Deans Knight Income Corporation

Interim Financial Statements
June 30, 2013
(Unaudited)

Notice of No Auditor Review of Interim Financial Statements

The accompanying unaudited interim financial statements of the Company have been prepared in accordance with CICA Handbook Section 1751 - *Interim Financial Statements* 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, 2013 financial statements.

Deans Knight Income Corporation

Statements of Net Assets
(Unaudited)

	June 30, 2013 $	December 31, 2012 $
Assets		
Investments - at fair value (cost - June 30, 2013 - $104,603,635; December 31, 2012 - $117,207,284)	110,270,115	118,788,753
Cash and cash equivalents	24,774,944	20,091,125
Accrued interest receivable	1,555,115	1,662,373
Prepaid expenses	101,440	56,460
Future income tax benefits (note 7)	1,260,000	2,390,000
	137,961,614	142,988,711
Liabilities		
Accounts payable and accrued liabilities (note 5)	752,181	713,711
Net assets	137,209,433	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)	27,938,500	33,004,067
	137,209,433	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)	13.02	13.50

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

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

Deans Knight Income Corporation

Statements of Operations

Six-month period ended June 30, 2013 and 2012

(Unaudited)

	2013 $	2012 $
Investment income		
Interest and other	5,603,914	6,050,208
Expenses		
Management fees (note 5)	1,089,013	1,147,216
Legal fees (note 5)	176,101	11,098
Public company reporting costs	98,088	88,938
Director’s fees and expenses	79,100	77,913
Audit, accounting and tax fees	43,355	42,600
Custodial fees	23,798	23,379
Transaction costs	11,187	11,318
Independent Review Committee Fees	6,225	4,500
	1,526,867	1,406,962
Net investment income	4,077,047	4,643,246
Realized and unrealized gains (losses) on investments		
Net realized (loss) gain on investments sold (note 6)	(7,052,919)	953,729
Net realized loss on settlement of foreign currency contracts (note 6)	(1,358,770)	(503,955)
Change in unrealized appreciation (depreciation) on investments	5,412,464	(6,199,089)
Unrealized (depreciation) appreciation on foreign currency contracts	(1,327,454)	887,767
Net loss on investments	(4,326,679)	(4,861,588)
Decrease in net assets from operations before tax	(249,632)	(218,342)
Provision for future income tax (note 7)	(1,130,000)	(870,000)
Decrease in net assets from operations	(1,379,632)	(1,088,342)
Decrease in net assets from operations per weighted average common share (note 2)	(0.13)	(0.10)

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

Deans Knight Income Corporation

Statements of Changes in Net Assets

Six-month period ended June 30, 2013 and 2012

(Unaudited)

	2013 $	2012 $
Decrease in net assets from operations	(1,379,632)	(1,088,342)
Dividends to common shareholders (notes 4 and 9)	(3,685,935)	(3,685,935)
Decrease in net assets during the period	(5,065,567)	(4,774,277)
Net assets – Beginning of period	142,275,000	141,539,920
Net assets – End of period	137,209,433	136,765,643

Deans Knight Income Corporation

Statements of Cash Flows

Six-month period ended June 30, 2013 and 2012

(Unaudited)

	2013 $	2012 $
Cash flows from operating activities		
Decrease in net assets from operations	(1,379,632)	(1,088,342)
Items not affecting cash		
Net realized loss (gain) on investments sold	7,052,919	(953,729)
Net realized loss on settlement of foreign currency contracts	1,358,770	503,955
Change in unrealized (appreciation) depreciation on investments	(5,412,464)	6,199,089
Unrealized depreciation (appreciation) on foreign currency contracts	1,327,454	(877,767)
Future income tax provision	1,130,000	870,000
	4,077,047	4,643,246
Cost of investments purchased (note 6)	(16,081,596)	(13,398,699)
Proceeds from investments sold (note 6)	20,273,556	11,055,277
Net change in non-cash balances related to operations		
Accrued interest receivable	107,259	307,960
Prepaid expenses	(44,982)	(63,768)
Accounts payable and accrued liabilities	38,470	22,962
	8,369,754	2,566,978
Cash flows from financing activities		
Dividends paid to common shareholders (notes 4 and 9)	(3,685,935)	(3,685,935)
Net increase (decrease) in cash and cash equivalents during the period	4,683,819	(1,118,957)
Cash and cash equivalents – Beginning of period	20,091,125	4,997, 715
Cash and cash equivalents – End of period	24,774,944	3,878,758
Cash and cash equivalents comprise		
Cash	5,817,209	3,878,758
Short-term deposits	18,957,735	-
	24,774,944	3,878,758

