



XS CARGO INCOME FUND

Management's Discussion of Financial Condition and Results of Operations

For the three and six months ended June 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 period ended June 30, 2009 and 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 August 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").

The Fund Units currently trade on the Toronto Stock Exchange ("TSX") under the symbol XSC.UN, however the Fund has received notification that the Fund Units will be delisted from the TSX at the close of market on August 19, 2009. The Fund has made an application to have its Units listed for trading on the TSX Venture Exchange and anticipates that such listing will be approved on or before August 19, 2009; however, listing of the Fund's trust units on the TSX Venture Exchange or another stock exchange will be dependent on the Fund satisfying the minimum listing requirements of such exchange and such other conditions to listing it may require.

The Business of the Fund

XS Cargo LP operates 40 closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan, Ontario, Nova Scotia, Newfoundland and New Brunswick.

Operating Highlights

Sales from continuing operations in the second quarter declined by \$3.5 million or 13.9% compared to the same quarter in 2008. Gross Margins decreased by \$2.4 million or 22.9%. Several factors contributed to the declines. Sales were affected by lower inventory levels resulting from financing constraints. Inventory at June 30, 2009 was \$12.8 million compared to \$20 million at June 30, 2008. There was also an unanticipated temporary decrease in the opportunity buys that make up the majority of the Fund's inventory. Sales trended upward throughout the quarter from minus 23.8% in April to minus 6% in June (compared to 2008 sales). The decline in gross margins was due to a reduction in sales, a decline in the value of the Canadian dollar and the accelerated write off of warranty returns. Eighty percent of the Fund's inventory is purchased in US dollars. The acquisition cost of that inventory was approximately 13% higher than the second quarter of 2008.

Earnings from operations in the second quarter were \$0.5 million compared to a loss of \$2.2 million in the first quarter of 2009. Second quarter earnings decreased \$1.6 million from the second quarter of 2008.

The fund undertook a management restructuring in the second quarter in an effort to improve store operations. The Vice President of Distribution and Logistics was promoted to Vice President of Operations, assuming responsibility for store operations. The National Sales Manager position was eliminated in favour of two regional sales managers.

A new store was opened in May in Vaughan, Ontario.

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Second Quarter and Year-to-date Operating Results

The following tables show the unaudited results of the Fund for the three and six month periods ended June 30, 2009 compared to the three and six month periods ended June 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.

Second Quarter Operating Results (unaudited)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Change Q2 2009 from Q2 2008
Sales	21,605,018	25,080,819	(3,475,801)
Cost of Goods Sold	13,480,803	14,564,138	(1,083,335)
Gross Margin	8,124,215 37.6%	10,516,681 41.9%	(2,392,466) -4.3%
Administrative and Operating Expenses*	7,581,895	8,401,979	(820,084)
(Loss) Earnings from Operations, as defined*	542,320	2,114,702	(1,572,382)
Net Loss	(472,939)	248,174	(721,113)

Year-to-date Operating Results (unaudited)	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008	Change 2009 from 2008
Sales	41,036,541	46,846,666	(5,810,125)
Cost of Goods Sold	27,158,760	27,562,178	(403,418)
Gross Margin	13,877,781 33.8%	19,284,488 41.2%	(5,406,707) -7.4%
Administrative and Operating Expenses*	15,527,616	16,733,607	(1,205,991)
(Loss) Earnings from Operations, as defined*	(1,649,835)	2,550,881	(4,200,716)
Net Loss	(2,386,162)	(400,878)	(1,985,284)

* 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

Second Quarter

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

	Sales			
	2009	2008	Change	% change
Sales	21,605,018	25,080,819	(3,475,801)	-13.9%

Second quarter sales decreased by \$3.5 million, from \$25.1 million to \$21.6 million, a decrease of 13.9%. The decrease in sales was the result of lower inventory levels (\$12.8 million at June 30, 2009 versus \$20 million at June 30, 2008) and a temporary decrease in opportunity buys that 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	June 30, 2009		June 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	19	47.0%	18	46.5%
Alberta **	7	18.7%	8	19.5%
British Columbia	8	20.0%	8	19.5%
Saskatchewan and Manitoba	3	9.2%	3	8.7%
Atlantic Canada	3	5.1%	3	5.8%
Total	40	100.0%	40	100.0%

**The Red Deer store was closed permanently on March 23, 2009. The table above excludes Red Deer store sales for three month period ended June 30, 2009.

