# Deans Knight Income Corporation

Interim Financial Statements
**June 30, 2017**
(Unaudited)

# Notice of No Auditor Review of Interim Financial Statements

The accompanying unaudited interim financial statements of the Company have been prepared in compliance with International Financial Reporting Standards and are the responsibility of the Company’s management.

The Company’s independent auditor has not performed a review of these financial statements. The Company's auditor will perform an audit of the December 31, 2017 financial statements.

# Deans Knight Income Corporation

Interim Statements of Financial Position

(Unaudited)

| | June 30, 2017 $ | December 31, 2016 $ |
|---|---|---|
| **Assets** | | |
| **Current Assets** | | |
| Investments* - at fair value | - | - |
| Cash and cash equivalents | 1,125,785 | 1,370,561 |
| Prepaid expenses | 32,043 | 14,062 |
| | 1,157,828 | 1,384,623 |
| **Non-current Assets** | | |
| Prepaid tax asset (note 6) | 21,662,136 | 21,662,136 |
| | 22,819,964 | 23,046,759 |
| **Liabilities** | | |
| **Current Liabilities** | | |
| Accounts payable and accrued liabilities (note 4) | 69,234 | 233,384 |
| **Net Assets** | 22,750,730 | 22,813,375 |
| **Shareholders' Equity** | | |
| Common shares (note 3) | 17,724,189 | 17,724,189 |
| Contributed surplus (note 3) | 9,904,504 | 9,904,504 |
| Deficit | (4,877,963) | (4,815,318) |
| | 22,750,730 | 22,813,375 |
| **Number of common shares outstanding** (note 3) | 10,537,263 | 10,537,263 |
| **Net assets per common share** (note 6) | 2.16 | 2.17 |
| *Investments - at average cost | 938,142 | 938,142 |

**Contingencies** (notes 1 and 6)

**Commitments** (notes 1 and 8)

**Going concern** (note 1)

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

# Deans Knight Income Corporation

Interim Statements of Comprehensive Loss

**For the six-month period ended June 30, 2017 and 2016**

(Unaudited)

| | **2017** **$** | **2016** **$** |
|---|---|---|
| **Investment income** | | |
| Interest income | - | 1,003 |
| Change in unrealized depreciation on investments | - | (204,291) |
| | - | (203,288) |
| **Expenses** | | |
| Public company reporting costs | 37,678 | 45,443 |
| Audit, accounting and tax fees | 10,514 | 21,562 |
| Independent Review Committee fees | 7,613 | 7,613 |
| Custodial fees | 6,777 | 7,975 |
| Management fees (note 4) | 63 | 63 |
| Legal fees | - | 28,183 |
| | 62,645 | 110,839 |
| **Comprehensive loss** | (62,645) | (314,127) |
| **Comprehensive loss per weighted average common share** (note 2) | (0.01) | (0.03) |

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

# Deans Knight Income Corporation
Interim Statements of Changes in Equity
**For the six-month period ended June 30, 2017 and 2016**
(Unaudited)

| | Common shares<br>$ | Contributed surplus<br>$ | (Deficit)<br>$ | Total shareholders' equity<br>$ |
|---|---|---|---|---|
| **At January 1, 2016** | 17,724,189 | 9,904,504 | (3,915,446) | 23,713,247 |
| Comprehensive loss | - | - | (314,127) | (314,127) |
| **At June 30, 2016** | 17,724,189 | 9,904,504 | (4,229,573) | 23,399,120 |
| **At January 1, 2017** | 17,724,189 | 9,904,504 | (4,815,318) | 22,813,375 |
| Comprehensive loss | - | - | (62,645) | (62,645) |
| **At June 30, 2017** | 17,724,189 | 9,904,504 | (4,877,963) | 22,750,730 |

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

# Deans Knight Income Corporation

Interim Statements of Cash Flows

**For the six-month period ended June 30, 2017 and 2016**

(Unaudited)

| | 2017<br>$ | 2016<br>$ |
|---|---|---|
| **Cash flows from operating activities** | | |
| Comprehensive loss | (62,645) | (314,127) |
| Items not affecting cash | | |
| Change in unrealized depreciation on investments | - | 204,291 |
| Interest income | - | (1,003) |
| | (62,645) | (110,839) |
| Interest received | - | 1,003 |
| Change in prepaid expenses | (17,981) | (30,788) |
| Change in accounts payable and accrued liabilities | (164,150) | (109,452) |
| | (244,776) | (250,076) |
| **Net decrease in cash and cash equivalents during the period** | (244,776) | (250,076) |
| **Cash and cash equivalents – Beginning of period** | 1,370,561 | 1,924,070 |
| **Cash and cash equivalents – End of period** | 1,125,785 | 1,673,994 |

