

XS Cargo Income Fund
Interim Consolidated Financial Statements
Unaudited
September 30, 2008

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

	September 30, 2008 (unaudited)	December 31, 2007
	\$	\$
Assets		
Current		
Cash and cash equivalents	-	1,709,959
Rebate and other receivables	114,362	425,755
Inventory	23,308,097	21,144,060
Deposits on inventory	6,469,589	2,235,619
Prepaid expenses and deposits	893,372	399,188
	30,785,420	25,914,581
Deferred charges	133,087	267,076
Prepaid expenses and deposits	410,126	375,216
Property and equipment	5,776,357	7,000,853
Intangible assets	1,521,440	2,076,500
Goodwill	36,226,599	36,226,599
	74,853,029	71,860,825
Liabilities		
Current		
Bank indebtedness (Note 4)	11,728,744	-
Accounts payable and accrued liabilities	5,200,264	13,525,271
Deferred revenue	1,623,149	1,848,965
Term loan (Note 4)	11,097,799	11,250,000
Subordinated loan (Note 4)	13,082,856	12,162,695
	42,732,812	38,786,931
Deferred revenue	504,420	538,676
Unamortized lease inducements	745,220	848,527
	43,982,452	40,174,134
Non-controlling interest (Note 6)	18,494,413	18,901,771
	62,476,865	59,075,905
Unitholders' Equity		
Fund units (Note 5)	56,116,612	56,116,612
Contributed surplus	18,860	6,360
Deficit	(43,759,308)	(43,338,052)
	12,376,164	12,784,920
	74,853,029	71,860,825

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

	<i>Three Months Ended September 30, 2008 (unaudited)</i>	<i>Three Months Ended September 30, 2007 (unaudited) restated – see note 3</i>	<i>Nine Months Ended September 30, 2008 (unaudited)</i>	<i>Nine Months Ended September 30, 2007 (unaudited) restated – see note 3</i>
	\$	\$	\$	\$
Sales	24,525,830	29,250,232	71,372,496	82,427,072
Cost of goods sold	15,090,314	18,075,852	42,652,492	53,897,388
Gross Margin	9,435,516	11,174,380	28,720,004	28,529,684
Expenses				
Administrative and operating	8,148,572	9,321,239	24,885,304	26,115,854
Amortization of property and equipment	494,442	327,936	1,474,965	936,216
Amortization of intangible assets	78,770	328,100	555,060	954,200
	8,721,784	9,977,275	26,915,329	28,006,270
	713,732	1,197,105	1,804,675	523,414
Other expenses				
Interest on operating loan	144,949	54,027	352,189	229,442
Interest on term and subordinated loans	771,207	698,823	2,398,312	1,400,920
Foreign exchange (gain) loss	(162,340)	115,216	(117,212)	246,176
	753,816	868,066	2,633,289	1,876,538
(Loss) earnings before non-controlling interest and future income taxes	(40,084)	329,039	(828,614)	(1,353,124)
Future income taxes (Note 10)	-	(248,661)	-	396,719
(Loss) earnings before non-controlling interest	(40,084)	577,700	(828,614)	(1,749,843)
Non-controlling interest (Note 6)	(19,706)	161,720	(407,358)	(664,168)
Net (loss) earnings and comprehensive income (loss) for the period	(20,378)	415,980	(421,256)	(1,085,675)
Basic and diluted (loss) earnings per unit	(0.00)	0.07	(0.07)	(0.18)

XS Cargo Income Fund
Consolidated Statements of Deficit

	<i>Three Months Ended September 30, 2008 (unaudited) \$</i>	<i>Three Months Ended September 30, 2007 (unaudited) \$</i>	<i>Nine Months Ended September 30, 2008 (unaudited) \$</i>	<i>Nine Months Ended September 30, 2007 (unaudited) \$</i>
Deficit, beginning of the period	(43,738,930)	(6,038,982)	(43,338,052)	(1,560,652)
Net (loss) earnings for the period	(20,378)	415,980	(421,256)	(1,085,675)
Distributions declared in the period	-	(858,657)	-	(3,835,332)
Deficit, end of the period	(43,759,308)	(6,481,659)	(43,759,308)	(6,481,659)

