

# **Deans Knight Income Corporation**

Financial Statements  
(Unaudited)  
**June 30, 2010**

## **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Section 4.3(3)(a) of National Instrument 51-102, Continuous Disclosure Obligations, provides that if an auditor has not performed a review of the interim financial statements, the interim financial statements must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The Company's external auditors, PricewaterhouseCoopers LLP, have not performed a review of these interim financial statements of Deans Knight Income Corporation.

These interim financial statements should be read in conjunction with the most recent annual financial statements.

Signed "Craig Langdon"

Signed "Mark Myles"

Craig Langdon  
Chief Executive Officer

Mark Myles  
Chief Financial Officer

# Deans Knight Income Corporation

## Statement of Net Assets

(Unaudited)

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Investments - at fair value (cost – June 30, 2010 - \$106,061,337 ; December 31, 2009 - \$100,510,397)	122,604,003	113,245,040
Cash and short-term deposits	2,597,979	6,042,756
Accrued interest receivable	2,740,660	1,670,248
Prepaid expenses	167,619	89,840
Future income tax benefits (note 8)	2,358,000	2,210,000
	<u>130,468,261</u>	<u>123,257,884</u>
<b>Non-current</b>		
Future income tax benefits (note 8)	3,652,000	5,990,000
	<u>134,120,261</u>	<u>129,247,884</u>
<b>Liabilities</b>		
<b>Accounts payable and accrued liabilities</b> (note 6)	<u>682,819</u>	<u>566,190</u>
<b>Net assets</b>	<u>133,437,442</u>	<u>128,681,694</u>
<b>Shareholders' Equity</b>		
<b>Common shares</b> (note 4)	99,366,429	99,366,429
<b>Contributed surplus</b> (note 4)	9,904,504	9,904,504
<b>Retained earnings</b> (note 5)	<u>24,166,509</u>	<u>19,410,761</u>
	<u>133,437,442</u>	<u>128,681,694</u>
<b>Number of common shares outstanding</b> (note 4)	<u>10,537,263</u>	<u>10,537,263</u>
<b>Net assets per common share</b> (notes 8 and 12)	<u>12.66</u>	<u>12.21</u>
<b>Contingencies</b> (notes 2 and 8)		
<b>Commitment</b> (note 11)		
<b>Subsequent Events</b> (note 13)		

The accompanying notes are an integral part of these financial statements.

# Deans Knight Income Corporation

## Statement of Operations

Six-month period ended June 30

(Unaudited)

	<b>2010</b>	<b>2009</b>
	\$	\$
<b>Investment Income</b>		
Interest and other	<u>5,142,007</u>	<u>1,725,068</u>
<b>Expenses</b>		
Management fees (note 6)	980,755	424,864
Directors' fees and expenses	84,535	53,260
Audit fees	53,384	25,000
Public company reporting costs	72,699	24,418
Foreign exchange loss (gain)	105,965	(32,249)
Custodial fees	15,408	12,891
Legal fees	17,409	10,000
Independent Review Committee fees	4,500	-
Transaction costs	-	10,050
Accretion on convertible debenture (note 4)	-	103,730
Interest on convertible debenture (note 4)	-	215,213
	<u>1,334,655</u>	<u>847,177</u>
<b>Net investment income</b>	<u>3,807,352</u>	<u>877,891</u>
<b>Realized and unrealized gains (losses) on investments</b>		
Net realized gain on investments sold (note 7)	2,572,267	953,429
Net realized gain on settlement of foreign currency contracts (note 7)	444,042	3,936,637
Change in unrealized appreciation on investments	5,246,375	10,943,081
Unrealized depreciation on foreign currency contracts	<u>(1,438,353)</u>	<u>(2,470,292)</u>
<b>Net gain on investments</b>	<u>6,824,331</u>	<u>13,362,855</u>
<b>Increase in net assets from operations before tax</b>	10,631,683	14,240,746
<b>(Provision for) recovery of future income tax</b> (note 8)	<u>(2,190,000)</u>	<u>9,372,500</u>
<b>Increase in net assets from operations</b>	<u>8,441,683</u>	<u>23,613,246</u>
<b>Increase in net assets from operations per weighted average common share</b> (note 3)	<u>0.80</u>	<u>3.87</u>

The accompanying notes are an integral part of these financial statements.

# Deans Knight Income Corporation

## Statement of Changes in Net Assets

Six-month period ended June 30

(Unaudited)

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	2010 \$	2009 \$
<b>Increase in net assets from operations</b>	<u>8,441,683</u>	<u>23,613,246</u>
<b>Dividends to common shareholders from net investment income</b>	<u>(3,685,935)</u>	<u>(614,322)</u>
<b>Shareholder transactions</b> (note 4)		
Issuance of common shares on conversion of debenture	-	3,358,615
Conversion of equity component of convertible debenture	-	(398,615)
Issuance of common shares for payment of interest on convertible debenture	-	215,213
Issuance of common shares on initial public offering, net of offering costs	<u>-</u>	<u>95,853,678</u>
	<u>-</u>	<u>99,028,891</u>
<b>Increase in net assets during the period</b>	4,755,748	122,027,815
<b>Net assets (liabilities) - Beginning of period</b>	<u>128,681,694</u>	<u>(2,856,270)</u>
<b>Net assets - End of period</b>	<u>133,437,442</u>	<u>119,171,545</u>

The accompanying notes are an integral part of these financial statements.

