

For Immediate Release, August 5, 2011

Deans Knight Income Corporation

**Releases Interim Financial Statements and Management Report of
Fund Performance for the period ended June 30, 2011**

Vancouver, B.C. - Deans Knight Income Corporation (the “Company”) (TSX: DNC) is pleased to release its interim Financial Statements and Management Report of Fund Performance for the period ended June 30, 2011.

These documents can be found on SEDAR at www.sedar.com or the Company’s website: www.dkincomecorp.com.

Forward-Looking Statements

This press release contains forward-looking statements. More particularly, this press release contains forward-looking statements concerning the Company's corporate objectives, the investment of the Company's proceeds from the sale of investments previously made, availability of tax losses and deductions, the anticipated total return to the Company's shareholders and the Company's intention to pay out earned income in the form of monthly dividends. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, undue reliance should not be placed on them because the Company can give no assurance that they will prove to be correct since forward-looking statements address future events and conditions and by their very nature, involve inherent risks and uncertainties. The forward-looking statements contained in this press release are made as of the date hereof and the Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

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DEANS KNIGHT

INCOME CORPORATION

INTERIM MANAGEMENT REPORT

OF FUND PERFORMANCE

For the period from

January 1, 2011 to June 30, 2011

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, 2011 (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 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 AIF 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 annual information form dated March 15, 2011 (the "AIF"). 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 \$21,247,000, representing \$2.02 per common share at June 30, 2011.

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, 2011 were \$143,428,658, or \$13.61 per common share, compared to \$143,343,361, or \$13.60 per common share at December 31, 2010. The net assets of the Company consisted of the following components:

	June 30, 2011		
	\$	Per common share ⁽¹⁾	%
Investments ⁽²⁾	133,558,796	12.67	93.1
Cash and short-term deposits	2,618,721	0.25	1.8
Accrued income	1,888,705	0.18	1.3
Prepaid expenses	158,159	0.02	0.0
Future income tax asset ⁽³⁾	5,870,000	0.56	4.1
Accounts payable and accrued liabilities	(665,723)	(0.07)	(0.3)
	<u>143,428,658</u>	<u>13.61</u>	<u>100.0</u>

⁽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.

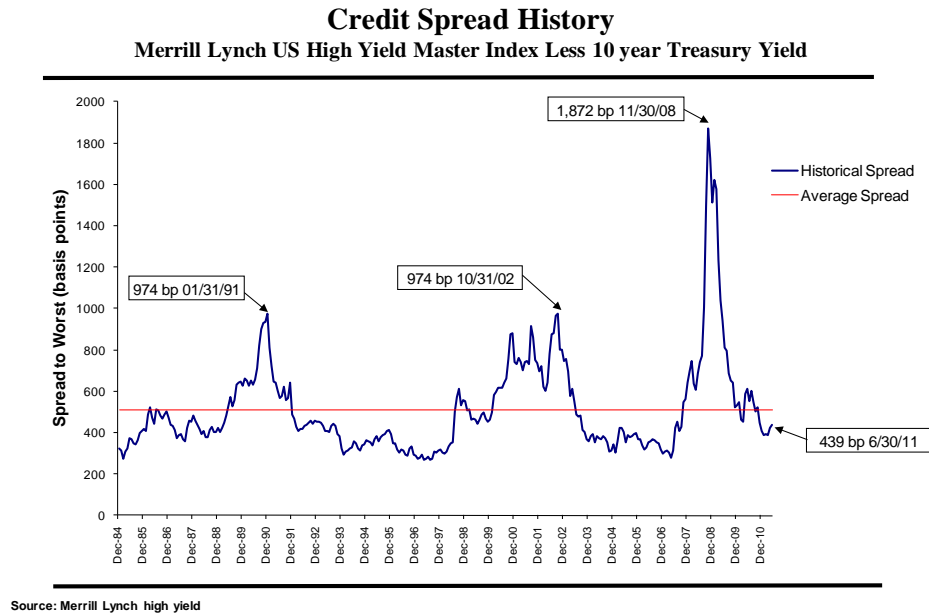
	December 31, 2010		
	\$	Per common share ⁽¹⁾	%
Investments ⁽²⁾	128,449,450	12.19	89.6
Cash and short-term deposits	7,137,967	0.68	5.0
Accrued income	1,808,756	0.17	1.2
Prepaid expenses	89,662	0.01	0.1
Future income tax asset ⁽³⁾	6,550,000	0.62	4.6
Accounts payable and accrued liabilities	(692,474)	(0.07)	(0.5)
	<u>143,343,361</u>	<u>13.60</u>	<u>100.0</u>

⁽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.

