

For Immediate Release, March 10, 2014

Deans Knight Income Corporation

**Releases Annual Management Report of Fund Performance and
Financial Statements for the year ended December 31, 2013**

Vancouver, B.C. - Deans Knight Income Corporation (the “Company”) (TSX: DNC) is pleased to release its annual Management Report of Fund Performance and Financial Statements for the year ended December 31, 2013.

These documents can be found on SEDAR at www.sedar.com or the Company’s website: www.dkincomecorp.com.

Forward-Looking Statements

This press release contains forward-looking statements. More particularly, this press release contains forward-looking statements concerning the Company's corporate objectives, the investment of the Company's proceeds from the sale of investments previously made, availability of tax losses and deductions, the anticipated total return to the Company's shareholders and the Company's intention to pay out monthly dividends. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, undue reliance should not be placed on them because the Company can give no assurance that they will prove to be correct since forward-looking statements address future events and conditions and by their very nature, involve inherent risks and uncertainties. The forward-looking statements contained in this press release are made as of the date hereof and the Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

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DEANS KNIGHT

INCOME CORPORATION

**ANNUAL MANAGEMENT REPORT
OF FUND PERFORMANCE FOR 2013**

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

A NOTE ON FORWARD-LOOKING STATEMENTS

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

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

Investment Objectives and Strategies

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

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

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

Risk

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

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

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

bearing on the Company's own tax position with the CRA. The Company will continue to assess its position as such litigation progresses.

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

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

Results of Operations

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

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

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

(2) The details of the investments are outlined in the Summary of Investment Portfolio below.

(3) Refer to the Taxation note to the Financial Statements for more detail.

December 31, 2012

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

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

(2) Refer to the Taxation note to the Financial Statements for more detail.

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

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

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

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

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

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

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

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

Recent Developments

Cash Distribution and Extension of Termination Date

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

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

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

Comparison of net asset value and net assets

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

International Financial Reporting Standards

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

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

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

Related Party Transactions

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

For the year ended December 31, 2013, management fees (including applicable taxes) totaled \$2,122,002 (2012 - \$2,311,289). At December 31, 2013, \$512,138 (2012 - \$589,251) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the statement of net assets, and is payable immediately.

A former director of the Company is a partner at a law firm that provides legal services to the Company. During the year ended December 31, 2013, the Company incurred \$299,969 (2012 - \$14,014) in legal services and disbursements provided by from this law firm. At December 31, 2013, accounts payable and accrued liabilities include \$133,884 (2012 - \$226) due to the law firm for legal fees and disbursements.

Financial Highlights

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

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

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

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

Ratios and Supplemental Data ⁽¹⁾

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

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

Management Fees

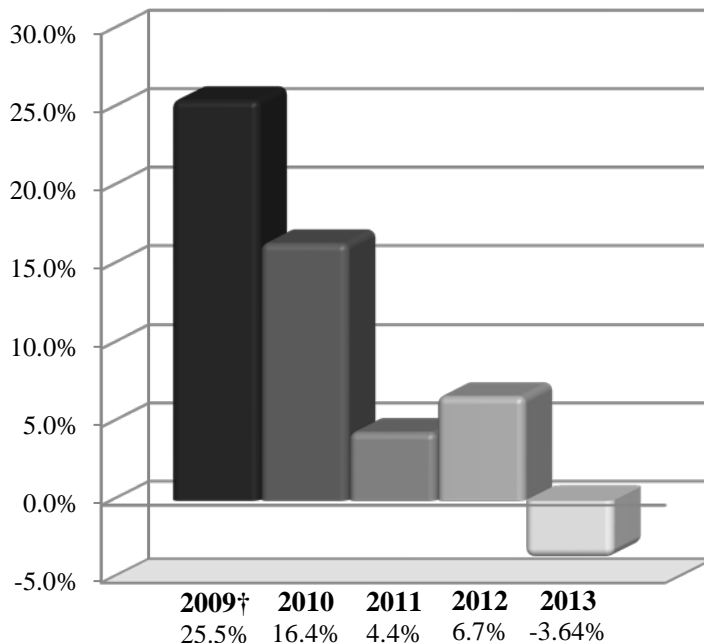
Deans Knight provides investment management services to the Company, as well as administration, financial reporting and other ancillary services required by a publicly listed company. Management fees are computed and paid quarterly, at an annual rate of 1.5% of the net asset value plus applicable taxes,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

