● TONUS CAPITAL INC.

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THIRD QUARTER 2010 - NEWSLETTER

TONUS SELECT FUND

Dear Partner,

We are pleased to send you this portfolio performance and review, along with commentary, for the third quarter of 2010.

PERFOMANCE REVIEW

During the third quarter of 2010, the Tonus Select Fund grew **3.97%**. Over the same period, the S&P/TSX Total Return climbed **10.27%** and the S&P 500 (in U.S. dollars) rose **11.29%.** The Canadian dollar gained approximately **3%** against the U.S. dollar, and this impacted our performance negatively.

On a year-to-date basis, the Fund was up **7.36%**, against **7.47%** and **3.89%**, respectively, for the S&P/TSX TR and the S&P 500 TR.

Since the Fund's inception in October 2007, we have achieved a compound rate of return of **2.57%**, compared with **-2.67%** for the S&P/TSX TR and **-7.86%** for the S&P 500 TR.

PORTFOLIO REVIEW

In the third quarter, we completed acquisition of **LoJack Corp. (LOJN - $3.91)**, a position we started building this past May. The company provides wireless radio-frequency technology for tracking and recovering stolen vehicles. It is a worldwide leader in its field and enjoys unmatched brand awareness in several countries. Though it is a multinational in many respects, LoJack has a market capitalization of only $65 million. Excluding the cash on its balance sheet, the company has a current enterprise value of $40 million. Interestingly, this amount is just shy of the EBITDA it generated in 2007, when it peaked at $41 million.

LoJack's EBITDA has since dropped considerably. We estimate that the company will post EBITDA of approximately $9 million in fiscal 2010. The abrupt decline in new car sales in the United States, a key driver for LoJack, is a major factor affecting the company's profitability. A lower order book from its international licensees is having a significant impact on profits as well.

This investment fits into our special situation bucket. LoJack is the type of potential turnaround candidate we like.

The company has a history of being profitable, it has no leverage (net cash of $1.50 per share), and certain special items make reading its income statement a gruelling exercise. For instance, a recent court battle lost against its Chinese licensee cost the company more than $20 million in legal fees and settlement. In addition, the true profitability of its core business has been masked by the development of new markets (e.g., Italy) and new products (e.g., wireless technology for tracking people at risk of wandering). Finally, the recent decision by management to right-size the business in line with the new reality of lower new car sales in the United States involved non-recurring charges that had a bearing on earnings in the short term.

The company operates under two business models. In the U.S. market, LoJack not only sells its tracking devices but also maintains and operates a platform through which all vehicles equipped with a unit can interface with law enforcement computers. If a vehicle is stolen, law enforcement can track it instantly, thus improving the chances of recovery. This model entails a significant barrier to entry, as competitors would have to sign multiple agreements with law enforcement in order to provide the same service.

In international markets, LoJack deals with licensees (except for Italy where the company applies the same model as in the United States) and earns revenue from selling its tracking devices on an exclusive basis. Some licensees have built large and profitable businesses using LoJack technology. For instance, last year, a private equity firm acquired a stake in LoJack's South African licensee, which valued its operations at more than $300 million (LoJack has no ownership interest in this licensee), proving that there is value in LoJack technology.

As mentioned above, we foresee the company generating about $9 million in EBITDA this year. In fiscal 2011, however, cost cutting and a more vigorous auto market should combine to boost EBITDA to roughly $15 million. Hence, the stock is currently trading at less than three times 2011 EBITDA. Moreover, we estimate that in a few years the company should be in a position to post EBITDA in excess of $20 million. LoJack is a small cap in a turnaround situation and, as such, carries potential risk. However, we have done our homework by talking to competitors in North America and Europe, to ex-employees, to its licensee in South Africa and, obviously, to management. The biggest risks we face with this investment are the following: 1) the difficult financial situation of its Brazilian licensee, which could hurt sales in the short term; 2) the ever-present risk of superior technology being developed; and 3) management misallocating cash towards unnecessary acquisitions. Having assessed these, we believe that, at its current valuation, LoJack is undervalued and these factors are already priced into the stock.

We made another investment that falls in the special situation bucket. In early July, we acquired shares in **Barnes and Noble Inc. (BKS – $16.21)** at $12.40 not long after management announced it would significantly increase investment in e-books to better compete against Amazon's Kindle, the market leader in this field. As the investment would hurt short-term profits, investors did not react too kindly to the news, sinking the stock more than 20% from $16.00 to $12.00 in a matter of days. Before this announcement was even made, the stock was already down from the $24.00 peak reached earlier in the spring. The cause of this prior decline was again investor apprehension regarding how Barnes and Noble's mega-bookstore model would compete against the hyperbolic growth of the e-book market. As often happens, investors placed too much emphasis on short-term trends and became blind to value no matter how cheap the stock became. We had our glasses on as did, we suppose, Barnes and Noble's chairman and largest shareholder, who put the company up for sale and included himself as a potential buyer. The stock shot up on the news and we sold our stock for a gain of 25%.

