DEANS KNIGHT
INCOME CORPORATION

ANNUAL MANAGEMENT REPORT
OF FUND PERFORMANCE FOR 2013

This annual management report of fund performance (the "**Report**") contains financial highlights of Deans Knight Income Corporation (the "**Company**"). This Report should be read in conjunction with the annual financial statements of the Company for the year ended December 31, 2013 (the "**Financial Statements**"), which, if not included with this Report, can be obtained at your request, at no cost by emailing info@dkincomecorp.com, visiting our website at www.dkincomecorp.com for contact details or on SEDAR at www.sedar.com. Readers may also contact us to request a free copy of the Company's proxy voting policies and procedures, proxy voting disclosure record or quarterly portfolio disclosure.

A NOTE ON FORWARD-LOOKING STATEMENTS

This Report contains certain forward-looking statements. In particular, this Report contains forward-looking statements in respect of the Company's investment strategy, behaviour of financial markets and reflects the Company's expectations regarding the growth, results of operations, performance and business prospects and opportunities of the Company and its investments, the Company's plans in respect of the meeting of shareholders to be held on April 4, 2014, payment of a special cash distribution in April 2014 and amendments to the Company's Articles of Incorporation and the Company's plans in the event that shareholders do not approve certain matters set forth for approval by the shareholders. In some cases, forward-looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. Such forward-looking statements reflect the Company's current beliefs and are based on information currently available to the Company. With respect to such forward-looking statements, the Company has made assumptions regarding, among other things, what type of debt securities will be included in its investment portfolio, currency, exchange and interest rates. A number of factors could cause actual events or results to differ materially from the results discussed in the forward-looking statements. In evaluating these statements, prospective investors should specifically consider various factors, including global equity and capital markets, business competition, technological change, changes in government regulations, unexpected judicial or regulatory proceedings, and catastrophic events and the risks outlined under "Risk Factors" in the AIF (as defined herein), which may cause actual results to differ materially from any forward-looking statement. Although the forward-looking statements contained in this Report are based upon what the Company believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. Forward-looking statements are made as of the date of this Report and, other than as required by applicable law, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

This Report also contains certain financial and operational information obtained from public sources in respect of certain companies included in the Company's investment portfolio. While management believes this data to be reliable, such information is subject to variations and may not be able to be verified due to limits on the availability and reliability of data inputs, the nature of the data gathering process and other limitations and uncertainties inherent in such information. Accordingly, the accuracy, currency and completeness of this information cannot be guaranteed. The Company has not independently verified any of the data from third party sources referred to in this Report or ascertained the underlying assumptions relied upon by such sources.

Investment Objectives and Strategies

The Company is a closed-end, non-redeemable investment company focused on investing in corporate debt securities. The Company's assets are actively managed by Deans Knight Capital Management Ltd. ("**Deans Knight**"), a respected British Columbia-based investment firm focused on managing high income and growth mandates for high net worth individuals. Deans Knight, formed in 1992, has an experienced management team and a long history of successful investing in corporate debt securities.

The Company's current investment objectives are to: (i) maximize the total return for shareholders, consisting of dividend income and capital appreciation; and (ii) provide shareholders with monthly dividends, which up to December 31, 2013 had been set at $0.0583 per common share per month. Historically, the Company has looked to achieve these objectives by investing primarily in corporate debt securities rated BBB or below by Standard & Poor's Rating Services ("**S&P**") or an equivalent rating by another nationally recognized statistical rating organization. The Company also invested in investment grade debt securities rated above BBB and non-rated debt securities from time to time.

The Company's Articles of Incorporation currently require the common shares of the Company are to be redeemed on April 30, 2014. Because of this fixed redemption date, the Company ceased paying a monthly dividend starting in January 2014 and began to liquidate its portfolio. Further, it has called a meeting of shareholders to be held on April 4, 2014 to consider various resolutions. See "Risk" and "Results of Operations" below.

