

DEANS KNIGHT

INCOME CORPORATION

**ANNUAL MANAGEMENT REPORT
OF FUND PERFORMANCE FOR 2014**

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, 2014 (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 plans to look for opportunities to sell the Remaining Investments, the Company's anticipation that its business will be limited solely to attending to and pursuing the Modified Business Objectives (as defined in this Report), the anticipated future performance of the Company, the Company's belief that its tax losses and other tax attributes may be used to offset profits generated by the Company, thereby reducing its taxes payable and other matters regarding the CRA Matter (as defined in this Report) including the disposition of the CRA Matter and the anticipated timing thereof. 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, that there will be no change or need for change in the Company's investment portfolio (other than disposition of the Remaining Investments (as described in this Report)), that the Services Agreement (as defined in this Report) will remain in force and not require amendment, current tax laws, regulations and policies and 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 decisions, and catastrophic events and the risks outlined under "Risk Factors" in the Company's annual information form dated March 26, 2015 (the "**AIF**"), 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 may also contain certain financial and operational information obtained or derived 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 that, prior to April 30, 2014, was focused on investing in corporate debt securities. The Company's assets are managed by Deans Knight Capital Management Ltd. ("**Deans Knight**"), a British Columbia-based investment firm focused on managing high income and growth mandates for high net worth individuals, foundations, endowments and pension funds.

Since making a special cash distribution to shareholders of the Company ("**Cash Distribution**") on April 30, 2014, the Company has ceased all investing and portfolio activities (other than in connection with the Modified Business Objectives). As such, the Company's business now consists of: (i) attending to, and if necessary, litigating, the Canada Revenue Agency ("**CRA**") tax matter and, if applicable, the related appeal; (ii) divesting of the securities held in the Company's portfolio that were not liquidated prior to the Cash Distribution (the "**Remaining Investments**"); (iii) attending to any additional distributions to shareholders of any surplus cash and the eventual wind-up and termination of the Company thereafter; and (iv) attending to any ancillary matters related to any of the foregoing (collectively, the "**Modified Business Objectives**").

Risk

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

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 the losses and other 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.

The NORAs indicate the Company's tax liability for the 2009 to 2012 taxation years to be approximately \$22.7 million or \$2.15 per Share ("**Disputed Amount**"), including arrears interest and penalties. Given the Company's financial results for 2013 and 2014, the Company estimates its overall potential net tax liability for the years 2009 through 2014 inclusive to be approximately \$21.6 million, or \$2.05 per Share ("**Potential Tax Liability**"). The Company has prepaid the \$21.6 million to the CRA to limit any future interest from being incurred.

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

In late October, 2014, the Company filed its Notice of Appeal to the Tax Court of Canada, appealing the NORAs and is now attending to normal pre-trial processes, including discovery of documents and examinations for discovery with the Crown.

The Company will continue to keep shareholders apprised of the CRA Matter, as it progresses through the appeal process.

On April 15, 2014, the Voting Shares (as defined herein) ceased trading on the Toronto Stock Exchange ("**TSX**") and as such, there is no active market through which the shares may be sold. Accordingly, holders of Voting Shares may not be able to resell their shares. This may affect the pricing of the Voting Shares in the secondary market, the transparency and availability of trading prices, the liquidity of the Voting Common Shares and decreased regulation of the Company.

Given the majority of the Company's business is now limited to attending to the CRA Matter, the resolution and disposition of which is uncertain at this time, and the lack of liquidity from the Company's shares no longer being listed on the TSX, an investment in the Company may be considered to be speculative. Therefore, an investment in the Company is only suitable for investors who are looking for potential capital appreciation and are willing to tolerate the speculative risk of the investment.

Results of Operations

On April 30, 2014, the Company executed on its plan to distribute a substantial portion of its assets to holders of voting common shares ("**Voting Shares**") and non-voting common shares ("**Non-Voting Shares**" and together with the Voting Shares, the "**Common Shares**") of the Company through the payment of the Cash Distribution in the aggregate amount of \$102.7 million (\$9.75 per Common Share). The Cash Distribution aligned with the Company's original business objective of completing a distribution to holders of Common Shares on or about April 30, 2014 while maintaining the necessary reserves to attend to and pursue the Modified Business Objectives. The Cash Distribution was considered a return of capital to holders of Voting Shares for income tax purposes.

In the fourth quarter of 2014, the Company received the expected refund of \$1.1 million from monies prepaid to the CRA. After receiving this refund, the Company assessed its cash needs to pursue its Modified Business Objectives. As a result of this exercise, the Company determined it had an excess of cash and declared and paid a dividend of \$1.05 million, or \$0.10 per Common Share in December 2014. This dividend is considered as an eligible dividend for income tax purposes.

