Deans Knight Income Corporation

Financial Statements
December 31, 2011

pwc

March 9, 2012

Independent Auditor's Report
To the Shareholders of Deans Knight Income Corporation

We have audited the accompanying financial statements of the Deans Knight Income Corporation (the "Corporation"), which comprise the statements of net assets as at December 31, 2011 and 2010, the statement of investment portfolio as at December 31, 2011, the statements of operations, changes in net assets, and cash flows for the years ended December 31, 2011 and 2010, and the related notes which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of the financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on the financial statements based on our audits. We conducted our audits in accordance with Canadian auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2011 and 2010 and the results of its operations, cash flows and changes in net assets for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

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Deans Knight Income Corporation

Statement of Net Assets

As at December 31, 2011

	2011 $	2010 $
Assets		
Current		
Investments - at fair value (cost - $125,475,983; 2010 - $118,563,957)	129,918,543	128,449,450
Cash and cash equivalents	4,997,715	7,137,967
Accrued interest receivable	2,339,751	1,808,756
Prepaid expenses	73,151	89,662
Future income tax benefits (note 7)	2,180,000	2,150,000
	139,509,160	139,635,835
Non-current		
Future income tax benefits (note 7)	2,740,000	4,400,000
	142,249,160	144,035,835
Liabilities		
Accounts payable and accrued liabilities (note 5)	709,240	692,474
Net assets	141,539,920	143,343,361
Shareholders' equity		
Common shares (note 3)	99,366,429	99,366,429
Contributed surplus (note 3)	9,904,504	9,904,504
Retained earnings (note 4)	32,268,987	34,072,428
	141,539,920	143,343,361
Number of common shares outstanding (note 3)	10,537,263	10,537,263
Net assets per common share (notes 7 and 10)	13.43	13.60

Contingencies (notes 1 and 7)
Commitment (note 9)
Subsequent events (note 11)

Approved by the Board of Directors

(signed) Craig Langdon Director (signed) Wayne Deans Director

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

Deans Knight Income Corporation

Statement of Operations

For the year ended December 31, 2011

	2011 $	2010 $
Investment income		
Interest and other	11,607,293	9,985,529
Expenses		
Management fees (note 5)	2,283,158	2,110,657
Directors' fees and expenses	157,681	136,347
Public company reporting costs	141,111	127,949
Audit, accounting and tax fees	87,003	142,515
Custodial fees	51,354	35,795
Legal fees (note 5)	37,336	30,195
Independent Review Committee fees	12,000	12,000
Transaction costs	-	13,500
	2,769,643	2,608,958
Net investment income	8,837,650	7,376,571
Realized and unrealized gains (losses) on investments		
Net realized gain on investments sold (note 6)	4,695,889	15,928,417
Net realized (loss) gain on settlement of foreign currency contracts (note 6)	(892,178)	3,227,698
Change in unrealized appreciation on investments	(5,832,280)	(3,674,974)
Unrealized appreciation on foreign currency contracts	389,347	825,824
Net (loss) gain on investments	(1,639,222)	16,306,965
Increase in net assets from operations before tax	7,198,428	23,683,536
Provision for future income tax (note 7)	(1,630,000)	(1,650,000)
Increase in net assets from operations	5,568,428	22,033,536
Increase in net assets from operations per weighted average common share (note 2)	0.53	2.09

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

Deans Knight Income Corporation

Statement of Changes in Net Assets

Year ended December 31

	2011 $	2010 $
Increase in net assets from operations	5,568,428	22,033,536
Dividends to common shareholders (notes 4 and 9)	(7,371,869)	(7,371,869)
(Decrease) increase in net assets during the year	(1,803,441)	14,661,667
Net assets – Beginning of year	143,343,361	128,681,694
Net assets – End of year	141,539,920	143,343,361