Risk

The overall risks of the Company are as described in its annual information form of the Company dated March 6, 2014 (the "**AIF**").

Prior to the reorganization and change in business as discussed in note 1 of the Financial Statements, the Company had generated significant tax losses and other tax attributes as a result of its prior businesses and research activities. The Company has recorded, as a tax asset, the full amount of the potential tax benefit of such items to the extent of its projected taxable income up to April 30, 2014, being the date common shares are to be redeemed based on the Company's Article of Incorporation ("Articles").

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

The Company has not yet received a notice of reassessment ("Reassessment"), which, if issued by the CRA, will provide the CRA's view of the proposed additional tax, interest and penalties owed by the Company. Based on the information in the Proposal Letter and discussions with the CRA, the Company estimates the potential tax liability to be approximately $21.7 million, or $2.06 per common share. This estimate is based on an aggregate reassessment for the 2009 through 2012 taxation years totaling approximately $22.7 million ("Disputed Amount") which is expected to be reduced by the anticipated tax refund for the Company's 2013 taxation year of approximately $1.0 million. The tax refund is based on the Company's results of operations for the 2013 taxation year. Subsequent to December 31, 2013, the Company prepaid the Disputed Amount to the CRA to minimize any further interest from accruing.

As per the Company's current Articles of Incorporation, the common shares of the Company are to be redeemed on, or around, April 30, 2014. As a result, the Company has begun to liquidate its investment portfolio. Given the liquidation of investments, distribution and the Disputed Amount discussed above, an investment in the Company may be considered to be speculative. An investment in the Company is generally suitable for investors looking for capital appreciation.

Results of Operations

The net assets of the Company at December 31, 2013 were $130,147,580 or $12.35 per common share (December 31, 2012 - $142,275,000 or $13.50 per common share). The net assets of the Company consisted of the following components:

	December 31, 2013		
	$	**Per common share[(1)]**	**%**
Investments[(2)]	65,439,969	6.21	50.3
Cash and short-term deposits	64,573,401	6.13	49.6
Accrued income	786,745	0.07	0.6
Prepaid expenses	41,370	0.00	0.0
Future income tax asset[(3)]	180,000	0.02	0.2
Accounts payable and accrued liabilities	(873,905)	(0.08)	(0.7)
	130,147,580	12.35	100.0

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

	December 31, 2012		
	$	Per common share(1)	%
Investments	118,788,753	11.27	83.5
Cash and short-term deposits	20,091,125	1.91	14.1
Accrued income	1,662,373	0.16	1.2
Prepaid expenses	56,460	0.00	0.0
Future income tax asset(2)	2,390,000	0.23	1.7
Accounts payable and accrued liabilities	(713,711)	(0.07)	(0.5)
	142,275,000	13.50	100.0

(1) Based on 10,537,263 common shares, including 10,191,592 voting common shares and 345,671 non-voting common shares, as outlined in the notes to the Financial Statements.
(2) Refer to the Taxation note to the Financial Statements for more detail.

The Company began operating as an Investment Company in March 2009 to take advantage of attractive pricing in the high yield bond market with the objectives of: (i) maximizing the total return for Shareholders, consisting of dividend income and capital appreciation; and (ii) providing Shareholders with monthly dividends targeted to payout a minimum of 75% of net earnings annually. During 2013, the Company made monthly dividend payments totaling $7,371,869, or $0.70 per common share (2012 - $7,371,869, or $0.70 per common share). This represented approximately 104.4% of net investment income (2012 – 83.9%).

Since commencement of its investment business, the Company has made monthly dividend payments totaling $33,787,733, or $3.21 per common share. This represents approximately 92.4 % of net investment income earned since March 17, 2009. In December 2013, the Company announced it would cease paying its regular monthly dividend payment starting in January 2014, as part of the Company's plans to pay a cash distribution to shareholders.

