Deans Knight Income Corporation

Financial Statements
December 31, 2013 and 2012

March 7, 2014

Independent Auditor's Report

To the Shareholders of Deans Knight Income Corporation

We have audited the accompanying financial statements of Deans Knight Income Corporation, which comprise the statement of investments as at December 31, 2013, the statements of net assets as at December 31, 2013 and December 31, 2012 and the statements of operations, cash flows, and changes in net assets for the years then ended, 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 generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the 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.

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Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Deans Knight Income Corporation as at December 31, 2013 and December 31, 2012 and the results of its operations, its cash flows and the changes in its net assets for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 of the financial statements which describes matters and conditions that indicate the existence of a material uncertainty that may cast doubt about the ability of Deans Knight Income Corporation to continue as a going concern.

PricewaterhouseCoopers LLP

Chartered Accountants

Deans Knight Income Corporation

Statements of Net Assets

As of December 31, 2013 and 2012

	2013 $	2012 $
Assets		
Investments - at fair value (cost - $68,222,974; December 31, 2012 - $117,207,284)	65,439,969	118,788,753
Cash and cash equivalents	64,573,401	20,091,125
Accrued interest receivable	786,745	1,662,373
Prepaid expenses	41,370	56,460
Future income tax benefits (note 7)	180,000	2,390,000
	131,021,485	142,988,711
Liabilities		
Accounts payable and accrued liabilities (note 5)	873,905	713,711
Net assets	130,147,580	142,275,000
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)	20,876,647	33,004,067
	130,147,580	142,275,000
Number of common shares outstanding (note 3)	10,537,263	10,537,263
Net assets per common share (notes 7 and 10)	12.35	13.50

Contingencies (notes 1 and 7)
Commitments (note 1)
Subsequent events (notes 1, 7 and 9)
Going concern (note 1)

Approved by the Board of Directors

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

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

Deans Knight Income Corporation

Statements of Operations

For the years ended December 31, 2013 and 2012

	2013 $	2012 $
Investment income		
Interest and other	10,066,296	11,547,744
Expenses		
Management fees (note 5)	2,122,002	2,311,289
Legal fees (note 5)	390,090	14,014
Public company reporting costs	156,126	127,384
Director's fees and expenses	136,510	148,727
Audit, accounting and tax fees	91,087	82,024
Transaction costs	47,875	11,318
Custodial fees	43,688	50,651
Independent Review Committee fees	16,650	12,180
	3,004,028	2,757,587
Net investment income	7,062,268	8,790,157
Realized and unrealized gains (losses) on investments		
Net realized (loss) gain on investments sold (note 6)	(2,572,824)	2,548,818
Net realized (loss) gain on settlement of foreign currency contracts (note 6)	(2,670,520)	2,159,065
Change in unrealized depreciation on investments	(4,300,675)	(2,564,496)
Unrealized depreciation on foreign currency contracts	(63,800)	(296,595)
Net (loss) gain on investments	(9,607,819)	1,846,792
(Decrease) increase in net assets from operations before tax	(2,545,551)	10,636,949
Provision for future income tax (note 7)	(2,210,000)	(2,530,000)
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
(Decrease) increase in net assets from operations per weighted average common share (note 2)	(0.45)	0.77

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

Deans Knight Income Corporation
Statements of Changes in Net Assets
For the years ended December 31, 2013 and 2012

	2013 $	2012 $
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
Dividends paid to common shareholders (notes 4 and 9)	(7,371,869)	(7,371,869)
(Decrease) increase in net assets during the year	(12,127,420)	735,080
Net assets – Beginning of year	142,275,000	141,539,920
Net assets – End of year	130,147,580	142,275,000