# Deans Knight Income Corporation

## Statement of Cash Flows

Six-month period ended June 30

(Unaudited)

	2010 \$	2009 \$
<b>Cash flows from operating activities</b>		
Increase in net assets from operations	8,441,683	23,613,246
Items not affecting cash		
Net realized gain on investments sold	(2,572,267)	(953,429)
Net realized gain on settlement of foreign currency contracts	(444,042)	(3,936,637)
Change in unrealized appreciation in value of investments	(5,246,375)	(10,943,081)
Unrealized depreciation on foreign exchange contracts	1,438,353	2,470,292
Accretion on convertible debenture	-	103,730
Interest on convertible debenture	-	215,213
Future income tax provision (recovery)	2,190,000	(9,372,500)
	<u>3,807,352</u>	<u>1,196,834</u>
Cost of investments purchased	(26,584,338)	(85,827,511)
Proceeds from investments sold	24,049,707	11,971,122
Net change in non-cash balances related to operations		
Accrued interest receivable	(1,070,412)	(1,475,270)
Prepaid expenses	(77,779)	(174,153)
Accounts payable and accrued liabilities	116,628	498,831
	<u>241,158</u>	<u>(73,810,147)</u>
<b>Cash flows from financing activities</b>		
Dividends paid to common shareholders (note 5)	(3,685,935)	(614,322)
Issuance of common shares on initial public offering, net of offering costs (note 4)	-	94,161,178
	<u>(3,685,935)</u>	<u>93,546,856</u>
<b>Net (decrease) increase in cash during the period</b>	(3,444,777)	19,736,709
<b>Cash and short-term deposits - beginning of period</b>	6,042,756	-
<b>Cash and short-term deposits - end of period</b>	<u>2,597,979</u>	<u>19,736,709</u>
<b>Cash and short-term deposits comprise</b>		
Cash	2,597,979	2,642,930
Short-term deposits	-	17,093,779
	<u>2,597,979</u>	<u>19,736,709</u>

### Supplemental cash flow information (note 10)

The accompanying notes are an integral part of these financial statements.

# Deans Knight Income Corporation

## Statement of Investments

As at June 30, 2010

(Unaudited)

	Par value <sup>1</sup> \$	Average cost <sup>2</sup> \$	Fair value <sup>2</sup> \$	Percentage of total fair value <sup>3</sup> %
<b>Fixed Income - Canadian</b>				
<i>Denominated in Canadian dollars</i>				
Garda World Security 9.75% 03-15-2017	2,500,000	2,472,105	2,525,000	2.1
North American Energy Partners Inc. 9.125% 04-07-2017	8,000,000	8,000,000	8,000,000	6.5
Sherritt International Corp. 7.75% 10-15-2015	3,500,000	2,718,438	3,648,750	3.0
Sherritt International Corp. 7.88% 11-26-2012	1,200,000	903,000	1,245,000	1.0
		14,093,543	15,418,750	12.6
<i>Denominated in United States dollars</i>				
Bombardier Inc. 8.00% 11-15-2014	5,268,000	5,029,913	5,796,762	4.7
CCS Inc. 11.0% 11-15-2015	7,750,000	3,879,423	6,986,702	5.7
Dollarama Group Holdings FRN 08-15-2012	5,248,000	5,354,661	5,556,049	4.5
Gibson Energy ULC 11.75% 05-27-2014	2,000,000	2,220,493	2,296,199	1.9
Harvest Operations Corp. 7.88% 10-15-2011 <sup>(4)</sup>	5,500,000	4,708,549	5,847,883	4.8
Methanex Corporation 6.0% 08-15-2015	1,000,000	879,586	1,012,873	0.8
Methanex Corporation 8.75% 08-15-2012	3,750,000	4,098,591	4,126,397	3.4
Opti Canada Inc. 7.88% 12-15-2014	2,000,000	1,257,971	1,834,838	1.5
Pacific Rubiales Energy Corporation 8.75% 11-10-2016	2,500,000	2,655,612	2,837,105	2.3
Paramount Resources Ltd. 8.5% 01-31-2013	8,300,000	8,821,516	8,802,980	7.2
Teck Resources Limited 10.75% 05-15-2019	5,500,000	6,297,137	7,087,459	5.8
West Fraser Timber Co. Ltd. 5.2% 10-15-2014	1,250,000	974,216	1,246,205	1.0
		46,177,668	53,431,452	43.6
Total Canadian fixed income		60,271,211	68,850,202	56.2
<b>Fixed income - United States</b>				
<i>Denominated in United States dollars</i>				
Beazer Homes USA, Inc. 9.13% 06-15-2018	3,250,000	3,327,056	3,205,664	2.6
Calfrac Holdings LP 7.75% 02-15-2015 <sup>(4)</sup>	7,140,000	6,670,487	7,307,640	6.0
Calfrac Holdings LP 7.75% 02-15-2015 144A <sup>(4)</sup>	500,000	500,141	511,740	0.4
Cott Beverages Inc. 8.38% 11-15-2017	4,350,000	4,622,109	4,636,678	3.8
McMoRan Exploration Co. 11.88% 11-15-2014	2,000,000	2,114,471	2,163,624	1.8
MetroPCS Wireless Inc. 9.25% 11-01-2014	5,400,000	5,761,266	5,884,739	4.8
MetroPCS Wireless Inc. 9.25% 11-01-2014	1,500,000	1,594,520	1,638,627	1.3
Total United States fixed income		24,590,050	25,348,712	20.7

