December 31, 2007

DK INCOME FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
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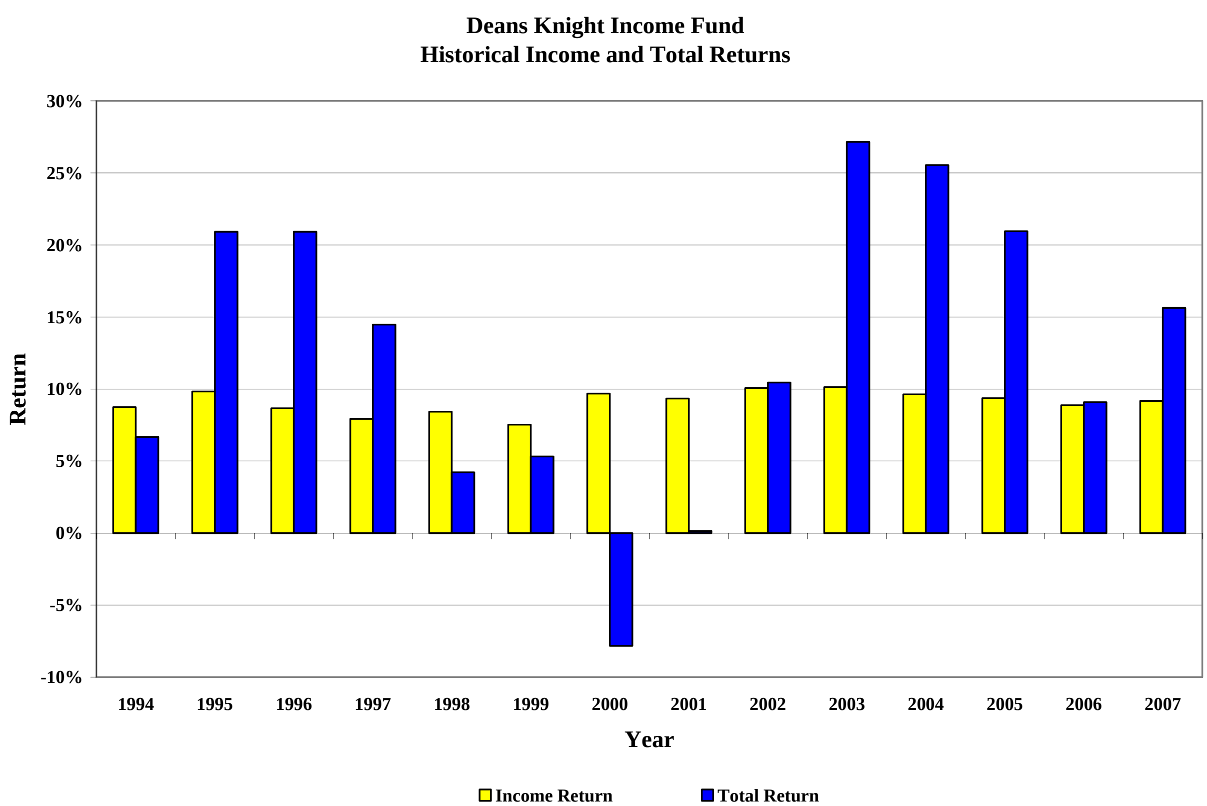
Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	Since June '93
DK Income Fund	**1.5%**	**15.6%**	**12.3%**	**15.1%**	**17.6%**	**19.5%**	**10.5%**	**11.9%**
SCM Universe Bond Index	2.8%	3.7%	3.9%	4.7%	5.3%	5.6%	6.3%	7.5%
ML CDN High Yield	0.5%	1.5%	5.3%	2.6%	4.3%	8.3%		
ML USD High Yield	-1.2%	2.2%	6.9%	5.5%	6.8%	10.8%	5.5%	7.2%

The main objective of the DK Income Fund is to ensure the income stream is high enough for the risk being taken. Since the Fund's inception, we have demonstrated an ability to generate stable income returns of 7.5% to 10% for our clients, depicted by the yellow bar in the graph below. 2007 was no exception; the portfolio generated an income distribution of 9.2% for unit holders.



