● TONUS CAPITAL INC.

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FIRST QUARTER 2015 - NEWSLETTER

Dear Partner,

I am pleased to send you this portfolio review and commentary for the first quarter of 2015.

PERFOMANCE REVIEW

During the first quarter of 2015, the Tonus Composite increased **3.86%**. Over the same period, the performance of the S&P/TSX Total Return was **2.58%** and that of the S&P 500 Total Return in Canadian dollars was **10.39%**.

Since the inception of the Tonus Composite in October 2007, it has achieved a compound rate of return of **11.67%**, compared with **3.25%** for the S&P/TSX TR and **10.47%** for the S&P 500 TR $CAD.

PORTFOLIO REVIEW

The new additions where we find value usually fall under one of two categories: undiscovered gems or unpopular stocks. In the case of the former, value is sometimes discerned in companies that, because they are flying under the radar, fail to be picked up by investors or to grab the attention of sell-side research at banks and brokerage firms. This can be due to the company's size, uniqueness (i.e. few comparable public companies), or complexity. The small number of holdings in our portfolio allows us to do our own internal research based on our own models and estimates. When a company finally catches the spotlight weeks or even months after we discovered it, the profits on our investment can be sizeable. Value investing is naturally inclined, also, towards stocks that are "unloved" or out of favour. For people capable of adopting contrarian views and thinking outside the herd, the stocks in this second category can often be acquired at bargain prices. Investing in companies facing short-term challenges will seldom pay off immediately, but it can deliver spectacular returns when the consensus view improves over the longer run.

In the first quarter of 2015, we bought stock in a company that, arguably, fits both these categories. **Blue Bird Corporation (BLBD - $10.25)**, the school bus manufacturer, was privately owned until it made its trading debut by way of a complex amalgamation with a special-purpose acquisition company (SPAC). As this was not a formal IPO, the company did not receive the market attention usually reserved to such transactions. This, combined with its relatively small size, meant that the deal went largely unnoticed and, to this day, there is still no coverage of the stock. When the company reported a drop in Q1 profitability, the stock fell from grace. However, detail-oriented investors would have picked up in the fine print of the prospectus that management had projected lower Q1 profits. Consequently, when the news broke, it came as no surprise. We had previously discussed this issue with management, who confirmed that most of the decline derived from a one-time warranty gain recorded the year before. Be that as it may, the stock took a plunge over the following trading days and we managed to double down on our position at very attractive prices. The stock has since recovered and is now trading above its initial deal price. We believe this investment will pan out nicely over the long term. The reasons for this are compelling. First, the school bus industry is an oligopoly where three competitors control the market. Blue Bird has grown its market share above 30% thanks to its leading position in the propane-powered bus segment. Second, the industry's clients are school boards and their main source of revenue is property taxes. In this regard, the U.S. housing market recovery bodes well for additional funding to support a growing student population. Finally, the business requires little capital expenditure and generates a lot of free cash flow. We believe management will focus on reducing leverage at first, but will soon reward shareholders by returning excess cash to them. The valuation is very appealing and we foresee a hefty return once the market takes notice of the company's positive attributes.

Another stock in the portfolio is worth mentioning in particular. **Uni-Sélect Inc. (UNS - $43.68)** was up 43% in the quarter driven by the company's announcement it was selling off its U.S. automotive parts distribution operations. As specified in our investment thesis back in 2013Q4, this business segment was dragging down margins and profitability. We suggested then that cost-cutting initiatives and restructuring of the distribution network could enable UNS to grow the segment's EBITDA margin from our estimated 2% to a more respectable 6.5%. With this objective achieved only halfway so far, the division continued to lag and whether or not it could ultimately reach the target constituted our biggest risk going forward. In our original sum-of-the-parts analysis, we had valued the U.S. parts segment at $235 million. Uni-Select sold the business in January for $340 million, well above our expectations. The divestiture dispelled the other risk we had pointed to in our original thesis, that is, the company's leverage ratio. Indeed, the proceeds of the deal will allow UNS to become debt free. We bought more shares in January prior to the announcement and believe the stock can generate more gains yet as the company enjoys a new-found financial flexibility.

COMMENTARY

Markets have been stable so far in 2015, climbing 1.8% in Canada and 0.9% in the United States. In Canada, most of the advance has been due to a single stock, Valeant Pharmaceuticals, which has accounted for 1.4 percentage points of the rise in the index. In general, valuations remain above historical levels, which means value is hard to come by. Most value investors will echo this sentiment. Meanwhile, momentum chasers continue to find the market attractive and to push companies to be creative in their deployment of capital. Every acquisition announcement seems to result in a steep jump in the purchaser's share price. Now, some acquisitions might make economic sense, granted. But when 1 + 1 = 3 systematically, we are left scratching our heads, all the more so because we arrive at 2 (or less) when we perform the same calculation.

A word on the energy sector. So far, 2015 is unfolding as we projected in the 2014Q4 letter. Indeed, oil prices and energy stocks have manifested a great deal of volatility. The former were down 11% in the first quarter and the latter, 5%. This detracted about 2% from our overall performance. Fortunately, some offset came from gains realized on the loonie's devaluation versus the greenback. In any event, we believe the industry is taking the right steps to remedy the situation. Indeed, considerably less drilling and capital expenditure should flatten U.S. shale production and thus stabilize the market. Though prices could swing up or down in the short term, the equilibrium price should surpass current levels by far in the medium term. As we continue to monitor our investments, we like the upside potential they hold. In this regard, the CEO of our largest holding in the sector, helicopter service provider **PHI Inc. (PHIIK - $30.08)**, was again active on the open market at the end of March buying 60,000 shares worth close to $2 million. Like him, we believe the stock is highly undervalued.

Our efforts are focussed on finding bargains of the sort in other sectors as well. We took advantage of the devaluation of the Canadian dollar to sell off all excess U.S. dollars. More of our time is now spent hunting for prospects north of the border. Our list is growing, but we have yet to pull the trigger as bargains remain a scarcity. With 11% of Canadian GDP stemming directly or indirectly from energy activities, we remain wary of the potential indirect impact lower commodity prices could have on other industries. We continue to seek out new ideas and will remain disciplined in our quest to deploy our liquidity.

Sincerely,

Philippe Hynes, CFA
April 9, 2015

Tonus Composite Performance Report
As of March 31, 2015

Date	Tonus Composite Gross Return	S&P/TSX Total Return	S&P 500 Total Return ($CAD)
3 Month	3.86%	2.58%	10.39%
6 Month	0.21%	1.08%	20.05%
Year-to-Date	3.86%	2.58%	10.39%
1 Year	2.31%	6.93%	29.35%
2 Years	15.17%	11.36%	30.86%
3 Years	18.80%	9.57%	25.65%
5 Years	15.71%	7.41%	19.62%
Since Inception (Oct. 31, 2007)	11.68%	3.25%	10.47%

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

The Tonus Composite was created October 31, 2007. The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow of at least 25% of portfolio assets.
Investors should carefully consider the firm's investment objectives, risks, and expenses before investing.
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 Composite return is not guaranteed; its value changes frequently and past performance may not be repeated.