DEANS KNIGHT INCOME CORPORATION

INTERIM MANAGEMENT REPORT OF FUND PERFORMANCE

For the period from

January 1, 2013 to June 30, 2013

This interim 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 six month period ending June 30, 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 targeted dividend payout, 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. 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 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 to date have been set at $0.0583 per common share per month. The Company intends to continue 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 may also invest in investment grade debt securities rated above BBB and non-rated debt securities from time to time.

The Company believes there are attractive investment opportunities today in owning corporate debt of businesses with tangible assets, strong cash flows and reasonable leverage.

When evaluating securities to purchase for the Company, Deans Knight focuses on the following:

- amount of security or collateral within a business to support the value of the securities;
- the position of the debt in the capital structure;
- covenants;
- liquidity;
- the business' ability to reduce or refinance the debt; and
- the overall term of the debt and yield to bondholders.

Deans Knight uses the above credit-based analysis to identify corporate debt for inclusion in the Company's investment portfolio with attractive valuations in order to maintain its targeted dividend payment.

Risk

The overall risks of the Company are as described in its annual information form of the Company dated March 11, 2013 (the "**AIF**").

Prior to the reorganization and change in business as discussed in Note 1 of the Financial Statements, the Company generated significant tax losses and other tax attributes as a result of its prior businesses and research activities. The Company has recorded, as a tax asset, the full amount of the potential tax benefit of such items to the extent of its projected taxable income. There is uncertainty as to whether the tax authorities will allow the Company to deduct some or all of the tax losses and other attributes.

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

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

There were no significant changes during the six month period ending June 30, 2013 that affected the overall risk of investing in the Company, other than noted above. Given the type of investments made by the Company, an investment in the Company may be considered to be speculative. An investment in the Company is generally suitable for investors who are looking to receive income, yet are willing to tolerate volatility in the value of their investment.

Results of Operations

The net assets of the Company at June 30, 2013 were $137,209,433 or $13.02 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:

	June 30, 2013		
	$	**Per common share[1]**	**%**
Investments[2]	110,270,115	10.46	80.3
Cash and short-term deposits	24,774,944	2.35	18.1
Accrued income	1,555,115	0.15	1.1
Prepaid expenses	101,440	0.01	0.1
Future income tax asset[3]	1,260,000	0.12	1.0
Accounts payable and accrued liabilities	(752,181)	(0.07)	(0.6)
	137,209,433	13.02	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(2)	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(3)	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) The details of the investments are outlined in the Summary of Investment Portfolio below.
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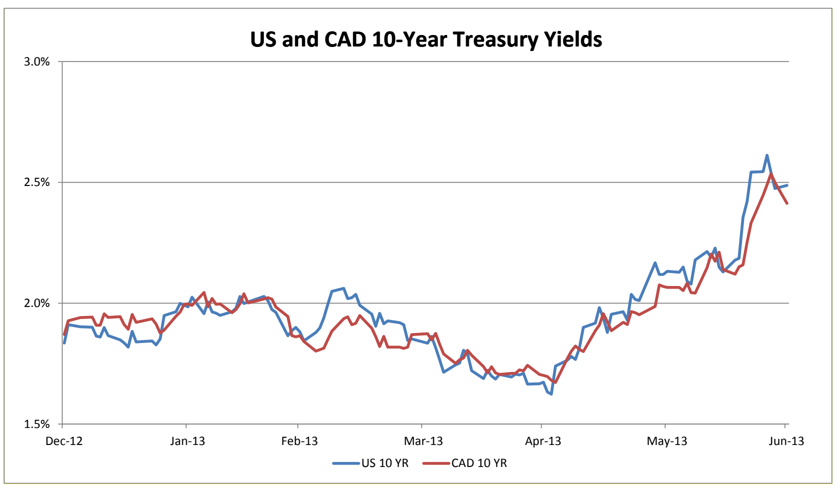
In May, interest rates began to rise with the yield on 10-year US treasuries going from 1.6% on May 2nd to 2.5% at quarter end. Canadian treasuries had a similar result, going from 1.7% to 2.4%.



Source: Reuters

This had a negative impact on government and investment grade bonds. The DEX Universe Index, an investment grade bond index primarily comprised of Government bonds, was down 4% from its peak in May. In our view, this is just a preview of what is to come. Interest rates in Canada have gone from 8.5% twenty years ago to 2.4% today. As a result, since 1993, the DEX Universe provided a total annualized return of 6.9% from interest and capital gains, the latter a result of the significant decline in rates. As declining interest rates shift to rising rates, capital gains will turn into capital losses for government and investment grade bonds.

