

DEANS KNIGHT

INCOME CORPORATION

INTERIM MANAGEMENT REPORT

OF FUND PERFORMANCE

For the period from

January 1, 2016 to June 30, 2016

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 financial statements of the Company for the six month period ending June 30, 2016 (the "**Financial Statements**"), which, if not included with this Report, can be obtained at your request, at no cost by emailing info@dkincomecorp.com, visiting our website at www.dkincomecorp.com for contact details or on SEDAR at www.sedar.com. Readers may also contact us to request a free copy of the Company's proxy voting policies and procedures, proxy voting disclosure record or quarterly portfolio disclosure.

A NOTE ON FORWARD-LOOKING STATEMENTS

This Report contains certain forward-looking statements. In particular, this Report contains forward-looking statements in respect of the Company's investment strategy, the availability and use of the tax attributes of the Company, the resolution and disposition of the CRA Matter (as defined herein) including the extent of the Potential Tax Liability (as defined herein), and reflects the Company's expectations regarding the results of operations and performance 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, the liquidity and potential proceeds to be realized from the Remaining Investments (as defined herein), currency, exchange and interest rates and concerning the disposition of the CRA Matter, assumptions based on the amount of time it has taken other companies to conclude similar matters in the past. 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 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 respected 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 defined below). As such, the Company's business now consists of: (i) attending to and litigating the CRA Matter; (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

The overall risks of the Company are as described in the annual information form of the Company dated March 29, 2016 (the "**AIF**").

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.

In July 2014, the Company received Notices of Reassessment ("**NORAs**") from the Canada Revenue Agency (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 2016 to date, the Company estimates its overall potential net tax liability ("**Potential Tax Liability**") for the years 2009 through 2016 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 Company anticipates that legal proceedings through the Tax Court of Canada to resolve the CRA Matter will take considerable time.

The Company's common voting shares ("**Voting Shares**") were delisted from trading on the Toronto Stock Exchange on April 15, 2014 and are no longer traded in a public market. The non-voting common shares of the Company ("**Non-Voting Shares**") are also not traded in a public market. As a result, there is no active market through which the Common Shares may be traded and there is also no guarantee that an active trading market will develop. The lack of a market for the Common Shares may affect the price of the shares in any secondary market that may develop; however, there can be no assurance that an active trading market or secondary market will develop, or if developed, that such a market will be sustained at the price level of the net asset value per share.

Given the majority of the Company's business is now limited to attending to the CRA Matter, the resolution and disposition of this matter which is uncertain at this time, 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 potentially significant volatility in the value of their investment.

Results of Operations

The net assets of the Company consisted of the following components for the periods indicated:

	June 30, 2016		
	\$	Per Common Share ⁽¹⁾	%
Remaining Investments ⁽²⁾	77,729	0.01	0.3
Cash and short-term deposits	1,673,994	0.16	7.2
Prepaid tax asset ⁽³⁾	21,662,136	2.06	92.6
Accrued liabilities less prepaid assets	<u>(14,739)</u>	<u>(0.01)</u>	<u>(0.1)</u>
	<u>23,399,120</u>	<u>2.22</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 Note 6 - Taxation in the Financial Statements for more detail.

December 31, 2015

	\$	Per Common Share ⁽¹⁾	%
Remaining Investments ⁽²⁾	282,020	0.03	1.2
Cash and short-term deposits	1,924,070	0.18	8.1
Prepaid tax asset ⁽³⁾	21,662,136	2.06	91.4
Accrued liabilities less prepaid assets	(154,979)	(0.02)	(0.7)
	<u>23,713,247</u>	<u>2.25</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 Note 6 - Taxation in the Financial Statements for more detail.

The majority of the decrease in the net asset value of the Company at June 30, 2016, compared to December 31, 2015, is due to the decrease in value of the common shares of Mirabela Nickel Limited ("**Mirabela**"). The investment was written down to nil on February 19, 2016 as a result of Mirabela announcing that its Santa Rita mine had been placed on care and maintenance as a result of reductions in the price of nickel, difficulties in obtaining additional funding and unsustainable levels of cash outflows from its wholly-owned subsidiary. In addition, cash and short-term deposits have decreased by approximately \$0.25 million as a result of general operating expenditure.

