XS Cargo Income Fund
Consolidated Financial Statements

December 31, 2009 and 2008

PRICEWATERHOUSECOOPERS

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March 22, 2010

Auditors' Report

To the Unitholders of
XS Cargo Income Fund

We have audited the consolidated balance sheets of **XS Cargo Income Fund** as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive loss, deficit and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Accountants

XS Cargo Income Fund
Consolidated Balance Sheets
As at December 31
(see note 1 – going concern discussion)

	2009	2008 *restated – see note 3*
	$	$
Assets		
Current		
Cash and cash equivalents	832,854	-
Inventory	16,391,551	17,677,390
Deposits on inventory	2,257,403	1,242,935
Prepaid expenses and deposits	992,305	770,988
	20,474,113	**19,691,313**
Deferred charges *(Note 8)*	**195,298**	**127,689**
Prepaid expenses and deposits	**401,262**	**439,362**
Property and equipment *(Note 4)*	**2,179,672**	**3,329,600**
Intangible assets *(Note 5)*	**2,951,111**	**3,660,507**
	26,201,456	**27,248,471**
Liabilities		
Current		
Bank indebtedness *(Note 7)*	-	2,776,346
Accounts payable and accrued liabilities	7,103,998	6,459,328
Deferred revenue *(Note 8)*	1,488,192	1,657,184
Term loan *(Note 7)*	6,750,000	6,665,444
Subordinated loan *(Note 7)*	14,829,366	13,199,409
	30,171,556	**30,757,711**
Deferred revenue *(Note 8)*	**573,624**	**604,423**
Unamortized lease inducements *(Note 9)*	**684,477**	**710,826**
	31,429,657	**32,072,960**
Non-controlling interest *(Note 11)*	**699,564**	**891,083**
	32,129,221	**32,964,043**
Unitholders' Equity		
Fund units *(Note 10)*	**56,110,694**	**56,110,332**
Warrants *(Note 10)*	**109,086**	**109,086**
Contributed surplus *(Note 13)*	**11,000**	**28,235**
Deficit	**(62,158,545)**	**(61,963,225)**
	(5,927,765)	**(5,715,572)**
	26,201,456	**27,248,471**

Approved on behalf of the Trustees:

(signed) *"David Margolus"*

David Margolus
Trustee

(signed) *"Gordon Clanachan"*

Gordon Clanachan
Trustee

XS Cargo Income Fund
Consolidated Statements of Operations and Comprehensive (Loss)
For the years ended December 31, 2009 and December 31, 2008

	Year Ended December 31, 2009	*Year Ended December 31, 2008 restated – see note 3*
	$	$
Sales	**106,035,278**	**110,085,560**
Cost of goods sold	**66,306,372**	**69,442,097**
Gross margin	**39,728,906**	**40,643,463**
Expenses		
Administrative and operating	**33,883,512**	**34,664,557**
Amortization of property and equipment	**1,475,967**	**1,428,430**
Amortization of intangible assets	**759,882**	**1,088,048**
	36,119,361	**37,181,035**
	3,609,545	**3,462,428**
Other expenses		
Interest on operating loan	**532,973**	**544,779**
Interest on term and subordinated loans	**3,332,642**	**3,447,185**
Foreign exchange loss (gain)	**130,769**	**(120,274)**
Impairment of goodwill *(Note 6)*	**-**	**36,226,599**
	3,996,384	**40,098,289**
(Loss) before non-controlling interest	**(386,839)**	**(36,635,861)**
Non-controlling interest *(Note 11)*	**(191,519)**	**(18,010,688)**
Net and comprehensive (loss) for the year	**(195,320)**	**(18,625,173)**
Basic and diluted (loss) per unit	(0.03)	(3.05)

The accompanying notes are an integral part of these financial statements

XS Cargo Income Fund
Consolidated Statements of (Deficit)
For the years ended December 31, 2009 and December 31, 2008

	Year Ended December 31, 2009	*Year Ended December 31, 2008*
	$	$
(Deficit), beginning of the year	(61,963,225)	(43,338,052)
Net (loss) for the year	(195,320)	(18,625,173)
(Deficit), end of the year	(62,158,545)	(61,963,225)

