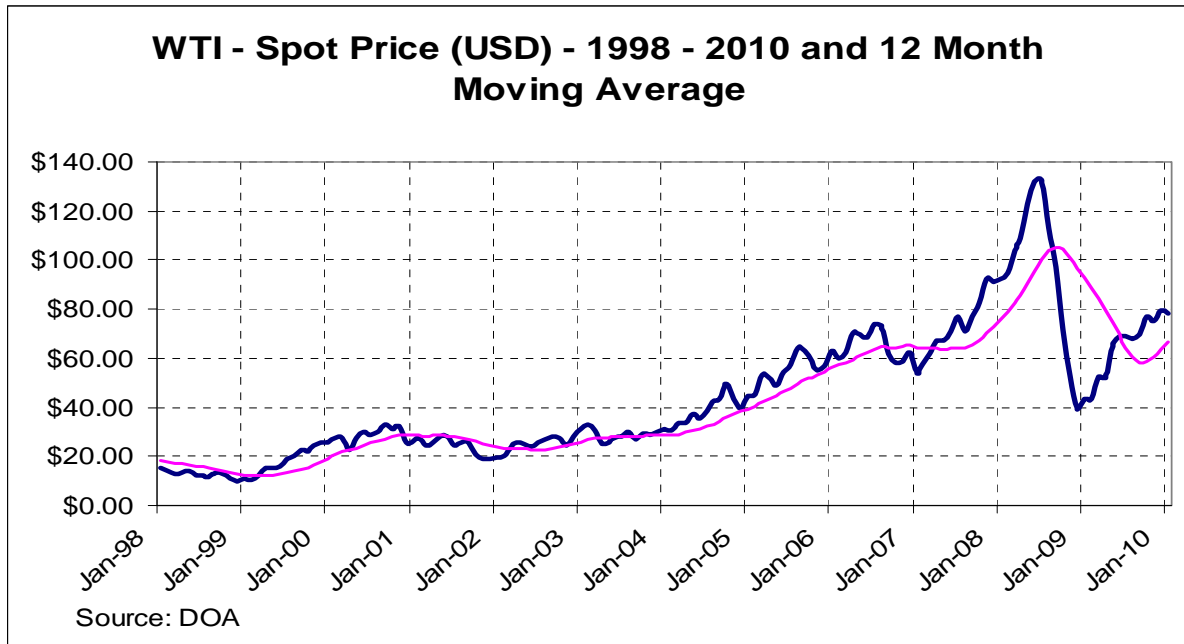


Keeping It Simple

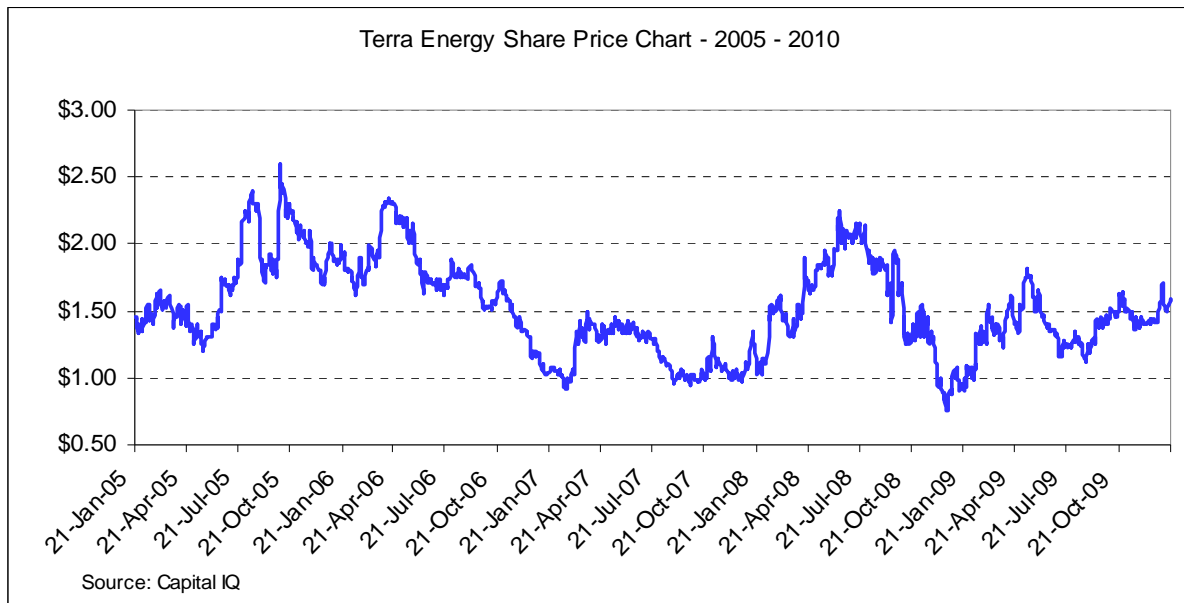
The world is a complicated place. However, as we launch into 2010 I remain optimistic for several reasons. First, most of the leading economic indicators that I track point to a very strong economic rebound in the first half of 2010. The second reason for my optimism is Canada itself! Whether by luck or design, Canada is impeccably well placed for the opportunities that are present in the global economy. In the most simplistic terms, we seemingly have what everyone else wants and this includes an abundance of natural resources, a sound banking system, and a liberal democracy that ensures that our domestic battles are fought with words and ideas rather than bombs and rifles. I'm long Canada and optimistic that 2010 will be another great year for investors in Canadian equities!