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

Deans Knight Income Corporation

Statements of Cash Flows

For the years ended December 31, 2013 and 2012

	2013 $	2012 $
Cash flows from operating activities		
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
Items not affecting cash		
Net realized loss (gain) on investments sold	2,572,824	(2,548,818)
Net realized loss (gain) on settlement of foreign currency contracts	2,670,520	(2,159,065)
Change in unrealized depreciation on investments	4,300,675	2,564,496
Unrealized depreciation on foreign currency contracts	63,800	296,595
Provision for future income tax	2,210,000	2,530,000
	7,062,268	8,790,157
Cost of investments purchased (note 6)	(26,749,307)	(18,898,699)
Proceeds from investments sold (note 6)	70,490,273	31,875,281
Net change in non-cash balances related to operations		
Accrued interest receivable	875,627	677,378
Prepaid expenses	15,090	16,691
Accounts payable and accrued liabilities	160,194	4,471
	51,854,145	22,465,279
Cash flows from financing activities		
Dividends paid to common shareholders (notes 4 and 9)	(7,371,869)	(7,371,869)
Net increase in cash and cash equivalents during the year	44,482,276	15,093,410
Cash and cash equivalents – Beginning of year	20,091,125	4,997,715
Cash and cash equivalents – End of year	64,573,401	20,091,125
Cash and cash equivalents comprise		
Cash	7,665,211	9,110,875
Short-term deposits	56,908,190	10,980,250
	64,573,401	20,091,125

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

Deans Knight Income Corporation

Statement of Investments

As at December 31, 2013

	Par value [1] $	Average cost [2] $	Fair value [2] $	Percentage of total fair value[3] %
Fixed income – Canadian				
Denominated in Canadian dollars				
Athabasca Oil Corp. 7.5% 11-19-2017	3,500,000	3,406,250	3,290,000	5.0
Black Press Group Libor + 5.00% 06-28-2018	1,127,075	1,115,804	1,115,804	1.7
Black Press Group 10% 12-28-2018	1,250,000	1,250,000	1,278,125	2.0
Crew Energy Inc. 8.38% 10-21-2020	1,900,000	1,889,626	1,923,750	2.9
Directcash Payments 8.13% 08-08-2019	3,160,000	3,169,550	3,199,500	4.9
Gateway Casinos 8.50% 11-26-2020	3,900,000	3,900,000	3,861,000	5.9
North American Energy Partners Inc. 9.13% 04-07-2017	3,025,000	3,039,909	3,146,000	4.8
Paramount Resources Ltd. 8.25% 12-13-2017	9,250,000	9,250,000	9,573,750	14.6
Perpetual Energy Inc. 8.75% 03-15-2018	5,000,000	5,000,000	4,812,500	7.4
Petroamerica Oil Corp. 11.50% 04-19-2015 [4]	4,000,000	4,000,000	4,000,000	6.1
Sherritt International Corp. 7.75% 10-15-2015	196,000	152,233	201,880	0.3
Sherritt International Corp. 8.00% 11-15-2018	3,750,000	3,750,000	3,693,750	5.6
Sherritt International Corp. 7.50% 09-24-2020	2,000,000	2,000,000	1,870,000	2.9
Skylink Aviation Inc. 12.25% 05-10-2018	525,800	525,800	320,738	0.5
Western Energy Services Corp. 7.88% 01-30-2019	2,250,000	2,250,000	2,328,750	3.6
		44,699,172	44,615,547	68.2
Denominated in United States dollars				
Mirabela Nickel Ltd. 8.75% 04-15-2018	9,285,000	8,442,717	987,553	1.5
Skylink Aviation Inc. 10.00% 03-08-2015	965,183	982,991	1,026,569	1.6
Tembec Industries 11.25% 12-15-2018	4,250,000	4,494,779	4,961,029	7.6
		13,920,487	6,975,151	10.7
Total Canadian fixed income		58,619,659	51,590,698	78.9
Fixed income – United States				
Denominated in United States dollars				
99 Cents Only Stores 11.00% 12-15-2019	1,850,000	1,926,584	2,233,294	3.4
Calfrac Holdings LP 7.5% 12-01-2020	2,350,000	2,401,045	2,555,699	3.9
Total United States fixed income		4,327,629	4,788,993	7.3
Total fixed income		62,947,288	56,379,691	86.2

[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 represent loans receivable

Deans Knight Income Corporation

Statement of Investments...*continued*

As at December 31, 2013

	Par value [1]	Average cost [2]	Fair value [2]	Percentage of total fair value [3]
	$	**$**	**$**	**%**
Convertible debentures – Canada				
Denominated in Canadian dollars				
Niko Resources Ltd. 7.00% 12-13-2017	2,000,000	2,000,000	1,060,000	1.6
Equities – Canada				
Conifex Timber Inc. - purchase warrants				
$9.33 strike, 12-31-2014	81,726	-	34,195	0.1
Uranerz Energy Corp. - purchase warrants				
$1.60 strike, 12-05-2015	600,000	-	72,434	0.1
Skylink Aviation Inc. - common shares	33,765	-	-	-
Whitecap Resources Inc. - common shares	531,767	3,275,686	6,716,216	10.3
Total equities		3,275,686	6,822,845	10.5
Royalties – Canada				
Denominated in Euro				
RapidEye Canada Royalty		-	1,241,233	1.9
Investments subtotal		68,222,974	65,503,769	100.2
Foreign currency contracts (note 8)				
Denominated in United States dollars				
Payable 17-01-2014 at 1.05870	2,000,000	-	(9,800)	(0.1)
Payable 06-01-2014 at 1.05860	10,800,000	-	(54,000)	(0.1)
Total foreign currency contracts		-	(63,800)	(0.2)
		68,222,974	65,439,969	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 represent loans receivable