The accompanying notes are an integral part of these financial statements

XS Cargo Income Fund
Consolidated Statements of Cash Flows
For the years ended December 31, 2009 and December 31, 2008

	Year Ended December 31, 2009	*Year Ended December 31, 2008 restated – see note 3*
Cash provided by (used for) the following activities	$	$
Operating Activities		
Net (loss) for the year	(195,320)	(18,625,173)
Items not affecting cash:		
Non-controlling interest	(191,519)	(18,010,688)
Impairment of goodwill	-	36,226,599
Amortization of property and equipment	1,475,967	1,428,430
Amortization of intangible assets	759,882	1,088,048
Amortization of transaction costs on loans	420,146	397,748
Capitalized interest on loans	1,372,516	1,091,825
Unit based compensation	(16,873)	21,875
Deferred charges, net of costs recognized	(67,609)	139,387
Deferred revenue, net of revenue recognized	(199,791)	(126,034)
Lease inducements received, net of amortization of lease inducements	(26,349)	(137,701)
Gain on sale of property and equipment	-	(27,500)
	3,331,050	3,466,816
Net change in non-cash working capital	732,824	(2,616,780)
	4,063,874	850,036
Financing Activities		
(Decrease) increase in bank indebtedness	(2,776,346)	2,776,346
Treasury units acquired	-	(6,280)
Capitalized transaction costs on loans	(78,149)	(428,329)
Repayment of term loan	-	(4,500,000)
	(2,854,495)	(2,158,263)
Investing Activities		
Purchases of property and equipment	(326,039)	(438,466)
Purchases of intangible assets	(50,486)	-
Proceeds from sale of property and equipment	-	36,734
	(376,525)	(401,732)
Increase (decrease) in cash and cash equivalents	832,854	(1,709,959)
Cash and cash equivalents, beginning of year	-	1,709,959
Cash and cash equivalents, end of year	832,854	-
Supplementary cash flow information		
Interest paid	2,044,113	2,426,448

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, 2008 – 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. As at December 31, 2009, 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 repayment has not been demanded by the lenders.

For the year ended December 31, 2009, the Fund reported a net loss of $195,320 (2008 - $18,625,173) an accumulated deficit of $62,158,545 (2008 - $61,963,225) and a working capital deficiency of $9,697,443 (2008 - $11,066,348). 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. Accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

Basis of presentation

These financial statements are prepared on a consolidated basis and include the accounts of the Fund, XS Cargo Operating Trust, XS Cargo LP and GP. All inter-entity balances and transactions have been eliminated on consolidation.

Cash and cash equivalents

Cash and cash equivalents include balances with banks and short-term investments with maturities of three months or less at acquisition. Cash and cash equivalents are classified as "held for trading," which are carried at fair value, with changes in fair value recognized through net income in the period they arise.

Loans and receivables

Should they arise, operating receivables are classified as "loans and receivables," which are initially measured at fair value, and subsequently measured at amortized cost using the effective interest method.

Inventory

Inventory, consisting of retail merchandise, is valued at the lower of cost, determined using the average cost basis, and net realizable value.

Deposits on inventory

On certain inventory purchases the Fund pays either a deposit or the balance in full prior to taking possession of the goods. Such payments are recorded as deposits on inventory until the Fund takes possession of the goods, at which time the balance is transferred to inventory.

Property and equipment

Property and equipment are recorded at cost. Amortization is provided using methods and rates intended to amortize the cost of assets over their estimated useful lives. The Fund will test its property and equipment for impairment when events and circumstances warrant such a review. An impairment loss is recorded when it is determined that the carrying amount is no longer recoverable and exceeds its fair value. Amortization rates are set forth below:

	Method	Rate
Leasehold improvements	straight-line	Shorter of lease term and 5 years
Office, computer and mobile equipment	straight-line	20%
Signs	straight-line	20%

Intangible assets

Software is recorded at cost and amortized on a straight-line basis at a rate of 20%.

