DEANS KNIGHT

INCOME CORPORATION

INTERIM MANAGEMENT REPORT

OF FUND PERFORMANCE

For the period from

January 1, 2012 to June 30, 2012

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, 2012 (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 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 9, 2012 (the "AIF"). The Company does not believe there have been any changes over the financial period that have 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 $20,100,000 representing $1.91 per common share at June 30, 2012.

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, 2012 were $136,765,643, or $12.98 per common share, compared to $141,539,920, or $13.43 per common share at December 31, 2011. The net assets of the Company consisted of the following components:

			June 30, 2012
	$	**Per common share[1]**	**%**
Investments[2]	127,400,378	12.09	93.1
Cash and short-term deposits	3,878,758	0.37	1.8
Accrued income	2,031,791	0.19	1.3
Prepaid expenses	136,918	0.01	0.0
Future income tax asset[3]	4,050,000	0.38	4.1
Accounts payable and accrued liabilities	(732,202)	(0.06)	(0.3)
	136,765,643	12.98	100.0

(1) Based on 10,537,263 common shares, including 10,191,592 voting common shares and 345,671 non-voting common shares, as outlined in the notes to the Financial Statements.
(2) The details of the investments are outlined in the Summary of Investment Portfolio below.
(3) Refer to the Taxation note to the Financial Statements for more detail.

			December 31, 2011
	$	**Per common share[1]**	**%**
Investments[2]	129,918,543	12.33	91.8
Cash and short-term deposits	4,997,715	0.47	3.5
Accrued income	2,339,751	0.22	1.7
Prepaid expenses	73,151	0.01	0.0
Future income tax asset[3]	4,920,000	0.47	3.5
Accounts payable and accrued liabilities	(709,240)	(0.07)	(0.5)
	141,539,920	13.43	100.0

(1) Based on 10,537,263 common shares, including 10,191,592 voting common shares and 345,671 non-voting common shares, as outlined in the notes to the Financial Statements.
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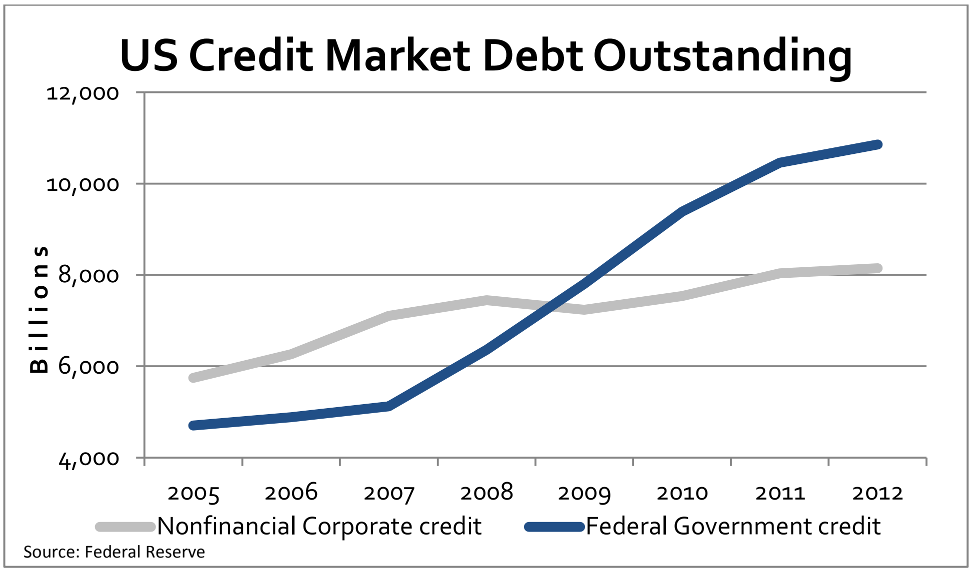
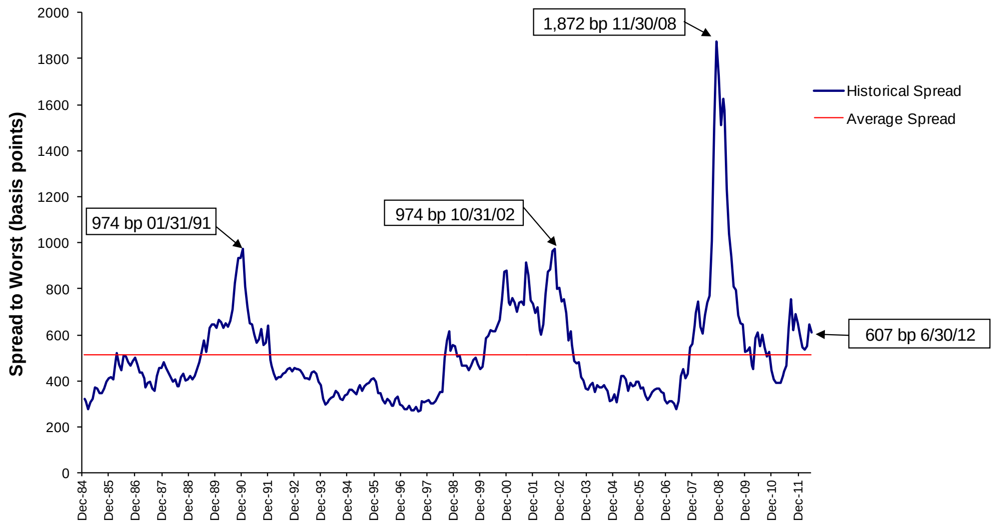
While it is certainly a difficult environment, especially in Europe, the Company strongly believes that corporate bonds will provide attractive future returns. Governments and individuals are saddled with too much debt, and too little tax revenue/income to support that debt. Corporations, on the other hand, have kept debt relatively flat since the financial crisis of 2008/2009, as government balance sheets continue to grow. The graph below shows the increase in U.S. government credit versus corporate credit from 2005 – 2012, as measured by the Federal Reserve. As you will note, corporate credit grew until 2008 and has since tapered off while government debt continues to grow, in fact doubled.