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

Deans Knight Income Corporation

Statement of Investments

As at June 30, 2013

(Unaudited)

	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	2,500,000	2,442,500	2,387,500	2.2
Black Press Group Libor + 5.00% 06-26-2018	1,250,000	1,237,500	1,250,000	1.1
Black Press Group 10% 12-28-2018	1,250,000	1,250,000	1,237,500	1.1
Cara Operations Ltd. 9.13% 12-01-2015	3,500,000	3,500,000	3,578,750	3.2
Garda World Security 9.75% 03-15-2017	3,250,000	3,237,105	3,396,250	3.1
Gateway Casinos 8.88% 11-15-2017	2,750,000	2,816,875	2,935,625	2.7
North American Energy Partners Inc. 9.13% 04-07-2017	8,750,000	8,793,125	8,925,000	8.1
Paramount Resources Ltd. 8.25% 12-13-2017	9,250,000	9,250,000	9,458,125	8.6
Perpetual Energy Inc. 8.75% 03-15-2018	5,000,000	5,000,000	4,700,000	4.3
Petroamerica Oil Corp. 11.50% 04-19-2015 [4]	4,000,000	4,000,000	4,000,000	3.6
Sherritt International Corp. 7.75% 10-15-2015	196,000	152,233	204,330	0.2
Sherritt International Corp. 8.00% 11-15-2018	3,750,000	3,750,000	3,778,125	3.4
Sherritt International Corp. 7.50% 09-24-2020	2,000,000	2,000,000	1,955,000	1.8
Skylink Aviation Inc. 12.25% 05-10-2018	495,454	495,454	302,227	0.3
Southern Pacific Resources 8.75% 01-25-2018	6,500,000	6,500,000	4,972,500	4.5
Sure Energy Inc. 6.00% 01-21-2014 [4]	2,500,000	2,500,000	2,500,000	2.3
Western Energy Services Corp. 7.88% 01-30-2019	2,250,000	2,250,000	2,261,250	2.1
		59,174,792	57,842,182	52.6
Denominated in United States dollars				
CCS Inc. 11.00% 11-15-2015	4,500,000	2,252,568	4,754,052	4.3
Mirabela Nickel Ltd. 8.75% 04-15-2018	10,050,000	9,138,320	8,029,066	7.3
Pacific Rubiales Energy Corp. 7.25% 12-12-2021	2,300,000	2,365,780	2,550,737	2.3
Skylink Aviation Inc. 10.00% 03-08-2015 [4]	965,183	982,991	1,014,600	0.9
Tembec Industries 11.25% 12-15-2018	4,250,000	4,494,779	4,780,332	4.3
		19,234,438	21,128,787	19.1
Total Canadian fixed income		78,409,230	78,970,969	71.7
Fixed income – United States				
Denominated in United States dollars				
99 Cents Only Stores 11.00% 12-15-2019	1,850,000	1,926,584	2,158,639	2.0
Beazer Homes USA, Inc. 9.13% 06-15-2018	3,250,000	3,327,056	3,570,138	3.2
Calfrac Holdings LP 7.5% 12-01-2020	6,000,000	6,130,329	6,244,128	5.7
Stone Energy Corp. 8.63% 02-01-2017	4,250,000	4,284,796	4,668,642	4.2
Uranerz Energy Corp. 6.00% 08-31-2013 [4]	2,250,000	2,303,550	2,365,200	2.1
Total United States fixed income		17,972,315	19,006,747	17.2
Total fixed income		96,381,545	97,977,716	88.9

[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

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

Deans Knight Income Corporation

Statement of Investments...*continued*

As at June 30, 2013

(Unaudited)