The Company believes the difficulty for bonds last quarter was caused by the Chairman of the US Federal Reserve, Ben Bernanke's remarks that Quantitative Easing (QE) will likely come to an end this year. All Bernanke did was state the obvious. QE has to end, the Fed cannot continue to “print money” in the face of improving economic results. The economy is able to stand on its own feet and, as a result, it is standard practice for the Fed to ‘remove the punchbowl once the party gets rolling!’ Improved recent employment figures in the US lead the Company to believe the world’s largest economy is returning to more normal business activity.

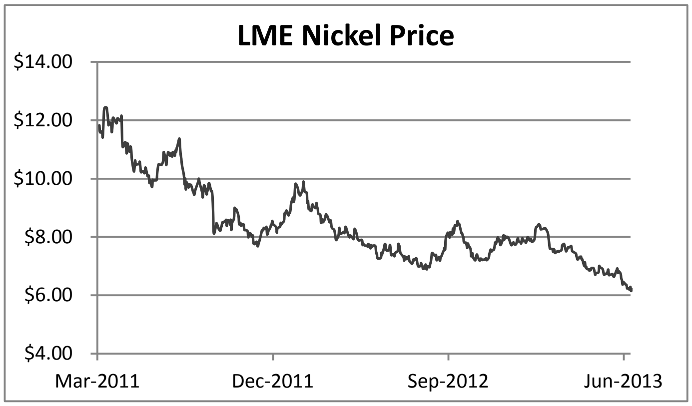
What happens to bonds if rates rise? The simple answer is when interest rates rise, bond prices fall and the longer the term of the bond, the further the price will fall. As we’ve outlined above, this is certainly true on government and investment grade bonds. However, the high yield market is not impacted to the same extent by rising rates. As an example, the Company produced a -1.0% return year-to-date, based on net asset value, compared to the DEX Universe Index return of -1.7%.

Why? Firstly, the coupon on the securities in the portfolio is significantly higher than the coupon in the DEX Universe. At June 30, 2013, the portfolio provided a yield to maturity of 7.5%, versus the DEX Universe which yields 2.7%. Secondly, the portfolio has a shorter term to maturity of 4.4 years versus the DEX Universe Index at almost 10 years, meaning it is less sensitive to changes in interest rates. Thirdly, interest rates rise because economic conditions are improving, which is positive for corporate earnings and balance sheets, thus positive for high yield bonds.

The Company had a holding which negatively impacted the portfolio’s return in the past six months. Northland Resources S.A. bonds, as discussed in more detail in our Q1 2013 Operational Update, were sold in the period and resulted in a decrease to the portfolio of approximately $0.34 per share. This decline, along with the decrease of the future tax asset ($0.11 per share) represents the majority of the decline in the net asset value for the six month period. On balance, the remaining holdings in the portfolio generated a positive return equal to the overall portfolio coupon.

An example of a bond providing a positive return during the six month period, through capital appreciation, was North American Energy Partners Inc. (“NAEP”). In June, NAEP announced the sale of their piling division for $210 million with an option to receive an additional $92.5 million if certain hurdles are met. Proceeds from the sale will be used to pay down the debt, which currently totals $310 million. NAEP retains their mining division, which management expects to generate $45 million over the next twelve months. In addition, the majority of their hard assets, roughly 80%, remain with NAEP after the sale of the piling division. This was positive for the bonds, which rose from $88.5 at December 31, 2012 to $102 at June 30, 2013.

The portfolio also has the potential for future capital appreciation. One example being Mirabela Nickel Ltd. bonds, which were trading in the mid- $70’s at June 30, 2013. Mirabela produces nickel from a world class sulphide deposit and facility in Brazil. The nickel market is in a very deep slump. The graph below shows the steep decline in the commodity price since March 2011.



Source: Bloomberg

At today's nickel price, very few producers make any money, including Mirabela. That said, it has a first class deposit and plant, strong shareholders, great management, they operate in a good jurisdiction (Brazil), and they have cash on hand to help them withstand low nickel prices for an estimated 18 months. Mirabela management has been working hard and has been effective in reducing mining costs. To be sure, a recovery in nickel prices is needed for Mirabela to remain current on their interest payments. The point is that because of the low commodity price, there will be no new nickel mines. Moreover, one may begin to see production cuts or shutdowns from higher-cost mining operations. Mirabela has a $50 million fully drawn bank facility and $395 million of high yield bonds which are currently marked in the low $70's. Assuming this price level, and ignoring cash on hand, the bonds are valuing Mirabela at $325 million. The replacement value of their plant alone is roughly $1 billion.