Deans Knight Income Corporation

Statement of Cash Flows

For the year ended December 31, 2011

	2011 $	2010 $
Cash flows from operating activities		
Increase in net assets from operations	5,568,428	22,033,536
Items not affecting cash		
Net realized gain on investments sold	(4,695,889)	(15,928,417)
Net realized loss (gain) on settlement of foreign currency contracts	892,178	(3,227,698)
Change in unrealized appreciation on investments	5,832,280	3,674,974
Unrealized appreciation on foreign currency contracts	(389,347)	(825,824)
Future income tax provision	1,630,000	1,650,000
	8,837,650	7,376,571
Cost of investments purchased (note 6)	(62,743,948)	(106,283,479)
Proceeds from investments sold (note 6)	59,635,633	107,386,034
Net change in non-cash balances related to operations		
Accrued interest receivable	(530,995)	(138,508)
Prepaid expenses	16,511	178
Accounts payable and accrued liabilities	16,766	126,284
	5,231,617	8,467,080
Cash flows from financing activities		
Dividends paid to common shareholders (note 4 and 9)	(7,371,869)	(7,371,869)
Net (decrease) increase in cash and cash equivalents during the year	(2,140,252)	1,095,211
Cash and cash equivalents – Beginning of year	7,137,967	6,042,756
Cash and cash equivalents – End of year	4,997,715	7,137,967
Cash and cash equivalents comprise		
Cash	2,402,631	5,340,955
Short-term deposits	2,595,084	1,797,012
	4,997,715	7,137,967

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

Deans Knight Income Corporation

Statement of Investments

As at December 31, 2011

	Par value [1] $	Average cost [2] $	Fair value [2] $	Percentage of total fair value [3] %
Fixed income - Canadian				
Denominated in Canadian dollars				
Air Canada 10.13% 08-01-2015	1,500,000	1,485,690	1,342,500	1.0
Black Press Group 10.00% 02-04-2014	2,750	2,750,000	2,701,875	2.1
Cara Operations Ltd. 9.13% 12-01-2015	3,500,000	3,500,000	3,473,750	2.7
Conifex Timber Inc. 10.00% 12-31-2012 [5]	3,000,000	3,000,000	3,000,000	2.3
Flint Energy Services 7.50% 06-15-2019	1,250,000	1,237,500	1,225,000	0.9
Garda World Security 9.75% 03-15-2017	2,500,000	2,472,105	2,525,000	1.9
Gateway Casinos 8.88% 11-15-2017	2,750,000	2,816,875	2,791,250	2.1
Mercator Minerals 6.50% 01-03-2013 [5]	4,500,000	4,500,000	4,500,000	3.5
North American Energy Partners Inc. 9.13% 04-07-2017 [4]	8,750,000	8,793,125	8,487,500	6.5
Paramount Resources 8.25% 12-13-2017	9,250,000	9,250,000	9,562,188	7.4
Perpetual Energy Inc. 8.75% 03-15-2018	5,000,000	5,000,000	4,625,000	3.6
RapidEye Canada 5.00% 08-31-2014 [5]	5,281,250	5,281,250	5,281,250	4.1
Sherritt International Corp. 7.75% 10-15-2015	196,000	152,233	203,840	0.2
Sherritt International Corp. 8.00% 11-15-2018	3,750,000	3,750,000	3,834,375	3.0
Skylink Aviation Inc. 12.25% 03-15-2016	5,350,000	5,277,250	4,333,500	3.3
Sure Energy 6.25% 01-21-2014 [5]	2,500,000	2,500,000	2,500,000	1.9
Trident Exploration 8.25% 04-13-2018	1,650,000	1,650,000	1,468,500	1.1
		63,416,028	61,855,528	47.6
Denominated in United States dollars				
CCS Inc. 11.00% 11-15-2015	7,750,000	3,879,423	7,684,706	5.9
CHC Helicopter 9.25% 10-15-2020	250,000	253,623	228,825	0.2
Mirabela Nickel Ltd. 8.75% 04-15-2018	7,850,000	7,512,897	7,145,188	5.5
National Money Mart 10.38% 12-15-2016	3,750,000	4,091,114	4,071,178	3.2
Pacific Rubiales Energy Corp. 7.25% 12-12-2021	2,300,000	2,365,780	2,339,100	1.8
Southern Pacific Resources Libor+8.5% 07-01-2016	5,940,000	5,868,031	6,010,775	4.6
Tembec Industries 11.25% 12-15-2018	5,000,000	5,287,975	5,237,550	4.0
		29,258,843	32,717,322	25.2
Total Canadian fixed income		92,674,871	94,572,850	72.8