Intangible assets acquired at the time of the IPO represent management's estimate of the fair value of the XS Cargo brand name and trademark, database of sales and purchasing history, and the value attributed to property leases at less than market rates. The intangible asset related to the brand name and trademark has an indefinite life and is not amortized. The intangible assets related to property leases are amortized over the remaining terms of the leases. The intangible asset related to the database of the sales and purchasing history is amortized over its five year expected life. The Fund will assess the carrying value of intangible assets that are not subject to amortization annually or more frequently if events or changes in circumstances indicate a potential impairment. Intangible assets that are amortized are assessed for impairment when events or changes in circumstances warrant such a review. An impairment loss is recorded when it is determined that the carrying amount is no longer recoverable and exceeds its fair value.

Goodwill

Goodwill represents the excess of the cost of an acquired business over the estimated fair value of the identifiable net assets acquired. Goodwill is not amortized, but is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. The Fund uses the two-step impairment test as outlined in the Canadian Institute of Chartered Accountants ("CICA") Handbook to assess whether the carrying value of goodwill is impaired.

Future income taxes

The Fund follows the liability method of tax allocation to account for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based upon the differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Under the terms of the Income Tax Act (Canada), the Fund is not subject to income taxes to the extent that its taxable income in a year is paid or payable to unitholders. Accordingly, no provision for current income taxes for the Fund is made. The Fund intends to distribute to its unitholders all or virtually all of its taxable income and taxable capital gains that would otherwise be taxable in the Fund and intends to continue to meet the requirements under the Income Tax Act (Canada) applicable to such trusts. Currently, the Fund does not pay income tax as long as distributions to unitholders meet or exceed the amount of the Fund's income that would otherwise be taxable.

Proposed changes to the taxation of income trusts were substantively enacted on June 12, 2007. The changes are not intended to apply to taxation years ending prior to 2011, for income trusts that commenced trading prior to November 2006. However, in accordance with the recommendations of the ClCA contained in Section 3465, the Fund has estimated its temporary differences reversing in the 2011 taxation year and beyond and applied the current substantively enacted tax rates that will apply in the periods those temporary differences are expected to reverse. Future tax assets are evaluated as to the likelihood of their realization. In instances where it is not more likely than not that the future tax asset will be realized, a valuation allowance is recorded to reduce all or a portion of the future tax asset to its realizable amount.

Taxable income that is not distributed to unitholders is generally taxed in the Trust at the highest federal and provincial income tax rates that are applicable to individuals. Beginning with the 2011 taxation year, distributions will be taxed at the Specified Investment Flow-Through Entity rate.

Revenue recognition

Revenue from retail product sales is recognized at the point of sale. Revenue from sales of product replacement extended warranty plans is recognized on a straight-line basis over the plan terms as described below.

Product replacement extended warranty plan

Revenue from sales of product replacement extended warranty plans (“PRPs”) is recognized on a straight-line basis over the two-year term of the plans. Amounts received but not yet recognized as revenue are included as deferred revenue on the balance sheet, with the amount to be recognized within twelve months of the balance sheet date separately classified as current.

Costs of product replacement and general administration of the PRPs are expensed as incurred. Direct incremental selling costs of PRPs are deferred and recognized on the same basis as the related PRP revenue.

Lease inducements

Lease inducements are received from certain of the Fund’s landlords, primarily in the form of rent-free periods. Lease inducements are recorded as a liability when received and are amortized as a reduction of rent expense over the terms of the related leases.

Other financial liabilities

Accounts payable and accrued liabilities, bank indebtedness, term and subordinated loans have been classified as “other financial liabilities,” which are initially measured at fair value and subsequently measured at amortized cost using the effective interest method. For the term and subordinated loans and any other non-operating loans, the Fund has elected to add transaction costs that are directly attributable to issuance to the initial carrying amount.

Foreign currency translation

Transaction amounts denominated in foreign currencies are translated into their Canadian dollar equivalents at exchange rates prevailing at the transaction dates. Carrying values of monetary assets and liabilities reflect the exchange rates at the balance sheet date. Translation gains and losses are included in current earnings.

