

# A YEAR OF TRANSFORMATION



Liquidation World Inc.  
Annual Report 2010

# The Vision

To be the consumers'  
number one choice  
for extreme value,  
variety and quality  
merchandise.

# CORPORATE PROFILE

Quality, brand name merchandise, much of what you need for daily living - food, consumables, furniture, clothing, housewares, hardware and more - Liquidation World sells it all at prices that are 30 - 70% below normal retail.

Liquidation World works closely with manufacturers, retailers, wholesalers, banks and insurance companies to help them deal with merchandise of almost every description that won't, or can't be sold through typical retail channels.

That may include merchandise from inventory overruns or packaging changes. Sometimes it means seasonal goods or goods from bankruptcies, receiverships or insurance claims. Merchandise often comes from healthy, going-concern businesses who view Liquidation World as an indispensable part of their inventory management strategy.

We buy these goods at deep discounts and pass the savings along to our retail customers through 48 fun, friendly and no-frill Liquidation World outlets and 44 "LW-Everybody's Outlet Store" locations.

We never stop looking for a deal and neither should you.

## SUMMARY OF SELECTED FINANCIAL DATA

(in thousands of Canadian dollars, except per share amounts)

	2010	2009	2008(3)	2007(3)	2006	2005	2004	2003	2002	2001
Revenues (1)	153,399	157,809	182,359	188,262	208,205	184,151	184,418	170,535	174,342	183,400
Cost of sales (1)	98,812	109,965	118,809	122,935	129,847	121,871	112,841	102,337	106,592	112,670
Gross Margin	54,587	47,844	63,550	65,327	78,358	62,280	71,577	68,198	67,750	70,730
Expenses	66,918	65,425	73,461	74,925	75,986	68,558	64,828	63,965	60,715	57,176
EBITDA (2)	(7,229)	(13,347)	(4,832)	(4,914)	5,944	(6,278)	6,749	4,233	7,035	13,554
Depreciation & amortization	3,021	3,345	3,997	3,875	3,196	2,078	1,283	1,442	1,460	1,427
Impairment of goodwill	-	233	-	-	-	-	-	-	-	-
Impairment of intangibles	618	-	-	-	-	-	-	-	-	-
Interest	1,463	656	1,082	809	376	125	-	-	7	125
Income taxes (recovery)	-	-	-	(2,957)	852	(2,027)	2,523	1,304	2,397	5,021
Earnings (loss) from discontinued operations	-	-	(1,428)	(5,070)	-	-	650	718	966	-
Net earnings (loss)	(12,331)	(17,581)	(11,339)	(11,711)	1,520	(6,454)	2,293	769	2,205	6,981
Earnings (loss) per share (\$)										
Basic	(0.67)	(1.32)	(1.37)	(1.42)	0.18	(0.77)	0.27	0.09	0.26	0.83
Fully diluted	(0.67)	(1.32)	(1.37)	(1.42)	0.18	(0.77)	0.27	0.09	0.25	0.81
% Increase (decrease) in revenue	(3%)	(13%)	(3%)	(10%)	13%	0%	8%	(2%)	(5%)	14%
Number of outlets at year end	89	92	99	118	106	104	102	98	97	87
Inventory at year end	39,619	33,941	44,178	48,816	55,184	46,552	55,705	48,831	44,677	49,778

(1) Revenues include commissions earned on consignment sales.

(2) EBITDA is calculated before discontinued operations. The Company recognizes that EBITDA is not a standard measure under generally accepted accounting principles, and therefore may not be comparable to similar measures presented by other Canadian public companies.

(3) Fiscal 2008 and fiscal 2007 reflect continuing operations.

# PRESIDENT'S MESSAGE

Liquidation World's ("LW") fiscal 2010 year was a very active year. We continued our rebuilding efforts, initiated in February 2009 when the Company completed a recapitalization. We succeeded in attracting fresh capital from current and new investors during the year, generating significant shareholder benefits including liquidity and an increase in LW's market capitalization. We recruited some very talented and experienced senior management and now have a seasoned, solid team in place to execute our objectives.