XS Cargo Income Fund
Consolidated Statements of Cash Flows

	<i>Three Months Ended September 30, 2008 (unaudited) \$</i>	<i>Three Months Ended September 30, 2007 (unaudited) \$</i>	<i>Nine Months Ended September 30, 2008 (unaudited) \$</i>	<i>Nine Months Ended September 30, 2007 (unaudited) \$</i>
		<i>restated – see note 3</i>		<i>restated – see note 3</i>
Cash provided by (used for) the following activities				
Operating Activities				
Net (loss) earnings for the period	(20,378)	415,980	(421,256)	(1,085,675)
Items not affecting cash:				
Non-controlling interest	(19,706)	161,720	(407,358)	(664,168)
Future income taxes	-	(248,661)	-	396,719
Amortization of property and equipment	494,442	327,936	1,474,965	936,216
Amortization of intangible assets	78,770	328,100	555,060	954,200
Amortization of transaction costs on subordinated loan	39,492	-	205,200	-
Capitalized interest on subordinated loan	260,225	-	759,961	-
Unit based compensation (<i>Note 8</i>)	9,375	29,693	12,500	103,053
Deferred charges, net of costs recognized	43,009	(14,134)	133,989	(18,492)
Deferred revenue, net of revenue recognized	(122,664)	11,604	(260,072)	7,005
Lease inducements received, net of amortization of lease inducements	(35,297)	276,558	(103,307)	362,491
	727,268	1,288,796	1,949,682	991,349
Net change in non-cash working capital	(5,575,551)	(3,221,818)	(15,137,916)	(7,107,304)
	(4,848,283)	(1,933,022)	(13,188,234)	(6,115,955)
Financing Activities				
Proceeds from bank indebtedness	4,885,940	2,787,187	11,728,744	9,964,175
Proceeds from subordinated loan	-	11,827,090	-	11,827,090
Proceeds from term loan	-	-	-	3,750,000
Repayment of term loan	-	(10,000,000)	-	(10,000,000)
Distributions paid on Fund units	-	(858,657)	-	(4,178,794)
Distributions paid to non-controlling interest	-	(491,175)	-	(3,130,691)
	4,885,940	3,264,445	11,728,744	8,231,780
Investing Activities				
Purchases of property and equipment	(37,657)	(1,308,526)	(277,948)	(3,110,752)
Proceeds from sale of property and equipment	-	-	27,479	-
Investment in LTIP trust (<i>Note 8</i>)	-	(22,897)	-	(22,897)
	(37,657)	(1,331,423)	(250,469)	(3,133,649)
Decrease in cash and cash equivalents	-	-	(1,709,959)	(1,017,824)
Cash and cash equivalents, beginning of period	-	-	1,709,959	1,017,824
Cash and cash equivalents, end of period	-	-	-	-
Supplementary cash flow information				
Interest paid	655,931	842,160	1,990,540	1,719,672

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 40 (December 31, 2007 – 40) closeout retail stores in Alberta, British Columbia, Manitoba, Saskatchewan, Ontario, Newfoundland, Nova Scotia and New Brunswick.

These consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of operations. From December 31, 2007, until the date of the agreements described in the following paragraph, the Fund has been in breach of certain financial covenants in its credit facilities. The Fund incurred a net loss of \$421,256 for the nine month period ended September 30, 2008. As at September 30, 2008, the Fund had an accumulated deficit of \$43,759,308.

At September 30, 2008 the Fund reached an agreement with its term and operating loan lender as described in note 4, resulting in compliance with the amended financial covenants as at the end of the third quarter. Subsequent to September 30, 2008, the Fund reached an agreement with its subordinated lender (see note 16) and the lender has provided a waiver covering the breach of all financial covenants. As a result of the short-term extension of the revised credit agreements, and relative importance of the fourth quarter to the Fund's annual results, there remains significant doubt that the Fund will be able to continue as a going concern.

The Fund has implemented certain supply chain improvements and other operational measures that management feels will return the Fund to profitability for fiscal 2008. The Fund also intends to work closely with its lenders through the fourth quarter in order to achieve a long term financing solution which is acceptable to all parties. There can be no assurance that these initiatives will be successful.

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

2. Basis of presentation

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

3. Change in accounting policies

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

Section 1535: Capital Disclosures

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

Section 3031: Inventories

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

Section 1400: General Standards of Financial Statement Presentation

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

(b) Future income taxes – Emerging Issues Committee Abstract EIC-171

On August 28, 2008, the CICA Emerging Issues Committee (the “Committee”) issued guidance on the future income tax consequences of exchangeable interests in an income trust or specified investment flow-through as Abstract EIC-171. The Committee reached a consensus that future income taxes related to the temporary differences associated with the assets and liabilities attributable to the exchangeable interests should not be recorded prior to the conversion of the exchangeable interests. Retrospective application is required to any interim and annual financial statements issued after August 28, 2008, with restatement of prior periods.

