



XS CARGO INCOME FUND

Management's Discussion of Financial Condition and Results of Operations

For the three and nine months ended September 30, 2009

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 year ended December 31, 2008. 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 November 13, 2009.

Readers are referred to the advisories regarding forward-looking information and non-GAAP measures in the "Forward Looking Statements" and "Non-GAAP Measures" sections of this MD&A.

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 and XS Cargo LP acquired the net assets (the "Acquired Business") of Famous Brands (Edmonton) Inc. (the "Vendor").

At the opening of the market on Thursday, August 20, 2009 the Fund's Units commenced trading on TSX Venture Exchange under the symbol XSC.UN. The Fund was delisted from trading on the Toronto Stock Exchange at the close of the market on Wednesday, August 19, 2009.

The Business of the Fund

XS Cargo LP operates 41 closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan, Ontario, Nova Scotia, Newfoundland and New Brunswick.

Operating Highlights

Sales from continuing operations in the third quarter declined by \$1.5 million or 6.1% compared to the same quarter in 2008. Gross margins decreased by \$35 thousand or 0.37%, however, gross margins as a percentage of sales increased by 2.3% from 38.5% to 40.8% compared to the same quarter in 2008.

Sales were affected by reduced opening inventory levels and a slower than anticipated build up through the quarter. However, as inventory levels, recovered sales trended upward from negative 7.7% in July to flat in September compared to the same period in 2008.

The decline in gross margin was due to a reduction in sales. The improvement in gross margin percentage can be attributed to reduced inventory shrinkage and an improved product mix.

EBITDA in the third quarter increased by \$0.3 million or 24.5% from \$1.3 million in 2008 to \$1.6 million in 2009. The increase is primarily a result of a reduction in Administrative and Operating costs.

In August, a second store was opened in Mississauga, Ontario, bringing the total store count to 41.

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Third Quarter and Year-to-date Operating Results

The following tables show the unaudited results of the Fund for the three and nine month periods ended September 30, 2009 compared to the three and nine month periods ended September 30, 2008. The results of operations for these periods are not necessarily indicative of the results of operations to be expected in any given period.

Third Quarter Operating Results (unaudited)	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Change Q3 2009 from Q3 2008
Sales	23,034,046	24,525,830	(1,491,784)
Cost of Goods Sold	13,633,328	15,090,314	(1,456,986)
Gross Margin	9,400,718 40.8%	9,435,516 38.5%	(34,798) 2.3%
Administrative and Operating Expenses*	7,787,349	8,139,197	(351,848)
Earnings from Operations, as defined*	1,613,369	1,296,319	317,050
Net Earnings (Loss)	84,015	(20,378)	104,393

Year-to-date Operating Results (unaudited)	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	Change 2009 from 2008
Sales	64,070,587	71,372,496	(7,301,909)
Cost of Goods Sold	40,792,088	42,652,492	(1,860,404)
Gross Margin	23,278,499 36.3%	28,720,004 40.2%	(5,441,505) (3.9%)
Administrative and Operating Expenses*	23,314,965	24,872,804	(1,557,839)
Earnings (Loss) from Operations, as defined*	(36,466)	3,847,200	(3,883,666)
Net Loss	(2,302,147)	(421,256)	(1,880,891)

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

Third Quarter

The following table compares sales for the three months ended September 30, 2009 to the three months ended September 30, 2008:

	Sales			
	2009	2008	Change	% change
Sales	23,034,046	24,525,830	(1,491,784)	(6.1%)

For the third quarter sales decreased by \$1.5 million, from \$24.5 million to \$23.0 million, a decrease of 6.1% compared to the same period in 2008. The decrease in sales was primarily the result of reduced opening inventory levels and a slower than anticipated build up through the quarter. Towards the end of the quarter inventory levels recovered and increased from \$12.8 million at the end of June to \$19.8 million at the end of September.