We have allowed cash to build in the portfolio over the past 12 months. Cash and short term deposits currently represents 18.1% of the portfolio. We did this because yields were declining and attractive opportunities became scarce.

During the period, Deans Knight designed and originated $6 million in short term secured notes with Uranerz Energy Corporation, a uranium company with assets in Wyoming. The Company provided $2,250,000, or 1.7% of the current portfolio value, of the notes. Uranerz has received approval in principle for a $20 million loan under the state of Wyoming's Industrial Development Revenue Bond program and is working with the State to finalize documentation. The secured notes will allow Uranerz to commence drilling of deep disposal wells in advance of the State financing. Uranerz intends to repay the notes in full upon closing of the $20 million loan.

The notes are secured senior obligations of Uranerz, bear interest at 6% per annum, which increase to 10% per annum on August 15, 2013 if the facility is still outstanding. The facility matures on the earlier of (i) 30 days from closing of the State loan, and (ii) December 31, 2013. As additional consideration, Uranerz paid an up-front commitment fee of 1.5%, and issued warrants to purchase 1,600,000 common shares at a price of $1.60 per share, of which 400,000 warrants will be exercisable only if the notes remain outstanding after August 15, 2013.

Recent Developments

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 $0.06 per common share at June 30, 2013 (December 31, 2012 - $0.08 per common share), as outlined in the notes to the Financial Statements.

International Financial Reporting Standards

The Company 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 has a termination date of April 30, 2014, and as such will not be required to issue statements reported on under IFRS. The Company will continue to monitor any further AcSB decisions that may affect the Company’s requirement to adopt IFRS.

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 six month period ending June 30, 2013, management fees totaled $1,089,013 (2012 - $2,311,284). At June 30, 2013, $536,774 (December 31, 2012- $589,251) was owed to Deans Knight, which was included in accounts payable and accrued liabilities in the statement of net assets, and is payable immediately. In calculating the management fee, the net asset value was reduced by the value of the future income tax asset included in the statement of net assets.

A former director of the Company is a partner at a law firm that provides legal services to the Company. During the six month period ending June 30, 2013, the Company incurred $175,830 (June 30, 2012 - $11,098) in legal services and disbursements received from this related party. At June 30, 2013, accounts payable and accrued liabilities include $103,000 (December 31, 2012 - $226) due to the law firm for legal fees and disbursements.

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)]

	Six months ended June 30, 2013	**Year ended December 31,**			**Period March 17 to December 31, 2009**
		2012 $	**2011 $**	**2010 $**	**$**
Net assets, beginning of year [(2)]	13.50	13.43	13.60	12.21	9.12
Increase from operations					
Total revenue	0.53	1.10	1.10	0.94	0.62
Total expenses	(0.14)	(0.26)	(0.26)	(0.24)	(0.20)
Realized gains	(0.80)	0.44	0.36	1.82	1.25
Unrealized losses	0.39	(0.27)	(0.52)	(0.27)	1.21
Future income taxes	(0.11)	(0.24)	(0.15)	(0.16)	0.62
Total increase from operations [(2)]	(0.13)	0.77	0.53	2.09	3.50
Dividends [(2)(3)]	(0.35)	(0.70)	(0.70)	(0.70)	(0.41)
Net assets, end of year [(4)]	13.02	13.50	13.43	13.60	12.21

(1) The information is derived from the Company's audited annual and unaudited interim 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)

	Six months ended June 30, 2013	Year Ended December 31, 2012	2011	2010	Period March 17 to December 31, 2009
Net asset value (000's)	$137,775	$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)	1.09%	1.96%	1.90%	1.91%	5.51%
Portfolio turnover rate (3)	14.07%	14.79%	79.90%	86.60%	36.69%
Trading expense ratio (4)	0.01%	0.01%	0.00%	0.01%	0.01%
Net asset value per common share	$13.08	$13.58	$13.49	$13.65	$12.23
Closing market price – common share	$12.25	$12.69	$11.84	$12.54	$11.40

(1) Management expense ratio is annualized and based on total expenses for the period and is expressed as a percentage of weekly average net asset values over the period. For 2009, this ratio is calculated from the date the Company began operating its business as an investment corporation, on March 17, 2009, to December 31, 2009.