Good management teams understand they are in a difficult environment and have adjusted their cost structures to offset weak growth. Corporations are also de-leveraging or extending the maturity on their debt to provide more financial flexibility in case of a prolonged slow down. In contrast, politicians around the world have failed to make any headway in balancing their budgets, as attempts at reducing spending have so far been fruitless. Despite these facts, spreads between corporate credits and ten-year US treasuries are actually above the long term average.

Credit Spread History

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



Source: Bank of America Merrill Lynch

With yields on government bonds as low as they are, the Company believes investors are not being compensated for the risk.

With individual companies, the visibility is much clearer. As a corporate debt holder, your main concern is the investee's ability to meet its coupon payments and pay back the principal at maturity. Between the time of issue and maturity, high yield bond prices can fluctuate based on individual company financial results and market sentiment. The Company has no control over this. What we do have control over is ensuring we have invested in businesses that can pay the principal back and if they cannot, we are compensated with adequate collateral. The goal is to provide maximum income to the shareholders with a minimum level of risk. Based on the June 30th share price the dividend yield is 5.5%, from a diversified portfolio consisting of corporate bonds (78.9%), private debt financings (15.2%), and an equity position in Whitecap Resources (5.3%).

The portfolio consists of corporate debt in businesses with good management teams, tangible assets as collateral, strong cash flows and reasonable leverage. Deans Knight uses their credit knowledge and experience in structuring debt securities to evaluate the trust indentures to ensure the Company's interests are protected. The majority of the holdings remained relatively flat so far in 2012. The portfolio was negatively impacted, we believe temporarily, by a few holdings, three of which are discussed below.

Mirabela Nickel Ltd. is a nickel producer with assets in Brazil. As Mirabela has ramped up production over 2011/2012, they have experienced higher than expected costs and, with the decline in nickel prices, their bonds have traded down on liquidity concerns. To ensure Mirabela had adequate liquidity, management raised over $120 million by issuing equity. They now have $150 million in cash on hand and have successfully reduced cash costs by

18% during the second quarter to $6.03 per pound. Despite this, Mirabela bonds are still priced at a steep discount. At June 30th, Mirabela bonds were yielding 17.5%, an attractive yield given the quality of the mine and where the bonds stand on the capital structure. As such, the Company added to the position during the quarter.

North American Energy Partners ("NAEP") provides a wide range of heavy construction and mining, piling and pipeline installation services to customers in the Canadian oil sands, mineral mining, commercial and public construction and conventional oil and gas markets. NAEP has continued to grow revenue; however, margins were compressed, especially in their pipeline business, which was operating at a loss. New CEO, Martin Ferron, should be a benefit to NAEP as they re-focus the business plan, improving margins. In addition to the ongoing business, the bonds are supported by a valuable heavy equipment asset base. At a yield of 13.1%, we believe bondholders are being compensated for the risk.

