

XS Cargo Income Fund
Interim Consolidated Financial Statements
Unaudited
March 31, 2008

XS Cargo Income Fund
Consolidated Balance Sheets
(see note 1 – going concern discussion)

	March 31, 2008 (unaudited)	December 31, 2007
	\$	\$
Assets		
Current		
Cash and cash equivalents	-	1,709,959
Rebate and other receivables	72,862	425,755
Inventory	19,095,062	21,144,060
Deposits on inventory	3,700,409	2,235,619
Prepaid expenses and deposits	1,158,948	399,188
	24,027,281	25,914,581
Deferred charges	195,395	267,076
Prepaid expenses and deposits	376,291	375,216
Property and equipment	6,690,649	7,000,853
Intangible assets	1,785,230	2,076,500
Goodwill	36,226,599	36,226,599
	69,301,445	71,860,825
Liabilities		
Current		
Bank indebtedness (Note 4)	5,854,453	-
Accounts payable and accrued liabilities	6,057,068	13,525,271
Deferred revenue	1,963,423	1,848,965
Term loan (Note 4)	11,250,000	11,250,000
Subordinated loan (Note 4)	12,492,465	12,162,695
	37,617,409	38,786,931
Deferred revenue	458,221	538,676
Unamortized lease inducements	815,815	848,527
	38,891,445	40,174,134
Non-controlling interest (Note 6)	18,274,132	18,901,771
	57,165,577	59,075,905
Unitholders' Equity		
Fund units (Note 5)	56,116,612	56,116,612
Contributed surplus	6,360	6,360
Deficit	(43,987,104)	(43,338,052)
	12,135,868	12,784,920
	69,301,445	71,860,825

XS Cargo Income Fund
Consolidated Statements of Operations and Comprehensive Income

	<i>Three Months Ended March 31, 2008 (unaudited) \$</i>	<i>Three Months Ended March 31, 2007 (unaudited) \$</i>
Sales	21,765,847	23,657,656
Cost of goods sold	12,998,040	16,437,941
Gross Margin	8,767,807	7,219,715
Expenses		
Administrative and operating	8,331,628	8,039,345
Amortization of property and equipment	488,127	294,978
Amortization of intangible assets	291,270	298,000
	9,111,025	8,632,323
	(343,218)	(1,412,608)
Other expenses		
Interest on operating loan	75,182	87,429
Interest on term and subordinated loans	781,224	342,942
Foreign exchange loss	77,067	17,479
	933,473	447,850
Loss before non-controlling interest	(1,276,691)	(1,860,458)
Non-controlling interest <i>(Note 6)</i>	(627,639)	(913,473)
Net loss and comprehensive loss for the period	(649,052)	(946,985)
Basic and diluted loss per unit	(0.11)	(0.16)

XS Cargo Income Fund
Consolidated Statements of Deficit

	<i>Three Months Ended March 31, 2008 (unaudited) \$</i>	<i>Three Months Ended March 31, 2007 (unaudited) \$</i>
Deficit, beginning of the period	(43,338,052)	(1,560,652)
Net loss for the period	(649,052)	(946,985)
Distributions declared in the period	-	(1,831,800)
Deficit, end of the period	(43,987,104)	(4,339,437)

XS Cargo Income Fund
Consolidated Statements of Cash Flows

	<i>Three Months Ended March 31, 2008 (unaudited) \$</i>	<i>Three Months Ended March 31, 2007 (unaudited) \$</i>
Cash provided by (used for) the following activities		
Operating Activities		
Net loss for the period	(649,052)	(946,985)
Items not affecting cash:		
Non-controlling interest	(627,639)	(913,473)
Amortization of property and equipment	488,127	294,978
Amortization of intangible assets	291,270	298,000
Amortization of transaction costs on subordinated loan	82,396	-
Capitalized interest on subordinated loan	247,374	-
Unit based compensation	-	43,500
Deferred charges, net of costs recognized	71,681	964
Deferred revenue, net of revenue recognized	34,003	20,584
Lease inducements received, net of amortization of lease inducements	(32,712)	48,808
	(94,552)	(1,153,624)
Net change in non-cash working capital	(7,291,937)	(4,076,788)
	(7,386,489)	(5,230,412)
Financing Activities		
Proceeds from bank indebtedness	5,854,453	4,647,293
Proceeds from term loan	-	3,750,000
Distributions paid on Fund units	-	(1,889,046)
Distributions paid to non-controlling interest	-	(1,822,193)
	5,854,453	4,686,054
Investing Activities		
Purchases of property and equipment	(205,402)	(473,466)
Proceeds from sale of property and equipment	27,479	-
	(177,923)	(473,466)
Decrease in cash and cash equivalents	(1,709,959)	(1,017,824)
Cash and cash equivalents, beginning of period	1,709,959	1,017,824
Cash and cash equivalents, end of period	-	-
Supplementary cash flow information		
Interest paid	609,032	430,371

