XS Cargo Income Fund
Interim Consolidated Financial Statements
Unaudited
March 31, 2010

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

	March 31, 2010 (unaudited)	December 31, 2009
	$	$
Assets		
Current		
Cash and cash equivalents	134,880	832,854
Inventory	19,706,568	16,391,551
Deposits on inventory	1,446,616	2,257,403
Prepaid expenses and deposits	1,029,981	992,305
	22,318,045	**20,474,113**
Deferred charges	**198,893**	**195,298**
Prepaid expenses and deposits	**608,939**	**401,262**
Property and equipment	**1,815,615**	**2,179,672**
Intangible assets	**2,762,422**	**2,951,111**
	27,703,914	**26,201,456**
Liabilities		
Current		
Bank indebtedness *(Note 3)*	6,502,210	-
Accounts payable and accrued liabilities	3,440,049	7,103,998
Deferred revenue	1,416,660	1,488,192
Term loan *(Note 3)*	6,750,000	6,750,000
Subordinated loan *(Note3)*	15,198,025	14,829,366
	33,306,944	**30,171,556**
Deferred revenue	**500,613**	**573,624**
Unamortized lease inducements	**646,073**	**684,477**
	34,318,750	**31,429,657**
Non-controlling interest *(Note 5)*	**(52,116)**	**699,564**
	34,401,514	**32,129,221**
Unitholders' Equity		
Fund units *(Note 4)*	**56,110,694**	**56,110,694**
Warrants *(Note 4)*	**109,086**	**109,086**
Contributed surplus	**12,250**	**11,000**
Deficit	**(62,929,630)**	**(62,158,545)**
	(6,697,600)	**(5,927,765)**
	27,703,914	**26,201,456**

The accompanying notes are an integral part of these financial statements

XS Cargo Income Fund
Consolidated Statements of Operations and Comprehensive (Loss)

	Three Months Ended March 31, 2010 (unaudited) $	*Three Months Ended March 31, 2009* (unaudited) $
Sales	**21,869,071**	**19,431,523**
Cost of goods sold	**13,871,390**	**13,677,957**
Gross margin	**7,997,681**	**5,753,566**
Expenses		
Administrative and operating	**8,017,823**	**7,955,096**
Amortization of property and equipment	**378,433**	**360,178**
Amortization of intangible assets	**192,356**	**189,755**
	8,588,612	**8,505,029**
	(590,931)	**(2,751,463)**
Other expenses		
Interest on operating loan	**105,297**	**89,467**
Interest on term and subordinated loans	**775,997**	**944,759**
Foreign exchange loss (gain)	**50,540**	**(6,465)**
	931,834	**1,027,761**
(Loss) before non-controlling interest	**(1,522,765)**	**(3,779,224)**
Non-controlling interest *(Note 5)*	**(751,680)**	**(1,866,001)**
Net and comprehensive (loss) for the period	**(771,085)**	**(1,913,223)**
Basic and diluted (loss) per unit	**(0.13)**	**(0.32)**

The accompanying notes are an integral part of these financial statements

XS Cargo Income Fund
Consolidated Statements of (Deficit)

	Three Months Ended March 31, 2010 (unaudited) $	*Three Months Ended March 31, 2009* (unaudited) $
(Deficit), beginning of the period	(62,158,545)	(61,963,225)
Net (loss) for the period	(771,085)	(1,913,223)
(Deficit), end of the period	(62,929,630)	(63,876,448)

