September 30, 2016

DK INCOME FUND

DEANS KNIGHT
CAPITAL MANAGEMENT LTD

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Quarterly Report
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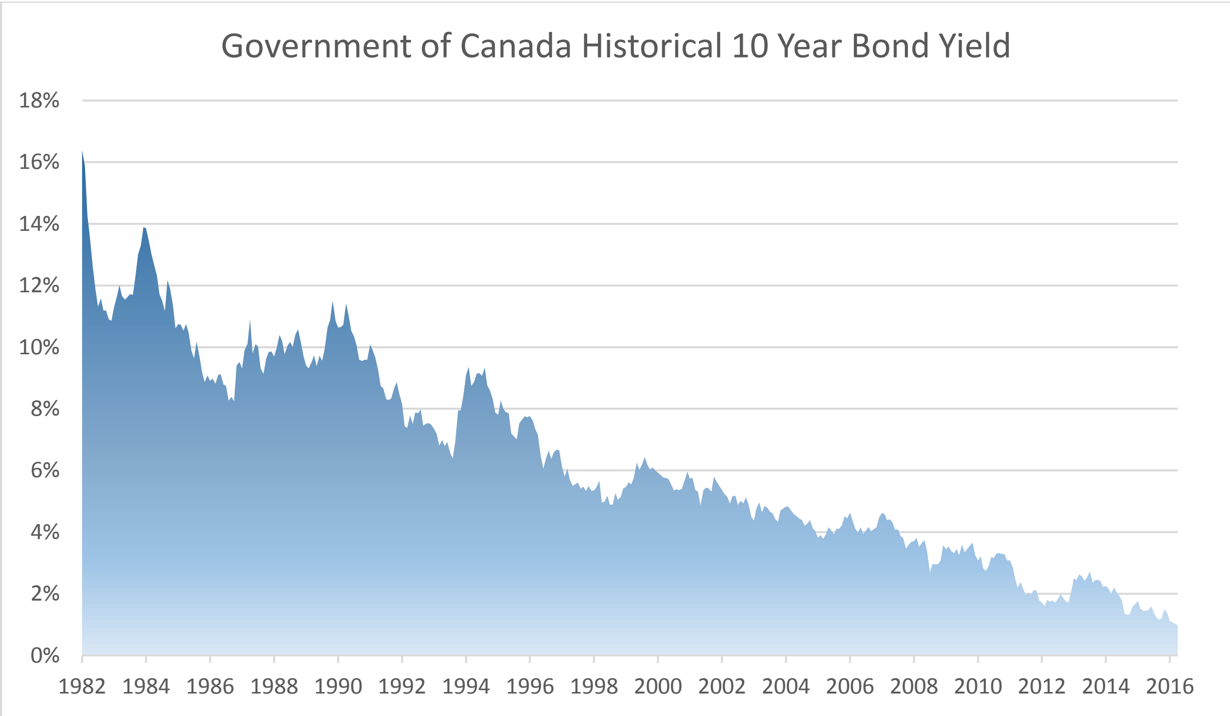
Investors who need income from their portfolios have had an increasingly tough time finding it. Bond yields have been declining for over 30 years.



30 years ago, a $1 million investment in a 10 year Government of Canada Bond ("GoC") provided $100,000 in coupon income annually. Today, to earn $100,000 with a 10 year GoC bond, investors need $10 million! If the same investor was willing to take more risk and buy a portfolio of investment grade corporate bonds (yielding 2.4%[1]), they need almost $5 million.

Today, the DK Income portfolio provides an annualized coupon yield of 7.5%, with an average maturity of 4 years. An investment in the DK Income Fund will generate $100,000 of income with a capital investment of only $1.6 million (after fees). Our goal is to maximize income earned while protecting your capital. We use our credit knowledge to assess our businesses and value the assets, to determine their ability to meet coupon payments and pay back our principal at maturity.

