DEANS KNIGHT

INCOME CORPORATION

INTERIM MANAGEMENT REPORT

OF FUND PERFORMANCE

For the period from

January 1, 2010 to June 30, 2010

This interim management report of fund performance (the "Report") contains financial highlights of Deans Knight Income Corporation (the "Company"). This Report should be read in conjunction with the interim financial statements of the Company for the six month period ending June 30, 2010 (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 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.

This Report also contains certain financial and operational information obtained from public sources in respect of certain companies included in the Company's investment portfolio. While management believes this data to be reliable, such information is subject to variations and cannot be verified due to limits on the availability and reliability of data inputs, the nature of the data gathering process and other limitations and uncertainties inherent in such information. Accordingly, the accuracy, currency and completeness of this information cannot be guaranteed. The Company has not independently verified any of the data from third party sources referred to in this Report or ascertained the underlying assumptions relied upon by such sources.

Investment Objective and Strategies

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, to date, been set at $0.0583 per month. The Company intends to 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.

When evaluating bonds to purchase for the Company, Deans Knight focuses 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 employs the above credit-based analysis to identify corporate debt for inclusion in the Company's investment portfolio with attractive valuations in order to maintain its targeted dividend payment.

Risk

The overall risks of the Company are as described in its prospectus dated March 9, 2009 (the "Prospectus"). 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.

Prior to the reorganization and change in business, as discussed in the notes of the Financial Statements, 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 recorded 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 uncertainty, amount to $17,290,000, representing $1.64 per common share at June 30, 2010.

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 who are willing to tolerate volatility in the value of their investment.

Results of Operations

As per the financial statements, the net assets of the Company at June 30, 2010 were $133,437,442, or $12.66 per common share, compared to $128,681,694, or $12.21 per common share at December 31, 2009. The net assets of the Company consisted of the following components:

			June 30, 2010
	$	**Per common share[1]**	**%**
Investments[2]	122,604,003	11.63	91.9
Cash and short-term deposits	2,597,979	0.24	1.9
Accrued income	2,740,660	0.26	2.1
Prepaid expenses	167,619	0.02	0.1
Future income tax asset[3]	6,010,000	0.57	4.5
Accounts payable and accrued liabilities	(682,819)	(0.06)	(0.5)
	133,437,442	12.66	100.0

1. Based on 10,537,263 common shares, including 10,191,592 voting common shares and 345,671 non-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 Portfolio below.
3. Refer to the Taxation note to the Financial Statements for more detail.

			December 31, 2009
	$	**Per common share[1]**	**%**
Investments[2]	113,245,040	10.74	87.9
Cash and short-term deposits	6,042,756	0.57	4.7
Accrued income	1,670,248	0.16	1.3
Prepaid expenses	89,840	0.01	0.1
Future income tax asset[3]	8,200,000	0.78	6.4
Accounts payable and accrued liabilities	(566,190)	(0.05)	(0.4)
	128,681,694	12.21	100.0

