

Deans Knight Income Corporation

Interim Financial Statements

June 30, 2015

(Unaudited)

Notice of No Auditor Review of Interim Financial Statements

The accompanying unaudited interim financial statements of the Company have been prepared in compliance with International Financial Reporting Standards and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements. The Company's auditor will perform an audit of the December 31, 2015 financial statements.

Deans Knight Income Corporation

Interim Statements of Financial Position

(Unaudited)

	June 30, 2015 \$	December 31, 2014 \$
Assets		
Current Assets		
Investments - at fair value *	3,436,202	3,266,854
Cash and cash equivalents	1,866,505	1,399,985
Accrued interest receivable	113,506	155,666
Prepaid expenses	41,794	12,000
Prepaid tax asset (note 6)	21,662,136	21,606,636
Total Assets	27,120,143	26,441,141
Liabilities		
Current Liabilities		
Accounts payable and accrued liabilities (note 4)	119,727	66,597
Net Assets	27,000,416	26,374,544
Shareholders' Equity		
Common shares (note 3)	17,724,189	17,724,189
Contributed surplus (note 3)	9,904,504	9,904,504
Deficit	(628,277)	(1,254,149)
	27,000,416	26,374,544
Number of common shares outstanding (note 3)	10,537,263	10,537,263
Net assets per common share (note 6)	2.56	2.50
*Investments – at average cost	2,140,768	2,513,316
Contingencies (notes 1 and 6)		
Commitments (notes 1 and 8)		
Going concern (note 1)		
Subsequent event (note 10)		

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

Deans Knight Income Corporation
Interim Statements of Comprehensive Income
For the six-month period ended June 30, 2015 and 2014
(Unaudited)

	2015	2014
	\$	\$
Investment income		
Dividend and interest income for distribution purposes	90,824	985,212
Royalty income	162,095	189,601
Net realized gain (loss) on investments sold (note 5)	93,268	(3,446,354)
Net realized loss on foreign currency contracts (note 5)	-	(450,708)
Change in unrealized appreciation on investments	541,896	3,595,891
	<u>888,083</u>	<u>873,642</u>
Expenses		
Legal fees	143,337	31,733
Public company reporting costs	65,277	107,088
Audit, accounting and tax fees	38,443	21,151
Custodial fees	7,965	14,376
Independent Review Committee fees	7,125	6,225
Management fees (note 4)	63	554,701
Director's fees and expenses	-	40,292
Transaction costs	-	28,552
	<u>262,210</u>	<u>804,118</u>
Comprehensive income before tax	625,873	69,524
Provision for deferred income tax (note 6)	-	(180,000)
Comprehensive income (loss)	<u>625,873</u>	<u>(110,476)</u>
Comprehensive income (loss) per weighted average common share (note 2)	<u>0.06</u>	<u>(0.01)</u>

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

Deans Knight Income Corporation

Interim Statements of Changes in Equity

For the six-month period ended June 30, 2015 and 2014

(Unaudited)

	Common shares	Contributed surplus	Retained earnings (deficit)	Total shareholders' equity
	\$	\$	\$	\$
At January 1, 2014	99,366,429	9,904,504	21,096,074	130,367,007
Comprehensive loss	-	-	(110,476)	(110,476)
Return of capital	(81,642,240)	-	(21,096,074)	(102,738,314)
At June 30, 2014	<u>17,724,189</u>	<u>9,904,504</u>	<u>(110,476)</u>	<u>27,518,217</u>
At January 1, 2015	17,724,189	9,904,504	(1,254,149)	26,374,544
Comprehensive income	-	-	625,873	625,873
At June 30, 2015	<u>17,724,189</u>	<u>9,904,504</u>	<u>(628,276)</u>	<u>27,000,417</u>

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

Deans Knight Income Corporation

Interim Statements of Cash Flows

For the six-month period ended June 30, 2015 and 2014

(Unaudited)

