DEANS KNIGHT

INCOME CORPORATION

INTERIM MANAGEMENT REPORT

OF FUND PERFORMANCE

This interim management report of fund performance (the "Report") contains financial highlights of the Company. This Report should be read in conjunction with the interim financial statements of the Company for the period ending June 30, 2009 (the "Financial Statements"), which, if not included with this Report, can be obtained at your request, at no cost by emailing info@dkincomecorp.com, visiting our website at www.dkincomecorp.com for contact details or on SEDAR at www.sedar.com. Shareholders may also contact us to request a free copy of the Company's proxy voting policies and procedures, proxy voting disclosure record or quarterly portfolio disclosure.

A NOTE ON FORWARD-LOOKING STATEMENTS

This Report contains certain forward-looking statements. These statements relate to future events or future performance, including the Company's targeted dividend payout, investment strategy, behaviour of financial markets and reflect the Company's expectations regarding the growth, results of operations, performance and business prospects and opportunities of the Company and its investments. Such forward-looking statements reflect the Company's current beliefs and are based on information currently available to the Company. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. With respect to such forward-looking statements, the Company has made assumptions regarding, among other things, what type of debt securities will be included in its investment portfolio. A number of factors could cause actual events or results to differ materially from the results discussed in the forward-looking statements. In evaluating these statements, prospective investors should specifically consider various factors, including the risks outlined under "Risk Factors" in the Company's Prospectus (as defined herein), which may cause actual results to differ materially from any forward-looking statement. Although the forward-looking statements contained in the Prospectus are based upon what the Company believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. Forward-looking statements are made as of the date of this Report and, other than as required by applicable law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Investment Objective and Strategies

Deans Knight Income Corporation (the "**Company**") is a closed-end, non-redeemable investment company focused on investing in corporate debt securities. The Company's assets are actively managed by Deans Knight Capital Management Ltd. ("**Deans Knight**"), a respected British Columbia-based investment firm focused on managing high income and growth mandates for high net worth individuals. Deans Knight, formed in 1992, has an experienced management team and a long history of successful investing in corporate debt securities.

The Company's investment objectives are to: (i) maximize the total return for Shareholders, consisting of dividend income and capital appreciation; and (ii) provide Shareholders (as defined herein) with monthly dividends, which have been initially set at $0.0583 per month. The Company will achieve these objectives by investing primarily in corporate debt securities rated BBB or below by Standard & Poor's Rating Services ("**S&P**") or an equivalent rating by another nationally recognized statistical rating organization. The Company may also invest in investment grade debt securities rated above BBB and non-rated debt securities from time to time.

The Company believes there are attractive investment opportunities today in owning corporate debt of businesses with tangible assets, strong cash flows and reasonable leverage, which, due to bonds trading below par value, are currently providing equity-like returns.

When evaluating bonds to purchase for the Company, Deans Knight intends to focus on the following:

- amount of security or collateral within a business to offset the value of the bonds;
- the position of the debt in the capital structure;
- covenants;
- liquidity;
- the business's ability to reduce or refinance the debt; and
- the overall term of the debt and yield to bondholders.

Deans Knight intends to employ the above credit-based analysis to identify corporate debt for inclusion in the Company with attractive valuations in order to maintain its targeted dividend payment, as well as achieve capital appreciation as bond pricing returns to more reasonable levels.

Risk

The overall risks of the Company are as described in its prospectus dated March 9, 2009. The Company does not believe there have been any changes over the financial period that has affected the overall level of risk associated with an investment in the Company.

Given the type of investments made by the Company, an investment in the Company may be considered to be speculative. An investment in the Company is generally suitable for investors who are looking to receive income yet are willing to tolerate volatility in the value of their investment.

Results of Operations

The net assets of the Company at June 30, 2009 were $119,171,545, or $11.31 per common share, which consisted of the following components:

	$	**Per common share**[(1)]	**%**
Investments[(2)]	87,219,244	8.28	73.2
Cash and short-term deposits	19,736,709	1.87	16.6
Accrued income	1,475,270	0.14	1.2
Prepaid expenses	174,153	0.02	0.1
Future income tax asset[(3)]	11,095,000	1.05	9.3
Accounts payable and accrued liabilities	(498,831)	(0.05)	(0.4)
	119,171,545	11.31	100.0

1. Based on 10,537,263 common shares, being 10,191,592 voting common shares, as outlined in the notes to the Financial Statements.
2. The details of the investments are outlined in the Summary of Investment Portfolios below.
3. Refer to the Taxation note to the Financial Statements for more detail.