Past Performance

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

Year-by-year Returns

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



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

Annual Compound Returns

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

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

Summary of Investment Portfolio

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

Top 25 Investments				% of Net Asset Value	Portfolio Composition	% of Net Asset Value
PARAMOUNT RESOURCES	8.250%	13-Dec-17	7.4			
WHITECAP RESOURCES	N/A	N/A	5.2			
TEMBEC INDUSTRIES	11.250%	15-Dec-18	3.8	Fixed Income		
PERPETUAL ENERGY INC	8.750%	15-Mar-18	3.7	Canadian denominated in CAD	35.0	
PETROAMERICA OIL	11.500%	19-Apr-15	3.1	Canadian denominated in USD	5.4	
GATEWAY CASINOS	8.500%	26-Nov-20	3.0	United States denominated in USD	3.7	
SHERRITT INTL CORP	8.000%	15-Nov-18	2.8	Other Foreign denominated in EUR	1.0	
ATHABASCA OIL CORP	7.500%	19-Nov-17	2.5		<u>45.1</u>	
DIRECTCASH PAYMENTS	8.125%	8-Aug-19	2.5	Equity and Warrants		<u>5.2</u>
NORTH AMERICAN ENERGY	9.125%	7-Apr-17	2.4	Investment Portfolio		50.3
CALFRAC HOLDINGS LP	7.500%	1-Dec-20	2.0	Cash & Short-term Deposits		49.6
WESTERN ENERGY SVS	7.785%	30-Jan-19	1.8	Other Net Assets		<u>0.1</u>
99 CENTS ONLY STORES	11.000%	15-Dec-19	1.7			<u>100.0</u>
CREW ENERGY INC	8.375%	21-Oct-20	1.5	Sector Breakdown		
SHERRITT INTL CORP	7.500%	24-Sep-20	1.4	Energy		30.3
BLACK PRESS GROUP	10.000%	28-Dec-18	1.0	Materials & Metals		5.2
RAPIDEYE CANADA	N/A	1-Jan-21	1.0	Consumer Discretionary		6.5
BLACK PRESS GROUP	L+5.0%	28-Jun-18	0.9	Forestry		3.8
NIKO RESOURCE LTD CV	7.000%	13-Dec-17	0.8	Financial Services		2.5
SKYLINK AVIATION INC	10.000%	8-Mar-15	0.8	Technology		1.0
MIRABELA NICKEL LTD	8.750%	15-Apr-18	0.8	Services		<u>1.0</u>
SKYLINK AVIATION INC	12.250%	10-May-18	0.2	Investment Portfolio		50.3
SHERRITT INTL CORP	7.750%	15-Oct-15	0.2	Cash & Short-term Deposits		49.6
URANERZ ENERGY CORP	N/A	N/A	0.1	Other Net Assets		<u>0.1</u>
CONIFEX TIMBER INC	N/A	N/A	0.0			<u>100.0</u>

Deans Knight Income Corporation

Financial Statements
December 31, 2013 and 2012

Deans Knight Income Corporation

Statements of Net Assets

As of December 31, 2013 and 2012

	2013 \$	2012 \$
Assets		
Investments - at fair value (cost - \$68,222,974; December 31, 2012 - \$117,207,284)	65,439,969	118,788,753
Cash and cash equivalents	64,573,401	20,091,125
Accrued interest receivable	786,745	1,662,373
Prepaid expenses	41,370	56,460
Future income tax benefits (note 7)	180,000	2,390,000
	<u>131,021,485</u>	<u>142,988,711</u>
Liabilities		
Accounts payable and accrued liabilities (note 5)	<u>873,905</u>	<u>713,711</u>
Net assets	<u>130,147,580</u>	<u>142,275,000</u>
Shareholders' Equity		
Common shares (note 3)	99,366,429	99,366,429
Contributed surplus (note 3)	9,904,504	9,904,504
Retained earnings (note 4)	<u>20,876,647</u>	<u>33,004,067</u>
	<u>130,147,580</u>	<u>142,275,000</u>
Number of common shares outstanding (note 3)	<u>10,537,263</u>	<u>10,537,263</u>
Net assets per common share (notes 7 and 10)	<u>12.35</u>	<u>13.50</u>
Contingencies (notes 1 and 7)		
Commitments (note 1)		
Subsequent events (notes 1, 7 and 9)		
Going concern (note 1)		