[1] BofA Merrill Lynch Canada Corporate Index

The adjacent table shows Deans Knight Income Fund's historical returns since 1993: annual income earned, price changes, and total return. Despite the decline in interest rates, the annual income earned has been remarkably stable (7 – 10%). Year to date, the DK Income Fund has earned an income return of 5.2% (7% annualized).

Table 1: Deans Knight Income Fund Historical Annual Returns:

Year	Income Earned	Price Movement	Total Return
2016 YTD	5.2%	4.1%	9.3%
2015	8.4%	-8.1%	0.3%
2014	7.9%	-3.8%	4.1%
2013	7.2%	-7.1%	0.1%
2012	8.2%	2.7%	10.9%
2011	8.3%	-4.1%	4.1%
2010	7.7%	10.6%	18.3%
2009	11.5%	49.1%	60.6%
2008	9.4%	-29.7%	-20.3%
2007	8.5%	7.2%	15.6%
2006	9.0%	0.1%	9.1%
2005	9.3%	11.6%	21.0%
2004	9.7%	15.9%	25.5%
2003	10.1%	17.1%	27.2%
2002	9.9%	0.6%	10.5%
2001	9.1%	-8.9%	0.2%
2000	9.7%	-17.5%	-7.8%
1999	7.5%	-2.2%	5.3%
1998	7.9%	-3.6%	4.2%
1997	8.1%	6.4%	14.5%
1996	8.7%	7.7%	16.4%
1995	9.8%	11.1%	20.9%
1994	8.7%	-2.1%	6.7%
1993*	4.0%	4.5%	8.5%
Annualized Since Inception	**8.8%**	**1.7%**	**10.5%**

* Fund Inception was June 30, 1993. Not a full year of return data.

Research has shown that longer term returns from a bond fund are determined by the yield-to-maturity, which is primarily made up from income earned. In the short term, bond prices are volatile but they always trend back to par. In 2015, oil prices declined from a peak of $107 to a low of $27 which drove bond prices down for all energy companies, regardless of the credit quality. The debt of our energy holdings was backed by assets, and our management teams had options in a low price environment to reduce costs and meet their obligations. This gave us the conviction to add to our energy holdings earlier in the year despite the negative sentiment. The oil price has since recovered modestly to $48 and bond prices of our energy holdings have moved back up. As a result, the DK Income Fund has a year to date price appreciation of 4.1% and a total return of 9.3%.

An example of the market not recognizing asset values is our largest holding, **Paramount Resources Ltd.** We own two series of Paramount bonds: 6.875% due 2023 and 7.625% due 2019. At December 31st, 2015 the bonds were trading at $71.50 and $75.50 providing a cash yield of 9.6% and 10.1%, respectively. Over the previous two years, Paramount had invested in its business, doubling production and building proprietary infrastructure to transport and process their increased production. As stated in our December 2015 quarterly report, while debt increased to fund these investments, the Company had options to raise cash, which included the sale of assets. We took the opportunity to add to both issues at an average price of $73.

Following our purchase of Paramount bonds, the Company sold assets in two separate transactions and both issues are now trading above $100. First, Paramount sold its gas plant and related infrastructure for $556 million in cash. Secondly, in early July, they sold 310 net sections of land in the Deep Basin and associated production of 30,000 boepd to Seven Generations Energy Ltd. for $1.9 billion. The proceeds were made up of $475 million in cash, 33.5 million publicly traded shares of Seven Generations, and the assumption of Paramount's $450 million USD debt, due 2023. Due to Seven Generations' strong balance sheet, these bonds traded up to $104 at the end of the quarter. While we continue to own these bonds, the lower coupon of 6.875% and longer term of 7 years means we are looking to replace this issue with bonds at a more attractive yield.

On September 22nd, Paramount sold most of the Seven Generations stock and now has $780 million of cash on hand, 10,500 boepd of production, $450 million of equity in publicly traded energy companies and only $284 million of high yield debt due in 2019. We expect this debt to be refinanced in the next 12 months. In the meantime, we are collecting an attractive 7.3% coupon yield.