The net assets of the Company decreased during the year ended December 31, 2013 to $12.35 from $13.50 at December 31, 2012. The decrease is predominantly attributed to events that lowered prices of two of our holdings during the year: Northland Resource AB and Mirabela Nickel Ltd., along with the $0.21 per common share decrease in the future income tax asset.

Northland is a producer of a high grade iron ore concentrate from their Kaunisvaara project in Northern Sweden. In January 2013, Northland announced a funding shortfall at its Kaunisvaara mine and the immediate need to raise approximately $400 million in additional capital. The unanticipated cost overruns destroyed confidence in management and fundraising efforts failed, as a result, Northland began the process of restructuring. The Company sold the position in April 2013, realizing $30 per $100 par value on the investment.

Mirabela produces nickel from a sulphide deposit in Brazil, with the capability to produce 20,000 tonnes of nickel per annum. Mirabela also has a first-class processing plant. It had cash of $108 million USD on the balance sheet at June 30th; however, with low nickel prices, was producing negative cash flow after administrative and debt servicing costs. In late

September, Mirabela provided a disappointing operational update outlining higher cash costs in July and August resulting in a reduction of cash on hand to $80 million USD. In addition, Mirabela received notification from one of its two customers, Votorantim Metals, of its intention to terminate their offtake agreement at the end of November. Subsequent to December 31, 2013, Mirabela established a framework for a proposed recapitalization of the Company, whereby Mirabela will raise $115 million USD from existing bondholders. The investment was priced at $10 per $100 par value at December 31, 2013.

At December 31, 2013, the Company had a large cash and cash equivalents balance. The increase in the cash balance is the result of certain bond positions held in its investment portfolio being called by the issuers and the Company selling investments in anticipation of the pending distribution in April 2014. Since December 31, 2013, the Company has continued to liquidate the portfolio, and at February 28, 2014 the cash and cash equivalents totaled $88.7 million, not including the $22.7 million prepaid tax asset.

Net investment income for the year ended December 31, 2013 was $7,062,268 compared to $8,790,157 for the year ended December 31, 2012. The rising cash position and related smaller investment portfolio throughout fiscal 2013 are the primary drivers to the decrease in the Company’s net investment income.

Recent Developments

Cash Distribution and Extension of Termination Date

On January 27, 2014, the Company called a special meeting of shareholders to be held on April 4, 2014. At the meeting, the Company intends to seek the approval of shareholders to reduce the stated capital of the voting common shares thereby permitting the Company to make a special cash distribution ("Cash Distribution") to shareholders of the Company as a return of capital (the "Capital Reduction Resolution"). Additionally, the Company intends to seek the approval of shareholders to (i) extend the term of the Company from April 30, 2014 until such time as is reasonably practicable following the conclusion of the CRA Audit or any appeal made to the Tax Court of Canada, or such other date as the Corporation deems appropriate on not less than 30 days' notice to shareholders; and (ii) remove the remove the restrictions on the business that the Corporation may carry on, which currently restrict the Corporation to carrying on investment activities in accordance with its investment objectives (collectively, the "Article Amendment Resolution"). The Company anticipates mailing an information circular in respect of the special meeting of shareholders in mid-March 2014.

In the event that shareholders approve the foregoing matters, it is the intention of the Company to pay the Cash Distribution and take actions necessary to continue as a going concern. If shareholders do not approve the Capital Reduction Resolution, the Company may: (i) pay the Cash Distribution as a dividend, which may be less tax efficient for certain shareholders or the Company; (ii) book the Disputed Amount as a liability of the Company and wind-up the Corporation in accordance with the terms of the current Articles; or (iii) delay payment of the Cash Distribution to the amended termination date of the Company provided the Article Amendment Resolution is approved or the termination date of the Company is otherwise extended.

If shareholders do not approve the Article Amendment Resolution, the Company may extend the termination date of the Company by 180 days pursuant to its discretionary power to do so under the Articles without shareholder approval or apply to a Court of competent jurisdiction for an order to extend the termination date of the Company.