We own an equity position in *Whitecap Resources Inc.*, which resulted from the conversion of a private debt financing that Deans Knight designed and funded in September 2009 as part of Whitecap's first financing. Whitecap's common shares had increased in price from the portfolio's conversion cost of $2.88 to $8.29 at December 31 2011, as production grew from 275 barrels of oil equivalent per day ("boepd") at inception in 2009, to 14,500 boepd. The share price has since pulled back to $6.72 at June 30th, because of market anxiety about Europe, China and U.S. growth. Whitecap should grow production to 17,000 boepd by the end of 2012. This could generate more than $230 million in cash flow when the company is worth $1.1 billion today; an attractive valuation in our opinion. Furthermore, Whitecap's high netback, low decline assets lend themselves well to long-term growth regardless of what the oil price is. The Company will continue to hold its investment in Whitecap as we believe management will grow the business, adding shareholder value.

One does not know what will happen to high yield bond prices in the next few quarters or when prices of our investments in Mirabela and NAEP may recover. We do know, at June 30th, the Company's portfolio has a yield to maturity of approximately 8.75% which should be a good predictor of its return over the remaining term of the Company. Given the credit quality of the businesses in the portfolio the Company believes this offers a strong incentive for investors given other income opportunities such as treasury securities, currently yielding less than 1.0%[1].

[1] Merrill Lynch U.S. Treasury Master Index

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 $0.05 per common share at June 30, 2012, as outlined in the notes to the Financial Statements.

International Financial Reporting Standards

The Company will be 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) would replace current Canadian standards and interpretations as GAAP for publicly accountable enterprises, which include investment companies.

In December 2011, the AcSB issued a decision to defer adoption of IFRS for investment companies currently applying Accounting Guideline 18 - Investment Companies until years beginning on or after January 1, 2014.

Under the above noted decision, the Company's first set of financial statements to be reported on under IFRS would be for the semi-annual period ending June 30, 2014. These statements would include corresponding comparative financial information for 2013, including an opening statement of net assets as at January 1, 2013. However, the Company has a termination date of April 30, 2014, and as such will not be required to issue statements reported on under IFRS. The Company will continue to monitor any further AcSB decisions that may affect the Company's requirement to adopt IFRS.

Harmonized Sales Tax

The Company is subject to non-recoverable Harmonized Sales Tax on its expenses. The BC Government has announced that the Harmonized Sales Tax will be replaced by the Federal Goods and Services Tax and a Provincial Sales Tax in 2013; however, the legislation has not yet been announced. Accordingly, until further information becomes available the impact cannot be quantified.

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, 2012, management fees totaled $1,147,216 (2011 - $1,165,607). 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, 2012, the Corporation incurred $11,098 (2011 - $17,895) in legal services and disbursements received from this related party. At June 30, 2012, accounts payable and accrued liabilities include $nil (December 31, 2011 - $1,532) 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, 2012 $	Year ended December 31, 2011 $	2010 $	Period March 17 to December 31, 2009 $
Net assets, beginning of period [(2)(3)]	13.43	13.60	12.21	9.12
Increase (decrease) from operations[(3)]				
Total revenue	0.57	1.10	0.95	0.62
Total expenses	(0.13)	(0.26)	(0.25)	(0.20)
Realized gains (losses) for the period	0.04	0.36	1.82	1.25
Unrealized (losses) gains for the period	(0.50)	(0.52)	(0.27)	1.21
Provision for future income taxes	(0.08)	(0.15)	(0.16)	0.62
Total (decrease) increase from operations	(0.10)	0.53	2.09	3.50
Dividends from income [(4)]	(0.35)	(0.70)	(0.70)	(0.41)
Net assets, end of period [(5)]	12.98	13.43	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, beginning of the period for 2009 reflect the net assets in the Company at March 17, 2009, after giving effect to the conversion of the convertible debenture and interest owing thereon and the issuance of common shares on the Company's initial public offering less total share issue expenses

(3) Net assets and dividends are based on the actual number of shares outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of shares outstanding over the period..

(4) Dividends were paid in cash.

(5) The net assets per share presented in the financial statements differs from the net asset value per share calculated for 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, 2012**	**Year ended December 31, 2011**	**2010**	**Period March 17 to December 31, 2009**
Net asset value (000's)	$137,296	$142,178	$143,880	$128,930
Number of common shares outstanding (000's)	10,537	10,537	10,537	10,537
Management expense ratio (1) (2)	1.99%	1.90%	1.91%	5.51%
Portfolio turnover rate (3)	8.44%	79.90%	86.60%	36.69%
Trading expense ratio (4)	0.01%	0.00%	0.01%	0.01%
Net asset value per common share	$13.03	$13.49	$13.65	$12.23
Closing market price – common share	$12.62	$11.84	$12.54	$11.40

(1) Management expense ratio is annualized and 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 corporation, 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.