	2015 \$	2014 \$
Cash flows from operating activities		
Comprehensive income (loss)	625,873	(110,476)
Adjustments for		
Net realized (loss) gain on investments sold	(93,268)	3,446,354
Net realized loss on foreign currency contracts	-	450,708
Change in unrealized appreciation on investments	(541,896)	(3,595,891)
Dividend and interest income for distribution purposes	(90,824)	(985,212)
Royalty income	(162,095)	(189,601)
Provision for deferred income tax	-	180,000
	<u>(262,210)</u>	<u>(804,118)</u>
Proceeds from investments sold (note 5)	502,087	61,878,978
Interest received	43,107	1,623,566
Royalty received	215,700	251,783
Prepaid expenses	(29,794)	9,370
Prepaid tax asset	(55,500)	(22,690,000)
Change in accounts payable and accrued liabilities	53,130	(830,166)
	<u>466,520</u>	<u>39,439,413</u>
Cash flows from financing activities		
Return of capital to common shareholders (notes 3 and 8)	-	(102,738,314)
	<u>-</u>	<u>(102,738,314)</u>
Net increase (decrease) in cash and cash equivalents during the period	466,520	(63,298,901)
Cash and cash equivalents – Beginning of period	<u>1,399,985</u>	<u>64,573,401</u>
Cash and cash equivalents – End of period	<u>1,866,505</u>	<u>1,274,500</u>

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

Deans Knight Income Corporation

Interim Schedule of Investment Portfolio

As at June 30, 2015

(Unaudited)

	Par value ¹ \$	Average cost ² \$	Fair value ² \$	Percentage of total fair value ³ %
Fixed income				
<i>Denominated in Canadian dollars</i>				
Skylink Aviation Inc. 12.25% 05-10-2018	628,454	628,454	-	-
<i>Denominated in United States dollars</i>				
Mirabela Nickel Ltd. 1.00% 09-10-2044	117,532	124,999	73,304	2.1
Skylink Aviation Inc. 10.00% 03-08-2015 ⁴	563,770	574,172	70,325	2.0
		699,171	143,629	4.1
Total fixed income		1,327,625	143,629	4.1
Equity – Australia				
Mirabela Nickel Ltd. - common shares	20,231,470	813,143	2,235,648	65.1
Total equity		813,143	2,235,648	65.1
Royalty – Canada				
<i>Denominated in Euro</i>				
Blackbridge (formally RapidEye Canada)		-	1,056,925	30.8
Total investments		2,140,768	3,436,202	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 This investment represents a loan receivable for which lenders agreed to forbear the repayment date of March 8, 2015.

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

Deans Knight Income Corporation

Notes to Interim Financial Statements

June 30, 2015

(Unaudited)

1 Nature of operations and going concern

Deans Knight Income Corporation (the “Company”) is a corporation continued under the laws of Canada on April 11, 2001. The Company is a public closed-end, non-redeemable investment company, which prior to April 15, 2014 was listed on the Toronto Stock Exchange. The address of the Company’s registered office, and its principal place of business, is 1500 – 999 West Hastings Street, Vancouver, British Columbia.

In April 2014, the Company’s shareholders voted in favour of the special resolution authorizing: (i) an extension of the termination date of the Company until such time as reasonably practicable following the conclusion of the Canada Revenue Agency (“CRA”) tax matter (note 6); and (ii) the removal of the restrictions on business that the Company can carry on. Going forward, the Company’s business will comprise of (i) divesting of any remaining investments held; (ii) attending to, and if necessary, litigating, the CRA audit and related tax appeal (note 6); and, (iii) attending to any distributions to shareholders of surplus cash and the eventual wind-up and termination of the Company thereafter.

Prior to April 30, 2014, the Company's investment objectives were to: (i) maximize the total return for 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. The Company did this through investing 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.

As per the Company’s Articles of Incorporation, the common shares of the Company are to be redeemed at such time as is reasonably practicable following the resolution of the CRA tax audit and related tax appeal (note 6), or such other date as the Company deems appropriate, on not less than 30 days' notice to shareholders.

The Company does not anticipate that there will be a resolution to the CRA tax dispute in the next 12 months, and as such is not anticipating winding up in that period. Therefore, these financial statements have been prepared on a going concern basis. If a resolution is achieved, or the Company deems it appropriate to wind up, then the Company will settle all outstanding liabilities, including obtaining a tax clearance certificate, and redeem the common shares of the Company.