Comparison of net asset value and net assets

National Instrument 81-106 (“NI 81-106”) permits investment companies to have two different net asset values: (i) one for financial statements, which will be prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”) including Section 3855 (and referred to as “net assets”) and (ii) another for all other purposes, including unit pricing for investor transactions (referred to as “net asset value”). The main difference in calculating net assets and net asset value is that GAAP requires bid price to be used in valuing securities traded in an active market where quoted prices are readily and regularly available, rather than the use of a price between the bid and the ask price currently used for determining net asset value. This difference results in an insignificant difference of approximately $0.02 per common share at December 31, 2013 (December 31, 2012 - $0.08 per common share), as outlined in the notes to the Financial Statements.

International Financial Reporting Standards

Investment companies will be required to adopt international financial reporting standards ("IFRS"). The Canadian Accounting Standards Board (AcSB) previously announced January 1, 2011 as the date international financial reporting standards (IFRS) would replace current Canadian standards and interpretations as GAAP for publicly accountable enterprises, which include investment companies.

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

Under the above noted decision, the Company’s first set of financial statements to be reported on under IFRS would be for the semi-annual period ending June 30, 2014. These statements would include corresponding comparative financial information for 2013, including an opening statement of net assets as at January 1, 2013. However, the Company currently has a termination date of April 30, 2014, and as such will not be required to issue statements reported on under IFRS. If shareholders approve an extension to the April 30, 2014 termination date at the special meeting of shareholders to be held on April 4, 2014, the Company will adopt IFRS commencing January 1, 2014. The Company does not expect the adoption to result in significant measurement differences to current reporting under GAAP, though it will continue to assess the potential impact when the extension is approved.

Related Party Transactions

The officers, and certain directors, of the Company are also employees of Deans Knight, the Company's investment advisor. These officers, and directors, are not paid by the Company. Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees, for the services outlined above, are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, and adjusted for certain non-investment related assets.

For the year ended December 31, 2013, management fees (including applicable taxes) totaled $2,122,002 (2012 - $2,311,289). At December 31, 2013, $512,138 (2012 - $589,251) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the 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 year ended December 31, 2013, the Company incurred $299,969 (2012 - $14,014) in legal services and disbursements provided by from this law firm. At December 31, 2013, accounts payable and accrued liabilities include $133,884 (2012 - $226) due to the law firm for legal fees and disbursements.

Financial Highlights

The following tables show selected key financial information about the Company and are intended to help you understand the Company's financial performance since it began operating its new business of investing in corporate debt in March 2009.

The Company's Net Assets per Common Share [1]

	2013 $	2012 $	2011 $	2010 $	Period March 17 to December 31, 2009 $
Net assets, beginning of year [2]	13.50	13.43	13.60	12.21	9.12
Increase from operations					
Total revenue	0.96	1.10	1.10	0.94	0.62
Total expenses	(0.29)	(0.26)	(0.26)	(0.24)	(0.20)
Realized (losses) gains	(0.50)	0.44	0.36	1.82	1.25
Unrealized (losses) gains	(0.41)	(0.27)	(0.52)	(0.27)	1.21
Future income taxes	(0.21)	(0.24)	(0.15)	(0.16)	0.62
Total (decrease) increase from operations [2]	(0.45)	0.77	0.53	2.09	3.50
Dividends [2][3]	(0.70)	(0.70)	(0.70)	(0.70)	(0.41)
Net assets, end of year [4]	12.35	13.50	13.43	13.60	12.21

(1) The information is derived from the Company's audited annual financial statements. Common shares outstanding are 10,537,263, including 10,191,592 voting common shares and 345,671 non-voting common shares.
(2) Net assets, beginning of the period for 2009 reflect the net assets in the Company at March 17, 2009, after giving effect to the conversion of the convertible debenture and interest owing thereon and the issuance of common shares on the Company's initial public offering less total share issue expenses.
(3) Net assets and dividends are based on the actual number of shares outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of shares outstanding over the period.
(4) Dividends were paid in cash.
(5) The net assets per share presented in the financial statements differs from the net asset value per share calculated for pricing purposes due to the provisions of CICA Handbook Section 3855. An explanation of the differences can be found in the notes to the financial statements.