# Deans Knight Income Corporation

Statement of Investments ...continued

As at June 30, 2010

(Unaudited)

	Par value <sup>1</sup> \$	Average cost <sup>2</sup> \$	Fair value <sup>2</sup> \$	Percentage of total fair value <sup>3</sup> %
<b>Foreign</b>				
<i>Denominated in United States dollars</i>				
FMG Finance Pty Ltd. 10.62% 09-01-2016	1,750,000	1,834,705	2,060,216	1.7
<i>Denominated Australian dollars</i>				
Western Areas NL 8.0% 07-02-2012	3,250,000	2,864,931	2,805,816	2.3
Total foreign fixed income		29,289,686	30,214,744	24.7
Total fixed income		89,560,897	99,064,946	80.9
<b>Convertible debentures</b>				
<i>Denominated in Canadian dollars</i>				
Harvest Energy Trust 7.25% 09-30-2013 <sup>(4)</sup>	5,500,000	3,635,076	5,541,250	4.5
Trinidad Drilling Ltd. 7.75% 07-31-2012	6,441,000	5,365,364	6,505,410	5.3
Whitecap Resources Inc. 8.0% 09-30-2012	7,500,000	7,500,000	12,930,750	10.5
		16,500,440	24,977,410	20.3
Investments subtotal		106,061,337	124,042,356	101.2
<b>Hedges</b>				
<i>Denominated in United States and Australian dollars</i>				
Foreign currency exchange contracts (note 9)	82,200,000	-	(1,438,353)	-1.2
		106,061,337	122,604,003	100.0

<sup>1</sup> Par values are presented in their source currency

<sup>2</sup> All amounts are shown in Canadian dollars

<sup>3</sup> Percentages are shown as a percentage of total investments

<sup>4</sup> These investments share a common director with the Company

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## 1 Nature of operations and basis of presentation

Deans Knight Income Corporation (the “Company”) is a corporation continued under the laws of Canada on April 11, 2001. The Company is a closed-end, non-redeemable investment company. It invests primarily, in corporate debt rated BBB or below by recognized credit rating organizations.

Prior to the Company completing its reorganization in May 2008, it was in the business of pharmaceutical research. In May 2008, the Company was reorganized and the pharmaceutical research operations and all assets and liabilities were transferred out of the Company (note 2). In March 2009, the Company completed an initial public offering, whereby it raised gross proceeds of \$100,368,900 (note 4) and began operating its new business of investing in corporate debt.

The common shares of the Company will be redeemed on, or around, April 30, 2014, for a cash amount equal to 100% of the net asset value per share.

The accompanying financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). All amounts are presented in Canadian dollars, unless otherwise noted.

## 2 Reorganization

In 2008, the Company reorganized its corporate structure and business, and issued a convertible debenture for \$2,960,000. The convertible debenture was convertible into 20,683,685 voting common shares and 123,818,901 non-voting common shares at the option of the third party. On March 17, 2009, the third party opted to convert the full amount of the convertible debenture and interest accrued thereon (note 4).

Prior to the Reorganization, the Company was a life sciences company involved in the research, development and commercialization of innovative products for the prevention and treatment of life-threatening diseases. Forbes Medi-Tech Inc (“Forbes”), who now carries on the prior business of the Company, has provided an indemnity to the Company with respect to liabilities relating to the Company’s assets transferred to Forbes and the Company’s prior business. In addition, Forbes obtained, on behalf of the Company, product liability insurance for certain claims that may arise in the future in connection with the Company’s prior business. To date, no such claims or potential claims have arisen. There can be no assurance that the above noted guarantee will be sufficient to cover any future claims.

## 3 Summary of significant accounting policies

The following is a summary of significant accounting policies followed by the Company, and these policies are consistent with the most recent annual financial statements.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## Financial Instruments

### *Investments*

Investments are held for trading and are recorded at fair values determined as follows:

#### *Short-term deposits*

Short-term deposits are valued at cost plus accrued interest, which approximates market value.

#### *Fixed income investments*

Fixed income investments traded on a public securities exchange or traded on an over-the-counter market are valued at the closing bid price. Where no closing bid price is available, the last sale or close price is used, where, in management's opinion, this provides the best estimate of fair value.