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

# Deans Knight Income Corporation
Interim Schedule of Investment Portfolio
**As at June 30, 2017**
(Unaudited)

| | Par value[1] $ | Average cost[2] $ | Fair value[2] $ | Percentage of total fair value[3] % |
|---|---|---|---|---|
| **Fixed income** | | | | |
| *Denominated in United States dollars* | | | | |
| Mirabela Nickel Ltd. 1.00% 06-30-2044[4] | 117,532 | 124,999 | - | - |
| Total fixed income | | 124,999 | - | - |
| **Equities – Australia** | | | | |
| Mirabela Nickel Ltd. - common shares | 20,231,470 | 813,143 | - | - |
| Total equities | | 813,143 | - | - |
| Total investments | | 938,142 | - | - |

[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] This investment represents a loan receivable

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

## 1 Nature of operations and going concern

Deans Knight Income Corporation (the "Company") is a corporation continued under the laws of Canada on April 11, 2001. The Company is a public closed-end, non-redeemable investment company, which prior to April 15, 2014 was listed on the Toronto Stock Exchange. The address of the Company's registered office, and its principal place of business, is 1500 – 999 West Hastings Street, Vancouver, British Columbia.

In April 2014, the Company's shareholders voted in favour of the special resolution authorizing: (i) an extension of the termination date of the Company until such time as reasonably practicable following the conclusion of the Canada Revenue Agency ("CRA") tax matter (note 6); and (ii) the removal of the restrictions on business that the Company can carry on. Going forward, the Company's business will comprise (i) divesting of any remaining investments held; (ii) attending to, and if necessary, litigating, the CRA audit and related tax appeal (note 6); and (iii) attending to any distributions to shareholders of surplus cash and the eventual wind-up and termination of the Company thereafter.

Prior to April 30, 2014, the Company's investment objectives were to: (i) maximize the total return for shareholders, consisting of dividend income and capital appreciation; and (ii) provide shareholders with monthly dividends targeted to pay out a minimum of 75% of net investment income annually. The Company did this through investing primarily in corporate debt rated BBB or below by recognized credit rating organizations. Prior to its reorganization in May 2008, the Company was a life sciences company involved in the research, development and commercialization of innovative products for the prevention and treatment of life-threatening diseases.

As per the Company's Articles of Incorporation, the common shares of the Company are to be redeemed at such time as is reasonably practicable following the resolution of the CRA tax audit and related tax appeal (note 6), or such other date as the Company deems appropriate, on not less than 30 days notice to shareholders. The common shares are presented as equity because they meet the criteria in paragraphs 16C – D of International Accounting Standard ("IAS") 32 '*Financial instruments: presentation*' for such classification.

The Company does not anticipate that there will be a resolution to the CRA tax dispute in the next 12 months, and accordingly is not anticipating winding up in that period. Therefore, these financial statements have been prepared on a going concern basis. If a resolution to the CRA tax dispute is achieved, or the Company deems it appropriate to wind up, then the Company would settle all outstanding liabilities, including obtaining a tax clearance certificate, and redeem the common shares of the Company.

## 2 Summary of significant accounting policies

The following is a summary of significant accounting policies followed by the Company.

**Basis of preparation**

These financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34 '*Interim financial reporting'*.

The policies applied in these financial statements are based on IFRS issued and outstanding as of August 2, 2017, which is the date on which the interim financial statements were authorized for issue by the Board of Directors. Any subsequent changes to IFRS that are given effect in the Company's annual financial statements for the year ending December 31, 2017 could result in restatement of these financial statements.

**Financial instruments**

*a) Classification*

The Company classifies its investments in debt and equity securities, and derivatives, as financial assets or financial liabilities at fair value through profit or loss ("FVTPL"). All other financial assets and liabilities are measured at amortized cost.