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

Region	September 30, 2009		September 30, 2008	
	Number of stores, end of quarter	Percentage of sales during the quarter	Number of stores, end of quarter	Percentage of sales during the quarter
Ontario	20	47.6%	18	45.5%
Alberta	7	18.3%	8	20.1%
British Columbia	8	20.1%	8	19.6%
Saskatchewan and Manitoba	3	8.9%	3	8.5%
Atlantic Canada	3	5.1%	3	6.3%
Total	41	100.0%	40	100.0%

Year-to-Date

The following table compares sales for the nine months ended September 30, 2009 to the nine months ended September 30, 2008:

	Sales			
	2009	2008	Change	% change
Sales	64,070,587	71,372,496	(7,301,909)	(10.2%)

For the year-to-date, sales decreased by \$7.3 million, from \$71.4 million to \$64.1 million, a decrease of 10.2% compared to the same period in 2008. The decrease in sales was primarily the result of reduced traffic due to economic conditions and lower store

inventories due to a temporary decrease in opportunity buys in the first half of the year. The opportunity buys make up the majority of the Fund's inventory.

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

Region	September 30, 2009		September 30, 2008	
	Number of stores, end of quarter	Percentage of sales during the nine months	Number of stores, end of quarter	Percentage of sales during the nine months
Ontario	20	46.8%	18	45.8%
Alberta	7	18.6%	8	20.3%
British Columbia	8	20.2%	8	19.6%
Saskatchewan and Manitoba	3	9.2%	3	8.7%
Atlantic Canada	3	5.2%	3	5.6%
Total	41	100.0%	40	100.0%

Cost of Goods Sold and Gross Margin

Third Quarter

Cost of goods sold as a percentage of sales for the quarter decreased by 2.3%, from 61.5% to 59.2% compared to the same period in 2008. The decrease is due to lower negotiated freight costs and a reduction of inventory write-offs at the stores due to stronger inventory control processes.

Gross margin percentage for the quarter increased by 2.3%, from 38.5% to 40.8% compared to the same period in 2008. This increase is due to cost of goods sold variances discussed above.

Year-to-Date

Cost of goods sold as a percentage of sales for the year-to-date increased by 3.9%, from 59.8% to 63.7% compared to the same period in 2008. This increase is the result of a decline in both the value of the Canadian dollar, combined with accelerated write-offs of warranty returns, in the first half of the year.

Gross margin percentage for the year-to-date decreased by 3.9%, from 40.2% to 36.3% compared to the same period in 2008. This decrease is due to the cost of goods sold variances discussed above.

Combined Administrative and Operating Expenses

Third Quarter

For the quarter, administrative and operating expenses decreased by approximately \$0.3 million from \$8.1 million to \$7.8 million compared to the same period in 2008. This decrease is primarily the result of decreases in wages (\$0.1 million) from efficiencies in distribution, advertising (\$0.1 million), and legal fees (\$0.1 million) related to the subordinated loan in 2008.

Year-to-Date

For the year-to-date, administrative and operating expenses decreased by approximately \$1.6 million from \$24.9 million to \$23.3 million compared to the same period in 2008. This decrease is primarily the result of decreases in wages (\$0.5 million) from efficiencies in distribution, rent (\$0.2 million) due to closing of the service centre in Burlington, advertising (\$0.3 million), professional fees (\$0.4 million) because of a one time evaluation of the Fund's strategic options fees and legal fees related to the subordinated loan in 2008, custom brokerage (\$0.1 million) due to a decrease in purchasing and travel (\$0.1 million).

Earnings from Operations

Third Quarter

For the quarter, earnings from operations increased by \$0.3 million, from earnings of \$1.3 million to \$1.6 million, an increase of 24.5% compared to the same period in 2008, as a result of the factors discussed above.

Year-to-Date

For the year-to-date, earnings from operations decreased by \$3.884 million, from earnings of \$3.847 million to a loss of \$37 thousand, a decrease of 100.9% compared to the same period in 2008, as a result of the factors discussed above.