The Company's comprehensive (loss) income for the six-month period to June 30, 2016 was approximately \$(0.314) million (\$(0.03) per Common Share) versus \$0.626 million (\$0.06 per Common Share) for the six-month period to June 30, 2015. The decrease is the result of the Company having liquidated the majority of income generating investments by December 31, 2015. In the six-month period to June 30, 2016, the Company generated \$0.204 million of unrealized capital losses due to the common shares of Mirabela being written down to nil.

Recent Developments

Going forward, because the majority of the Company's income generating investments have been liquidated, the Company is expected to continue to generate a comprehensive loss.

See also the section titled "Risk" in this Report for recent developments regarding the CRA Matter and a description of the Modified Business Objectives.

Related Party Transactions

The Officers and Directors of the Company are also employees of 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 at www.sedar.com.

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, 2016, management fees totaled \$63 (2015 - \$63). At June 30, 2016, \$nil (December 31, 2015 - \$189) 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.

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 5 years.

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

	Six months	Year ended December 31,				
	ended June 30, 2016	2015	2014	2013	2012	2011
	\$	\$	\$	\$	\$	\$
Net assets, beginning of period	2.25	2.50	12.37	13.58	13.43	13.60
Increase from operations						
Total revenue	0.00	0.01	0.14	0.96	1.10	1.10
Total expenses	(0.01)	(0.04)	(0.09)	(0.29)	(0.26)	(0.26)
Realized gains (losses)	-	0.22	(0.37)	(0.50)	0.44	0.36
Unrealized gains (losses)	(0.02)	(0.24)	0.32	(0.47)	(0.19)	(0.52)
Future income taxes	-	-	(0.02)	(0.21)	(0.24)	(0.15)
Total (decrease) increase from operations ⁽²⁾	(0.03)	(0.05)	(0.02)	(0.51)	0.85	0.53
Return of capital ⁽²⁾⁽³⁾	-	-	(9.75)	-	-	-
Dividends ⁽²⁾⁽³⁾	-	(0.20)	(0.10)	(0.70)	(0.70)	(0.70)
Net assets, end of period	2.22	2.25	2.50	12.37	13.58	13.43

(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 Shares and 345,671 Non-Voting Shares.

(2) Net assets, return of capital and dividends are based on the actual number of Common Shares outstanding at the relevant time. The increase / (decrease) from operations is based on the weighted average number of Common Shares outstanding over the period.

(3) Return of capital and dividends were paid in cash.

Ratios and Supplemental Data ⁽¹⁾

	Six months ended June 30,		Year ended December 31,			
	2016	2015	2014	2013	2012	2011
Net asset value (000's)	\$23,399	\$23,713	\$26,375	\$130,367	\$143,065	\$142,178
Number of common shares outstanding (000's)	10,537	10,537	10,537	10,537	10,537	10,537
Management expense ratio ⁽²⁾	0.47%	1.53%	1.09%	2.21%	1.96%	1.90%
Portfolio turnover rate ⁽³⁾	0.00%	0.00%	0.20%	25.23%	14.79%	79.90%
Trading expense ratio ⁽⁴⁾	0.00%	0.00%	0.03%	0.03%	0.01%	0.00%
Net asset value per common share	\$2.22	\$2.25	\$2.50	\$12.37	\$13.58	\$13.49
Closing market price – common share ⁽⁵⁾	n/a ⁽⁵⁾	n/a ⁽⁵⁾	n/a ⁽⁵⁾	\$10.01	\$12.69	\$11.84

- (1) This information is provided as at December 31 of the years shown, except for the information pertaining to the six months ended June 30, 2016.
- (2) Management expense ratio is based on total expenses for the period and is expressed as a percentage of weekly average net asset values over the period. 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 is paid a fee of \$10.00 per month and is 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 value of the portfolio securities. 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 year. This trading expense is insignificant, as the purchasing and selling of bonds do not generally attract a commission from the buying or selling party.
- (5) 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. Additionally, the Non-Voting Shares are not traded on a public market. As a result, a closing market price is not available for either the Voting Shares or Non-Voting Shares.