Approved by the Board of Directors

(signed) Wayne Deans _____ Director

(signed) Craig Langdon _____ Director

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

Deans Knight Income Corporation

Statements of Operations

For the years ended December 31, 2013 and 2012

	2013 \$	2012 \$
Investment income		
Interest and other	<u>10,066,296</u>	<u>11,547,744</u>
Expenses		
Management fees (note 5)	2,122,002	2,311,289
Legal fees (note 5)	390,090	14,014
Public company reporting costs	156,126	127,384
Director's fees and expenses	136,510	148,727
Audit, accounting and tax fees	91,087	82,024
Transaction costs	47,875	11,318
Custodial fees	43,688	50,651
Independent Review Committee fees	<u>16,650</u>	<u>12,180</u>
	<u>3,004,028</u>	<u>2,757,587</u>
Net investment income	<u>7,062,268</u>	<u>8,790,157</u>
Realized and unrealized gains (losses) on investments		
Net realized (loss) gain on investments sold (note 6)	(2,572,824)	2,548,818
Net realized (loss) gain on settlement of foreign currency contracts (note 6)	(2,670,520)	2,159,065
Change in unrealized depreciation on investments	(4,300,675)	(2,564,496)
Unrealized depreciation on foreign currency contracts	<u>(63,800)</u>	<u>(296,595)</u>
Net (loss) gain on investments	<u>(9,607,819)</u>	<u>1,846,792</u>
(Decrease) increase in net assets from operations before tax	(2,545,551)	10,636,949
Provision for future income tax (note 7)	<u>(2,210,000)</u>	<u>(2,530,000)</u>
(Decrease) increase in net assets from operations	<u>(4,755,551)</u>	<u>8,106,949</u>
(Decrease) increase in net assets from operations per weighted average common share (note 2)	<u>(0.45)</u>	<u>0.77</u>

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

Deans Knight Income Corporation

Statements of Changes in Net Assets

For the years ended December 31, 2013 and 2012

	2013 \$	2012 \$
(Decrease) increase in net assets from operations	<u>(4,755,551)</u>	<u>8,106,949</u>
Dividends paid to common shareholders (notes 4 and 9)	<u>(7,371,869)</u>	<u>(7,371,869)</u>
(Decrease) increase in net assets during the year	(12,127,420)	735,080
Net assets – Beginning of year	<u>142,275,000</u>	<u>141,539,920</u>
Net assets – End of year	<u>130,147,580</u>	<u>142,275,000</u>

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

Deans Knight Income Corporation

Statements of Cash Flows

For the years ended December 31, 2013 and 2012

	2013 \$	2012 \$
Cash flows from operating activities		
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
Items not affecting cash		
Net realized loss (gain) on investments sold	2,572,824	(2,548,818)
Net realized loss (gain) on settlement of foreign currency contracts	2,670,520	(2,159,065)
Change in unrealized depreciation on investments	4,300,675	2,564,496
Unrealized depreciation on foreign currency contracts	63,800	296,595
Provision for future income tax	2,210,000	2,530,000
	<u>7,062,268</u>	<u>8,790,157</u>
Cost of investments purchased (note 6)	(26,749,307)	(18,898,699)
Proceeds from investments sold (note 6)	70,490,273	31,875,281
Net change in non-cash balances related to operations		
Accrued interest receivable	875,627	677,378
Prepaid expenses	15,090	16,691
Accounts payable and accrued liabilities	160,194	4,471
	<u>51,854,145</u>	<u>22,465,279</u>
Cash flows from financing activities		
Dividends paid to common shareholders (notes 4 and 9)	(7,371,869)	(7,371,869)
Net increase in cash and cash equivalents during the year	44,482,276	15,093,410
Cash and cash equivalents – Beginning of year	20,091,125	4,997,715
Cash and cash equivalents – End of year	<u>64,573,401</u>	<u>20,091,125</u>
Cash and cash equivalents comprise		
Cash	7,665,211	9,110,875
Short-term deposits	56,908,190	10,980,250
	<u>64,573,401</u>	<u>20,091,125</u>