Fund Net Earnings

For the quarter, the Fund had net earnings of \$84 thousand or \$0.01 per unit on a basic and diluted basis. This compares with the prior year's net loss of \$20 thousand.

For the year-to-date, the Fund had a net loss of \$2.3 million or \$0.38 per unit on a basic and diluted basis. This compares with the prior year's net loss of \$0.4 million or \$0.07 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:

	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008
Cash and cash equivalents	-	-	-	-
Inventory	19,803,957	12,837,212	13,580,942	17,677,390
Total current assets	26,299,439	16,357,330	16,439,742	19,691,313
Total assets	32,420,071	22,881,280	23,421,230	27,248,471
Total current liabilities excluding term loan and subordinated loan	19,517,647	10,397,693	10,424,517	10,892,858
Term loan	6,711,161	6,750,000	6,728,861	6,665,444
Subordinated loan	14,460,531	14,154,264	13,669,200	13,199,409
Non-controlling interest	(1,354,244)	(1,436,183)	(974,918)	891,083
Unitholders' equity	(8,037,342)	(8,123,269)	(7,619,420)	(5,715,572)

Distributable Cash and Cash Distributions

On December 17, 2007, the Fund announced that it was suspending monthly cash distributions on Fund Units and Exchangeable LP Units beginning with the December 2007 distribution.

No distributions were paid on Fund Units, Exchangeable LP Units or Subordinated LP Units during 2008 and during the first nine months of 2009.

As of September 30, 2009 the following number of units was outstanding:

Fund Units (Note 5)	6,054,000
XS Cargo LP Exchangeable LP Units (Note 6)	3,492,802
XS Cargo LP Subordinated LP Units (Note 6)	2,408,847
	<hr/>
	11,955,649

Deferred revenue and deferred charges relating to Product Replace Plans ("PRPs"), net of revenue or costs recognized, are adjusted as the revenue and direct costs related to the PRPs are deferred and recognized over the term of the PRPs. The amounts will be included in net earnings once they are recognized.

Lease inducements received, net of amortization of lease inducements is also adjusted as the inducements received from landlords are deferred and recognized over the course of the leases. The amounts will be included in net earnings once they are amortized.

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

	Three months ended		Nine months ended	
	September 30, 2009 (unaudited)	September 30, 2008 (unaudited)	September 30, 2009 (unaudited)	September 30, 2008 (unaudited)
Cash used for operating activities	(8,756,809)	(4,848,283)	(10,993,201)	(13,188,234)
Less: Net change in non-cash working capital	9,703,789	5,575,551	8,987,714	15,137,916
Less: Deferred charges, net of costs recognized	17,168	(43,009)	(19,962)	(133,989)
Less: Deferred revenue, net of revenue recognized	108,269	122,664	523,429	260,072
Less: Lease inducements received, net of amortization of lease inducements	(23,675)	35,297	(12,055)	103,307
Less: Maintenance capital expenditures ¹	(19,542)	(37,657)	(29,162)	(213,613)
Distributable cash ²	1,029,200	804,563	(1,543,237)	1,965,459
Average Units outstanding during the period	11,952,845	12,004,649	11,952,715	12,004,649
Distributable cash per Unit	0.09	0.07	(0.13)	0.16
Distributions declared	-	-	-	-
Distributions declared per Unit	-	-	-	-
Ratio of distributions declared to distributable cash (payout ratio)	-	-	-	-

¹ 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.

² See discussion under “Non-GAAP Measures” below.

EBITDA

Management believes that EBITDA³ is a useful measure in evaluating the performance of the Fund.

	Three months ended		Nine months ended	
	September 30, 2009 (unaudited)	September 30, 2008 (unaudited)	September 30, 2009 (unaudited)	September 30, 2008 (unaudited)
Net earnings (loss) for the period	84,015	(20,378)	(2,302,147)	(421,256)
Add: non-controlling interest	81,939	(19,706)	(2,245,327)	(407,358)
Add: Interest expense and foreign exchange	883,840	753,816	2,862,597	2,633,289
Add: Amortization of property and equipment	371,870	357,096	1,098,731	1,068,753
Add: Amortization of intangible assets	189,793	216,116	569,303	961,272
EBITDA	1,611,457	1,286,944	(16,843)	3,834,700

Unitholders' Equity and Non-controlling Interest

The following table outlines the Fund Units and non-controlling interest outstanding as of September 30, 2009.