XS Cargo Income Fund

Notes to the Interim Consolidated Financial Statements

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1. Nature of the Fund and going concern

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

The Fund commenced business operations on May 17, 2005, when it completed an initial public offering (the "IPO") of 6,106,000 trust units ("Fund Units"), at a price of \$10 per unit, for aggregate gross proceeds of \$61,060,000. Concurrent with the closing of the IPO, the Fund acquired a 51% indirect interest in XS Cargo LP and XS Cargo LP acquired the net assets (the "Acquired Business") of Famous Brands (Edmonton) Inc. (the "Vendor"). XS Cargo LP operates 40 (December 31, 2007 – 40) closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan, Ontario, Newfoundland, Nova Scotia and New Brunswick.

These consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of operations. At March 31, 2008 and December 31, 2007, the Fund was in breach of certain financial covenants under the credit facilities described in note 4, giving the lenders the right to demand repayment. The Fund also incurred a net loss of \$649,052 for the three month period ended March 31, 2008. As at March 31, 2008, the Fund had an accumulated deficit of \$43,987,104. As a result of these circumstances, there is substantial doubt that the Fund would be able to continue as a going concern.

The Fund continues to work with its lenders to remedy the breaches and negotiate mutually acceptable terms as quickly as possible. Further, the Fund has implemented certain supply chain improvements and other operational measures that management feels will return the Fund to profitability for fiscal 2008. Nevertheless, there can be no assurance that these initiatives will be successful.

These financial statements do not reflect any adjustments relating to the carrying values of the Fund's assets and liabilities, the balance sheet classifications used, and the results of operations that might be necessary if the going concern assumption were not appropriate, and these adjustments could be material.

2. Basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those for the audited financial statements for the year ended December 31, 2007, except as described in note 3. However, the interim consolidated financial statements do not include all information and footnote disclosures required under Canadian GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with audited financial statements and notes thereto, for the year ended December 31, 2007.

XS Cargo Income Fund
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3. Change in accounting policies

(a) Effective January 1, 2008, the Fund adopted the Canadian Institute of Chartered Accountants (“CICA”) Handbook sections as follows:

Section 1535: Capital Disclosures

This new standard established disclosure requirements concerning capital such as: qualitative information about the Fund’s objectives, policies and processes for managing capital; quantitative data about what the Fund regards as capital; whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance. The Fund has included the required disclosures as part of these consolidated financial statements.

Section 3031: Inventories

This new standard provides guidance in determining the cost of inventory and its subsequent recognition as an expense. The standard is effective for fiscal periods beginning on or after January 1, 2008 and requires the retrospective application to prior period financial statements. This section did not have a significant impact on the Fund’s consolidated financial statements.

Section 1400: General Standards of Financial Statement Presentation

This section was amended to include requirements for management to assess and disclose the Fund’s ability to continue as a going concern. These requirements are effective for interim and annual financial statements for years beginning on or after January 1, 2008, and have been incorporated into the Fund’s consolidated financial statements in note 1.

(b) Future accounting changes

Section 3064: Goodwill and intangible assets

In February 2008, the CICA issued this new standard which provides guidance over the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard is effective for fiscal periods beginning on or after October 1, 2008 and requires retrospective application to prior period financial statements. The Fund is presently evaluating the impact of this new standard.

4. Credit facilities

Term loan

Term loan consists of a committed non-revolving term loan facility. 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. As at March 31, 2008, \$11,250,000 remains outstanding on the term loan (December 31, 2007 - \$11,250,000). The term loan is collateralized by a first charge on all present and after acquired personal property and an assignment of inventory. Interest on the term facility is charged at the lender’s Canadian prime rate or U.S. base rate plus 0.25% to 1.25% or the bankers’ acceptance rate plus 1.75% to 2.75%, depending on the Fund’s senior debt to earnings before interest, taxes, depreciation and amortization (“EBITDA”) ratio.

During the three months ended March 31, 2008 interest was charged at a rate of prime plus 1.25% and totaled \$219,300 (March 31, 2007 - \$342,942). As at March 31, 2008, prime rate was 5.25% (December 31, 2007 – 6.0%). The principal balance of the term loan is due on May 16, 2008.