In early 2009, in the midst of the global recession and financial panic, non-investment grade corporate bond prices collapsed. The spread between high yield bonds and government bonds widened to unprecedented levels not seen before (see graph below).



At that time, the Investment Manager felt strongly that the market was overreacting because of fear. It saw many opportunities where they believed that bonds were backed by solid assets, and in the unlikely case of default, full recovery of investments was reasonably assumed.

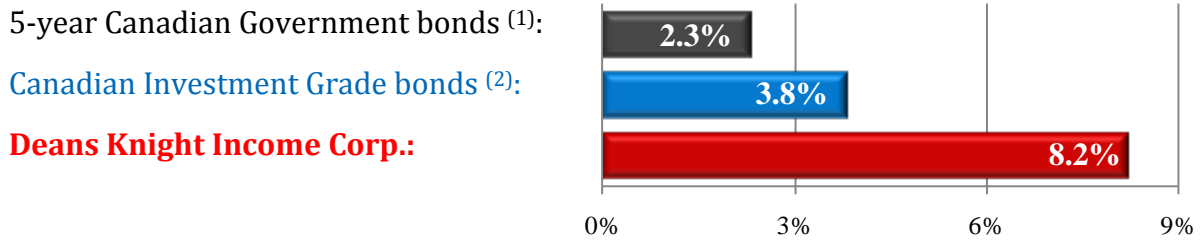
To take advantage of these opportunities, the Company raised \$94,100,000 (net of offering costs of \$6,268,900) by way of an initial public offering (“IPO”) that closed on March 18, 2009. Although the recovery has been disappointing in some respects, unemployment remains stubbornly high and real estate continues to be a soft spot, confidence has gradually been restored. Non-investment grade bond prices have recovered and yield spreads have returned to normal levels.

The Company’s net asset value has risen 36% since the IPO, excluding the \$0.70 per share annual dividend we have maintained since June 30, 2009.

As we move through 2011, the U.S. economic recovery is slowing; China’s growth is slowing; and Greece’s debt woes have called the stability of the Eurozone into question. Nevertheless, the fundamentals of many companies, including the portfolio’s investments, are stronger now than prior to the recession. Moreover, the average yield on the Company’s bond holdings is still very attractive....double that of investment grade bonds and three times that of government bonds.

Yield to Maturity

As of June 30, 2011



(1) Source: Bloomberg

(2) Source: Merrill Lynch Canadian Corporate Index

Given the solid credit quality of the Company's holdings, the current 8.2% yield is very attractive compared to either government or investment grade bonds. The yields provided by government and investment grade bonds are far too low to compensate investors for the risk of rising interest rates. Further to this, the average duration of the Company's portfolio at June 30, 2011 is 4.2 years, compared to 4.7 years for 5-year Canadian Government Bonds' and 5.6 years for Canadian Investment Grade bonds.

The Company also attempts to add additional value, by opportunistically investing in private debt financings with equity incentives. In August 2009, the Company purchased a portion of a \$10 million, 8% convertible debenture for Whitecap. The Whitecap Debenture had an exercise price of \$2.88 and on December 8, 2010, the Company converted the Whitecap Debenture into equity. On June 30, 2011 Whitecap's share price closed at \$6.27 per share. Whitecap has grown production from 850 barrels of oil equivalent per day ("boepd") to 6,000 boepd, 60% of which is oil, and the Company believes management can continue to grow production per share and create additional value for shareholders going forward. Deans Knight Income Corp. sold 52% of its holding in Whitecap at \$6.16, but still holds 1,254,167 shares (5.5% of the Company's net asset value).

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 a difference of approximately \$0.02 per common share at June 30, 2011, 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 the remainder of 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.

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, 2011, management fees totaled \$1,165,607 (2010 - \$980,755). 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, 2011, the Corporation incurred \$17,895 (2010 - \$17,409) in legal services and disbursements received from this related party. At June 30, 2011, accounts payable and accrued liabilities include \$1,532 (December 31, 2010 - \$1,355) 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, 2011	Year ended December 31,	
	2011	2010	2009
	\$	\$	\$
Net assets, beginning of period ⁽²⁾	13.60	12.21	9.12
Increase (decrease) from operations			
Total revenue	0.52	0.95	0.62
Total expenses	(0.14)	(0.25)	(0.20)
Realized gains (losses) for the period	0.41	1.82	1.25
Unrealized (losses) gains for the period	(0.37)	(0.27)	1.21
Recovery of future income taxes	(0.06)	(0.16)	0.62
Total increase from operations	0.36	2.09	3.50
Dividends from income ⁽³⁾	(0.35)	(0.70)	(0.41)
Net assets at end of period ⁽⁴⁾	13.61	13.60	12.21

⁽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 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.