Year-to-Date

The following table compares sales for the six months ended June 30, 2009 to the six months ended June 30, 2008:

	Sales			
	2009	2008	Change	% change
Sales	41,036,541	46,846,666	(5,810,125)	-12.4%

For the year-to-date, sales decreased by \$5.8 million, from \$46.8 million to \$41.0 million, a decrease of 12.4%. The decrease in sales was the result of reduced traffic due to economic conditions and lower store inventories due to a temporary decrease in opportunity buys that 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	June 30, 2009		June 30, 2008	
	Number of stores, end of quarter	Percentage of sales during the 6 month period	Number of stores, end of quarter	Percentage of sales during the 6 month period
Ontario	19	46.3%	18	46.5%
Alberta **	7	18.8%	8	19.5%
British Columbia	8	20.3%	8	19.5%
Saskatchewan and Manitoba	3	9.4%	3	8.7%
Atlantic Canada	3	5.2%	3	5.8%
Total	40	100.0%	40	100.0%

**The Red Deer store was closed permanently on March 23, 2009. The table above excludes Red Deer store sales for three month period ended June 30, 2009.

Cost of Goods Sold and Gross Margin

Second Quarter

Cost of goods sold for the quarter decreased by \$1.1 million from \$14.6 million to \$13.5 million, a decrease of 7.5% compared to the same period in 2008.

Gross margin for the quarter decreased by \$2.4 million, from \$10.5 million to \$8.1 million, a decrease of 22.9%. This decrease resulted from a decrease in sales, a decline in the value of the Canadian dollar and accelerated write-offs of warranty returns.

Year-to-Date

Cost of goods sold for the year-to-date decreased by \$0.4 million from \$27.6 million to \$27.2 million, a decrease of 1.4% compared to the same period in 2008.

Gross margin for the year-to-date decreased by \$5.4 million, from \$19.2 million to \$13.8 million, a decrease of 28.1% compared to the same period in 2008. This decrease resulted from a decrease in sales, a decline in the value of the Canadian dollar and accelerated write-offs of warranty returns.

Combined Administrative and Operating Expenses

Second Quarter

For the quarter, administrative and operating expenses decreased by approximately \$0.8 million from \$8.4 million to \$7.6 million as compared to the same period in 2008. This decrease is primarily the result of decreases in wages (\$0.2 million) primarily from efficiencies in distribution, rent (\$0.1 million) due to closing of the service centre in

Burlington, advertising (\$0.1 million), professional fees (\$0.3 million) because of a project in 2008 to evaluate the Fund's strategic options., and travel (\$0.1 million).

Year-to-Date

For the year-to-date, administrative and operating expenses decreased by approximately \$1.2 million from \$16.7 million to \$15.5 million as compared to the same period in 2008. This decrease is primarily the result of decreases in wages (\$0.4 million) primarily from efficiencies in distribution, rent (\$0.2 million) due to closing of the service centre in Burlington, advertising (\$0.1 million), professional fees (\$0.3 million) because of a one time evaluation of the Fund's strategic options in 2008, customs brokerage fees (\$0.1 million) due to a decrease in purchasing, and travel (\$0.1 million).

Earnings from Operations

Second Quarter

For the quarter, earnings from operations decreased by \$1.6 million, from earnings of \$2.1 million to \$0.5 million, a decrease of 76.2% as compared to the same period in 2008, as a result of the factors discussed previously.

Year-to-Date

For the year-to-date, earnings from operations decreased by \$4.2 million, from earnings of \$2.6 million to a loss of \$1.6 million, a decrease of 161.5% as compared to the same period in 2008, as a result of the factors discussed previously.

Fund Net Earnings

For the quarter, the Fund had a net loss of \$0.5 million or \$0.08 per unit on a basic and diluted basis. This compares with the prior year's net earnings of \$0.2 million or \$0.04 per unit on a basic and diluted basis.