Unlisted or non-exchange traded investments, or investments where a last bid, sale or close price is unavailable or investments for which market quotations are, in the Company's opinion, inaccurate, unreliable, or not reflective of all available material information, are valued at their fair value as determined by the Company using appropriate and accepted industry valuation techniques including valuation models. The fair value determined using valuation models requires the use of inputs and assumptions based on observable market data including volatility and other applicable rates or prices. In limited circumstances, the fair value may be determined using valuation techniques that are not supported by observable market data.

The resulting values for investments not traded in an active market may differ from values that would be determined had a ready market existed, and the difference could be significant.

#### *Forward currency contracts*

Forward currency contracts are recorded at fair value. The proceeds (payments) on contracts settled during the period are included in the net realized gain on investments sold (note 7). The Company's policy is to hedge 95% - 106% of the fair value of foreign denominated investments with foreign exchange forward sell contracts.

The impact of changes in fair value on net income of the Company arising from changes in estimated fair value for investments is detailed in the statement of operations.

#### *Accrued interest receivable*

Accrued interest is designated as loans and receivables and is accounted for at amortized cost. Due to the immediate and short-term nature, carrying value approximates fair value.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## *Financial liabilities*

Financial liabilities, consisting of accounts payable and accrued liabilities, are designated as other financial liabilities and are accounted for at amortized cost. Due to the immediate and short-term nature, carrying value approximates fair value.

## **Investment transactions**

Investment transactions are recorded on the trade date. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment, which include fees and commissions paid to agents, advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. These costs are expensed and are included in the statement of operations.

## **Cash and short-term deposits**

Cash and short-term deposits consists of cash and deposits with maturities at the time of purchase of three months or less and are held with a Canadian chartered bank.

## **Income recognition**

Income from investments is recognized on an accrual basis. Interest income is accrued based on the number of days the investment is held during the year. Gains or losses on the sale of investments, including foreign exchange gain or loss on such investments, are calculated on an average cost basis.

## **Forward foreign currency contracts**

Forward foreign currency contracts (note 9) entered into by the Company are valued at an amount that is equal to the gain or loss that would be realized if the position were to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized appreciation/depreciation of foreign currency contracts in the statement of operations.

## **Foreign exchange**

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate applicable on the valuation date. Purchases and sales of investments, investment income and expenses are calculated at the exchange rates prevailing on the dates of the transactions.

## **Accretion in carrying value of convertible debenture**

The carrying value of the liability component of the redeemable convertible debenture is accreted to the estimated redemption value using the effective yield method through charges to income over the year up to the redemption date.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## **Income taxes**

The Company follows the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are measured using rates expected to apply to the taxable income in the years in which the temporary differences are expected to be settled. The Company accounts for uncertain tax positions using the contingent liability model, whereby a provision is established only where the probability that a payment will be required to be made is considered to be greater than 75%.

A valuation allowance is recognized to the extent it is more likely than not that future income tax assets will not be realized. Management has estimated the income tax provision and future income tax balances taking into account its expectation of future income and an interpretation of the various income tax laws and regulations. It is possible, due to the complexity inherent in estimating income taxes, that the tax provision and future tax balances could change (note 8), and the change could be significant.

## **Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those reported and such differences could be material. Significant areas involving the use of estimates include determining the estimated fair value of private investments and future income tax assets.

## **Net assets per common share**

The net assets per common share is computed by dividing the net assets of the Company by the total number of common shares outstanding on the valuation date.

## **Increase in net assets from operations per weighted average common share**

The increase in net assets from operations per common share represents the increase in net assets from operations divided by the weighted average number of common shares outstanding during the period.

The weighted-average number of shares outstanding during the period ended June 30, 2010 was 10,537,263 (June 30, 2009 – 6,097,337). This weighted average includes both the voting common shares and non-voting common shares of the Company.

## **Comparative figures**

Certain of the comparative figures have been re-classified to conform with the current period presentation.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

## 4 Capital stock

The Company is authorized to issue an unlimited number of voting common shares without par value, and an unlimited number of non-voting common shares without par value.

	<u>Voting common shares</u>		<u>Non-voting common shares</u>	
	<u>Number of shares</u>	<u>Amount</u>	<u>Number of shares</u>	<u>Amount</u>
	\$	\$	\$	\$
Balance - December 31, 2008	38,412,100	1	-	-
Shares issued on conversion of debenture	20,683,685	480,742	123,818,901	2,877,873
Shares issued for payment of interest owed on convertible debenture	-	-	8,227,260	215,213
Share consolidation	(58,941,083)	-	(131,700,490)	-
	154,702	480,743	345,671	3,093,086
Shares issued in initial public offering	10,036,890	100,368,900	-	-
Less: Offering costs - net of tax	-	(4,576,300)	-	-
Balance - December 31, 2009 and June 30, 2010	<u>10,191,592</u>	<u>96,273,343</u>	<u>345,671</u>	<u>3,093,086</u>
Total common shares outstanding at December 31, 2009 and June 30, 2010			<u>10,537,263</u>	<u>99,366,429</u>

On February 6, 2009, the Company cancelled its stock option plan and cancelled the authorized, but unissued, preferred shares.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## Initial Public Offering

On March 17, 2009, the Company completed an initial public offering.