⁽³⁾ Dividends were paid in cash.

⁽⁴⁾ 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

	Six months ended June 30, 2011	Year ended December 31,	
	2011	2010	2009
	\$	\$	\$
Net asset value (000's)	143,343	143,880	128,930
Number of common shares outstanding (000's)	10,537	10,537	10,537
Management expense ratio ⁽¹⁾⁽²⁾	1.56%	1.91%	5.51%
Portfolio turnover rate ⁽³⁾	26.7%	86.60%	36.69%
Trading expense ratio ⁽⁴⁾	0.00%	0.01%	0.01%
Net asset value per common share	\$13.63	\$13.65	\$12.23
Closing market price – common share	\$12.61	\$12.54	\$11.40

⁽¹⁾ 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.

⁽²⁾ 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.

⁽³⁾ 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.

⁽⁴⁾ 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. As the purchasing and selling of bonds do not attract a commission from the buying or selling party.

Management Fees

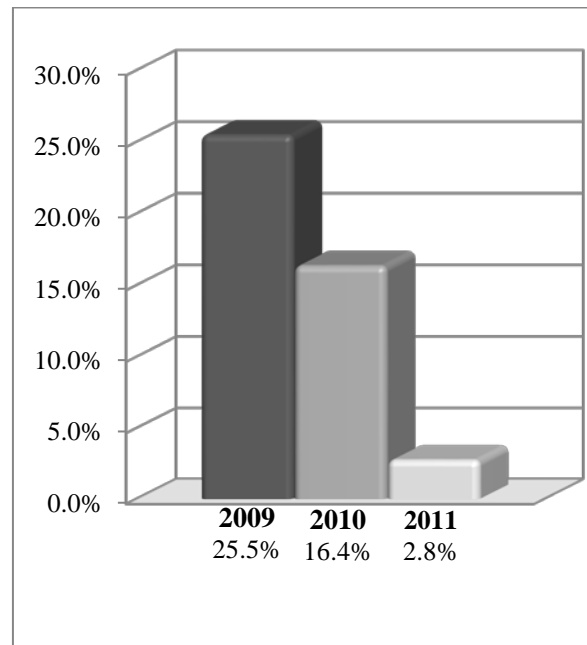
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, 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, how much an investment made for the year ended December 31, 2010, and how much an investment made for the six month period ending June 30, 2011.



Summary of Investment Portfolio

Top 25 Investments				% of Net Asset Value	Portfolio Composition		% of Net Asset Value
Paramount Resources Ltd.	8.250%	13-Dec-17		6.6			
North American Energy	9.125%	7-Apr-17		6.1	Equity and Warrants		5.7
Stone Energy Corp.	8.625%	1-Feb-17		6.0			
Whitecap Resources Inc.	N/A	N/A		5.5	Fixed Income		
CCS Inc.	11.000%	15-Nov-15		5.4	Canadian denominated in CAD		40.2
Calfrac Holdings LP	7.500%	1-Dec-20		4.1	Canadian denominated in USD		24.8
Southern Pacific Resource Corp.	10.750%	7-Jan-16		4.1	United States denominated in USD		17.6
Mirabella Nickel Inc.	8.750%	15-Apr-18		4.0			<u>82.6</u>
Perpetual Energy Inc.	8.750%	15-Mar-18		3.5	Convertible Debentures		
Harvest Energy, Inc.	7.250%	30-Sep-13		3.3	Canadian denominated in CAD		3.3
Skylink Aviation Inc.	12.250%	15-Mar-16		3.3	Other Foreign denominated in AUD		1.1
Mercator Minerals	6.500%	3-Jan-13		3.1			
Cott Beverages Inc.	8.375%	15-Nov-17		3.1	Investment Portfolio		92.7
National Money Mart Company	10.375%	15-Dec-16		3.0	Cash & Short-term Deposits		1.8
Cara Operations Ltd.	9.125%	1-Dec-15		2.7	Other Net Assets		5.5
Tembec Industries Inc.	11.250%	15-Dec-18		2.6			<u>100.0</u>
Trinidad Drilling Ltd.	7.875%	15-Jan-19		2.4			
Gateway Casinos & Entertainment Inc.	8.875%	15-Nov-17		2.0	Sector Breakdown		
Black Press Group	10.000%	4-Feb-14		1.9	Energy		57.0
Pacific Rubiales Energy	8.750%	10-Nov-16		1.9	Consumer Discretionary		9.6
Beazer Homes USA, Inc.	9.125%	15-Jun-18		1.9	Services		6.1
Garda World Security Corp.	9.750%	15-Mar-17		1.8	Materials & Metals		9.4
Sure Energy Inc.	6.250%	21-Jan-14		1.7	Forestry		3.8
Newalta Corp.	7.625%	23-Nov-17		1.6	Financial Services		3.0
McMoran Exploration	11.875%	15-Nov-14		1.4	Industrial/Manufacturing		3.8
					Investment Portfolio		<u>92.7</u>
					Cash & Short-term Deposits		1.8
					Other Net Assets		5.5
							<u>100.0</u>

