June 30, 2010

DK INCOME FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report

June 30, 2010

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	**2.0%**	**5.6%**	**33.7%**	**10.4%**	**9.7%**	**12.0%**	**13.2%**	**13.2%**	**11.9%**	**12.0%**
SCM Universe Bond Index	2.8%	4.2%	6.9%	6.9%	6.9%	6.4%	4.9%	6.6%	7.3%	7.3%
ML CDN High Yield	0.1%	5.7%	27.4%	3.6%	1.0%	3.6%	2.5%	3.4%	n/a	n/a
ML USD High Yield	-0.1%	4.7%	27.5%	10.9%	6.4%	7.7%	7.1%	7.1%	7.1%	7.3%
S&P/TSX Composite Index	-5.5%	-2.5%	12.0%	-8.8%	-3.9%	2.2%	5.5%	3.3%	8.5%	8.6%

DK Income Fund had a positive return of 2.0% during the quarter in large part due to our holding in **Whitecap Resources**, a private oil and gas producer (4.4% of portfolio). In August last year, Deans Knight structured a $10 million 8% convertible debenture forming part of Whitecap's seed capital along with a $36 million equity issue. Whitecap is Grant Fagerheim's fourth junior oil and gas startup company. We have invested successfully with Grant in the past with Ketch Energy, Ketch Resources and Cadence Energy.

On June 1st, Whitecap announced an agreement to merge with **Spitfire Energy Ltd.**, a public oil and gas producer with assets in Saskatchewan. The combined entity will have production of 1,360 boepd, half of which is oil. The two core areas with 7 million BOE of reserves and $15 million in net debt will be run by Grant and his team. With the completion of the merger on June 25th, the value of our convertible debenture increased by 72% which provided a 1.8% return to the DK Income Fund during the quarter.

The ML USD High Yield Index had a flat return during the quarter as spreads widened, causing prices to fall by 2%.

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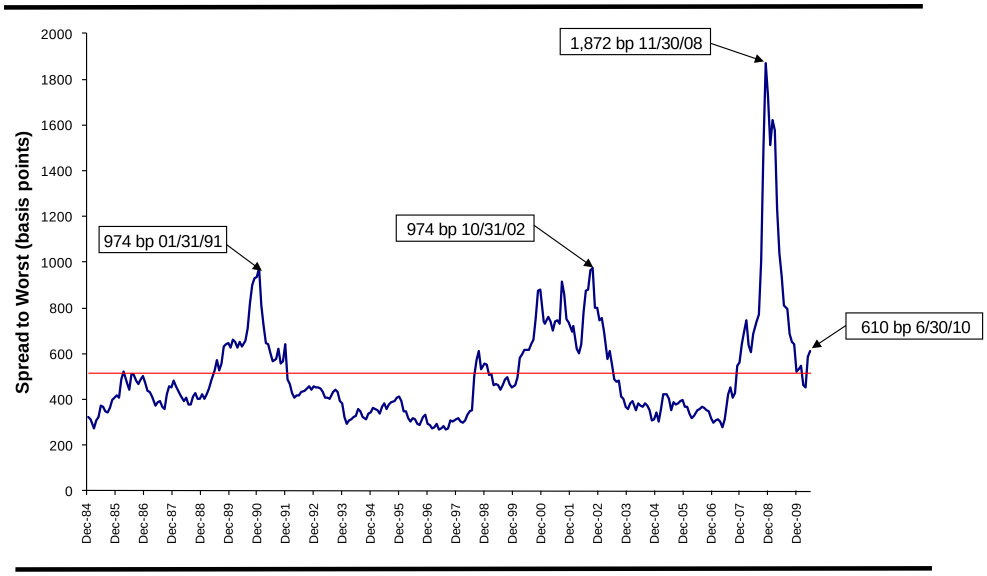
[1] Returns longer than one year are annualized.

Credit Spread History

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



Source: Merrill Lynch high yield

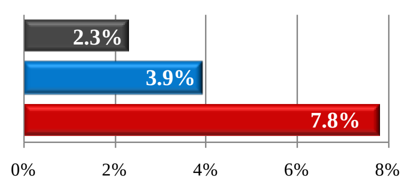
The recent widening in spreads should not be a surprise. Investors are being bombarded constantly by the mainstream media with a negative spin on just about everything economic. . . the collapse of the EURO, the sovereign debt crisis in Europe, the faltering global economic recovery, massive government deficits, the economic threat of the withdrawal of government stimulus . . . the list is endless.

The positive side to all this angst is that the worst case scenario is well known. It is when the worst case scenario is not well known, that trouble is often just around the corner. For example, take the giddiness which preceded the 2008/09 meltdown. The media hyped nothing but good news until the financial crisis/recession. Investors forgot about risk. Bonds (yields) became expensive.

The scenario has now done a 180. We are now collectively worried about everything. As a bondholder, your only concerns are if the company can service its debt and will they be able to repay or refinance their debt when it comes due.

We are not attempting to belittle the challenges ahead. There are many of them, and some are monumental; however, earnings of the companies we are invested in are improving, their balance sheets are in better shape than they were 18 months ago and the average yield on our holdings is twice that of investment grade bonds, and 3 times 5-year government bonds.

- 5-year Canadian Government bonds:
- Canadian Investment Grade bonds:
- **Deans Knight Income Fund:**



To give you an idea of the types of Companies we are invested in, we are including some brief comments on our major bond holdings.