For the year-to-date, the Fund had a net loss of \$2.4 million or \$0.39 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:

	June 30, 2009	March 31, 2009	December 31, 2008
Cash and cash equivalents	-	-	-
Inventory	12,837,212	13,580,942	17,677,390
Total current assets	16,357,330	16,439,742	19,691,313
Total assets	22,881,280	23,421,230	27,248,471
Total current liabilities excluding term loan and subordinated loan	10,397,693	10,424,517	10,892,858
Term loan	6,750,000	6,728,861	6,665,444
Subordinated loan	14,154,264	13,669,200	13,199,409
Non-controlling interest	(1,436,184)	(974,918)	891,083
Unitholders' equity	(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.

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.

No distributions were paid on Fund Units, Exchangeable LP Units or Subordinated LP Units during 2008 nor during the first 6 months of 2009.

As of June 30, 2009 the following number of units were outstanding:

Fund Units (Note 5)	6,051,000
XS Cargo LP Exchangeable LP Units (Note 6)	3,492,802
XS Cargo LP Subordinated LP Units (Note 6)	2,408,847
	<hr/>
	11,952,649

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

	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2009	2008	2009	2008
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Cash used for operating activities	505,663	(953,462)	(2,236,392)	(8,339,951)
Less: Net change in non-cash working capital	(568,549)	2,270,428	(716,075)	9,562,365
Less: Deferred charges, net of costs recognized	(13,002)	(19,299)	(37,130)	(90,980)
Less: Deferred revenue, net of revenue recognized	195,737	171,411	415,160	137,408
Less: Lease inducements received, net of amortization of lease inducements	(22,322)	35,298	11,620	68,010
Less: Maintenance capital expenditures ¹	(1,490)	(18,553)	(9,800)	(175,955)
Distributable cash ²	96,037	1,485,823	(2,572,617)	1,160,897
Average Units outstanding during the period	11,952,649	12,004,649	11,952,649	12,004,649
Distributable cash per Unit	0.01	0.12	(0.22)	0.10
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		Six months ended	
	June 30, 2009 (unaudited)	June 30, 2008 (unaudited)	June 30, 2009 (unaudited)	June 30, 2008 (unaudited)
Net (loss) for the period	(472,939)	248,174	(2,386,162)	(400,878)
Add: non-controlling interest	(461,265)	239,987	(2,327,266)	(387,652)
Add: Interest expense and foreign exchange	950,996	946,000	1,978,757	1,879,473
Add: Amortization of property and equipment	366,683	355,123	726,861	711,657
Add: Amortization of intangible assets	189,755	322,293	379,510	745,156
EBITDA	573,230	2,111,577	(1,628,300)	2,547,756

Unitholders' Equity and Non-controlling Interest

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

	Units	Issue Costs	Unitholders' Equity	Non-controlling Interest
	#	\$	\$	\$
Fund Units	6,051,000	4,928,124	56,110,332	-
Special Voting Units	5,901,649	-	-	-
Non-controlling Interest	5,901,649	-	-	(1,436,183)

On December 31, 2008 the Fund acquired 52,000 Fund Units under its unit-based compensation. There have been no changes in the number of Special Voting Units from December 31, 2008 to June 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 established 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.

LIQUIDITY AND CAPITAL RESOURCES

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.

The Fund declared no distributions in 2008 nor during the six months ended June 30, 2009.

Credit Facilities

On September 30, 2008, 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 \$12,500,000 (\$20,000,000 available from August to December 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 2.50%. If funds are withdrawn in U.S. dollars, interest will be charged at the lender's U.S. base rate plus 2.50%. The Fund is also required to pay a standby charge of 0.50% based on the amount equal to the operating facility commitment amount less the aggregate principal amount under the operating facility.

Under the amended credit facility agreement, the term loan was extended to April 30, 2009 and 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. The term loan was permanently reduced by \$4,500,000 on December 31, 2008 and was to be further permanently reduced on March 31, 2009 by an amount equal to 75% multiplied by 2008 excess cash flow as defined in the agreement. Excess cash flow is defined as cash in excess of EBITDA less principal payments, cash interest, cash taxes, permitted distributions to unit holders and unfunded capital expenditures. Management has determined that the Fund did not generate 2008 excess cash flow, as defined, such that no payment will be required. 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 2.50%. 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. 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. 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.