Given the Cash Distribution, the net assets of the Company at December 31, 2014 (\$26,374,544 or \$2.50 per Common Share) were significantly lower than at December 31, 2013 (\$130,367,007 or \$12.37 per Common Share).

The net assets of the Company consisted of the following components:

	December 31, 2014		
	\$	Per Common Share ⁽¹⁾	%
Remaining Investments ⁽²⁾	3,266,854	0.31	12.4
Cash and short-term deposits	1,399,985	0.13	5.3
Accrued income	155,666	0.01	0.6
Prepaid tax asset ⁽³⁾	21,606,636	2.05	81.9
Accrued liabilities less prepaid assets	<u>(54,597)</u>	<u>0.00</u>	<u>(0.2)</u>
	<u>26,374,544</u>	<u>2.50</u>	<u>100.0</u>

- (1) Based on 10,537,263 Common Shares, including 10,191,592 Voting Shares and 345,671 Non-Voting Shares, as outlined in the notes to the Financial Statements.
- (2) The details of the Remaining Investments are outlined in the Summary of Investment Portfolio below.
- (3) Details of the prepaid tax asset are outlined in the Risk section above. Further, refer to the Taxation note to the Financial Statements for more detail.

	December 31, 2013		
	\$	Per Common Share ⁽¹⁾	%
Investments ⁽²⁾	65,659,396	6.23	50.4
Cash and short-term deposits	64,573,401	6.13	49.5
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	<u>(873,905)</u>	<u>(0.08)</u>	<u>(0.7)</u>
	<u>130,367,007</u>	<u>12.37</u>	<u>100.0</u>

- (1) Based on 10,537,263 Common Shares, including 10,191,592 Voting Shares and 345,671 Non-Voting Shares, as outlined in the notes to the Financial Statements.
- (2) The details of the investments are outlined in detail in the 2013 audited annual financial statements (the "**2013 Financial Statements**").
- (3) Refer to the Taxation note to the 2013 Financial Statements for more detail.

There were no significant developments or changes to report relating to the Remaining Investments other than as disclosed in our June 30, 2014 Interim Management Report of Fund Performance. The Company will continue to look for opportunities to sell the Remaining Investments as prudently as possible. Otherwise, the Company's business will be limited solely to pursuing the Modified Business Objectives.

The Company's net investment income, being dividend and interest for distribution purposes and royalty income less expenses, for the year ended December 31, 2014 was approximately \$0.560 million, or \$0.05 per share. The comparative figure for the year ended December 31, 2013 was \$7.062 million or \$0.67 per share. The decrease is the result of the Company liquidating the majority of its income generating investments in anticipation of paying the Cash Distribution. In addition, the Company incurred \$3.897 million of realized capital losses in the year ended December 31, 2014 from the sale of all the liquid investments held in the portfolio, the exchange of debt securities for common shares of Mirabela Nickel Ltd., and the settlement of foreign currency contracts. Conversely, the sales resulted in the majority of the change in unrealized appreciation on investments of \$3.317 million for the year ended December 31, 2014.

Since the Cash Distribution, the Company's investment income is limited to income it receives from its investments in Skylink Aviation Inc. and the royalty stream it is entitled to from BlackBridge Space Holdings Ltd. (formerly Rapid Eye Canada Inc). For the year ended December 31, 2014, these investments generated approximately \$500,000 of investment income.

Recent Developments

Cash Distribution and Extension of Termination Date

On April 4, 2014, shareholders voted in favour of a special resolution authorizing: (i) the reduction in the stated capital of the Voting Shares; (ii) an extension of the termination date of the Company until such time as is reasonably practicable following the conclusion of the CRA Matter (as defined herein) or such other date as the Company deems appropriate on not less than 30 days' notice to shareholders; and (iii) the removal of the restrictions on business that the Company may carry on.

With these shareholder approvals, on April 30, 2014, the Company executed on its plan to distribute a substantial portion of its assets to shareholders through the payment of the Cash Distribution in the amount of \$9.75 per Common Share. Further, since that time, the Company has and plans to limit its business activities solely to the Modified Business Objectives. Other than in connection with the Modified Business Objectives, there are no planned reorganizations, mergers or similar transactions.

International Financial Reporting Standards

This reporting period represents the Company's first set of financial statements reported under International Financial Reporting Standards ("**IFRS**"). The Financial Statements include corresponding comparative financial information for 2013, including an opening statement of financial position as at January 1, 2013.