The turnaround process has been more challenging than I had thought it would be 18 months ago, when we embarked on our goal of transforming Liquidation World from a liquidator of closeout goods to Canada's premier retailer for value based shoppers. I am disappointed that LW did not achieve profitability in fiscal 2010, but I am more convinced than ever that the foundation required for LW to achieve profitability year in and year out is nearly complete. Our strategy has been validated by investors and management who have committed financially and personally to ensure that it will succeed.

Notable achievements in fiscal 2010 include:

- Closing of 10 underperforming stores;
- Opening of 6 new "LW - Everybody's Outlet Store" branded stores;
- Conversion of 27 legacy "Liquidation World" branded stores to the new "LW - Everybody's Outlet Store" brand;
- Same store sales increased 10.4% for the LW-Everybody's Outlet store conversion locations;
- Successful testing and launch of new marketing programs;
- Consolidation and expansion of the Company's distribution centers;
- Addition of new members to the Company's senior management team;
- Raising \$13.5 million of new capital and the expansion of the Company's credit facility from \$20 million to \$25 million; and
- The addition of more new name brand vendors than ever before.

In fiscal 2011, the Company will continue to (i) convert legacy "Liquidation World" branded stores to the new "LW-Everybody's Outlet Store" branded locations, (ii) open new stores under the "LW - Everybody's Outlet Store" brand, and (iii) refine our marketing programs with flyers, the development of our VIP email campaigns and the use of new social media programs.

In addition, LW will be rolling out new initiatives which should drive more every day traffic into our stores. One of our goals for fiscal 2011 that is already in motion is the creation of our "Always in" program. This initiative allows the Company to have specific stock-keeping units, or SKU's, that will always be available in our stores. To date, the Company has not had a program of buying and restocking specific replenishable SKU's. All successful closeout retailers use replenishable SKU's to drive every day traffic and supplement sales generated from one time "deal" buys. The addition of this "Always In" program requires changes in the Company's distribution systems and purchasing practices. These changes will help make the Company more efficient and will not only drive the expansion of top line sales, but will also drive cost savings and help the Company focus on achieving its goal of profitability. The impact of our "Always in" replenishment initiative should improve and grow our sales per square foot.

A fiscal 2010 achievement that I want to highlight is the Company's ability to attract and retain proven leadership personnel. In September 2010, LW announced the appointment of Charlie Brunjes to Chief Merchandising Officer. Charlie brings with him more than thirty years of retail expertise and has held various executive leadership roles. Charlie's extensive background in merchandising, procurement, and operations at value oriented retailers represents a significant vote of confidence in the opportunity that is ahead of us at LW. Charlie's proven track record will allow us to achieve our merchandising goals.

One additional personnel item which I want to highlight is the November 2010 hiring of Denise Allen as Vice President, Supply Chain Management. Denise brings both depth of experience and a skill set capable of the design and execution of our "Always in" replenishment strategy and corresponding optimization of our distribution model. The flow of "Always in" goods to our stores is key to the fulfillment of our 2011 performance and will allow us to further leverage our investment in infrastructure and inventory.

Attracting talent is only successful if there is a solid strategy and financial certainty. In fiscal 2010, the Company was successful in



raising \$13.5 million in three separate transactions, increasing liquidity for the Company's shares, while attracting a significant new investor base for LW. The success of these financings allowed us to approach our supportive bankers who worked with us to increase our credit facility by an additional \$5 million. Similar to most growth companies in transition, we continue to pursue the investment of additional capital to accelerate our growth.

I would like to thank all of our associates, vendors and investors for their contributions and support during this past year of change. I am personally energized and excited by the strategies and business initiatives which will come to life in 2011.

A handwritten signature in black ink, appearing to read "J. M. ...", positioned above the title.

President & Chief Executive Officer

# MD & A

The following Management Discussion and Analysis ("MD&A") is a review of our financial condition and results of operations, based upon Canadian Generally Accepted Accounting Principles ("GAAP") and covers the 52 weeks ended October 3, 2010.

This MD&A is dated as of January 3, 2011 and should be read in conjunction with the 2010 audited annual Consolidated Financial Statements and accompanying Notes. This MD&A contains forward-looking statements and potential future circumstances and developments. Forward-looking statements regarding future performance are subject to risks and uncertainties, and actual results may differ materially.

