



XS CARGO INCOME FUND

Management's Discussion of Financial Condition and Results of Operations

**For the period from April 6, 2005
to December 31, 2005**

(including business operations from May 17, 2005 to December 31, 2005)

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 consolidated financial statements and accompanying notes (the "Financial Statements") of XS Cargo Income Fund (the "Fund") for the initial period from April 6, 2005 to December 31, 2005, which includes business operations from May 17, 2005 to December 31, 2005. 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 March 17, 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 acquisition of the Fund's interest in the Acquired Business has been accounted for using the purchase method.

The purchase price 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
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	112,816,984
Net working capital	16,979,392
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	129,796,376
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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
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Total consideration	129,796,376
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The Fund Units trade on the Toronto Stock Exchange under the symbol XSC.UN.

Basis of Management’s Discussion and Analysis

The Fund was established on April 6, 2005 and acquired, indirectly, the Acquired Business on May 17, 2005. Accordingly, the Fund’s Financial Statements only include business operations from May 17, 2005 to December 31, 2005.

To provide more meaningful information, the following MD&A refers to the operating results of the Fund for the three months ended December 31, 2005 and the combined operating results of the Fund from May 17, 2005 to December 31, 2005 and the Vendor from January 1, 2005 to May 16, 2005. These operating results are compared to the Vendor’s results of operations for the three months and twelve months ended December 31, 2004 (See “Non-GAAP Measures”).

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.

The Business of the Fund

XS Cargo LP operates 27 closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan and Ontario.

Operating Highlights

XS Cargo posted record sales for the Fourth Quarter of 2005 at \$36.4 million and for the year ended December 31, 2005 at \$97.4 million as a result of the successful execution of its store expansion plan. New stores were opened during the quarter in Surrey, British Columbia and Medicine Hat, Alberta, bringing the total to eight new stores in 2005. Although sales during the beginning of the Fourth Quarter were still impacted by the supply disruption caused by a trucking strike at the Vancouver port in the third quarter, late November and December holiday shopping sales were strong.

On October 1, 2005 XS Cargo introduced the sales of two-year product replacement extended warranty plans ("PRP"s). During the three months since implementation, over 63,000 PRPs were sold for a total of \$0.8 million. The revenue from PRP sales is recognized for accounting purposes over the 2-year term of the plans and, as a result, less than \$0.1 million of PRP sales have been recognized in revenue for the three months ended December 31, 2005. Based on the successful implementation of the plan, management expects that it will contribute significantly to cash flow from operations and net income in the future.

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Fourth Quarter Operating Results

The following table shows the unaudited results of the Fund for the Fourth Quarter of 2005 compared to the Vendor's Fourth Quarter of 2004. The sales, cost of sales, and administrative and operating expenses for the period from October 1, 2004 to December 31, 2004 have been derived from the financial statements of the Vendor and are presented for comparative purposes. The results of operations for these periods are not necessarily indicative of the results of operations to be expected in any given period.

	Fund October 1, 2005 to December 31, 2005	Vendor October 1 to December 31, 2004	Change Q4 2005 to Q4 2004
Sales	36,436,104	31,563,634	4,872,470
Cost of Sales	22,670,875	20,233,335	2,437,540
Gross Margin	13,765,229	11,330,299	2,434,930
Administrative and Operating Expenses*	7,047,239	5,101,926	1,945,313
Earnings from Operations, as defined*	6,717,990	6,228,373	489,617

Annual Operating Results

The following table shows the combined operating results of the Fund and the Vendor for the year ended December 31, 2005. These annual operating results were derived from the audited financial statements of the Fund for the period ended December 31, 2005, which include business operations from May 17, 2005 to December 31, 2005, combined with the unaudited results of the Vendor for the period January 1, 2005 to May 16, 2005. These annual operating results are compared to the unaudited results of the Vendor for the year ended December 31, 2004. The results of operations for these periods are not necessarily indicative of the results of operations to be expected in any given period.

	Fund May 17 to Dec. 31, 2005	Vendor Jan 1 to May 16, 2005	Combined Fund and Vendor twelve months ended December 31, 2005	Vendor twelve months ended December 31, 2004	Change 2005 over 2004
Sales	68,967,157	28,400,077	97,367,234	78,871,519	18,495,715
Cost of Sales	42,967,716	18,380,761	61,348,477	50,477,772	10,870,705
Gross Margin	25,999,441	10,019,316	36,018,757	28,393,747	7,625,010
Administrative and Operating Expenses*	14,444,162	6,234,880	20,679,042	14,305,118	6,373,924
Earnings from Operations, as defined*	11,555,279	3,784,436	15,339,715	14,088,629	1,251,086

* Earnings from operations have been calculated as described under "Non-GAAP Measures" on page 15. 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".

