December 31, 2015

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	3 Yrs	5 Yrs	10 Yrs	15 Yrs	20 Yrs	Since Inception June 1993
DK Income Fund	**-2.1%**	**0.3%**	**1.5%**	**3.8%**	**8.7%**	**11.2%**	**9.9%**	**10.4%**
ML CDN High Yield	-4.4%	-10.4%	-1.2%	2.8%	3.7%	3.7%		
ML USD High Yield	-2.2%	-4.6%	1.6%	4.8%	6.8%	7.3%	6.7%	7.0%

The Deans Knight Income Fund generated a return of 0.3% in 2015. By comparison, the Canadian High Yield Index declined 10.4% and the US High Yield Index declined 4.6%. The biggest impact on the high yield market in 2015 was the deteriorating credit quality of natural resource companies. The Canadian High Yield Index fared worse than the U.S. because of a heavier weight in resources (41% vs. 14%).

The DK Income Fund did better than the high yield indices due to our higher cash position, a result of bond repayments, which cushioned the portfolio against falling bond prices.

During 2015, six of our bonds were repaid, two of which matured at par.

The **Petroamerica Oil Corp.** (11.5% due April 2015) bonds in the portfolio matured at par on April 30th. The Company was able to repay our bonds with cash flow generated from operations. This investment provided an annualized total return of 16.5%, a combination of coupon income earned of 12% and capital appreciation from warrants issued with the debt.

JDS Silver Inc. (12.5% due December 2015) repaid our $7.5 million secured bridge note at maturity with proceeds from a debt & equity issuance of roughly $50 million. Our note was secured by all the assets of the Company and earned a coupon of 12.5% over the 18 months the debt was outstanding.

[1] Returns are presented gross of management fees.

The other four bonds repaid were called early, three of them at a premium to par.

In August, **North American Energy Partners** (9.125% due April 2017) called a portion of the debt we own, paying down 60% of the bonds at $101.52. The Company is now almost debt free, has assets worth more than our debt, and continues to generate cash flow in today's environment. Our remaining position represents a 2.6% weight in the portfolio.

Russell Metals (7.75% due September 2016) bonds were called at par in November. The Company redeemed bonds using cash on hand and their credit facility.

Canadian International Oil Corp. (11% due May 2016) raised over $200 million in equity earlier in the year, using the proceeds to call our notes in December at $103.75. This investment provided a total return of 15%.

Paramount Resources (8.25% due December 2017) called the bonds we owned in June at $102.875 and refinanced with 6.875% debt due 2023. We participated in the new issue, at a smaller commitment given the lower coupon and longer maturity. Since then, Paramount bonds have declined in price and we added to the position at an average price of $93.50, or a yield of 9.7%.

Over the past two years production has grown from 20,000 boepd to 50,000 boepd. To transport and to process the gas at lower operating costs, Paramount invested heavily in proprietary infrastructure. This was financed primarily with debt.

The subsequent sharp decline in oil and natural gas prices has put Paramount in a position where their debt to cash flow is too high. The Company has options to right size the balance sheet, which includes the sale of assets (the most likely of which would be their infrastructure).

These bond repayments significantly increased our cash position through the latter part of 2015. The cash had a short term effect of cushioning us from falling bond prices, and positioned us to take advantage of opportunities as they arose. In December, we began to see attractive opportunities, resulting in us starting 4 new bond positions, lowering our cash balance to 25% by year end.

We purchased **Lundin Mining** 7.875% bonds due November 2022 at a discount price of $92.63 or a yield of 9.4%. Bondholders are well compensated and secured by $500 million of cash on the balance sheet, plus operating assets that have value well in excess of total debt.

We purchased **Garda World** 7.25% bonds due November 2021 at $91.25 or a yield of 9.2%. Garda is one of the fastest-growing security companies globally providing security services at airports, sporting events, office buildings etc. and is the North American leader in cash service solutions, including armored transportation. Bondholders are well compensated as Garda generates free cash flow to secure and service our debt.

We purchased **Newalta** 5.875% bonds due April 2021 at $86, a yield of 8.6%. Newalta is a landfill and waste management company servicing the oil & gas sector. At the beginning of this cycle Newalta strengthened their balance sheet by selling a non-core division for $300 million, and reducing their net debt below 2x EBTIDA. Despite a difficult environment, Newalta generates free cash flow to service debt due to the essential nature of their service. We expect to add to this position as prices weaken.

Subsequent to our short term 7.75% bonds being repaid we purchased **Russell Metals** 6% bonds due April 2022 at $96, or a yield of 6.6%. Russell is one of the largest metals distribution and processing companies in North America. Despite being in a cyclical industry, Russell consistently generates cash to service its debt and has a conservative balance sheet which is covered 3x by working capital (Cash and Inventory).

The 75% of the portfolio invested in bonds currently yields 9%. With our cash balance of 25%, we are in position to take advantage of any weakness in bond prices, increasing the income payable to our clients. Simply deploying cash on hand at current yields will boost the total portfolio yield from 6.75% to 9%.