Deans Knight Income Corporation

Interim Financial Statements
June 30, 2014
(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, 2014 financial statements.

Deans Knight Income Corporation

Interim Statements of Financial Position
(Unaudited)

	June 30, 2014 $	December 31, 2013 $	January 1, 2013 $
Assets			
Current Assets			
Investments - at fair value (cost - June 30, 2014 - $2,479,138, December 31, 2013 - $68,222,974, January 1, 2013 – $117,207,284)	3,511,452	65,659,396	119,578,722
Cash and cash equivalents	1,274,500	64,573,401	20,091,125
Accrued interest receivable	54,004	786,745	1,662,373
Prepaid expenses	32,000	41,370	56,460
Prepaid tax asset	22,690,000	-	-
	27,561,956	131,060,912	141,388,680
Non-Current Assets			
Deferred income tax benefits (note 6)	-	180,000	2,390,000
Total Assets	27,561,956	131,240,912	143,778,680
Liabilities			
Current Liabilities			
Accounts payable and accrued liabilities (note 4)	43,739	873,905	713,711
Net assets	27,518,217	130,367,007	143,064,969
Shareholders' equity			
Common shares (note 3)	17,724,189	99,366,429	99,366,429
Contributed surplus (note 3)	9,904,504	9,904,504	9,904,504
(Deficit) Retained earnings	(110,476)	21,096,074	33,794,036
	27,518,217	130,367,007	143,064,969
Number of common shares outstanding (note 3)	10,537,263	10,537,263	10,537,263
Net assets per common share (note 6)	2.61	12.37	13.58

Contingencies (notes 1 and 6)
Commitments (notes 1 and 8)
Going concern (note 1)
Subsequent events (note 6)

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

Deans Knight Income Corporation
Interim Statements of Comprehensive Income
Six-month period ended June 30, 2014 and 2013
(Unaudited)

	2014 $	2013 $
Investment income		
Interest for distribution purposes	985,212	5,404,383
Royalty	189,601	199,531
Net realized loss on investments sold (note 5)	(3,446,354)	(7,052,919)
Net realized loss on foreign currency contracts (note 5)	(450,708)	(1,358,770)
Change in unrealized appreciation on investments (note 5)	3,595,891	5,187,866
Unrealized depreciation on foreign currency contracts (note 5)	-	(1,327,454)
	873,642	1,052,637
Expenses		
Management fees (note 4)	554,701	1,089,013
Public company reporting costs	107,088	98,088
Director's fees and expenses	40,292	79,100
Legal fees (note 4)	31,733	176,101
Transaction costs	28,552	11,187
Audit, accounting and tax fees	21,151	43,355
Custodial fees	14,376	23,798
Independent Review Committee Fees	6,225	6,225
	804,118	1,526,867
Increase (decrease) in net assets from operations before tax	69,524	(474,230)
Provision for deferred income tax (note 6)	(180,000)	(1,130,000)
Decrease in net assets from operations	(110,476)	(1,604,230)
Decrease in net assets from operations per weighted average common share (note 2)	(0.01)	(0.15)

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

Deans Knight Income Corporation

Interim Statements of Changes in Equity

Six-month period ended June 30, 2014 and 2013

(Unaudited)

	Common shares $	Contributed surplus $	Retained earnings (deficit) $	Total shareholders' equity $
At January 1, 2013	99,366,429	9,904,504	33,794,036	143,064,969
Decrease in net assets from operations	-	-	(1,604,230)	(1,604,230)
Dividends paid from net investment income	-	-	(3,685,935)	(3,685,935)
At June 30, 2013	99,366,429	9,904,504	28,503,871	137,774,804

	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
Decrease in net assets from operations	-	-	(110,476)	(110,476)
Return of Capital (note 3)	(81,642,240)	-	(21,096,074)	(102,738,314)
At June 30, 2014	17,724,189	9,904,504	(110,476)	27,518,217

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

Deans Knight Income Corporation

Interim Statements of Cash Flows

Six-month period ended June 30, 2014 and 2013

(Unaudited)