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

Deans Knight Income Corporation

Statement of Investments

As at December 31, 2013

	Par value ¹ \$	Average cost ² \$	Fair value ² \$	Percentage of total fair value ³ %
Fixed income – Canadian				
<i>Denominated in Canadian dollars</i>				
Athabasca Oil Corp. 7.5% 11-19-2017	3,500,000	3,406,250	3,290,000	5.0
Black Press Group Libor + 5.00% 06-28-2018	1,127,075	1,115,804	1,115,804	1.7
Black Press Group 10% 12-28-2018	1,250,000	1,250,000	1,278,125	2.0
Crew Energy Inc. 8.38% 10-21-2020	1,900,000	1,889,626	1,923,750	2.9
Directcash Payments 8.13% 08-08-2019	3,160,000	3,169,550	3,199,500	4.9
Gateway Casinos 8.50% 11-26-2020	3,900,000	3,900,000	3,861,000	5.9
North American Energy Partners Inc. 9.13% 04-07-2017	3,025,000	3,039,909	3,146,000	4.8
Paramount Resources Ltd. 8.25% 12-13-2017	9,250,000	9,250,000	9,573,750	14.6
Perpetual Energy Inc. 8.75% 03-15-2018	5,000,000	5,000,000	4,812,500	7.4
Petroamerica Oil Corp. 11.50% 04-19-2015 ⁴	4,000,000	4,000,000	4,000,000	6.1
Sherritt International Corp. 7.75% 10-15-2015	196,000	152,233	201,880	0.3
Sherritt International Corp. 8.00% 11-15-2018	3,750,000	3,750,000	3,693,750	5.6
Sherritt International Corp. 7.50% 09-24-2020	2,000,000	2,000,000	1,870,000	2.9
Skylink Aviation Inc. 12.25% 05-10-2018	525,800	525,800	320,738	0.5
Western Energy Services Corp. 7.88% 01-30-2019	2,250,000	2,250,000	2,328,750	3.6
		44,699,172	44,615,547	68.2
<i>Denominated in United States dollars</i>				
Mirabela Nickel Ltd. 8.75% 04-15-2018	9,285,000	8,442,717	987,553	1.5
Skylink Aviation Inc. 10.00% 03-08-2015	965,183	982,991	1,026,569	1.6
Tembec Industries 11.25% 12-15-2018	4,250,000	4,494,779	4,961,029	7.6
		13,920,487	6,975,151	10.7
Total Canadian fixed income		58,619,659	51,590,698	78.9
Fixed income – United States				
<i>Denominated in United States dollars</i>				
99 Cents Only Stores 11.00% 12-15-2019	1,850,000	1,926,584	2,233,294	3.4
Calfrac Holdings LP 7.5% 12-01-2020	2,350,000	2,401,045	2,555,699	3.9
Total United States fixed income		4,327,629	4,788,993	7.3
Total fixed income		62,947,288	56,379,691	86.2

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 These investments represent loans receivable

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

Deans Knight Income Corporation

Statement of Investments...continued

As at December 31, 2013

	Par value ¹ \$	Average cost ² \$	Fair value ² \$	Percentage of total fair value ³ %
Convertible debentures – Canada				
<i>Denominated in Canadian dollars</i>				
Niko Resources Ltd. 7.00% 12-13-2017	2,000,000	2,000,000	1,060,000	1.6
Equities – Canada				
<i>Denominated in Canadian dollars</i>				
Conifex Timber Inc. - purchase warrants \$9.33 strike, 12-31-2014	81,726	-	34,195	0.1
Uranerz Energy Corp. - purchase warrants \$1.60 strike, 12-05-2015	600,000	-	72,434	0.1
Skylink Aviation Inc. - common shares	33,765	-	-	-
Whitecap Resources Inc. - common shares	531,767	3,275,686	6,716,216	10.3
Total equities		3,275,686	6,822,845	10.5
Royalties – Canada				
<i>Denominated in Euro</i>				
RapidEye Canada Royalty		-	1,241,233	1.9
Investments subtotal		68,222,974	65,503,769	100.2
Foreign currency contracts (note 8)				
<i>Denominated in United States dollars</i>				
Payable 17-01-2014 at 1.05870	2,000,000	-	(9,800)	(0.1)
Payable 06-01-2014 at 1.05860	10,800,000	-	(54,000)	(0.1)
Total foreign currency contracts		-	(63,800)	(0.2)
		68,222,974	65,439,969	100.0

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 These investments represent loans receivable

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

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

1 Nature of operations and basis of presentation 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 closed-end, non-redeemable investment company. It invests, 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. The Company maintains product liability insurance for certain claims that may arise in the future in connection with its prior business. To date, no such claims or potential claims have arisen. In March 2009, the Company completed an initial public offering, whereby it raised gross proceeds of \$100,368,900 and began operating its new business as an investment company.

As per the Company’s Articles of Incorporation (“Articles”), the common shares of the Company are to be redeemed on, or around, April 30, 2014, for a cash amount equal to 100% of the net asset value per common share.

On January 27, 2014, the Company called a special meeting of shareholders to be held on April 4, 2014. The meeting is to seek shareholder approval to extend the term of the Company until such time as is reasonably practicable following the conclusion of the CRA Audit or any appeal made to the Tax Court of Canada, or such other date as the Company deems appropriate on not less than 30 days’ notice to shareholders. Should its shareholders vote to extend the term of the Company, it has the intent and ability to take actions necessary to continue as a going concern. The Company anticipates obtaining approval for this extension; therefore these financial statements have been prepared on a going concern basis. If the shareholders do not vote to extend the term of the Company, then in accordance with the Articles the Company must be wound up by April 30, 2014. However, the Company may, in its discretion, extend the redemption date by a period of up to 180 days, pursuant to its discretionary power to do so under the Articles, to enable illiquid securities to be converted to cash. Further, the Company would have to settle all outstanding liabilities, including tax assessments, by that date in order to obtain a tax clearance certificate.