The FVTPL category has two sub-categories: financial assets or financial liabilities held for trading; and those designated at FVTPL at inception.

(i) Financial assets and liabilities held for trading

A financial asset or financial liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term or if on initial recognition is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking. Derivatives are also categorized as held for trading. The Company does not classify any derivatives as hedges in a hedging relationship.

(ii) Financial assets and liabilities designated at FVTPL at inception

Financial assets and financial liabilities designated at FVTPL at inception are financial instruments that are not classified as held for trading but are managed, and their performance is evaluated, on a fair value basis in accordance with the Company's documented investment strategy. The Company evaluates the information about these financial assets and liabilities on a fair value basis together with other related financial information.

Unlisted or non-exchange traded investments, or investments where a last bid, sale or close price is unavailable, or investments for which market quotations are, in the Company's opinion, inaccurate, unreliable, or not reflective of all available material information, are valued at their fair value as determined by the Company using appropriate and accepted industry valuation techniques including valuation models. The fair value determined using valuation models requires the use of inputs and assumptions based on observable market data including volatility and other applicable rates or prices. In certain circumstances, the fair value may be determined using valuation techniques that are not supported by observable market data.

The resulting values for investments not traded in an active market may differ from values that would be determined had a ready market existed, and the difference could be significant.

*(b) Recognition, de-recognition and measurement*

Regular way purchases and sales of investments are recognized on the trade date – the date on which the Company commits to purchase or sell the investment. Financial assets are de-recognized when the rights to receive cash flows from the investments have expired or the Company has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities at FVTPL are initially recognized at fair value. Transaction costs are expensed as incurred. Subsequent to initial recognition, all financial assets and financial liabilities at FVTPL are measured at fair value. Gains and losses arising from changes in the fair value of the 'financial assets or financial liabilities at FVTPL' category are included in the statements of comprehensive loss in the period in which they arise.

Under the amortized cost method, financial assets and liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract's effective interest rate. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

At each reporting date, the Company assesses whether there is objective evidence that a financial asset at amortized cost is impaired. If such evidence exists, the Company recognizes an impairment loss as the difference between the amortized cost of the financial asset and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. Impairment losses on financial assets at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

The interest for distribution purposes shown on the statements of comprehensive loss represents the coupon interest received by the Company accounted for on an accrual basis. The Company does not amortize premiums paid or discounts received on the purchase of fixed income securities except for zero coupon bonds, which are amortized on a straight-line basis.

Realized gain/loss on sale of investments and unrealized appreciation/depreciation in investments are determined on an average cost basis. Average cost does not include amortization of premiums or discounts on fixed income securities with the exception of zero coupon bonds. Royalty income is recognized on an accrual basis as earned. Dividend income is recognized at the ex-dividend date.

Transaction costs are any costs that can be directly attributable to the acquisition and disposal of an investment, which include fees and commissions paid to agents, advisors, brokers and dealers; levies by regulatory agencies and securities exchanges; and transfer taxes and duties.

*(c) Presentation*

Financial assets and liabilities are offset and the net amount reported in the statements of financial position, when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. In the normal course of business, the Company may enter into master netting arrangements or similar agreements that do not meet the criteria for offsetting in the statements of financial position, but still allow for the related amounts to be offset in certain circumstances, such as bankruptcy or termination of the contracts. The Company has not offset any material financial instruments as at June 30, 2017 or December 31, 2016.

**Fair value measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair values of financial assets and liabilities traded in active markets (such as publicly traded derivatives and marketable securities) are based on quoted market prices at the close of trading on the reporting date. The Company uses the last traded market price for both financial assets and financial liabilities where the last traded price falls within that day's bid-ask spread. In circumstances where the last traded price is not within the bid-ask spread, management determines the point within the bid-ask spread that is most representative of fair value based on the specific facts and circumstances. The Company's policy is to recognize transfers into and out of the fair value hierarchy levels as of the date of the event or change in circumstances giving rise to the transfer.

The fair value of financial assets and liabilities that are not traded in an active market is determined using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques include the use of comparable recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and others commonly used by market participants and which make the maximum use of observable inputs. In certain circumstances, the fair value may be determined using valuation techniques that are not supported by observable market data.

The resulting values for investments not traded in an active market may differ from values that would be determined had a ready market existed, and the difference could be significant.