Sales

Annual sales increased by \$18.5 million from \$78.9 million to \$97.4 million, an increase of 23.4%. The additional sales from new store growth was \$24.1 million as a result of eight new store stores that opened in 2005 and four stores that opened during 2004. The increase in sales from new store growth was offset by a decrease in sales of \$5.6 million or 8.7% from stores that were open for a full year in both 2005 and 2004. The decrease in same store sales was primarily attributable to supply disruptions caused by a trucking strike that shut down the Vancouver port in the third quarter. In addition, five stores experienced decreases in same store sales as a result of new stores opening in overlapping trading areas. The level of decreased sales from new stores in overlapping trading areas was expected and has not impacted our expansion plan to reach our target of 70 XS Cargo stores in Canada.

Sales per square foot of gross retail space[^] was \$431 in 2005 compared to \$466 in 2004. The decrease was the result of the decline in same store sales described above.

Fourth Quarter sales increased by \$4.9 million from \$31.5 million in 2004 to \$36.4 million in 2005, an increase of 15.6%. The increase in sales was attributable to eight new stores that were open in the Fourth Quarter of 2005 that were not open in 2004. The new stores contributed a combined \$8.5 million in sales, which was offset by a decrease of \$3.6 million in same store sales. Although sales in late November and December were relatively strong, sales in the first part of the quarter were impacted by supply disruptions from a trucking strike that shut down the Vancouver during the third quarter. In addition, five stores experienced decreases in same store sales primarily as a result of new stores opening in overlapping trading areas.

Revenue from PRP sales is recognized on a straight-line basis over the two-year term of the plans. For the three months ended December 31, 2005, PRP sales amounted to \$0.8 million, however less than \$0.1 million was recognized as revenue during the period.

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

Region	2005		2004	
	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	12	50.4%	9	49.2%
Alberta	7	24.3%	4	22.7%
Saskatchewan and Manitoba	3	10.8%	3	14.3%
British Columbia	5	14.5%	3	13.8%
Total	27	100.0%	19	100.0%

[^] Sales per square foot of gross retail space were calculated for each year using only stores that had been open for a full year.

Cost of Sales and Gross Margin

Cost of sales for the year increased by \$10.8 million from \$50.5 million to \$61.3 million, an increase of 21.4%, primarily as a result of new store openings.

Gross margin for the year increased by \$7.6 million from \$28.4 million to \$36.0 million, an increase of 26.8%. \$6.6 million of the increase relates to new store growth and the remaining \$1.0 million was the result of an increase in gross margin percentage of 1.0% from 36.0% to 37.0%. The increase in gross margin percentage for the year is primarily as a result of XS Cargo's continued ability to improve product selection with higher margin items.

For the Fourth Quarter, cost of sales increased by \$2.5 million from \$20.2 million to \$22.7 million, an increase of 12.4%, primarily as a result of new store openings.

Gross margin for the Fourth Quarter increased by \$2.5 million from \$11.3 million to \$13.8 million, an increase of 22.1%. Of the increase in gross margin, \$1.9 million was attributable to eight additional stores in 2005 compared to 2004 and the remaining \$0.6 million was the result of a 1.5% increase in gross margin percentage from 36.3% to 37.8%. Gross margin percentage increased as result of XS Cargo's continued ability to improve product selection with higher margin items. Freight costs, which are included in cost of sales, were relatively consistent with the prior year at 7.3% of sales, despite higher fuel prices. The effect of higher fuel prices was offset by the efficiencies gained as a result of the new distribution centre, which opened in Mississauga, Ontario in May 2005. For the first time since it opened, the estimated freight savings exceeded the operating costs of the distribution centre during the quarter.

Combined Administrative and Operating Expenses

For the year, administrative and operating expenses increased by approximately \$6.4 million from \$14.3 million to \$20.7 million. This increase is primarily the result of increases in rent (\$1.5 million increase), wages (\$2.8 million increase) and advertising (\$1.4 million increase). The increases in these expenses were the result of new store openings and the new distribution centre in Mississauga, Ontario that opened in May 2005. In addition, incremental public company administrative expenses accounted for \$0.3 million of the annual increase.

For the Fourth Quarter, administrative and operating expenses increased by approximately \$1.9 million from \$5.1 million to \$7.0 million. The increase is primarily the result of increases in rent (\$0.5 million increase), wages (\$0.8 million increase) and advertising (\$0.3 million increase). The increase in these expenses was the result of new store openings and the new distribution centre in Mississauga, Ontario. In addition, incremental public company administrative expenses accounted for \$0.2 million of the increase.