2 Summary of significant accounting policies

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

Basis of preparation and adoption of IFRS

These financial statements have been prepared in compliance with International Financial Reporting Standards (“IFRS”) applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting* and IFRS 1, *First-time Adoption of International Financial Reporting Standards*. The Company adopted this basis of accounting on January 1, 2014, as required by Canadian securities legislation and the Canadian Accounting Standards Board.

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The policies applied in these financial statements are based on IFRS issued and outstanding as of August 20, 2015, which is the date on which the interim financial statements were authorized for issue by the Board of Directors. Any subsequent changes to IFRS that are given effect in the Company's annual financial statements for the year ending December 31, 2015 could result in restatement of these financial statements.

The common shares are presented as equity because they meet the criteria in paragraphs 16C – D of International Accounting Standards (“IAS”) 32 ‘*Financial Instruments: Presentation*’ for such classification.

Financial instruments

(a) Classification

The Company classifies its investments in debt and equity securities, and derivatives, as financial assets or financial liabilities at fair value through profit or loss (“FVTPL”). All other financial assets and liabilities are measured at amortized cost.

The FVTPL category has two sub-categories: financial assets or financial liabilities held for trading; and those designated at FVTPL at inception.

(i) Financial assets and liabilities held for trading

A financial asset or financial liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives are also categorized as held for trading. The Company does not classify any derivatives as hedges in a hedging relationship.

(ii) Financial assets and liabilities designated at FVTPL at inception

Financial assets and financial liabilities designated at FVTPL at inception are financial instruments that are not classified as held for trading but are managed, and their performance is evaluated, on a fair value basis in accordance with the Company's documented investment strategy. The Company evaluates the information about these financial assets and liabilities on a fair value basis together with other related financial information.

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.

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(b) Recognition, de-recognition and measurement

Regular way purchases and sales of investments are recognized on the trade date – the date on which the Company commits to purchase or sell the investment. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or the Company has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities at FVTPL are initially recognized at fair value. Transaction costs are expensed as incurred. Subsequent to initial recognition, all financial assets and financial liabilities at FVTPL are measured at fair value. Gains and losses arising from changes in the fair value of the ‘financial assets or financial liabilities at FVTPL’ category are included in the statements of comprehensive income in the period in which they arise.

Under the amortized cost method, financial assets and liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract’s effective interest rate. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

At each reporting date, the Company assesses whether there is objective evidence that a financial asset at amortized cost is impaired. If such evidence exists, the Company recognizes an impairment loss as the difference between the amortized cost of the financial asset and the present value of the estimated future cash flows, discounted using the instrument’s original effective interest rate. Impairment losses on financial assets at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

The interest for distribution purposes shown on the statements of comprehensive income represents the coupon interest received by the Company accounted for on an accrual basis. The Company does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds, which are amortized on a straight line basis.

Realized gain/loss on sale of investments and unrealized appreciation/depreciation in investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds. Royalty income is recognized on an accrual basis as earned. Dividend income is recognized at the ex-dividend date.

Transaction costs are any costs that can be directly attributable to the acquisition and 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.

(c) Presentation

Financial assets and liabilities are offset and the net amount reported in the statements of financial position, when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. In the normal course of business, the Company may enter into master netting arrangements or similar agreements that do not meet the criteria for offsetting in the statements of financial position, but still allow for the related amounts to be offset in certain circumstances,

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such as bankruptcy or termination of the contracts. The Company has not offset any material financial instruments as at June 30, 2015 or December 31, 2014.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial assets and liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Company uses the last traded market price for both financial assets and financial liabilities where the last traded price falls within that day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, management determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances. The Company's policy is to recognize transfers into and out of the fair value hierarchy levels as of the date of the event or change in circumstances giving rise to the transfer.

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques include the use of comparable recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and others commonly used by market participants and which make the maximum use of observable inputs. 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.