While much can and will change as the year goes on, I think there are two areas of the Canadian stock market that hold the greatest promise for 2010 and the first of these is the energy sector. Virtually all commodities are to some degree a play on global economic growth but oil in particular appears to be the most straightforward given its ubiquity as an input in virtually all types of economic activity. However, when this point is combined with the concept of scarcity which is now well ensconced in many speculators minds, the preconditions for another significant ramp-up in price for all energy related commodities is created. Some pundits will argue that the supply and demand data justifies an oil price of no more than \$80 a barrel, but the reality is that once the market believes that oil is going higher, supply tends to be withheld and stockpiling occurs. My expectation is that oil will reach the \$100 a barrel price sometime this year and probably reach new highs by 2012 at the latest. I am similarly bullish with respect to the outlook for natural gas.



Even if my energy price assumptions prove unduly bullish, I still see excellent value in the junior end of the Canadian energy sector – and have positioned the Capital Ideas portfolio accordingly. New drilling technologies are lowering the cost of production for many junior companies that are not saddled with legacy projects that require high oil and gas prices to be economically viable. Indeed, many junior oil and gas companies I have met with recently are spectacularly profitable at current energy prices. It is also worth noting that many of these “juniors” are bringing on new production in 2010 that will result in an explosion of cash flows even if energy prices retreat from current levels.

Supporting my enthusiastic outlook for the junior end of the energy sector is the reality that valuations still remain extremely attractive. A case in point is **Terra Energy**, a company I visited with my colleague Jordan Zinberg last week in Calgary. Terra trades at less than 3.0x 2010 cash flow per share and less than 0.4x its Net Asset Value (NAV). While Terra has a number of exciting projects coming up in the Montney in 2010, one could easily argue that the stock could (should) more than double in price simply based on the assets and cash flows that it already has in place. Outside of management, the Company has only two significant institutional shareholders (Tom Stanley and Donville Kent) but I think that others will soon see the upside potential in this stock as well. Besides Terra, we are also quite bullish on **Yoho, Vero, Rock, Open Range** and **Painted Pony**.