Fund Net Earnings

For the three months ended December 31, 2005, the Fund had net earnings of \$3,062,775, or \$0.502 per unit on a basic and diluted basis. Since the commencement of business operations (May 17, 2005) the Fund had net earnings of \$4,983,399 or \$0.816 per unit on a basic and diluted basis.

Financial Position

The following are the significant assets, liabilities and equity of the Fund as at December 31, 2005:

	December 31, 2005
Cash	7,442,496
Current assets	28,388,003
Total assets	140,941,626
Current liabilities	9,085,481
Term loan	15,000,000
Non-controlling interest	59,527,529
Unitholders' equity	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 May 17, 2005 to December 31, 2005:

Record Date	Payment Date	Fund Units		Exchangeable LP Units and Subordinated LP Units		Total	
		Declared \$	Paid \$	Declared \$	Paid \$	Declared \$	Paid \$
June 30, 2005	July 15, 2005	846,902	846,902	815,304	815,304	1,662,206	1,662,206
July 31, 2005	August 15, 2005	572,438	572,438	326,148	326,148	898,586	898,586
August 31, 2005	September 15, 2005	572,437	572,437	326,148	326,148	898,585	898,585
September 30, 2005	October 15, 2005	572,438	572,438	1,000,943	1,000,943	1,573,381	1,573,381
October 31, 2005	November 15, 2005	572,438	572,438	326,148	326,148	898,586	898,586
November 30, 2005	December 15, 2005	572,437	572,437	326,148	326,148	898,585	898,585
December 31, 2005	January 15, 2006	572,438	-	1,000,943	-	1,573,381	-
		<u>4,281,528</u>	<u>3,709,090</u>	<u>4,121,782</u>	<u>3,120,839</u>	<u>8,403,310</u>	<u>6,829,929</u>

^ The first distribution covered the period from May 17, 2005 to June 30, 2005. Subsequent distributions are monthly on Fund Units and Exchangeable LP Units and quarterly on Subordinated LP Units.

Distributions are paid on Fund Units, XS Cargo LP Exchangeable LP Units and XS Cargo LP Subordinated LP Units. As of December 31, 2005 the following number of units were outstanding:

Fund Units (Note 9)	6,106,000
XS Cargo LP Exchangeable LP Units (Note 10)	3,478,914
XS Cargo LP Subordinated LP Units (Note 10)	<u>2,399,269</u>
	<u>11,984,183</u>

During the three months ended December 31, 2005, the Fund approved distributions of \$0.28125 per Fund Unit to unitholders. Distributions during the period were consistent with the distributions contemplated in the Fund's final prospectus dated May 6, 2005 (available on www.sedar.com.) It is the Fund's policy to review the monthly distributions on at least a quarterly basis.

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

	Three Months Ended December 31, 2005	May 17, 2005 to December 31, 2005
Earnings before non-controlling interest	6,011,277	9,780,880
Add: Amortization of property and equipment	147,648	337,148
Add: Amortization of intangible assets	298,000	745,000
Add: Interest expense	231,065	504,922
EBITDA ¹	6,687,990	11,367,950
Add: Unit based compensation	30,000	187,330
Less: Interest paid	(231,065)	(504,922)
Less: Maintenance capital expenditures ²	(78,715)	(195,005)
Distributable cash ³	6,408,210	10,855,353
Average Units outstanding during the period	11,984,183	11,984,183
Distributable cash per Unit	0.53	0.91
Distributions declared	3,370,552	8,403,310
Distributions declared per Unit	0.28	0.70
Ratio of distributions declared to distributable cash (payout ratio)	52.6%	77.4%

Since inception, the Fund had distributable cash per unit of \$0.91. For the Fourth Quarter, the Fund had distributable cash per unit of \$0.53. Basic and diluted earnings per unit were \$0.82 since inception and \$0.50 per unit for the Fourth Quarter.

As disclosed in “Non-GAAP Measures”, management views distributable cash as a measure of operating performance of the Fund and therefore begins the reconciliation of distributable cash with earnings before non-controlling interest as opposed to cash flow from operations.

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 December 31, 2005, cash distributions were less than distributable cash. The monthly cash distributions are based on the distributable cash for the 12 months ended January 31, 2005. 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 in some quarters and be less than distributable cash in the fourth quarter.

Unitholders' Equity and Non-controlling Interest

The following table outlines the Fund Units and non-controlling interest outstanding as of December 31, 2005.

	Units	Issue Costs	Unitholders' Equity	Non-controlling Interest
	#	\$	\$	\$
Fund Units	6,106,000	4,928,124	56,131,876	-
Special Voting Units	5,878,183	-	-	-
Non-controlling Interest	5,878,183	-	-	59,457,529

There were no changes in the number of units issued and outstanding during the period and there have been no changes between December 31, 2005 and the date of this MD&A.