The accompanying financial statements are prepared in accordance with Part V of the Chartered Professional Accountants (CPA) Canada Handbook, Pre-changeover Accounting Standards (GAAP). All amounts are presented in Canadian dollars, unless otherwise noted.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

2 Summary of significant accounting policies

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

Financial instruments

Investments

Investments are held for trading and are recorded at fair values determined as follows:

Fixed income investments

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

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.

Foreign currency contracts

Foreign currency contracts are recorded at fair value. The proceeds (payments) on contracts settled during the year are included in the net realized loss on settlement of foreign currency contracts (note 6). The Company's policy is to hedge 95% - 105% of the fair value of foreign denominated investments with foreign exchange forward sell contracts.

Public company equities

Publicly traded equities are recorded at bid 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.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

Warrants

Warrants are recorded at their estimated fair value using appropriate and accepted industry valuation techniques.

The impact of changes in fair value of investments is recorded in the statements of operations.

Cash and cash equivalents

Cash and cash equivalents are accounted for at amortized cost. They consist of cash and deposits with maturities, at the time of purchase, of three months or less.

Accrued interest receivable

Accrued interest is designated as loans and receivables and is accounted for at amortized cost. Due to the immediate and short-term nature, the carrying value approximates fair value.

Financial liabilities

Financial liabilities, consisting of accounts payable and accrued liabilities, are designated as other financial liabilities and are accounted for at amortized cost. Due to the immediate and short-term nature, the carrying value approximates fair value.

Investment transactions

Investment transactions are recorded on the trade date. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or 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. These costs are expensed and are included in the statements of operations.

Income recognition

Income from investments is recognized on an accrual basis. Interest income is accrued based on the number of days the investment is held during the year. Royalty income is recognized on an accrual basis as earned. Gains or losses on the sale of investments, including foreign exchange gain or loss on such investments, are calculated on an average cost basis.

Foreign currency contracts

Foreign currency contracts (note 8) 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 to be closed out, which is equivalent to the difference between the deliverable asset and the value of the asset to be received. Changes in the value of a forward contract or the assets deliverable under such a contract are included as unrealized depreciation on foreign currency contracts in the statements of operations.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

Foreign exchange

Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate applicable on the valuation date. Purchases and sales of investments, investment income and expenses are calculated at the exchange rates prevailing on the dates of the transactions.

Income taxes

The Company follows the asset and 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 likely that a payment will be required to be made.

A valuation allowance is recognized to the extent that it is not more likely than not that future income tax assets will be realized. Management has estimated the income tax provision and future income tax balances taking into account its expectation of future 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 future tax balances could change (note 7), and the change could be significant.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those reported and such differences could be material. Significant areas involving the use of estimates include determining the estimated fair value of investments and future income tax assets.

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 statement of net assets date.

Increase in net assets from operations per weighted average common share

The increase in net assets from operations per weighted average common share represents the increase in net assets from operations divided by the weighted average number of common shares outstanding during the year.

The weighted average number of shares outstanding during the year ended December 31, 2013 was 10,537,263 (2012 - 10,537,263). This weighted average includes both the voting common shares and non-voting common shares of the Company.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

Future changes in accounting policies

The Company will transition to International Financial Reporting Standards (IFRS) for its fiscal year beginning January 1, 2014. IFRS comparative financial information will be required in interim and annual financial statements relating to fiscal periods beginning on or after January 1, 2013. As a result, the Company will adopt IFRS commencing January 1, 2014. The Company is assessing the potential impact of adopting IFRS and does not expect the adoption to result in significant measurement differences to current reporting under GAAP.

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.

There were no changes in the number of voting and non-voting common shares issued or outstanding during the years ended December 31, 2013 and 2012.

The total shares outstanding at December 31 are summarized as follows:

	2013		2012	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Voting common shares	10,191,592	96,273,343	10,191,592	96,273,343
Non-voting common shares	<u>345,671</u>	<u>3,093,086</u>	<u>345,671</u>	<u>3,093,086</u>
Total common shares outstanding	<u>10,537,263</u>	<u>99,366,429</u>	<u>10,537,263</u>	<u>99,366,429</u>

Contributed surplus

The contributed surplus balance did not change during the years ended December 31, 2013 and 2012, and consists of:

	2013 \$	2012 \$
Surplus related to stock compensation, warrants and options associated with common shares	8,030,295	8,030,295
Surplus relating to warrants associated with previously issued preferred shares	<u>1,874,209</u>	<u>1,874,209</u>
	<u>9,904,504</u>	<u>9,904,504</u>

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

4 Retained earnings

The changes in retained earnings for the years ended December 31, 2013 and 2012 are as follows:

	2013 \$	2012 \$
Retained earnings – opening balance	33,004,067	32,268,987
(Decrease) increase in net assets from operations	(4,755,551)	8,106,949
Dividends paid from net investment income	<u>(7,371,869)</u>	<u>(7,371,869)</u>
Retained earnings – closing balance	<u>20,876,647</u>	<u>33,004,067</u>