Unit-based compensation

The Fund grants unit options to employees, directors, trustees and consultants pursuant to a trust unit option plan. The Fund recognizes compensation expense on the issuance of options to employees, directors and trustees over the vesting term of the options with a corresponding entry to contributed surplus. Upon exercise of these options, the Fund transfers the amount previously credited to contributed surplus along with any consideration paid by the employees, directors and trustees, to fund units. Awards of options to consultants, should they occur, will be accounted for in accordance with the fair value method of accounting for unit based compensation, and will result in compensation expense when issued.

Measurement uncertainty and use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period. For example, amortization is based on the estimated useful lives of property and equipment and inventory is recorded after an evaluation as to the net realizable value and is appropriately reduced if net realizable value is estimated to be below cost. As well, freight costs are allocated to inventory based on a percentage of the freight paid in the period in comparison to the total purchases made in the period. This percentage is then applied to the ending inventory balance.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

3. Change in accounting policies

Effective January 1, 2009, the Fund adopted Canadian Institute of Chartered Accountants ("CICA") Handbook 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 "Intangible assets" on the consolidated balance sheet. The Fund also retroactively reclassified amortization of software of $546,424 for the year ended December 31, 2008 from "Amortization of property and equipment" to "Amortization of intangible assets." There is no impact on net earnings in the current or prior periods as a result of this change.

4. Property and equipment

	December 31, 2009		
	Cost	***Accumulated Amortization***	***Net book Value***
	$	**$**	**$**
Leasehold improvements	1,651,820	1,061,704	590,116
Office, computer and mobile equipment	5,376,943	3,964,361	1,412,582
Signs	531,899	354,925	176,974
	7,560,662	5,380,990	2,179,672

	December 31, 2008		
	Cost	***Accumulated Amortization***	***Net book Value***
	$	**$**	**$**
Leasehold improvements	1,556,235	741,718	814,517
Office, computer and mobile equipment	5,193,071	2,909,797	2,283,274
Signs	485,497	253,688	231,809
	7,234,803	3,905,203	3,329,600

5. Intangible assets

	December 31, 2009		
	Cost	*Accumulated Amortization*	*Net book Value*
Indefinite life	**$**	**$**	**$**
Brand name and trademark	690,000	-	690,000
Limited life			
Computer software	2,890,522	1,284,079	1,606,443
Operating lease agreements	1,600,000	1,138,832	461,168
Database of sales and purchasing history	430,000	236,500	193,500
	4,920,522	2,659,411	2,261,111
	5,610,522	2,659,411	2,951,111

	December 31, 2008		
	Cost	*Accumulated Amortization*	*Net book Value*
Indefinite life	**$**	**$**	**$**
Brand name and trademark	690,000	-	690,000
Limited life			
Computer software	2,840,036	714,405	2,125,631
Operating lease agreements	1,600,000	1,034,624	565,376
Database of sales and purchasing history	430,000	150,500	279,500
	4,870,036	1,899,529	2,970,507
	5,560,036	1,899,529	3,660,507

6. Goodwill

A non-cash impairment charge of $36,226,599 has been recognized as a result of performing the goodwill impairment test as of December 31, 2008, reducing the balance to $nil.

7. Credit facilities

Bank indebtedness

The Fund has available under its credit facilities a $17,500,000 ($12,500,000 available from January to July 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 acquired personal property and an assignment of inventory.

Effective September 14, 2009, the interest rate on the operating loan was increased by 2.00% per annum as a result of default in covenants mentioned below and shall remain in effect as long as the default subsists. 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% (0.50% prior to September 14, 2009) based on the amount equal to the operating facility commitment amount less the aggregate principal amount under the operating facility. During the year, the Fund incurred interest of $532,973 (2008 - $544,779) on amounts drawn on the operating loan. As at December 31, 2009, prime rate was 2.25% (2008 – 3.50%), and $nil (2008 - $2,776,346) was outstanding on the operating loan.

The Fund is currently in default on certain financial covenants as described under *Financial covenants*.

Term loan

On September 30, 2008, the Fund re-negotiated the credit facility agreement covering its term and operating loans. Under the amended credit facility agreement, the term loan was extended to April 30, 2009 and consisted of a committed non-revolving term loan facility. 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% of 2008 excess cash flow as defined in the agreement. The Fund did not generate 2008 excess cash flow, as defined, such that no payment was required.