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 months ended December 31, 2005, the Fund declared distributions of \$0.28125 per Fund Unit to Unitholders, or \$1,717,313 in total.

Credit Facilities

In May 2005 the Fund established credit facilities with a Canadian chartered bank. These credit facilities consist of a \$7.5 million demand revolving operating loan and a \$15 million committed non-revolving term loan. On May 17, 2005 the Fund drew \$15 million on the term loan in connection with the acquisition. No amounts were drawn on the operating loan at the beginning or end of the period.

Subsequent to December 31, 2005 the Fund has amended its available credit facilities. The limit on the demand revolving operating loan has been increased to \$10.0 million for the period from January 1 to July 31 annually and to \$12.5 million from August 1 to December 31 annually. The term loan limit has been increased from \$15.0 million to \$17.5 million, with the additional \$2.5 million available to be drawn at the Fund's option until August 31, 2006. As well, the term loan has been extended by 365 days to May 31, 2007. The increases in the credit facilities are to fund working capital and capital expenditure requirements related to store expansion in 2006.

Capital Expenditures

Since inception, the Fund acquired \$694,373 of property and equipment, \$124,973 of which were non-cash acquisitions that were paid for by the Vendor under the terms of the agreement to acquire the business from Vendor. The remaining \$569,400 of capital expenditures were funded by cash generated from operations. \$374,395 of the capital expenditures related to new store openings and distribution infrastructure and the remaining \$195,005 related to capital expenditures at existing stores and warehouses.

During the Fourth Quarter the Fund incurred capital expenditures of \$345,723 funded by cash generated from operations. \$267,008 of the capital expenditures related to new store openings and the remaining \$78,715 related to capital expenditures at existing stores and warehouses.

As at December 31, 2005, the Fund had capital expenditure commitments of approximately \$350,000 related to the consolidation of its Edmonton distribution facilities in the first quarter of 2006. Subsequent to December 31, 2005, the Fund entered into lease agreements for new stores in Sudbury, Ontario and Barrie, Ontario. The new stores will require capital expenditures of approximately \$240,000 in the first quarter of 2006. As discussed above, the Fund has arranged for increases in its available credit facilities to finance these and other growth related capital expenditures in 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 \$150,000 annually (\$37,500 during the quarter) on distributable cash based on \$15 million of debt outstanding.

Contractual Obligations

The table below sets forth the contractual obligations of the Fund as of December 31, 2005, due in the years indicated, which relate to various premises operating leases and the \$15,000,000 term loan that matures on May 17, 2007, but may be extended with approval of the lender until 2008.

	Total	2006	2007	2008	2009	2010 and thereafter
Operating						
Leases	16,376,494	3,414,060	2,808,151	2,542,922	2,254,263	5,357,098
Term loan	15,000,000		15,000,000	-	-	-
Total	31,376,494	3,414,060	17,808,151	2,542,922	2,254,263	5,357,098

Summary of Quarterly Results

	October 1 to December 31, 2005	July 1 to September 30, 2005	May 17 to June 30, 2005
Sales	36,436,104	20,775,101	11,755,952
Net earnings	3,062,775	1,173,328	747,296
Basic and diluted earnings per unit	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.

Selected Annual Information

	May 17 to December 31, 2005
Sales	68,967,157
Net earnings	4,983,399
Basic and diluted earnings per unit	0.816
Total assets	140,941,626
Total long-term financial liabilities	15,000,000
Distributions declared per unit	0.701

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.

Product replacement extended warranty plans

On October 1, 2005 XS Cargo introduced the sales of two-year product replacement extended warranty plans ("PRP"s). Revenue from the sale of PRPs is deferred and recognized on a straight-line basis over the two year terms of the plans. Costs of product replacement and general administration of the PRP are recognized as incurred. Direct incremental costs related to selling the PRPs are deferred and recognized on the same basis as the related PRP revenue.

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 months ended December 31, 2005 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 consolidation of XS Cargo's existing Edmonton distribution and warehousing operations and the introduction of new revenue streams. XS Cargo has entered into lease agreements for new stores in Sudbury, Ontario and Barrie, Ontario, which are scheduled to open in March and April 2006.

Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that relevant information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure.

At the end of the period covered by this report, management evaluated the effectiveness and design of its disclosure controls and procedures, under the supervision of, and with the participation of the Chief Executive Officer and Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Fund's disclosure controls and procedures, as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers Annual and Interim Filings, are effective to ensure that material information relating to the Fund is made known to management on a timely basis and is included in this report. It should be noted that while the Chief Executive Officer and Chief Financial Officer believe that the Fund's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

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 “Fourth Quarter Operating Results” and “Annual 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.