Deans Knight Income Corporation

Financial Statements

June 30, 2011

(Unaudited)

Deans Knight Income Corporation

Statement of Net Assets

As at June 30, 2011 (Unaudited)

	June 30, 2011 \$	December 31, 2010 \$
Assets		
Current		
Investments - at fair value (cost – June 30, 2011 - \$127,518,870; December 31, 2010 - \$118,563,957)	133,558,796	128,449,450
Cash and cash equivalents	2,618,721	7,137,967
Accrued interest receivable	1,888,705	1,808,756
Prepaid expenses	158,159	89,662
Future income tax benefits (note 8)	2,250,000	2,150,000
	<hr/>	<hr/>
	140,474,381	139,635,835
Non-current		
Future income tax benefits (note 8)	3,620,000	4,400,000
	<hr/>	<hr/>
	144,094,381	144,035,835
Liabilities		
Accounts payable and accrued liabilities (note 6)	665,723	692,474
	<hr/>	<hr/>
Net Assets	143,428,658	143,343,361
	<hr/>	<hr/>
Shareholders' Equity		
Common shares (note 4)	99,366,429	99,366,429
Contributed surplus (note 4)	9,904,504	9,904,504
Retained earnings (note 5)	34,157,725	34,072,428
	<hr/>	<hr/>
	143,428,658	143,343,361
	<hr/>	<hr/>
Number of common shares outstanding (note 4)	10,537,263	10,537,263
	<hr/>	<hr/>
Net assets per common share (notes 8 and 11)	13.61	13.60
	<hr/>	<hr/>
Contingencies (notes 2 and 8)		
Commitment (note 10)		
Subsequent events (note 12)		

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

Deans Knight Income Corporation

Statement of Operations

Six-month period ended June 30, 2011 (Unaudited)

	2011 \$	2010 \$
Investment income		
Interest and other	5,459,044	5,036,042
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Expenses		
Management fees (note 6)	1,165,607	980,755
Public company reporting costs	93,067	72,699
Directors' fees and expenses	87,086	84,535
Audit, accounting and tax fees	37,043	53,384
Custodial fees	24,607	15,408
Legal fees	17,895	17,409
Independent Review Committee fees	4,500	4,500
	<hr/>	<hr/>
	1,429,805	1,228,690
	<hr/>	<hr/>
Net investment income	4,029,239	3,807,352
	<hr/>	<hr/>
Realized and unrealized gains (losses) on investments		
Net realized gain on securities sold (note 7)	2,064,001	2,572,267
Net realized gain on settlement of foreign currency contracts (note 7)	2,203,559	444,042
Change in unrealized (depreciation) appreciation on investments	(4,457,177)	5,246,375
Unrealized appreciation (depreciation) on foreign currency contracts	611,610	(1,438,353)
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Net gain on investments	421,993	6,824,331
	<hr/>	<hr/>
Increase in net assets from operations before tax	4,451,232	10,631,683
	<hr/>	<hr/>
Provision for future income tax (note 8)	(680,000)	(2,190,000)
	<hr/>	<hr/>
Increase in net assets from operations	3,771,232	8,441,683
	<hr/>	<hr/>
Increase in net assets from operations per weighted average common share (note 3)	0.36	0.80
	<hr/>	<hr/>

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, 2011 (Unaudited)

	2011 \$	2010 \$
Increase in net assets from operations	3,771,232	8,441,683
Dividends to common shareholders (notes 5 and 10)	<u>(3,685,935)</u>	<u>(3,685,935)</u>
Increase in net assets during the period	85,297	4,755,748
Net assets – Beginning of period	<u>143,343,361</u>	<u>128,681,694</u>
Net assets – End of period	<u>143,428,658</u>	<u>133,437,442</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, 2011 (Unaudited)

