DEANS KNIGHT
INCOME CORPORATION

ANNUAL MANAGEMENT REPORT

OF FUND PERFORMANCE FOR 2010

This annual 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 annual financial statements of the Company for the year ended December 31, 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. Readers 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. In particular, this Report contains forward-looking statements in respect of 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. 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. Such forward-looking statements reflect the Company's current beliefs and are based on information currently available to the Company. 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, currency, exchange and interest rates. 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 global equity and capital markets, business competition, technological change, changes in government regulations, unexpected judicial or regulatory proceedings, and catastrophic events and the risks outlined under "Risk Factors" in the AIF (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 (as defined herein), consisting of dividend income and capital appreciation; and (ii) provide Shareholders with monthly dividends, which to date have been set at $0.0583 per share 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. Examples of investments made during the period are detailed below in the Results from Operations.

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 securities to purchase for the Company, Deans Knight focuses on the following:

- amount of security or collateral within a business to support the value of the securities;
- 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'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 annual information form of the Company dated March 15, 2011 (the "**AIF**").

Prior to the reorganization and change in business as discussed in Note 1 of the Financial Statements, the Company 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 uncertainty as to whether 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 in full, 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 $20,747,249 (2009 - $15,647,415), representing $1.97 per common share at December 31, 2010 (2009 - $1.48).

There were no significant changes during the year ending December 31, 2010 that affected the overall risk of investing 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 December 31, 2010 were $143,343,361 or $13.60 per common share (2009 - $128,681,694 or $12.21 per common share). The net assets of the Company consisted of the following components:

	December 31, 2010		
	$	**Per common share[1]**	**%**
Investments[2]	128,449,450	12.19	89.6
Cash and short-term deposits	7,137,967	0.68	5.0
Accrued income	1,808,756	0.17	1.2
Prepaid expenses	89,662	0.01	0.1
Future income tax asset[3]	6,550,000	0.62	4.6
Accounts payable and accrued liabilities	(692,474)	(0.07)	(0.5)
	143,343,361	13.60	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 included in the 2009 Management Report of Fund Performance
(3) Refer to the Taxation note to the Financial Statements for more detail.

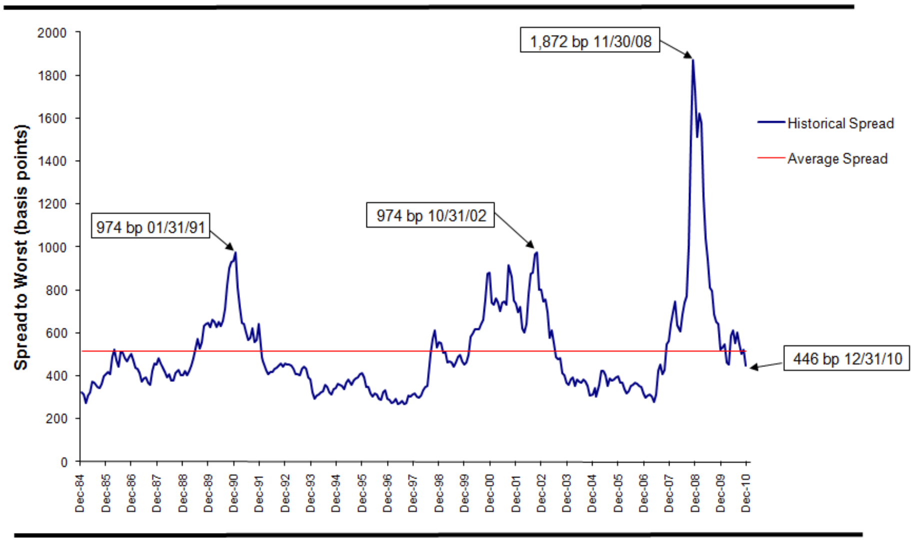
During 2010, the Company made monthly dividend payments of $0.0583 per share to holders of voting common shares and non-voting common shares (collectively, the "**Shareholders**"), resulting in total dividend payments in 2010 of $0.70 per share (2009 - $0.41 per share). On January 6, 2011, the Company announced it will maintain monthly cash dividends at $0.0583 per share for each of the first three months of 2011.