	Units	Issue Costs	Unitholders' Equity	Non-controlling Interest
	#	\$	\$	\$
Fund Units	6,054,000	4,928,124	56,110,694	-
Special Voting Units	5,901,649	-	-	-
Non-controlling Interest	5,901,649	-	-	(1,354,244)

On December 31, 2008 the Fund acquired 52,000 Fund Units held for unit-based compensation. There have been no changes in the number of Special Voting Units from December 31, 2008 to September 30, 2009. During the fourth quarter of 2008 the Fund issued 1 million warrants as part of its renewal of the sub debt credit facility.

The Fund has also approved an option plan for its directors at its annual general meeting in June 2009. The Fund has awarded 300,000 options that will vest over the period to January 2, 2012.

³ EBITDA refers to earnings before interest, taxes, depreciation and amortization. See discussion under "Non-GAAP Measures" below.

During the quarter the Fund transferred 3,000 Fund Units to employees for unit-based compensation. The remaining 49,000 units did not meet the contractual conditions and have not been granted. These units are currently held by the Fund as Treasury Units.

LIQUIDITY AND CAPITAL RESOURCES

Credit Facilities

On September 14, 2009, the Fund re-negotiated the credit facility agreement covering its operating and term loans. The Fund has available under its amended credit facilities agreement a \$17,500,000 (\$12,500,000 available from January to June annually each year) demand revolving loan. Under the terms of the credit facility agreement, the operating loan is collateralized by a first charge on all present and after required personal property and an assignment of inventory. Interest on the operating loan is charged at the lender's prime rate plus 4.50%. If funds are withdrawn in U.S. dollars, interest will be charged at the lender's U.S. base rate plus 4.50%. The Fund is also required to pay a standby charge of 1.00% based on the amount equal to the operating facility commitment amount less the aggregate principal amount under the operating facility.

The term loan agreement expired on April 30, 2009, but repayment has not been demanded. The maximum available on the term loan facility was \$21,250,000 until July 31, 2007, at which time it was reduced to \$11,250,000. The term loan was permanently reduced by \$4,500,000 on December 31, 2008. The term loan is collateralized along with the operating loan as described above. Under the agreement interest on the term loan facility is charged at the lender's Canadian prime rate plus 4.50% or the bankers' acceptance rate plus 5.75%. Management is currently attempting to negotiate a renewal satisfactory to both parties.

On August 20, 2007, the Fund entered into a subordinated loan agreement for \$12,000,000, funded 50% by an independent third party and 50% by a company owned by the President and CEO of the Fund. The subordinated loan is collateralized by a second charge on all of the present and future undertakings and property including an acknowledged assignment of leases and material contracts. The principal balance was due on August 20, 2008; however the subordinated loan was renegotiated on November 5, 2008. The maturity date of the subordinated loan agreements was extended to June 30, 2009. As part of the extension, the Fund also issued 1,000,000 fund unit purchase warrants, exercisable at \$0.60 at any time within 36 months of issuance, with a cashless exercise feature at the option of subordinated lenders.

The cashless exercise feature allows the subordinated lenders the option of exercising the warrants to acquire units of the fund, without a cash payment, by netting out the difference between the trading price of units at the date of exercise of the warrant and the warrant exercise price of \$0.60 per unit then issuing the proportionately reduced number of fully paid units to the warrant holder.

Interest on the subordinated loan has increased from 16% to 18% effective September 26, 2008, with the Fund's option to capitalize up to 10.0% per annum.

