● TONUS CAPITAL INC.

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FIRST QUARTER 2011 - NEWSLETTER

TONUS SELECT FUND

Dear Partner,

We are pleased to send you this portfolio performance and review, along with commentary, for the first quarter of 2011.

PERFOMANCE REVIEW

During the first quarter of 2011, the Tonus Select Fund declined **0.64%**. Over the same period, the S&P/TSX Total Return rose **5.60%** and the S&P 500 (in U.S. dollars) climbed **5.92%**. The Canadian dollar registered another strong quarter, gaining **2.4%** on the U.S. dollar, and this impacted our performance negatively.

Since the Fund's inception in October 2007, we have achieved a compound rate of return of **3.68%**, compared with **1.94%** and **-2.29%** for the S&P/TSX and the S&P 500, respectively.

PORTFOLIO REVIEW

Last September we started to build a new position in **Primerica Inc. (PRI – $25.51)**. The company was spun off from Citigroup in April 2010 at $15.00 per share and shot up quickly to about $25.00, denying us the opportunity to buy then. We nevertheless did our homework and we were prepared to acquire the stock when it retreated to a more reasonable level around $20.00 last fall.

Primerica was founded in 1977 and is today the largest provider of individual term life insurance in North America. The company also distributes other products like mutual funds, variable annuities and segregated funds. Primerica targets the large under-served market of middle-income consumers through approximately 100,000 sales representatives.

The company's sales distribution model is unique. It recruits more than 200,000 potential sales representatives annually, primarily among part-time professionals such as teachers. Less than 20% will manage to obtain the license to become a Primerica agent and many will sell only a small number of policies thereafter. However, at its core, Primerica counts more than 4,000 Regional Vice-Presidents (RVP) who keep their books as though managing their own small businesses. They serve two main functions, namely, selling financial products and recruiting potential financial advisors. When financial advisors thus recruited begin selling products, a portion of their commissions goes to the RVP. Commissions can thus be split at more than ten different levels. This can come across as a pyramid sales scheme, but Primerica is a legitimate and very serious organization that cannot be compared, for instance, to certain natural products firms that do operate along this model. Recruitment is not a profit centre for the company as the initial registration fee essentially covers the cost of material needed to prepare for the exam and the actual licensing.

Moreover, the demanding nature of the licensing process early on eliminates those individuals who are not serious about joining and making a real commitment to succeed with Primerica.

Normally, we are not particularly big fans of this sort of sales organization. This is why one of us went under cover and signed up for the Primerica advisor program. After a few months at it, we realized that the licensing process was perfectly legitimate and that we were dealing with a very serious organization, so much so that we ended up buying two term life insurance policies from them. Their premiums were equal to or lower than anything we could find elsewhere. Thanks to its unique sales structure, Primerica is the industry's low-cost provider of individual term life insurance.

The reason we were intrigued by Primerica is that, as you know, we like to find situations where there is a willing seller. Citigroup fit this mould as it needed capital to replenish its weak balance sheet. Primerica was non-core and an ideal asset to sell off.

The deal was a complicated one and necessitated extra work on our part to sift through the thick prospectus. The effort was worth the while, however. Just prior to the IPO, Primerica ceded 80% to 90% of its in-force policies to Citi Reinsurers. In other words, Primerica shrunk its business by more than 80%.

What makes this structure interesting going forward is that, as a new public company, Primerica will not need to work excessively hard to grow. If it just manages to maintain the rate at which it underwrote term life policies prior to going public, Primerica will grow at least 10% annually for many years to come. This is because the company will retain a much larger portion of the new policies than the 20% of its old book of business that it did not cede to Citi. We believe the company will earn more than $2.30 per share this year and could potentially earn as much as $4.00 a share within the next six years. The company is well capitalized, enjoys an A+ credit rating from A.M. Best, and can count on co-CEOs who have been with the company for more than 20 years, long before Primerica was part of Citigroup. The two are very excited about reverting to being an independent firm that no longer has to funnel all of its free cash flow to head office. To our eyes, the main risks facing the company are failure to recruit and license new financial advisors at a faster pace than in recent years and regulatory changes that could jeopardize the unique structure of its sales force. Moreover, Citigroup remains a large shareholder and any decision to sell a large block of shares could exert pressure on the stock in the short term. This is precisely what happened in April when Citigroup decided to unload 12 million of its shares. As a result, the stock dropped from about $25.00 to its actual price of $22.70. However, as this event had no impact on the intrinsic value of Primerica, we see this as no more than a temporary fluctuation. After the transaction, Citigroup still owned 17 million shares or approximately 20% of Primerica.

During the quarter, we also sold our remaining position in **Penn Millers Holding Corp. (PMIC – $14.17)** at $14.50 a share. The demutualization of this small U.S.-based P&C insurance company turned out to be a good investment for us (for those not familiar with this name, check out our previous letters). When we bought the stock in the fall of 2009, the margin of safety was so wide that the risk of losing money was practically nil. We realized a profit of more than 30% with Penn Millers and, as it accounted for more than 6% of our portfolio at cost, the impact on our performance was significant.