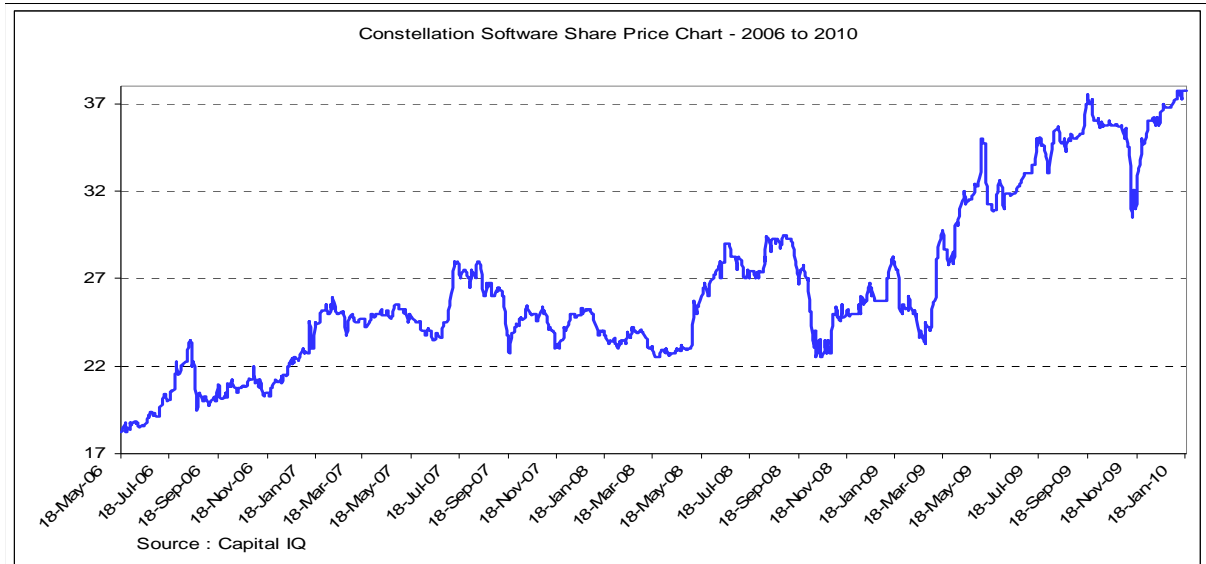


The second area where I see tremendous value in 2010 are those stocks that I refer to as “Franchise” companies. These are the companies that represent the core positions around which the Capital Ideas portfolio is built. Franchise companies normally have four important characteristics. First, they have a high degree of recurring revenue which typically means that their customers are either loyal or sticky (high barriers to exit). Second, they have a high degree of excess cash flow by virtue of their low capital expenditure requirements. Third, they typically enjoy some kind of competitive advantage that results in high margins. Fourth, they have a superb track record of acquiring bolt-on companies at attractive prices relative to their subsequent cash flows. Because of these four factors, businesses that exhibit these characteristics tend to enjoy high and sustained ROE’s which I believe is the secret to long-term share price out-performance. As we enter 2010, the best four “Franchise” companies that we can identify outside of the financial services industry are **Constellation Software, Logibec, MTY Food Group, and Paladin Labs.**

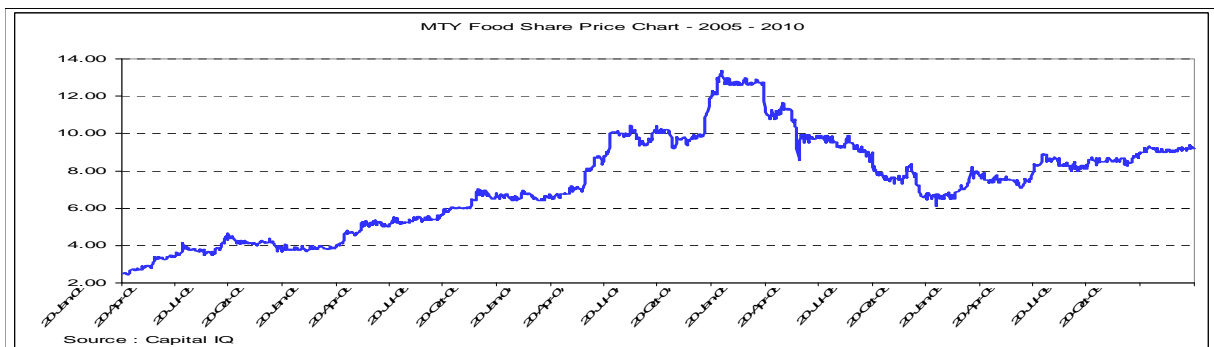
Great Franchise Ideas For 2010

Constellation Software is a superbly managed Toronto based software company that provides software and services to a number of industries in both the private and public sector. **Constellation** employs more than 2,200 people around the world in sectors ranging from transportation to manufacturing. The company currently generates about \$18MM of cash on a quarterly basis while capital expenditures are less than \$1.0MM. This means the company only needs to reinvest about 5.5% of its existing cash earnings to support its current and future growth. We expect **Constellation** to earn \$3.80 in cash earnings in 2010 which puts the stock on a cash P/E multiple of just 9.7x. This level of profitability implies an ROE of close to 70% and even if we adjust the understated equity base to fair market value, I still believe the Company’s real ROE is close to 30%. I also consider the management team to be among the strongest in corporate Canada and look forward to reading President Mark Leonard’s annual

letter to shareholders that discusses the company's accomplishments and challenges in a straightforward and candid manner.