The Company's transition to IFRS is as outlined in the notes to the Financial Statements. More specifically, Note 11 of the Financial Statements outlines the Company's transition to IFRS and the related impact on the Company's equity and comprehensive loss. This change has resulted in certain comparative figures in this Report being updated to reflect the changes to the Financial Statements.

Composition of the Independent Review Committee

Up to the date of June 25, 2014, the members of the Company's Independent Review Committee were Denyse Chicoyne, Philip Hampson and Alan Ross. Following the Company's annual meeting of shareholders held on June 25, 2014, each of Ms. Chicoyne, Mr. Hampson and Mr. Ross did not stand for re-election as directors of the Company, and Ms. Chicoyne resigned from the Independent Review Committee. The Independent Review Committee is now comprised of Mr. Hampson, Mr. Ross and Robert Rothstein.

Related Party Transactions

The officers and 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 administration, financial reporting and other ancillary services required by a public company, as well as management services related to the Remaining Investments, all as more particularly set forth in the services agreement between the Company and Deans Knight dated May 20, 2014 ("**Services Agreement**") and available for review on SEDAR at www.sedar.com. Deans Knight 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 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 year ending December 31, 2014, management fees totaled \$554,785 (2013- \$2,122,002). At December 31, 2014, \$63 (December 31, 2013- \$512,138) was owed to Deans Knight, which was unsecured and included in accounts payable and accrued liabilities in the statement of financial position, and is payable immediately.

A former director of the Company, who ceased being a director and therefore a related party in June 2013, is a partner at a law firm that provides legal services to the Company. During the year ending December 31, 2013, the Company incurred \$299,969 in legal services and disbursements provided by this law firm. At December 31, 2013, accounts payable included \$133,884 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 for the past five years.

The Company's Net Assets per Common Share ⁽¹⁾

	2014	2013	2012	2011	2010
	\$	\$	\$	\$	\$
Net assets, beginning of year ⁽²⁾	12.37	13.58	13.49	13.65	12.23
Increase from operations ⁽²⁾					
Total revenue	0.14	0.96	1.10	1.10	0.94
Total expenses	(0.09)	(0.29)	(0.26)	(0.26)	(0.24)
Realized (losses) gains	(0.37)	(0.50)	0.44	0.36	1.82
Unrealized gains (losses)	0.32	(0.47)	(0.25)	(0.51)	(0.24)
Future income taxes	(0.02)	(0.21)	(0.24)	(0.15)	(0.16)
Total (decrease) increase from operations ⁽²⁾	(0.02)	(0.51)	0.79	0.54	2.12
Return of capital ⁽²⁾⁽³⁾	(9.75)	-	-	-	-
Dividends ⁽²⁾⁽³⁾⁽⁴⁾	(0.10)	(0.70)	(0.70)	(0.70)	(0.70)
Net assets, end of year (December 31)	2.50	12.37	13.58	13.49	13.65

(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 Shares and 345,671 Non-Voting Shares.

(2) Net assets, return of capital 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.

(3) See "Results of Operations" and "Recent Development – Cash Distribution and Extension of Termination Date" for additional information regarding the return of capital.

(4) Dividends were paid in cash.

Ratios and Supplemental Data ⁽¹⁾

	2014	2013	2012	2011	2010
Net asset value (\$000's)	26,375	\$130,367	\$143,065	\$142,178	\$143,880
Number of Common Shares outstanding (000's)	10,537	10,537	10,537	10,537	10,537
Management expense ratio ⁽²⁾	1.09%	2.21%	1.96%	1.90%	1.91%
Portfolio turnover rate ⁽³⁾⁽⁴⁾	159.96%	25.23%	14.79%	79.90%	86.60%
Trading expense ratio ⁽⁵⁾	0.03%	0.03%	0.01%	0.00%	0.01%
Net asset value per Common Share	\$2.50	\$12.37	\$13.58	\$13.49	\$13.65
Closing market price – Common Share	n/a ⁽⁶⁾	\$10.01	\$12.69	\$11.84	\$12.54

(1) This information is provided as at December 31 of the years shown.

(2) Management expense ratio is based on total expenses for the year and is expressed as a percentage of weekly average net asset values over the year. See "Related Party Transactions" and "Management Fees" in this Report for a description of and structure of the nominal monthly fee to be paid to Deans Knight under the Services Agreement which was amended on May 20, 2014. As a result of the amendment to the Services Agreement, Deans Knight will be paid a fee of \$10.00 per month and will be entitled to be reimbursed for any expenses incurred by it on behalf of the Company.