	Par value [1] $	Average cost [2] $	Fair value [2] $	Percentage of total fair value [3] %
Convertible debentures - Canada				
Denominated in Canadian dollars				
Just Energy Group 6.00% 06-30-2017	1,850,000	1,483,405	1,402,115	1.3
Niko Resources Ltd. 7.00% 12-13-2017	2,000,000	2,000,000	2,160,000	2.0
Total convertible debentures		3,483,405	3,562,115	3.3
Equities – Canada				
Conifex Timber Inc. - purchase warrants $9.33 strike, 12-31-2014	81,726	-	17,759	0.0
Petroamerica Oil Corp. - purchase warrants $0.20 strike, 04-19-2015	400	-	317,846	0.3
Sure Energy Inc. - purchase warrants $1.80 strike, 12-21-2013	625,000	-	-	0.0
Uranerz Energy Corp. - purchase warrants $1.60 strike, 12-05-2015	600,000	-	55,014	0.0
Skylink Aviation Inc. - common shares	33,765	-	-	-
Whitecap Resources Inc. - common shares	769,267	4,738,685	8,354,240	7.6
Total equities		4,738,685	8,744,859	7.9
Royalties – Canada				
Denominated in Euro				
RapidEye Canada Royalty		-	1,312,879	1.1
Investments subtotal		104,603,635	111,597,569	101.2
Foreign Currency Contracts (note 8)				
Denominated in United States dollars				
Payable 07-18-2013 at 1.01785	3,000,000		(102,922)	(0.1)
Payable 07-18-2013 at 1.01865	18,000,000	-	(603,736)	(0.5)
Payable 08-13-2013 at 1.02175	20,000,000	-	(620,796)	(0.6)
Total foreign currency contracts		-	(1,327,454)	(1.2)
		104,603,635	110,270,115	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

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

1 Nature of operations and basis of presentation

Deans Knight Income Corporation (the "Company") is a corporation continued under the laws of Canada on April 11, 2001. The Company is a closed-end, non-redeemable investment company. It invests, primarily, in corporate debt rated BBB or below by recognized credit rating organizations.

Prior to its reorganization in May 2008, the Company was a life sciences company involved in the research, development and commercialization of innovative products for the prevention and treatment of life-threatening diseases. 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, 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.

The accompanying interim financial statements are prepared in accordance with Part V of the Canadian Institute of Chartered Accountants Handbook, Pre-changeover Accounting Standards (GAAP). All amounts are presented in Canadian dollars, unless otherwise noted.

2 Summary of significant accounting policies

The following is a summary of significant accounting policies followed by the Company, and these policies are consistent with the most recent annual financial statements. These statements should be read in conjunction with the most recent annual financial statements.

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 gain (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 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 statement of operations.

Cash and cash equivalents

Cash and cash equivalents are accounted for at amortized cost. They consist of cash and deposits with maturities, at the time of purchase, of three months or less and are held with a Canadian chartered bank.

Accrued interest receivable

Accrued interest is designated as loans and receivables and is accounted for at amortized cost. Due to the immediate and short-term nature, carrying value approximates fair value.

Financial liabilities

Financial liabilities, consisting of accounts payable and accrued liabilities, are designated as other financial liabilities and are accounted for at amortized cost. Due to the immediate and short-term nature, the carrying value approximates fair value.

Investment transactions

Investment transactions are recorded on the trade date. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment, which include fees and commissions paid to agents, advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. These costs are expensed and are included in the statement of operations.

Income recognition

Income from investments is recognized on an accrual basis. Interest income is accrued based on the number of days the investment is held during the year. Royalty income is recognized on an accrual basis as earned. Gains or losses on the sale of investments, including foreign exchange gain or loss on such investments, are calculated on an average cost basis.

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 appreciation/depreciation on foreign currency contracts in the statement of operations.

Foreign exchange

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

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

Increase in net assets from operations per weighted average common share

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

The weighted average number of shares outstanding during the six-month period ended June 30, 2013 was 10,537,263 (June 30, 2012 - 10,537,263). This weighted average includes both the voting common shares and non-voting common shares of the Company.

3 Capital stock

The Company is authorized to issue an unlimited number of voting common shares without par value, and an unlimited number of non-voting common shares without par value.

