

XS Cargo Income Fund
Interim Consolidated Financial Statements
Unaudited
March 31, 2009

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

	March 31, 2009 (unaudited)	December 31, 2008 <i>restated – see note 3</i>
	\$	\$
Assets		
Current		
Inventory	13,580,942	17,677,390
Deposits on inventory	1,903,720	1,242,935
Prepaid expenses and deposits	955,080	770,988
	16,439,742	19,691,313
Deferred charges	103,561	127,689
Prepaid expenses and deposits	425,414	439,362
Property and equipment	2,977,732	3,329,600
Software and other intangible assets	3,474,781	3,660,507
	23,421,230	27,248,471
Liabilities		
Current		
Bank indebtedness (Note 4)	5,557,104	2,776,346
Accounts payable and accrued liabilities	3,341,335	6,459,328
Deferred revenue	1,526,068	1,657,184
Term loan (Note 4)	6,728,861	6,665,444
Subordinated loan (Note 4)	13,669,200	13,199,409
	30,822,568	30,757,711
Deferred revenue	516,116	604,423
Unamortized lease inducements	676,884	710,826
	32,015,568	32,072,960
Non-controlling interest (Note 6)	(974,918)	891,083
	31,040,650	32,964,043
Unitholders' Equity		
Fund units (Note 5)	56,110,332	56,110,332
Warrants	109,086	109,086
Contributed surplus	37,610	28,235
Deficit	(63,876,448)	(61,963,225)
	(7,619,420)	(5,715,572)
	23,421,230	27,248,471

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

	<i>Three Months Ended March 31, 2009 (unaudited)</i>	<i>Three Months Ended March 31, 2008 (unaudited) <i>restated – see note 3</i></i>
	\$	\$
Sales	19,431,523	21,765,847
Cost of goods sold	13,677,957	12,998,040
Gross Margin	5,753,566	8,767,807
Expenses		
Administrative and operating	7,955,096	8,331,628
Amortization of property and equipment	360,178	356,534
Amortization of software and other intangible assets	189,755	422,863
	8,505,029	9,111,025
	(2,751,463)	(343,218)
Other expenses		
Interest on operating loan	89,467	75,182
Interest on term and subordinated loans	944,759	781,224
Foreign exchange (gain)/loss	(6,465)	77,067
	1,027,761	933,473
Loss before non-controlling interest	(3,779,224)	(1,276,691)
Non-controlling interest (Note 6)	(1,866,001)	(627,639)
Net loss and comprehensive loss for the period	(1,913,223)	(649,052)
Basic and diluted loss per unit	(0.32)	(0.11)

XS Cargo Income Fund
Consolidated Statements of Deficit

	<i>Three Months Ended March 31, 2009 (unaudited) \$</i>	<i>Three Months Ended March 31, 2008 (unaudited) \$</i>
Deficit, beginning of the period	(61,963,225)	(43,338,052)
Net loss for the period	(1,913,223)	(649,052)
Deficit, end of the period	(63,876,448)	(43,987,104)

XS Cargo Income Fund
Consolidated Statements of Cash Flows

	<i>Three Months Ended March 31, 2009 (unaudited)</i>	<i>Three Months Ended March 31, 2008 (unaudited) <i>restated – see note 3</i></i>
Cash provided by (used for) the following activities	\$	\$
Operating Activities		
Net loss for the year	(1,913,223)	(649,052)
Items not affecting cash:		
Non-controlling interest	(1,866,001)	(627,639)
Amortization of property and equipment	360,178	356,534
Amortization of software and other intangible assets	189,755	422,863
Amortization of transaction costs on loans	226,786	82,396
Capitalized interest on loans	332,786	247,374
Unit based compensation	9,375	-
Deferred charges, net of costs recognized	24,128	71,681
Deferred revenue, net of revenue recognized	(219,423)	34,003
Lease inducements received, net of amortization of lease inducements	(33,942)	(32,712)
	(2,889,581)	(94,552)
Net change in non-cash working capital	147,526	(7,291,937)
	(2,742,055)	(7,386,489)
Financing Activities		
Proceeds from bank indebtedness	2,780,758	5,854,453
Capitalized transaction costs on loans	(26,364)	-
	2,754,394	5,854,453
Investing Activities		
Purchases of property and equipment	(8,310)	(57,459)
Purchases of intangible assets	(4,029)	(147,943)
Proceeds from sale of property and equipment	-	27,479
	(12,339)	(177,923)
(Decrease) Increase in cash and cash equivalents	-	(1,709,959)
Cash and cash equivalents, beginning of period	-	1,709,959
Cash and cash equivalents, end of period	-	-
Supplementary cash flow information		
Interest paid	449,823	609,032