	2014 $	2013 $
Cash flows from operating activities		
Decrease in net assets from operations	(110,476)	(1,604,230)
Items not affecting cash		
Net realized loss on investments sold	3,446,354	7,052,919
Net realized loss on settlement of foreign currency contracts	450,708	1,358,770
Change in unrealized appreciation on investments	(3,595,891)	(5,187,866)
Unrealized depreciation on foreign currency contracts	-	1,327,454
Interest for distribution purposes	(985,212)	(5,404,383)
Royalty	(189,601)	(199,531)
Provision for deferred income tax	180,000	1,130,000
	(804,118)	(1,526,867)
Cost of investments purchased (note 5)	(32,204)	(16,081,596)
Proceeds from investments sold (note 5)	61,878,978	20,273,556
Net change in non-cash balances related to operations		
Interest received	1,655,770	5,438,917
Royalty received	251,783	272,256
Prepaid expenses	9,370	(44,982)
Prepaid tax asset	(22,690,000)	-
Accounts payable and accrued liabilities	(830,166)	38,470
	39,439,413	8,299,751
Cash flows from financing activities		
Return of capital to common shareholders (notes 3 and 8)	(102,738,314)	-
Dividends to common shareholders (note 8)	-	(3,685,935)
	(102,738,314)	(3,685,935)
Net (decrease) increase in cash and cash equivalents during the period	(63,298,901)	4,683,819
Cash and cash equivalents – Beginning of period	64,573,401	20,091,125
Cash and cash equivalents – End of period	1,274,500	24,774,944
Cash and cash equivalents comprise		
Cash	1,274,500	5,817,209
Short-term deposits	-	18,957,735
	1,274,500	24,774,944

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, 2014

(Unaudited)

	Par value[1]	Average cost[2]	Fair value[2]	Percentage of total fair value[3]
	$	$	$	%
Fixed income				
Denominated in Canadian dollars				
Skylink Aviation Inc. 12.25% 05-10-2018	558,005	558,005	351,543	10.0
Denominated in United States dollars				
Mirabela Nickel Ltd. 1.00% 06-30-2044	117,084	124,999	124,999	3.6
Skylink Aviation Inc. 10.00% 03-08-2015 [4]	965,183	982,991	1,030,430	29.4
		1,107,990	1,155,429	33.0
Total fixed income		1,665,995	1,506,972	43.0
Equities – Canada				
Conifex Timber Inc. - purchase warrants $9.33 strike, 12-31-2014	81,726	-	7,730	0.2
Mirabela Nickel Ltd. - common shares	20,231,470	813,143	814,600	23.2
Total equities		813,143	822,330	23.4
Royalties – Canada				
Denominated in Euro				
RapidEye Canada Royalty		-	1,182,150	33.6
Total investments		2,479,138	3,511,452	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

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 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.

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 was achieved, or the Company deems it appropriate to wind up, then the Company would 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. Previously, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles as defined in the Part V of the Chartered Professional Accountant ("CPA") Canada Handbook ("Canadian GAAP"). The comparative information has been restated from Canadian GAAP to comply with IFRS. The Company has consistently applied the accounting policies used in the preparation of its opening IFRS statement of financial position as at January 1, 2013 and throughout all periods presented, as if these policies had always been in effect. Note 11 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the financial statements for the year ended December 31, 2013 prepared under Canadian GAAP.

The policies applied in these financial statements are based on IFRS issued and outstanding as of August 15, 2014, 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, 2014 could result in restatement of these financial statements, including the transition adjustments recognized on transition to IFRS.

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.

(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, such as bankruptcy or termination of the contracts.**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 (note 7) 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.

Warrants
Warrants are recorded at their estimated fair value using a Black Scholes pricing model, which includes the following inputs: the underlying stock price; the warrant's exercise price; the expected term of the warrant; the underlying stock volatility, expected dividend yield and risk-free interest rate.

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.

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 forecasting cash flows using an appropriate discount rate.

Foreign exchange

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate applicable on the valuation date, which is also its functional and presentation currency. 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' 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 (note 6), and the change could be significant.

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.

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 period.

The weighted average number of shares outstanding during the period ended June 30, 2014 was 10,537,263 (2013 - 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, 2014 and 2013. The total shares outstanding at June 30, 2014, December 31, 2013 and January 1, 2013 are summarized as follows:

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

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, 2014 and 2013. The balance at June 30, 2014, December 31, 2013 and January 1, 2013 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	1,874,209
	9,904,504

4 Related party transactions and balances

Deans Knight Capital Management (the "Investment Advisor"), a corporation with common directors and officers of the Company, provides administration, financial reporting and other ancillary services required by a public company. The Investment Advisor is also providing investment management services related to the disposition of the remaining investments held by the Company. The Investment Advisor is paid a nominal fee of $10 per month, starting May 1, 2014, for the services it provides to the Company under the Services Agreement. Prior to that, and for the period from 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, 2014, management fees totaled $554,701 (2013 - $1,089,013). At June 30, 2014, $20 (June 30, 2013 - $536,774) was owed to the Investment Advisor, which was unsecured and included in accounts payable and accrued liabilities in the statements of financial position, and is payable immediately.