Net investment income during the year ended December 31, 2010 was $7,376,571 (2009 - $4,500,960). The increase in net investment income of $2,875,611 was due predominantly to the Company earning income for the entire year of 2010, whereas in 2009 it only earned income once investments were made, starting in March 2009. Furthermore, the Company did not incur any expenses related to the convertible debenture repaid in March 2009.

As the Company has previously stated, it believes higher yielding shorter term corporate bonds are a more attractive investment than government or high grade corporate bonds. Government and corporate investment grade yields are simply too low to compensate investors for the risk of rising interest rates. By contrast, the shorter maturity schedule and relative strength of the companies within the portfolio provide an attractive income stream where investors are being compensated for the risk.

Even though the current spread in yields between U.S. 10-year treasuries and high yield bonds has narrowed to the long term average (see graph below) the Company is still uncovering attractive opportunities within the high yield universe.

Credit Spread History
Merrill Lynch US High Yield Master Index Less 10 year Treasury Yield



Source: Merrill Lynch high yield

The Company is focused on investing in debt instruments of businesses with tangible assets as collateral, strong cash flows and reasonable leverage, with covenants which limit the issuance of additional debt that would rank ahead of the Company.

For example, the Company participated in the new issue of Cara Operations Limited ("Cara") 9.125% Senior Secured Notes due December 1, 2015 ("Cara Notes"). Cara is an owner, operator and franchisor of full service and quick service restaurants across Canada. Cara's restaurant portfolio includes Swiss Chalet Rotisserie & Grill, Milestones Grill & Bar, Montana's Cookhouse, Kelsey's Neighbourhood Bar & Grill and Harvey's. Cara has a strong management team and currently has stable free cash flow. As management of Cara expands its brands further into western Canada, which appears will require modest capital expenditures by Cara, the Company believes that leverage will naturally improve the credit quality of the Cara Notes. Deans Knight believes at a yield of 9.125%, the Company is well compensated for the risk.

The Company also attempts to add additional value, by opportunistically investing in private debt financings with equity incentives that provide additional capital appreciation. The Company participated in three private financings over the past 18 months. In August 2009, the Company purchased a portion of structured a $10 million, 8% convertible debenture ("Whitecap Debenture") for Whitecap Resources Inc. ("Whitecap"), a junior Calgary-based oil and gas producer. Deans Knight is very familiar with and has great confidence in the management team of Whitecap, and has invested successfully with the same management team in previous initiatives. Whitecap grew production from 850 barrels of oil equivalent per day ("boepd") to 2,900 boepd, 60% of which is oil. The Whitecap Debenture had an exercise price of $2.88 and on December 8, 2010, the Company converted the Whitecap

Debenture into equity and subsequently sold a portion of its holding at $6.16 per share. The Company still holds shares of Whitecap (5.5% of the Company's net asset value), as the Company believes management can grow production per share and create additional value for shareholders going forward.

In the past three months, Deans Knight, on behalf of its clients, provided a $20 million secured subordinated credit facility (the "Facility") to Sure Energy Inc. ("Sure"), another junior oil and gas producer, where again Deans Knight has invested in other companies previously managed by the principals of Sure. Sure is currently producing 1,250 boepd, 46% of which is oil & liquids. Sure is undergoing a transition to a higher growth oil producer, with a significant position in the emerging Viking light oil resource at Redwater in the Plains area of central Alberta, an extensive inventory of low risk oil development (45 locations) and additional oil inventory (74 locations). The required use of proceeds by Sure under the Facility is for the development of the Viking asset and for infrastructure to increase production.

On December 21, 2010, Sure drew down $10 million of the Facility; of which the Company provided $2.5 million (1.7% of the Company’s net asset value). Additional draws on the Facility may be made at Sure’s discretion in minimum tranches of $2.5 million. The drawn portion of the Facility bears interest at 6.25 percent per annum. The undrawn portion bears a standby fee of 0.25 percent. The Facility matures on January 21, 2014. Further, 625,000 common share purchase warrants of Sure, at a price of $1.80 per share, were issued as additional consideration to the Company in connection with the Facility. These warrants expire on December 21, 2013. As of December 31, 2010, the common shares of Sure closed at $1.75 on the Toronto Stock Exchange.