We continue to add to a handful of our bond holdings which offer good security and an attractive coupon yield.

We added to our **GardaWorld** (7.25% November 15, 2021) holding throughout the year at an average price of $76.50. Bond prices have appreciated during the quarter to $95, but still offer an attractive yield of 8.5%. Garda, a private company based in Montreal, is one of the world's largest security companies providing security services at airports, sporting events, office buildings etc. . . and the North American leader in moving cash securely (aka armored transport). Earlier this year, 45% of Garda was sold to Rhone Capital (a private equity firm), which estimated Garda's enterprise value at $2.9 billion. This valuation, in addition to $180 million in operating cash flows and low capital requirements, provides ample coverage for the $1.7 billion in debt.

We added to our position in **Gateway Casinos & Entertainment Limited** (8.5% November 26, 2020) below par at an average yield of 9.9%. With operations in British Columbia and Alberta, Gateway is the second largest gaming company in Canada and the largest in B.C. Gateway continues to pursue growth opportunities in their existing jurisdictions as well as Ontario. The business has high barriers to entry, hard assets and a predictable cash flow stream to service and reduce their debt over time.

We added to our holding in **Imperial Metals Corporation** (7% March 15, 2019) at $90.25 in June. Bonds currently trade at $93.50 for a 10% yield. Imperial is a copper/gold producer with 2 open pit mines in British Columbia. The Mount Polley mine is targeted to produce 27 million pounds of copper and 48,000 ounces of gold with a mine life of 9 years. The Red Chris mine, which reached commercial production in mid-2015, is targeting production of 95 million pounds of copper and 65,000 ounces of gold with a 30 year mine life. Red Chris is only the second greenfield mine to be brought into production in BC over the last 15 years and will be one of the largest copper producing mines in Canada. Management's focus is on improving operations and increasing the production capacity while extending the resource base.

With both mines now in full production, Imperial will generate cash flow in excess of $100 million, compared to cash losses of $67 million over the past 2 years. This cash flow can be used to invest back into the Red Chris mine or reduce debt.

Since January we have been building a position in **Newalta Corporation** (7.75% November 14, 2019 and 5.875% April 1, 2021) which continues to trade at a discount to par and provide a 10.4% yield. This is primarily due to the dependence on oil and gas and the continued uncertainty in the industry. Newalta is the 3rd largest landfill and waste management company in Canada with a market share of 15%. Their legacy landfill business is a barrier to entry, difficult to replicate, and they have diversified their product offerings to be more mobile and appeal to a broader range of clients. With a large divesture in 2015 and a smaller equity issue early this year they have the balance sheet strength to endure a prolonged recovery in oil.

Western Energy Services Corp. (7.875% January 30, 2019) is an oilfield service company focused on contract drilling, well servicing and rental equipment services. We recently added to our position at $90.50, a 13% yield. With the decline in energy prices, drilling activity has slowed considerably, negatively impacting Western's short term cash flows. Western's management team has taken a proactive approach to reducing its cost structure, to preserve its balance sheet. With only $265 million high yield debt outstanding, due 2019, and roughly $50 million in cash on hand, Western has ample flexibility to withstand the lower activity levels and will benefit as demand returns.

In addition to our traditional high yield bond holdings, we continue to look for alternative debt opportunities to augment our income earned. For example, during the quarter we provided U.S. $10 million of total U.S. $15 million debt facilities raised for **Adventus Realty Trust**. Adventus is a private Real Estate Investment Trust with a portfolio of 9 properties (2.9 million square feet) in the suburban office markets of Chicago, Illinois and Atlanta, Georgia. The proceeds were used as an advance in connection with the potential acquisition of their 10th property.

Following the closing of the transaction, the Company is expected to have property valued at U.S. $630 million with U.S. $400 million of first mortgage debt, valuing the equity at U.S. $230 million. Our debt facility received a 2% initial fee and carries a 12% coupon with a maximum term of 1 year. It is secured by the equity in the properties, which will generate more than U.S. $15 million in adjusted funds from operations annually.