



XS CARGO INCOME FUND

Management's Discussion of Financial Condition and Results of Operations

For the three and six months ended June 30, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This management's discussion and analysis ("MD&A") should be read in conjunction with the interim consolidated financial statements and accompanying notes (the "Financial Statements") of XS Cargo Income Fund (the "Fund") for the three and six months ended June 30, 2006 and the audited consolidated financial statements and management's discussion and analysis of the Fund for the period ended December 31, 2005. These financial statements, management's discussion and analysis and other documents filed with regulatory authorities can be found on SEDAR at www.sedar.com. Results are reported in Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain dollar amounts have been rounded to the nearest thousand dollars, while other amounts have been rounded to the nearest hundred thousand dollars. References to notes are to the notes to the Financial Statements of the Fund unless otherwise stated.

This MD&A is dated August 10, 2006.

OVERVIEW OF THE FUND

Issuance of Fund Units and Acquisition

XS Cargo Income Fund is an unincorporated open-ended trust established under the laws of the Province of Alberta. The Fund invests in the broadline closeout retail business, through an indirect controlling interest in XS Cargo Limited Partnership ("XS Cargo LP") and its general partner ("GP") (collectively "XS Cargo"), and such other investments as the Trustees may determine.

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").

The Fund Units trade on the Toronto Stock Exchange under the symbol XSC.UN.

Basis of Management's Discussion and Analysis

To provide more meaningful information, the following MD&A compares the operating results of the Fund for the three and six months ended June 30, 2006 to those of the combined results for the Vendor and Fund for the three and six months ended June 30, 2005. (See "Non-GAAP Measures"). The Fund commenced operations on May 17, 2005, therefore the Fund results are only available for the period from May 17, 2005 to June 30, 2005 for comparatives purposes.

It is management's view that employee profit sharing plan contributions incurred by the Vendor are not relevant when compared to the Fund because of differences between the structure and policies of the Fund to those of the Vendor. Those contributions have been added back when computing earnings from operations as described in "Non-GAAP Measures."

The Business of the Fund

XS Cargo LP operates 32 closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan and Ontario.

Operating Highlights

Our second quarter was one of rapid store expansion with four new stores opening during the period. The new stores were opened in Barrie, Ontario on April 28th; Port Coquitlam, British Columbia on May 19th; Grande Prairie, Alberta on June 29th; and Burlington, Ontario on June 29th. We also set the stage for our expansion into Atlantic Canada. Leases were finalized for new stores in Halifax, Nova Scotia and St. John's, Newfoundland, which are scheduled to open in early November. In addition, we finalized a lease for our first store in the city of Vancouver, which is also scheduled to open in November.

Our stores continue to perform well. Same store sales are up 9.7% for the quarter and 2.8% for the year-to-date, excluding three of our stores that experienced expected cannibalization from new stores opening in overlapping trading areas. We are not only increasing sales, but our gross margin percentages continue to improve. This is a reflection of our strong focus on our core competency, that being our ability to source quality, high demand merchandise from distressed situations at significant discounts to regular wholesale prices.

In common with all businesses having significant operations in Alberta, we are facing increased challenges attracting and retaining employees at the wage rates we were accustomed to paying historically. We currently have eight stores, our corporate head office and one distribution centre in Alberta. We believe we are doing very well relative to other employers in mitigating the effects of these upward wage pressures. For example, we have reduced the pressure on base wages at the store level by introducing a variable incentive compensation package to all hourly employees that is funded by incremental product replacement extended warranty plan sales.

The most significant impact of the wage pressure is being felt at our distribution facility in Edmonton that employs over 30 hourly team members. Although we feel that increases in our average hourly wage rates were necessary, throughout the rest of the year we will be looking to improve efficiencies and reduce the number of labour hours used in both of our distribution centres. We are currently in the process of upgrading our point-of-sale and distribution software. We anticipate that the improved functionality in the new distribution system will allow us improve our distribution efficiency and reduce labour requirements.