XS Cargo Income Fund

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1. Nature of the Fund and going concern

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

The Fund commenced business operations on May 17, 2005, when it completed an initial public offering (the "IPO") of 6,106,000 trust units ("Fund Units"), at a price of \$10 per unit, for aggregate gross proceeds of \$61,060,000. Concurrent with the closing of the IPO, the Fund acquired a 51% indirect interest in XS Cargo LP and XS Cargo LP acquired the net assets (the "Acquired Business") of Famous Brands (Edmonton) Inc. (the "Vendor"). XS Cargo LP operates 39 (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. From December 31, 2008, through March 31, 2009, the Fund has been in breach of certain financial covenants in its credit facilities, giving the lenders the right to demand repayment. The Fund has received waivers for the periods ending December 31, 2008, January 31, 2009, and February 28, 2009, and is working with its lenders to resolve the defaults of certain covenants as of March 31, 2009.

The Fund incurred a net loss of \$1,913,223 for the three month period ended March 31, 2009. As at March 31, 2009, the Fund had an accumulated deficit of \$63,876,448 and a working capital deficiency of \$14,382,826. The Fund intends to work closely with its lenders through the second quarter 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, 2008, except as described in note 3. However, the interim consolidated financial statements do not include all information and footnote disclosures required under Canadian GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with audited financial statements and notes thereto, for the year ended December 31, 2008.

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3. Change in accounting policies

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 \$1,987,457 as at March 31, 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 to March 31, 2009 (March 31, 2008 - \$131,593) from “Amortization of property and equipment” to “Amortization of software and other intangible assets.”

4. Credit facilities

Bank indebtedness

The Fund has available under its credit facilities a \$12,500,000 (\$20,000,000 available from August to December 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. Interest on the operating loan will be 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. During the three months ended March 31, 2009, the Fund incurred interest of \$89,467 (March 31, 2008 - \$75,182) on amounts drawn on the operating loan. As at March 31, 2009 prime rate was 2.5%, and \$5,557,104 (December 31, 2008 - \$2,776,346) was outstanding on the operating loan.

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 has been 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% 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. Under the amended agreement, interest on the term loan facility is charged at the lender's Canadian prime rate plus 2.50%. Under the previous agreement, interest on the term facility was charged at the lender's Canadian prime rate or U.S. base rate plus 0.25% to 1.25% or the bankers' acceptance rate plus 1.75% to 2.75%, depending on the Fund's senior debt to earnings before interest, taxes, depreciation and amortization (“EBITDA”) ratio.

During the three months ended March 31, 2009, interest expense recorded for the term loan totaled \$182,177 (March 31, 2008 - \$219,300). As at March 31, 2009, prime rate was 2.5% (March 31, 2008 - 5.25%).

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The following table details the balance of the term loan:

	<i>March 31, 2009</i>	<i>December 31, 2008</i>
	\$	\$
Initial principal amount	6,750,000	11,250,000
Unamortized transaction costs	(21,139)	(84,556)
Repayment of term loan	-	(4,500,000)
	6,728,861	6,665,444

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 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 and then issuing at 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 three months ended March 31, 2009, interest expense totaling \$762,582 (March 31, 2008 - \$561,924) was recorded, including \$332,786 (2008 - \$247,374) which was capitalized as part of the outstanding principal balance.