1. Based on 10,537,263 common shares, including 10,191,592 voting common shares and 345,671 non-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 Portfolio below.
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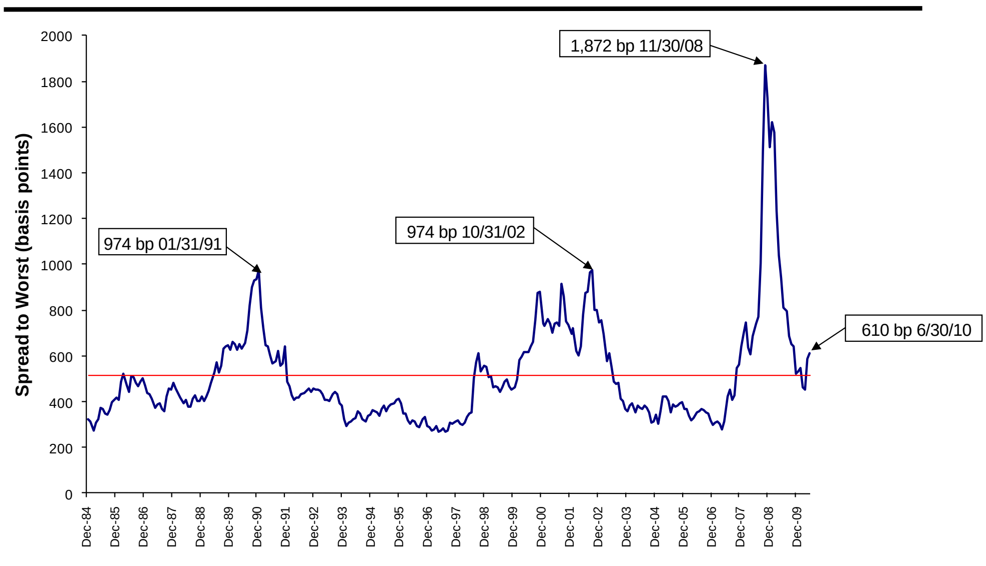
The increase in the net assets of the Company over the past six months was in large part due to our holding in **Whitecap Resources Inc.**, a private oil and gas producer (9.7% of the Company's net asset value). In August last year, Deans Knight invested $7.5 million in an 8% convertible debenture, which formed part of Whitecap's seed capital, along with a $36 million equity issue. With this capital, Whitecap acquired an asset producing 900 barrels of oil equivalent per day ("boepd') (50% oil and 50% natural gas). On June 1st, 2010, Whitecap announced an agreement to merge with **Spitfire Energy Ltd.**, a public oil and gas producer with assets in Saskatchewan. The combined entity is expected to have production of 1,360 boepd, half of which is oil, in two core areas, with 7 million barrels of oil equivalent ("BOE") of reserves and $15 million in net debt. The merged company will be run by Grant Fagerheim and his team, who have successfully run other junior oil and gas companies, including Ketch Energy, Ketch Resources and Cadence Energy. With the completion of the merger on June 25th, Whitecap's share price rose significantly, resulting in the value of our convertible debenture increasing by 72%, which provided a 4% return to Deans Knight Income Corporation during the period.

Credit Spread History

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



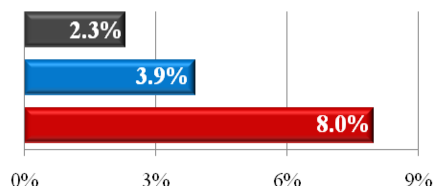
Source: Merrill Lynch high yield

As noted in the graph above, credit spreads widened during the period. This should not be a surprise, given investors exposure to the mainstream media which appears to be putting negative connotations on most economic matters. Examples include the collapse of the Euro, the sovereign debt crisis in Europe, the faltering global economic recovery, massive government deficits, the economic threat of the withdrawal of government stimulus, and others.

A positive factor in respect of the media's current portrayal of economic unrest is that the worst case scenario can be predicted. It is when the worst case scenario is not predictable that trouble is often just around the corner. For example, prior to the 2008/2009 downturn in the markets, the media had hyped nothing but good news until the financial crisis/recession. This caused investors to forget about risk and made bond (yields) expensive.

Regardless of the macro environment, as a bondholder we are only concerned that a business can service its debt and that it has the ability to repay or refinance the debt when it becomes due. The Company is not attempting to belittle the economic challenges ahead. There are many of them, and some may be monumental; however, earnings are improving. In most cases, the investee companies' balance sheets are in better shape than they were 18 months ago and the average yield on the Company's holdings is twice that of investment grade bonds, and 3 times 5-year government bonds.

- 5-year Canadian Government bonds[1]:
- Canadian Investment Grade bonds[2]:
- **Deans Knight Income Corp.:**



[1] Bloomberg

[2] Merrill Lynch Canadian Corporate Index

To give you an idea of the types of companies we are invested in, we are including some brief comments on our major bond holdings.

Paramount Resources 8.5% due January 31, 2013. Paramount is an oil and gas producer with assets in Alberta, Northwest Territories, and North Dakota. Paramount is currently producing 13,500 boepd which is predominantly natural gas. In addition to its producing assets, the bonds are secured by their holding in Trilogy Energy Corp which is currently worth $240 million. Paramount has a current market cap of $1.4 billion with only $90 million in debt.

