March 31, 2013

DK INCOME FUND

DEANS KNIGHT

CAPITAL MANAGEMENT LTD

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Quarterly Report
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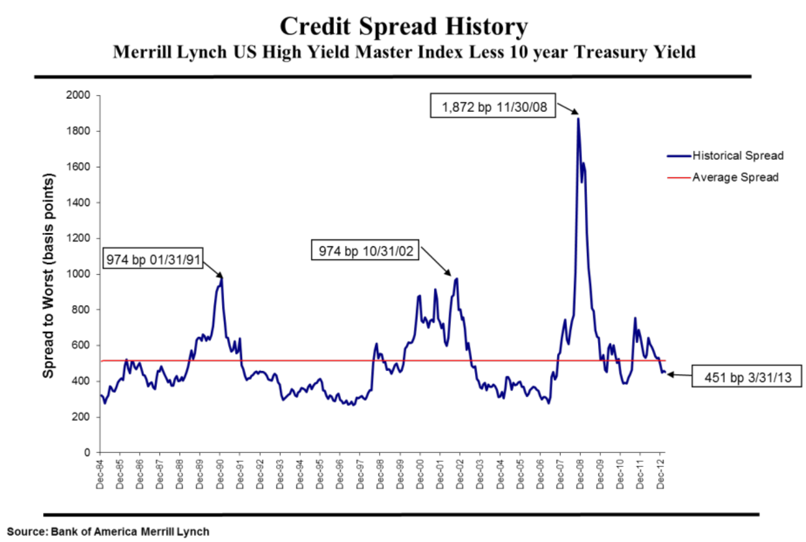
Rates of Return[1]

	3 Mths	1 Yr	2 Yrs	3 Yrs	4 Yrs	5 Yrs	10 Yrs	15 Yrs	Since June '93
DK Income Fund	**1.3%**	**6.5%**	**5.8%**	**10.1%**	**21.7%**	**11.5%**	**15.2%**	**10.8%**	**11.8%**
DEX Universe Bond Index	0.7%	4.5%	7.1%	6.4%	6.1%	5.9%	6.1%	6.1%	7.1%
ML CDN High Yield	2.7%	12.4%	9.3%	9.5%	20.3%	7.7%	6.6%	4.2%	
ML USD High Yield	2.9%	13.1%	9.3%	10.9%	21.0%	11.3%	9.9%	7.0%	7.9%
S&P/TSX Composite Index	3.3%	6.1%	-2.1%	4.9%	13.1%	2.1%	10.0%	5.9%	8.4%

The DK Income Fund provided a return of 1.3% during the 1st quarter, 6.5% for the last 12 months, and an annualized return of 11.5% over the last 5 years. Currently, the DK Income Fund has a short duration (3 years) and provides a coupon yield of 7.0%. The Fund holds 14% in cash, the result of bonds being repaid and inflows of cash into the fund. Cash will be used to take advantage of attractive opportunities that can develop in current volatile markets.

Interest rates in North America are at 50-year lows. However, the spread between High Yield and Government bonds is still near the long term average. Please refer to graph below. We find it hard to understand how investors can view a 1.8% 10-year U.S. treasury bond as an attractive investment. As famed investor James Grant would say, the U.S. government is offering investors "return-free risk".



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

We are very selective when it comes to investing in high yield bonds. At March 31st, we own 26 issues, by contrast, the high yield universe has over 2,000 issues. Investing in a concentrated portfolio of the best opportunities allows us to provide a higher level of income than the index while preserving capital over the long term. To give you an idea of the types of companies we are invested in, we are including some brief comments on a few of our bond holdings.

Paramount Resources *8.25% due December 13, 2017*. Paramount is an Alberta based intermediate natural gas exploration and production Company with assets in Alberta, Northwest Territories, and North Dakota. The Company expects to more than double its production from 22,000 boepd to a run rate of 50,000 boepd in 2014, as their gas plant in Musreau is commissioned and their Montney wells are brought on stream. The Company estimates the free cash flow, after CAPEX, from their Montney play alone will be $340 – $520 million. In addition to its producing assets, the Company has an extensive land position and a number of investments in other, predominantly public, oil and gas companies. Paramount has a current market cap of $3.3 billion, of which management owns 50%, and the value of their holdings in public companies alone, being $800 million, is worth more than their debt outstanding of $700 million. Our bonds are currently yielding 7.3% to maturity and are well secured by the increasing cash flows and the extensive asset base of the Company.

Mirabela Nickel *8.75% due April 15, 2018.* Mirabela is a nickel producer with assets in Brazil. Mirabela endured the very strong headwind of lower global nickel prices. The price of the metal is down 36%, to $7.54 per pound, over the past two years. Mirabela's management has responded by lowering operating costs to adjust to this difficult environment, making Mirabela one of the lower cost producers. Using conservative estimates for operating costs and nickel prices in 2013, Mirabela should generate EBITDA of $50 million, which is enough to meet its interest payments of $40 million on its debt of $465 million. In addition, the Company currently has $140 million in cash on hand providing ample liquidity. Mirabela bonds mature in 2018 and are currently yielding 11.1%.

North American Energy Partners *9.125% due April 7, 2017*. North American Energy provides a wide range of mining, heavy construction, industrial, and piling services to customers in the Canadian oil sands, mineral mining, commercial and public construction and conventional oil and gas markets. A new CEO, Martin Ferron, was appointed in June 2012. He has re-focused the business plan and cost structure, thereby improving margins, and has since sold the money losing pipeline business. As a result, EBITDA has improved to $70 million annualized and we expect cash flows to continue to grow, as this only includes two quarters under new management. The Company currently has $330 million of total debt which, in addition to growing cash flows, is supported by a valuable heavy equipment asset base. Our Notes currently yield 9.7%.