Ratios and Supplemental Data [1]

	2013	2012	2011	2010	Period March 17 to December 31, 2009
Net asset value (000's)	$130,367	$143,065	$142,178	$143,880	$128,930
Number of common shares outstanding (000's)	10,537	10,537	10,537	10,537	10,537
Management expense ratio [2]	2.21%	1.96%	1.90%	1.91%	5.51%
Portfolio turnover rate [3]	25.23%	14.79%	79.90%	86.60%	36.69%
Trading expense ratio [4]	0.03%	0.01%	0.00%	0.01%	0.01%
Net asset value per common share	$12.37	$13.58	$13.49	$13.65	$12.23
Closing market price – common share	$10.01	$12.69	$11.84	$12.54	$11.40

(1) This information is provided as at December 31 of the years shown.
(2) Management expense ratio is based on total expenses for the period and is expressed as a percentage of weekly average net asset values over the year.
(3) The Company's portfolio turnover rate indicates how actively the Company manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Company buying and selling all of the securities in its portfolio once in the course of the year. The higher a portfolio turnover-rate in a year, the greater the trading costs payable by the Company in the year. There is not necessarily a relationship between a high turnover rate and the performance of the investment portfolio.
(4) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period. This expense is $47,875 for 2013 (2012- $11,318), as the purchasing and selling of bonds do not generally attract a commission from the buying or selling party.

Management Fees

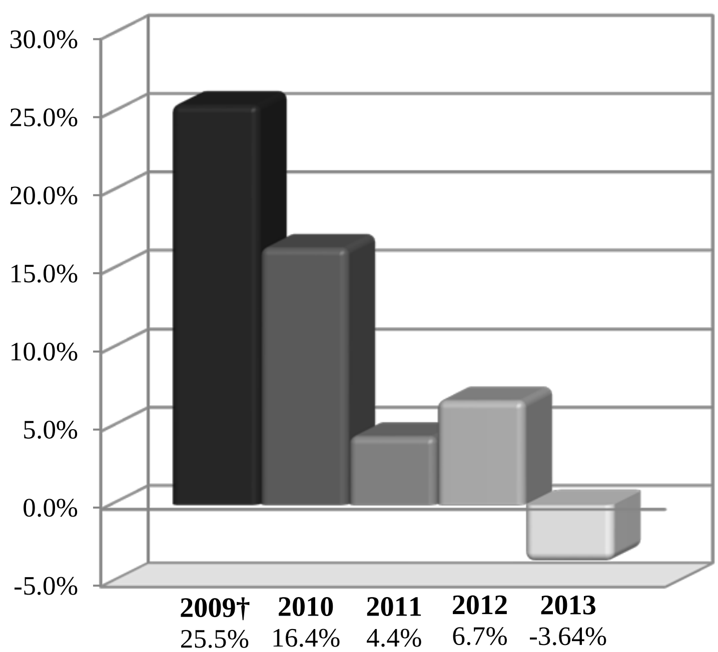
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, and adjusted for certain non-investment related assets.

Past Performance

This section shows the Company's past performance, since it began operating its business as an investment fund. The past performance information includes changes in net asset value and assumes the reinvestment of all dividends paid to common shareholders. It is important to note that the past performance will not necessarily indicate what performance in the future will be.

Year-by-year Returns

The accompanying bar chart shows the Company's performance for the years shown and illustrates how the Company's performance has changed from year to year. The bar chart shows, in percentage terms, how much an investment made from when the Company began its operation as an investment fund on March 17, 2009 to December 31, 2009, and how much an investment made for the years ending December 31, 2010, 2011, 2012 and 2013.