Immediately prior to the initial public offering, the \$2,960,000 convertible debenture was converted at the holder's option, resulting in the issuance of 20,683,685 voting common shares and 123,818,901 non-voting common shares. The value ascribed to these shares was the value of the convertible debenture, being \$2,960,000, and the value of the equity component of the convertible debenture, being \$398,615. The Company also issued 8,227,260 non-voting common shares in satisfaction of the \$215,213 of interest owed on the convertible debenture.

Immediately after the issuance of shares related to the Convertible Debenture and the related interest owed, the 59,095,785 voting common shares and the 132,046,161 non-voting common shares outstanding were consolidated on a 382 to 1 basis, into 154,702 voting common shares and the 345,671 non-voting common shares.

The Company then issued 10,036,890 voting common shares at a price of \$10.00 per share, for gross proceeds of \$100,368,900. The net cash proceeds of \$94,100,100 (June 30, 2009 - \$94,161,178) were used to invest in a portfolio of debt instruments. As a result of the income tax benefit of \$1,692,500 related to offering costs of \$6,268,800, the total increase in share capital relating to voting common shares was \$95,792,600 (June 30, 2009 - \$95,853,678).

## Contributed surplus

The contributed surplus balance did not change during the period, and consists of:

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
	\$	\$
Surplus related to stock compensation, warrants and options associated with common shares	8,030,295	8,030,295
Surplus relating to warrants associated with previously issued preferred shares	<u>1,874,209</u>	<u>1,874,209</u>
	<u>9,904,504</u>	<u>9,904,504</u>

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## 5 Retained earnings

The changes in retained earnings for the period were as follows:

	\$
Deficit - December 31, 2008	(13,159,390)
Increase in net assets from operations	36,870,408
Dividends paid from net investment income	<u>(4,300,257)</u>
Retained earnings - December 31, 2009	19,410,761
Increase in net assets from operations	8,441,683
Dividends paid from net investment income	<u>(3,685,935)</u>
Retained earnings - June 30, 2010	<u>24,166,509</u>

## 6 Related party transactions and balances

Management fees are paid quarterly to Deans Knight Capital Management Ltd. (the Investment Advisor), a corporation with certain common directors and officers of the Company, for services received in connection with the management of the investment portfolio and financial accounts, among other services provided. Management fees are computed quarterly at an annual rate of 1.5% of Net Asset Value, adjusted for certain non-investment related assets. For the period ended June 30, 2010, management fees totalled \$980,755 (June 30, 2009 - \$424,864). Of this amount, \$504,095 (December 31, 2009 - \$476,700) was included in accounts payable and accrued liabilities in the statement of net assets at June 30, 2010, and is payable immediately.

A director of the Company is a partner at a law firm that provides legal services to the Company. During the period ended June 30, 2010, the Company incurred \$17,409 (June 30, 2009 - \$330,000) in legal services and disbursements received from this related party. At June 30, 2010, accounts payable and accrued liabilities include \$ nil (December 31, 2009 - \$550) to the law firm for legal fees and disbursements.

# Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2010

(Unaudited)

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## 7 Net realized gains on investments sold and foreign currency contracts

The net realized gain (loss) on sale of investments for the period ended June 30 was as follows:

	2010 \$	2009 \$
Proceeds from sale of investments	<u>24,049,707</u>	<u>11,971,122</u>
Investments at cost - Beginning of period	100,510,397	-
Add: Cost of investments purchased	<u>26,584,338</u>	<u>85,827,511</u>
	127,094,735	85,827,511
Less: Investments at cost - End of period	<u>(106,061,337)</u>	<u>(78,746,455)</u>
Cost of investments sold	<u>21,033,398</u>	<u>7,081,056</u>
Net realized gains on investments sold	<u>3,016,309</u>	<u>4,890,066</u>

Net realized gains on investments sold consists of:

	2010 \$	2009 \$
Realized gains on securities sold	2,572,267	953,429
Realized gains on settlement of foreign currency contracts	<u>444,042</u>	<u>3,936,637</u>
	<u>3,016,309</u>	<u>4,890,066</u>

## 8 Taxation

### Uncertainty of deductibility of tax losses

Prior to the reorganization and change in business as discussed in notes 1 and 2, the Company had generated significant tax losses and other tax attributes as a result of its prior businesses and research activities. The Company has recorded, as a tax asset, the full amount of the potential tax benefit of such items to the extent of its projected taxable income. There is no guarantee that the tax authorities will allow the Company to deduct some, or all, of the tax losses and other attributes. Should the Company be denied the deductions, the recognized amount of the tax assets, as well as such amounts claimed to date, would be recorded as a charge to income. The total tax assets recognized and tax losses and other attributes claimed to date, which are subject to

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uncertainty, amount to \$17,290,000 (December 31, 2009 - \$15,647,415), representing \$1.64 per common share at June 30, 2010 (December 31, 2009 - \$1.48 per common share).