North American Energy Partners (NAEP) 9.125% due April 7, 2017. NAEP provides a wide range of heavy construction and mining, piling and pipeline installation services to customers in the Canadian oil sands, mineral mining, commercial and public construction and conventional oil and gas markets. NAEP's EBITDA to year end March 31, 2010 was $120 million and has net debt of $180 million.

Despite the low debt level, NAEP has only a B credit rating due to the perceived cyclical nature of their cash flows. As a result, NAEP has to pay a high coupon and adhere to stricter covenants protecting the bondholders. Although a portion of their business is cyclical, NAEP has a strong management team, with a core oil sands business generating recurring cash flows sufficient to service its debt.

MetroPCS Wireless Inc. 9.25% due November 1, 2014. MetroPCS is a wireless communications provider servicing many of the major markets in the US. MetroPCS has $3.6 billion in debt and generated $900 million in EBITDA last year, which should grow as MetroPCS gains more traction in their new markets, being Boston, Los Angeles and New York. Given that MetroPCS has already spent the majority of the capex required to achieve their growth targets, the Company believes that the debt multiples of MetroPCS should decrease over the next few years. In addition, MetroPCS has a strong cash position of $1.1 billion, which could be used for further growth in new markets or to reduce debt.

During the six months ended June 30, 2010, the Company continued to make monthly dividend payments of $0.0583 per share to holders of voting common shares and non-voting common shares (collectively, the "**Shareholders**"), resulting in total dividend payments in the six month period of $0.35 per share. On July 7, 2010, the Company announced that it intends to maintain monthly cash dividends at $0.0583 per share for the three months ended September 30, 2010.

Recent Developments

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 $0.05 per common share at June 30, 2010, as outlined in the notes to the Financial Statements.

International Financial Reporting Standards

The Company is required to adopt international financial reporting standards (IFRS). The Canadian Accounting Standards Board (AcSB) previously announced 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 companies.

However, the AcSB recently issued an exposure draft of proposed accounting standard to defer IFRS for investment companies currently applying Accounting Guideline 18 - Investment Companies until years beginning on or after January 1, 2012.

Under this exposure draft, the Company's first set of financial statements to be reported on under IFRS will be for the semi-annual period ending June 30, 2012. These statements will include corresponding comparative financial information for 2011, including an opening statement of net assets as at January 1, 2011.

The Company has established a transition plan to ensure that it is able to meet its reporting requirements. The plan consists of three main elements, which include:

- Identifying differences between the current accounting policies of the Company, which reflect current Canadian GAAP, and those expected to apply under IFRS and the likely financial statement impact resulting from the adoption of IFRS;
- Analyzing the impact of the adoption of IFRS on business and reporting processes;
- Disclosing the qualitative impact in the December 31, 2009 management report of fund performance and disclosing the quantitative impact, if any, in the December 31, 2010 management report of fund performance.

Based on the Company's analysis of current accounting policies and presentation under GAAP against IFRS the adoption of IFRS is not expected to have a material effect on the Company's net assets or net assets per share. The primary impact will be in the areas of presentation and note disclosure. Further, the Company does not believe that the changeover to IFRS will materially affect the Company's existing business arrangements.

However, it should be noted that there are additional changes to IFRS expected during the remainder of 2010 and in 2011. This potential for change creates some uncertainty regarding the expected accounting standards that will be upon the Company adopting IFRS. As such, the Company cannot conclusively determine the impact that the adoption of IFRS will have.

Throughout the balance of 2010 and in 2011, the Company will continue to monitor new standards and recommendations as they are issued by both the International Accounting Standards Board, who is responsible for the development and publication of IFRS, and the AcSB, to update its analysis as appropriate. By the fourth quarter of the year predating the required adoption, the Company expects to complete its analysis, determine overall financial statement presentation, and complete its assessment. Any changes required with respect to its business arrangements will then be adopted.