A former director of the Company, who was no longer a director in 2014, is a partner at a law firm that provides legal services to the Company. During the six-month period ending June 30, 2013, the Company incurred $175,830 in legal services and disbursements received from this related party, of which $103,000 was owing. This amount was unsecured. At December 31, 2013, all amounts owing had been paid.

5 Net realized loss on investments sold and foreign currency contracts

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

	2014 **$**	**2013** **$**
Proceeds from sale of investments	61,878,978	20,273,556
Investments at cost – Beginning of period	68,222,974	117,207,284
Add: Cost of investments purchased	32,204	16,081,596
	68,255,178	133,288,880
Less: Investments at cost – End of period	(2,479,138)	(104,603,635)
Cost of investments sold	65,776,040	28,685,245
Net realized loss on investments sold	(3,897,062)	(8,411,689)

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

	2014 $	**2013** $
Realized loss on investments sold	(3,446,354)	(7,052,919)
Realized loss on settlement of foreign currency contracts	(450,708)	(1,358,770)
	(3,897,062)	(8,411,689)

6 Taxation

Uncertainty of deductibility of tax losses

Prior to the reorganization and change in business in May 2008 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. 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 profits generated by the Company, thereby reducing its taxes payable.

On July 16, 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 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 "CRA 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. As such, on July 24, 2014, the Company filed Notices of Objection to the NORAs. If the CRA does not reverse its ruling within 90 days from the date the Notices of Objection were filed, the Company intends to appeal to the Tax Court of Canada to defend its tax filing 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. If the CRA's position were to be followed by the Company in future years, the overall tax liability will continue to fluctuate depending on the profitability of the Company. Given the Company's financial results for 2013, the Company estimates it is entitled to a refund of $1.1 million ("2013 Tax Refund") following the CRA's position. As such, the Company estimates its overall potential net tax liability to be approximately $21.6 million, or $2.05 per share ("Potential Tax Liability").

The Company has prepaid the Disputed Amount to the CRA to minimize any further interest from accruing. Should the Company be successful in defending its tax filing position, the Disputed Amount will be refunded with interest. However, if the Company is unsuccessful, the Disputed Amount of $22,690,000, as well as any amounts claimed subsequent to the 2012 taxation year would be recorded as a charge to income.

Deferred tax asset

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.

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:

	Research and development expenses $	Issuance costs $	Total $
At January 1, 2013	2,076,560	313,440	2,390,000
Charged to the income statement	(816,560)	(313,440)	(1,130,000)
At June 30, 2013	1,260,000	-	1,260,000
At January 1, 2014	180,000	-	180,000
Charged to the income statement	(180,000)	-	(180,000)
At June 30, 2014	-	-	-

Future tax assets expected to be realized in:

	June 30, 2014 $	December 31, 2013 $	January 1, 2013 $
Less than 12 months	-	180,000	1,930,000
Greater than 12 months	-	-	460,000
Net future 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 and that investments will be sold at their current value.

Tax pools available to offset future tax expense and payable

The operations of the Company and related tax interpretations, regulations and legislation are continually changing. As a result, significant estimates are required to compute income tax balances. As at June 30, 2014, the Company has accumulated non-capital losses of approximately $2,476,000 and scientific research and experimental development expenditures in the amount of $18,135,000 available to offset future tax expense and payable. The non-capital losses will expire in 2033, whereas the scientific research and experimental development expenditures are available for carry forward indefinitely. In addition, 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 June 30, using a 26.0% statutory tax rate (2013 - 25.75%), is:

	2014 $	2013 $
Increase (decrease) in net assets from operations before	69,524	(474,230)
Statutory tax rate	26.00%	25.75%
Income tax expense (recovery) at statutory rates	18,076	(122,114)
Non-capital loss carry forward	-	122,114
Use of non-capital loss carry forward	(18,076)	-
Reduction of future tax asset	180,000	870,000
Provision for future income tax	180,000	870,000

7 Financial instruments

The following tables present the carrying amounts of the Company's financial instruments by category as at June 30, 2014:

Financial instruments by category	**Amortized cost** $	**Assets/liabilities at FVTPL** $	**Total** $
Assets as per statements of financial position			
Held for trading:			
Warrants	-	7,730	7,730
Designated as FVTPL:			
Investments	-	3,503,722	3,503,722
Cash and accrued interest receivable	1,328,504	-	1,328,504
	1,328,504	3,511,452	4,839,956
Liabilities as per statements of financial position			
Held for trading:			
Accounts payable and accrued liabilities	43,739	-	43,739
	43,739	-	43,739

The following tables present the carrying amounts of the Company's financial instruments by category as at December 31, 2013:

Financial instruments by category	**Amortized cost** $	**Assets/liabilities at FVTPL** $	**Total** $
Assets as per statements of financial position			
Held for trading:			
Warrants	-	106,629	106,629
Designated as FVTPL:			
Investments	-	65,616,567	65,616,567
Cash and accrued interest receivable	65,360,146	-	65,360,146
	65,360,146	65,723,196	131,083,342
Liabilities as per statements of financial position			
Held for trading:			
Foreign currency contracts	-	63,800	63,800
Accounts payable and accrued liabilities	873,905	-	873,905
	873,905	63,800	937,705

The following tables present the carrying amounts of the Company's financial instruments by category as at January 1, 2013:

Financial instruments by category	**Amortized cost** $	**Assets/liabilities at FVTPL** $	**Total** $
Assets as per statements of financial position			
Held for trading:			
Warrants	-	677,413	677,413
Designated as FVTPL:			
Investments	-	119,197,904	119,197,904
Cash and accrued interest receivable	21,753,498	-	21,753,498
	21,753,498	119,875,317	141,628,815
Liabilities as per statements of financial position			
Held for trading:			
Foreign currency contracts	-	296,595	296,595
Accounts payable and accrued liabilities	713,711	-	713,711
	713,711	296,595	1,010,306

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 table illustrates the classification of the Company's assets and liabilities measured at fair value within the fair value hierarchy as at June 30, 2014, December 31, 2013 and January 1, 2013:

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

	Financial assets at fair value – June 30, 2014			
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**	**Total** **$**
Corporate debt	-	-	1,506,972	1,506,972
Equity	814,600	-	7,730	822,330
Royalty	-	-	1,182,150	1,182,150
	814,600	-	2,696,852	3,511,452

	Financial assets at fair value – December 31, 2013			
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**	**Total** **$**
Corporate debt	-	50,264,259	6,334,859	56,599,118
Convertible debentures	-	1,060,000	-	1,060,000
Equity	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	51,260,459	7,682,721	65,659,396

	Financial assets at fair value – January 1, 2013			
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**	**Total** **$**
Corporate debt	-	94,459,352	13,965,857	108,425,209
Convertible debentures	-	2,200,000	-	2,200,000
Equity	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	95,000,257	15,882,040	119,578,722

There were no transfers between Level 1 and Level 2 of the fair value hierarchy.

All fair value measurements above are recurring.

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

	Corporate debt **$**	**Equities** **$**	**Royalty** **$**	**Total** **$**
Balance – January 1, 2013	13,965,857	677,413	1,238,770	15,882,040
Purchases	982,991	-	-	982,991
Sales	(3,000,000)	-	-	(3,000,000)
Realized and unrealized (depreciation) appreciation included in net loss on investments	319,805	(286,794)	74,109	107,120
Balance – June 30, 2013	12,268,653	390,619	1,312,879	13,972,151
Unrealized appreciation (depreciation)	319,805	(286,794)	74,109	107,120
Balance – January 1, 2014	6,334,859	106,629	1,241,233	7,682,721
Settlement	(813,143)	-	-	(813,143)
Sales	(4,000,000)	(264,473)	-	(4,264,473)
Realized and unrealized (depreciation) appreciation included in net loss on investments	(14,744)	165,574	(59,083)	91,747
Balance – June 30, 2014	1,506,972	7,730	1,182,150	2,696,852
Unrealized depreciation	(14,744)	(26,466)	(59,083)	(100,293)

The settlement from Level 3 to Level 1 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. 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 June 30, 2014:

	Increase by 5%	Decrease by 5%
Cash flow growth rate	237,700	(184,100)
Discount rate	(184,800)	275,300

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 investments prior to making an investment and by regular ongoing monitoring of the investment performance of the individual investee companies. A 10% change in the value of the Company's equity investments (excluding warrants) would have an $81,460 impact on profit or loss.

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. 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.