Finally, on November 15, 2010, the Company participated in a short term debenture ("P1 Debenture") with P1 Energy Corp. (3.5% of the Company's net asset value). The P1 Debentures bore interest at 12 percent per annum and paid a 2.5% set-up fee at maturity. Subsequent to year-end on January 12, 2011, the P1 Debenture was repaid providing a return of 4.4% in 58 days to the Company, which equates to an annualized return of 27.7%.

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”) and (ii) another for all other purposes, including unit pricing for investor transactions (referred to as “net asset value”). 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 December 31, 2010 (2009 - $0.02 per common share), 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, on January 12, 2011, the AcSB issued a decision to defer adoption of IFRS for investment companies until years beginning on or after January 1, 2013. This is a further delay from the previously issued 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 the above noted decision, the Company's first set of financial statements to be reported on under IFRS will be for the semi-annual period ending June 30, 2013. These statements will include corresponding comparative financial information for 2012, including an opening statement of net assets as at January 1, 2012.

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, 2012 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 2011 and 2012. This potential for change creates some uncertainty regarding the expected accounting standards that will be applicable upon the Company adopting IFRS. As such, the Company cannot conclusively determine the impact that the adoption of IFRS will have.

Throughout 2011 and 2012, 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 were subject to the 5% GST, but not PST, these services are subject to the new HST. Since the Company is not able to recover this tax, the 8% difference represents an additional cost to the Company.

Related Party Transactions

The officers, and certain directors, of the Company are also employees of Deans Knight, the Company's investment advisor. 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 year ended December 31, 2010, management fees totaled $2,110,657 (2009 - $1,361,226). At December 31, 2010, $599,474 (December 2009 - $476,700) was owed to Deans Knight, which was included in accounts payable and accrued liabilities in the statement of net assets, and is payable immediately. In calculating the management fee, 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 year ended December 31, 2010, the Corporation incurred $30,195 (2009 - $355,000) in legal services and disbursements received from this related party. At December 31, 2010, accounts payable and accrued liabilities include $1,355 (2009 - $550) to the law firm for legal fees and disbursements, which had 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)

	2010 **$**	**2009** **$**
Net assets, beginning of period (2)(3)	12.21	9.12
Increase (decrease) from operations		
Total revenue	0.94	0.62
Total expenses	(0.24)	(0.20)
Realized gains (losses) for the period	1.82	1.25
Unrealized gains (losses) for the period	(0.27)	1.21
Recovery of future income taxes	(0.16)	0.62
Total increase (decrease) from operations (3)	2.09	3.50
Dividends (3)(4)		
From income	(0.70)	(0.41)
Net assets at end of period (5)	13.60	12.21

(1) The information is derived from the Company's audited annual 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 2009 reflect the net assets in the Company at March 17, 2009, after giving effect to the conversion of the convertible debenture (as described in Note 2 to the Financial Statements) and interest owing thereon and the issuance of common shares on the Company's initial public offering 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. For 2009, the period is 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 (1)	**2010**	**2009**
Net asset value (000's)	$143,880	$128,930
Number of common shares outstanding (000's)	10,537	10,537
Management expense ratio (2) (3)	1.91%	5.51%
Portfolio turnover rate (4)	86.60%	36.69%
Trading expense ratio (5)	0.01%	0.01%
Net asset value per common share	$13.65	$12.23
Closing market price – common share	$12.54	$11.40

(1) This information is provided as at December 31 of the years shown.
(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 initial public offering of the Company 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 $13,500 for 2010 (2009 - $13,050), as the purchasing and selling of bonds do not attract a commission from the buying or selling party.