This document has been reviewed by the Audit Committee and Board of Directors of the Company and contains information that is current as of January 3, 2011. Events occurring after that date could render the information contained herein inaccurate or misleading in a material respect. Dollar amounts shown are in thousands of Canadian dollars, except per share amounts.

Additional information relating to Liquidation World is available on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## OVERVIEW

(Dollar amounts in thousands of Canadian dollars, except per share amounts)

Liquidation World Inc. ("Liquidation World" or the "Company") is the largest liquidator of opportunity inventory in Canada. Opportunity inventory results from a variety of situations, including insolvencies, insurance claims, overruns, cancelled orders, and close-outs. The Company continues to make its transformation from a lot based liquidator of opportunistically purchased goods to a professionally managed closeout retailer that offers its customers great values on a broad selection of food, consumables, furniture, home goods and seasonal merchandise. Liquidation World distributes such acquired inventory to value-oriented customers through its network of corporately run stores in Canada and in the US and through its Chicago-based US wholesale operations. A typical Liquidation World retail store occupies between 20,000 and 25,000 square feet. At year end, the Company had a total of 88 stores in Canada and 1 store in the US. Subsequent to year end, seven new stores were opened in Canada. The Company also closed two stores during the same period. Four of the Company's seven new stores are replacing stores that the Company closed in the same geographic market during the last six months. In addition to the seven store openings since year-end, the Company converted four "Liquidation World" banner stores to its new "LW- Everybody's Outlet Store" banner. At present, the Company is operating a total of 92 stores in Canada and one store in the US. Of the 92 Canadian stores, 44 are operating under the "LW-Everybody's Outlet Store" banner and 48 are operating under the "Liquidation World" banner.

Among liquidators, Liquidation World is unique insofar as it maintains a national network of retail stores and distribution centres; Liquidation World is particularly appealing to US vendors because it is big enough to transact large purchases and can effectively move merchandise away from key US markets.

The success of Liquidation World's business model is predicated on its ability to service key constituents, namely consumers and vendors. Consumers look to Liquidation World to provide new, quality products at excellent prices. Manufacturers, wholesalers and retailers look to Liquidation World as a channel for effectively managing excess inventory. With its financial resources, scale and positive reputation among vendors, the Company capitalizes on inventory opportunities as they arise.

## OVERALL PERFORMANCE

A summary of results of operations for the 2010 fiscal year, comprising the 52 weeks ended October 3, 2010:

- There were 92 stores at the beginning of fiscal 2010. During the year, 7 new stores were opened (6 in Canada and 1 in the US) and 10 were closed (9 in Canada and 1 in the US) resulting in a total of 89 open stores at the end of 2010. In addition, the Company rebranded 27 existing "Liquidation World" stores into "LW- Everybody's Outlet Store" stores, bringing the total to 33 stores at the end of fiscal 2010.
- Total revenue from all operations decreased \$4,410, or 2.8%, to \$153,399 from \$157,809 in the prior year. The variance was attributable to several factors:
  - Same store sales increased 10.4%, or \$1,232, in the weeks following the conversions, for store locations that were renovated and reopened under the "LW - Everybody's Outlet Store" banner. During the same time period, same store sales decreased 3.5% or \$4,342, for legacy "Liquidation World" banner stores.
  - In total, same store sales declined 2.3%, or \$3,089. Other factors causing a variance in the Company's fiscal 2010 revenue versus the Company's fiscal 2009 revenue include (i) a decline in liquidation services fee revenue of \$468, (ii) a decline of \$846 in US wholesale revenue, (iii) an increase of \$11,868 in sales from seven new store opening, (iv) a decline of \$11,479 from store closures and (v) a decline in other sales of \$396.