The term loan is collateralized by a first charge on all present and after acquired personal property and an assignment of inventory. Effective September 14, 2009, the interest rate on the term loan was increased by 2.00% per annum as a result of default in covenants mentioned below and shall remain in effect as long as the default subsists. Under the amended 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%.

During the year, interest and transaction cost expense recorded for the term loan totaled $562,468 (2008 - $985,896).

The following table details the balance of the term loan:

	December 31, 2009	***December 31, 2008***
	$	**$**
Initial principal amount	6,750,000	11,250,000
Unamortized transaction costs	-	(84,556)
Repayment	-	(4,500,000)
	6,750,000	6,665,444

The Fund is currently in default on certain financial covenants as described under *Financial covenants*.

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 was initially due on August 20, 2008. On November 5, 2008, the Fund reached an agreement with its subordinated lenders to extend the maturity date of the subordinated loan agreements 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 (previously 8.0%). 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 the subordinated lenders (note 10).

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 and then issuing the proportionately reduced number of fully paid units to the warrant holder.

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.

During the year, interest expense totaling $2,770,174 (2008 - $2,461,289) was recorded, including $1,372,516 (2008 - $1,091,825) which was capitalized as part of the outstanding principal balance.

The following table details the balance of the subordinated loan:

	December 31, 2009	***December 31, 2008***
	$	**$**
Initial principal amount	12,000,000	12,000,000
Unamortized transaction costs	-	(175,627)
Unamortized issue of warrants	-	(81,814)
Interest capitalized	2,829,366	1,456,850
	14,829,366	13,199,409

The Fund is currently in default on certain financial covenants as described under *Financial covenants*.

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 December 31, 2009, the Fund was not in compliance with the minimum adjusted trailing twelve months EBITDA, and total funded debt to adjusted EBITDA covenants. The Fund is working with its lenders to negotiate mutually acceptable financial covenants.

8. Deferred revenue and deferred charges

The following tables detail the deferred revenue and charges associated with the product replacement extended warranty plans ("PRP"), gift cards issued, as well as an advertising contract:

	December 31, 2009	*December 31, 2008*
Deferred revenue	**$**	**$**
Deferred PRP revenue, beginning of year	1,976,313	2,235,149
PRP sales	1,794,361	1,849,045
Amounts recognized as revenue	(1,853,781)	(2,107,881)
Deferred PRP revenue, end of year	1,916,893	1,976,313
Advertising deferred revenue	104,167	154,167
Gift card deferred revenue	40,756	131,127
Deferred revenue, end of year	2,061,816	2,261,607
Less: current portion of deferred revenue	1,488,192	1,657,184
	573,624	604,423
Deferred charges		
Deferred charges, beginning of year	127,689	267,076
Direct incremental selling costs	195,999	100,514
Costs recognized	(128,390)	(239,901)
Deferred charges, end of year	195,298	127,689

In February 2008, an advertising vendor paid the Fund $200,000 as an incentive for signing a four year contract. The benefit is recognized on a straight-line base over the four year period.

9. Unamortized lease inducements

	December 31, 2009	*December 31, 2008*
	$	**$**
Cost	1,110,506	1,142,205
Accumulated amortization	(426,029)	(431,379)
	684,477	710,826

Lease inducements received are non-cash transactions in the form of rent-free periods and, as such, have been added back as a non-cash item in operating activities on the statement of cash flows. Amortization of lease inducements represents a non-cash reduction in rent expense and, as such, is a deduction in cash flow from operating activities on the statement of cash flows. During the year ended December 31, 2009, $151,982 of lease inducements were fully amortized and $120,283 of new inducements were received.

10. Unitholders' equity

Fund units

The following units are issued and outstanding:

	Number of Units #	Issue Costs $	Net Capital Contributions $
Balance, December 31, 2007	6,103,000	4,928,124	56,116,612
Treasury Units acquired	(52,000)	-	(6,280)
Balance, December 31, 2008	6,051,000	4,928,124	56,110,332
Treasury Units transferred to employees	3,000	-	362
Balance, 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.

