December 31, 2015

DK EQUITY GROWTH FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Report
December 31, 2015

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	**1.9%**	**-2.1%**	**5.8%**	**4.9%**	**-1.0%**	**6.2%**	**15.5%**	**12.5%**	**14.4%**
S&P/TSX Composite Index	-1.4%	-8.3%	0.7%	4.6%	2.3%	4.4%	5.1%	7.6%	8.3%
S&P 500 (in U.S. Dollars)	7.0%	1.4%	7.4%	15.1%	12.6%	7.3%	5.0%	8.2%	9.0%

Over the past year, North American equity markets have been volatile and, using broad market indices as a measure, they have produced negative returns. The Canadian market fared worse than the U.S., because Canada's TSX index is more heavily weighted toward resource producers, which have had a very difficult year. Our portfolio returns did better than the TSX index.

Canada was definitely an out of favour place in 2015. Not only was our stock market an underperformer, but the Canadian dollar depreciated 16% versus the U.S. dollar. We refer readers to the note we published August 25, 2015 on the subject of the Canadian dollar (included with your 3rd quarter report). Our reputation as a global energy super power and a major producer of gold and base metals, although much overstated in its impact on the domestic economy, nonetheless had a negative impact on our currency.

The Canadian economy experienced two consecutive quarters of negative GDP this year, Q1 (-0.8%) and Q2, (-0.5%) mainly as a consequence of lower oil and gas prices. However, the economy recovered with modest growth of 2.5% in Q3.

In mid-2015, we saw a market correction in both Canada and the U.S. (defined as a decline of 10% or more). The U.S. S&P 500 declined 12% from its high point on May 21 to a low on August 25, 2015. The TSX declined by 18% between April 15 and December 14. As we remind our readers on a regular basis, market corrections are not unusual, nor are they cause for alarm. Since WWII, such corrections have occurred in North American markets 34 times or, on average, every 2 years.

[1] Returns are presented gross of management fees.

There have been many negative headline stories over the past year . . . The "Collapse" in the oil price . . . The "War" on Terror . . . The "Collapse" of growth in China . . . The "Implosion" of the corporate debt market. . . The "Threat" of the Federal Reserve interest rate increases.

Unquestionably, the story that garnered the most headlines during the year is oil. Almost daily there has been a negative story about oil. Oil has been the most valuable commodity traded on world markets for the past 100 years. Oil is the dominant source of global energy and it is also a significant raw material for many chemical products, pharmaceuticals, solvents, fertilizers, pesticides and plastics.

The oil industry is cyclical, highly competitive, and increasingly high tech. The price of crude oil declined from a peak of $107 per barrel in June 2014 to end the year $37 per barrel.

Over a year ago Saudi Arabia, the world's largest producer, started a price war by ramping up production with the objective of gaining market share from non-OPEC competitors . . . e.g. U.S. shale producers . . . Canadian oil sands producers . . . It is not the first time this has happened, and it will not likely be the last.

What is happening is simple Economics 101. With the ramp-up in Saudi production the world is now consuming the lowest cost global production at a greater rate. This is as it should be. We should be consuming the low cost production and shutting down or delaying higher cost production. This is exactly what is happening. Production of, and drilling for, higher cost oil is declining. Existing wells and reservoirs are depleting. Billions of dollars of capital programs in the oil industry are being cancelled or delayed. All this is taking place while global consumption continues to rise . . . from 91 million barrels per day early in 2013, to 95 million barrels per day by the end of 2015. Ultimately, we will deplete lower cost resources and the price of oil will rise again.

Roughly 7% of your portfolio is currently invested in two publicly traded, oil focused producers, **Parex Resources Inc.** and **Whitecap Resources Inc.** The position in privately owned **Canadian International Oil Corp.** has been sold with the closing of the transaction expected to be early in the New Year.

Parex is a low cost producer of 27,400 barrels of oil per day ("boepd") in Colombia**,** with no debt and net $109 mm USD cash on the balance sheet. Whitecap is a low cost Western Canadian light oil producer with a manageable debt level and a dividend yield of 8.3%.

In low oil price environments, it is critical to be invested in companies that are low cost producers, and are run by the best management teams. Our two oil producers are among the very best.

In fact, in spite of the challenging pricing environment, Parex's share price is up roughly 34% on the year, and Whitecap is down 21%. On a weighted basis our two oil investments are up roughly 10% on the year.