(3) The Company's portfolio turnover rate indicates how actively the Company manages its portfolio investments. It is calculated as a ratio of investments purchased or sold over the average net asset value. 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) 2014's portfolio turnover rate is significantly higher because the Company finished liquidating the majority of its portfolio in 2014 and returned a significant portion of its net asset value to the shareholders.

- (5) 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 year. This expense is \$28,552 for 2014 (2013- \$47,875), as the purchasing and selling of bonds do not generally attract a commission from the buying or selling party.
- (6) On April 15, 2014, the Voting Shares were delisted from trading on the Toronto Stock Exchange. As a result, the Company's Voting Shares are no longer traded on a public market, and therefore a closing market value is not available.

Management Fees

Deans Knight provides administration, financial reporting and other ancillary services required by a public company, as well as investment management services related to the Remaining Investments, all as more particularly set forth in the Services Agreement. Deans Knight 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 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.

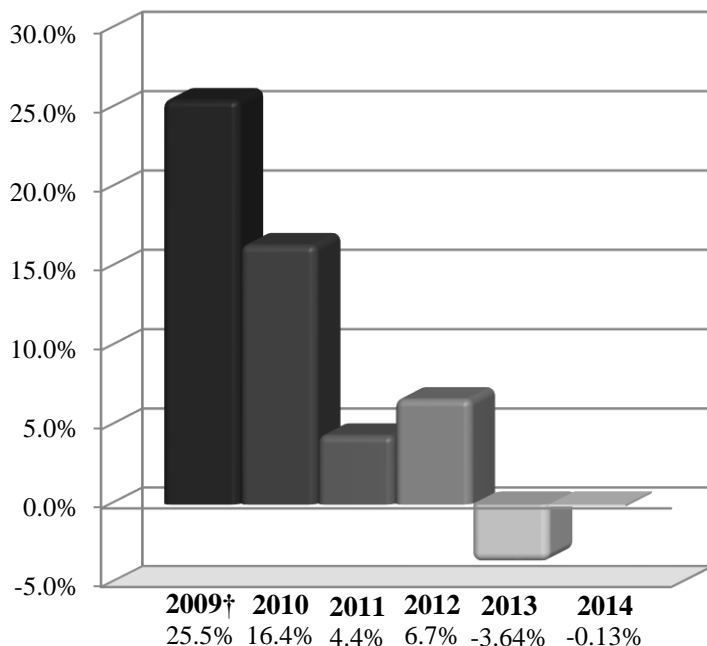
Past Performance

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 holders of Common Shares. The performance information presented is after the deduction of performance fees and expenses paid or payable by the Company to the investment manager. It is also important to note that the past performance will not necessarily indicate what performance in the future will be.

Following the completion of the Cash Distribution on April 30, 2014, the Company's investment portfolio is comprised solely of the Remaining Investments. Additionally, the Voting Shares were delisted from the Toronto Stock Exchange on April 15, 2014. As a result of these significant changes, it is anticipated that the future performance of the Company will not be reflective of or comparable to the past performance of the Company.

Year-by-year Returns

The accompanying bar chart shows the Company's annual 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 in the Common Shares on the first day of each financial year would have grown or decreased by the last day of each financial year.



† 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.

<i>Annual Compound Returns</i>	Company	Index
1 Year	-0.13%	0.93%
2 Years	-1.92%	3.80%
3 Years	0.98%	7.43%
5 Years	4.85%	7.81%
Since Inception	8.67%	15.03%

Summary of Investment Portfolio

The following is a summary of the Company's investment portfolio as at December 31, 2014. 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.

Summary of Investment Portfolio

Investments		% of Net Asset Value	Portfolio Composition	% of Net Asset Value
BLACKBRIDGE SPACE HOLDINGS LTD. (formerly RAPIDEYE CANADA)		1-Jan-21 4.3		
SKYLINK AVIATION INC	10.000%	8-Mar-15 4.2	Fixed Income	
MIRABELA NICKEL LTD COMMON SHARES		2.1	Canadian denominated in CAD	1.4
SKYLINK AVIATION INC	12.250%	10-May-18 1.4	Canadian denominated in USD	4.6
MIRABELA NICKEL LTD	1.000%	30-Jun-44 0.4	Other Foreign denominated in EUR	4.3
				<u>10.3</u>
			Equity	<u>2.1</u>
			Investment Portfolio	12.4
			Cash & Short-term Deposits	5.3
			Other Net Assets	<u>82.3</u>
				<u>100.0</u>
			Sector Breakdown	
			Materials & Metals	2.5
			Technology	4.3
			Services	<u>5.6</u>
			Investment Portfolio	12.4
			Cash & Short-term Deposits	5.3
			Other Net Assets	<u>82.3</u>
				<u>100.0</u>