The Fund evaluated the impact of this guidance on its financial statements, and concluded that for the periods ending June 30, 2007, September 30, 2007 and December 31, 2007, the Fund had recorded those temporary differences associated with the Fund’s exchangeable interests or non-controlling interest. As such, the Fund has recorded a reduction in future income tax expense for the nine months ended September 30, 2007 of \$383,441, and a reduction in the future income tax recovery for the three months ended September 30, 2007 of \$240,339. As this also results in an offsetting change in non-controlling interest, there was no effect on net income or earnings per unit for the periods. For the quarters ended March 31, 2008 and June 30, 2008, there has been no change due to the valuation allowance for the future income tax assets as described in note 10. No periods other than those indicated above are affected.

(c) Future accounting changes

Section 3064: Goodwill and intangible assets

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

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4. Credit facilities

Term loan

During the third quarter, 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 will be permanently reduced by \$4,500,000 on December 31, 2008 and further permanently reduced on March 31, 2009 by an amount equal to 75% of 2008 excess cash flow as defined in the agreement.

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%.

During the three and nine months ended September 30, 2008 interest was charged at a rate of prime plus 1.25% and totaled \$229,778 and \$730,401 respectively (September 30, 2007 - \$434,210 and \$1,136,307). As at September 30, 2008, the prime rate was 4.75% (December 31, 2007 - 6.0%).

The following table details the balance of the term loan:

	<i>September 30, 2008</i>	<i>December 31, 2007</i>
	\$	\$
Initial principal amount	11,250,000	11,250,000
Unamortized transaction costs	(152,201)	-
	11,097,799	11,250,000

Transaction costs of \$152,201 including legal fees and bank contract charges have been capitalized as part of the outstanding loan balance. These costs will be amortized over the remaining life of the term loan.

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 due on August 20, 2008, however the subordinated loan was renegotiated subsequent to September 30, 2008, as described in note 16.

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 and nine months ended September 30, 2008, interest expense totaling \$541,429 and \$1,667,911 was recorded respectively (September 30, 2007 - \$265,857 and \$265,857), including \$260,225 and \$759,961 which was capitalized as part of the outstanding principal balance (September 30, 2007 - \$116,490 and \$116,490).

The following table details the balance of the subordinated loan:

	<i>September 30, 2008</i>	<i>December 31, 2007</i>
	\$	\$
Initial principal amount	12,000,000	12,000,000
Unamortized transaction costs	(42,130)	(202,330)
Interest capitalized	1,124,986	365,025
	13,082,856	12,162,695

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Operating loan

The Fund has available under its credit facilities a \$20,000,000 (\$12,500,000 available from January to July annually) demand revolving loan. Under the terms of the credit facility agreement, the operating loan is collateralized along with the term loan as described above. Interest on the operating loan will 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 and nine months ended September 30, 2008, the Fund paid interest of \$144,949 and \$352,189 respectively (September 30, 2007 - \$54,027 and \$229,442) on amounts drawn on the operating loan at a rate of prime plus 1.0%. As at September 30, 2008 prime rate was 4.75%, and \$11,728,744 (December 31, 2007 - \$nil) was outstanding on the operating loan.

Financial covenants

Both the term loan and operating loan require the Fund to maintain certain financial covenants, including a maximum senior debt to 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 lender.

The subordinated loan agreement requires the Fund to maintain certain financial covenants, and these covenants were renegotiated subsequent to September 30, 2008, as described in note 16.

The Fund manages liquidity risk by monitoring actual and projected cash flows, taking into account the seasonality of the Fund's sales and purchases. Management's current intention is to fund the required term loan reductions out of operating cash flow. Management continues to evaluate its options with the respect to the term and subordinated loans in the context of a longer term capital strategy.

5. Unitholders' Equity

Fund Units

The following units are issued and outstanding:

	Number of Units #	Issue Costs \$	Net Capital Contributions \$
Fund Units Issued	6,106,000	4,928,124	56,131,876
Fund Units held by LTIP trust	(3,000)	-	(15,264)
Balance, September 30, 2008 and December 31, 2007	6,103,000	-	56,116,612

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

Fund Units acquired by LTIP Trust represents the value of unvested units held in the LTIP Trust (note 8).

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6. Non-controlling interest

	<i>XS Cargo LP Exchangeable LP Units #</i>	<i>XS Cargo LP Subordinated LP Units #</i>	<i>Total #</i>
Balance – September 30, 2008 and December 31, 2007	3,492,802	2,408,847	5,901,649
	\$	\$	\$
Balance – December 31, 2007	10,158,712	8,743,059	18,901,771
Non-controlling interest – loss	(241,088)	(166,269)	(407,358)
Balance – September 30, 2008	9,917,624	8,576,790	18,494,413

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, 2007, the criteria were not met for the automatic exchange to occur.

