

**XS Cargo Income Fund**  
**Interim Consolidated Financial Statements**  
*June 30, 2006*

**XS Cargo Income Fund**  
**Consolidated Balance Sheets**

	<i>June 30,</i> <b>2006</b>	<i>December 31,</i> <b>2005</b>
	<i>(unaudited)</i>	
	\$	\$
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents	-	7,442,496
Rebate and other receivables	306,158	501,486
Inventory	23,643,349	15,752,388
Deposits on inventory	2,123,286	4,079,482
Prepaid expenses and deposits	741,701	612,151
	<b>26,814,494</b>	<b>28,388,003</b>
<b>Deferred charges</b>	<b>218,979</b>	<b>124,414</b>
<b>Property and equipment</b>	<b>3,809,833</b>	<b>2,730,783</b>
<b>Intangible assets</b>	<b>7,314,000</b>	<b>7,910,000</b>
<b>Goodwill (Note 3)</b>	<b>101,788,426</b>	<b>101,788,426</b>
	<b>139,945,732</b>	<b>140,941,626</b>
<b>Liabilities</b>		
<b>Current</b>		
Bank indebtedness (Note 4)	2,866,316	-
Accounts payable and accrued liabilities	4,910,379	7,094,948
Deferred revenue	945,168	417,152
Distributions payable to unitholders (Note 5)	629,681	572,438
Distributions payable to non-controlling interest (Note 6)	1,102,247	1,000,943
	10,453,791	9,085,481
Term loan (Note 4)	15,000,000	-
	<b>25,453,791</b>	<b>9,085,481</b>
<b>Term Loan (Note 4)</b>	<b>-</b>	<b>15,000,000</b>
<b>Deferred revenue</b>	<b>529,572</b>	<b>352,753</b>
<b>Unamortized lease inducements</b>	<b>168,313</b>	<b>142,116</b>
	<b>26,151,676</b>	<b>24,580,350</b>
<b>Non-controlling interest (Note 6)</b>	<b>58,298,532</b>	<b>59,527,529</b>
	<b>84,450,208</b>	<b>84,107,879</b>
<b>Unitholders' Equity</b>		
<b>Fund Units (Note 5)</b>	<b>56,131,876</b>	<b>56,131,876</b>
<b>Cumulative earnings</b>	<b>7,308,776</b>	<b>4,983,399</b>
<b>Cumulative distributions declared</b>	<b>(7,945,128)</b>	<b>(4,281,528)</b>
	<b>55,495,524</b>	<b>56,833,747</b>
	<b>139,945,732</b>	<b>140,941,626</b>

The accompanying notes are an integral part of these financial statements

**XS Cargo Income Fund**  
**Consolidated Statements of Earnings**

	<i>Three Months ended June 30, 2006 (unaudited)</i>	<i>Period from May 17, 2005 to June 30, 2005 (unaudited)</i>	<i>Six Months ended June 30, 2006 (unaudited)</i>
	\$	\$	\$
<b>Sales</b>	27,822,876	11,755,952	48,494,741
<b>Cost of goods sold</b>	17,255,921	7,328,286	30,325,263
<b>Gross margin</b>	10,566,955	4,427,666	18,169,478
<b>Expenses</b>			
Administrative and operating	6,537,933	2,663,932	12,011,072
Amortization of property and equipment	212,820	60,030	387,677
Amortization of intangible assets	298,000	149,000	596,000
	7,048,753	2,872,962	12,994,749
<b>Earnings before the undernoted</b>	3,518,202	1,554,704	5,174,729
<b>Other expenses</b>			
Interest on bank indebtedness	84,122	-	123,887
Interest on term loan	243,789	85,676	466,421
Foreign exchange loss	45,885	2,304	19,921
	373,796	87,980	610,229
<b>Earnings before non-controlling interest</b>	3,144,406	1,466,724	4,564,500
<b>Non-controlling interest (Note 6)</b>	1,542,574	719,428	2,239,123
<b>Net earnings for the period</b>	1,601,832	747,296	2,325,377
<b>Basic and diluted earnings per unit (Note 10)</b>	0.262	0.122	0.381