The accompanying notes are an integral part of these financial statements

	Three Months Ended March 31, 2010 (unaudited) $	*Three Months Ended March 31, 2009* (unaudited) $
Cash provided by (used for) the following activities		
Operating Activities		
Net (loss) for the period	(771,085)	(1,913,223)
Items not affecting cash:		
Non-controlling interest	(751,680)	(1,866,001)
Amortization of property and equipment	378,433	360,178
Amortization of intangible assets	192,356	189,755
Amortization of transaction costs on loans	-	226,786
Capitalized interest on loans	368,659	332,786
Unit based compensation	1,250	9,375
Deferred charges, net of costs recognized	(3,595)	24,128
Deferred revenue, net of revenue recognized	(144,543)	(219,423)
Lease inducements received, net of amortization of lease inducements	(38,404)	(33,942)
	(768,609)	(2,889,581)
Net change in non-cash working capital	(6,413,532)	147,526
	(7,182,141)	(2,742,055)
Financing Activities		
Increase in bank indebtedness	6,502,210	2,780,758
Capitalized transaction costs on loans	-	(26,364)
	6,502,210	2,754,394
Investing Activities		
Purchases of property and equipment	(14,376)	(8,310)
Purchases of intangible assets	(3,667)	(4,029)
	(18,043)	(12,339)
Decrease in cash and cash equivalents	(697,974)	-
Cash and cash equivalents, beginning of period	832,854	-
Cash and cash equivalents, end of period	134,880	-
Supplementary cash flow information		
Interest paid	501,153	449,823

The accompanying notes are an integral part of these financial statements

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 41 (December 31, 2009 – 41) 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. From December 31, 2008 to February 28, 2010, the Fund was in breach of certain financial covenants in its credit facilities, giving the lenders the right to demand repayment. In addition, the Fund's term loan was due April 30, 2009 and subordinated loan was due June 30, 2009. The Fund has not met these repayment requirements and the previous covenant breaches have not been waived, however repayment has not been demanded by the lenders.

The Fund incurred a net loss of $771,085 for the three month period ended March 31, 2010. As at March 31, 2010, the Fund had an accumulated deficit of $62,929,630 and a working capital deficiency of $10,988,899. The Fund intends to work closely with its lenders in order to achieve a long term financing solution which is acceptable to all parties. There can be no assurance that this initiative will be successful, and there remains significant doubt that the Fund will be able to continue as a going concern.

The Fund's ability to continue as a going concern is dependent on its ability to secure sufficient financing and to generate positive cash flows from operations. 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, 2009. 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, 2009.

3. Credit facilities

Bank indebtedness

The Fund has available under its credit facilities a $12,500,000 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 acquired personal property and an assignment of inventory.

Interest on the operating loan is charged at the lender's Canadian 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.

During the three months ended March 31, 2010, the Fund incurred interest of $105,297 (2009 - $89,467) on amounts drawn on the operating loan. As at March 31, 2010, prime rate was 2.25% (2009 - 2.5%), and $6,502,210 (December 31, 2009 - $nil) was outstanding on the operating loan.

Term loan

The term loan consists of a $6,750,000 committed non-revolving term loan facility. The principal balance was due on April 30, 2009. The Fund has not met this repayment requirement and repayment has not been demanded by the lenders. 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 loan facility is charged at the lender's Canadian prime rate plus 4.50% or the bankers' acceptance rate plus 5.75%.

During the three months ended March 31, 2010, interest and transaction cost expense recorded for the term loan totaled $124,277 (2009 - $182,177).

Subordinated loan

The subordinated loan consists of a $12,000,000 subordinated loan funded 50% by an independent third party and 50% by a company owned by the President and CEO of the Fund. The principal balance was due on June 30, 2009. The Fund has not met this repayment requirement and repayment has not been demanded by the lenders. The subordinated loan is collateralized by a second charge on all of the present and future undertakings and property of the Fund, including an acknowledged assignment of leases and material contracts. Interest on the subordinated loan is charge at a fixed rate of 18%, with the Fund's option to capitalize up to 10% per annum as part of the outstanding principal balance.

During the three months ended March 31, 2010, interest expense totaling $651,720 (2009 - $762,582) was recorded, including $368,659 (2009 - $332,786) which was capitalized as part of the outstanding principal balance.