Specifically, financial assets and liabilities that are classified as held for trading are recorded at fair values determined as follows:

Foreign currency contracts

Foreign currency contracts 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.

Financial assets and liabilities that are designated at FVTPL at inception are recorded at fair values determined as follows:

Equities

Publicly traded equities are recorded at closing 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.

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Fixed income investments and convertible debentures

Fixed income investments traded on a public securities exchange or traded on an over-the-counter market are valued at the closing price. Where no closing price is available, the last sale price is used where, in management's opinion, this provides the best estimate of fair value.

Fixed income investments not traded on a public securities exchange or over-the-counter market are 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.

Royalties

Royalty investments are measured on a discounted cash flow basis, where the value is imputed through discounting forecast cash flows using an appropriate discount rate.

Foreign exchange

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars, which is also the Company's functional and presentation currency at the exchange rate applicable on the valuation date. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates that transactions occur. Foreign currency assets and liabilities denominated in a foreign currency are translated into the functional currency using the exchange rate prevailing at the measurement date. Foreign exchange gains and losses relating to cash are presented as 'Foreign exchange gain (loss) on cash' and those relating to other financial assets and liabilities are presented within 'Net realized gain (loss)' and 'Change in unrealized appreciation (depreciation)' in the statements of comprehensive income.

Income taxes

The Company follows the balance sheet 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 probable that a payment will be required to be made.

Management has estimated the income tax provision and future income tax balances taking into account its expectation of deferred taxable 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 deferred tax balances could change (notes 6 and note 10), and the change could be significant.

Current income taxes are the expected taxes payable on the taxable income for the year using tax rates enacted or substantially enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

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Net assets per common share

The net assets per common share are computed by dividing the net assets of the Company by the total number of common shares outstanding on the statements of financial position.

Comprehensive income (loss) per weighted average common share

The comprehensive income (loss) per weighted average common share represents comprehensive income (loss) divided by the weighted average number of common shares outstanding during the period.

The weighted average number of shares outstanding during the period ended June 30, 2015 was 10,537,263 (2014 - 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. The holders of the voting common shares shall have one vote for each share held. The holders of non-voting common shares will have no such right to vote.

The holders of both the voting common shares and the non-voting common shares shall be entitled to receive dividends, which must be declared and paid in an equal amount per share and at the same time without preference or distinction.

In the event of the liquidation, dissolution or winding up of the Company whether voluntary or involuntary, or any other distribution of the assets of the Company among its shareholders for the purpose of winding up its affairs, the holders of the voting common shares and the holders of the non-voting common shares shall rank equally and shall be entitled to share and receive the remaining property of the Company.

There were no changes in the number of voting and non-voting common shares during the periods ended June 30, 2015 and 2014. The total shares outstanding at June 30, 2015 and December 31, 2014 are summarized as follows:

	Number of shares
Voting common shares	10,191,592
Non-voting common shares	<u>345,671</u>
Total common shares outstanding	<u>10,537,263</u>

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On April 30, 2014, the Company paid a return of capital to shareholders of \$102,738,314. This was accounted for by first reducing retained earnings, and then reducing common shares by the residual amount. As a result, retained earnings decreased by \$21,096,074, the carrying amount of voting common shares was reduced by \$79,100,874 and the carrying amount of non-voting common shares was reduced by \$2,541,366.

Contributed surplus

The contributed surplus balance did not change during the periods ended June 30, 2015 and 2014. The balance at June 30, 2015 and December 31, 2014 consists of:

	\$
Surplus related to stock compensation, warrants and options associated with common shares	8,030,295
Surplus relating to warrants associated with previously issued preferred shares	<u>1,874,209</u>
	<u>9,904,504</u>

4 Related party transactions and balances

The officers and directors of the Company are also employees of Deans Knight Capital Management Ltd. ("Deans Knight"), the Company's investment fund manager. These officers and directors are not paid by the Company. Deans Knight provides administration, financial reporting and other ancillary services required by a public company, as well as investment management services related to the remaining investments, all as more particularly set forth in the Services Agreement between the Company and Deans Knight dated May 20, 2014 and available for review on SEDAR. Deans Knight is paid a nominal fee of \$10 per month plus G.S.T. for the services it provides to the Company under the Services Agreement. Prior to May 20, 2014, and for the period January 1, 2014 to April 30, 2014, Deans Knight was paid a management fee computed 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 ending June 30, 2015, management fees totaled \$63 (2014 - \$554,701). At June 30, 2015, \$147 (December 31, 2014 - \$84) was owed to Deans Knight, which was unsecured and included in accounts payable and accrued liabilities in the statements of financial position, and is payable immediately.