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**XS Cargo Income Fund**

**Consolidated Statements of Cumulative Earnings and Cumulative Distributions**

	<i>Three Months ended June 30, 2006 (unaudited)</i>	<i>Period from May 17, 2005 to June 30, 2005 (unaudited)</i>	<i>Six Months ended June 30, 2006 (unaudited)</i>
	\$	\$	\$
<b>Cumulative earnings, beginning of period</b>	5,706,944	-	4,983,399
<b>Net earnings for the period</b>	1,601,832	747,296	2,325,377
<b>Cumulative earnings, end of period</b>	7,308,776	747,296	7,308,776
<b>Cumulative distributions, beginning of period</b>	6,056,084	-	4,281,528
<b>Distributions declared during the period</b>	1,889,044	846,902	3,663,600
<b>Cumulative distributions, end of period</b>	7,945,128	846,902	7,945,128
<b>Cumulative distributions, declared in excess of earnings</b>	(636,352)	(99,606)	(636,352)

The accompanying notes are an integral part of these financial statements

**XS Cargo Income Fund**  
**Consolidated Statements of Cash Flows**

	<i>Three Months ended June 30, 2006 (unaudited)</i>	<i>Period from May 17, 2005 to June 30, 2005 (unaudited)</i>	<i>Six Months ended June 30, 2006 (unaudited)</i>
<b>Cash provided by (used for) the following activities</b>	\$	\$	\$
<b>Operating Activities</b>			
Net earnings for the period	1,601,832	747,296	2,325,377
Items not affecting cash:			
Non-controlling interest	1,542,574	719,428	2,239,123
Amortization of property and equipment	212,820	60,030	387,677
Amortization of intangible assets	298,000	149,000	596,000
Unit based compensation (Note 8)	30,000	117,330	60,000
Lease inducements received, net of amortization of lease inducements	41,121	87,001	26,197
	3,726,347	1,880,085	5,634,374
Net change in non-cash working capital	3,849,669	4,212,164	(7,443,287)
	7,576,016	6,092,249	(1,808,913)
<b>Financing Activities</b>			
Repayment of amounts due to Vendor	-	(180,180)	-
Net proceeds from the issuance of Units	-	56,396,400	-
Proceeds from bank indebtedness	-	-	6,043,348
Repayment of bank indebtedness	(3,177,032)	-	(3,177,032)
Proceeds from term loan	-	15,000,000	-
Distributions paid on Fund Units	(1,889,044)	-	(3,606,356)
Distributions paid to non-controlling interest	(1,773,577)	-	(3,426,816)
	(6,839,653)	71,216,220	(4,166,856)
<b>Investing Activities</b>			
Purchases of property and equipment	(736,363)	(25,281)	(1,466,727)
Business acquisition – net of cash acquired (Note 3)	-	(71,332,305)	-
	(736,363)	(71,357,586)	(1,466,727)
<b>Increase (decrease) in cash</b>	-	5,950,883	(7,442,496)
<b>Cash, beginning of period</b>	-	-	7,442,496
<b>Cash, end of period</b>	-	5,950,883	-
<b>Supplementary cash flow information</b>			
Interest paid	327,911	85,676	590,308

The accompanying notes are an integral part of these financial statements

# XS Cargo Income Fund

## Notes to the Interim Consolidated Financial Statements

June 30, 2006

Unaudited

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### 1. The Fund

XS Cargo Income Fund (the "Fund") is an unincorporated open-ended trust established under the laws of the Province of Alberta pursuant to the Fund Declaration of Trust dated April 6, 2005. The Fund was created to invest in the broadline closeout retail business, through an indirect acquisition of the controlling interest of XS Cargo Limited Partnership ("XS Cargo LP") and its general partner ("GP") (collectively "XS Cargo"), and such other investments as the Trustees may determine. Income tax obligations related to the distributions of the Fund are obligations of the Unitholder.

The Fund commenced business operations on May 17, 2005, when it completed an initial public offering (the "IPO") of 6,106,000 trust units ("Fund Units"), at a price of \$10 per unit, for aggregate gross proceeds of \$61,060,000. Concurrent with the closing of the IPO, the Fund acquired a 51% indirect interest in XS Cargo LP (note 3) and XS Cargo LP acquired the net assets (the "Acquired Business") of Famous Brands (Edmonton) Inc. (the "Vendor"). XS Cargo LP operates 32 closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan and Ontario.

### 2. Basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those for the audited financial statements for the period ended December 31, 2005. However, the interim consolidated financial statements do not include all information and footnote disclosures required under Canadian GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with audited financial statements and notes thereto, for the period ended December 31, 2005.

### 3. Issuance of Units and business acquisition

On May 17, 2005, the Fund completed the IPO for aggregate proceeds of \$61,060,000. The cost of the issuance of Units was \$4,928,124 resulting in net proceeds of \$56,131,876. The Fund used the net proceeds from the IPO to acquire an indirect 51% interest in XS Cargo LP, represented by 6,106,000 Ordinary LP Units. XS Cargo LP combined these Funds with proceeds from new credit facilities (note 4) to acquire 100% of the net business assets of the Vendor.