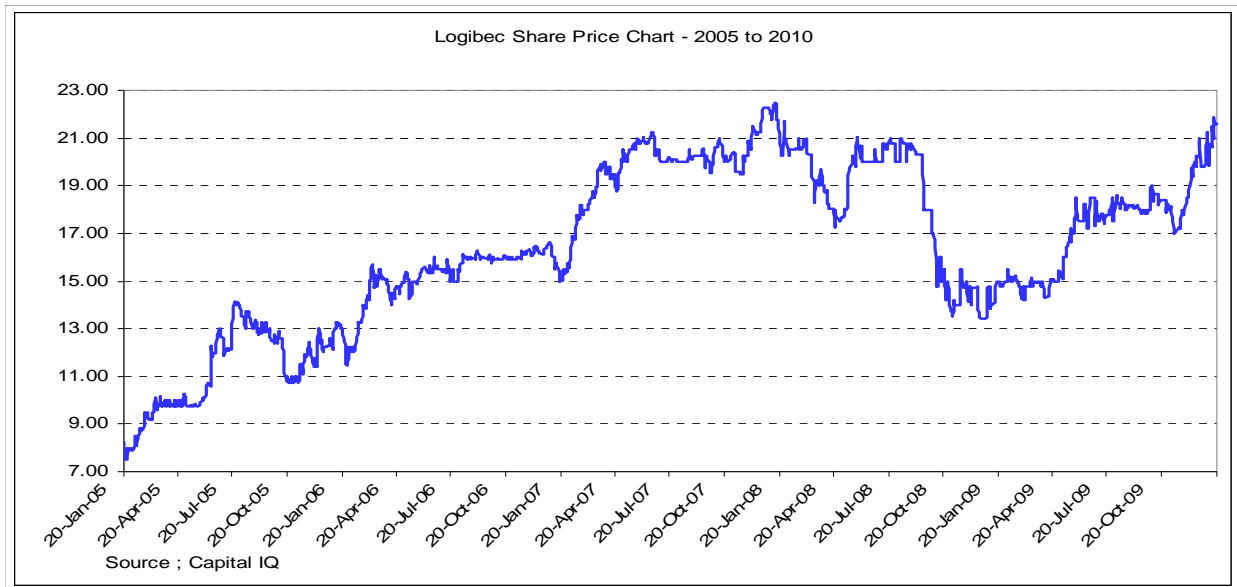
MTY Food Group is the greatest fast-food company that you have probably never heard of! However, if you visit a food court somewhere in Canada this week, you will almost certainly pass by one or more of the chains owned by **MTY Food Group**. The company, which has been run since inception (1979) by Stanley Ho, is the owner of such well known brands as Cultures, Yogen Fruz, TCBY, Taco Time, Country Style, Tandori and Thai Express. All told, **MTY** owns 1,534 quick service restaurants under 25 different banners. While **MTY's** brands are well known to many Canadians, what many investors fail to appreciate is the strength of the **MTY Food Group** management team which has proven to be extremely proficient in turning around stale or poorly managed brands. I view each chain that it acquires as an annuity which **MTY Food Group** tends to buy cheaply in relation to what the chain earns once **MTY** has "repositioned" the business. Each quarter, the company earns roughly \$3.6MM in cash flow while capital expenditures are less than \$100,000 a quarter. As a consequence, the cash just keeps piling up at **MTY Food Group**. I expect the company to earn 91 cents in cash earnings in 2010, while its net cash position should be close to \$1.50 a share. Thus, after netting out the cash, an investor is paying roughly 8.5x 2010 cash earnings for a company boasting an ROAE of 25%. Looked at another way, an unlevered ROE of 25% is simply an outstanding rate of return for any equity investment.



Paladin Labs is a specialty pharmaceutical company based in Montreal. The company's strategy has been to acquire products or companies that it can integrate into its own successful sales and marketing network and this has allowed the company to grow at a tremendous clip over the past decade. The company is also adept at buying companies with tax losses and as such has not had to pay taxes in more than a decade. Like the two previous companies that I have discussed, **Paladin** generates an amazing amount of cash. In 2010, the company should generate annual cash flow of \$42.8MM, while capital expenditures are projected to be less than \$1.0MM. The Company has a market capitalization of \$360MM, and cash balances at the end of its most recent quarter of \$85MM. Thus, net of cash, the stock trades at 6.4x 2010 cash earnings. The Company also boasts a net profit margin (based on cash earnings) of almost 30%, which illustrates just how lucrative this business is!



Logibec is a Montreal based software company which was founded in 1982 and is among the fastest-growing North American companies specializing in the development, marketing, implementation and support of information systems for the health and social services sectors. The vast majority (95% +) of the company's revenue is recurring and its cash ROE is close to 30%. Like the other companies that I have spoken about, the cash flow in 2010 should exceed \$22MM while capital expenditures should be less than \$2.0MM. Thus, the company is required to invest less than 10% of its current income to maintain its current level of profitability – the rest goes into growth. Investors should note that this Company has a net margin (based on cash earnings) of 27.5% - staggeringly good when you think about it. I expect Logibec to earn \$2.70 in cash earnings in 2010, which puts the stock on 8.0x 2010 earnings.



Concluding remarks

I believe that a new economic cycle started sometime in the first half of 2009 and like past economic cycles will run for anywhere from four to seven years. However, while such macroeconomic optimism may seem reassuring, I would like to reiterate that my investment strategy continues to be built around the idea of owning large positions in extremely well managed companies such as Home Capital, Alliance Grain, SEMAFO, First National, Logibec, Constellation Software, MTY Food Group, Paladin Labs and Canadian Western Bank – just to name a few.

In 2009, the DKAM Capital Ideas fund was up 88.17% while the DKAM Financial Services Fund was up 53.73%. If you would like to chat about either fund or the outlook for 2010 and beyond, feel free to call me at 416 – 364 – 8886.

J.P. Donville – January 2010