- Gross margin increased to \$54,587 (35.6% of sales) from \$47,844 (30.3% of sales) in the prior year.
- Selling, general and administrative expenses of \$61,918 (40.4% of sales) compared to \$60,877 (38.6% of sales) in 2009, included:
  - Advertising costs totaling \$3,650 compared to \$2,730 in 2009 reflecting the Company's renewed emphasis on consumer awareness, focused on the store rebranding and product promotions.
- Restructuring and other costs of \$3,317 (consisting of new store expenses of \$627, conversion and store relocation expenses of \$771, closed store and distribution centre costs of \$1,313, severances of \$485, financing of \$103 and other expenses of \$18) compared to \$2,094 of restructuring costs in the prior year (consisting of new store expenses of \$66, closed store expenses of \$481, severances of \$1,383, financing of \$60, expenses in connection with the Talon acquisition of \$308, other costs of \$242 and a receipt of \$446 for termination of a store lease).
- A net loss of \$12,331 was recorded for the year, including a \$9,739 net loss from Canadian operations and a \$2,592 net loss from US operations. In the prior year, the Company recorded a net loss of \$17,581, including a net loss from Canadian operations of \$14,583 and a net loss of \$2,998 from US operations.
- EBITDA for 2010 was a loss of \$7,229 or 4.7% of sales, as compared to a loss of \$13,348 or 8.5% of sales in 2009.

## RESULTS OF OPERATIONS

### Revenue

Revenue, which includes sales of merchandise and fee revenue, totaled \$153,399 for the 2010 fiscal year versus \$157,809 in fiscal 2009, representing a decrease of \$4,410 or 2.8%. The decrease was attributable to i) a decline in same store sales (defined as sales from stores open a full 14 months or more) of 2.3% or \$3,089, ii) a favourable impact of \$11,868 from the seven new store openings iii) an unfavourable impact of \$11,479 from store closures iv) a decrease in liquidation services fee revenue of \$468, v) a decrease of \$846 attributable to US wholesale sales and vi) a decline in other sales of \$396.

At year end, the Company had a total of 88 stores in Canada and 1 store in the US. Of the Company's 88 Canadian stores, 33 were operating under the new "LW-Everybody's Outlet Store" banner and 55 were operating under the "Liquidation World" banner.

In Canada, revenue for the year decreased by 1.2% to \$151,308 from \$153,132 in fiscal 2009. In the United States, revenue decreased by 55.3% to \$2,091 from \$4,677, comprised of a decline in store revenue from \$2,129 in 2009 to \$793 in 2010 and a decrease in non-store revenue from \$2,548 in 2009 to \$1,298 in 2010.

Inventory at the end of the year increased 16.7% to \$39,619 from \$33,941 in 2009.

### Gross Margin

Gross margin was \$54,587 (35.6% of sales) in fiscal 2010 compared to \$47,844 (30.3% of sales) in fiscal 2009. The increase in gross margin rate in fiscal 2010 was mainly due to improved merchandise procurement practices, focused on selection and pricing, which resulted in higher point of sale margins. During 2009 the Company reduced slow moving and aged inventory (principally lots based inventory items) through aggressive markdown programs. All lots inventory was sold or converted to SKU's in 2009. Inventory shrinkage and valuation improved significantly in 2010 to \$5,110 (3.3% of sales) from \$10,303 (6.5% of sales) in 2009.

Gross margins can fluctuate as a result of the underlying cost of product purchased, distribution and processing costs, shrinkage, product mix sold and markdowns taken. Liquidation World's pricing policies and strategy are to ensure prices for comparable products are lower than any other in the market, including discount stores, warehouse type stores and special promotions. The Company continues to place an emphasis on attaining inventory turnover results that are more in line with industry standards. Gross margins are subject to pressure under this policy and can fluctuate as a result. Where specific price matching is concerned, Liquidation World will continue to mark down product as required.

### Selling, General and Administrative

Selling, general and administrative, which includes all expenses of occupying, operating, and supporting stores and all head office general and administrative costs, increased to \$61,918 (40.4% of sales) in 2010 from \$60,877 (38.6% of sales) in 2009. Included in 2010 were certain expenses totaling \$3,317, which arose primarily from restructuring (including severances and store closures) and other costs (primarily store conversion costs, new store set ups and bank amendment/accommodation fees), compared to \$2,094 incurred in 2009. The 2009 costs also included severances, store closings, new store setups and certain bank fees. In addition, 2009 included certain costs related to Talon Wholesale. There were no store conversion costs in 2009. Additional detail is provided above under Overall Performance.

Included in selling, general and administrative costs are advertising expenses totaling \$3,650 in 2010 (2.4 % of sales), an increase of \$920 (33.7%) over the total incurred in 2009 of \$2,730 (1.7% of sales). The increase is attributable to a renewed emphasis on consumer awareness, focused on the store rebranding and product promotions.