5 Related party transactions and balances

Management fees are paid quarterly to Deans Knight Capital Management Ltd. (the Investment Advisor), a corporation with certain common directors and officers of the Company, for services received in connection with the management of the investment portfolio and financial accounts, among other services provided. Management fees are computed quarterly at an annual rate of 1.5% of net asset value, adjusted for certain non-investment related assets. For the year ended December 31, 2013, management fees (including applicable taxes) totalled \$2,122,002 (2012 - \$2,311,289). At December 31, 2013, \$512,138 (2012 - \$589,251) was owed to the Investment Advisor, which was included in accounts payable and accrued liabilities in the statements of net assets, and is payable immediately.

A former director of the Company is a partner at a law firm that provides legal services to the Company. During the year ended December 31, 2013, the Company incurred \$299,969 (2012 - \$14,014) in legal services and disbursements provided by from this law firm. At December 31, 2013, accounts payable and accrued liabilities include \$133,884 (2012 - \$226) due to the law firm for legal fees and disbursements.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

6 Net realized (loss) gain on investments sold and foreign currency contracts

The net realized (loss) gain on investments sold and foreign currency contracts for the year ended December 31 was as follows:

	2013 \$	2012 \$
Proceeds from investments sold	70,490,273	31,875,281
Investments at cost – Beginning of year	117,207,284	125,475,983
Add: Cost of investments purchased	26,749,307	18,898,699
	143,956,591	144,374,682
Less: Investments at cost – End of year	(68,222,974)	(117,207,284)
Cost of investments sold	75,733,617	27,167,398
Net realized (loss) gain on investments sold	(5,243,344)	4,707,883

Net realized (loss) gain on investments sold and foreign currency contracts consists of:

	2013 \$	2012 \$
Realized (loss) gain on investments sold	(2,572,824)	2,548,818
Realized (loss) gain on settlement of foreign currency contracts	(2,670,520)	2,159,065
	(5,243,344)	4,707,883

7 Taxation

Uncertainty of deductibility of tax losses

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

On January 21, 2014, the Company received a proposal letter ("Proposal Letter") from the Canada Revenue Agency ("CRA"). In it, the CRA stated that it intends to reassess the Company and deny the deduction of certain non-capital losses and other tax attributes in the Company's taxation years ending in 2009 to and including 2012, which are currently the subject of an audit by the CRA (the "CRA Audit"). The CRA has indicated in the Proposal Letter that it intends to deny the use of certain tax attributes by the Company on the basis that an acquisition of control of the Company occurred and on the basis of the General Anti-Avoidance Rule in the Income Tax Act (Canada). The Company, in consultation with its legal advisors, remains of the

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

view that its tax filing position is appropriate, and does not believe any additional assessment of income tax by the CRA is appropriate. There continues to be tax litigation in progress involving the CRA and other companies which may have a bearing on the Company's own tax position with the CRA. The Company will continue to assess its position as such litigation progresses.

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

Future tax asset

Canadian GAAP requires a valuation allowance to be recognized against any future tax asset to the extent that it is more likely than not that the future income tax asset will not be realized. This is also the Company's stated accounting policy.

As the Company's investments in debt securities are generating interest income, but are not expected to generate sufficient taxable income in order to fully utilize the available tax credits prior to April 30, 2014, the Company has recorded a valuation allowance. The difference between the total value of these tax benefits less the valuation allowance, being \$180,000 (December 31, 2012 - \$2,390,000), is the amount of the future income tax asset that has been recorded by the Company in the statement of net assets. The valuation allowance is reviewed, based on updated projections of taxable income, and adjusted accordingly by a credit or charge to the statements of operations.

The tax effects of temporary differences and tax credits that give rise to significant components of the future income tax assets, at the statutory enacted rates when such benefits are expected to be realized, are as follows:

	2013	2012
	\$	\$
Future income tax assets		
Non-capital loss carry forward	987,800	-
Research and development expenditures	4,715,100	4,533,250
Investment tax credits	5,322,750	5,322,750
Share issuance costs	-	313,440
	<hr/>	<hr/>
Total gross future income tax assets	11,025,650	10,169,440
Valuation allowance	(10,845,650)	(7,779,440)
Net future income tax asset	<hr/> <u>180,000</u>	<hr/> <u>2,390,000</u>

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

Future income tax assets expected to be realized in:

	2013	2012
	\$	\$
Less than 12 months	180,000	1,930,000
Greater than 12 months	-	460,000
Net future income tax asset	<u>180,000</u>	<u>2,390,000</u>

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 future income tax assets may not be deductible for tax purposes and, accordingly, the amount of future income taxes and provision for income taxes recorded in the financial statements could change by a material amount.