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Second Quarter and Year-to-Date Operating Results

The following tables show the unaudited results of the Fund for the second quarter and year-to-date of 2006 compared to the combined results of the Fund and the Vendor for the second quarter and year-to-date of 2005. The results of operations for these periods are not necessarily indicative of the results of operations to be expected in any given period.

Second Quarter Results (unaudited)	Fund	Combined Vendors and Fund	Change Q2 2006 from 2005
	April 1 to June 30, 2006	April 1 to June 30, 2005	
Sales	27,822,876	22,675,993	5,146,883
Cost of Sales	17,255,921	14,207,011	3,048,910
Gross Margin	10,566,955 38.0%	8,468,982 37.3%	2,097,973
Administrative and Operating Expenses*	6,507,933	4,889,157	1,618,776
Earnings from Operations, as defined*	4,059,022	3,579,925	479,197

Year-to-Date Results (unaudited)	Fund	Combined Vendors and Fund	Change 2006 over 2005
	January 1 to June 30, 2006	January 1 to June 30, 2005	
Sales	48,494,741	40,156,029	8,338,712
Cost of Sales	30,325,263	25,709,047	4,616,216
Gross Margin	18,169,478 37.5%	14,446,982 36.0%	3,722,496
Administrative and Operating Expenses*	11,951,072	8,778,877	3,172,195
Earnings from Operations, as defined*	6,218,406	5,668,105	550,301
Non-recurring operating expenses**	170,000	-	170,000
Earnings from Operations before non-recurring expenses	6,388,406	5,668,105	720,301

* Earnings from operations have been calculated as described under “Non-GAAP Measures” on page 14. For purposes of this table, administrative and operating expenses exclude the expenses outlined in the calculation of Earnings from Operations as described under “Non-GAAP Measures”.

** Non-recurring operating expenses consist of expenses relating to the consolidation of the Edmonton distribution facilities.

Sales

Quarter

The following table compares sales for the three months ended June 30, 2006 to the three months ended June 30, 2005 for new and same stores:

	Sales				Number of Stores as of June 30	
	2006	2005	Change	% change	2006	2005
Same stores	18,432,044	17,520,880	911,164	5.2%	18	18
New stores	9,390,832	5,155,113	4,235,719	82.2%	14	5
Total	27,822,876	22,675,993	5,146,883	22.7%	32	23

Second quarter sales increased by \$5.1 million, from \$22.7 million to \$27.8 million, an increase of 22.7%. New stores, defined as stores that have been not been open for a full 12 months in the current and prior period, contributed an additional \$4.2 million in sales. The remaining \$0.9 million increase represents a 5.2% increase in same store sales. Excluding three stores that experienced cannibalization from new stores opening in overlapping trading areas, same store sales for period were 9.7% higher than the second quarter of 2005. Part of this increase in same store sales was the result of the Easter weekend falling in April in 2006 and March in 2005.

Year-to-date

For the year-to-date, sales have increased by \$8.3 million from \$40.2 million to \$48.5 million an increase of 20.6%. Year-to-date same store sales were up 2.8%, excluding three stores that experienced cannibalization from new stores opening in overlapping trading areas.

Product Replacement Plan Sales

Sales of two-year product replacement extended warranty plans continue to be strong. During the nine months since implementation, \$1.9 million of Product Replacement Plan Sales (“PRPs”) were sold, however only \$0.4 million has been recognized as revenue to date and approximately \$0.2 million was recognized during the quarter. Revenue from PRP sales is deferred and recognized on a straight-line basis over the two-year terms of the PRPs.

The following table outlines the number of stores and percentage of sales by geographical region:

Region	June 30, 2006		June 30, 2005	
	Number of stores, end of period	Percentage of sales during the period	Number of stores, end of period	Percentage of sales during the period
Ontario	15	50.8%	11	54.0%
Alberta	8	21.8%	6	23.6%
Saskatchewan and Manitoba	3	9.2%	3	10.5%
British Columbia	6	18.2%	3	11.9%
Total	32	100.0%	23	100.0%

Cost of Sales and Gross Margin

Quarter

Cost of sales for the quarter increased by \$3.0 million from \$14.2 million to \$17.2 million, an increase of 21.5%, primarily as a result of new store openings.