The acquisition of the Fund's interest in the Acquired Business has been accounted for using the purchase method and has been allocated to the assets acquired and liabilities assumed, as follows:

	\$
Property and equipment	2,373,558
Goodwill	101,788,426
Intangible assets	8,655,000
	<hr/> 112,816,984
Net working capital	16,979,392
	<hr/> 129,796,376
Consideration, being cash from IPO and new credit facilities	71,131,876
XS Cargo LP Exchangeable LP Units	34,719,700
XS Cargo LP Subordinated LP Units	23,944,800
	<hr/> Total consideration 129,796,376

Included in net working capital is cash acquired of \$64,095.

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The Fund finalized the fair value of assets acquired and the liabilities assumed subsequent to June 30, 2005. Working capital amounts were estimated as at June 30, 2005 and, pursuant to the purchase agreement with the Vendor, the purchase price was adjusted to reflect the actual amount of working capital purchased. As a result of these adjustments, Goodwill was reduced by \$652,549 and net working capital was increased by \$388,025, resulting in a net reduction to the purchase price of \$264,524 from the amount recorded in the June 30, 2005 financial statements.

**4. Credit facilities**

**Term loan**

Term loan consists of a committed non-revolving term loan facility. The maximum available on the term loan facility is \$17,500,000, of which \$15,000,000 was outstanding at June 30, 2006. The remaining credit available may be drawn at the Fund's option prior to August 31, 2006. The term loan is collateralized by a first charge on all present and after acquired personal property and an assignment of inventory. Interest on the term facility is charged at the lender's Canadian prime rate or U.S. base rate plus 0.25% to 0.75% or the bankers' acceptance rate plus 1.75% to 2.25%, depending on the Fund's senior debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio. The credit facility includes limits on incurring additional indebtedness or granting encumbrances without the consent of the lender and is subject to the maintenance of senior debt to EBITDA, current assets to current liabilities and fixed charge coverage ratios and minimum equity.

The term loan was drawn in the form of prime rate loans on May 17, 2005 concurrent with the acquisition described in note 3. During the three and six months ended June 30, 2006, the Fund paid interest of \$243,789 and \$466,421 respectively on the term loan. Interest was charged at a rate of prime plus 0.75%. As at June 30, 2006, prime rate was 6%. The principal balance of the term loan is due on May 17, 2007 and may be extended for an additional year to May 17, 2008 based on approval by the lender.

**Operating loan**

The Fund has available under its credit facilities a \$10,000,000 (\$12,500,000 available from August to December) demand revolving loan. Under the terms of the credit facility agreement, the operating loan is collateralized along with the term loan as described above. Interest on the operating loan will vary between the lender's prime rate and the lender's prime rate plus 0.25% depending on the Fund's ratio of senior debt to EBITDA. During the three and six months ended June 30, 2006, the Fund paid interest of \$84,122 and \$123,887 respectively on amounts drawn on the operating loan at a rate of prime plus 0.25%.

**5. Unitholders' Equity**

**Fund Units**

The following units were issued and outstanding at the end of the period:

	Number of units #	Issue costs \$	Net capital contributions \$
<u>Fund units issued</u>	<u>6,106,000</u>	<u>4,928,124</u>	<u>56,131,876</u>

An unlimited number of Fund Units may be created and issued pursuant to the Declaration of Trust. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund.

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All Fund Units have equal voting rights or privileges. There were no changes in the number or amount of Fund Units issued during the period.

**Distributions to Unitholders**

The Fund's policy is to distribute annually to unitholders available cash from operations after cash required for capital expenditures, working capital reserve and other reserves considered advisable by the Trustees of the Fund. The policy allows the Fund to make stable monthly distributions to its unitholders based on its estimate of distributable cash for the year. Distributions totaling \$0.309375 and \$0.600000 per Fund Unit (\$1,889,044 and \$3,663,600) were declared by the Fund during the three and six months ended June 30, 2006, respectively. The distribution declared for the month of June 2006 in the amount of \$0.103125 per Fund Unit (\$629,681) was included in distributions payable to unitholders at June 30, 2006 and was paid on July 15, 2006.