[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
[5] These investments represent loans receivable

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

Deans Knight Income Corporation
Statement of Investments...*continued*
As at December 31, 2011

	Par value [1] $	Average cost [2] $	Fair value [2] $	Percentage of total fair value [3] %
Fixed income – United States				
Denominated in United States dollars				
ABI Escrow Corp. 10.25% 10-15-2018	1,390,000	1,433,090	1,551,459	1.2
Beazer Homes USA, Inc. 9.13% 06-15-2018	3,250,000	3,327,056	2,264,096	1.7
Calfrac Holdings LP 7.5% 12-01-2020	6,000,000	6,130,329	5,949,450	4.6
McMoRan Exploration Co. 11.88% 11-15-2014	2,000,000	2,114,471	2,156,040	1.7
Number Merger Sub 11.00% 12-15-2019	1,850,000	1,926,584	1,890,857	1.5
Stone Energy Corp. 8.63% 2-01-2017	8,750,000	8,821,638	8,987,738	6.9
Total United States fixed income		23,753,168	22,799,640	17.5
Total fixed income		116,428,039	117,372,490	90.3
Convertible debentures - Australian				
Denominated Australian dollars				
Western Areas NL 8.0% 07-02-2012	1,500,000	1,322,276	1,554,218	1.2
		1,322,276	1,554,218	1.2
Equities				
Conifex Timber Inc.- purchase warrants	81,250	-	32,129	0.0
Sure Energy Inc.- purchase warrants	625,000	-	173,315	0.1
Whitecap Resources Inc.- common shares	1,254,167	7,725,668	10,397,044	8.1
		7,725,668	10,602,488	8.2
Investments subtotal		125,475,983	129,529,196	99.7
Hedges				
Denominated in United States and Australian dollars				
Foreign currency exchange contracts (note 8)	55,500,000	-	389,347	0.3
		125,475,983	129,918,543	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

[5] These investments represent loans receivable

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 its reorganization in May 2008, 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. 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 Part V of the Canadian Institute of Chartered Accountants Handbook, Pre-Changeover Accounting Standards (GAAP). All amounts are presented in Canadian dollars, unless otherwise noted.

2 Summary of significant accounting policies

The following is a summary of significant accounting policies followed by the Company:

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 year are included in the net realized gain on settlement of foreign currency contracts (note 6). The Company's policy is to hedge 95% - 105% 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 Company's publicly-traded investments could be disposed of currently may differ from the 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.

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 of 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, the 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, the 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 during the year. Royalty income is recognized on an accrual basis as earned. 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 8) entered into by the Company are valued at an amount that is equal to the gain or loss that would be realized if the position were to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized appreciation/depreciation of foreign currency contracts in the statement of operations.

Foreign exchange

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

Fair value measurement

Financial instruments are classified in a hierarchy that prioritizes the inputs to fair value measurement. Each level is based on the transparency of the inputs used to measure the fair values of assets and liabilities. The three levels of the fair value hierarchy are:

Level 1 – inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs that reflect other than quoted prices that are observable for the assets or liabilities either directly or indirectly;

Level 3 – inputs that are not based on observable market data.

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 7), 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.

Comparative figures

Certain of the comparative figures have been reclassified to conform with the current year presentation.

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 Statement of net assets 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 year ended December 31, 2011 was 10,537,263 (December 31, 2010 - 10,537,263). This weighted average includes both the voting common shares and non-voting common shares of the Company.

3 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 December 31, 2010 and December 31, 2011.