1 Nature of operations and basis of presentation 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 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. The Company maintains product liability insurance for certain claims that may arise in the future in connection with its prior business. To date, no such claims or potential claims have arisen. 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 as an investment company.

As per the Company's Articles of Incorporation ("Articles"), the common shares of the Company are to be redeemed on, or around, April 30, 2014, for a cash amount equal to 100% of the net asset value per common share.

On January 27, 2014, the Company called a special meeting of shareholders to be held on April 4, 2014. The meeting is to seek shareholder approval to extend the term of the Company until such time as is reasonably practicable following the conclusion of the CRA Audit or any appeal made to the Tax Court of Canada, or such other date as the Company deems appropriate on not less than 30 days' notice to shareholders. Should its shareholders vote to extend the term of the Company, it has the intent and ability to take actions necessary to continue as a going concern. The Company anticipates obtaining approval for this extension; therefore these financial statements have been prepared on a going concern basis. If the shareholders do not vote to extend the term of the Company, then in accordance with the Articles the Company must be wound up by April 30, 2014. However, the Company may, in its discretion, extend the redemption date by a period of up to 180 days, pursuant to its discretionary power to do so under the Articles, to enable illiquid securities to be converted to cash. Further, the Company would have to settle all outstanding liabilities, including tax assessments, by that date in order to obtain a tax clearance certificate.

The accompanying financial statements are prepared in accordance with Part V of the Chartered Professional Accountants (CPA) Canada 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.

Foreign currency contracts

Foreign currency contracts are recorded at fair value. The proceeds (payments) on contracts settled during the year are included in the net realized loss 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 of investments is recorded in the statements 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.

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 statements 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.

Foreign currency contracts

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 depreciation on foreign currency contracts in the statements 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.

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 that it is not more likely than not that future income tax assets will be realized. Management has estimated the income tax provision and future income tax balances taking into account its expectation of future 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 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.

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 statement of net assets date.

Increase in net assets from operations per weighted average common share

The increase in net assets from operations per weighted average common share represents the increase in net assets from operations divided by the weighted average number of common shares outstanding during the year.

The weighted average number of shares outstanding during the year ended December 31, 2013 was 10,537,263 (2012 - 10,537,263). This weighted average includes both the voting common shares and non-voting common shares of the Company.

Future changes in accounting policies

The Company will transition to International Financial Reporting Standards (IFRS) for its fiscal year beginning January 1, 2014. IFRS comparative financial information will be required in interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2013. As a result, the Company will adopt IFRS commencing January 1, 2014. The Company is assessing the potential impact of adopting IFRS and does not expect the adoption to result in significant measurement differences to current reporting under GAAP.

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 were no changes in the number of voting and non-voting common shares issued or outstanding during the years ended December 31, 2013 and 2012.

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

		2013		2012
	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 years ended December 31, 2013 and 2012, and consists of:

	2013 $	2012 $
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 years ended December 31, 2013 and 2012 are as follows:

	2013 $	2012 $
Retained earnings – opening balance	33,004,067	32,268,987
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
Dividends paid from net investment income	(7,371,869)	(7,371,869)
Retained earnings – closing balance	20,876,647	33,004,067

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, 2013, management fees (including applicable taxes) totalled $2,122,002 (2012 - $2,311,289). At December 31, 2013, $512,138 (2012 - $589,251) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the statements of net assets, and is payable immediately.

A former director of the Company is a partner at a law firm that provides legal services to the Company. During the year ended December 31, 2013, the Company incurred $299,969 (2012 - $14,014) in legal services and disbursements provided by from this law firm. At December 31, 2013, accounts payable and accrued liabilities include $133,884 (2012 - $226) due to the law firm for legal fees and disbursements.