**6. Non-controlling interest**

	<i>XS Cargo LP Exchangeable LP Units #</i>	<i>XS Cargo LP Subordinated LP Units #</i>	<i>Total #</i>
Balance – December 31, 2005	3,478,914	2,399,269	5,878,183
Contingent unit based compensation award issued during the three month period ended June 30, 2006 (Note 8)	6,944	4,789	11,733
<b>Balance – June 30, 2006</b>	<b>3,485,858</b>	<b>2,404,058</b>	<b>5,889,916</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Balance – May 17, 2005	34,789,140	23,992,690	58,781,830
Non-controlling interest – cumulative earnings	4,164,508	2,872,096	7,036,604
Unit based compensation award issued during the three month period ended June 30, 2006 (Note 8)	69,440	47,890	117,330
Cumulative distributions declared	(4,527,479)	(3,122,423)	(7,649,902)
	34,495,609	23,790,253	58,285,862
Accrued contingent unit based compensation award (Note 8)			12,670
			<b>58,298,532</b>

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**XS Cargo LP Exchangeable LP Units (“Exchangeable LP Units”)**

The Exchangeable LP Units issued by XS Cargo LP have economic and voting rights equivalent to the Fund Units (note 5), except in connection with the exchangeability terms as described below. They are exchangeable directly or indirectly, on a one-for-one basis for Fund Units at the option of the holder, under the terms of the Exchange Agreement. The Exchangeable LP Units are not required to be exchanged for Fund Units before transferring to third parties. As a result, they have been treated as non-controlling interest, in accordance with the CICA Emerging Issues Committee Abstract #151.

Each Exchangeable LP Unit entitles the holder to receive distributions from XS Cargo LP pro rata with distributions made by XS Cargo LP on Fund Units.

**XS Cargo LP Subordinated LP Units (“Subordinated LP Units”)**

The Subordinated LP Units have economic and voting rights equivalent to the Fund Units (note 5), except in connection with the subordination terms as described below. As a result, they have been treated as non-controlling interest, in accordance with the CICA Emerging Issues Committee Abstract #151.

Distributions are to be made monthly on the Fund Units (note 5) and Exchangeable LP Units equal to \$0.103125 per Unit to the extent cash is available to make cash distributions. Distributions on the Subordinated LP Units are subordinated and are made quarterly in an amount equal to the amount distributed on Fund Units and Exchangeable LP Units and to the extent cash is available to make such distributions.

The Subordinated LP Units will be automatically exchanged for Exchangeable LP Units on a one-for-one basis and the subordination provisions will apply until the end of any fiscal year ending on or after December 31, 2006 if, for that fiscal year the Fund has earned EBITDA (earnings before interest, taxes, depreciation and amortization) of at least \$14.432 million and the Fund has paid distributions of at least \$1.125 per Fund Unit for such fiscal year.

**Fund Special Voting Units**

	Number #	Amount \$
Issued and outstanding	5,889,916	-

Fund Special Voting Units are non-participating and are used solely for providing voting rights to persons holding Exchangeable LP Units and Subordinated LP Units. Fund Special Voting Units are not transferable separately from Exchangeable LP Units and Subordinated LP Units to which they relate. The Fund Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund or in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Fund Unit and Fund Special Voting Unit entitles the holder thereof to one vote at all meetings of the Unitholders.

If the Exchangeable LP Units or the Subordinated LP Units are purchased in accordance with the Exchange Agreement, a like number of Fund Special Voting Units will be redeemed by the Fund for a nominal amount.

**Distributions to non-controlling interest**

The Fund’s policy is to distribute annually to holders of Fund Units, Exchangeable LP Units and Subordinated LP Units available cash from operations after cash required for capital expenditures, working capital reserve and other reserves considered advisable by the Trustees of the Fund. The policy allows the Fund to make stable monthly distributions to holders of Exchangeable LP Units and quarterly distributions to holders of Subordinated LP Units based on its estimate of distributable

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# XS Cargo Income Fund

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cash for the year. Distributions totaling \$0.309375 and \$0.600000 per Exchangeable LP Unit (\$1,077,005 and \$2,088,064) and \$0.309375 and \$0.600000 per Subordinated LP Unit (\$742,768 and \$1,440,055) were declared by the Fund during the three and six months ended June 30, 2006 respectively. Distributions declared on Exchangeable LP Units for the month of June in the amount of \$0.103125 per unit (\$359,479) and Distributions on Subordinated LP Units for the three months ended June 30, 2006 in the amount of \$0.309375 per unit (\$742,768) were included in distributions payable to non-controlling interest at June 30, 2006 and were paid on July 15, 2006.

### 7. Long-term incentive plan

The Fund has adopted a long-term incentive plan (the "Plan") to provide key senior management, officers and directors of the Fund with compensation opportunities that will enhance the ability of the Fund to attract, retain and motivate key personnel and reward these key employees for significant performance and associated per unit cash flow growth. Fund bonuses, in the form of the Units of the Fund, will be provided to eligible employees on an annual basis where the distributable cash of the Fund exceeds certain specified threshold amounts.

