**June 30, 2012**

# DK INCOME FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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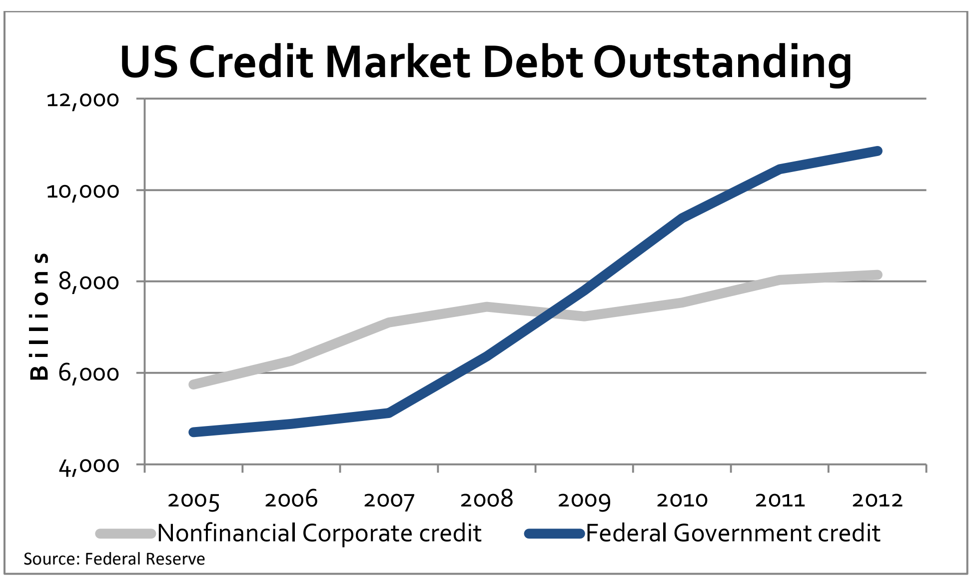
## Quarterly Report
## June 30, 2012

### Rates of Return[1]

| | 3 Mths | YTD | 1 Yr | 2 Yrs | 3 Yrs | 4 Yrs | 5 Yrs | 10 Yrs | 15 Yrs | Since June '93 |
|---|---|---|---|---|---|---|---|---|---|---|
| **DK Income Fund** | **-3.7%** | **1.5%** | **1.5%** | **2.5%** | **8.8%** | **16.6%** | **9.3%** | **14.9%** | **10.8%** | **11.7%** |
| DEX Universe Bond Index | 2.3% | 2.0% | 9.5% | 7.1% | 7.0% | 7.0% | 7.0% | 6.5% | 6.6% | 7.3% |
| ML CDN High Yield | 1.7% | 7.0% | 8.1% | 9.0% | 14.8% | 6.3% | 4.1% | 6.9% | | |
| ML USD High Yield | 1.8% | 7.1% | 6.5% | 10.9% | 16.2% | 10.9% | 8.2% | 9.9% | 6.9% | 7.7% |
| S&P/TSX Composite Index | -5.7% | -1.5% | -10.3% | 4.2% | 6.7% | -2.5% | -0.7% | 7.6% | 6.2% | 8.1% |

While it is certainly a difficult environment, especially in Europe, we strongly believe that corporate bonds will provide attractive future returns. Governments and individuals are saddled with too much debt, and too little tax revenue/income to support that debt. Corporations, on the other hand, have kept debt relatively flat since the financial crisis of 2008/2009, as government balance sheets continue to grow. The graph below shows the increase in U.S. government credit versus corporate credit from 2005 – 2012, as measured by the Federal Reserve. As you will note, corporate credit grew until 2008 and has since tapered off while government debt continues to grow, in fact doubled.

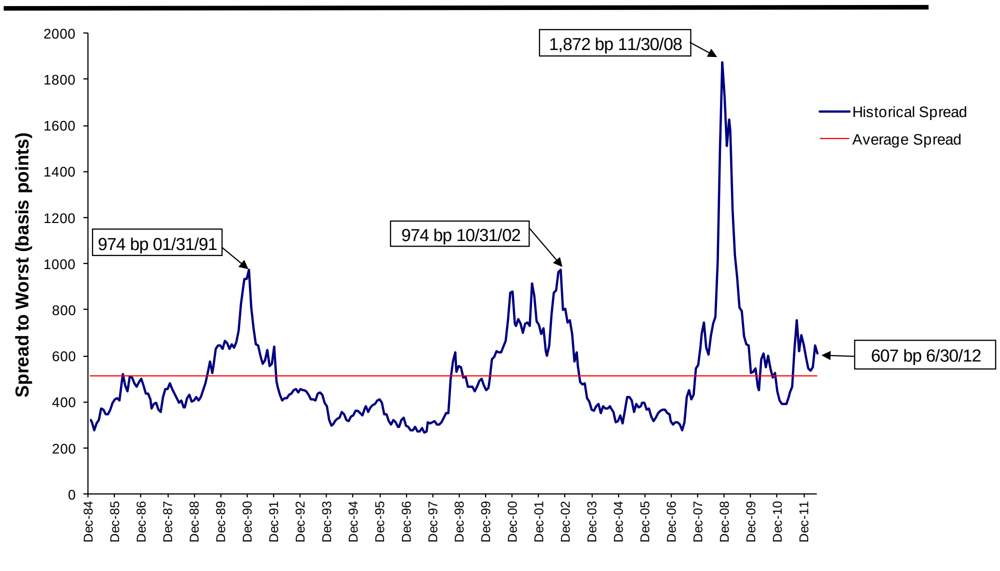



[1] Returns longer than one year are annualized gross of management fees.