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Subordinated loan

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 principal balance is due on August 20, 2008, but is renewable for an additional six months at the request of the Fund, conditional upon the Fund's compliance with the agreements and the lenders' approval. 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. Interest on the subordinated loan is charged at 16%, with the Fund's option to capitalize up to 8.0% per annum. During the three months ended March 31, 2008, interest expense totaling \$561,924 was recorded, including \$247,374 which was capitalized as part of the outstanding principal balance.

The following table details the balance of the subordinated loan:

	<i>March 31,</i> <i>2008</i>	<i>December 31,</i> <i>2007</i>
	\$	\$
Initial principal amount	12,000,000	12,000,000
Unamortized transaction costs	(119,934)	(202,330)
Interest capitalized	612,399	365,025
	<hr/> 12,492,465	<hr/> 12,162,695

Operating loan

The Fund has available under its credit facilities a \$12,500,000 (\$20,000,000 available from August to December) demand revolving loan. Under the terms of the credit facility agreement, the operating loan is collateralized along with the term loan as described above. Interest on the operating loan will vary between the lender's prime rate and the lender's prime rate plus 1.00% depending on the Fund's ratio of senior debt to EBITDA. If funds are withdrawn in U.S. dollars, interest will vary between the lender's U.S. base rate and the lender's U.S. base rate plus 1.00%, depending on the Fund's ratio of senior debt to EBITDA. During the three months ended March 31, 2008, the Fund paid interest of \$75,182 (March 31, 2007 - \$87,429) on amounts drawn on the operating loan at a rate of prime. As at March 31, 2008 prime rate was 5.25%, and \$5,854,453 (December 31, 2007 - \$nil) was outstanding on the operating loan.

Financial covenants

Both the term loan and operating loan require the Fund to maintain certain financial covenants, including a maximum senior debt to EBITDA ratio of 2.0:1.0; a minimum current ratio of 1.5:1.0, a minimum fixed charge coverage ratio of 1.0:1.0 and a minimum EBITDA value of \$5,500,000 on a rolling twelve month basis. Additionally, the covenants limit the Fund's ability to undertake mergers, acquisitions, new indebtedness, declare distributions in excess of distributable cash and other changes in the business without approval of the lender.

The subordinated loan agreement requires the Fund to maintain certain financial covenants, including a total funded debt to EBITDA ratio of less than 3.75:1.0. There are additional restrictive covenants that limit the Fund's ability to undertake mergers, acquisitions, new indebtedness and other changes in the business without approval of the lenders.

As at March 31, 2008, the Fund was not in compliance with its senior debt to EBITDA covenant, total debt to EBITDA covenant and the minimum twelve-month EBITDA covenant. All loans are presented as current liabilities. See discussion in note 1 regarding going concern.

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5. Unitholders' Equity

Fund Units

The following units are issued and outstanding:

	Number of Units #	Issue Costs \$	Net Capital Contributions \$
Fund Units Issued, March 31, 2007 and December 31, 2006	6,106,000	4,928,124	56,131,876
Fund Units held by LTIP trust	(3,000)	-	(15,264)
Balance, March 31, 2008 and December 31, 2007	6,103,000	-	56,116,612

An unlimited number of Fund Units may be created and issued pursuant to the Declaration of Trust. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. All Fund Units have equal voting rights and privileges. There were no changes in the number or amount of Fund Units issued during the period. Distributions on Fund Units were suspended effective December 2007.

6. Non-controlling interest

	<i>XS Cargo LP</i> <i>Exchangeable LP</i> <i>Units</i> #	<i>XS Cargo LP</i> <i>Subordinated LP</i> <i>Units</i> #	<i>Total</i> #
Balance – March 31, 2008 and December 31, 2007	3,492,802	2,408,847	5,901,649
	\$	\$	\$
Balance – December 31, 2007	10,158,712	8,743,059	18,901,771
Non-controlling interest – loss	(371,459)	(256,180)	(627,639)
Balance – March 31, 2008	9,787,253	8,486,879	18,274,132

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

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

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

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

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

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

The Subordinated LP Units will be automatically exchanged for Exchangeable LP Units on a one-for-one basis and the subordination provisions will apply until the end of any fiscal year ending on or after December 31, 2006 if, for that fiscal year the Fund has earned EBITDA (earnings before interest, taxes, depreciation and amortization) of at least \$14.432 million and the Fund has paid distributions of at least \$1.125 per Fund Unit for such fiscal year. For the year ended December 31, 2007, the criteria were not met for the automatic exchange to occur.