Although oil grabbed most of the headlines in 2015, natural gas was actually the bigger of the two stories. The North American natural price declined by over 70% from a peak in early 2014, to a low of $1.75 in late 2015.

Technology has changed North America's natural gas industry in the last 5 years. Advances in fracturing and well completion technology have resulted in a reduction in production costs and a boost in output. In spite of rising demand, the market is currently oversupplied. In this lower price environment, drilling activity is now declining, existing wells are depleting, and the market is rebalancing. We own three of the best operators in the gas business. Nevertheless, the share prices have taken a drubbing over the year.

Paramount Resources Ltd. (-78%) was hit the hardest in spite of being a low cost producer, and run by one of the very best management teams in the business. The Riddell Family has operated Paramount since they founded the company in 1974 and they own 40% of the common stock. Over the past two years production has grown from 20,000 boepd to 50,000 boepd. To transport and to process the gas, Paramount invested heavily in proprietary facilities. The timing proved unfortunate as the investment, financed with debt, was followed by the drop in gas pricing.

Paramount's debt level is currently too high. We anticipate that they will sell some of their facilities and pay down debt to repair their balance sheet.

Our other two gas producers, **Tourmaline Oil Corp.** (-42%), and **Pinecliff Energy Ltd.** (-45%), have manageable debt levels, strong growth profiles, and are also low cost producers. Both companies have taken advantage of acquisition opportunities during the year. Pinecliff, for example, late in the year, doubled the size of their production to 22,000 boepd, by purchasing non-core Canadian assets from ConocoPhillips. George Fink, Founder and Executive Chairman of Pinecliff was recently named Chairperson of the Year by Alberta Oil Magazine. Click here to read the related article.

The mining industry has suffered from similar woes as oil and gas in 2015. . . oversupply and soft product prices. Many of the global industry titans . . . Anglo American (-75%), Glencore (-72%), Freeport-McMoRan (-70%) . . . have been brought to their knees. Our four mining companies have fared better than most. **Lundin Mining Corporation** (-27%) (copper, zinc, nickel) is a global low cost operator, with a strong balance sheet. This enabled Lundin to acquire the world class Candelaria Copper Mine from Freeport-McMoRan in Q4 2014. Lundin continues to evaluate acquisition opportunities as more asset divestures are coming from overleveraged, higher cost operators.

Nevsun Resources Ltd. (-16%) operates one of the highest grade, lowest cost copper mines in the world. Nevsun has no debt, has a market cap of $750 mm, has $600 mm cash in the bank, and pays us 5.9% dividend yield. CEO Cliff Davis has been looking at a host of acquisition opportunities over the past year, but has not struck as yet.

Asanko Gold Inc. (+13%) will be pouring its first gold in January 2016 and ramping up to target production of 190,000 ounces per year by mid-year. Asanko is a low cost producer and has a strong balance sheet. At current gold prices, and estimated all in sustaining cash costs, Asanko will deliver to shareholders an ongoing free cash flow yield of 17%.

Our non-producing, yet to be developed gold company, **Lundin Gold Inc.**, has been trading at roughly our investment cost since we made an initial investment in late 2014. At that time, Lundin acquired the Fruta del Norte gold project in Ecuador from Kinross Gold Corp. for $240 million. In 2008, Kinross had acquired the property for $1 billion. Kinross decided to exit the project because of balance sheet constraints. Fruta del Norte is the largest, highest grade, undeveloped gold deposit in the world.

Note that we have invested in two Lundin Companies. We have known the Lundin family and have successfully invested in their companies for over 20 years. They are proven entrepreneurs and operators, and they always have a significant equity stake in their enterprises.

Our two forest products companies, **West Fraser Timber Co.** (-21%) and **Conifex Timber Inc.** (-64%) faced weak lumber markets in 2015. The U.S. housing market has been slow to recover from the 2008/09 bust. Recall that U.S. housing starts were running at over 2mn annual units, prior to 2008. Starts dropped to under 500,000 units at a low in 2009, and have recovered to just over 1mn units. The industry expected to get back to a more normal level of 1.5mn annual starts by now, but it has not happened. Moreover, demand has also cooled in China with the infrastructure-led slowdown.