There were no changes in the number of voting and non-voting common shares during the period ended June 30, 2013.

The total shares outstanding are summarized as follows:

	June 30, 2013		**December 31, 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

Contributed surplus balance did not change during the six-month period, and consists of:

	June 30, 2013 $	December 31, 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 six-month period ended June 30 were as follows:

	2013 $	2012 $
Retained earnings – opening balance	33,004,067	32,268,987
Decrease in net assets from operations	(1,379,632)	(1,088,342)
Dividends paid from net investment income	(3,685,935)	(3,685,935)
Retained earnings – closing balance	27,938,500	27,494,710

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 six-month period ended June 30, 2013, management fees (including applicable taxes) totalled $1,089,013 (June 30, 2012- $1,147,216). At June 30, 2013, $536,774 (December 31, 2012 - $589,251) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the statement 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 six-month period ended June 30, 2013, the Company incurred $175,830 (June 30, 2012 - $11,098) in legal services and disbursements received from this related party. At June 30, 2013, accounts payable and accrued liabilities include $103,000 (December 31, 2012 - $226) due to the law firm for legal fees and disbursements.

6 Net realized gains on investments sold and foreign currency contracts

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

	2013 $	2012 $
Proceeds from sale of investments	20,273,556	11,055,277
Investments at cost – Beginning of year	117,207,284	125,475,983
Add: Cost of investments purchased	16,081,596	13,398,699
	133,288,880	138,874,682
Less: Investments at cost – End of year	(104,603,635)	(128,269,140)
Cost of investments sold	28,685,245	10,605,542
Net realized (loss) gain on investments sold	(8,411,689)	449,734

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

	2013 $	2012 $
Realized (loss) gain on investments sold	(7,052,919)	953,729
Realized loss on settlement of foreign currency contracts	(1,358,770)	(503,995)
	(8,411,689)	449,734

7 Taxation

Uncertainty of deductibility of tax losses

Prior to the reorganization and change in business as discussed in note 1, the Company had generated significant tax losses and other tax attributes as a result of its prior businesses and research activities. The Company has recorded, as a tax asset, the full amount of the potential tax benefit of such items to the extent of its projected taxable income. There is no guarantee that the tax authorities will allow the Company to deduct some, or all, of the tax losses and other attributes.

In May 2013, the Company received and responded to a letter from the Canada Revenue Agency (CRA), advising the Company that it is under audit for the taxation years 2008 to 2012, being those that end after the recapitalization and reorganization of the Company. The Company believes the audit is a normal course audit and has provided the CRA with the information requested. The CRA has asserted no opinion on the Company's use of its tax attributes in the years under audit. After consultation with legal counsel, the Company remains of the view that such tax attributes were eligible for use by the Company.

Should the Company be denied the deductions, the recognized amount of the tax assets, as well as such amounts claimed to date, would be recorded as a charge to income. The total tax assets recognized and tax losses and other attributes claimed to date, which are subject to uncertainty, amount to $19,960,000 (December 31, 2012 - $21,154,044), representing $1.89 per common share at June 30, 2013 (December 31, 2012 - $2.01 per common share).

Future tax asset

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

As the Company's investments in debt securities are generating interest income, but are not expected to generate sufficient taxable income in order to fully utilize the available tax credits during the years of operations through to April 30, 2014, the Company has recorded a valuation allowance. The difference between the total value of these tax benefits less the valuation allowance, being $1,260,000 (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 statement 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:

	June 30, 2013 $	**December 31, 2012 $**
Future tax assets		
Non-capital loss carry forward	62,400	-
Research and development expenditures	4,533,250	4,533,250
Investment tax credits	5,322,750	5,322,750
Share issuance costs	313,440	313,440
Total gross future tax assets	10,231,840	10,169,440
Valuation allowance	(8,971,840)	(7,779,440)
Net future tax asset	1,260,000	2,390,000

Future tax assets expected to be realized in:

	2013 $	2012 $
Less than 12 months	1,260,000	1,930,000
Greater than 12 months	-	460,000
Net future tax asset	1,260,000	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.