As at December 31, 2009, the Fund holds 52,000 (2008 – 55,000) Treasury Units. Treasury Units represent units held for unit-based compensation (note 13).

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 December 31, 2008.

Warrants

On November 5, 2008, pursuant to the extension of the subordinated loan agreements as described in note 7, the Fund issued 1,000,000 warrants to purchase fund units at $0.60 per unit. The warrants have a term of 36 months and are exercisable at any time. The proceeds from the extension were allocated to the subordinated loan and warrants based on the relative fair values. The fair value attributed to the warrants using the Black-Scholes option pricing model was $109,086. The assumptions used in the Black-Scholes calculation were:

Annualized volatility	100.0%
Risk-free interest rate	2.5%
Expected life	3 years
Exercise price	$0.600
Unit price at grant date	$0.247

No warrants were converted into fund units during the year ended December 31, 2009 and December 31, 2008.

11. Non-controlling interest

	XS Cargo LP Exchangeable LP Units #	*XS Cargo LP Subordinated LP Units* #	*Total* #
Balance – December 31, 2009 and December 31, 2008	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	(10,659,354)	(7,351,334)	(18,010,688)
Balance – December 31, 2008	(500,642)	1,391,725	891,083
Non-controlling interest – loss	(113,348)	(78,171)	(191,519)
Balance – December 31, 2009	(613,990)	1,313,554	699,564

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 10), 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 10), 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 10) 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.

Fund Special Voting Units

	Number #	Amount $
Issued and outstanding – December 31, 2009 and December 31, 2008	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

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 December 31, 2008.

12. Commitments

The Fund occupies the premises of its stores, warehouses and office under lease agreements requiring basic monthly rents for the years indicated and in aggregate as follows:

Years ending December 31,	
2010	$4,799,725
2011	3,997,355
2012	3,234,273
2013	2,628,341
2014	2,142,535
Thereafter	3,032,836
Total	$19,835,065

13. Unit-based compensation

Units

In 2008, under the terms of employment agreements, the Fund purchased 52,000 units to be issued to certain employees. Issuance of the units was conditional upon one year of service to June 16, 2009. During the year ended December 31, 2009, 3,000 units were transferred to an employee. The remaining 49,000 units were not granted as the employee did not meet the contractual conditions. As a result, the Fund has recovered a net $28,235 of compensation cost to administrative expenses and contributed surplus based on the estimated fair value of the units at the grant date.

Options

On June 11, 2009, the board approved a unit option plan for its employees, directors, trustees and consultants at its annual general meeting. The Fund has awarded a total of 300,000 options that will vest over the period to January 2, 2012. The fair value attributed to the options using the Black-Scholes option pricing model was $18,000. The assumptions used in the Black-Scholes calculation were:

Annualized volatility	100.0%
Risk-free interest rate	2.13%
Expected life	3 years
Exercise price	$0.100
Unit price at grant date	$0.095

At December 31, 2009, 300,000 options remain outstanding, of which, none are exercisable. Compensation expense of $11,000 has been included in administrative and operating expenses and contributed surplus related these options for the year ended December 31, 2009.

14. Financial instruments

Credit risk

As the Fund does not sell its products to consumers on terms of credit, the Fund is exposed to credit risk only through deposits on inventory to the extent of credits on account with suppliers. Deposits on inventory relate to specific inventory purchases with vendors requiring a deposit or advance payment prior to shipment of goods. The Fund has recorded a provision of $nil (2008 - $6,439) for certain of these receivables it has determined to be doubtful as at December 31, 2009.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund purchases a significant amount of its inventory from suppliers in the United States and China, mostly denominated in United States dollars. Consequently, the Fund's gross margin is exposed to foreign exchange fluctuations. This exposure is limited because the Fund does not enter into significant future purchase commitments, but generally wires funds in advance upon placing orders with foreign suppliers. The Fund also typically minimizes a United States dollar overdraft position on a timely basis.