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

The net realized (loss) gain on investments sold and foreign currency contracts for the year ended December 31 was as follows:

	2013 $	2012 $
Proceeds from investments sold	70,490,273	31,875,281
Investments at cost – Beginning of year	117,207,284	125,475,983
Add: Cost of investments purchased	26,749,307	18,898,699
	143,956,591	144,374,682
Less: Investments at cost – End of year	(68,222,974)	(117,207,284)
Cost of investments sold	75,733,617	27,167,398
Net realized (loss) gain on investments sold	(5,243,344)	4,707,883

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

	2013 $	2012 $
Realized (loss) gain on investments sold	(2,572,824)	2,548,818
Realized (loss) gain on settlement of foreign currency contracts	(2,670,520)	2,159,065
	(5,243,344)	4,707,883

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 up to April 30, 2014, being the date common shares are to be redeemed based on the Company's Article of Incorporation.

On January 21, 2014, the Company received a proposal letter ("Proposal Letter") from the Canada Revenue Agency ("CRA"). In it, the CRA stated that it intends to reassess the Company and deny the deduction of certain non-capital losses and other tax attributes in the Company's taxation years ending in 2009 to and including 2012, which are currently the subject of an audit by the CRA (the "CRA Audit"). The CRA has indicated in the Proposal Letter that it intends to deny the use of certain tax attributes by the Company on the basis that an acquisition of control of the Company occurred and on the basis of the General Anti-Avoidance Rule in the Income Tax Act (Canada). The Company, in consultation with its legal advisors, remains of the view that its tax filing position is appropriate, and does not believe any additional assessment of income tax by the CRA is appropriate. There continues to be tax litigation in progress involving the CRA and other companies which may have a bearing on the Company's own tax position with the CRA. The Company will continue to assess its position as such litigation progresses.

The Company has not yet received a notice of reassessment ("Reassessment"), which, if issued by the CRA, will provide the CRA's view of the proposed additional tax, interest and penalties owed by the Company. Based on the information in the Proposal Letter and discussions with the CRA, the Company estimates the potential tax liability to be approximately $21.7 million. This estimate is based on an aggregate reassessment for the 2009 through 2012 taxation years totaling approximately $22.7 million ("Disputed Amount") which is expected to be reduced by the anticipated tax refund for the Company's 2013 taxation year of approximately $1.0 million. The tax refund is based on the Company's results of operations for the 2013 taxation year. Subsequent to December 31, 2013, the Company prepaid the Disputed Amount to the CRA to minimize any further interest from accruing.

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 prior 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 $180,000 (December 31, 2012 - $2,390,000), 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, based on updated projections of taxable income, and adjusted accordingly by a credit or charge to the statements of operations.

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:

	2013 **$**	**2012** **$**
Future income tax assets		
Non-capital loss carry forward	987,800	-
Research and development expenditures	4,715,100	4,533,250
Investment tax credits	5,322,750	5,322,750
Share issuance costs	-	313,440
Total gross future income tax assets	11,025,650	10,169,440
Valuation allowance	(10,845,650)	(7,779,440)
Net future income tax asset	180,000	2,390,000

Future income tax assets expected to be realized in:

	2013	**2012**
	$	**$**
Less than 12 months	180,000	1,930,000
Greater than 12 months	-	460,000
Net future income tax asset	180,000	2,390,000

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, and that investments maturing after April 30, 2014 will be sold at their current value.

As per note 1, a special meeting will be held on April 4, 2014 to obtain shareholder approval to extend the term of the Company. Should that approval be obtained it is anticipated that some of the valuation allowance will be reversed to the extent that the future income tax assets are consistent with the expected term of the Company.

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, 2013, the Company has accumulated scientific research and experimental development expenditures in the amount of $18,135,000 available for carry forward indefinitely. The Company incurred non-capital losses during the year ended December 31, 2013, which will expire in 2033 and amount to $2,545,551. 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 at December 31, using a 25.75 % statutory tax rate (2012 - 25.0%), is as follows:

	2013 $	2012 $
(Decrease) increase in net assets from operations before tax	(2,545,551)	10,636,949
Statutory tax rate	25.75%	25.0%
Income tax (recovery) expense at statutory rates	(655,479)	2,659,238
Use of scientific research and experimental development expenditures	-	(2,345,798)
Non-capital loss carry forward	978,319	-
Reduction of future income tax asset	2,210,000	2,530,000
Current tax deductions for offering costs	(322,840)	(313,440)
Provision for future income tax	2,210,000	2,530,000

8 Financial instruments

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.