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Fund Special Voting Units

	Number #	Amount \$
Issued and outstanding – September 30, 2008 and December 31, 2007	5,901,649	-

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

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

Distributions to non-controlling interest

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

7. Variable interest entity

The Fund has a vendor supply and volume rebate agreement with Samra Imports Ltd., (“Samra”). Samra imports products from China which it sells to the Fund and other customers. Samra has historically been the Fund’s largest supplier accounting for approximately 8.9% of the Fund’s purchases since the commencement of the agreement and the Fund believes it is Samra’s largest customer. The purpose of the agreement is to outline the supply terms and to provide the Fund with a rebate based on its significant volume of purchases from Samra. The Fund has determined that Samra is a variable interest entity and that the supply and rebate agreement represents a variable interest in Samra. The Fund has determined, however, that it is not the primary beneficiary under the supply and rebate agreement since the Fund is not entitled to receive a majority of Samra’s expected residual returns or absorb a majority of its expected losses. As Samra is a separate legal entity, XS Cargo does not have direct access to Samra’s assets and Samra’s creditors do not have recourse against XS Cargo.

During the three and nine months ended September 30, 2008, the Fund purchased approximately \$350,600 and \$2,305,600 respectively (September 30, 2007 - \$1,800,000 and \$3,600,000) of inventory from Samra. Included in deposits on inventory is a balance of \$715,925 (December 31, 2007 - \$282,369) outstanding from Samra related to those purchases. In addition, included in accounts payable and accrued liabilities is a balance of \$nil (December 31, 2007 - \$1,477,750) owing to Samra. Samra did not issue the Fund a volume rebate for purchases made during the quarter.

8. Unit-based compensation

Under the terms of the employment agreement of the Fund’s Chief Financial Officer, the Fund must purchase 50,000 units to be issued to the Chief Financial Officer on June 16, 2009. Issuance of the units is conditional upon one year of service. During the three and nine months ended September 30, 2008, the Fund has accrued \$9,375 and \$12,500 respectively based on the estimated fair value of the units at the grant date.

Historically the fund adopted a long-term incentive plan (“LTIP”) to reward key senior management, officers, and directors of the Fund for significant performance and associated per unit cash flow. For the year ended December 31, 2006, the distributable cash per unit of the Fund exceeded the threshold amount. As a result, the Fund transferred \$22,897 to the LTIP trust in the third quarter of 2007. On May 9, 2007, the LTIP award was granted and will vest over three years. Compensation expense of \$13,993 was recorded in the period ended September 30, 2007. No other awards have been made under the LTIP. No further awards will be made under the LTIP.

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9. Capital risk management

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

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

The Fund uses the ratio requirements in the financial covenants as described in note 4 to monitor its capital. As at September 30, 2008 there is uncertainty surrounding the Fund's capital structure and management plan, as outlined in note 1.

10. Future income taxes

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

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

The components of future income taxes are as follows:

	September 30, 2008	December 31, 2007
	\$	\$
		<i>restated – see note 3</i>
<i>Future income tax assets</i>		
Property and equipment	52,500	243,450
Intangible assets	170,000	112,400
Debt issue costs	6,800	-
Unamortized lease inducements	59,700	48,150
Future income tax assets before valuation allowance	289,000	404,000
Valuation allowance	(289,000)	(404,000)
Net future income tax assets	-	-

The Fund's valuation allowance of \$289,000 at September 30, 2008 relates principally to the uncertainty of the utilization of the future tax assets due to the circumstances as described in note 1.

The Fund has restated the figures as at December 31, 2007 in accordance with EIC-171. See note 3 for additional details.

11. 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 \$260,255 and \$823,497 was recorded on the portion of the loan outstanding to the related party during the three and nine months ended September 30, 2008. The loan and related interest have been recorded at the exchange amount, which represents fair value.

Mr. William Gray, a director of XS Cargo GP Inc, is a partner of Fleming LLP, a law firm which provides legal services to the Fund. Legal fees totaling approximately \$26,000 and \$120,000 were charged to the Fund by Fleming LLP during the three and nine months ended September 30, 2008.

12. Basic and diluted earnings 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.

13. 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.

14. 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.

15. Comparative figures

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

16. Subsequent events

On November 5, 2008, the Fund reached an agreement with its subordinated loan lenders. The maturity date of the subordinated loan agreements is extended to June 30, 2009. Interest on the subordinated loan has increased from 16% to 18%, with the Fund's option to capitalize up to 10.0% per annum. Each of the subordinated loan lenders are to be issued 500,000 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 subordinated loan agreement requires 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, and a total funded debt to adjusted EBITDA ratio of less than 5.0:1.0 until December 30, 2008, at which point the ratio reduces to 3.5:1.0. There are additional restrictive covenants that 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 lenders have provided a waiver covering the breach of all financial covenants as at September 30, 2008.