If the distributable cash flow per unit exceeds the base distribution, a percentage of the distributable cash (the participation rate) is contributed by the Fund into a long-term incentive pool. The funds in the pool are used to purchase units of the Fund in the open market, to be provided to eligible employees as bonus compensation. Threshold amounts and participation rates are as follows:

Excess percentage	Proportion of excess percentage paid to plan Trustee
5% or less	Nil
Greater than 5% and up to 10%	10% of any excess over 5%
Greater than 10% and up to 20%	10% of any excess over 5%, plus 20% of any excess over 10%
Greater than 20%	10% of any excess over 5%, plus 20% of any excess over 10%, plus 25% of any excess over 20%

The portion attributable to service in the second quarter has not been accrued since the amount is not material. The Plan pool will be \$44,940 at the end of the year based on current monthly distribution amount.

### 8. Unit-based compensation

Under the terms of the Acquisition Agreement between the Vendor and the Fund, the Fund assumed certain obligations under an employment agreement with the Chief Financial Officer. Under the employment agreement the Fund may issue a maximum of 6,944 of XS Cargo Exchangeable LP Units and 4,789 Subordinated LP Units per year based on performance. If awarded, the units are issued on the anniversary date of the IPO, May 17. The Fund accrues a contingent award throughout the year, based on the estimated fair value of the units at the grant date. The estimated value is included in administrative and operating expenses and increases non-controlling interest on the balance sheet. For the three and six months ended June 30, 2006, the Fund has recognized compensation costs of \$30,000 and \$60,000 respectively.

### 9. Variable interest entity

Pursuant to the business acquisition described in note 3, the Fund assumed a vendor supply and volume rebate agreement with Samra Imports Ltd., ("Samra"). Samra imports products from China which it sells to the Fund and other customers. Samra is the Fund's largest supplier accounting for approximately 19% of the Fund's purchases since the commencement of the agreement and the Fund is Samra's largest customer. The purpose of the agreement is to outline the supply terms and to provide the Fund with a rebate based on its significant volume of purchases from Samra. The Fund has determined that Samra is a variable interest entity and that the supply and rebate agreement represents a variable interest in Samra. The

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Fund has determined, however, that it is not the primary beneficiary under the supply and rebate agreement since the Fund is not entitled to receive a majority of Samra's expected residual returns or absorb a majority of its expected losses.

During the three and six months ended June 30, 2006, the Fund purchased approximately \$4,200,000 and \$6,700,000 respectively of inventory from Samra. Included in the deposit on inventory, as at June 30, 2006, is a balance of \$134,960 outstanding from Samra related to those purchases. Samra issued the Fund a volume rebate for purchases made for the three and six months ended June 30, 2006 in the amounts of \$450,000 and \$795,540 respectively.

**10. Basic and diluted earnings per unit**

The following table outlines the adjustments to the numerator and denominator to calculate the basic and diluted earning per unit:

	Basic Earnings per Unit	Dilution Adjustments		Diluted Earnings per Unit
<b>Three months ended June 30, 2006</b>				
Net earnings	1,601,832	1,542,574	(a)	3,144,406
Average Units outstanding	6,106,000	5,878,312	(b)	11,984,312
Earnings per Unit	0.262			0.262
<b>Six months ended June 30, 2006</b>				
Net earnings	2,325,377	2,239,123	(a)	4,564,500
Average Units outstanding	6,106,000	5,878,248	(b)	11,984,248
Earnings per Unit	0.381			0.381

(a) Adjustment to add back non-controlling interest if Exchangeable LP Units and Subordinated LP Units are converted to Fund Units

(b) Adjustment to reflect the conversion of Exchangeable LP Units and Subordinated LP Units to Fund Units on a one-for-one basis

**11. Seasonal nature of the business**

The Fund's results for the period are not necessarily indicative of the results that may be expected for the full year due to seasonal variations in sales levels. The business historically experiences a higher level of sales in the fourth quarter and a lower level of sales in the first quarter due to seasonal shopping patterns. Occupancy-related expenses, certain administrative and operating expenses, amortization, and interest expense remain relatively steady throughout the year.

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**12. Segmented information**

Each store constitutes an operating segment in that its performance is monitored by senior management and discreet financial information is available. Since each store sells the same products to the same types of customers and uses similar distribution and sales processes, they have been aggregated for reporting purposes into one segment.

**13. Subsequent events**

Subsequent to the balance sheet date, XS Cargo entered into lease agreements to open three new stores in Vancouver, British Columbia; Halifax, Nova Scotia; and St. John's, Newfoundland.