Gross margin for the quarter increased by \$2.1 million, from \$8.5 million to \$10.6 million, an increase of 24.8%. \$0.2 million of the increase was the result of an increase in gross margin percentage from 37.3% to 38.0% and the remaining \$1.9 million increase is the result in net increases in sales volumes from new store development. The increase in gross margin percentage is the result of XS Cargo's continued ability to improve product selection with higher margin items as well as a reduction of freight costs as a percentage of sales.

Year-to-date

Cost of sales for the year-to-date increased by \$4.6 million, from \$25.7 million to \$30.3 million, an increase of 17.8%, primarily as a result of new store openings.

Gross margin for the year-to-date increased by \$3.7 million, from \$14.5 million to \$18.2, an increase of 25.5%. \$0.7 million of the increase was the result of an increase in gross margin percentage from 36.0% to 37.5% and the remaining \$3.0 million increase is the result in net increases in sales volumes from new store development.

Combined Administrative and Operating Expenses

Quarter

For the quarter, administrative and operating expenses increased by approximately \$1.6 million from \$4.9 million to \$6.5 million. This increase is primarily the result of increases in rent (\$0.5 million increase), wages (\$0.6 million increase) and advertising (\$0.2 million increase). The increases in these expenses relate primarily to new stores as well as the eastern distribution centre in Mississauga, Ontario that opened in May 2005 (\$0.2 million). In addition, incremental public company administrative expenses accounted for \$0.1 million of the increase.

Year-to-date

Administrative and operating expenses for the year-to-date increased by \$3.2 million from \$8.8 million to \$12.0 million. This increase is primarily the result of increases in rent (\$1.0 million increase), wages (\$1.2 million increase) and advertising (\$0.4 million increase). The increases in these expenses relate primarily to new stores as well as the eastern distribution centre in Mississauga, Ontario that opened in May 2005 (\$0.6 million). In addition, incremental public company administrative expenses accounted for \$0.2 million of the increase. Included in year-to-date administrative and operating costs are \$0.2 million non-recurring expenses relating to the consolidation of the Edmonton distribution facilities that were incurred in the first quarter.

Earnings from Operations

Quarter

For the quarter, earnings from operations increased by \$0.5 million, from \$3.6 million to \$4.1 million, an increase of 13.9%. The increase resulted from the higher gross margin earned and the addition of new stores.

Year-to-date

For the year-to-date, earnings from operations increased by \$0.6 million, from \$5.6 million to \$6.2 million, an increase of 10.7%. Excluding the non-recurring expenses related to the consolidation of the Edmonton distribution facilities that were incurred in the first quarter, earnings from operations increased by \$0.7 million, or 12.5%.

Fund Net Earnings

For the three months ended June 30, 2006, the Fund had net earnings of \$1.6 million or \$0.262 per unit on a basic and diluted basis.

For the six months ended June 30, 2006, the Fund had net earnings of \$2.3 million or \$0.381 per unit on a basic and diluted basis.

Financial Position

The following are the significant assets, liabilities and equity of the Fund as at the specified dates:

	June 30, 2006 (unaudited)	March 31, 2006 (unaudited)	December 31, 2005
Cash	-	-	7,442,496
Inventory	23,643,349	24,360,418	15,752,388
Total current assets	26,814,494	29,430,837	28,388,003
Total assets	139,945,732	142,308,234	140,941,626
Bank indebtedness	2,866,316	6,043,348	-
Total current liabilities excluding term loan	10,453,791	12,382,815	9,085,481
Term loan	15,000,000	15,000,000	15,000,000
Non-controlling interest	58,298,532	58,545,731	59,527,529
Unitholders' equity	55,495,524	55,782,736	56,833,747

Distributable Cash and Cash Distributions

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. The Fund pays cash distributions on or about the 15th of the month to unitholders of record on the last business day of the previous month.