DirectCash Payments Inc. *8.125% due August 8, 2019*. DirectCash**,** a leading provider of ATMs, issued $200 million of debt in 2012 to fund the acquisition of Customer Limited, the largest provider of ATMs in Australia. Post-acquisition, DirectCash has a leading global ATM business, with the #1 market share in both Canada and Australia and the 3rd largest independent deployer of ATMs in the U.K. The Canadian market is currently well-served; however, growth should come from both Australia and the U.K. whose markets are relatively unsaturated. With the Customer Limited acquisition, DirectCash's pro forma EBITDA is $73 million and management has identified potential synergies, which should improve those cash flows further. DirectCash has a current market cap of

$440 million, of which management owns 30%. DirectCash has stable, recurring revenue streams with a proven track record of growing cash flows. Bonds currently yield 7.2%.

We have two holdings in the Fund that we are currently working on restructuring: **Skylink Aviation** (*12.25% due March 15, 2016*) and **Northland Resources** (*13% due March 6, 2017*). Skylink Notes were priced at $5 per $100 face value on December 31, 2012, negatively impacting our 2012 return, which was 10.9% despite the writedown. Skylink Notes are now trading at $8, represent 0.2% of the portfolio, and had no impact on the recent quarter's return. Northlands did have a negative impact on our return during the quarter. As we discuss below, the Company is awaiting bids/restructuring proposals and we will know more in the coming weeks. We have participated in such restructurings 15 times over the past 20 years. The outcomes can vary, but historically our average experience has been to achieve roughly 100% recovery of our original investments, some below and some above par.

In March 2011, we purchased second lien notes of Skylink Aviation. The Company provides logistics services to Government and international organizations, with the majority of their revenue coming from contracts in Afghanistan. In 2012, management was unable to adjust costs or replace revenues as the Canadian presence in Afghanistan was reduced, and the Company could no longer support their debt. As a result, Skylink filed for CCAA protection on March 8, 2013.

We have been involved in the restructuring process, as we sit on the steering committee, and will be represented on the Board of Directors post restructuring. As members of the steering committee, we were in a position to backstop our pro rata share ($1.5 million) of an $18 million Debtor-In-Process (DIP) financing. The DIP allows Skylink to continue operations which was necessary to benefit the ultimate recovery of the second lien notes. The DIP financing is attractive as it has security over the Company's assets (specifically accounts receivable), earns a 10% coupon, and the providers of the DIP will own 75% of the equity. Although the total return on the DIP is not quantifiable at this time, we anticipate it will generate an attractive return with equity upside and, in our opinion, will increase the recovery value for our second lien notes relative to the alternative scenario, which would be liquidation.

In February 2012, we purchased first lien notes of Northland Resources, which produces a high grade iron ore concentrate from their Kaunisvaara project in Northern Sweden. In January 2013, Northlands Resources announced a funding shortfall at its Kaunisvaara mine and the need to raise approximately $400 million in additional capital. The unanticipated cost overruns destroyed confidence in management and fundraising efforts failed. As a result, the Company filed for reconstruction, and a bondholder group formed to protect our interests. The bondholder group is currently considering a number of term sheets from more than one potential buyer and more information is expected in the coming weeks. Bonds are currently being quoted in the mid-$50's.

In addition to our investments in high yield bonds, we look to add value by creatively structuring short term private debt financings that provide additional income and capital appreciation through equity incentives.

In late 2011, we provided $12 million in Secured Notes to **Conifex Timber Inc.** to fund working capital. The Notes pay a 12% coupon and are secured by the assets of the Company, including sawmills in northern BC, in which they have already invested $80 million. In addition to the coupon, Noteholders received a commitment fee of 2% and warrants to purchase 325,000 common shares.

Since 2011, management has improved efficiencies and are now enjoying the benefits from the beginning of a housing industry recovery in the U.S. and consequent rising lumber prices. As a result of the improved outlook, Conifex secured a $25 million ABL facility with Royal Bank of Canada and repaid our $12 million Secured Notes on April 3rd. The annualized return on our investment, including commitment fees, was 14.5% which excludes the potential further upside from the warrants. The stock is currently trading at roughly $9 which is just below our exercise price of $9.33.

Subsequent to quarter end, Deans Knight designed and originated an $8 million Secured Note facility with **BuildDirect.com Technologies Inc.,** a private company. The commitment from the DK Income Fund is $3.5 million, or 2.0% of the current portfolio value. BuildDirect is North America's largest, online destination for Do-It-Yourself customers, Do-It-For-Me customers and professional contractors and subcontractors to purchase quality building materials conveniently at a lower cost. The Company has been around since 1999, and stands to benefit from the housing recovery in the United States, its largest market.

The Notes will be secured senior obligations of the Company and can be drawn in $2 million tranches up to the $8 million. The drawn portion of the Secured Note Facility bears interest at 9% per annum. The undrawn portion bears a standby fee of 0.5%. The facility matures on September 30, 2016. As additional consideration, the Company will pay an up-front commitment fee of 1.5%, and issue warrants to purchase 225,000 common shares at a price of $2.15 per share. Additional warrants will be issued upon draw down of the facility, up to a maximum of 525,000 common shares at $2.15 per share.

In June 2012, BuildDirect raised $20 million in equity from OMERS Ventures and BDC Venture Capital IT Fund. The proceeds are being used to continue to grow the Company's presence in the flooring market, currently 90% of revenues, as well as expanding its product offering. As a result of the cash injection, the Company is budgeting to more than double 2012 revenues to over $100 million in 2013.