The following table details the balance of the subordinated loan:

	<i>March 31, 2009</i>	<i>December 31, 2008</i>
	\$	\$
Initial principal amount	12,000,000	12,000,000
Unamortized transaction costs	(79,529)	(175,627)
Unamortized issue of warrants	(40,907)	(81,814)
Interest capitalized	1,789,636	1,456,850
	13,669,200	13,199,409

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 3.5:1.0 until December 31, 2008, at which time the ratio reduces to 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.

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The subordinated loan agreement also requires the Fund to maintain a total funded debt to adjusted EBITDA ratio of less than 5.0:1.0 until December 31, 2008, at which point the ratio reduces to 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 is working with its lenders to obtain a waiver and negotiate mutually acceptable financial covenants as part of its credit renewals.

5. Unitholders' Equity

Fund Units

The following units are issued and outstanding:

	Number of Units #	Issue Costs \$	Net Capital Contributions \$
Fund Units Issued, March 31, 2008 and December 31, 2007	6,106,000	4,928,124	56,131,876
Treasury Units acquired	(55,000)	-	(21,544)
Balance, March 31, 2009 and December 31, 2008	6,051,000	-	56,110,332

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.

Treasury Units represent unvested units held for unit-based compensation.

Warrants

No warrants were converted into fund units during the three months ended March 31, 2009.

6. Non-controlling interest

	<i>XS Cargo LP</i> <i>Exchangeable LP</i> <i>Units</i> #	<i>XS Cargo LP</i> <i>Subordinated LP</i> <i>Units</i> #	<i>Total</i> #
Balance – March 31, 2008 and December 31, 2007	3,492,802	2,408,847	5,901,649
	\$	\$	\$
Balance – December 31, 2008	(500,642)	1,391,725	891,083
Non-controlling interest – loss	(1,104,365)	(761,636)	(1,866,001)
Balance – March 31, 2009	(1,605,007)	630,089	(974,918)

The non-controlling interest continues to be allocated its share of losses and is shown in a net debit balance as further financial support is provided as part of the subordinated loan, as disclosed in note 4.

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

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

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

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

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

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

The Subordinated LP Units will be automatically exchanged for Exchangeable LP Units on a one-for-one basis and the subordination provisions will apply until the end of any fiscal year ending on or after December 31, 2006 if, for that fiscal year the Fund has earned EBITDA (earnings before interest, taxes, depreciation and amortization) of at least \$14.432 million and the Fund has paid distributions of at least \$1.125 per Fund Unit for such fiscal year. For the year ended December 31, 2008, the criteria were not met for the automatic exchange to occur.

Fund Special Voting Units

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

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

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

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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 was required to give recognition in the quarter ended June 30, 2007 to future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011, at the 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, 2009	December 31, 2008
	\$	\$
<i>Future income tax assets</i>		
Goodwill	3,431,300	3,859,300
Intangible assets	168,100	160,900
Debt issue costs	6,100	-
Unamortized lease inducements	41,800	60,700
Future income tax assets before valuation allowance	3,647,300	4,080,900
Valuation allowance	(3,647,300)	(4,080,900)
Net future income tax assets	-	-

The Fund's valuation allowance of \$3,647,300 at March 31, 2009 relates principally to the uncertainty of the utilization of the future tax assets due to the breach of financial covenants as described in notes 1 and 4.

8. Related party transactions

On August 20, 2007, the Fund entered into a subordinated loan agreement for \$12,000,000, funded 50% by an independent third party and 50% by a company owned by the President and CEO of the Fund, as described in note 4. Interest expense totaling \$377,923 was recorded on the portion of the loan outstanding to the related party during the three months ended March 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 \$36,000 were charged to the Fund by Fleming LLP during the three months ended March 31, 2009.

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.

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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.

12. Comparative figures

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