The following table summarizes the distributions from January 1, 2006 to June 30, 2006:

Record Date	Payment Date	Fund Units		Exchangeable LP Units and Subordinated LP Units		Total	
		Declared \$	Paid \$	Declared \$	Paid \$	Declared \$	Paid \$
January 31, 2006	February 15, 2006	572,438	572,438	326,148	326,148	898,586	898,586
February 28, 2006	March 15, 2006	572,437	572,437	326,148	326,148	898,585	898,585
March 31, 2006	April 15, 2006	629,681	629,681	1,056,051	1,056,051	1,685,732	1,685,732
April 30, 2006	May 15, 2006	629,682	629,682	358,763	358,763	988,445	988,445
May 31, 2006	June 15, 2006	629,681	629,681	358,763	358,763	988,444	988,444
June 30, 2006	July 15, 2006	629,681	-	1,102,247	-	1,731,928	-
		<u>3,663,600</u>	<u>3,033,919</u>	<u>3,528,120</u>	<u>2,425,873</u>	<u>7,191,720</u>	<u>5,459,792</u>

Distributions are paid on Fund Units, XS Cargo LP Exchangeable LP Units and XS Cargo LP Subordinated LP Units. As of June 30, 2006 the following number of units were outstanding:

Fund Units (Note 5)	6,106,000
XS Cargo LP Exchangeable LP Units (Note 6)	3,485,858
XS Cargo LP Subordinated LP Units (Note 6)	<u>2,404,058</u>
	<u>11,995,916</u>

During the three months ended June 30, 2006, the Fund approved distributions of \$0.309375 per Fund Unit to unitholders. It is the Fund's policy to review the monthly distribution amount at least quarterly. Our monthly distribution rate at the time of our initial public offering was \$0.09375 per unit. The monthly distribution rate was increased to \$0.103125 per unit in March 2006.

Distributable Cash per Unit (Fund Units, XS Cargo LP Exchangeable LP Units, XS Cargo LP Subordinated LP Units)

	April 1 to June 30, 2006	January 1 to June 30, 2006	Since Inception on May 17, 2005
	(unaudited)	(unaudited)	(unaudited)
Cash provided by operating activities	7,576,016	(1,808,913)	13,870,210
Less: Net change in non-cash working capital	(3,849,669)	7,443,287	2,956,638
Add: Interest expense	327,911	590,308	1,095,230
Less: Unit based compensation	(30,000)	(60,000)	(247,330)
Less: Lease inducements received, net of amortization of lease inducements	(41,121)	(26,197)	(168,313)
EBITDA¹	3,983,137	6,138,485	17,506,435
Add: Unit based compensation	30,000	60,000	247,330
Less: Interest paid	(327,911)	(590,308)	(1,095,230)
Less: Maintenance capital expenditures ²	(51,206)	(166,206)	(361,211)
Distributable cash³	3,634,020	5,441,971	16,297,324
Average Units outstanding during the period	11,984,312	11,984,248	11,984,212
Distributable cash per Unit	0.30	0.45	1.36
Distributions declared	3,707,607	7,190,509	15,593,819
Distributions declared per Unit	0.31	0.60	1.30
Ratio of distributions declared to distributable cash (payout ratio)	102%	132%	96%

Since inception, the Fund has had distributable cash per unit of \$1.36 and has declared distributions of \$1.30 per unit. For the second quarter, the Fund had distributable cash per unit of \$0.30 and declared distributions of \$0.31 per unit. Basic and diluted earnings per unit were \$0.26 for the second quarter.

¹ EBITDA refers to earnings before interest, taxes, depreciation and amortization. See discussion under “Non-GAAP Measures” below.