In determining the amount of future income tax assets recognized, management assessed the projected taxable income of the Company. Inherent in all forward looking information is uncertainty and actual amounts could differ from these estimates and the difference could be material. In developing the projection, management has assumed full payment of all contractual interest, that investments maturing prior to April 30, 2014 will be redeemed for par value, and that investments maturing after April 30, 2014 will be sold at their current value.

As per note 1, a special meeting will be held on April 4, 2014 to obtain shareholder approval to extend the term of the Company. Should that approval be obtained it is anticipated that some of the valuation allowance will be reversed to the extent that the future income tax assets are consistent with the expected term of the Company.

Tax pools available to offset future tax expense and payable

The operations of the Company and related tax interpretations, regulations and legislation are continually changing. As a result, significant estimates are required to compute income tax balances. As at December 31, 2013, the Company has accumulated scientific research and experimental development expenditures in the amount of \$18,135,000 available for carry forward indefinitely. The Company incurred non-capital losses during the year ended December 31, 2013, which will expire in 2033 and amount to \$2,545,551. The Company also has accumulated approximately \$7,097,000 of unclaimed federal investment tax credits, which expire as follows:

Year of expiry	Investment tax credits
	\$
2018	265,000
2019	990,000
2020	1,872,000
2021	2,483,000
2022	298,000
2023	187,000
2024	496,000
2025	506,000
	<u>7,097,000</u>

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

Reconciliation of income tax expense

The reconciliation of income tax computed at the statutory tax rate to income tax expense at December 31, using a 25.75 % statutory tax rate (2012 - 25.0%), is as follows:

	2013	2012
	\$	\$
(Decrease) increase in net assets from operations before tax	(2,545,551)	10,636,949
Statutory tax rate	<u>25.75%</u>	<u>25.0%</u>
Income tax (recovery) expense at statutory rates	(655,479)	2,659,238
Use of scientific research and experimental development expenditures	-	(2,345,798)
Non-capital loss carry forward	978,319	-
Reduction of future income tax asset	2,210,000	2,530,000
Current tax deductions for offering costs	<u>(322,840)</u>	<u>(313,440)</u>
Provision for future income tax	<u>2,210,000</u>	<u>2,530,000</u>

8 Financial instruments

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.

Deans Knight Income Corporation

Notes to Financial Statements

December 31, 2013

The following tables illustrate the classification of the Company's financial instruments within the fair value hierarchy:

Financial assets at fair value – December 31, 2013

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Corporate debt	-	50,044,832	6,334,859	56,379,691
Convertible debentures	-	1,060,000	-	1,060,000
Equities	6,716,216	-	106,629	6,822,845
Royalty	-	-	1,241,233	1,241,233
Foreign currency contracts	-	(63,800)	-	(63,800)
	6,716,216	51,041,032	7,682,721	65,439,969

Financial assets at fair value – December, 31 2012

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Corporate debt	-	93,669,383	13,965,857	107,635,240
Convertible debentures	-	2,200,000	-	2,200,000
Equities	8,696,425	-	677,413	9,373,838
Royalty	-	-	1,238,770	1,238,770
Other	-	(1,362,500)	-	(1,362,500)
Foreign currency contracts	-	(296,595)	-	(296,595)
	8,696,425	94,210,288	15,882,040	118,788,753

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The following table reconciles the Company's Level 3 fair value measurements:

	Fair value measurements of Level 3 inputs				
	Corporate debt \$	Convertible debentures \$	Equities \$	Royalty \$	Total \$
Balance – December 31, 2011	22,965,956	1,554,218	205,444	-	24,725,618
Purchases	4,000,000	-	-	-	4,000,000
Sales	(13,081,762)	(1,558,378)	-	-	(14,640,140)
Unrealized appreciation included in net gain on Investments	81,663	4,160	471,969	1,238,770	1,796,562
Balance – December 31, 2012	13,965,857	-	677,413	1,238,770	15,882,040
Purchases	982,991	-	-	-	982,991
Transfers	2,223,464	-	-	-	2,223,464
Sales	(10,233,152)	-	(510,000)	-	(10,743,152)
Unrealized (depreciation) appreciation included in net gain on investments	(604,301)	-	(60,784)	2,463	(662,622)
Balance – December 31, 2013	6,334,859	-	106,629	1,241,233	7,682,721

The transfers from Level 2 to Level 3 during the year ended December 31, 2013, totalling \$2,223,434, relate to corporate debt securities that experienced significant reductions in trading activity during the year. The valuation inputs for these securities were not therefore based on market observable inputs and resulted in the reclassification to Level 3.

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. Accordingly, in the absence of any reasonably possible alternative assumptions, and except as noted below, it is not practicable to provide a sensitivity analysis.