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5 Net realized gain (loss) on investments sold and foreign currency contracts

The net realized gain (loss) on investments sold and foreign currency contracts for the six-month period ended June 30 was as follows:

	2015 \$	2014 \$
Proceeds from sale of investments	502,087	61,878,978
Investments at cost – Beginning of period	2,513,316	68,222,974
Add: Cost of investments purchased	36,271	32,204
	2,549,587	68,255,178
Less: Investments at cost – End of period	2,140,768	(2,479,138)
Cost of investments sold	408,819	65,776,040
Net realized gain (loss) on investments sold	93,268	(3,897,062)

Costs of investment purchased of \$36,271 (2014 - \$32,204) represent income paid in kind.

Net realized gain (loss) on investments sold and foreign currency contracts consists of:

	2015 \$	2014 \$
Realized gain (loss) on investments sold	93,268	(3,446,354)
Realized loss on settlement of foreign currency contracts	-	(450,708)
	93,268	(3,897,062)

6 Taxation

Uncertainty of deductibility of tax losses

Prior to the reorganization and change in the Company's business that occurred in 2008, as discussed in Note 1, the Company had generated significant tax losses and other tax attributes as a result of its prior business activities. In its tax filings since the reorganization, the Company has taken the position that these losses and other tax attributes could be used to offset taxable income generated by the Company, thereby reducing its taxes payable.

In July 2014, the Company received Notices of Reassessment ("NORAs") from the CRA for the taxation years 2009 to 2012, inclusive. In the NORAs, the CRA denied the use of the losses and other tax attributes by the Company on the basis that an acquisition of control of the Company occurred, as a result of the 2008 reorganization, and on the basis of the General Anti-Avoidance Rule in the Income Tax Act (Canada) (the "CRA

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Matter"). The Company, in consultation with its legal advisors, remains of the view that its tax filing position is appropriate, and intends to vigorously defend its position.

The NORAs indicate the Company's tax liability for the 2009 to 2012 taxation years to be approximately \$22.7 million or \$2.15 per Share ("Disputed Amount"), including arrears interest and penalties. Given the Company's financial results for 2013 and 2014, the Company estimates its overall potential net tax liability for the years 2009 through 2014 inclusive to be approximately \$21.7 million, or \$2.05 per share ("Potential Tax Liability"). The Company has prepaid the \$21.7 million to the CRA to limit any future interest from being incurred. Considering the financial results for the Company for the period January 1, 2015 to June 30, 2015, the Company estimates its Potential Tax Liability to have increased by \$0.2 million or \$0.02 per share. The Company intends to reassess its Potential Tax Liability at December 31, 2015 and prepay any additional amount, if necessary, to limit any future interest from being incurred.

Should the Company be successful in defending its tax filing position, the amount prepaid to the CRA will be refunded to the Company with interest. However, if the Company is unsuccessful, the recorded amount of the deferred tax assets, if any, as well as such amounts claimed to date would be recorded as a charge to income, and the Potential Tax Liability would be forfeited to the CRA.

In late 2014, the Company filed its Notice of Appeal to the Tax Court of Canada, appealing the NORAs and is now attending to normal pre-trial processes, including discovery of documents and examinations for discovery with the Crown. The Company is hopeful that the case will be heard by the Court in the first half of 2016.