The following table details the balance of the subordinated loan:

	March 31, 2010	***December 31, 2009***
	$	**$**
Initial principal amount	12,000,000	12,000,000
Interest capitalized	3,198,025	2,829,366
	15,198,025	14,829,366

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 March 31, 2010, the Fund is in compliance with all financial covenants mentioned above. For the period from December 31, 2008 to February 28, 2010, the Fund was in breach of certain financial covenants mentioned above and these breaches have not been waived by the lender.

4. Unitholders' equity

Fund units

The following units are issued and outstanding:

	Number of Units #	Issue Costs $	Net Capital Contributions $
Balance, December 31, 2008	6,051,000	4,928,124	56,110,332
Treasury Units transferred to employees	3,000	-	362
Balance, March 31, 2010 and December 31, 2009	6,054,000	4,928,124	56,110,694

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.

Distributions to unitholders

The Fund's policy is to distribute annually to unitholders available cash from operations after cash required for capital expenditures, working capital reserve and other reserves considered advisable by the trustees of the Fund. Distributions on Fund Units were suspended effective December 2007. No distributions were declared by the Fund during the year ended December 31, 2009 and the three months ended March 31, 2010.

Warrants

No warrants were converted into fund units during the three months ended March 31, 2010.

5. Non-controlling interest

	XS Cargo LP Exchangeable LP Units	*XS Cargo LP Subordinated LP Units*	*Total*
	#	*#*	*#*
Balance – March 31, 2010 and December 31, 2009	3,492,802	2,408,847	5,901,649
	$	**$**	**$**
Balance – December 31, 2009	(613,990)	1,313,554	699,564
Non-controlling interest – loss	(444,870)	(306,810)	(751,680)
Balance – March 31, 2010	(1,058,860)	1,006,744	(52,116)

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 4), 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.

XS Cargo LP Subordinated LP Units ("Subordinated LP Units")

The Subordinated LP Units have economic and voting rights equivalent to the Fund Units (note 4), 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 4) 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, 2009, the criteria were not met for the automatic exchange to occur.

Distributions to non-controlling interest

The Fund's policy is to distribute annually to holders of Fund Units, Exchangeable LP Units and Subordinated LP Units available cash from operations after cash required for capital expenditures, working capital reserve and other reserves considered advisable by the trustees of the Fund. Distributions on all Exchangeable LP Units were suspended effective December 2007 and distributions on Subordinated LP Units were suspended in March 2007. No distributions were declared by the Fund during the year ended December 31, 2009 and the three months ended March 31, 2010.

6. Unit-based compensation

During the three months ended March 31, 2010, no options were granted or exercised under the Fund's unit option plan. During the period, the Fund recognized $1,250 (2009 - $nil) in unit option expenses, which was reflected in unitholders' equity as an increase in contributed surplus.

7. 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 is required to give recognition to future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011, at the 25% 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, 2010 $	**December 31, 2009 $**
Future income tax assets		
Goodwill	3,431,500	3,431,500
Non-capital losses carried forward	854,000	854,000
Intangible assets	192,200	167,200
Debt issue costs	14,400	6,100
Unamortized lease inducements	46,000	52,000
Future income tax assets before valuation allowance	4,538,100	4,510,800
Valuation allowance	(4,538,100)	(4,510,800)
Net future income tax assets	-	-

As at March 31, 2010, the Fund has approximately $3,415,900 (December 31, 2009 - $3,415,900) of non-capital losses available for carry forward for income tax purposes that expire in 2027.

8. Related party transactions

Under its credit facilities, the Fund has an outstanding 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. Interest expense totaling $323,962 was recorded on the portion of the loan outstanding to the related party during the three months ended March 31, 2010. The loan and related interest have been recorded at the exchange amount, which represents fair value.

A director of XS Cargo GP Inc. is also a partner of Fleming LLP, a law firm which provides legal services to the Fund. Legal fees totaling approximately $31,000 were charged to the Fund by Fleming LLP during the three months ended March 31, 2010.

9. Basic and diluted (loss) per unit

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

10. 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.

11. 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.