### Future tax asset

Canadian GAAP requires a valuation allowance to be recognized against any future tax asset to the extent that it is more likely than not that the future income tax asset will not be realized. This is also the Company's stated accounting policy.

Prior to commencing operations as an investment corporation in March 2009, the Company had determined that it had not met this test. As such, the Company recorded a full valuation allowance against the potential value of all of its tax losses and deductions available to be taken against future years' taxable income.

As the Company's investments in debt securities are now generating interest income, and are expected to continue to generate income during the years of operations through to April 30, 2014, the Company concluded that the valuation allowance should be reduced accordingly. The difference between the total value of these tax benefits less the valuation allowance, being \$6,010,000 (December 31, 2009 - \$8,200,000), is the amount of the future income tax asset that has been recorded by the Company in the statement of net assets. The valuation allowance is reviewed periodically, based on updated projections of taxable income, and adjusted accordingly by a credit or charge to the statement of operations in that period.

The tax effects of temporary differences that give rise to significant components of the future income tax assets at the statutory enacted rates are as follows:

	June 30, 2010 \$	December 31, 2009 \$
<b>Future tax assets</b>		
Non-capital loss carry-forwards	3,718,750	5,150,041
Research and development expenditures	8,599,750	8,599,750
Investment tax credits	5,677,600	5,677,600
Share issuance costs	977,900	1,316,448
Property, plant and equipment and intangible assets	-	490,500
	<u>18,974,000</u>	<u>21,234,339</u>
Total gross future tax assets	18,974,000	21,234,339
Valuation allowance	<u>(12,964,000)</u>	<u>(13,034,339)</u>
	6,010,000	8,200,000
Net future tax asset	6,010,000	8,200,000
Less: current portion	<u>(2,358,000)</u>	<u>(2,210,000)</u>
	<u>3,652,000</u>	<u>5,990,000</u>

The tax balances and income tax expense recognized by the Company are based on management's interpretation of the tax laws. Due to the complexity inherent in tax interpretations, regulations and legislation, there are significant estimates required to compute income tax balances. It is possible that some or all of the Company's significant components of the future income tax assets may not be deductible for tax purposes and,

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accordingly, the amount of future income taxes and provision for (recovery of) income taxes recorded in the financial statements could change by a material amount.

In determining the amount of future income tax assets recognized management assessed the projected taxable income of the Company. Inherent in all forward looking information is uncertainty and actual amounts could differ from these estimates and the difference could be material. In developing the projection, management has assumed full payment of all contractual interest, that investments maturing prior to April 30, 2014 will be redeemed for par value and reinvested funds will achieve an 8% yield.

## Tax pools available to offset future tax expense and payable

The operations of the Company and related tax interpretations, regulations and legislation are continually changing. As a result, there are significant estimates required to compute income tax balances. As at June 30, 2010, the Company has accumulated scientific research and experimental development expenditures in the amount of \$34,399,000 available for carry-forward indefinitely. The Company also has accumulated approximately \$7,097,000 of unclaimed federal investment tax credits and accumulated non-capital losses in the amount of \$14,303,000. The investment tax credits and non-capital losses for income tax purposes expire as follows:

Year of expiry	Investment tax credits \$	Non-capital losses \$
2018	265,000	
2019	990,000	
2020	1,872,000	
2021	2,483,000	
2022	298,000	
2023	187,000	
2024	496,000	
2025	506,000	
2026		2,002,000
2027		9,823,000
2028		2,478,000
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	7,097,000	14,303,000

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## Reconciliation of income tax expense

The reconciliation of income tax computed at the statutory tax rate to income tax expense, using a 28.5% statutory tax rate (2009 – 30%) is:

	June 30, 2010 \$	June 30, 2009 \$
Income before income taxes	10,631,683	14,240,746
Statutory tax rate	28.5%	30%
Income tax expense at statutory rates	3,030,030	4,272,224
Use of prior year losses	(2,672,708)	(3,927,215)
Changes in valuation allowance	2,190,000	(11,065,000)
Income tax benefit related to offering cost	-	1,692,500
Share issuance costs	(357,322)	(345,009)
Income tax provision (recovery)	2,190,000	(9,372,500)

## 9 Financial instruments

The following tables illustrate the classification of the Company's financial instruments within the fair value hierarchy:

	Financial assets at fair value – June 30, 2010			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Bonds	-	88,026,223	8,232,908	96,259,131
Convertible debentures	-	12,046,660	15,736,565	27,783,225
Foreign currency forward contract	-	(1,438,353)	-	(1,438,353)
	-	98,634,530	23,969,473	122,604,003

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	<b>Financial assets at fair value – December 31, 2009</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Bonds	-	75,338,513	11,616,418	86,954,931
Convertible debentures	-	15,636,660	10,561,008	26,197,668
Foreign currency forward contract	-	92,441	-	92,441
	-	91,067,614	22,177,426	113,245,040

All investments remained at their respective levels within the fair value hierarchy during the periods.