Management Fees

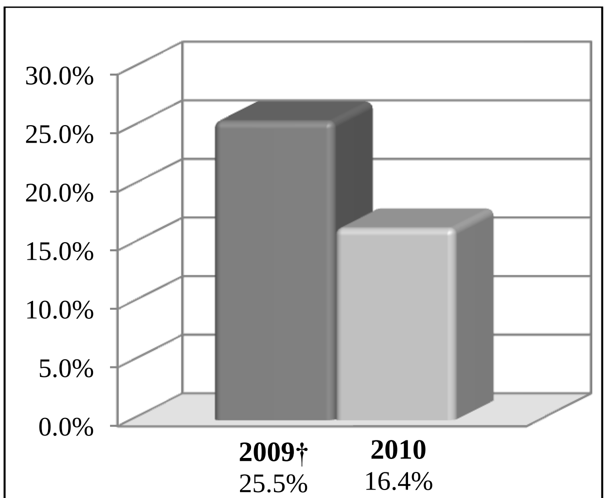
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, 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. Also note that the performance information does not take into account sales, redemptions, or other optional charges that would have reduced returns on performance. 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 years shown and illustrates how the Company's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made from when the Company began its operation as an investment fund on March 17, 2009 to December 31, 2009, and how much an investment made for the year ending December 31, 2010.



† March 20, 2009 (Inception) to Dec. 31, 2009

Annual Compound Returns

The table below summarizes the Company's annual compound total returns for the periods ended December 31 as indicated. As a basis for comparison, we have provided the performance of the Merrill Lynch Canada High Yield Bond Index ("Index"). The Index is a broad based index that tracks the performance of the Canadian high-yield bond market. As the criteria for determining the constituents of the Company and the Index differ, it is not expected that the Company's performance will mirror that of the Index. Further, the return of the Index is calculated without the deduction of management fees and fund expenses whereas the performance of the Company is calculated after deducting fees and expenses.

Period	Company	Index
1 Year	16.4	13.5
Since Inception	24.5	36.9

Summary of Investment Portfolio

The following is a summary of the Company's investment portfolio as at December 31, 2010. This is a summary only and will change due to ongoing portfolio transactions of the Company. A quarterly update is available at www.dkincomecorp.com.

Top 25 investments	**% of Net asset value**
Paramount Resources 8.3% 12-13-2017	6.6
North America Energy Partners Inc. 9.1% 04-07- 2017	6.4
Stone Energy Corp 8.6% 02-01-2017	6.2
Whitecap Resources Inc.- common shares	5.5
CCS Inc. 11.0% 11-15-2011	4.9
Calfrac Holdings LP 7.5% 12-01-2020	4.2
Harvest Energy 7.3% 09-30-2013	3.9
Trinidad Drilling 7.9% 01-15-2019	3.7
P1 Energy Corp. 12.0% 03-31-2011	3.5
Cott Beverages Inc. 8.4% 11-15-2017	3.3
National Money Mart 10.4% 12-15-2016	3.0
Methanex Corp. 8.8% 08-15-2012	2.7
Tembec Industries 11.3% 12-15-2018	2.7
Cara Operations Ltd. 9.1% 12-01-2015	2.7
Sherritt International Corp. 7.8% 10-15-2015	2.6
Trinidad Drilling 7.8% 07-31-2012	2.6
NewAlta Corp. 7.6% 11-23-2017	2.3
Beazer Homes USA, Inc. 9.1% 06-15-2018	2.2
Pacific Rubiales Energy Corp. 8.8% 11-10-2016	1.9
Garda World Security 9.8% 03-15-2017	1.8
Harvest Operations 6.9% 10-01-2017	1.8
Sure Energy Inc. 6.3% 01-21-2014	1.7
Gateway Casinos 8.9% 11-15-2017	1.6
Gibson Energy ULC 11.8% 05-27-2014	1.5
McMoran Exploration 11.9% 11-15-2014	1.5

Portfolio composition	**% of Net asset value**
Equity	5.8
Fixed Income	
Canadian denominated in CAD	31.2
Canadian denominated in USD	24.1
United States denominated in USD	19.0
	74.3
Convertible Debentures	
Canadian denominated in CAD	6.5
Other Foreign denominated in AUD	2.5
	9.0
Investment Portfolio	89.1
Cash and cash equivalents	4.9
Other Net Assets	6.0
	100.0
Sector Breakdown	
Energy	57.2
Consumer goods	9.4
Materials and metals	6.0
Forestry	4.3
Services	3.6
Chemicals	3.4
Financial Services	3.0
Industrial/manufacturing	2.2
Investment Portfolio	89.1
Cash and cash equivalents	4.9
Other net assets	6.0
	100.0