(2) The Management expense ratio for 2009 includes offering costs for the IPO of $6,268,800 less the offsetting related future tax benefit of $1,692,500.

(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.

Management Fees

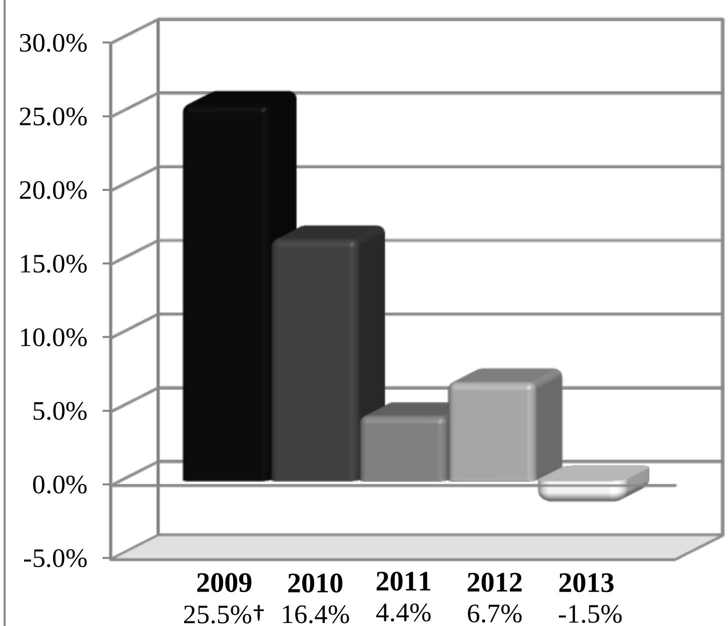
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes, 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 how much an investment made for the six-month period ending June 30, 2013.



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

‡ Simple holding period return for the six months ended June 30, 2013

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	6.9
NORTH AMERICA ENERGY	9.125%	7-Apr-17	6.5
WHITECAP RESOURCES	N/A	N/A	6.1
MIRABELA NICKEL LTD	8.750%	15-Apr-18	5.9
CALFRAC HOLDINGS LP	7.500%	1-Dec-20	4.6
SOUTHERN PACIFIC RES	8.750%	25-Jan-18	3.6
TEMBEC INDUSTRIES	11.250%	15-Dec-18	3.5
CCS INC	11.000%	15-Nov-15	3.5
PERPETUAL ENERGY INC	8.750%	15-Mar-18	3.4
STONE ENERGY CORP	8.625%	1-Feb-17	3.4
PETROAMERICA OIL	11.500%	19-Apr-15	2.9
SHERRITT INTL CORP	8.000%	15-Nov-18	2.8
CARA OPERATIONS LTD	9.125%	1-Dec-15	2.6
BEAZER HOMES USA	9.125%	15-Jun-18	2.6
GARDA WORLD SECURITY	9.750%	15-Mar-17	2.5
GATEWAY CASINOS	8.875%	15-Nov-17	2.1
PACIFIC RUBIALES	7.250%	12-Dec-21	1.9
SURE ENERGY	6.250%	21-Jan-14	1.8
ATHABASCA OIL CORP	7.500%	19-Nov-17	1.7
URANERZ ENERGY CORP	6.000%	31-Aug-13	1.7
WESTERN ENERGY SVS	7.785%	30-Jan-19	1.7
NIKO RESOURCE LTD CV	7.000%	13-Dec-17	1.6
99 CENTS ONLY STORES	11.000%	15-Dec-19	1.6
SHERRITT INTL CORP	7.500%	24-Sep-20	1.4
JUST ENERGY GROUP	6.000%	30-Jun-17	1.0

Portfolio Composition	% of Net Asset Value
Fixed Income	
Canadian denominated in CAD	44.8
Canadian denominated in USD	14.4
United States denominated in USD	13.9
Other Foreign denominated in EUR	0.9
	74.0
Equity and Warrants	6.4
Investment Portfolio	80.4
Cash & Short-term Deposits	18.0
Other Net Assets	1.6
	100.0
Sector Breakdown	
Energy	50.5
Materials & Metals	10.2
Consumer Discretionary	11.8
Forestry	3.5
Technology	1.0
Services	3.4
Investment Portfolio	80.4
Cash & Short-term Deposits	18.0
Other Net Assets	1.6
	100.0