	2011 \$	2010 \$
Cash flows from operating activities		
Increase in net assets from operations	3,771,232	8,441,683
Items not affecting cash		
Net realized gain on securities sold	(2,064,001)	(2,572,267)
Net realized gain on settlement of foreign currency contracts	(2,203,559)	(444,042)
Change in unrealized depreciation (appreciation) on investments	4,457,177	(5,246,375)
Unrealized (appreciation) depreciation on foreign exchange contracts	(611,610)	1,438,353
Future income tax provision	680,000	2,190,000
	<u>4,029,239</u>	<u>3,807,352</u>
Cost of investments purchased (note 7)	(40,887,826)	(26,584,338)
Proceeds from investments sold (note 7)	36,200,473	24,049,707
Net change in non-cash balances related to operations		
Accrued interest receivable	(79,949)	(1,070,412)
Prepaid expenses	(68,497)	(77,779)
Accounts payable and accrued liabilities	(26,751)	116,628
	<u>(833,311)</u>	<u>241,158</u>
Cash flows from financing activities		
Dividends paid to common shareholders (note 5)	(3,685,935)	(3,685,935)
	<u>(3,685,935)</u>	<u>(3,685,935)</u>
Net decrease in cash during the period	(4,519,246)	(3,444,777)
Cash and cash equivalents – Beginning of period	<u>7,137,967</u>	<u>6,042,756</u>
Cash and cash equivalents – End of period	<u><u>2,618,721</u></u>	<u><u>2,597,979</u></u>
Cash and cash equivalents comprise		
Cash	2,618,721	2,597,979
Short-term deposits	-	-
	<u><u>2,618,721</u></u>	<u><u>2,597,979</u></u>

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

Deans Knight Income Corporation

Statement of Investments

As at June 30, 2011 (Unaudited)

	Par value ¹	Average cost ²	Fair value ²	Percentage of total fair value ³
	\$	\$	\$	%
Fixed income - Canadian				
<i>Denominated in Canadian dollars</i>				
Air Canada 10.13% 08-01-2015	1,500,000	1,485,690	1,545,000	1.2
Black Press Group 10% 02-04-2014	2,750,000	2,750,000	2,750,000	2.1
Cara Operations Ltd. 9.13% 12-01-2015	3,750,000	3,750,000	3,890,625	2.9
Flint Energy Services 7.5% 06-15-2019	1,750,000	1,732,500	1,723,750	1.3
Garda World Security 9.75% 03-15-2017	2,500,000	2,472,105	2,643,750	2.0
Gateway Casinos 8.88% 11-15-2017	2,750,000	2,816,875	2,860,000	2.1
Mercator Minerals Ltd. 6.50% 01-03-2013	4,500,000	4,500,000	4,500,000	3.4
Newalta Corp. 7.63% 11-23-2017	2,250,000	2,250,000	2,345,625	1.8
North American Energy Partners Inc. ⁴ 9.13% 04-07-2017	8,750,000	8,793,125	8,815,625	6.6
Paramount Resources 8.25% 12-13-2017	9,250,000	9,250,000	9,458,125	7.1
Perpetual Energy Inc. 8.75% 03-15-2018	5,000,000	5,000,000	4,975,000	3.7
Sherritt International Corp. 7.75% 10-15-2015	1,500,000	1,165,045	1,606,875	1.2
Skylink Aviation Inc. 12.25% 03-15-2016	4,750,000	4,750,000	4,666,875	3.5
Sure Energy 6.25% 01-21-2014	2,500,000	2,500,000	2,500,000	1.9
Trident Exploration Corp. 8.25% 04-13-2018	1,650,000	1,650,000	1,596,375	1.2
Vermilion Energy Inc. 6.50% 02-10-2016	1,750,000	1,750,000	1,780,625	1.3
		56,615,340	57,658,250	43.3
<i>Denominated in United States dollars</i>				
CCS Inc. 11.00% 11-15-2015	7,750,000	3,879,423	7,809,625	5.8
CHC Helicopter 9.25% 10-15-2020	250,000	253,623	218,776	0.2
Harvest Operations Corp. 6.88% 10-01-2017	1,750,000	1,783,273	1,742,370	1.3
Mirabela Nickel Ltd. 8.8% 04-15-2018	6,000,000	5,811,649	5,727,942	4.3
National Money Mart 10.38% 12-15-2016	4,000,000	4,363,855	4,233,277	3.2
Pacific Rubiales Energy Corp. 8.75% 11-10-2016	2,500,000	2,655,612	2,726,558	2.0
Southern Pacific Resource Corp. LIBOR+8.5% 01-07-2016	5,970,000	5,897,667	5,814,440	4.4
Tembec Industries 11.25% 12-15-2018	3,750,000	4,015,216	3,787,891	2.8
Trinidad Drilling 7.88% 01-15-2019	3,500,000	3,507,651	3,493,177	2.6
		32,167,969	35,554,056	26.6
Total Canadian fixed income		88,783,309	93,212,306	69.9