Specifically, financial assets and liabilities that are classified as held for trading are recorded at fair values determined as follows:

*Foreign currency contracts*
Foreign currency contracts (note 7) entered into by the Company are valued at an amount that is equal to the gain or loss that would be realized if the position were transferred, which is equivalent to the difference between the deliverable asset and the value of the asset to be received.

Financial assets and liabilities that are designated at FVTPL at inception are recorded at fair values determined as follows:

*Equities*
Publicly traded equities are recorded at closing prices as quoted on recognized stock exchanges.

The amounts at which the Company's publicly traded investments could be disposed of currently may differ from the carrying value based on market quotes, as the value at which significant ownership positions are sold is often different than the quoted market price due to a variety of factors such as premiums paid for large blocks or discounts due to illiquidity.

*Fixed income investments and convertible debentures*
Fixed income investments traded on a public securities exchange or traded on an over-the-counter market are valued at the closing price. Where no closing price is available, the last sale price is used where, in management's opinion, this provides the best estimate of fair value.

Fixed income investments not traded on a public securities exchange or over-the-counter market are valued by considering data inputs such as the last price the security was traded at, most recent bid/ask information, prices of similar securities with available prices, and comparison of yields of comparable investments.

*Royalties*
Royalty investments are measured on a discounted cash flow basis, where the value is imputed through forecasting cash flows using an appropriate discount rate.

**Cash and cash equivalents**

Cash and cash equivalents represent cash and short-term deposits with original maturities of less than 90 days held with a Tier 1 Canadian financial institution.

**Foreign exchange**

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars, which is also the Company's functional and presentation currency, at the exchange rate applicable on the valuation date. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates that transactions occur. Foreign currency assets and liabilities denominated in a foreign currency are translated into the functional currency using the exchange rate prevailing at the measurement date. Foreign exchange gains and losses relating to cash are presented as 'Foreign exchange gain (loss) on cash' and those relating to other financial assets and liabilities are presented within 'Net realized (loss) gain on investments sold' and 'Change in unrealized (depreciation) appreciation on investments' in the statements of comprehensive loss.

**Income taxes**

The Company follows the balance sheet liability method of accounting for income taxes. Future income tax assets and liabilities are measured using rates expected to apply to the taxable income in the years in which the temporary differences are expected to be settled. The Company accounts for uncertain tax positions using the contingent liability model, whereby a provision is established only where it is probable that a payment will be required to be made.

Management has estimated the income tax provision and future income tax balances taking into account its expectation of deferred taxable income and an interpretation of the various income tax laws and regulations. It is possible, due to the complexity inherent in estimating income taxes, that the tax provision and deferred tax balances could change (note 6 and note 9), and the change could be significant.

Current income taxes are the expected taxes payable on the taxable income for the year using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

**Net assets per common share**

The net assets per common share are computed by dividing the net assets of the Company by the total number of common shares outstanding on the statements of financial position.

**Comprehensive (loss) income per weighted average common share**

The comprehensive (loss) income per weighted average common share represents comprehensive (loss) income divided by the weighted average number of common shares outstanding during the period.

The weighted average number of shares outstanding during the period ended June 30, 2017 was 10,537,263 (2015 - 10,537,263). This weighted average includes both the voting common shares and non-voting common shares of the Company.

## 3 Capital stock

The Company is authorized to issue an unlimited number of voting common shares without par value, and an unlimited number of non-voting common shares without par value. The holders of the voting common shares have one vote for each share held. The holders of non-voting common shares have no such right to vote.

The holders of both the voting common shares and the non-voting common shares are entitled to receive dividends, which must be declared and paid in an equal amount per share and at the same time without preference or distinction.

In the event of the liquidation, dissolution or winding up of the Company whether voluntary or involuntary, or any other distribution of the assets of the Company among its shareholders for the purpose of winding up its affairs, the holders of the voting common shares and the holders of the non-voting common shares rank equally and are entitled to share and receive the remaining property of the Company.