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

	As a % of net assets		
	June 30, 2014	**December 31, 2013**	**January 1, 2013**
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*	12.8	11.1	15.7
	12.8	50.3	83.5

* Unrated debt securities consist primarily of loans receivable.

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		
	June 30, 2014	**December 31, 2013**	**January 1, 2013**
Sector			
Services	5.0	1.0	0.2
Technology	4.3	1.0	0.9
Materials and metals	3.5	5.2	13.7
Consumer goods	-	6.5	8.4
Energy	-	30.3	49.8
Financial services	-	2.5	-
Forestry	-	3.8	6.2
Industrial/manufacturing	-	-	4.3
	12.8	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 interest-bearing investments:

	Fair value		
	June 30, 2014 $	**December 31, 2013 $**	**January 1, 2013 $**
Maturity			
Less than 1 year	1,030,430	-	-
1 – 3 years	-	5,228,449	20,543,660
3 – 5 years	351,543	38,100,249	46,527,959
Greater than 5 years	1,307,150	14,110,990	42,639,891
	2,689,123	57,439,688	109,711,510

As at June 30, 2014, 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 $120,000, or approximately 0.5% of profit or loss (December 31, 2013 - $2,100,000, or approximately 1.6% 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 had a ready market existed.

The Company continually reviews its investment portfolio 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.

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 $157,600 at June 30, 2014 (December 31, 2013 - $160,000).

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. As such, there were no dividend payments in the period ended June 30, 2014 (June 2013 - $3,685,935).

9 Cash and cash equivalents

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

	June 30, 2014	December 31, 2013	January 1, 2013
Cash at bank	1,274,500	7,665,211	9,110,875
Short-term deposits	-	56,908,190	10,980,250
Total	1,274,500	64,573,401	20,091,125

10 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 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.

11 Transition to IFRS

Transition elections

The only voluntary exemption adopted by the Company was the ability to designate a financial asset or liability at fair value through profit or loss upon transition to IFRS. All financial assets designated at fair value through profit or loss upon transition were previously carried at fair value under Canadian GAAP as required by Accounting Guideline 18, *Investment Companies*.

The table below provides a reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS:

Equity	**June 30, 2014**	**December 31, 2013**	**January 1, 2013**
Equity as reported per Canadian GAAP	25,518,217	130,147,580	142,275,000
Revaluation of investments at FVTPL	-	219,427	789,969
Equity per IFRS	25,518,217	130,367,007	143,064,969

Comprehensive income	**June 30, 2014**	**June 30, 2013**
Comprehensive income as reported per Canadian GAAP	(110,476)	(1,379,632)
Revaluation of investments at FVTPL	-	(224,598)
Comprehensive income per IFRS	(110,476)	(1,604,230)

Revaluation of investments at fair value through profit or loss

Under Canadian GAAP, the Company measured the fair value of its investments in accordance with Section 3855, *Financial Instruments – Recognition and Measurement*, which required the use of bid prices for long positions and ask prices for short positions, to the extent such prices were available. Under IFRS, the Company measures the fair values of its investments using the guidance in IFRS 13, *Fair Value Measurement*, which requires that if an asset or a liability has a bid price and an ask price, then its fair value is to be based on a price within the bid-ask spread that is most representative of fair value. It also allows the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread. As a result, upon adoption of IFRS an adjustment was recognized to increase the carrying amount of the Company's investments by $789,969 and $219,427 as at December 31, 2013 and January 1, 2013, respectively. The impact of this adjustment was to increase the Company's increase (decrease) in net assets attributable to shareholders by $570,542 for the year ended December 31, 2013.

Reclassification adjustments

In addition to the adjustments noted above, the Company reclassified certain amounts upon transition in order to conform to its financial statement presentation under IFRS. Under Canadian GAAP, the Company presented investment income on the statement of comprehensive income; under IFRS the Company presents royalty and interest and other income separately. Further, the statement of cash flows under IFRS requires the Company to provide the royalty and interest and other income accrued separately to the royalty and interest and other income received.

12 Future accounting changes

IFRS 9, *Financial Instruments*

The final version of IFRS 9 was issued by the International Accounting Standards Board ("IASB") in July 2014 and will replace IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces a model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially reformed approach to hedge accounting. The new single, principle based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 is effective for annual periods beginning on or after January 1, 2018; however it is available for early adoption. In addition, the own credit changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The Company is in the process of assessing the impact of IFRS 9 and has not yet determined when it will adopt the new standard.