Paramount Resources 8.5% due January 31, 2013. Paramount is an oil and gas producer with assets in Alberta, Northwest Territories, and North Dakota. The Company is currently producing 13,500 boepd which is predominantly natural gas. In addition to its producing assets, the bonds are secured by their holding in Trilogy Energy Corp which is currently worth $240 million. Paramount has a current market cap of $1.4 billion with only $90 million in Debt.

North American Energy Partners (NAEP) 9.125% due April 7, 2017. NAEP provides a wide range of heavy construction and mining, piling and pipeline installation services to customers in the Canadian oil sands, mineral mining, commercial and public construction and conventional oil and gas markets. NAEP's EBITDA to year end March 31, 2010 was $120 million and has Net Debt of $180 million.

Despite the low debt level, NAEP has only a B credit rating due to the perceived cyclical nature of their cash flows. As a result, the Company has to pay a high coupon and adhere to stricter covenants protecting the bondholders. Although a portion of the Company's business is cyclical, NAEP has a strong management team, with a core oil sands business generating recurring cash flows sufficient to service its debt.

Calfrac Holdings 7.75% due February 15, 2015. Calfrac is a specialized oilfield service provider using fracturing equipment to increase production from oil and gas wells. Despite a difficult year for energy services companies in 2009, Calfrac was able to generate EBITDA of $69 million and increase its capacity by 59%, predominantly from acquisitions made during the second half of the year. Given Calfrac's focus on cost reduction and its increase in capacity, we believe Calfrac is well positioned to increase cash flows as the sector improves. As of the end of 2009, Calfrac's debt less working capital was less than $150 million.

Harvest Operations 7.875% due October 15, 2011 and 7.25% due September 30, 2013. Harvest is an integrated energy company with upstream operations, currently producing 54,000 barrels of oil equivalent per day ("boepd") weighted at approximately 70%/30% oil & gas. In addition to its upstream operations, Harvest owns a refinery in Come By Chance, Newfoundland operating as a standalone business.

On October 21, 2009, Harvest Energy Trust entered into an agreement with Korea National Oil Corporation to sell all of its issued and outstanding trust units at a price of $10 per unit for total cash consideration of $1.8 billion, plus the assumption of $2.3 billion of debt. Since the transaction, KNOC has reduced bank debt by over $1 billion with total bank and senior notes now totalling $400 million. Harvest generated $455 million in EBITDA over the last twelve months which has resulted in a significant increase in the value of the secured notes.

Cott Beverages USA 8.375% due November 15, 2017. Subsequent to the quarter, Cott Beverages announced the acquisition of Cliffstar Corporation, the largest private label shelf stable juice manufacturer. The acquisition brings together the largest private label soft drink manufacturer with the largest juice drink manufacturer in North America. The combined company will have $2.3 billion in sales, $260 million in EBITDA, $125 million in free cash flow and up to $690 million in debt. Cott is committed to using the free cash flow to pay down their debt. Without any growth the Company could repay the additional debt incurred to complete the acquisition in three years.

MetroPCS Inc. 9.25% due November 15, 2015. MetroPCS is a wireless communications provider servicing many of the major markets in the US. The Company has $3.6 billion in debt and generated $900 million in EBITDA last year which should grow as they gain more traction in their new markets, Boston, LA and NY. Given that MetroPCS has already spent the majority of the capex required to achieve their growth targets, we should see debt levels decrease over the next few years. In addition, the Company has a strong cash position of $1.1 billion, which could be used for further growth in new markets or to reduce debt.

Dollarama Group FRN due August 15, 2012. Dollarama owns and operates over 600 dollar stores generating $200 million in cash flow and has less than $350 million in debt. Dollarama recently did an IPO and has a market cap of $1.9 billion with an excellent management team. This bond was called in June following the announcement of a new bank facility which is well in excess of the debt outstanding. Proceeds will be received in July.

CCS Inc. 11% Senior Notes due November 15, 2015. CCS has a very strong franchise as a specialized waste management and environmental solutions provider primarily to the oil and gas sector. CCS has $1.9 billion of debt, $300 million of which is subordinated to our Senior Notes, and will generate roughly $275 million of EBITDA in 2010.

As the North American basins mature, oil and natural gas producers are operating an increasing number of wells at lower productivity levels. The increase in number of producing wells means an increase in demand for services provided by CCS. Given current industry fundamentals and the Company's strong franchise within the industry, CCS will be able to grow cash flows over time.

Teck Resources 10.75% due May 15, 2019. Prior to the credit crunch, Teck acquired Fording Canadian Coal Trust, their partner in the Elk Valley Coal asset, financed almost entirely with short-term bank debt. With falling commodity prices and a strained balance sheet during the credit crunch, Teck became "at-risk" of default. Teck was able to reduce debt and extend its maturity through a combination of selling non-core assets, raising equity and issuing high coupon paying notes. The Company went from a debt level of almost $13 billion to $5 billion. They plan on continuing to reduce debt to ensure they maintain their investment grade credit rating, which was recently upgraded. Despite the sale of assets, the Company was able to produce EBITDA of $3.4 billion in 2009, which was only slightly below levels seen in 2006, their highest year on record which was aided by high nickel and coal prices. Teck has a market cap of $21.5 billion.