TONUS CAPITAL INC.

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THIRD QUARTER 2015 - NEWSLETTER

Dear Partner,

We are pleased to send you this portfolio review and commentary for the third quarter of 2015.

PERFOMANCE REVIEW

During the third quarter of 2015, the Tonus Composite decreased **-4.71%**. Over the same period, the performance of the S&P/TSX Total Return was **-7.86%** and that of the S&P 500 Total Return in Canadian dollars was **0.47%**.

Year to date, the Tonus Composite is up **1.51%** against **-7.02%** and **9.63%** for the S&P/TSX TR and the S&P 500 TR $CAD, respectively.

Since the inception of the Tonus Composite in October 2007, it has achieved a compound rate of return of **10.58%**, compared with **1.77%** for the S&P/TSX TR and **9.68%** for the S&P 500 TR $CAD.

PORTFOLIO REVIEW

The third quarter was a challenging one for stocks. From mid-August to the end of September, the North American markets retreated 10%. Very few companies escaped the bloodbath, as 80% and 90% of the stocks in the S&P500 and the S&P/TSX, respectively, registered losses over the quarter. Our portfolio was not exempt and, consequently, some of the gains made year to date were erased. It closed the first nine months of the year with a positive return of 2%. As mentioned in previous letters, the overall valuation of the market has been a concern of ours for some time now. With multiples above historical averages, earnings growth is the only remaining driver for stock price appreciation. Consequently, holding fast to our principles, we have kept a sizeable portion of our portfolio in cash over the past 18 months. We believed that our holdings represented good value and could hold their own in a down market. Needless to say that we are disappointed with the portfolio's return in the third quarter and that we were surprised by the further decline of some of our investments, especially the less liquid ones like **Blue Bird Corporation (BLBD - $9.96)** and **PHI Inc (PHIIK - $18.88)**. We nevertheless took advantage of recent volatility to deploy some cash to increase our weight in certain positions and to make new additions. At this point, their reduced valuations increase our expected long-term returns. Moreover, new stocks have been added to our research list and our team is working hard to find good value to swell our holdings.

During the quarter, we initiated a position in **Points International Ltd (PTS - $14.40)**. The company provides technology solutions to loyalty program operators around the world. Originally set up as an exchange marketplace where consumers could swap points between programs, Points now derives more than 80% of its revenues from its buy, gift, and transfer

solutions. It handles back-office operations and ongoing portal-related research and development for its loyalty program partners. The company boasts an impressive roster of partners, including the likes of United Mileage Plus, AirFrance Flying Blue, Marriott Rewards and many more. The stock appeared on our radar following a 50% decline in 2014 when Points lost customers further to the U.S. airline mega-mergers (Delta, USAir, American). This is now a thing of the past and the company has since added United Airlines on its platform. Revenues will grow more than 15% this year and chances are good that some airlines will return to the fold once the dust from the mergers settles. Looking forward, Points has clearly benefitted from the increased popularity of reward programs worldwide. Membership is growing at a rate in excess of 20% in North America and the company is increasing the engagement level of members on its platform. Further expansion will come from Asia where loyalty programs are just being introduced. As the company's cost structure is relatively flat at the operating level, margins are bound to widen and we expect this year's free cash flow per share of $0.65 to jump 30% next year. Converted to Canadian dollars (the company reports financials in USD but trades on the TSX in CDN), free cash flow per share will flirt with $1.15, that is, 11x our purchase price. What's more, Points has a clean balance sheet with a net cash position of more than $8 million, not counting the cash generated this year. This has allowed the company to be active on the marketplace and, so far this year, it has bought back 160,000 shares.

COMMENTARY

We wish to focus our comment this quarter on the advantage we enjoy of being able to pick the best investments available in Canada or the United States. As mentioned in previous letters, our interest in Canadian equities began to rise as indices began to fall. The TSX and TSX small caps are down 8% and 25%, respectively, over the past 12 months and the decline has begun to affect stocks outside the mining and energy sectors. Some companies that might experience collateral damage from the resource downslide are becoming interesting. One of these is AutoCanada (ACQ), which is down more than 65% from its peak in 2014. ACQ owns more than 50 car dealerships across Canada with half of them in Alberta, which drove record volumes and margins in 2014. As with their acquisition strategy (they doubled their dealership count in four years), profits were growing rapidly. An attractive valuation prompted us to do work on it and, in this regard, we benchmarked ACQ to U.S. peers. We were not quite ready to buy ACQ because of the added risk related to the Alberta economy. However, to our delight, stock prices for all dealerships took a hit in September when Volkswagen admitted tricking consumers and regulators. As a result, the valuations of competing dealerships have fallen more in line with ACQ's.

We set our sights on **Penske Automotive Group (PAG - $48.44)**, in which we initiated a position late in the quarter. At time of purchase, PAG was trading at less than 12x next year's earnings. On the growth side, PAG's strategy is not centred on massively acquiring more dealerships in the United States. Instead, they are focusing on same-store growth, as well as expanding their presence in Europe and entering the medium- and heavy-duty commercial truck dealership business. Where automobiles are concerned, they focus on luxury brands, a category growing at a faster clip than others. The market share of these brands in the United States has sprung from 10% to 18% over the past decade. From a growth perspective, we believe that both ACQ and PAG should do well over the next few years. From a risk perspective, however, we much prefer PAG at this point in time because the company does not face the same pressure on volumes and margins. The company is geographically dispersed in the United States and should benefit from its presence in Europe, where new vehicle registrations have more room to grow. Moreover, gross margins on new and used cars are steady and efforts are being made to lower operating expenses.

As we do with all our holdings, we will continue to monitor these two businesses and their stock prices closely. At current levels and under existing conditions, we have a certain preference for Penske. Stock price and end-market movements could change everything, however, and we could end up owning more Penske, adding ACQ, swapping PAG for ACQ, or owning neither. Valuation and risk will drive our decisions.

Finally, our cash position is still high. Our research team is striving to add more names to the portfolio, but not at any price. We remain focused on ferreting out solid companies with great valuations. We will update you on our findings in our year-end letter.

Sincerely,

Philippe Hynes, CFA
October 15, 2015

Tonus Composite Performance Report
As of September 30, 2015

Date	Tonus Composite Gross Return	S&P/TSX Total Return	S&P 500 Total Return ($CAD)
3 Month	-4.70%	-7.86%	0.47%
6 Month	-2.26%	-9.36%	-0.68%
Year-to-Date	1.51%	-7.02%	9.63%
1 Year	-2.06%	-8.38%	19.23%
2 Years	8.81%	5.02%	24.58%
3 Years	15.80%	5.70%	24.56%
5 Years	14.72%	4.46%	19.48%
Since Inception (Oct. 31, 2007)	10.58%	1.77%	9.68%

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.