Financial Covenants

The bank indebtedness, term loan and subordinated loan require the Fund to maintain certain financial covenants, including a maximum senior debt to adjusted EBITDA ratio of 2.5:1.0; a minimum current ratio of 1.4:1.0, and a minimum adjusted trailing twelve months EBITDA value of \$8,000,000. Additionally, the covenants limit the Fund's ability to undertake mergers, acquisitions, new indebtedness, declare distributions and other changes in the business without approval of the lenders.

The subordinated loan agreement also requires the Fund to maintain a total funded debt to adjusted EBITDA ratio of less than 3.5:1.0.

As at September 30, 2009, the Fund was not in compliance with its senior debt to adjusted EBITDA, minimum adjusted trailing twelve months EBITDA, and total funded debt to adjusted EBITDA covenants. The Fund has received waivers for the periods ending December 31, 2008, January 31, 2009, February 28, 2009, and is working with its lenders to resolve the default of certain covenants as of September 30, 2009. The term loan was due on April 30, 2009 and the subordinated loan was due on June 30, 2009. Repayment has not been demanded. The Fund is working with its lenders to negotiate mutually acceptable financial covenants as part of its credit renewals.

Effective September 14, 2009, the interest rate on the operating and term loan was increased by 2.00% per annum (0.50% increased standby charge on operating loan) as a result of default in financial covenants and shall remain in effect as long as the default exists.

The Fund continues to manage its liquidity risk by monitoring actual and projected cash flows taking into consideration the seasonality of its business.

There can be no assurance that these initiatives will be successful and these circumstances lend significant doubt as to the ability of the Fund to continue as a going concern.

Capital Expenditures

During the third quarter, the Fund acquired \$159,488 of property and equipment. Of this, \$19,542 is related to “maintenance capital expenditures” at existing stores and warehouses and \$125,532 is related to “growth capital expenditures” for the two new Ontario stores opened during the year. The remaining \$14,414 is related “maintenance capital expenditures” for the head office and other infrastructure.

	Stores and Warehouses	Head Office and Infrastructure	Total
Maintenance Expenses	19,542	14,414	33,956
Growth Expenses	125,532	-	125,532
Total	145,074	14,414	159,488

Interest Rate Risk and Sensitivity

The Fund’s term and operating loans bear interest with floating rates based on the bank’s prime rate, thus exposing the Fund to interest rate fluctuations. A 1.0% change in interest rates would have an impact of \$208,414 annually on distributable cash and interest expense based on \$20.84 million of debt outstanding at September 30, 2009.

XS Cargo LP Subordinated LP Units

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. For the year ended December 31, 2008 the criteria were not met for the automatic exchange to occur.

Contractual Obligations

The table below sets forth the contractual obligations of the Fund as of September 30, 2009, due in the years indicated which relate to various premises operating leases, the term loan that matured on April 30, 2009, and the subordinated loan matured on June 30, 2009.

	Total	2009	2010	2011	2012	2013	2014 and thereafter
Operating Leases	28,508,744	1,322,395	4,337,579	3,592,670	2,885,781	2,443,396	13,926,923
Subordinated Loan	14,460,531	14,460,531	-	-	-	-	-
Term loan	6,711,161	6,711,161	-	-	-	-	-
Total	49,680,436	22,494,087	4,337,579	3,592,670	2,885,781	2,443,396	13,926,923

Summary of Quarterly Results (unaudited)

	Q3	2009 Q2	Q1	Q4	2008 Q3	Q2	Q1	2007 Q4
Sales	23,034,046	21,605,018	19,431,523	38,713,064	24,525,830	25,080,819	21,765,847	42,653,087
Net earnings (loss) before impairment of goodwill and intangible assets	84,015	(472,939)	(1,913,223)	(208,063)	(20,378)	248,174	(649,052)	(2,322,853)
Net earnings (loss)	84,015	(472,939)	(1,913,223)	(18,203,917)	(20,378)	248,174	(649,052)	(36,283,954)
Basic and diluted earnings (loss) per unit	0.01	(0.08)	(0.32)	(2.98)	0.00	0.04	(0.11)	(5.95)

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

Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

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. 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