¹ Par values are presented in their source currency

² All amounts are shown in Canadian dollars

³ Percentages are shown as a percentage of total investments

⁴ These investments share a common director with the Company

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

Deans Knight Income Corporation

Statement of Investments...continued

As at June 30, 2011 (Unaudited)

	Par value ¹ \$	Average cost ² \$	Fair value ² \$	Percentage of total fair value ³ %
Fixed income – United States				
<i>Denominated in United States dollars</i>				
ABI Escrow Corp. 10.25% 10-15-2018	1,585,910	1,635,073	1,659,283	1.2
Beazer Homes USA, Inc. 9.13% 06-15-2018	3,250,000	3,327,056	2,710,888	2.0
Calfrac Holdings LP 7.5% 12-01-2020	6,000,000	6,130,329	5,858,123	4.4
Cott Beverages Inc. 8.38% 11-15-2017	4,350,000	4,622,109	4,404,440	3.3
McMoRan Exploration Co. 11.88% 11-15-2014	2,000,000	2,114,471	2,073,245	1.6
Stone Energy Corp. 8.63% 2-01-2017	8,750,000	8,821,638	8,564,189	6.4
Total United States fixed income		26,650,676	25,270,168	18.9
Total fixed income		115,433,985	118,482,474	88.8
Convertible debentures - Canadian				
<i>Denominated in Canadian dollars</i>				
Harvest Energy 7.25% 09-30-2013	4,595,000	3,036,941	4,721,363	3.5
Convertible debentures - Australian				
<i>Denominated Australian dollars</i>				
Western Areas NL 8.0% 07-02-2012	1,500,000	1,322,276	1,587,125	1.2
		4,359,217	6,308,488	4.7
Equity				
Sure Energy Inc.- purchase warrants	625,000	-	292,599	0.2
Whitecap Resources Inc.- common shares	1,254,167	7,725,668	7,863,625	5.9
		7,725,668	8,156,224	6.1
Investments subtotal		127,518,870	132,947,186	99.6
Hedges				
<i>Denominated in United States and Australian dollars</i>				
Foreign currency exchange contracts (note 9)	67,600,000	-	611,610	0.4
		127,518,870	133,558,796	100.0

¹ Par values are presented in their source currency

² All amounts are shown in Canadian dollars

³ Percentages are shown as a percentage of total investments

⁴ These investments share a common director with the Company

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

Deans Knight Income Corporation

Notes to Financial Statements

As at June 30, 2011 (Unaudited)

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 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

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

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

Financial instruments

Investments

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

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 certain 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 six month period are included in the net realized gain on settlement of foreign currency contracts (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.

Public company equities

Publicly traded equities are recorded at bid prices as quoted on recognized stock exchanges.

The amounts at which the Fund's publicly-traded investments could be disposed of currently may differ from carrying value based on market quotes, as the value at which significant ownership positions are sold is often different than the quoted market price due to a variety of factors such as premiums paid for large blocks or discounts due to illiquidity.

Deans Knight Income Corporation

Notes to Financial Statements

As at June 30, 2011 (Unaudited)

Warrants

Warrants are recorded at their estimated fair value, using appropriate and accepted industry valuation techniques.

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

Cash and cash equivalents

Cash and cash equivalents are accounted for at amortized cost. They consist of cash and deposits with maturities, at the time of purchase, of three months or less and are held with a Canadian chartered bank.

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.

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.

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. 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.

Deans Knight Income Corporation

Notes to Financial Statements

As at June 30, 2011 (Unaudited)

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.

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 it is likely that a payment will be required to be made.

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 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 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 balance sheet 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 six month period ended June 30, 2011 was 10,537,263 (June 30, 2010 - 10,537,263). 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 reclassified to conform with the current period presentation.

Deans Knight Income Corporation

Notes to Financial Statements

As at June 30, 2011 (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.

There have been no changes in the number of voting and non-voting common shares for the periods ended June 30, 2010 and June 30, 2011.