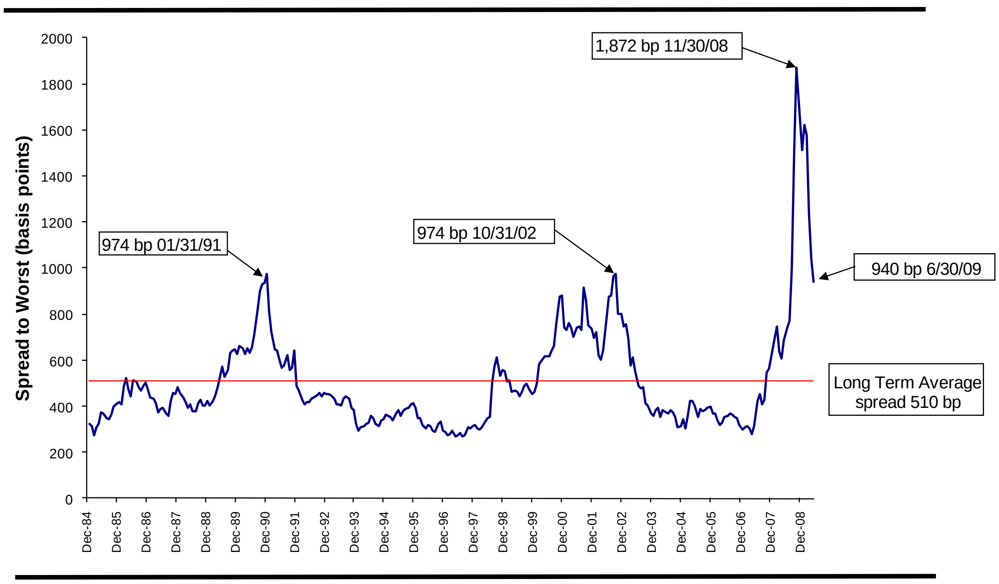
In order to generate a positive return on capital for shareholders, the Company needs to invest its available cash appropriately. Having a large cash balance in a rising price environment has a negative impact on this return. Thus, following the initial public offering ("**IPO**") on March 17, 2009, the Company has made an effort to deploy the capital as quickly and prudently as possible. At March 31, 2009, the Company had a cash balance of $62.9 million, or 59.1% of net assets. During the quarter, the Company made several investments, bringing the cash balance down to $19.7 million, or 16.5% of net assets. As of August 12, 2009, the Company's cash balance is approximately $12 million (10% of net assets). Despite having high cash balances, the Company has grown shareholders' net assets by approximately 13.1% from the IPO price of $10 per share.

In addition, the Company made its first monthly dividend payment to holders of voting common shares and non-voting common shares (collectively, the "**Shareholders**") on June 30, 2009 in the amount of $0.0583 per share, or $614,322. On July 10, 2009 the Company announced it will maintain monthly cash dividends at $0.0583 per share for the next three months, July 31, 2009, August 31, 2009, and September 30, 2009.

In the most recent quarter, high yield bond prices rose dramatically. Moreover, credit spreads between high yield bonds and government bonds have narrowed significantly from the record spread levels of late 2008 (see graph below).

Credit Spread History

Merrill Lynch US High Yield Master Index Less 10 year Treasury Yield



Source: Merrill Lynch high yield

Despite the narrowing of spreads, corporate bonds currently offer attractive yield to maturity and cash on cash yields of 10%[1], providing the Company with attractive investing opportunities.

One of the most common terms associated with high yield bonds is default risk. This is the risk that a company is not able to repay its interest or principle obligations. Many investors assume all high yield bonds are likely to default, and all default situations result in debt holders losing all of their capital. Both of these assumptions can be incorrect. To demonstrate, let's look at the Company's investment in the senior secured notes of Harvest Energy Trust (Harvest Operations 7.88% 10-15-2011). These bonds were purchased for the Company during April and May 2009, at an average cost of US$688 per US$1,000 note. This provided the Company with a yield to maturity, at time of purchase, of approximately 17.8%, and these bonds are considered to be high yield (i.e. below investment grade). Harvest Energy had total debt of $2.3 billion at December 31, 2008[2] and generated $656 million in cash flow for the year in 2008[2]. Although cash flow has declined thus far in 2009[3], Harvest has ample cash flow to service its debt.

In addition, Deans Knight estimates that the asset value of Harvest's oil production and refinery business is in excess of the total debt outstanding. Therefore, even if the company was to default, and assuming Deans Knight's assumptions are correct, bondholders would be repaid in full.