² Maintenance capital expenditures refer to acquisitions of property and equipment to replace or upgrade equipment and information systems at existing stores and distribution centres. See discussion under “Capital Expenditures” below.

³ See discussion under “Non-GAAP Measures” below.

During the three months ended June 30, 2006, cash distributions were higher than distributable cash. The monthly cash distributions are based on management's estimate of distributable cash for the year. Since the Fund's business is seasonal in nature, with approximately 40% of the annual distributable cash being generated in the fourth quarter, it is expected that cash distributions based on annual cash flows will exceed distributable cash during the first three quarters and be less than distributable cash in the fourth quarter. Management currently targets a payout ratio on an annual basis of approximately 85-90%.

Unitholders' Equity and Non-controlling Interest

The following table outlines the Fund Units and non-controlling interest outstanding as of June 30, 2006.

	Units	Issue Costs	Unitholders' Equity	Non-controlling Interest
	#	\$	\$	\$
Fund Units	6,106,000	4,928,124	56,131,876	-
Special Voting Units	5,889,916	-	-	-
Non-controlling Interest	5,889,916	-	-	58,298,532

On June 30, 2006, 6,944 Exchangeable Units, 4,789 Subordinated Units and 11,733 Special Voting Units were issued to the Chief Financial Officer as described in Note 8.

LIQUIDITY AND CAPITAL RESOURCES

Distributable Cash and Cash Distributions

The Fund's policy is to make stable monthly distributions to its Unitholders based on its estimate of distributable cash for the year. It has a policy to pay cash distributions on or about the 15th of each month to Unitholders of record on the last business day of the previous month.

During the three and six months ended June 30, 2006, the Fund declared distributions of \$0.309375 and \$0.600000 per Fund Unit respectively to Unitholders, or \$1,889,044 and \$3,663,600 in total.

Credit Facilities

The Fund has established credit facilities with a Canadian chartered bank. These credit facilities consist of a \$10.0 million demand revolving operating loan and a committed non-revolving term loan to a maximum amount of \$17.5 million. On May 17, 2005 the Fund drew \$15.0 million on the term loan in connection with the acquisition described on page 1. As at June 30, 2006, \$15.0 million remains outstanding on the term loan and \$2.9 million was outstanding on the operating loan. The limit on the operating loan increases to \$12.5 million between the months of August and December to facilitate the build up of inventories for the fourth quarter holiday shopping season.

The term loan is due on May 17, 2007 and may be extended for an additional year based on approval by the lender to May 17, 2008.

Capital Expenditures

During the quarter, the Fund acquired \$736,363 of property and equipment financed using the operating loan. The Fund anticipates that it will draw additional amounts available on the term loan in the third quarter in order to finance the capital expenditures for new store growth as well as capital expenditures that were previously financed using cash flow from operations. Of the \$736,363 of capital expenditures, \$685,157 related to new store openings, distribution infrastructure and head office capacity and the remaining \$51,206 related to capital expenditures at existing stores and warehouses (“maintenance capital expenditures”).

Subsequent to June 30, 2006, the Fund entered into lease agreements for new stores in Vancouver, British Columbia; Halifax, Nova Scotia; and St. John’s, Newfoundland. The new stores will require capital expenditures of approximately \$360,000 in the third and fourth quarters of 2006. As discussed above, the Fund has credit facilities available to finance these and other growth related capital expenditures in the remainder of 2006.

Interest Rate Risk and Sensitivity

The Fund is not significantly impacted by interest rate changes. The Fund’s long-term debt bears interest with floating rates based on the bank’s prime rate, thus exposing the Fund to interest rate fluctuations. A 1.0% increase in interest rates would have an impact of \$200,000 annually (\$50,000 during the quarter) on distributable cash based on \$20.0 million of debt outstanding.

Contractual Obligations

The table below sets forth the contractual obligations of the Fund as of June 30, 2006, due in the years indicated, which relate to various premises operating leases and the \$15.0 million outstanding on the term loan that matures on May 17, 2007, but may be extended with approval of the lender until 2008.

