including in the massive Marcellus shales in the North East will begin to decline over the next five years.

In the business of investing, the most critical principle is "know what you don't know" … and we do NOT know what 2015 will bring. What we do know is that oil and gas producers have taken some big lumps last year. We do know we own some of the very best energy companies in Canada. We know they operate in the best reservoirs in Canada, and in the case of Parex, one of the most financially lucrative royalty regimes (Colombia). Outside of oil and gas we have a unique portfolio of companies in niche industries. We cannot tell you what global growth will look like in 2015 nor can we predict "black swans". What we do know is that our companies are well financed; run by super managers; have identifiable competitive advantages; and that if the world is doing more business in 10 years than it is today, our companies will be too.