[1] As defined by the Merrill Lynch US High Yield Master II Index, using the July index at June 30, 2009. It is calculated by dividing the par weighted coupon by the par weighted price.

[2] 2008 Annual Report for Harvest Energy Trust

[3] Q2 2009 Quarterly Report for Harvest Energy Trust

Not all high yield debt issuers are as fortunate as Harvest Energy to have sufficient cash flows and asset value to support their debt. Thus, a number of high yield issuers may default in the coming months. However, Deans Knight's experience should enable the Company to invest in bonds that are unlikely to default, and in the case of a default the bonds will likely be supported by underlying asset value.

In addition to default risk, certain market participants suggest that it is likely interest rates will rise with an improving economy, and thus bond prices will go down.These assumptions are not necessarily true. A rising interest rate environment can actually be positive for high yield bonds. High yield bond prices are generally determined by credit quality. Interest rates likely will not rise until the economy shows signs of recovery, which generally correlates to an improved business environment for most companies, thus credit quality also improves. Historically, this has resulted in positive pricing movement for high yield bonds. In addition, the average term on high yield bonds is lower than investment grade bonds, 6.6 years versus 9.9 years[4], as investors are willing to lend money to higher rated credits for longer periods (Note: the average term on our bonds is 4.1years). As interest rates rise the average price of investment grade bonds should fall by almost 40% more than high yield bonds, all else being equal.[5]

With high yield bond spreads still at high levels, Deans Knight's proven track record of investing in corporate bonds and $19.7 million of cash and short-term deposits at June 30th, the Company is well positioned to take advantage of attractive investment opportunities.

Recent Developments

Reorganization into the business of investing

On February 27, 2008, the Company reorganized its corporate structure pursuant to a plan of arrangement under the Canada Business Corporations Act (the "Arrangement"). Pursuant to the Arrangement, all of the Company's then outstanding common shares, options and warrants were exchanged for common shares, options and warrants of Forbes, a newly formed entity. As a result of the exchange of shares, the Company became a wholly-owned subsidiary of Forbes and the common shares of Forbes began to trade on the TSX and NASDAQ in substitution for the common shares of the Company.

On March 19, 2008, a third party, Forbes and the Company entered into an investment agreement pursuant to which the third party agreed to purchase a convertible debenture for $2,960,000 and the Company and Forbes agreed to reorganize the business of the Company (the "Reorganization").

[4] Bloomberg: US High Yield Master II Index vs US Corporate Master Index as of June 30, 2009
[5] Calculated using duration of the ML US Corporate Index (6.0) and the ML US High Yield Index (4.2). Duration can be defined as the percentage change in a bond's price function with respect to interest rates.

On May 9, 2008, the Company completed the Reorganization pursuant to which it entered into an asset purchase and sale agreement with Forbes whereby the Company transferred all of its assets and operations to, and its related liabilities were assumed by Forbes.

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. The Company's infrastructure supported a portfolio of discovery and development stage pharmaceutical compounds and nutraceutical products. Forbes continues to carry on the prior business of the Company and in accordance with the asset purchase agreement between the Company and Forbes providing for the Reorganization, Forbes 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.

On February 6, 2009, the Company filed articles of amendment to change its name to "Deans Knight Income Corporation". In connection with the reorganization of the Company into an investment company, the Company amended its Articles to, among other things, consolidate the issued and outstanding voting and non-voting common shares on the basis of one voting and non-voting common share for every 382 voting and non-voting common shares held, respectively. Further, the amendments provided for investment objectives and investment restrictions of the Company and redemption feature on the Company's voting and non-voting common shares, as more particularly described in the Prospectus.

In March 2009, the Company completed its IPO, whereby it raised gross proceeds of $100,368,900 and began operating its new business of investing in corporate debt.

Due to the change in the nature of the Company's business resulting from the corporate reorganization and its subsequent IPO, the comparative statements of net assets, operations, changes in net assets and cash flows for the prior period would not be meaningful and have therefore not been presented in the Financial Statements. Should you wish to review prior year's financial statements, the comparative financial statements can be found in our Prospectus. You can obtain a free copy of the Prospectus by emailing info@dkincomecorp.com, visiting our website at www.dkincomecorp.com for contact details or on SEDAR at www.sedar.com.