Harmonized Sales Tax

On July 1, 2010, British Columbia and Ontario provincial sales taxes (PST) were replaced with a value-added tax and combined with the federal Goods and Services Tax (GST) to create a Harmonized Sales Tax (HST). The HST has a combined rate of 12% and 13% in British Columbia and Ontario, respectively. of which the provincial portion will be 7% and 8%, respectively, and the federal portion will be 5%. Although management fees and certain other service costs of the Company are currently subject to the 5% GST, but not PST, these services will be subject to the new HST. Since the Company is not able to recover this tax, the 8% difference will represent an additional cost to the Company.

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, for the services outlined above, 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 six month period ended June 30, 2010, management fees totaled $980,755 (2009 - $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.

A director of the Company is a partner at a law firm that provides legal services to the Corporation. During the six month period ended June 30, 2010, the Corporation incurred $17,409 (2009 - $330,000) in legal services and disbursements received from this related party. At June 30, 2010, accounts payable and accrued liabilities include $ nil (2009 - $10,000) to the law firm for legal fees and disbursements, which have not been billed.

Financial Highlights

The following tables show selected key financial information about the Company and are intended to help you understand the Company's financial performance since it began operating its new business of investing in corporate debt in March 2009.

The Company's Net Assets per Common Share (1)

	Six months ended June 30, 2010 $	**Year ended December 31, 2009 $**
Net assets, beginning of period (2)(3)	12.23	9.12
Increase (decrease) from operations		
Total revenue	0.49	0.62
Total expenses	(0.13)	(0.20)
Realized gains (losses) for the period	0.28	1.25
Unrealized gains (losses) for the period	0.40	1.23
Recovery of future income taxes	(0.21)	0.62
Total increase (decrease) from operations (3)	0.83	3.52
Dividends (3)(4)		
From income	(0.35)	(0.41)
Net assets at end of period (5)	12.71	12.23

(1) The information is derived from the Company's audited annual and unaudited interim financial statements. Common shares outstanding are 10,537,263, including 10,191,592 voting common shares and 345,671 non-voting common shares.
(2) Net assets, beginning of the period for the year ended December 31, 2009 reflect the net assets in the Company at March 17, 2009, after giving effect to the conversion of the Convertible Debenture and interest owing thereon and the issuance of common shares on the IPO less total share issue expenses.
(3) Net assets and dividends are based on the actual number of shares outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of shares outstanding over the period from the date the Company began operating its new business to December 31, 2009.
(4) Dividends were paid in cash.
(5) The net assets per share presented in the financial statements differs from the net asset value per share calculated for fund pricing purposes due to the provisions of CICA Handbook Section 3855. An explanation of the differences can be found in the notes to the financial statements.

Ratios and Supplemental Data	**2010** **$**	**2009** **$**
Net asset value (000's)	133,996	$128,930
Number of common shares outstanding (000's)	10,537	10,537
Management expense ratio (2) (3)	1.02%	5.51%
Portfolio turnover rate (4)	19.4%	36.69%
Trading expense ratio (5)	0.00%	0.01%
Net asset value per common share	$12.71	$12.23
Closing market price – common share	$11.00	$11.40

(1) This information is provided as at December 31, 2009
(2) Management expense ratio is based on total expenses for the period and is expressed as an percentage of weekly average net asset values over the period. For 2009, this ratio is calculated from the date the Company began operating its business as an investment fund, on March 17, 2009, to December 31, 2009.
(3) The Management expense ratio for 2009 includes offering costs for the IPO of $6,268,800 less the offsetting related future tax benefit of $1,692,500.
(4) The Company's portfolio turnover rate indicates how actively the Company manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Company buying and selling all of the securities in its portfolio once in the course of the year. The higher a portfolio turnover-rate in a year, the greater the trading costs payable by the Company in the year. There is not necessarily a relationship between a high turnover rate and the performance of the investment portfolio.
(5) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period. This expense is $10,050, as the purchasing and selling of bonds do not attract a commission from the buying or selling party.