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 as at October 31, 2008 and thereafter. 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, 2009, the Fund was not in compliance with its minimum twelve-month EBITDA, senior debt to EBITDA, and total debt to 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 June 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.

The Fund continues to manage its liquidity risk by monitoring actual and projected cash flows taking into consideration the seasonality of its business. Further, the Fund has implemented certain operational measures that management believes will return the Fund to profitability for fiscal 2009.

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 second quarter, the Fund acquired \$117,833 of property and equipment at the stores and warehouses. Of this, \$9,801 related to “maintenance capital expenditures” at existing stores and warehouses and \$95,368 related to “growth capital expenditures” for the new Vaughan, Ontario store opened in the second quarter. The remaining \$12,664 related to capital expenditures at distribution infrastructure and head office capacity (“maintenance capital expenditures”).

	Stores and Warehouses	Infrastructure and Head Office	Total
Maintenance Expenses	9,801	12,664	22,465
Growth Expenses	95,368		95,368
Total	105,169	12,664	117,833

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 \$119,110 annually on distributable cash and interest expense based on \$11.91 million of debt outstanding at June 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 and the quarter ended June 30, 2009, 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 June 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 due on June 30, 2009.

	Total	2009	2010	2011	2012	2013	2014 and thereafter
Operating Leases	21,520,930	3,825,309	4,175,995	3,420,897	2,703,999	2,261,614	5,133,026
Subordinated Loan	6,750,000	6,750,000					
Term loan	14,154,264	14,154,264					
Total	42,425,194	24,729,573	4,175,995	3,420,987	2,703,999	2,261,614	5,133,026

As noted above, the Fund's term and subordinated loans are now due..

Summary of Quarterly Results (unaudited)

	2009		2008				2007	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales	21,605,018	19,431,523	38,713,064	24,525,830	25,080,819	21,765,847	42,653,087	29,250,232
Net (loss) earnings	(472,939)	(1,913,223)	(18,203,917)	(20,378)	248,174	(649,052)	(36,283,954)	415,980
Basic and diluted (loss) earnings per unit	(0.08)	(0.32)	(2.98)	0.00	0.04	(0.11)	(5.95)	0.07

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 as follows:

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 \$1,845,254 as at June 30, 2009 (December 31, 2008 - \$2,125,631) from “Property and equipment” to “Software and other intangible assets” on the consolidated balance sheet. The Fund also retroactively reclassified amortization of software of \$142,203 and \$284,406 during the three and six months ended June 30, 2009 (June 30, 2008 - \$137,273 and \$268,866) from “Amortization of property and equipment” to “Amortization of software and other intangible assets.”

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 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 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 \$377,923 and \$755,389 was recorded on the portion of the loan outstanding to the related party during the three and six month period ended June 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 \$41,000 and \$77,000 were charged to the fund by Fleming LLP during the three and six month period ended June 30, 2009 respectively.

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Outlook

Gross Margins recovered significantly from the first quarter, increasing from 29.6% to 37.6% . Management expects continued improvement based on recent strength in the Canadian dollar.

Management expects a substantial build up in inventory in the third quarter resulting in higher sales. Contributing to the inventory build up is an improved import program. A portion of the third quarter purchases have been hedged to reduce currency risk.

We expect significant improvements in store operations due to the management restructuring. This should result in higher sales from improved merchandising and customer service, and reduced labour costs and product returns.

A new store will open in the third quarter in Mississauga, Ontario and additional locations are under review.

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.

Earnings from operations disclosure under "First 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:

Second Quarter & Year-to-date (unaudited)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net Loss	(472,939)	248,174	(2,386,162)	(400,878)
Add:				
Non-controlling interest	(461,265)	239,987	(2,327,266)	(387,652)
Foreign exchange loss (gain)	4,643	(31,939)	(1,823)	45,128
Interest on term and subordinated loans	863,973	845,881	1,808,731	1,627,105
Interest on operating loan	82,380	132,058	171,849	207,240
Amortization of intangible assets	189,755	322,293	379,510	745,156
Amortization of property and equipment	366,683	355,123	726,861	711,657
Unit based compensation expense	(30,910)	3,125	(21,535)	3,125
(Loss) earnings from Operations, as defined	542,320	2,114,702	(1,649,835)	2,550,881

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 six months ended June 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 six months ended June 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.