West Fraser is best in class; best management, lowest cost and largest lumber producer in North America. They generate positive cash flow in the most negative environments, including during the housing meltdown in 2008/09. Conifex is a much smaller cap, two mill lumber producer, with greater exposure to Asian markets.

Our unique commercial interiors design and construction company, **Dirtt Environmental Solutions Ltd.** (+96%), continues to successfully grow their business, by increasing penetration of existing markets and by expanding in new markets. Dirtt has demonstrated strong sales, cash flow, and earnings growth since its November 2014 IPO. Dirtt is in a strong financial position to continue to support growth with cash on hand of $92 million and only $10 million of debt.

Cott Corporation (+88%) is the world’s largest private label producer of beverages . . . carbonated soft drinks, juices, teas, new age beverages. Cott, with its extensive network of 60 plants and 180 distribution centres in the U.S., Canada, U.K., and Mexico, also has a lucrative business of co-packing for branded beverage companies, like Monster.

In December 2014, Cott completed the acquisition of DS Services, one of the two dominant players in North America, in the direct-to-home and office delivery service of bottled waters, water filtration systems, and coffee. DS supplies 1.5 million customer locations via a daily operation of over 2,200 routes.

Cott is run by CEO Jerry Fowden. He has done a masterful job of diversifying Cott's business away from the declining soft drink category, cutting costs, reducing debt, and paying shareholders a 2.1% dividend yield.

Uni-Select Inc. (+124%) had an eventful year. Early in 2015, the Company sold its U.S. auto parts distribution business to Carl Ichan for a surprisingly large price of U.S. $340 million. With the proceeds, Uni-Select paid down all of its debt. Uni-Select remains with two operating units….. they are the largest distributor of automotive aftermarket paint in North American, and the largest distributor of aftermarket auto parts in Canada. With its improved financial flexibility, Uni-Select has completed a number of accretive acquisitions in both paint and auto parts in the second half of the year.

The share prices of our two global auto parts manufacturing companies, **Linamar Corporation** and **Martinrea International Inc.**, are unchanged for the year, even though both companies reported record sales and earnings. Due to the aging fleet of existing cars, new car sales in the U.S. in 2015 were a record 17.5 million units, while Canada hit a record 1.9 million units.

The share price of Canada's largest retail home improvement company, **Rona Inc.**, declined roughly 10%. In spite of the softer Canadian economy in the early part of the year, same store sales are growing, margins are improving, they're buying back shares, and are paying us a 1.3% dividend yield. In a key development in July, Rona negotiated an accretive deal to buy its 20 franchise stores. Rona is now all corporate stores.

Our specialty packaging company, **Winpak Ltd**. (+39%), continues to deliver outstanding performance. The Company operates with no debt, consistently generates free cash flow year after year, grows sales and earnings steadily, and pays a current annual dividend yield of 0.3%. Moreover, the Company declared and paid a special dividend of $1.50 per share in October. Winpak also paid us a special dividend of $1.00 in 2014.

New Look Eyewear Inc. (+34%), which we acquired in August 2014, continues to execute superbly. New Look is the largest chain of retail eyewear stores in Canada. The Company currently dominates the market in Quebec and the Maritime provinces. The eyewear market in Canada is fragmented and ripe for consolidation. Just before year end, New Look announced the acquisition of Forward Vision Group, a chain of 15 locations in Southwestern Ontario.

Transat A.T. Inc. (-14%) North America's largest tour operator, continues to post terrific operating numbers. To us, Transat is a classic value play. As we wrote in detail in our June 30 report, we estimate that Transat's breakup value (cash on hand, hotel assets, operating cash flow) to be between $13-$16 per share. This compares to a year-end closing price of $7.35.

Velan Inc. (-29%), is our global specialty valve manufacturer. Business is not nearly as bad as the share price action would suggest. Remember, the shares are very thinly traded. The founding Velan family own 75% of the shares, and the remaining 25% is held mainly by long term shareholders such as ourselves. Velan's operating environment is challenging because a large portion of their business is driven by the oil & gas markets. Velan operates with no debt, generates free cash flow, pays us an on-going 2.6% dividend yield, and has paid periodic special dividends as cash builds up. The Company is currently flush with liquid assets . . . working capital of $230 million. . . . current ratio of over 2/1 . . . and net cash of $70 million. The stock closed the year at roughly $15. We have repeatedly argued the stock is worth $25 - $30.