† March 17, 2009 (Inception) to Dec. 31, 2009

Annual Compound Returns

The table below summarizes the Company's annual compound total returns for the periods ended December 31 as indicated. As a basis for comparison, we have provided the performance of the Merrill Lynch Canada High Yield Bond Index ("Index"). The Index is a broad based index that tracks the performance of the Canadian high-yield bond market. As the criteria for determining the constituents of the Company's investment portfolio and the Index differ, it is not expected that the Company's performance will mirror that of the Index. Further, the return of the Index is calculated without the deduction of management fees and fund expenses whereas the performance of the Company is calculated after deducting fees and expenses.

Annual Compound Returns	**Company**	**Index**
1 Year	-3.64%	4.74%
2 Years	1.53%	9.79%
3 Years	2.65%	7.23%
Since Inception	10.54%	17.97%

Summary of Investment Portfolio

The following is a summary of the Company's investment portfolio as at June 30, 2013. This is a summary only and will change due to ongoing portfolio transactions of the Company. A quarterly update is available at www.dkincomecorp.com.

Top 25 Investments			**% of Net Asset Value**
PARAMOUNT RESOURCES	8.250%	13-Dec-17	7.4
WHITECAP RESOURCES	N/A	N/A	5.2
TEMBEC INDUSTRIES	11.250%	15-Dec-18	3.8
PERPETUAL ENERGY INC	8.750%	15-Mar-18	3.7
PETROAMERICA OIL	11.500%	19-Apr-15	3.1
GATEWAY CASINOS	8.500%	26-Nov-20	3.0
SHERRITT INTL CORP	8.000%	15-Nov-18	2.8
ATHABASCA OIL CORP	7.500%	19-Nov-17	2.5
DIRECTCASH PAYMENTS	8.125%	8-Aug-19	2.5
NORTH AMERICAN ENERGY	9.125%	7-Apr-17	2.4
CALFRAC HOLDINGS LP	7.500%	1-Dec-20	2.0
WESTERN ENERGY SVS	7.785%	30-Jan-19	1.8
99 CENTS ONLY STORES	11.000%	15-Dec-19	1.7
CREW ENERGY INC	8.375%	21-Oct-20	1.5
SHERRITT INTL CORP	7.500%	24-Sep-20	1.4
BLACK PRESS GROUP	10.000%	28-Dec-18	1.0
RAPIDEYE CANADA	N/A	1-Jan-21	1.0
BLACK PRESS GROUP	L+5.0%	28-Jun-18	0.9
NIKO RESOURCE LTD CV	7.000%	13-Dec-17	0.8
SKYLINK AVIATION INC	10.000%	8-Mar-15	0.8
MIRABELA NICKEL LTD	8.750%	15-Apr-18	0.8
SKYLINK AVIATION INC	12.250%	10-May-18	0.2
SHERRITT INTL CORP	7.750%	15-Oct-15	0.2
URANERZ ENERGY CORP	N/A	N/A	0.1
CONIFEX TIMBER INC	N/A	N/A	0.0

Portfolio Composition	**% of Net Asset Value**
Fixed Income	
Canadian denominated in CAD	35.0
Canadian denominated in USD	5.4
United States denominated in USD	3.7
Other Foreign denominated in EUR	1.0
	45.1
Equity and Warrants	5.2
Investment Portfolio	50.3
Cash & Short-term Deposits	49.6
Other Net Assets	0.1
	100.0
Sector Breakdown	
Energy	30.3
Materials & Metals	5.2
Consumer Discretionary	6.5
Forestry	3.8
Financial Services	2.5
Technology	1.0
Services	1.0
Investment Portfolio	50.3
Cash & Short-term Deposits	49.6
Other Net Assets	0.1
	100.0