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, 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 in the six-months ended June 30, 2013, which will expire in 2033 and amount to $250,000. The Company also has accumulated approximately $7,097,000 of unclaimed federal investment tax credits, which expire as follows:

Year of expiry	**Investment tax credits** **$**
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 25.75% statutory tax rate (2012 - 25.0%), is:

	2013 $	2012 $
(Decrease) in net assets from operations before tax	(249,632)	(218,342)
Statutory tax rate	25.75%	25%
Income tax expense at statutory rates	(64,280)	(54,600)
Non-capital loss carry forward	64,280	54,600
Reduction of future tax asset	1,130,000	870,000
Provision for future income tax	1,130,000	870,000

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 – June 30, 2013			
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total $**
Corporate debt	-	85,709,064	12,268,652	97,977,716
Convertible debentures	-	3,562,115	-	3,562,115
Equity	8,354,240	-	390,619	8,744,859
Royalty	-	-	1,312,879	1,312,879
Foreign currency contracts	-	(1,327,454)	-	(1,327,454)
	8,354,240	87,943,724	13,972,151	110,270,115

	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
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	94,210,288	15,882,040	118,788,753

All investments remained at their respective levels within the fair value hierarchy during the six-month period.

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
Sales	(3,000,000)	-	-	-	(3,000,000)
Unrealized appreciation (depreciation) included in net gain on investments	319,805	-	(286,794)	74,109	107,110
Balance – June 30, 2013	12,268,653	-	390,619	1,312,879	13,972,151

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 certain Level 3 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, 2013:

	Increase by 5%	Decrease by 5%
Cash flow growth rate	237,100	(146,700)
Discount rate	(179,800)	374,000

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 an $835,424 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	
	June 30, 2013	**December 31, 2012**
Credit rating		
BB+	4.3	4.4
BB	1.9	1.8
BB-	-	0.9
B+	4.6	8.3
B	14.2	6.0
B-	11.2	10.6
CCC+	20.8	30.3
CCC	6.1	3.1
CCC-	-	2.4
Not rated*	17.3	15.7
	80.4	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 & 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, 2013	**December 31, 2012**
Sector		
Consumer goods	11.8	8.4
Energy	50.5	49.8
Forestry	3.5	6.2
Industrial/manufacturing	-	4.3
Materials and metals	10.2	13.7
Services	3.4	0.2
Technology	1.0	0.9
	80.4	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	
	June 30, 2013 $	**December 31, 2012 $**
Maturity		
Less than 1 year	4,865,200	-
1 – 3 years	13,551,732	20,543,660
3 – 5 years	58,157,188	46,527,959
Greater than 5 years	26,278,590	42,639,891
	102,852,710	109,711,510

As at June 30, 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 approximately $3,600,000, or approximately 2.6% of net assets (December 31, 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 statement of operations. The potential impact to net assets of a 5% change in foreign currency rates against the Canadian dollar, assuming all other variables remain constant, would be $132,000 (December 31, 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, or $614,322. During the six month period ended June 30, 2013, the Company made dividend payments of $3,685,935 (June 30, 2012 - $3,685,935).

The Company is committed to continue paying a monthly dividend of $0.0583 per voting and non-voting common share for the three months ending September 30, 2013, totalling $1,842,966 (note 11).

10 Comparison of net asset value per share and net assets per share

In accordance with Section 3.6(1) of National Instrument 81-106, the Company's net asset value per share, the net assets per share calculated in accordance with Canadian GAAP for financial reporting purposes, and an explanation of the differences between such amounts, are required disclosures in the notes to the financial statements. For investments that are traded in an active market, Canadian GAAP requires that bid prices be used in the fair value of instruments, rather than the use of the last traded price, as currently used for the purpose of determining net asset value. This change accounts for the difference between the net asset value and the net assets.

	June 30, 2013 **$**	**December 31, 2012** **$**
Net asset value per share	13.08	13.58
Canadian GAAP adjustments	(0.06)	(0.08)
Net assets per share	13.02	13.50

11 Subsequent events

On July 4, 2013, the Company announced a monthly dividend of $614,322, or $0.0583 per common share, payable on each of July 31, 2013, August 30, 2013 and September 30, 2013.