In our second-quarter letter, we mentioned that we might revisit **Washington Post Co. (WPO - $399.41)** as the stock was being punished for the company's involvement in the for-profit higher education sector through its Kaplan division. We did purchase shares at prices ranging from $303 to $404. By our conservative calculations, at less than $320 per share, the market attributed no value whatsoever to WPO's higher education division and to the Washington Post newspaper. There is no need to dwell on this stock here as it has been the subject of extensive coverage in previous letters. Suffice it to mention that we are fully aware of the political risk associated with this industry and we are monitoring the situation very closely.

The negative sentiment surrounding for-profit higher education served up the opportunity to acquire stock in another company in the sector that we believe is undervalued. **American Public Education Inc. (APEI - $32.86)** is a corporation that we admire for its steadfast commitment to offering quality education at great value. Indeed, most companies in the sector have for years benefited from annual mid-single-digit increases in tuition fees. However, this escalation has had the perverted effect of forcing students to indebt themselves ever more. APEI is the only company to our knowledge that has not hiked tuition for its undergraduate program in the past 10 years. As a result, its courses today are even less expensive than in some state universities. We believe that this will confer a non-negligible competitive advantage to the company in future.

Offering courses at a cheaper price does not make the company less profitable. In the past three years, the company has consistently recorded net profit margins above 10% even though it more than doubled in size during this period. APEI was able to achieve such a solid performance by offering online programs exclusively, by having significantly lower student acquisition costs, and by targeting students in the military. Since going public in 2007, the company had always had an overly rich valuation for us to consider acquiring its stock. However, as a result of investor nervousness about the sector and lower-than-expected growth in enrolment from APEI’s military student base in Q2, the stock plunged 50% from its high of $50.00 attained in late July. We pounced on the opportunity to buy the stock in the high 20s.

There are two principal risks to owning APEI: 1) the slowdown in enrolment among its core military student base is proving to be permanent owing to increased competition; and 2) the company’s strategy of further expanding its non-military clientele, which today represents one third of its student population, may not prove as easy and profitable as expected. However, its recent venture with Wal-Mart to offer courses to Wal-Mart employees is certainly a step in the right direction and evidence that APEI can find ways of offering its programs to a broader market.

The company has a pristine balance sheet with nearly $5.00 per share in cash. We believe that paying the stock 15 times 2010 EPS was a bargain for this growing, high-quality business.

Finally, in late September, we purchased shares in a new company that, needless to say, we felt was undervalued and misunderstood. It already represents 4% of our portfolio but as we might continue to build our position, we will refrain from disclosing any names for now.

COMMENTARY

The level of volatility endured so far this year, especially on the U.S. market, has provided the opportunity to put our cash to good use by investing in companies that we estimate are trading at attractive valuations. Our portfolio has gone from holding almost 60% in cash at the start of the year to less than 30% at present. However, despite the fact that the stock market has been robust of late, we are not itching to invest our remaining liquidity. The fear of underperforming the market during a bullish run is not a motivator for us. On the contrary, our recent buys mentioned above all have one thing in common: They have fallen out of favour with investors for the time being. This is further confirmation that we are not momentum buyers. When markets are volatile, it is important for investors to remember that the stock market is merely an auction mechanism for fixing prices. Its *raison d’être* is to serve investors, not to instruct them. We do not judge the attractiveness of a stock based on price fluctuations but rather on the value we get for the price we pay.

Sincerely,

Steve Boutin, CFA

Philippe Hynes, CFA

Tonus Select Fund Performance Report

As at September 30, 2010

Tonus Select Fund : Class A shares	Unit Value
Current Quarter	**105.1222**
Previous Quarter	101.1056

Date	Tonus Select Fund Return	S&P/TSX Total Return	S&P 500 Total Return ($US)
1 Month	2.82%	4.10%	8.92%
3 Month	3.97%	10.27%	11.29%
6 Month	1.38%	4.20%	-1.42%
Year-to-Date	7.36%	7.47%	3.89%
1 Year	10.05%	11.61%	10.16%
2 Years*	1.15%	5.91%	1.27%
Since Inception* (Oct. 31, 2007)	2.57%	-2.67%	-7.86%

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

Investors should consider carefully the investment objectives, risks, and charges and expenses of the Fund before investing. Important information about the Fund is contained in the Offering Memorandum, which should be read carefully before investing.

Portfolio composition is subject to change at any time and references to specific securities, industries, and sectors referenced in this letter are not recommendations 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.