Management Fees

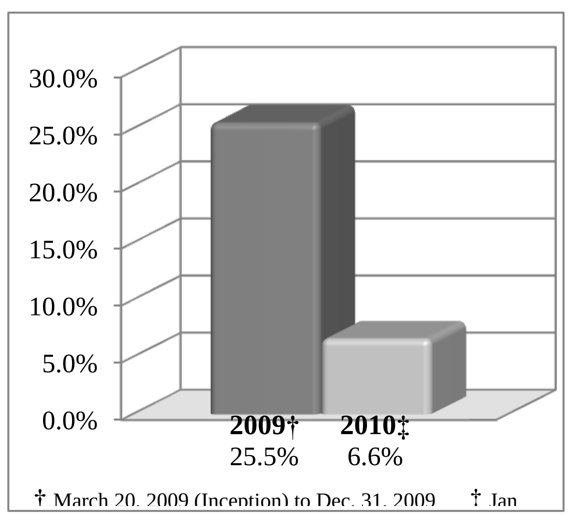
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, and adjusted for certain non-investment related assets.

Past Performance

This section shows the Company's past performance, since it began operating its business as an investment fund. The past performance information includes changes in net asset value and assumes the reinvestment of all dividends paid to common shareholders. It is important to note that the past performance will not necessarily indicate what performance in the future will be.

Year-by-year Returns

The accompanying bar chart shows the Company's performance for the periods shown and illustrates how the Company's performance has changed from period to period. The bar chart shows, in percentage terms, how much an investment made when it began its operation as an investment fund, March 17, 2009 to December 31, 2009 and how much an investment made for the six month period ending June 30, 2010.



Summary of Investment Portfolio

Top 25 investments	% of Net asset value
Whitecap Resources 8.0% 09-30-2012	9.7
Paramount Resources 8.5% 01-31-2013	6.6
North America Energy 9.125% 04-07-2017	6.0
Calfrac Holdings LP 7.75% 02-15-2015	5.5
Teck Resources Ltd. 10.75% 05-15-2019	5.3
CCS Inc. 11.0% 11-15-2015	5.2
Trinidad Drilling 7.75% 07-31-2012	4.9
MetroPCS Wireless 9.25% 11-01-2014	4.4
Harvest Operations 7.875% 10-15-2011	4.4
Bombardier Inc. 8.0% 11-15-2014	4.3
Dollarama Group LP FRN 08-15-2012	4.2
Harvest Energy 7.25% 09-30-2013	4.2
Cott Beverages Inc. 8.375% 11-15-2017	3.5
Methanex Corp. 8.75% 08-15-2012	3.1
Sherritt International Corp. 7.75% 10-15-2015	2.7
Beazer Homes USA 9.125% 06-15-2018	2.4
Pacific Rubiales 8.75% 11-10-2016	2.1
Western Areas NL 8.0% 07-02-2012	2.1
Garda World Security 9.75% 03-15-2017	1.9
Gibson Energy ULC 11.75% 05-27-2014	1.7
McMoRan Exploration 11.875% 11-15-2014	1.6
FMG FIN PTY LTD 10.62% 09-01-2016	1.5
Opti Canada Inc. 7.875% 12-15-2014	1.4
MetroPCS Wireless AC4 9.25% 11-01-2014	1.2
West Fraser Timber 5.2% 10-15-2014	0.9

Portfolio composition	% of Net asset value
Fixed Income	
Canadian denominated in CAD	11.6
Canadian denominated in USD	40.0
United States denominated in USD	19.0
Other Foreign denominated in USD	1.5
Other Foreign denominated in AUD	2.1
	74.2
Convertible Debentures	
Canadian denominated in CAD	18.7
Other Foreign denominated in AUD	0.0
	18.8
Investment Portfolio	93.0
Cash & short-term deposits	1.9
Other assets less liabilities	5.1
	100.0

Sector Breakdown	
Energy	53.8
Materials and metals	12.6
Consumer goods	9.5
Industrial/Manufacturing	6.7
Telecommunications	5.6
Chemicals	3.9
Forestry	0.9
Investment Portfolio	93.0
Cash and short-term deposits	1.9
Other net assets	5.1
	100.0