[1] Returns longer than one year are annualized.

Total return, the blue bar in the graph above, differs from income return because it includes the effect of year to year market price fluctuations in our holdings. For example, when credit spreads doubled in 2000 it resulted in a negative capital return in the portfolio that was greater than the income return. This increase in spreads provided a great investment opportunity for the DK Income Fund. Credit spreads normalized in 2003 - 2004 and the portfolio generated capital returns of over 15% in those years. Over 14 years, the DK Income Fund total return is 11.9%, versus our average annual income return of 9.0%. The point is market prices are volatile in the short term; however, we have been able to provide additional return from capital gains in the long term.

In 2007, there were two important market events which had a major affect on equity and credit markets. Firstly, the U.S. housing price bubble finally popped. Mortgage defaults and foreclosures are on the rise and new house sales are falling. As the housing bubble progressed in the U.S. between 2001 and 2007, lending practices became increasingly sloppy. Over these years increasing volumes of much riskier (sub prime) mortgages were written. These sub prime loans were subsequently packaged with other debt instruments such as credit card receivables, auto loans, etc., and sold to banks and other investors as Asset-backed commercial paper (ABCP) and Collateralized Debt Obligations (CDO's). As the value of the underlying mortgage paper has come into question, the value of the ABCP and CDO's has been marked down.

Investors holding these instruments have collectively taken massive write downs. At the time of writing, the global banking community has absorbed write downs of roughly $70 billion dollars. This is likely to go substantially higher. This is a sizeable sum but it is worth bearing in mind that the bursting of the tech bubble in 2000 wiped out $5 trillion in market value of tech companies alone. A painful and disruptive adjustment is underway. As a senior U.S. banker recently said, "Why did the banks have to find new ways to lose money, when the old ways were working well enough?" Investors in these instruments will take losses, and owners of financial institutions (banks) and investments funds that own these instruments will incur losses, some very significant. Very simply . . . the interest rates on these obligations were not nearly high enough to compensate the buyers for the risks taken.

As a footnote, we did not purchase any of these types of obligations. It is not that we were clever enough to foresee today's problem. It was simply that interest rates were too low and in our opinion did not offer the prospect of sufficient return to compensate for risk.

Despite the recent "credit crunch" caused by the problems in ABCP and subprime markets, the capital value of the DK Income Fund increased in 2007 primarily from the appreciation in value of our shareholdings in **LionOre Mining** and **Anvil Mining** and from bonds/income trusts that were redeemed/purchased during the year. In total, over 25% of the holdings in the portfolio were purchased or redeemed in 2007.

We were fortunate last year when LionOre Mining was purchased by Norilsk. We held shares as a direct result of our investment in two private debt financings purchased in 2000 and 2001. We were able to acquire 163,800 shares at an average cost of $2.33. In the first half of the year

LionOre was the target of a bidding war between Norilsk Nickel and Xstrata. Norilsk eventually won, purchasing Lionore at $27.50, for a capital gain of over $4 million and more than double the price it was trading at on December 31, 2006. The return on our original private debt investment in LionOre turned out to be over 40% per annum.

We also hold shares of Anvil Mining, an Australian-based public company with low cost copper production in the Congo. We negotiated an 18-month Promissory Note in December 2005 and our $1 million Note provided an income return of 15.5% annualized when it was repaid in 2006 with proceeds from a $150 million equity offering. In addition to the income return we received warrants to buy 100,000 shares at $6.25. We exercised the warrants at the end of the year when they were set to expire. Anvil shares have appreciated to $15.24 meaning our return to date, including the "equity kicker", is roughly 100%.