(unaudited)	Total	2006	2007	2008	2009	2010 and thereafter
Operating Leases	19,379,632	1,960,190	3,444,341	3,239,822	2,971,205	7,764,074
Term loan	15,000,000	-	15,000,000	-	-	-
Total	34,379,632	1,960,190	18,444,341	3,239,822	2,971,205	7,764,074

Summary of Quarterly Results (unaudited)

	April 1 to June 30, 2006	January 1 to March 31, 2006	October 1 to December 31, 2005	July 1 to September 30, 2005	May 17 to June 30, 2005
Sales	27,822,876	20,671,865	36,436,104	20,775,101	11,755,952
Net earnings	1,601,832	723,545	3,062,775	1,173,328	747,296
Basic and diluted earnings per unit	0.262	0.119	0.502	0.192	0.122

Due to seasonal shopping trends, the fourth quarter is typically the strongest quarter for XS Cargo and the first quarter is the slowest.

Off-Balance Sheet Arrangements

The Fund has not entered into any off-balance sheet arrangements.

Critical Accounting Estimates

Goodwill

Goodwill is not amortized, but is tested for impairment annually or more frequently if circumstances indicate a potential impairment. Goodwill is tested for impairment by comparing the estimated fair value of the reporting unit to its carrying value. If the carrying value of the reporting unit exceeds its fair value, the fair value is allocated to the assets and liabilities of the reporting unit and the resulting difference between the carrying value and fair value of goodwill is recorded as an impairment loss and recorded in earnings of the current period.

Inventory Valuation

Inventory is valued at the lower of cost and estimated net realizable value. Inventory cost includes freight charges, which are allocated to inventory based on a percentage of freight paid during a period compared to the total purchases made during the period. In addition, accrued supplier rebates are allocated between cost of goods sold and a reduction of inventory based on the estimated proportion related to goods remaining in inventory at the end of a period. Management believes that the estimates, assumptions and allocation methods are reasonable in the circumstances. It is possible that materially different results would be reported using different assumptions or allocation methods.

Changes in Accounting Policies Including Initial Adoptions

Management is not aware of any recent accounting pronouncements or developments that will affect the Fund's financial statements. Management will continue to monitor and assess the impact of accounting pronouncements on the financial statements of the Fund as they become available.

Financial Instruments

Due to the nature of its business, the Fund does not engage in activities or hold assets that would require the Fund to acquire financial instruments for hedging or speculative purposes. The financial instruments that are held by the Fund are held in the normal course of operations and as a result no significant accounting policies need to be adopted or assumptions made in reporting the Fund's financial instruments.

Transactions with Related Parties

Transactions with related parties include XS Cargo LP's purchase of the assets of the business from the Vendor on May 17, 2005. During the three and six months ended June 30, 2006 there were no related party transactions.

Outlook

Management believes that operating results will continue to improve in the upcoming year due to new store openings, the realization of freight savings from the new distribution centre in Ontario, the realization of efficiencies from consolidation of the Edmonton distribution and warehousing operations and the introduction of new revenue streams. XS Cargo has entered into lease agreements for new stores in Vancouver, British Columbia; Halifax, Nova Scotia; and St. John's, Newfoundland which will be opened during the fourth quarter of 2006.

Additional Information

Additional information relating to the Fund is available on SEDAR (www.sedar.com) and on the Fund's website at www.xscargo.com.

Non-GAAP Measures

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization and references to "distributable cash" are to cash available for distribution to Unitholders in accordance with the distribution policies of the Fund. Management believes that, in addition to income or loss, EBITDA is a useful supplemental measure of performance and cash available for distribution before debt service, changes in working capital, capital expenditures and income taxes. Specifically, management believes that EBITDA is the appropriate measure from which to make adjustments to determine the distributable cash of the Fund. Distributable cash of the Fund is a measure generally used by open-ended trusts as an indicator of financial performance. As one of the factors that may be considered relevant by prospective investors is the cash distributed by the Fund relative to the price of the Units, management believes that distributable cash of the Fund is a useful supplemental measure that may assist prospective investors in assessing an investment in the Fund.