New accounting policies

With the new business of investing in corporate debt, the Company has many new accounting policies it has adopted. Most significant are the policies associated with Section 3855 – Financial Instruments – Recognition and Measurement; Section 3862, Financial Instruments – Disclosures, Section 3863; and, Financial Instruments – Presentation of the Canadian Institute of Chartered Accountants ("CICA") Handbook – Accounting. For a detailed explanation of these policies and the anticipated impact on the Company please refer to our Financial Statements.

Comparison of net asset value and net assets

National Instrument 81-106 ("NI 81-106") permits investment companies to have two different net asset values: (i) one for financial statements, which will be prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") including Section 3855 (and referred to as "net assets", previously disclosed as "GAAP Net Assets"); and (ii) another for all other purposes, including unit pricing for investor transactions (referred to as "net asset value", previously referred to as "Pricing NAV"). The main difference in calculating net assets and net asset value is that GAAP requires bid price to be used in valuing securities traded in an active market where quoted prices are readily and regularly available, rather than the use of a price between the bid and the ask price currently used for determining net asset value. This difference results in an insignificant difference of approximately $0.03 per common share at June 30, 2009, as outlined in the notes to the Financial Statements.

Future accounting standards

The Canadian Accounting Standards Board confirmed January 1, 2011 as the date international financial reporting standards (IFRS) will replace current Canadian standards and interpretations as GAAP for publicly accountable enterprises, which include investment funds. Management has commenced activities to identify key issues and the likely impacts resulting from the adoption of IFRS. The impact on the Company's financial statements is not certain at this time.

Related Party Transactions

The officers, and certain directors, of the Company are also employees of the Investment Advisor, Deans Knight Capital Management Ltd. These officers, and directors, are not paid by the Company. Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the Net Asset Value plus applicable taxes, and adjusted for certain non-investment related assets.

For the period ended June 30, 2009, management fees totaled $424,864. In calculating the amount, the net asset value was reduced by the value of the future income tax asset included in the statement of net assets. The Portfolio Manager did not charge a management fee for the period ended March 31, 2009.

A director of the Company is a partner at a law firm that provides legal services to the Corporation. During the period ended June 30, 2009, the Corporation incurred approximately $330,000 in legal services and disbursements received from this related party, which predominantly related to the Company's IPO. At June 30, 2009, accounts payable and accrued liabilities include $10,000 to the law firm for legal fees and disbursements, which have not been billed.

Summary of Investment Portfolio

Top investments	**% of Net asset value**
Pacific Rubiales Energy 8.0% 08-29-2013	6.3
Cott Beverages USA 8.0% 12-15-2011	6.2
Athabasca Oil Sands Corp. 13.0% 07-31-2011	6.1
Teck Resources Ltd. 10.75% 05-15-2019	5.8
Paramount Resources 8.5% 01-31-2013	5.6
CCS Inc. 11.0% 11-22-2012	4.8
Harvest Operations 7.88% 10-15-2011	4.5
Chesapeake Energy CO 7.5% 09-15-2013	4.2
Dollarama Group LP 8.88% 08-15-2012	3.8
Bombardier Inc. 8.0% 11-15-2014	3.5
Methanex Corp. 8.75% 08-15-2012	3.5
Trinidad Drilling 7.75% 07-31-2012	3.5
Sherritt International Corp. 7.75% 10-15-2015	2.6
Provident Energy 6.5% 04-30-2011	2.4
Calfrac Holdings LP 7.75% 02-15-2015	2.3
Gibson Energy ULC 11.75% 05-27-2014	1.9
Harvest Energy 7.25% 09-20-2013	1.9
FMG FIN PTY LTD 10.63% 09-01-2013	1.6
Opti Canada Inc. 7.88% 12-15-2014	1.3
CGA Mining Limited 12.0% 11-22.2012	0.9
Sherritt International Corp. 7.88% 11-26-2012	0.9
West Fraser Timber 5.2% 10-15-2014	0.9
Methanex Corp. 6.0% 08-15-2015	0.7

Portfolio composition	**% of Net asset value**
Fixed Income	
Canadian denominated in CAD	9.6
Canadian denominated in USD	37.4
United States denominated in USD	12.7
Other Foreign denominated in USD	1.6
	61.3
Convertible Debentures	
Canadian denominated in CAD	14.0
Investment Portfolio	75.3
Cash & short-term deposits	16.5
Other assets less liabilities	8.2
	100.0
Sector Breakdown	
Energy	44.8
Materials and metals	15.2
Consumer goods	6.2
Retail	3.8
Industrial/Manufacturing	3.5
Precious metals	0.9
Forestry	0.9
Investment Portfolio	75.3
Cash and short-term deposits	16.5
Other net assets	8.2
	100.0