### Depreciation and Amortization

Depreciation and amortization decreased by \$324 (9.7%) in 2010 to \$3,021 from \$3,345 in the prior year. The decrease was attributable to the impact of fully depreciated assets exceeding new capital expenditures. Included in the 2010 depreciation and amortization expense is an impairment charge related to property and equipment of \$139 (nil in 2009).

### Impairment of Goodwill and Intangible Assets

The Company recorded an impairment charge of \$618 in the second quarter of 2010, related to the net book value of the intangible assets, which were part of the 2009 Talon acquisition. As a result, there were no net intangible assets remaining on the Company's consolidated balance sheet as at October 3, 2010.

The Company recorded a goodwill impairment charge of \$233 in the fourth quarter of 2009, related to the 2009 Talon acquisition, which resulted in no goodwill remaining on the Company's consolidated balance sheet as at October 4, 2009.

### Interest

Interest expense increased \$807 to \$1,463 in fiscal 2010 as compared to \$656 in the prior year due to higher borrowing levels and higher effective interest rates resulting from an amendment to the Company's credit facility in August 2009 and the additional interest cost of \$214 related to the subordinated notes issued in March 2010. The increase was partially offset by declining capital lease obligations which reduced interest expense by \$94.

### Foreign Exchange

In fiscal 2010, the Company realized a net foreign exchange gain of \$102 compared to a foreign exchange loss of \$314 in the prior year. Exchange gains or losses are incurred on US dollar transactions and period end balances.

### Income Taxes

The statutory income tax rate in effect in fiscal 2010 was 32.6% (2009 - 32.9%). The Company recorded no income tax provision in fiscal 2010 or 2009. As a result of income tax losses in the current period and prior periods, the Company has accumulated income tax loss carry-forwards totaling approximately \$36,719 in Canada and \$9,234 in the US at the end of fiscal 2010.

### Net Loss

The Company recorded a net loss of \$12,331 (\$0.67 per share) in fiscal 2010 versus a net loss of \$17,581 (\$1.32 per share) in the prior year. The lower net loss in fiscal 2010 was primarily attributable to improved gross margins, partially offset by an increase in selling, general and administrative costs and interest expense.

### Fourth Quarter (Q4) Results

There was a net decrease in the number of open stores in the period from 91 at the beginning of the quarter to 89 at the end of the quarter. Two stores were closed. There were no new stores opened during the quarter.

Revenue for Q4 2010 comprising 13 weeks of operations ended October 3, 2010 decreased \$842 (2.4%) to \$34,722 from \$35,564 in the prior year. The fourth quarter variance was attributable to several factors. During the fourth quarter of fiscal 2010 same store sales increased 6.8%, or \$563 in the weeks following the conversions for store locations that were renovated and reopened under the "LW-Everybody's Outlet Store" banner. During the same time period, same store sales decreased 4.6%, or \$1,078, for legacy "Liquidation World" banner stores. In total, same store sales (defined as sales from stores open a full 14 months or more) declined 1.5% or \$483. Other factors causing a variance in the Company's fourth quarter 2010 revenue versus the comparable period in 2009 include i) a decline of \$369 in US wholesale revenue ii) an increase of \$3,000 from the seven new store openings iii) a decline of \$2,686 from store closures and iv) a decrease in other sales of \$304.

Gross margin was \$9,231 (26.6% of sales) in Q4 2010 compared to \$13,012 (36.6% of sales) in Q4 2009. The reduction in gross margin can be attributed to markdowns taken during the quarter on slow moving inventory, increased distribution costs, shrink and net realizable value.

Distribution centre costs increased to \$1,882 (5.4% of sales) in the quarter over last year \$1,522 (4.3% of sales). The Company booked shrink and valuation adjustments of \$915 (2.6% of sales) versus a positive adjustment of \$299 ((0.8)% of sales) in the quarter last year. The Company increased provisions for declines in expected net realizable value("NRV") of slow moving inventory by \$749 (2.2% of sales) versus \$185 (0.5% of sales) in the same quarter last year.