Earnings from operations for disclosure under "Second Quarter and Year-to-Date Operating Results" has been calculated as described below. In the case of the Fund, earnings from operations have been derived by adding interest expense, amortization of property and equipment and intangible assets, unit-based compensation and non-controlling interest to net earnings for the period. In the case of the Vendor, earnings from operations have been derived by adding amortization expense, employee profit sharing plan contributions, interest expense, and income tax expense to net earnings (loss) for the period.

EBITDA, distributable cash and earnings from operations are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP. Investors are cautioned that EBITDA, distributable cash and earnings from operations should not replace net income or loss (as determined in accordance with GAAP) as an indicator of the Fund's performance, of its cash flows from operating, investing and financing activities or as a measure of its liquidity and cash flows. The Fund's methods of calculating EBITDA, distributable cash and earnings from operations may differ from the methods used by other issuers and may not be comparable to similar measures presented by other issuers.

RISK FACTORS

The Fund's results of operations, business prospects, financial condition, cash distributions to unitholders and the trading price of the Fund's units are subject to a number of risks. These risk factors include: the ability to maintain profitability and manage growth; the ability to expand through new store openings; the ability to source products in adequate

quantities and on acceptable terms; changes in trends and consumer tastes; economic conditions and consumer spending; competition; reliance on centralized distribution centres; freight costs; ability to maintain comparable store sales; seasonality and fluctuations in quarterly results; reliance on management information systems; increase in the cost of, or disruption in the flow of, imported products; successful management of exposure to merchandise returns; foreign exchange fluctuations; costs and availability of insurance coverage; protection of intellectual property; reliance on key personnel; labour matters; absence of history as a public company; dependence on external funding sources; uncertainties arising from world events; income tax legislation; and property taxes. For a discussion of these risks and other risks associated with an investment in Fund Units, see “Risk Factors” detailed in the Fund’s final prospectus dated May 6, 2005 and the Fund’s Annual Information Form available at www.sedar.com.

On September 8, 2005, the Department of Finance launched public consultations on tax issues related to publicly traded income trusts and other “flow-through entities”. On November 23, 2005 the government ended the consultations and instead proposed to increase the dividend tax credit for investors in public corporations. A change in government in January, 2006 has put any changes in abeyance. There is a risk that regulatory authorities could alter the tax treatment of income trusts, the distribution of trust income, or the tax on corporations and dividends, which could adversely affect the income trust structure and their market valuations. As of the date of this MD&A the nature and impact of those changes, if any, are unknown.

FORWARD LOOKING STATEMENTS

This MD&A contains forward-looking statements. All statements other than statements of historical fact contained in this MD&A are forward-looking statements, including, without limitation, statements regarding the future financial position, cash distributions, proposed store openings, budgets, litigation, projected costs and plans and objectives of or involving the Fund or XS Cargo LP. You can identify many of these statements by looking for words such as “believe”, “expects”, “will”, “intends”, “projects”, “anticipates”, “estimates”, “continues” or similar words or the negative thereof. These forward-looking statements include statements with respect to the amount and timing of the payment of distributions of the Fund. There can be no assurance that the plans, intentions or expectations upon which these forward-looking statements are based will occur. Forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, those discussed elsewhere in the MD&A. There can be no assurance that such expectations will prove to be correct.

Some of the factors that could affect future results and could cause results to differ materially from those expressed in the forward-looking statements contained herein include, but are not limited to, those discussed under “Risk Factors”.

The information contained in this MD&A, including the information set forth under “Risk Factors”, identifies additional factors that could affect the operating results and performance of the Fund and XS Cargo LP.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this MD&A are made as of the date of this MD&A and, except as required by law, the Fund assumes no obligation to update or revise them to reflect new events or circumstances.