Deferred tax asset

The tax effects of temporary differences and tax credits that give rise to significant components of the deferred income tax assets, at the statutory enacted rates when such benefits are expected to be realized, are as follows:

	Research and development expenses	Issuance costs	Total
	\$	\$	\$
At January 1, 2014	180,000	-	180,000
Charged to the income statement	(180,000)	-	(180,000)
	<hr/>	<hr/>	<hr/>
At June 30, 2014 and 2015	-	-	-
	<hr/>	<hr/>	<hr/>

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, and changes in the operations of the Company, 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 deferred income tax assets may not be deductible for tax purposes and, accordingly, the amount of deferred income taxes and provision for income taxes recorded in the financial statements could change by a material amount.

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Deferred income tax assets are recognized only to the extent that it is probable that future taxable income will be available against which temporary differences can be utilized.

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 and that investments will be sold at their current value.

Tax pools available to offset future tax expense and payable

As at June 30, 2015, the Company has accumulated non-capital losses of approximately \$3,800,000. The benefit of these losses has been recorded as a reduction of the prepaid tax asset. If the Company is successful in defending its tax filing position, these losses would be reinstated for carry forward and will expire in 2033. In addition, the Company has scientific research and experimental development ("SR&ED") expenditures of \$17,510,000, which do not expire, available to offset future taxable income and \$7,097,000 of unclaimed federal investment tax credits ("ITCs"), which expire from 2018 to 2025, available to offset future taxes payable. The benefit of the SR&ED expenditures and ITCs have not been recognized in the financial statements based on management's assessment that it is not probable that these tax attributes will be realized in the future.

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 26.0 % statutory tax rate (2014 – 26.0%), is:

	2015 \$	2014 \$
Comprehensive income before tax	625,873	69,524
Statutory tax rate	26.00%	26.00%
Income tax expense at statutory rates	162,727	18,076
SR&ED credit utilized	(162,727)	-
Non-capital loss carry forward	-	(18,076)
Reduction of future tax asset	-	180,000
Provision for future income tax	-	180,000

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7 Financial instruments

The following tables present the carrying amounts of the Company's financial instruments by category as at June 30, 2015:

Financial instruments by category

	Amortized cost \$	Assets/liabilities at FVTPL \$	Total \$
Assets as per statements of financial position			
Designated as FVTPL:			
Investments	-	3,436,202	3,436,202
Loans and receivables:			
Cash and accrued interest receivable	1,980,011	-	1,980,011
	<u>1,980,011</u>	<u>3,436,202</u>	<u>5,416,213</u>
Liabilities as per statements of financial position			
Other financial liabilities:			
Accounts payable and accrued liabilities	119,727	-	119,727
	<u>119,727</u>	<u>-</u>	<u>119,727</u>

The following tables present the carrying amounts of the Company's financial instruments by category as at December 31, 2014:

Financial instruments by category

	Amortized cost \$	Assets/liabilities at FVTPL \$	Total \$
Assets as per statements of financial position			
Designated as FVTPL:			
Investments	-	3,266,854	3,266,854
Loans and receivables:			
Cash and accrued interest receivable	1,555,651	-	1,555,651
	<u>1,555,651</u>	<u>3,266,854</u>	<u>4,822,505</u>
Liabilities as per statements of financial position			
Other financial liabilities:			
Accounts payable and accrued liabilities	66,597	-	66,597
	<u>66,597</u>	<u>-</u>	<u>66,597</u>

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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.

If inputs of different levels are used to measure an asset's or liability's fair value, the classification within the hierarchy is based on the lowest level input that is significant to the fair value measurement.

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

Financial assets at fair value – June 30, 2015

	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Corporate debt	-	-	143,629	143,629
Equity	2,235,648	-	-	2,235,648
Royalty	-	-	1,056,925	1,056,925
	<u>2,235,648</u>	<u>-</u>	<u>1,200,554</u>	<u>3,436,202</u>

Financial assets at fair value – December 31, 2014

	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Corporate debt	-	-	1,588,228	1,588,228
Equity	-	556,145	-	556,145
Royalty	-	-	1,122,481	1,122,481
	<u>-</u>	<u>556,145</u>	<u>2,710,709</u>	<u>3,266,854</u>

There was one transfer from Level 2 to Level 1 in the period ending June 30, 2015. This transfer occurred as the security, which had its trading halted at December 31, 2014, was once again actively trading.