The following table reconciles the Company's Level 3 fair value measurements:

	<b>Fair value measurements of Level 3 inputs</b>		
	<b>Bonds</b>	<b>Convertible debentures</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Balance - December 31, 2008	-	-	-
Purchases	9,671,316	10,364,931	20,036,247
Unrealized appreciation included in net gain on investments	1,945,102	196,077	2,141,179
Balance - December 31, 2009	11,616,418	10,561,008	22,177,426
Sales	(4,750,001)	-	(4,750,001)
Unrealized appreciation included in net gain on investments	1,366,491	5,175,557	6,542,048
Balance – June 30, 2010	8,232,908	15,736,565	23,969,473

Level 3 fair value measurements have predominantly been valued by considering data inputs such as the last price the security was traded at, most recent bid/ask information, prices of similar securities with available prices, and comparison of yields of comparable investments.

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## Management of financial risks

In the normal course of business, the Company is exposed to various financial risks, including credit risk, liquidity risk and market risk (consisting of interest rate risk, currency risk and other price risk). The Company's overall risk management program seeks to minimize potentially adverse effects of these risks on the Company's financial performance by employing a professional, experienced portfolio adviser, monitoring daily the Company's positions and market events, diversifying the investment portfolio within the constraints of the investment guidelines and periodically using derivatives to hedge certain risk exposures. Further, the Company monitors the portfolio to ensure compliance with its investment strategy, investment guidelines and securities regulations.

## Fair value risk

The Company's investments are exposed to market price risk and this risk affects the fair value of the investments. All investments in fixed income investments have an inherent risk of loss of capital. The maximum risk resulting from investments is determined by their fair value. The Company seeks to manage valuation risks by careful selection of fixed income investments prior to making an investment and by regular ongoing monitoring of the investment performance of the individual investee companies.

## Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company.

All transactions executed by the Company in listed securities are settled/paid for upon delivery using approved brokers. The risk of this settlement not occurring is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation. Since the Company invests in high-yield debt instruments and derivatives, this represents the main concentration of credit risk. The fair value of debt securities includes consideration of the creditworthiness of the debt issuer. The maximum credit exposure of these assets is represented by their carrying amounts. This maximum exposure may be offset to varying degrees in each investment, based on the collateral held, if any. Collateral may include such things as a general security agreement over all assets, or specific security over specific assets. It may also entitle the debt holder to take over the overall business, through restructuring of the investment.

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The Company's credit risk exposure by credit ratings on its investments is listed as follows:

<b>Credit rating</b>	<b>As a % of net assets</b>	
	<b>June 30, 2010</b>	<b>December 31, 2009</b>
BBB	5.3	-
BB	17.2	18.3
B	39.1	25.1
CCC	10.6	10.3
Not rated*	20.8	34.2
	<b>93.0</b>	<b>87.9</b>

\* Unrated debt securities consist primarily of convertible debentures and promissory notes in publicly traded companies

Credit ratings are obtained from Standard & Poor's and/or Moody's. Where one or more rating is obtained for a security, the lowest rating has been used.

The Company's credit risk exposure by sector on its investments is as follows:

<b>Sector</b>	<b>As a % of net assets</b>	
	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Energy	53.8	56.2
Materials and metals	12.6	16.9
Consumer goods	9.5	2.8
Industrial/manufacturing	6.7	4.5
Telecommunications	5.6	4.4
Chemicals	3.9	-
Forestry	0.9	0.8
Precious metals	-	2.3
	<b>93.0</b>	<b>87.9</b>

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## Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or fair values of financial instruments.

The Company invests in interest-bearing financial instruments. As such, the Company is exposed to the risk that the value of such financial instruments will fluctuate due to changes in the prevailing levels of market interest rates. The table below summarizes the Company's exposure to interest rate risk by term to maturity:

	At Fair Value	
	June 30, 2010 \$	December 31, 2009 \$
<b>Maturity</b>		
Less than 1 year	(1,438,353)	1,942,441
1 - 3 years	47,820,285	42,986,354
3. 5 years	34,221,624	35,149,061
Greater than 5 years	42,000,447	33,167,184
	<u>122,604,003</u>	<u>113,245,040</u>

As at June 30, 2010, if the prevailing interest rates had been raised or lowered by 1%, assuming a parallel shift in the yield curve, with all other factors remaining constant, net assets could possibly have decreased or increased, respectively by approximately \$4,118,868, or approximately 3.1% of net assets (December 31, 2009 - \$3,590,949, or approximately 2.8% of net assets).

## Liquidity risk

As the Company is a publicly traded, closed-end investment company with a fixed number of common shares outstanding, unlike an open-ended mutual fund, it is not exposed to the liquidity risk associated with daily cash redemptions of securities.

Investments in fixed income investments may not be able to be liquidated quickly at an amount close to their fair value to respond to specific events such as deterioration in the creditworthiness of any particular issuer. Fixed income investments purchased by the Company may be subject to resale restrictions such as hold periods. The resulting values for fixed income investments may differ from values that would be realized had a ready market existed.