There were no changes in the number of voting and non-voting common shares during the periods ended June 30, 2017 and 2016. The total shares outstanding at June 30, 2017 and December 31, 2016 are summarized as follows:

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

**Contributed surplus**

The contributed surplus balance did not change during the periods ended June 30, 2017 and 2016. The balance at June 30, 2017 and December 31, 2016 consists of:

| | $ |
|---|---|
| Surplus related to stock compensation, warrants and options associated with common shares | 8,030,295 |
| Surplus relating to warrants associated with previously issued preferred shares | 1,874,209 |
| | 9,904,504 |

## 4 Related party transactions and balances

The Officers and Directors of the Company are also employees of Deans Knight Capital Management Ltd. ("Deans Knight"), the Company's investment advisor and manager. 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 investment 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 and available for review on SEDAR. Deans Knight is paid a nominal fee of $10 per month plus G.S.T. for the services it provides to the Company under the Services Agreement.

For the six-month period ending June 30, 2017, management fees totaled $63 (2016 - $63). At June 30, 2017, $nil (December 31, 2016 - $nil) was owed to Deans Knight, which was unsecured and included in accounts payable and accrued liabilities in the statements of financial position, and is payable immediately.

## 5 Net realized gain on investments sold

The net realized gain on investments sold for the six-month periods ended June 30 was as follows:

| | 2017<br>$ | 2016<br>$ |
|---|---|---|
| Proceeds from sale of investments | - | - |
| Investments at cost – Beginning of period | 938,142 | 2,104,497 |
| Add: Cost of investments purchased | - | - |
| | - | 2,104,497 |
| Less: Investments at cost – End of period | 938,142 | 2,104,497 |
| Cost of investments sold | - | - |
| Net realized gain on investments sold | - | - |

## 6 Taxation

**Uncertainty of deductibility of tax losses**

Prior to the reorganization and change in the Company's business that occurred in 2008, as discussed in note 1, 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.

In July 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, as a result of the 2008 reorganization, 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 is vigorously defending its position.

The NORAs indicate that the Company's tax liability for the 2009 to 2012 taxation years is approximately $22.7 million or $2.15 per share ("Disputed Amount"), including arrears interest and penalties. Given the Company's financial results for 2013 through 2017 to date, the Company estimates its overall potential net tax liability ("Potential Tax Liability") for the years 2009 through 2017 to date inclusive to be, as of the date hereof, approximately $21.5 million, or $2.04 per common voting share and per common non-voting share (collectively, the "Common Shares"). The Company prepaid $21.6 million to the CRA in 2014, which was equal to the Potential Tax Liability at that time, to limit any future interest from being incurred. The Company intends to reassess its Potential Tax Liability at regular intervals and prepay any additional amount, if necessary, 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 deferred 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 2014, the Company filed its Notice of Appeal to the Tax Court of Canada, appealing the NORAs and the Company is now attending to normal pre-trial processes, including discovery of documents and examinations for discovery with the Crown. The Tax Court of Canada has scheduled to hear the Tax Appeal from February 13 to 22, 2018.

**Tax pools available to offset future tax expense and payable**

As at June 30, 2017, the Company has accumulated non-capital losses of approximately $5.3 million. The benefit of these losses has been recorded as a reduction of the prepaid tax asset. If the Company is successful in defending its tax filing position, these losses would be reinstated for carry forward and will expire in 2033. In addition, the Company has scientific research and experimental development (“SR&ED”) expenditures of $18.1 million, which do not expire, available to offset future taxable income and $7.1 million of unclaimed federal investment tax credits (“ITCs”), which expire from 2018 to 2025, available to offset future taxes payable. The benefit of the

SR&ED expenditures and ITCs has not been recognized in the financial statements based on management's assessment that it is not probable that these tax attributes will be realized in the future.

**Reconciliation of income tax expense**

The reconciliation of income tax computed at the statutory tax rate to income tax expense at June 30, using a 26.00 % statutory tax rate (2016 – 26.00%), is:

| | 2017<br>$ | 2016<br>$ |
|---|---|---|
| Comprehensive loss before tax | (62,645) | (314,127) |
| Statutory tax rate | 26.00% | 26.00% |
| Income tax recovery at statutory rates | (16,288) | (81,673) |
| SR&ED credit utilized | - | - |
| Non-capital loss carry forward | 16,288 | 81,673 |
| Provision for deferred income tax | - | - |

## 7 Financial instruments

The following tables present the carrying amounts of the Company's financial instruments by category as at June 30, 2017:

**Financial instruments by category**

| | Amortized cost<br>$ |
|---|---|
| **Assets as per Statements of Financial Position** | |
| Other financial assets: | |
| Cash and cash equivalents | 1,125,785 |
| | 1,125,785 |
| **Liabilities as per Statements of Financial Position** | |
| Other financial liabilities: | |
| Accounts payable and accrued liabilities | 69,234 |
| | 69,234 |

The following tables present the carrying amounts of the Company's financial instruments by category as at December 31, 2016:

**Financial instruments by category**

| | Amortized cost $ |
|---|---|
| **Assets as per Statements of Financial Position** | |
| Other financial assets: | |
| Cash and cash equivalents | 1,370,561 |
| | 1,370,561 |
| **Liabilities as per Statements of Financial Position** | |
| Other financial liabilities: | |
| Accounts payable and accrued liabilities | 233,384 |
| | 233,384 |

**Fair value measurement**

Financial instruments are classified in a hierarchy that prioritizes the inputs to fair value measurement. Each level is based on the transparency of the inputs used to measure the fair values of assets and liabilities. The three levels of the fair value hierarchy are:

Level 1 – inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – inputs that reflect other than quoted prices that are observable for the assets or liabilities either directly or indirectly;

Level 3 – inputs that are not based on observable market data.

If inputs of different levels are used to measure an asset's or liability's fair value, the classification within the hierarchy is based on the lowest level input that is significant to the fair value measurement.

Investments had no value at June 30, 2017 and at December 31, 2016, therefore no table is presented.

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

| | Corporate debt $ | Equities $ | Royalty $ | Total $ |
|---|---|---|---|---|
| **Balance – January 1, 2016** | 78,026 | 203,994 | - | 282,020 |
| Unrealized depreciation | (297) | (203,994) | - | (204,291) |
| **Balance – June 30, 2016** | 77,729 | - | - | 77,729 |
| **Balance – January 1, 2017** | - | - | - | - |
| **Balance – June 30, 2017** | - | - | - | - |

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. Any reasonably possible alternative assumptions, except as noted below, would result in immaterial changes to total net assets.

**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 regular ongoing monitoring of the investment performance of the individual investee companies. A 10% change in the value of the Company's equity investments would have a $nil (December 31, 2016 - $nil) impact on comprehensive loss.

### Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company.

All transactions executed by the Company in listed securities are settled/paid for upon delivery using approved brokers. The risk of this settlement not occurring is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet its obligation. Since the Company invests primarily in high-yield debt instruments and derivatives, this represents the main concentration of credit risk. The fair value of debt securities includes consideration of the creditworthiness of the debt issuer. The maximum credit exposure of these assets is represented by their carrying amounts. However, this maximum exposure is mitigated to varying degrees in each investment, based on the collateral held, if any. Collateral may include such things as a general security agreement over all assets, or specific security over specific assets. It may also entitle the debt holder to take over the overall business through restructuring of the investment.

At June 30, 2017 and December 31, 2016, all remaining investments held by the Company were unrated by the various credit rating agencies. The Company's credit risk exposure at June 30, 2017 is limited to investments valued at 0% of net assets (December 31, 2016 – 0%).

Credit risk associated with the Company's cash and cash equivalents is not considered significant, as they are held with Tier 1 Canadian financial institutions.

### 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's investments include interest-bearing financial instruments. Accordingly, 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.

As at June 30, 2017, 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 by approximately $0, or approximately 0% of net assets (December 31, 2016- $0, or approximately 0% of net assets).

### Liquidity risk

As the Company is a closed-end investment company with a fixed number of common shares outstanding, unlike an open-ended mutual fund, it is not exposed to the liquidity risk associated with daily cash redemptions of securities.

The Company's remaining investments may not be able to be liquidated quickly at an amount close to their fair value to respond to specific events such as deterioration in the creditworthiness of any particular issuer. Investments held by the Company may be subject to resale restrictions such as hold periods. The resulting values for the Company's remaining investments may differ from values that would be realized if a ready market exists.

The Company reviews its investment portfolio to assess liquidity risk on its holdings.

### Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company's remaining investments include 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 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 $nil at June 30, 2017 (December 31, 2016 - $nil).