Fund Special Voting Units

	Number #	Amount \$
Issued and outstanding – March 31, 2008 and December 31, 2007	5,901,649	-

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

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

Distributions to non-controlling interest

Distributions on all Exchangeable LP Units were suspended effective December 2007 and distributions on Subordinated LP Units were suspended in March 2007.

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7. Variable interest entity

The Fund has a vendor supply and volume rebate agreement with Samra Imports Ltd., (“Samra”). Samra imports products from China which it sells to the Fund and other customers. Samra has historically been the Fund’s largest supplier accounting for approximately 13% of the Fund’s purchases since the commencement of the agreement and the Fund is Samra’s largest customer. The purpose of the agreement is to outline the supply terms and to provide the Fund with a rebate based on its significant volume of purchases from Samra. The Fund has determined that Samra is a variable interest entity and that the supply and rebate agreement represents a variable interest in Samra. The Fund has determined, however, that it is not the primary beneficiary under the supply and rebate agreement since the Fund is not entitled to receive a majority of Samra’s expected residual returns or absorb a majority of its expected losses. As Samra is a separate legal entity, XS Cargo does not have direct access to Samra’s assets and Samra’s creditors do not have recourse against XS Cargo.

During the three months ended March 31, 2008, the Fund purchased approximately \$820,000 (March 31, 2007 - \$1,800,000) of inventory from Samra. Included in deposits on inventory is a balance of \$452,594 (December 31, 2007 - \$282,369) outstanding from Samra related to those purchases. In addition, included in accounts payable and accrued liabilities is a balance of \$nil (December 31, 2007 - \$1,477,750) owing to Samra. Samra did not issue the Fund a volume rebate for purchases made during the quarter.

8. Capital risk management

The Fund’s capital management objectives are to ensure the longevity of its capital so as to support continued operations and unitholder returns, and maintain the most optimal capital structure possible with a view to keeping capital costs to a minimum.

In the management of capital, the Fund includes unitholders’ equity and non-controlling interest. The Fund manages its capital structure in accordance with changes in economic conditions. In order to maintain or adjust its capital structure, the Fund may elect to adjust the amount of distributions paid to unitholders, return capital to its unitholders and repurchase its units in the marketplace or issue new units. There were no changes to the Fund’s approach to capital management during the period.

The Fund uses the ratio requirements as described in note 4 to monitor its capital. As at March 31, 2008 there is uncertainty surrounding the Fund’s capital structure and management plan, as outlined in note 1. The Fund is in breach of certain bank covenants, and a resolution has not yet been reached.

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9. Future income taxes

Prior to June 12, 2007, the Fund was effectively exempt from income taxes and, accordingly, its consolidated financial statements did not include a provision for Canadian income taxes related to the Fund's income. On October 31, 2006, the Minister of Finance (Canada) announced proposed tax legislation Bill C-52 ("trust legislation") that will change the income tax rules applicable to publicly traded trusts rendering income trusts taxable in 2011.

The October 31, 2006 trust legislation was substantively enacted into law on June 12, 2007, at which time the Fund gave accounting recognition to these new tax rules. While the Fund will not be liable for current taxes until January 1, 2011, it was required to give recognition in the quarter ended June 30, 2007 to future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011, at the 28% tax rate applicable to the Fund. The fund then continues to recognize changes in future income taxes in each subsequent quarter as they arise.

The components of future income taxes are as follows:

	March 31, 2008	December 31, 2007
	\$	\$
<i>Future income tax assets</i>		
Property and equipment	426,100	478,907
Intangible assets	288,600	221,058
Debt issue costs	13,000	-
Unamortized lease inducements	111,300	95,035
Future income tax assets before valuation allowance	839,000	795,000
Valuation allowance	(839,000)	(795,000)
Net future income tax assets	-	-

The Fund's valuation allowance of \$839,000 at March 31, 2008 relates principally to the uncertainty of the utilization of the future tax assets due to the breach of financial covenants as described in notes 1 and 4.

10. Related party transactions

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, as described in note 4. Interest expense totaling \$280,962 was recorded on the portion of the loan outstanding to the related party during the three months ended March 31, 2008. The loan and related interest have been recorded at the exchange amount, which represents fair value.

11. Basic and diluted earnings per unit

Basic (loss) earnings per unit are based on the weighted average number of units outstanding during the period. Diluted earnings per unit are computed based on the weighted average number of units and dilutive unit equivalents.

12. Seasonal nature of the business

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

13. Segmented information

The Fund identifies operating segments based on business activities, management responsibility and geography. The Fund operates within a single operating segment, being the operation of closeout retail stores in Canada. All of the Fund's assets are located in Canada.

14. Comparative Figures

Certain comparative figures have been reclassified to conform with the current period's presentation.