We expect continuing credit problems to provide us with more private debt opportunities going forward. For example, during the 4th quarter, we participated in a private debt financing to **CGA Mining Ltd.** CGA is a gold mining company with interests in Zambia, Nigeria and a new development project in the Philippines. CGA raised $130 million to bring their mine in the Philippines into operation. Funds were raised through a $65 million senior debt facility arranged by BNP Paribas, $25 million through the note we have participated in and $40 million in equity. The project is expected to take 12 – 18 months to build and will produce over 200,000 ounces of gold per year at a cash cost of $306/oz. Once the mine is in full production, using a gold price of $600 per ounce, CGA will generate a projected cash flow of $60 million per year.

The Company has a strong management team with a proven track record, developing 6 gold mines to date ranging in size from 75,000 – 250,000 oz/annum. The portfolio holds $2.5 million of the CGA note, which has a term of 5 years and pays interest of 12%. In addition, each $100 of debt receives 25 warrants to purchase CGA shares at $1.03 for 3 years (the stock was $1.28 at year end). At the exercise price of $1.03, CGA is valued at 0.5x NAV on a conservative basis. We expect the loan to be paid down out of cash flow or an equity issue within 4 years. In the interim, the fund receives a cash yield of 12% on the note.

We began accumulating a position in **Cott Beverages USA** 8% bonds due December 15, 2011 at an average cost of $92.125 for a yield of 10.5%. We are familiar with the Company because we currently own shares in our equity portfolios. Cott is North America's dominant manufacturer of private label soft drinks. The Company has been beset with shrinking margins and profitability over the past few years, due to their inability to adjust to rising packaging costs (cans / PET bottles). Also, the Company failed to capitalize on the consumer shift to higher margin specialty beverages. As a result, Moody's and S&P downgraded Cott's credit rating causing bonds to fall in price from par during the quarter. We are comfortable owning the bonds as Cott has a very strong franchise in North America that has been built over the past 20 years and we feel breakup value is well in excess of the $400 million of debt on the balance sheet. At a 10.5% yield to maturity, we feel bondholders are being compensated for the risk and will continue to add to our position as bonds become available.

We also began accumulating a position in **Kereco Energy Ltd.** 4.75% June 30, 2012 at an average cost of $83.25 for a yield of 9.4%. In July 2007, Kereco commenced a repositioning of their company disposing of the majority of its natural gas prone assets. As of today, Kereco has sold 5,800 Boe/day for total proceeds of $241 million in four separate transactions with the last one closing January 14, 2008. Kereco had $161 million of net bank debt and a $70 million convertible issue. Proceeds from the sale will be used to pay down bank debt leaving the company no net debt (i.e. convertible debt minus cash is less than zero). Once the sales are complete, Kereco will be producing 4,200 of Boe/day with financial flexibility to develop their long-life light oil assets at Sturgeon Lake. We purchased bonds subsequent to the final sale announcement in December. In January, the Company announced they expect to make an offer to repurchase the debentures at 95% of their par value.

Finally, we started building a position in **Contrans Income Fund** at an average price of $9.48, a yield of over 13%. Contrans is a transportation company focusing on flatbed and bulk trucking in Ontario. The trucking industry is experiencing a downturn with the reduction in manufacturing & construction activity and a rising Canadian dollar. As a result, Contrans units are down almost 25% from their 2007 high of $12.35. CEO, Stan Dunford, who personally owns 19.3% of the units, has a long history in the trucking business and is positioning it to take advantage of the downturn as the competition struggles to remain profitable. Management maintains a manageable debt level and continues to improve gross margins focusing on reducing its empty mile percentage (miles logged while not carrying freight). At $9.48 we are purchasing Contrans at 5.5x enterprise value of $350 million before taking into account their large land position which is likely worth between $60 - 100 million. In addition, Mr. Dunford stated his desire to continue to pay their current distribution of $1.25 past 2011, after trusts become taxable. Given the current payout ratio of 80% and the Company's ability to handle downturns and emerge as a stronger business, we feel this is attainable.