The total shares outstanding at June 30 are summarized as follows:

	June 30, 2011		December 31, 2010	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Voting common shares	10,191,592	96,273,343	10,191,592	96,273,343
Non-voting common shares	<u>345,671</u>	<u>3,093,086</u>	<u>345,671</u>	<u>3,093,086</u>
Total common shares outstanding	<u>10,537,263</u>	<u>99,366,429</u>	<u>10,537,263</u>	<u>99,366,429</u>

Contributed surplus

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

	June 30, 2011 \$	December 31, 2010 \$
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, 2011 (Unaudited)

5 Retained earnings

The changes in retained earnings for the six month period ended June 30 were as follows:

	2011	2010
	\$	\$
Retained earnings – Opening balance	34,072,428	19,410,761
Increase in net assets from operations	3,771,232	8,441,683
Dividends paid from net investment income	<u>(3,685,935)</u>	<u>(3,685,935)</u>
Retained earnings – closing balance	<u>34,157,725</u>	<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 six month period ended June 30, 2011, management fees totalled \$1,165,607 (June 30, 2010 - \$980,755). At June 30, 2011, \$576,164 (December 31, 2010 - \$599,474) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the statement of net assets 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 six month period ended June 30, 2011, the Company incurred \$17,895 (June 30, 2010 - \$17,409) in legal services and disbursements received from this related party. At June 30, 2011, accounts payable and accrued liabilities include \$1,532 (December 31, 2010 - \$1,355) due to the law firm for legal fees and disbursements.

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

7 Net realized gains on investments sold and foreign currency contracts

The net realized gain on sale of investments for the six-month period ended June 30 was as follows:

	2011 \$	2010 \$
Proceeds from sale of investments	36,200,473	24,049,707
Investments at cost – Beginning of period	118,563,957	100,510,397
Add: Cost of investments purchased	40,887,826	26,584,338
	159,451,783	127,094,735
Less: Investments at cost – End of period	(127,518,870)	(106,061,337)
Cost of investments sold	31,932,037	21,033,398
Net realized gains on investments sold	4,267,560	3,016,309

Net realized gains on investments sold consist of:

	2011 \$	2010 \$
Realized gains on securities sold	2,064,001	2,572,267
Realized gains on settlement of foreign currency contracts	2,203,559	444,042
	4,267,560	3,016,309

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 uncertainty, amount to \$21,247,000 (December 31, 2010 - \$20,747,249), representing \$2.02 per common share at June 30, 2011 (December 31, 2010 - \$1.97 per common share).

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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 \$5,870,000 (December 31, 2010 - \$6,550,000), 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, 2011	December 31, 2010
	\$	\$
Future tax assets		
Research and development expenditures	7,630,000	8,467,000
Investment tax credits	6,032,450	6,032,450
Share issuance costs	629,900	959,100
	<hr/>	<hr/>
Total gross future tax assets	14,292,350	15,458,550
Valuation allowance	(8,422,350)	(8,908,550)
	<hr/>	<hr/>
Net future tax asset	5,870,000	6,550,000
Less: current portion	(2,250,000)	(2,150,000)
	<hr/>	<hr/>
	3,620,000	4,400,000

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,

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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, that reinvested funds will achieve an 8% yield, and that investments maturing after April 30, 2014 will be sold at their current value.

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, significant estimates are required to compute income tax balances. As at June 30, 2011, the Company has accumulated scientific research and experimental development expenditures in the amount of \$30,264,000 available for carry-forward indefinitely. The Company also has accumulated approximately \$7,097,000 of unclaimed federal investment tax credits, which expire as follows:

Year of expiry	Investment tax credits \$
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
	<hr/>
	7,097,000
	<hr/>

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

Reconciliation of income tax expense

The reconciliation of income tax computed at the statutory tax rate to income tax expense at June 30, using a 26.5 % statutory tax rate (2010 – 28.5%), is:

	2011 \$	2010 \$
Increase in net assets from operations before taxes	4,451,232	10,631,683
Statutory tax rate	<u>26.5%</u>	<u>28.5%</u>
Income tax expense at statutory rates	1,179,576	3,030,030
Use of prior year losses	-	(2,672,708)
Use of scientific research and experimental development expenditures	(847,330)	-
Changes in valuation allowance	680,000	2,190,000
Current tax deductions for offering costs	<u>(332,246)</u>	<u>(357,322)</u>
Income tax provision	<u>680,000</u>	<u>2,190,000</u>

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, 2011			
	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Corporate debt	-	102,085,725	16,396,749	118,482,474
Convertible debentures	-	6,308,488	-	6,308,488
Equity	7,863,625	-	292,599	8,156,224
Foreign currency forward contracts	-	611,610	-	611,610
	<u>7,863,625</u>	<u>109,005,823</u>	<u>16,689,348</u>	<u>133,558,796</u>

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

Financial assets at fair value – December 31, 2010

	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Corporate debt	-	91,969,703	14,475,875	106,445,578
Convertible debentures	-	9,334,369	3,617,677	12,952,046
Equity	7,826,002	-	400,000	8,226,002
Foreign currency forward contracts	-	825,824	-	825,824
	7,826,002	102,129,896	18,493,552	128,449,450

All investments remained at their respective levels within the fair value hierarchy during the six month period.