The total shares outstanding at December 31 are summarized as follows:

	December 31, 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	345,671	3,093,086	345,671	3,093,086
Total common shares outstanding	10,537,263	99,366,429	10,537,263	99,366,429

Contributed surplus

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

	December 31, 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	1,874,209	1,874,209
	9,904,504	9,904,504

4 Retained earnings

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

	2011 $	2010 $
Retained earnings – Opening balance	34,072,428	19,410,761
Increase in net assets from operations	5,568,428	22,033,536
Dividends paid from net investment income	(7,371,869)	(7,371,869)
Retained earnings – closing balance	32,268,987	34,072,428

5 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 year ended December 31, 2011, management fees totalled $2,283,158 (December 31, 2010 - $2,110,657). At December 31, 2011, $575,224 (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 at December 31, 2011, 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 year ended December 31, 2011, the Company incurred $42,750 (December 31, 2010 - $ 30,195) in legal services and disbursements received from this related party. At December 31, 2011, accounts payable and accrued liabilities include $4,185 (December 31, 2010 - $1,355) due to the law firm for legal fees and disbursements.

6 Net realized gains on investments sold and foreign currency contracts

The net realized gain on sale of investments for the year ended December 31 was as follows:

	2011 **$**	**2010** **$**
Proceeds from investments sold	59,635,633	107,386,034
Investments at cost – Beginning of year	118,563,957	100,510,397
Add: Cost of investments purchased	62,743,948	106,283,479
	181,307,905	206,793,876
Less: Investments at cost – End of year	(125,475,983)	(118,563,957)
Cost of investments sold	55,831,922	88,229,919
Net realized gain on investments sold	3,803,711	19,156,115

Net realized gains on investments sold consist of:

	2011 **$**	**2010** **$**
Realized gain on securities sold	4,695,889	15,928,417
Realized (loss) gain on settlement of foreign currency contracts	(892,178)	3,227,698
	3,803,711	19,156,115

7 Taxation

Uncertainty of deductibility of tax losses

Prior to the reorganization and change in business as discussed in note 1, 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 $21,024,806 (December 31, 2010 - $20,747,249), representing $2.00 per common share at December 31, 2011 (December 31, 2010 - $1.97 per common share).

Future tax asset

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

As the Company's investments in debt securities are generating interest income, but are not expected to generate sufficient taxable income in order to fully utilize the available tax credits during the years of operations through to April 30, 2014, the Company has recorded a valuation allowance. The difference between the total value of these tax benefits less the valuation allowance, being $4,920,000 (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 and tax credits that give rise to significant components of the future income tax assets at the statutory enacted rates, when such benefits are expected to be realized are as follows:

	December 31, 2011 $	**December 31, 2010 $**
Future tax assets		
Research and development expenditures	6,879,250	8,467,000
Investment tax credits	6,032,450	6,032,450
Share issuance costs	626,880	959,100
Total gross future tax assets	13,538,580	15,458,550
Valuation allowance	(8,618,580)	(8,908,550)
Net future tax asset	4,920,000	6,550,000
Less: current portion	(2,180,000)	(2,150,000)
	2,740,000	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, accordingly, the amount of future income taxes and provision for 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 December 31, 2011, the Company has accumulated scientific research and experimental development expenditures in the amount of $27,500,000 available for carry-forward indefinitely. The Company also has accumulated approximately $7,097,000 of unclaimed federal investment tax credits, which expire as follows:

	Investment tax credits $
Year of expiry	
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
	7,097,000

Reconciliation of income tax expense

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

	December 31, 2011 $	December 31, 2010 $
Increase in net assets from operations before taxes	7,198,428	23,683,536
Statutory tax rate	26.5%	28.5%
Income tax expense at statutory rates	1,907,583	6,749,808
Use of prior year losses	-	(6,124,935)
Use of scientific research and experimental development expenditures	(1,575,337)	(267,551)
Recognition of future tax asset	1,630,000	1,650,000
Current tax deductions for offering costs	(332,246)	(357,322)
Provision for future income tax	1,630,000	1,650,000

8 Financial instruments

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

	Financial assets at fair value – December 31, 2011			
	Level 1 $	Level 2 $	Level 3 $	Total $
Corporate debt	-	94,406,534	22,965,956	117,372,490
Convertible debentures	-	-	1,554,218	1,554,218
Equities	10,397,044	-	205,444	10,602,488
Foreign currency forward contracts	-	389,347	-	389,347
	10,397,044	94,795,881	24,725,618	129,918,543

	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
Equities	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 year.