For royalty investments measured on a discounted cash flow basis the value is imputed through forecasted cash flows and discount rates. The following summarizes the affect a change in assumptions would have on total net assets at December 31, 2013:

	<u>Increase by 5%</u>	<u>Decrease by 5%</u>
Cash flow growth rate	201,735	(192,930)
Discount rate	(175,670)	222,462

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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 careful selection of fixed income investments prior to making an investment and by regular ongoing monitoring of the investment performance of the individual investee companies. Due to the predominantly fixed income nature of the investment portfolio, the Company has minimal direct price risk. A 10% change in the value of the Company's equity investments (excluding warrants) would have a \$671,622 impact on net assets, on an after tax basis.

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 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. This maximum exposure may be offset 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.

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The Company's credit risk exposure, by credit ratings on its investments, is listed as follows:

Credit rating	As a % of net assets	
	2013	2012
BB+	4.4	4.4
BB	-	1.8
BB-	-	0.9
B+	2.8	8.3
B	4.3	6.0
B-	15.2	10.6
CCC+	11.6	30.3
CCC	-	3.1
CCC-	-	2.4
D	0.9	-
Not rated	11.1	15.7
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	50.3	83.5

Credit ratings are obtained from various credit rating agencies and sources. Where one or more rating is obtained for a security, the lowest rating has been used.

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.

The Company's credit risk exposure by sector on its investments is as follows:

Sector	As a % of net assets	
	2013	2012
Consumer goods	6.5	8.4
Energy	30.3	49.8
Financial services	2.5	-
Forestry	3.8	6.2
Industrial/manufacturing	-	4.3
Materials and metals	5.2	13.7
Services	1.0	0.2
Technology	1.0	0.9
	<hr/>	<hr/>
	50.3	83.5

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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 invests primarily in interest-bearing financial instruments. As such, 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. The table below summarizes the Company's exposure to interest rate risk by term to maturity on its investments:

	Fair value	
Maturity	2013	2012
	\$	\$
Less than 1 year	-	-
1 – 3 years	5,228,449	20,543,660
3 – 5 years	38,100,249	46,527,959
Greater than 5 years	14,110,990	42,639,891
	<hr/>	<hr/>
	57,439,688	109,711,510
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As at December 31, 2013, 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, respectively, by \$2,100,000, or approximately 1.6 % of net assets (2012 - \$4,000,000, or approximately 2.8% of net assets).

Liquidity risk

As the Company is a publicly traded, 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.

Investments in fixed income 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. Fixed income investments purchased by the Company may be subject to resale restrictions such as hold periods. The resulting values for fixed income investments may differ from values that would be realized had a ready market existed.

The Company actively reviews its investment portfolio, and the fixed income market, to assess liquidity risk on its holdings.

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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 invests a portion of its assets in 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 Company enters into foreign currency contracts with financial institutions to hedge the value of foreign currency denominated investments. The fair value of these contracts is reflected in investments. Gains or losses arising from these contracts offset the gains or losses from translation of the underlying investments. The unrealized gains or losses are reflected in unrealized appreciation/depreciation on foreign currency contracts on the statements of operations. 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 \$160,000 (2012 - \$16,000).

9 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 investment objectives. The Company's investment objectives are to: (i) maximize the total return for common shareholders, consisting of dividend income and capital appreciation; and (ii) provide shareholders with monthly dividends targeted to payout a minimum of 75% of net investment income annually. Net investment income, in reference to the Company's dividend payments to shareholders, excludes any realized and unrealized capital gains and losses from debt securities in the portfolio and any income or loss not derived from debt securities in the portfolio. The Company commenced its dividend payments on June 30, 2009, making monthly payments of \$0.0583 per voting and non-voting common share. During the year ended December 31, 2013, the Company made dividend payments of \$7,371,869 (2012 - \$7,371,869).

The Company has ceased its monthly dividend payment starting in January 2014. Further, it has begun to liquidate its investment portfolio, with proceeds not being reinvested in new opportunities.

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10 Comparison of net asset value per common share and net assets per common share

In accordance with Section 3.6(1) of National Instrument 81-106, the Company's net asset value per share, the net assets per share calculated in accordance with Canadian GAAP for financial reporting purposes, and an explanation of the differences between such amounts, are required disclosures in the notes to the financial statements. For investments that are traded in an active market, Canadian GAAP requires that bid prices be used in the fair value of instruments, rather than the use of the last traded price, as currently used for the purpose of determining net asset value. This change accounts for the difference between the net asset value and the net assets.

	December 31, 2013	December 31, 2012
	\$	\$
Net asset value per share	12.37	13.58
Canadian GAAP adjustments	(0.02)	(0.08)
Net assets per common share	12.35	13.50