Héroux Devtek Inc. (+14%), the world's third largest aircraft landing gear manufacturer continues to win new business. Héroux is also on budget and on time to begin deliveries on their new Boeing 777 contract in late 2016.

Bird Construction Co. (+8%), our industrial and commercial construction company, continues to acquire new contracts and grow their order backlog to a current record level of $1.8 billion.

During 2015, we exited one significant position and added 3 new companies. We sold our holding in Western Canadian cable company **Shaw Communications Inc.** Shaw had served us reasonably over the 1 1/2 years we owned it, paying us a steady 5% dividend yield and modest capital appreciation. However, cable continues to lose subscribers to satellite and internet streaming.

We added new positions in **AutoCanada Inc.**, **XBiotech Inc.**, and **Sleep Country Canada.** We wrote up Auto Canada and XBiotech in detail in our September report after initiating the positions around mid-year. The share prices of both declined in the second half of the year, even though both companies are operating according to, or better than plan. AutoCanada, Canada's largest network of retail auto dealerships, continues to grow its network. They made 6 dealer acquisitions in 2015 and announced intentions to open 2 new additional dealerships. The knock against the Company is they have roughly 40% of their dealer revenues in Alberta, and that economy is suffering from low oil and gas prices. True, but temporary.

XBiotech is a biotech company that is developing drugs and therapies focused on true human antibodies. The share price has been volatile since the IPO and our purchase in June. However, XBiotech has hit major milestones and had some significant successes since then. Late in the year, the Company completed a unique Phase III clinical trial in Europe with its Xilonix anti-cancer compound, targeting patients with late stage colorectal cancer. The trial results were positive, with a significant number of patients showing meaningful improvements. XBiotech is now applying to the EU authorities to market the drug commercially in Europe. Late in the year, the Company initiated a Phase III trial under the auspices of the U.S. Foods & Drug Administration, again using Xilonix for patients with colorectal cancer. Xbiotech also began developing a Phase II trial to assess Xilonix for treatment of non-small cell lung cancer. They also have programs underway using its human antibody technology to target C. difficile infection, ebola, cardiac therapies, staph infections, type 2 diabetes, acne, and psoriasis. XBiotech is well-funded, has its own proprietary manufacturing facilities, solid patent protections, and a strong management team and Board of Directors.

In December, we bought a position in Sleep Country, Canada's leading speciality mattress retailer. The Company has a dominant 23% market share. Sleep Country currently operates 224 stores across Canada and plan to add up to 70 new stores over the next 5 years. New stores turn cash flow positive within 12 months.

It is the time where the investment community focusses on predictions for the upcoming year. For those who have followed our writings over the past 23 years, and have read our book published in 2013, you know what we think about that exercise . . . baloney! We have never been able to understand why the world is hooked on predictions. It has been proven that none of us have the ability to forecast accurately. However we cling to that hope. Perhaps the behavioural finance experts will one day dissuade us from the "folly of predictions".

As an example of this folly, Canaccord Genuity, in a recent morning note, referenced a study of the S&P 500 stock index forecasts made by the 22 chief marketing strategists of the biggest U.S. banks and brokerage firms from 2000-2014. On average, these annual forecasts missed the actual market performance by an incredible 14.6 percentage points per year . . . not 14.6%, but 14.6 percentage points!

We prefer to deal in facts, and it is a fact that stock prices are volatile and unpredictable in the short term. For investors, the big risk is being out of the market when it surprises to the upside. Many investors sell when they see bad news, fail to get invested again, and miss the unpredictable upside.

A study done by JP Morgan examined the S&P 500 over 20 years from 1993 to 2013. If an investor stayed fully invested in the index, they would have enjoyed an annualized return of 9.3%. If they missed the 10 best days in that 20-year period, the return dropped to 5.4%. If they missed the 30 best days, a zero return. When we looked at the Deans Knight Equity returns over our 22-year history, the results were similar. The DK annualized return is 14.5%. Missing the 10 best months (we do not have daily returns), the return drops to 8.7%. By comparison over the same period the TSX had a return of 8.4%, and missing the 10 best dropped the return to 4.4%. We can't predict these swings, nor can anyone else. The message is clear . . . stay the course with individual stocks and with portfolios.