All fair value measurements above are recurring.

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The following tables reconcile the Company's Level 3 fair value measurements:

	Corporate debt \$	Equities \$	Royalty \$	Total \$
Balance – January 1, 2014	6,334,859	106,629	1,241,233	7,682,721
Transfers out	(813,143)	-	-	(813,143)
Sales	(4,000,000)	(264,473)	-	(4,264,473)
Realized and unrealized (depreciation) appreciation	<u>(14,744)</u>	<u>165,574</u>	<u>(59,083)</u>	<u>91,747</u>
Balance – June 30, 2014	<u>1,506,972</u>	<u>7,730</u>	<u>1,182,150</u>	<u>2,696,852</u>
Unrealized appreciation (depreciation)	<u>(14,744)</u>	<u>(26,466)</u>	<u>(59,083)</u>	<u>(100,293)</u>
Balance – January 1, 2015	1,588,228	-	1,122,481	2,710,709
Transfers out	-	-	-	-
Sales	(502,087)	-	-	(502,087)
Realized and unrealized depreciation	<u>(942,572)</u>	<u>-</u>	<u>(65,556)</u>	<u>(1,008,128)</u>
Balance – June 30, 2015	<u>143,629</u>	<u>-</u>	<u>1,056,925</u>	<u>1,200,554</u>
Unrealized depreciation	<u>(849,304)</u>	<u>-</u>	<u>(65,556)</u>	<u>(914,860)</u>

The transfer from Level 3 to Level 2 during the period ended June 30, 2014, totalling \$813,143, related to corporate debt securities that were exchanged for common shares traded on an active market, as part of a corporate restructuring.

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. Any reasonably possible alternative assumptions, except as noted below, would result in immaterial changes to total net assets.

For royalty investments measured on a discounted cash flow basis, the value is imputed through forecasted cash flows and discount rates. The following summarizes the affect a change in assumptions would have on total net assets at June 30, 2015:

	<u>Increase by 5%</u>	<u>Decrease by 5%</u>
Cash flow growth rate	\$ 10,000	\$ (335,800)
Discount rate	\$ (360,400)	\$ 77,200

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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 advisor, 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 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 regular ongoing monitoring of the investment performance of the individual investee companies. A 10% change in the value of the Company's equity investment would have a \$223,565 (December 31, 2014 - \$55,615) impact on comprehensive income.

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 primarily 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. However, this maximum exposure is mitigated 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.

At June 30, 2015 and December 31, 2014, all remaining investments held by the Company were unrated by the various credit rating agencies. The Company's credit risk exposure by sector at June 30, 2015 is limited to investments valued at 0.3% of net assets (5.6% - December 31, 2014), which are in the service sector.

Credit risk associated with the Company's cash and cash equivalents is not considered significant, as they are held with Tier 1 Canadian financial institutions.

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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 on its investments:

	Fair value	
	June 30, 2015 \$	December 31, 2014 \$
Maturity		
Less than 1 year	70,325	1,119,709
1 – 3 years	-	-
3 – 5 years	-	373,075
Greater than 5 years	1,130,229	1,217,925
	<u>1,200,554</u>	<u>2,710,709</u>

As at June 30, 2015, 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 \$88,000, or approximately 0.3% of net assets (December 31, 2014 - \$104,000, or approximately 0.5% of net assets).

Liquidity risk

As the Company is a 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.

The Company's remaining 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. Investments held by the Company may be subject to resale restrictions such as hold periods. The resulting values for the Company's remaining investments may differ from values that would be realized if a ready market existed.

The Company continually reviews its investment portfolio to assess liquidity risk on its holdings.

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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.

Prior to April 30, 2014, being the date the Company returned \$102,738,314 of capital to its shareholders (note 3), the Company entered into foreign currency contracts with financial institutions to hedge the value of foreign currency denominated investments. The fair value of these contracts was reflected in investments. Gains or losses arising from these contracts offset the gains or losses from translation of the underlying investments. The unrealized gains or losses were reflected in unrealized appreciation/depreciation on foreign currency contracts on the statements of comprehensive income. 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 \$178,000 at June 30, 2015 (December 31, 2014 - \$145,000).