Management Fees

Deans Knight provides administration, financial reporting and other ancillary services required by a publicly listed 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 at www.sedar.com. Deans Knight is paid a nominal fee of \$10 per month for the services it provides to the Company under the Services Agreement.

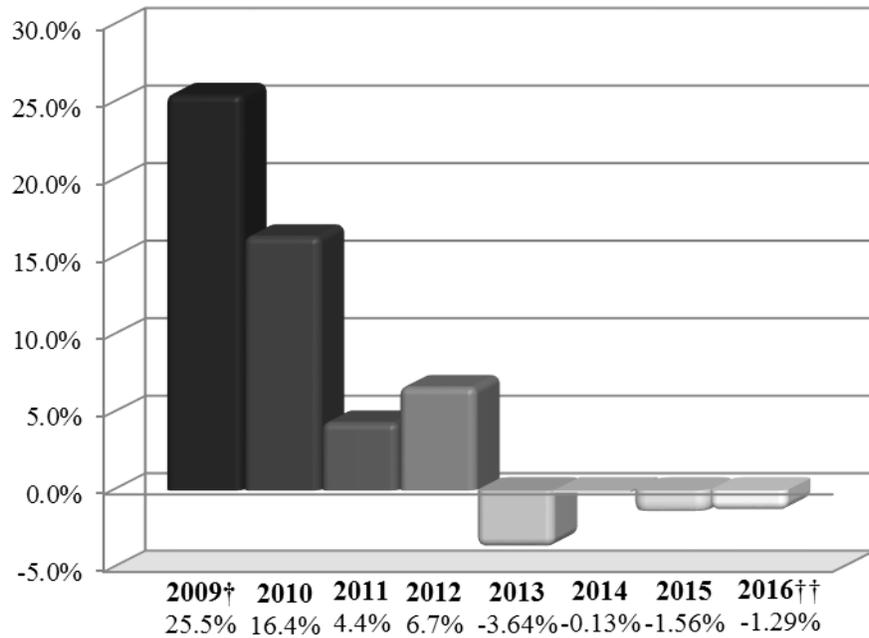
Past Performance

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 Deans Knight, its investment fund advisor and 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 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 through to 2015, and how much an investment made for the six-month period ended June 30, 2016. Given the Company has ceased all investing activities, other than liquidating the Remaining Investments, the returns provided below for the six-month period ended June 30, 2016 and for the year ended December 31, 2015 are not necessarily indicative of what the returns would have been for the periods if the Company had continued to actively manage the investment portfolio.



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

†† Dec 31, 2015 to June 30, 2016

Summary of Investment Portfolio

The following is a summary of the Company's investment portfolio as at June 30, 2016. This is a summary only and will change as the Company divests the Remaining Investments. A quarterly update is available at www.dkincomecorp.com.

Summary of Investment Portfolio

Investments				% of Net Asset Value	Portfolio Composition	% of Net Asset Value
SKYLINK AVIATION INC	10.00%	Nov 9 16	0.3		Fixed Income	
SKYLINK AVIATION INC	12.25%	May 10 18	0.0		Canadian denominated in USD	0.3
SKYLINK AVIATION INC COMMON SHARES			0.0			
MIRABELA NICKEL LTD COMMON SHARES			0.0			
MIRABELA NICKEL LTD	1.00%	Sep 10 44	0.0			
					Investment Portfolio	0.3
					Cash & Short-term Deposits	7.2
					Other Net Assets	92.5
						<u>100.0</u>
					Sector Breakdown	
					Services	0.3
					Investment Portfolio	0.3
					Cash & Short-term Deposits	7.2
					Other Net Assets	92.5
						<u>100.0</u>