Moreover, we decided to sell our holdings in **Washington Post Corp. (WPO – $437.56)** and **American Public Education Inc. (APEI – $40.45)** at a nice profit as we felt investors were not sufficiently discounting the growing regulatory risk surrounding the for-profit education industry and the impact it could have on profits. Also, we did not believe that the market fully realized the gravity of the fact that the size of the potential student pool is shrinking. Most companies in the industry, if not all, have more stringent criteria for recruiting new students and are looking for those with a higher likelihood of completing their diplomas versus those with a high probability of dropping out. Being more selective will have a long-term positive effect on bad debt as dropping out is a main reason students default on their student loans. However, in the short term, the process will restrict the target group of potential students, raise student acquisition costs, and impact the student-to-program ratio adversely.

COMMENTARY

One stock impacted our performance dearly during the quarter, though we believe it is only a short-term hit. **LoJack Corporation (LOJN – $4.69)** dropped 27% on the quarter after posting a very strong performance in the second half of 2010. What we learned from this investment is that it is sometimes better to have no sell-side analyst tracking a stock than to have one doing a terrible job of it.

We knew that this particular analyst was overly generous in his 2011 EBITDA estimates, but this did not really bother us as we make our investment decisions based on our own analysis of the facts, not someone else's. However, we believe others trusted his guidance and, when the company released strong earnings in the third quarter of 2010, a new group of momentum investors cropped up among the top LoJack shareholders. Most of these players probably trusted the analyst's EBITDA forecast of $21 million for 2011 yearend. However, last February, when LoJack issued its guidance of $16 to $18 million in EBITDA for 2011, these same short-term momentum players exited the stock as fast as they bought in. This exodus bore down on the stock price. As you might recall from our Q3 letter, we expected LoJack to earn about $15 million, which is even lower than the company's forecast. So, we were actually quite satisfied with the results.

Then news broke on March 23 that LoJack's Brazilian licensee, Global Tracker, was suing the company for $400 million for breach of contract. Naturally, we were not pleased with this turn of events. However, we did not panic. First, we were aware of the friction between the two: Global Tracker experienced some financial difficulties during the past recession and, as a result, LoJack was having problems collecting receivables from them. Management put pressure on them to get their money and, by the end of 2010, receivables were back in line with historical levels. Chances are that Global Tracker did not appreciate being "bullied" by LoJack and retaliated with this bogus lawsuit. Although we believe the grievance to be without merit, we are not taking it lightly given that litigation is often a long process to settle and the legal costs can be substantial. Though the stock of course reacted negatively to this situation, it still held at about $5.00 after the news came out.

What really pushed the stock price down as low as $4.25, though, was when the sell-side analyst posted a note two days after the lawsuit was filed downgrading the stock from buy to neutral. In it, he slashed LoJack's international growth by 500 basis points, implying that the Brazilian licensee represented 20% of the company's revenue. We knew from all the work we had done that this was way off the actual figure of about 10%. We immediately advised LoJack management of the analyst's obvious error and asked them, despite their policy of not commenting on the magnitude of their business with licensees, to set him straight. They must have done so because, later that same day, the analyst posted a second note stating now that he believed revenue from the Brazilian licensee to be closer to 10% of total company sales instead of 20%. Interestingly, though, he never adjusted his international growth figure to reflect this.

Needless to say that it is upsetting to see one of our largest positions hit hard and all the more so when it occurs in part because of inaccurate reporting. However, the situation afforded the chance to be opportunistic. When the analyst published his first erroneous note, we jumped on the occasion to buy more LoJack stock at very attractive prices as low as $4.25.

We believe the stock is still extremely inexpensive. Even if we write off all profits from its Brazilian licensee, it would still be trading at four times EV/EBITDA. However, if we assume that the lawsuit is dismissed and EBITDA from Global Tracker holds at its present level, LoJack stock is trading at less than three times EV/EBIDTA, making this a very appealing investment for us.

Sincerely,

Steve Boutin, CFA

Philippe Hynes, CFA

Tonus Select Fund Performance Report

As at March 31, 2011

Tonus Select Fund : Class A shares	Unit Value
Current Quarter	110.4357
Previous Quarter	111.1506

Date	Tonus Select Fund Return	S&P/TSX Total Return	S&P 500 Total Return ($US)
1 Month	-2.05%	0.12%	0.04%
3 Month	-0.64%	5.60%	5.92%
6 Month	5.05%	15.57%	17.31%
Year-to-Date	-0.64%	5.60%	5.92%
1 Year	6.51%	20.41%	15.64%
2 Years*	13.00%	30.83%	31.61%
3 Years*	4.68%	4.97%	2.35%
Since Inception* (Oct. 31, 2007)	3.68%	1.94%	-2.29%

Source: Bloomberg Finance L.P.
All returns are net of fees.
* Please note that all returns greater than one year are annualized.

Investors should carefully consider the Fund's investment objectives, risks, and charges and expenses before investing. This and other important information is contained in the Fund's offering memorandum.

Portfolio composition is subject to change at any time and reference in this letter to specific securities, industries, and sectors should not be construed as a recommendation to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. The Fund is not guaranteed; its value changes frequently and past performance may not be repeated.