Effective January 1, 2009, the Fund adopted Canadian Institute of Chartered Accountants (“CICA”) Handbook section:

Section 3064: Goodwill and intangible assets

This section replaced section 3062, “Goodwill and Other Intangible Assets,” and 3450, “Research and Development Costs.” The new standard establishes standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. The adoption of this standard did not result in a change in the recognition of the Fund's goodwill and intangible assets. However, the Fund has retroactively reclassified intangible assets relating to software with a net book value of \$2,125,631 at December 31, 2008 from “Property and equipment” to “Software and other intangible assets” on the consolidated balance sheet. The Fund also retroactively reclassified amortization of software of \$137,346 and \$406,212 for the three and nine months ended September 30, 2008 from “Amortization of property and equipment” to “Amortization of software and other intangible assets.” There is no impact on net earnings in the current or prior periods as a result of this change.

Future accounting changes

The CICA has issued the following new accounting standards applicable to the Fund in future years:

International Financial Reporting Standards (IFRS)

The use of IFRS for financial reporting in Canada will become applicable for the year beginning January 1, 2011. To date, the Fund has performed a high-level diagnostic that has identified pertinent differences between IFRS and current accounting policies and procedures that conform to Canadian GAAP. The Fund is in the process of developing a plan for IFRS conversion and the related transition from current standards. Activities under this plan will include, among other things, the identification and documentation of pertinent accounting and reporting differences between IFRS and Canadian GAAP; the choice of IFRS accounting policies, including consideration of elections available under IFRS 1, *First-time Adoption of International Financial Reporting Standards*; determination of the impact of conversion on internal controls, accounting systems and other business solutions and processes; and the development of training to assist appropriate employees in the transition to and ongoing compliance with IFRS. Activities in connection with our IFRS implementation plan will continue throughout 2009 and 2010, and the Fund will provide the required disclosures regarding the status of this plan.

Transactions with Related Parties

On August 20, 2007, the Fund entered into a subordinated loan agreement for \$12,000,000, funded 50% by an independent third party and 50% by a company owned by Michael McKenna, the President, CEO and a director of XS Cargo GP Inc., the administrator of the Fund. The subordinated loan was renegotiated on November 5, 2008 and the maturity date of the subordinated loan agreements has been extended to June 30, 2009. As part of the extension, the Fund also issued 1,000,000 fund unit purchase warrants, exercisable at \$0.60 at any time within 36 months of issuance, with a cashless exercise feature at the option of subordinated lenders. See “Credit Facilities” above for further details regarding this agreement.

Interest expense totaling \$292,083 and \$1,047,472 was recorded on the portion of the loan outstanding to the related party during the three and nine month period ended September 30, 2009 respectively.

Mr. William Gray, a director of the XS Cargo GP Inc, is a partner of Fleming LLP, a law firm which provides legal services to the Fund. Legal fees totaling approximately \$23,000 and \$100,000 were charged to the fund by Fleming LLP during the three and nine month period ended September 30, 2009 respectively.

Outlook

Initiatives undertaken to improve store operations continued to gain traction throughout the third quarter. Significant progress has been made reducing inventory shrinkage and returns, contributing to increased gross margins. Improvements in store merchandising has helped drive an upward sales trend versus 2008. Store operations management is committed to the continued improvement in our customers' shopping experience.

A relative scarcity of opportunity buys in the first and second quarters proved temporary. The Fund has experienced a strong rebound in the availability of discounted merchandise in the third quarter. The resulting build up of store inventories bodes well for fourth quarter sales.

Management expects a continued upward sales trend based on the combination of improved store operations and increased selection of discounted merchandise.

Additional Information

Additional information relating to the Fund, including the Fund's AIF, 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 and foreign exchange, 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. 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.

Net earnings (loss) before impairment of goodwill and intangible assets disclosure under "Summary of Quarterly Results" has been calculated by adding back the goodwill and intangible assets impairment to net earnings (loss).