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

	Fair value measurements of Level 3 inputs			
	Corporate debt $	**Convertible debentures** $	**Equities** $	**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	14,812,500	-	-	14,812,500
Sales	(7,031,250)	(2,148,120)	-	(9,179,370)
Unrealized appreciation (depreciation) included in net gain on investments	708,831	84,661	(194,556)	598,936
Balance – December 31, 2011	22,965,956	1,554,218	205,444	24,725,618

Level 3 fair value measurements have predominantly been valued by considering data inputs such as the last price the security was traded at, most recent bid/ask information, prices of similar securities with available prices, and comparison of yields of comparable investments. Accordingly it is not practicable to provide a sensitivity analysis.

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. Except for foreign currency forward contracts, 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.

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

	As a % of net assets	
	December 31, 2011	**December 31, 2010**
Credit rating		
BB	1.7	10.7
B	37.3	36.0
CCC	23.0	21.3
CC	-	1.0
Not rated*	29.3	20.0
	91.3	89.0

* Unrated 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:

	As a % of net assets	
	December 31, 2011	**December 31, 2010**
Sector		
Energy	50.4	57.1
Materials and metals	12.2	6.0
Consumer goods	7.5	9.4
Services	4.2	3.6
Chemicals	-	3.4
Financial services	2.9	3.0
Industrial/manufacturing	3.5	2.2
Forestry	6.9	4.3
Technology	3.7	-
	91.3	89.0

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	
	December 31, 2011 $	**December 31, 2010 $**
Maturity		
Less than 1 year	1,943,565	5,825,824
1 – 3 years	20,139,165	16,154,645
3 – 5 years	27,120,250	27,443,442
Greater than 5 years	70,113,075	70,799,537
	119,316,055	120,223,448

As at December 31, 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 $5,000,000, or approximately 3.5% 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.

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 potential impact to net assets of a 5% change in foreign currency rates against the Canadian dollar, assuming all other variables remain constant, would be $160,000 (2010 - $180,000).

At December 31, 2011, the Company had outstanding foreign exchange contracts to sell US$54,000,000 and AUS$1,500,000 against future commitments at exchange rates ranging between 1.01745 and 1.03175 for US dollar foreign exchange contracts and 1.03000 for the AUS dollar foreign exchange contract. Those contracts had maturities ranging up to January 25, 2012 and are with AAA rated Canadian banks and counterparties.

9 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 3.

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 investment income annually. Net investment income, in reference to the Company’s dividend payments to shareholders, excludes any realized and unrealized capital gains and losses from debt securities in the portfolio and any income or loss not derived from debt securities in the portfolio. The Company commenced its dividend payments on June 30, 2009, making monthly payments of $0.0583 per voting and non-voting common share, or $614,322. During the year ended December 31, 2011, the Company made dividend payments of $7,371,869 (December 31, 2010 - $7,371,869).

The Company intends to continue paying a monthly dividend of $0.0583 per voting and non-voting common share for the three months ending March 31, 2012, totalling $1,842,966 (note 11).

10 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.

	December 31, 2011 $	December 31, 2010 $
Net asset value per share	13.49	13.65
Canadian GAAP adjustments	(0.06)	(0.05)
Net assets per common share	13.43	13.60

11 Subsequent events

On January 9, 2012, the Company announced a monthly dividend of $614,322, or $0.0583 per common share, payable on each of January 31, 2012, February 29, 2012 and March 30, 2012.