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

	Financial assets at fair value – December 31, 2013			
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total $**
Corporate debt	-	50,044,832	6,334,859	56,379,691
Convertible debentures	-	1,060,000	-	1,060,000
Equities	6,716,216	-	106,629	6,822,845
Royalty	-	-	1,241,233	1,241,233
Foreign currency contracts	-	(63,800)	-	(63,800)
	6,716,216	51,041,032	7,682,721	65,439,969

	Financial assets at fair value – December, 31 2012			
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total $**
Corporate debt	-	93,669,383	13,965,857	107,635,240
Convertible debentures	-	2,200,000	-	2,200,000
Equities	8,696,425	-	677,413	9,373,838
Royalty	-	-	1,238,770	1,238,770
Other	-	(1,362,500)	-	(1,362,500)
Foreign currency contracts	-	(296,595)	-	(296,595)
	8,696,425	94,210,288	15,882,040	118,788,753

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

	Fair value measurements of Level 3 inputs				
	Corporate debt $	**Convertible debentures $**	**Equities $**	**Royalty $**	**Total $**
Balance – December 31, 2011	22,965,956	1,554,218	205,444	-	24,725,618
Purchases	4,000,000	-	-	-	4,000,000
Sales	(13,081,762)	(1,558,378)	-	-	(14,640,140)
Unrealized appreciation included in net gain on Investments	81,663	4,160	471,969	1,238,770	1,796,562
Balance – December 31, 2012	13,965,857	-	677,413	1,238,770	15,882,040
Purchases	982,991	-	-	-	982,991
Transfers	2,223,464				2,223,464
Sales	(10,233,152)	-	(510,000)	-	(10,743,152)
Unrealized (depreciation) appreciation included in net gain on investments	(604,301)	-	(60,784)	2,463	(662,622)
Balance – December 31, 2013	6,334,859	-	106,629	1,241,233	7,682,721

The transfers from Level 2 to Level 3 during the year ended December 31, 2013, totalling $2,223,434, relate to corporate debt securities that experienced significant reductions in trading activity during the year. The valuation inputs for these securities were not therefore based on market observable inputs and resulted in the reclassification to Level 3.

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, in the absence of any reasonably possible alternative assumptions, and except as noted below, it is not practicable to provide a sensitivity analysis.

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 December 31, 2013:

	Increase by 5%	Decrease by 5%
Cash flow growth rate	201,735	(192,930)
Discount rate	(175,670)	222,462

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 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. Due to the predominantly fixed income nature of the investment portfolio, the Company has minimal direct price risk. A 10% change in the value of the Company's equity investments (excluding warrants) would have a $671,622 impact on net assets, on an after tax basis.

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	
	2013	**2012**
Credit rating		
BB+	4.4	4.4
BB	-	1.8
BB-	-	0.9
B+	2.8	8.3
B	4.3	6.0
B-	15.2	10.6
CCC+	11.6	30.3
CCC	-	3.1
CCC-	-	2.4
D	0.9	-
Not rated	11.1	15.7
	50.3	83.5

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.

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.

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

	As a % of net assets	
	2013	**2012**
Sector		
Consumer goods	6.5	8.4
Energy	30.3	49.8
Financial services	2.5	-
Forestry	3.8	6.2
Industrial/manufacturing	-	4.3
Materials and metals	5.2	13.7
Services	1.0	0.2
Technology	1.0	0.9
	50.3	83.5

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	
	2013	**2012**
	$	**$**
Maturity		
Less than 1 year	-	-
1 – 3 years	5,228,449	20,543,660
3 – 5 years	38,100,249	46,527,959
Greater than 5 years	14,110,990	42,639,891
	57,439,688	109,711,510

As at December 31, 2013, 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 $2,100,000, or approximately 1.6 % of net assets (2012 - $4,000,000, or approximately 2.8% 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 translation of the underlying investments. The unrealized gains or losses are reflected in unrealized appreciation/depreciation on foreign currency contracts on the statements 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 (2012 - $16,000).

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. During the year ended December 31, 2013, the Company made dividend payments of $7,371,869 (2012 - $7,371,869).

The Company has ceased its monthly dividend payment starting in January 2014. Further, it has begun to liquidate its investment portfolio, with proceeds not being reinvested in new opportunities.

10 Comparison of net asset value per common share and net assets per common 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, 2013 $	December 31, 2012 $
Net asset value per share	12.37	13.58
Canadian GAAP adjustments	(0.02)	(0.08)
Net assets per common share	12.35	13.50