Good management teams understand we are in a difficult environment and have adjusted their cost structures to offset weak growth. Corporations are also de-leveraging or extending the maturity on their debt to provide more financial flexibility in case of a prolonged slow down. In contrast, politicians around the world have failed to make any headway in balancing their budgets as attempts at reducing spending have so far been fruitless. Despite these facts, spreads between corporate credits and ten year US treasuries are actually above the long term average.

**Credit Spread History**

**Merrill Lynch US High Yield Master Index Less 10 year Treasury Yield**




**Source: Bank of America Merrill Lynch**

With yields on government bonds as low as they are, investors are certainly not being compensated for the risk.

With individual companies, the visibility is much clearer. Short term bond price movements are not relevant to us. What is important is the company's ability to meet its coupon payments and pay us back our principal at maturity. Between the time of issue and maturity, high yield bond prices can fluctuate based on individual company financial results and market sentiment. We have no control over this. What we do have control over is ensuring we are invested in companies that can pay us back and if they cannot, we are compensated with adequate collateral. Our goal is to provide maximum income to our clients with a minimum level of risk. For the first six months of 2012, the DK Income Fund has provided an income return of 8.6% annualized, from a diversified portfolio consisting of corporate bonds (65.1%), private debt financings (14.3%), dividend paying corporations (8.0%), an equity position in Whitecap Resources (3.1%) and cash (9.5%).

We own corporate debt in businesses with good management teams, tangible assets as collateral, strong cash flows and reasonable leverage. We use our credit knowledge and experience in structuring debt securities to evaluate the trust indentures to ensure our interests are protected. There are currently no defaults in our portfolio and all of our holdings are servicing their debt while, in most cases, continuing to reduce leverage. The majority of our holdings remained relatively flat so far in 2012. The portfolio was negatively impacted, we believe temporarily, by two bond holdings and our equity holding in Whitecap Resources.

***Mirabela Nickel*** is a nickel producer with assets in Brazil. As the Company has ramped up production over 2011/2012 they have experienced higher than expected costs and, with the decline in nickel prices, bonds have traded down on liquidity concerns. We met with management in March, and believe they will be able to reduce costs from $7.37 to below $6 per pound by year end. To ensure the Company had adequate liquidity, management raised over $120 million by issuing equity. They now have $150 million in cash on hand. Despite the added liquidity, the price of Mirabela bonds declined subsequent to the equity issue. At June 30th, Mirabela bonds were yielding 17.5%, an attractive yield given the quality of the mine and where the bonds stand on the capital structure and we added to our position during the quarter.

***Skylink Aviation*** has provided global aviation transportation and logistics services to commercial, governmental, non-governmental and humanitarian organizations in remote, austere or conflict-associated regions for over 20 years. In 2011, Skylink generated EBITDA above our expectations of $44 million as a result of a large contract with the Canadian Department of Defense, including one time revenues associated with demobilization. This contract expired last year. The Company has yet to replace this business and their first quarter numbers were down year-over-year as a result. This combined with the illiquid market for these bonds has pushed the bond price down to roughly 50 cents on the dollar. The Company expects to reduce costs in the second half of the year and is currently bidding on new business which would add substantially to revenues and EBITDA. In our opinion, the current valuation assumes little in the way of cost reductions and that the Company will be unsuccessful in replacing the contract with the Department of Defense. We are comfortable owning Skylink at this valuation and as the situation improves, we will benefit.

We own an equity position in ***Whitecap Resources*** (3.1% of the portfolio), which was a conversion of a private debt financing that we designed and funded in September 2009 as part of their first financing. Whitecap had increased in price from our cost of $2.88 to $8.29 at year end 2011, as production grew from 275 barrels of oil equivalent per day (boepd) at inception in 2009, to current production of 14,500 boepd. The share price has since pulled back to $6.72 at June 30th, because of market anxiety about Europe, China and U.S. growth. Whitecap should grow production to 17,000 boepd by the end of 2012. This could generate more than $230 million in cash flow when the company is worth $1.1 billion today; an attractive valuation in our opinion. Furthermore, Whitecap's high netback, low decline assets lend themselves well to long-term growth regardless of what the oil price is. We will continue to hold our investment in Whitecap as we believe management will grow the business, adding shareholder value.

We do not know what will happen to high yield bond prices in the next few quarters or when prices of our investments in Mirabela and Skylink will recover. We do know, at June 30th, the DK Income portfolio is yielding 9.0% which should be a good predictor of our return over the next five years. Given the credit quality of the businesses in our portfolio we believe this offers a strong incentive for investors given other income opportunities such as treasury securities, currently yielding less than 1.0%[2].

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[2] Merrill Lynch U.S. Treasury Master Index