As at December 31, 2009, the portion of accounts payable and accrued liabilities denominated in United States dollars is $4,933 USD (2008 - $65,354 USD). As at December 31, 2009, the Fund had $653,282 USD bank overdraft (2008 – $8,278 USD bank overdraft). These USD account balances may fluctuate significantly over the course of the year in relation to inventory purchasing activity.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates. The Fund’s bank indebtedness and term loan credit facilities, as described in note 7, bear interest with floating rates over prime or the applicable bankers’ acceptance rate, thus exposing the Fund to interest rate cash flow risk. A 1.0% increase in interest rates would have an impact of $67,500 annually on interest expense and cash flow based on $6,750,000 of debt outstanding at December 31, 2009.

Liquidity risk

Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations associated with financial liabilities. The Fund enters into transactions to purchase goods and services on credit, lease premises from various landlords, and borrow funds from financial institutions or other creditors, for which repayment is required at various maturity dates (note 1 and 7). Liquidity risk is managed by reviewing the Fund's future expected net cash flows for the possibility of a negative cash position. The Fund manages liquidity risk by monitoring actual and projected cash flows, taking into account the seasonality of the Fund's sales, purchases, and expenses. All of the Fund's financial liabilities are due on a current basis. The Fund's intention is to work with the lenders to renew their obligations and extend the maturity of the loans on mutually acceptable terms.

Fair value

The Fund's financial instruments consist of cash and cash equivalents, accounts payable and accrued liabilities, bank indebtedness, term loan, and subordinated loan. The carrying amount of financial instruments that are included in working capital approximate their fair values due to their relatively short terms to maturity. The carrying value of the bank indebtedness and term loan approximates fair value since the interest rate fluctuates and approximates rates currently available to the Fund. The carrying value of the subordinated loan approximates fair value as the interest rate approximates rates currently available to the Fund.

15. Capital 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 year.

External restrictions relevant to management of the Fund's capital include the financial covenants discussed in note 7.

16. Basic and diluted (loss) per unit

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

The following table outlines the adjustments to the numerator and denominator to calculate the basic and diluted (loss) per unit:

	Basic (Loss) per Unit	Dilution Adjustments		Diluted (Loss) per Unit
December 31, 2009				
Net loss	(195,320)	(191,519)	(a)	(386,839)
Average Units outstanding	6,051,805	5,901,649	(b)	11,953,454
Loss per Unit	(0.03)			(0.03)

	Basic (Loss) per Unit	Dilution Adjustments		Diluted (Loss) per Unit
December 31, 2008				
Net loss	$(18,625,173)	$(18,010,688)	(a)	$(36,635,861)
Average Units outstanding	6,103,000	5,901,649	(b)	12,004,649
Loss per Unit	(3.05)			(3.05)

(a) Adjustment to add back non-controlling interest if Exchangeable LP Units and Subordinated LP Units are converted to Fund Units

(b) Adjustment to reflect the conversion of Exchangeable LP Units and Subordinated LP Units to Fund Units on a one-for-one basis

(c) 1,000,000 Unit purchase warrants issued on November 5, 2008 that remain outstanding could potentially dilute basic earnings per unit in the future but were not included as their impact would be anti-dilutive to the periods presented.

(d) 52,000 Treasury units held at December 31, 2009 are not included in the calculation of average units outstanding during the year.

17. 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:

	December 31, 2009 $	December 31, 2008 $
Future income tax assets		
Goodwill	3,431,500	3,859,300
Non-capital losses carry forward	854,000	956,400
Intangible assets	167,200	160,900
Debt issue costs	6,100	-
Unamortized lease inducements	52,000	60,700
Future income tax assets before valuation allowance	4,510,800	5,037,300
Valuation allowance	(4,510,800)	(5,037,300)
Net future income tax assets	-	-

As at December 31, 2009, the Fund has approximately $3,415,900 (2008 - $3,415,900) of non-capital losses available for carry forward for income tax purposes that expire in 2027.

18. 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 7. Interest expense totaling $1,374,625 (2008 - $1,169,765) was recorded on the portion of the loan outstanding to the related party during year ended December 31, 2009. 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 $130,000 (2008 - $148,000) were charged to the Fund by Fleming LLP during the year ended December 31, 2009.

19. 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.