## 8 Capital management

The capital of the Company is divided into voting and non-voting common shares, each having an unlimited authorized amount. The number of voting and non-voting shares outstanding and changes thereto, are outlined in note 3.

The Company manages its capital in accordance with the Company's amended business objectives, as approved by shareholders at a meeting held in April 2014. The objectives include: (i) divesting of any remaining investments held; (ii) attending to, and if necessary, litigating, the CRA Matter and related tax appeal (note 6); and, (iii) attending to any distributions to shareholders of surplus cash and the eventual wind-up and termination of the Company thereafter.

The Company intends to pay cash dividends to shareholders as any remaining investments are liquidated, resulting in surplus cash in the Company. No dividends were declared during the period ended June 30, 2017 and in 2016.

## 9 Critical accounting estimates and judgments

The preparation of financial statements requires management to use judgment in applying its accounting policies and to make estimates and assumptions about the future. The following discusses the most significant accounting judgments and estimates that the Company has made in preparing the financial statements:

*Fair value measurement of derivatives and securities not quoted in an active market*

The Company holds financial instruments that are not quoted in active markets. Fair values of such instruments are determined using valuation techniques and may be determined using reputable pricing sources (such as pricing agencies) or indicative prices from market makers. Broker quotes, as obtained from the pricing sources, may be indicative and not executable or binding. Where no market data is available, the Company may value positions using its own models, which are usually based on valuation methods and techniques generally recognized as standard within the industry. Models use observable data, to the extent practicable. However, areas such as credit risk (both own and counterparty), volatilities and correlations require the Company to make estimates. Changes in assumptions about these factors could affect the reported fair values of financial instruments. The Company considers observable data to be market data that is readily available, regularly distributed and updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. Refer to note 2 for further information about the fair value measurement of the Company's financial instruments and to note 7 for further information about Level 3 investments.

*Income taxes*

The tax balances and income tax expense recognized by the Company are based on management's interpretation of the tax laws. Due to the complexity inherent in tax interpretations, regulations and legislation, there are significant estimates required to compute income tax balances. It is possible that some or all of the Company's significant components of the tax attributes may not be available for tax purposes and, accordingly, the amount of the prepaid tax assets and provision for income taxes recorded in the financial statements could change by a material amount (note 6).

## 10 Future accounting changes

At June 30, 2017, a number of standards and interpretations, and amendments thereto, have been issued by the International Accounting Standards Board ("IASB"), which are not effective for these financial statements. Those which are expected to have an effect on the Company's financial statements are discussed below:

IFRS 9 '*Financial instruments*' addresses the classification, measurement and recognition of financial assets and financial liabilities. The complete version of IFRS 9 was issued in July 2014. It replaces the guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 establishes three primary measurement categories for financial assets: amortized cost, fair value through other comprehensive income and FVTPL. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at FVTPL with the irrevocable option to recognize changes in fair value with no recycling of gains or loss to the statements of comprehensive loss. IFRS 9 requires credit losses to be recognized on an expected loss basis rather than using an incurred loss model. For financial liabilities, there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. The standard is effective for accounting periods beginning on or after January 1, 2018. The Company does not anticipate a material impact from IFRS 9.

IFRS 15 '*Revenue from contracts with customers*' deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 '*Revenue*' and IAS 11 '*Construction contracts*' and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018. The Company does not anticipate a material impact from IFRS 15 as the modified business objectives do not include engaging in material contracts with customers.

IAS 7 '*Statement of cash flows*' requires an entity to present a statement of cash flows as an integral part of its primary financial statements. Cash flows are classified and presented into operating activities, either using the 'direct' or 'indirect' method, and investing activities or financing activities. Amendments to IAS 7 include further clarity around providing disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. These amendments to IAS 7 come into effect for annual periods beginning on or after January 1, 2017. The Company does not anticipate a material impact from IAS 7.

IAS 12 '*Income taxes*' recognizes both the current tax consequences of transactions and events, and the future tax consequences of the future recovery or settlement of the carrying amount of an entity's assets and liabilities. Differences between the carrying amount and tax base of assets and liabilities, and carried forward tax losses and credits, are recognized as deferred tax liabilities or deferred tax assets. Amendments to IAS 12 come into effect for annual periods beginning on or after January 1, 2017. The Company is assessing the impact of IAS 12.