Management Fees

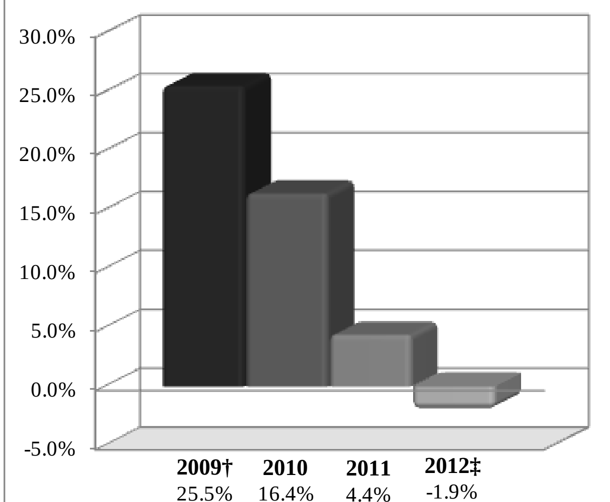
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, 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 corporation. 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 corporation, March 17, 2009 to December 31, 2009, how much an investment made for the years ended December 31, 2010 and 2011, and how much an investment made for the six-month period ending June 30, 2012.



† March 17, 2009 (Inception) to Dec. 31, 2009
‡Simple holding period return for the six months ended June 30, 2012

Summary of Investment Portfolio

Top 25 Investments			% of Net Asset Value
PARAMOUNT RESOURCES	8.250%	13-Dec-17	6.8
STONE ENERGY CORP	8.625%	1-Feb-17	6.6
NORTH AMERICA ENERGY	9.125%	7-Apr-17	5.5
CCS INC	11.000%	15-Nov-15	5.3
MIRABELA NICKEL LTD	8.750%	15-Apr-18	5.1
WHITECAP RESOURCES	N/A	N/A	4.9
SOUTHERN PACIFIC RES	10.750%	7-Jan-16	4.4
CALFRAC HOLDINGS LP	7.500%	1-Dec-20	4.2
RAPIDEYE CANADA	5.000%	31-Aug-14	3.8
TEMBEC INDUSTRIES	11.250%	15-Dec-18	3.7
NORTHLAND RESOURCES	13.000%	6-Mar-17	3.5
MERCATOR MINERALS	7.000%	3-Jan-13	3.3
PERPETUAL ENERGY INC	8.750%	15-Mar-18	3.1
PETROAMERICA OIL	11.500%	31-Mar-15	2.9
SHERRITT INTL CORP	8.000%	15-Nov-18	2.9
CARA OPERATIONS LTD	9.125%	1-Dec-15	2.6
CONIFEX TIMBER INC	10.000%	31-Dec-12	2.2
GATEWAY CASINOS	8.875%	15-Nov-17	2.2
BEAZER HOMES USA	9.125%	15-Jun-18	2.1
BLACK PRESS GROUP	100.000%	4-Feb-14	2.0
GARDA WORLD SECURITY	9.750%	15-Mar-17	1.9
PACIFIC RUBIALES	7.250%	12-Dec-21	1.9
SKYLINK AVIATION INC	12.250%	15-Mar-16	1.8
SURE ENERGY	6.250%	21-Jan-14	1.8
WESTERN ENERGY SVS	7.785%	30-Jan-19	1.7

Portfolio Composition	% of Net Asset Value
Fixed Income	
Canadian denominated in CAD	45.4
Canadian denominated in USD	20.5
United States denominated in USD	17.1
Other Foreign denominated in USD	3.5
	86.5
Convertible Debentures	
Other Foreign denominated in AUD	1.1
	87.6
Equity and Warrants	5.5
Investment Portfolio	93.1
Cash & Short-term Deposits	2.8
Other Net Assets	4.1
	100.0
Sector Breakdown	
Energy	51.5
Materials & Metals	16.1
Consumer Discretionary	8.8
Forestry	7.0
Industrial/Manufacturing	4.1
Technology	3.8
Services	1.8
Financial Services	-
Investment Portfolio	93.1
Cash & Short-term Deposits	2.8
Other Net Assets	4.1
	100.0