Earnings from operations disclosure under "Third Quarter Operating Results" has been calculated as described below. Earnings from operations have been derived by adding interest expense, amortization of property and equipment and intangible assets, unit-based compensation, impairment of intangible assets and goodwill, future income taxes and non-controlling interest to net earnings for the period. The following table details the reconciliation from net earnings:

Third Quarter & Year-to-date (unaudited)	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net Earnings (Loss)	84,015	(20,378)	(2,302,147)	(421,256)
Add:				
Non-controlling interest	81,939	(19,706)	(2,245,327)	(407,358)
Foreign exchange loss (gain)	34,722	(162,340)	32,900	(117,212)
Interest on term and subordinated loans	711,937	771,207	2,520,669	2,398,312
Interest on operating loan	137,181	144,949	309,028	352,189
Amortization of intangible assets	189,793	216,116	569,303	961,272
Amortization of property and equipment	371,870	357,096	1,098,731	1,068,753
Unit based compensation expense	1,912	9,375	(19,623)	12,500
Earnings (Loss) from Operations, as defined	<u>1,613,369</u>	<u>1,296,319</u>	<u>(36,466)</u>	<u>3,847,200</u>

Gross margin before non-recurring expenses has been calculated as outlined in the selected financial information and results from operations as gross margin plus non-recurring expenses included in cost of goods sold.

EBITDA, distributable cash, earnings from operations and gross margin before non-recurring expenses are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP. Investors are cautioned that EBITDA, distributable cash, earnings from operations and gross margin before non-recurring expenses 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, earnings from operations and gross margin before non-recurring expenses may differ from the methods used by other issuers and may not be comparable to similar measures presented by other issuers.

DISCLOSURE CONTROLS AND PROCEDURES

The Fund's disclosure controls and procedures (as defined under National Instrument 52-109 ("NI 52-109") of the Canadian Securities Administrators) have been designed to provide reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, is made known to the Chief Executive Officer and the Chief Financial Officer of the GP (the "Certifying Officers"), the administrator of the Fund and the general partner of XS Cargo LP, by others within those entities, particularly during the period in which the annual filings are being prepared.

The Certifying Officers of the Fund evaluated the effectiveness of the Fund's disclosure controls and procedures as of December 31, 2008, and concluded that the design and effectiveness of these controls and procedures provided reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, would be made known to the Certifying Officers on a timely basis to ensure adequate disclosure. There have been no changes in the design of the Fund's disclosure controls and procedures that occurred during the three and nine months ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Fund's disclosure controls and procedures.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Certifying Officers of the Fund are responsible for designing internal controls over financial reporting for the Fund as defined under NI 52-109. The Certifying Officers directed the assessment of the design and operating effectiveness of the Fund's internal control over financial reporting as at December 31, 2008 and based on that assessment determined that the Fund's internal control over financial reporting was, in all material respects, appropriately designed and operating effectively. There have been no changes in the design of the Fund's internal control over financial reporting that occurred during the three and nine months ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Fund's internal control over financial reporting.

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; the success of the Fund's marketing efforts and increased marketing expenditures; 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, including increased labour costs and labour shortages; absence of history as a public company; dependence on external funding sources; environmental regulation; uncertainties arising from world events; property taxes; the Fund's dependence on its operating subsidiaries; the unpredictability and volatility of the market price of the Fund Units; the nature of the Fund Units; the lack of certainty regarding cash distribution levels; cash on cash yield; the structural subordination of the Fund Units; leverage and restrictive covenants; restrictions on potential growth; changes in income tax legislation and other tax related risks; future sales of Fund Units from treasury; future sales of Fund Units by

insiders; the rights of the Vendor in relation to XS Cargo LP; conflicts of interest; unitholder limited liability; the distribution of securities on redemption or termination of the Fund; and the restrictions on certain unitholders and the liquidity of Fund Units. For a discussion of these risks and other risks associated with an investment in Fund Units, see “Risk Factors” detailed in the Fund’s Annual Information Form available at www.sedar.com.

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.