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

	Corporate debt \$	Convertible debentures \$	Equity \$	Total \$
Balance – December 31, 2009	11,616,418	10,561,008	-	22,177,426
Purchases	7,500,000	1,879,862	-	9,379,862
Sales	(6,061,608)	(17,921,531)	-	(23,983,139)
Unrealized appreciation included in net gain on investments	1,421,065	9,098,338	400,000	10,919,403
Balance – December 31, 2010	14,475,875	3,617,677	400,000	18,493,552
Purchases	4,500,000	-	-	4,500,000
Sales	(5,000,000)	(2,148,120)	-	(7,148,120)
Unrealized appreciation included in net gain on investments	833,749	117,568	(107,401)	843,916
Balance – June 30, 2011	14,809,624	1,587,125	292,599	16,689,348

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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 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.

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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

Credit rating	As a % of net assets	
	June 30, 2011	December 31, 2010
BB	5.5	10.7
B	50.9	36.0
CCC	21.3	21.3
CC	-	1.0
Not rated*	15.0	20.0
	<hr/>	<hr/>
	92.7	89.0

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

Credit ratings are obtained from various credit rating agencies and sources. 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:

Sector	As a % of net assets	
	June 30, 2011	December 31, 2010
Energy	57.0	57.1
Consumer goods	9.6	9.4
Materials and metals	9.4	6.0
Services	6.1	3.6
Industrial/manufacturing	3.8	2.2
Forestry	3.8	4.3
Financial services	3.0	3.0
Chemicals	-	3.4
	<hr/>	<hr/>
	92.7	89.0

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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 primarily 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:

	Fair value	
	June 30, 2011 \$	December 31, 2010 \$
Maturity		
Less than 1 year	611,610	5,825,824
1 – 3 years	16,058,487	16,154,645
3 – 5 years	29,187,309	27,443,442
Greater than 5 years	79,545,166	70,799,537
	<hr/>	<hr/>
	125,402,572	120,223,448

As at June 30, 2011, 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 \$5,150,000, or approximately 3.6% of net assets (December 31, 2010 - \$4,900,000, or approximately 3.4% 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.

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

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.

				As at June 30, 2011	
	Investments	Cash and cash equivalents	Foreign exchange contracts	Total	Impact on net assets
	\$	\$	\$	\$	\$
Currency					
United States dollars	60,824,223	1,165,454	611,458	61,378,239	3,068,912
As a % of net assets	42.4	0.8	0.4	42.8	2.1
Australian dollars	1,587,125	-	173	1,586,952	79,348
As a % of net assets	1.1	-	-	1.1	0.1

				As at December 31, 2010	
	Investments	Cash and cash equivalents	Foreign exchange contracts	Total	Impact on net assets
	\$	\$	\$	\$	\$
Currency					
United States dollars	61,640,143	5,024,395	916,045	67,580,583	3,379,029
As a % of net assets	43.1	3.5	0.6	47.3	2.4
Australian dollars	3,617,677	-	(90,221)	3,527,456	176,373
As a % of net assets	2.5	0.0	-0.1	2.5	0.1

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

At June 30, 2011, the Company had outstanding foreign exchange contracts to sell US\$66,000,000 and AUS\$1,600,000 against future commitments at exchange rates ranging between 0.9736 and 0.97436 for US dollar foreign exchange contracts and 1.0320 for the AUS dollar foreign exchange contract. Those contracts have maturities ranging up to July 28, 2011 and are with AAA rated Canadian bank counterparties.

10 Capital management

The capital of the Company is divided into 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 exclude 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, 2011, the Company made dividend payments of \$3,685,935 (June 30, 2010 - \$3,685,935).

The Company is committed to continue paying a monthly dividend of \$0.0583 per voting and non-voting common share for the three months ending September 30, 2011, totalling \$1,842,966.

11 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.

	June 30, 2011 \$	December 31, 2010 \$
Net asset value per share	13.63	13.65
Canadian GAAP adjustments	0.02	(0.05)
Net assets per share	13.61	13.60

Deans Knight Income Corporation

Notes to Financial Statements

June 30, 2011 (Unaudited)

12 Subsequent events

The Company announced a monthly dividend of \$614,322, or \$0.0583 per common share, payable on each of July 29, 2011, August 31, 2011 and September 30, 2011.