8 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. On April 30, 2014, the Company paid a return of capital of \$102,738,314 to voting and non-voting common shareholders, equal to \$9.75 per share.

The Company manages its capital in accordance with the Company's amended business objectives, as approved by shareholders at a meeting held April 4, 2014. The objectives include: (i) divesting of any remaining investments held; (ii) attending to, and if necessary, litigating, the CRA audit and related tax appeal (note 6); and, (iii) attending to any distributions to shareholders of surplus cash and the eventual wind-up and termination of the Company thereafter.

The Company discontinued its monthly dividend payment of \$0.0583 per voting and non-voting common share after its December 2013 payment. However, the Company intends to pay cash dividends to shareholders as any remaining investments are liquidated, resulting in surplus cash in the Company. There were no such dividend payments in the period ended June 30, 2015 (June 30, 2014 - \$nil).

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9 Cash and cash equivalents

For the purposes of the statements of financial position and cash flows, cash and cash equivalents comprise the following balances with original maturity of less than 90 days:

	June 30, 2015 \$	December 31, 2014 \$
Cash at bank	1,866,505	1,399,985
Short-term deposits	-	-
Total	<u>1,866,505</u>	<u>1,399,985</u>

10 Subsequent event

Subsequent to June 30, 2015, the Company announced the anticipated liquidation of its BlackBridge royalty stream. In the six-month period ending June 30, 2015, this investment generated \$162,095 (2014 - \$189,601).

This anticipated payment to the Company will be the result of the sale by BlackBridge of its RapidEye suite of core offerings, as announced by BlackBridge on July 15, 2015. BlackBridge has announced that it expects the transaction will close during the third quarter of 2015.

The liquidation of the BlackBridge royalty stream is expected to generate approximately \$2,000,000, or \$0.19 per Common Share. For reference, the Company had this royalty stream valued at approximately \$1.06 million, or \$0.10 per Common Share, at June 30, 2015. The Company intends to distribute the proceeds from the sale of the BlackBridge royalty stream, along with any additional excess cash, if any, to holders of Common Shares upon receiving payment from BlackBridge.

11 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgments and estimates that the Company has made in preparing the financial statements:

Fair value measurement of derivatives and securities not quoted in an active market

The Company holds financial instruments that are not quoted in active markets. Fair values of such instruments are determined using valuation techniques and may be determined using reputable pricing sources (such as pricing agencies) or indicative prices from market makers. Broker quotes, as obtained from the pricing sources, may be indicative and not executable or binding. Where no market data is available, the Company may value positions using its own models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require the Company to make estimates. Changes in assumptions about these factors could affect the reported fair values of financial

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instruments. The Company considers observable data to be market data that is readily available, regularly distributed and updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. Refer to note 2 for further information about the fair value measurement of the Company's financial instruments and to note 7 for further information about level 3 investments.

Deferred income taxes

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 deferred income tax assets may not be deductible for tax purposes and, accordingly, the amount of the prepaid tax assets, deferred income taxes, and provision for income taxes recorded in the financial statements could change by a material amount (note 6).

In determining the amount of deferred 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 and that investments will be sold at their current value.

12 Future accounting changes

At June 30, 2015, a number of standards and interpretations, and amendments thereto, had been issued by the International Accounting Standards Board (IASB), which are not effective for these financial statements. Those which are expected to have an effect on the Company's financial statements are discussed below:

IFRS 9, '*Financial instruments*', addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 establishes three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income and FVTPL. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at FVTPL with the irrevocable option to recognize changes in fair value with no recycling of gains or loss to the statements of comprehensive loss. IFRS 9 requires credit losses to be recognized on an expected loss basis rather than using an incurred loss model. For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted. The Company is yet to assess IFRS 9's full impact.

IFRS 15, '*Revenue from contracts with customers*' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 '*Revenue*' and IAS 11 '*Construction contracts*' and related interpretations. The standard is effective for annual periods beginning on or after 1 January 2017 and earlier application is permitted. The Company is yet to assess IFRS 15's full impact.