The Company actively reviews its investment portfolio, and the fixed income market, to assess liquidity risk on its holdings.

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## Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company invests a portion of its assets in securities that are denominated in a currency other than the Canadian dollar, which represents the functional currency of the Company. Consequently, the Company is exposed to currency risk as the value of the portfolio securities denominated in currencies other than the Canadian dollar will vary due to changes in foreign currency exchange rates.

The Company enters into foreign currency contracts with financial institutions to hedge the value of foreign currency denominated investments. The fair value of these contracts is reflected in investments. Gains or losses arising from these contracts offset the gains or losses from the underlying investments. The unrealized gains or losses are reflected in unrealized appreciation/depreciation on foreign currency contracts on the statement of operations.

The tables below indicate the foreign currency to which the Company had significant exposure in Canadian dollar terms. The tables also illustrate the potential impact to the Company's net assets, all other variables held constant, as a result of a 5% change in this currency relative to the Canadian dollar, assuming the forward currency contracts in place did not offset the foreign currency risk.

				<b>As at June 30, 2010</b>	
	<b>Investments</b>	<b>Cash and term deposits</b>	<b>Foreign exchange contracts</b>	<b>Total</b>	<b>Impact on net assets</b>
	\$	\$	\$	\$	\$
<b>Currency</b>					
United States dollars	80,840,380	959,180	(1,325,743)	80,473,817	4,023,691
As a % of net assets	60.6	0.7	-1.0	60.3	3.0
Australian dollars	2,805,816	-	(112,610)	2,693,206	134,660
As a % of net assets	2.1	0.0	-0.1	2.0	0.1

				<b>As at December 31, 2009</b>	
	<b>Investments</b>	<b>Cash and term deposits</b>	<b>Foreign exchange contracts</b>	<b>Total</b>	<b>Impact on net assets</b>
	\$	\$	\$	\$	\$
<b>Currency</b>					
United States dollars	71,989,931	1,259,819	18,727	73,268,477	3,663,424
As a % of net assets	55.9	1.0	0.0	56.9	2.8
Australian dollars	3,061,008	-	73,714	3,134,722	156,736
As a % of net assets	2.4	-	0.1	2.5	0.1

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At June 30, 2010, the Company had outstanding foreign exchange contracts to sell US\$79,000,000 and AUS\$3,200,000 against future commitments at exchange rates ranging between 1.03418 and 1.05815 for US dollar foreign exchange contracts and 0.86 for the AUS foreign exchange contract. Those contracts have maturities ranging up to July 29, 2010.

## 10 Supplemental cash flow information

	<u>Six-month period ended June 30,</u>	
	2010	2009
	\$	\$
<b>Non-cash financing transactions</b>		
Non-voting common shares issued on conversion of debenture (note 4)	-	2,877,873
Voting common shares issued on conversion of debenture (note 4)	-	480,742
Non-voting common shares issued for payment of interest on debenture (note 4)	-	215,213
Future income tax benefit from offering costs (note 4)	-	1,692,500

## 11 Capital management

The capital of the Company is divided in voting and non-voting common shares, each having an unlimited authorized amount. The number of voting and non-voting shares outstanding, and changes thereto, are outlined in note 4.

The Company manages its capital in accordance with the Company's investment objectives. The Company's investment objectives are to: (i) maximize the total return for common shareholders, consisting of dividend income and capital appreciation; and (ii) provide shareholders with monthly dividends targeted to payout a minimum of 75% of net earnings annually. Net earnings in reference to the Company's dividend payments to shareholders excludes any realized and unrealized capital gains and losses from debt securities in the portfolio and any income or loss not derived from debt securities in the portfolio. The Company commenced its dividend payments on June 30, 2009, making monthly payments of \$0.0583 per voting and non-voting common share, or \$614,322. During the six-month period ended June 30, 2010, the Company made dividend payments of \$3,685,935 (June 30, 2009 - \$614,322).

The Company is committed to pay a monthly dividend of \$0.0583 per voting and non-voting common share for the three months ending September 30, 2010, totalling \$1,842,966.

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## 12 Comparison of net asset value per share and net assets per share

In accordance with Section 3.6(1) of National Instrument 81-106, the Company's net asset value per share, the net assets per share calculated in accordance with Canadian GAAP for financial reporting purposes, and an explanation of the differences between such amounts, are required disclosures in the notes to the financial statements. For investments that are traded in an active market, Canadian GAAP requires that bid prices be used in the fair value of instruments, rather than the use of the last traded price, as currently used for the purpose of determining net asset value. This change accounts for the difference between the net asset value and the net assets.

	\$
Net asset value per share	12.71
Canadian GAAP adjustments	(0.05)
Net assets per share	12.66

## 13 Subsequent events

On July 7, 2010, the Company announced a monthly dividend of \$614,322, or \$0.0583 per common share, payable on each of July 30, 2010, August 31, 2010 and September 30, 2010.