### Q4 Gross Margin Analysis

	2010		2009		Variance	
	\$	%	\$	%	\$	%
Sales	34,722	100.0%	35,564	100.0%		
Landed Cost	21,945	63.2%	21,144	59.4%	801	3.8%
DC Cost	1,882	5.4%	1,522	4.3%	360	1.1%
Shrink & Valuation	915	2.6%	(299)	(0.80)%	1,214	3.4%
NRV	749	2.2%	185	0.5%	565	1.7%
Total Cost of Sales	25,491	73.4%	22,552	63.4%	2,939	10.00%
Gross Margin	9,231	26.6%	13,012	36.6%	(3,781)	(10.0)%



Selling, general and administrative expenses for Q4 2010 increased \$837, or 5.6%, to \$15,874 (45.7% of sales) from \$15,037 (42.3% of sales) in Q4 2009. Included in selling, general and administrative expenses for Q4 are:

- advertising costs of \$1,194 in Q4 2010 compared to \$1,368 in Q4 2009,
- restructuring and other costs of \$1,050 in Q4 2010 (consisting of new stores expenses of \$46, store conversions and relocation costs of \$399, closed store and distribution centre expenses of \$309, severances of \$49, financing of \$151 and other costs of \$96), compared to \$325 in Q4, 2009 (consisting of new store expenses of \$66, closed store expenses of \$74, severances of \$165 and financing and other costs of \$20).

Depreciation and amortization for Q4 2010 decreased 0.8% to \$844 from \$851 in Q4 2009. Included in the Q4 2010 depreciation and amortization expense is an impairment charge related to property and equipment of \$131 (nil in 2009).

Interest expense for Q4 2010 increased \$258 to \$447 compared to \$189 in Q4 2009 due to higher borrowing levels and higher effective interest rates and the additional interest cost of \$99 related to the subordinated notes issued in 2010.

The Company recorded a net foreign exchange gain of \$71 in Q4, 2010, compared to a foreign exchange loss of \$90 in Q4, 2009.

During Q4 2010, the Company recorded a net loss from operations of \$7,863 (\$0.31 per share) compared to a net loss from operations of \$3,388 (\$0.21 per share) in Q4 2009.

EBITDA for the fourth quarter of 2010 was a loss of \$6,572 or 18.9% of sales, as compared to a loss of \$2,115 or 6.0% of sales in the comparable quarter of 2009.

#### QUARTERLY INFORMATION

The following selected financial information is derived from the consolidated financial statements of the Company and should be read in conjunction with such financial statements and related notes (amounts in thousands of Canadian dollars, except per share amounts):

Quarter ended	October 3 2010	July 4 2010	April 4 2010	January 3 2010
Total Revenue	34,722	36,662	37,885	44,130
Net income (loss) and comprehensive income (loss)	(7,863)	(2,269)	(2,918)	719
Net income (loss) per common share Basic and Fully Diluted	(0.31)	(0.14)	(0.18)	0.05

Quarter ended	October 4 2009	July 5 2009	April 5 2009	January 4 2009
Total Revenue	35,564	37,044	38,142	47,059
Net loss and comprehensive loss	(3,388)	(5,457)	(7,927)	(809)
Net loss per common share Basic and Fully Diluted	(0.21)	(0.34)	(0.60)	(0.10)

#### CASH FLOW, FINANCIAL RESOURCES AND LIQUIDITY

##### Cash Flow

##### *Cash Flow From Operating Activities*

Cash flow consumed in operating activities for the year ended October 3, 2010 before changes in non-cash working capital, was \$8,579 as compared to cash consumed in operating activities of \$13,635 for the same period in 2009.

Changes in non-cash working capital in the year was a use of cash of \$7,460 compared to a source of cash of \$15,655 in fiscal 2009. The changes in non-cash working capital were comprised of the following:

	2010	2009
Accounts receivable	\$ 42	\$ 46
Inventory	(5,678)	11,797
Prepaid expenses	(64)	118
Accounts payable and accrued liabilities	(1,760)	2,688
Total	(7,460)	14,649
Allocation:		
Operations: non-cash working capital items	(7,460)	15,655
Investing	-	(1,006)
Total	\$ (7,460)	\$ 14,649

The increase in inventory for the year was \$5,678. The level of inventory at the end of the year was appropriate to support the existing number of stores. The increase reflected the focus of the Company on rebuilding inventory to planned operating levels in order to increase product quantities and assortment and increase average transaction amounts. The inventory build was effectively financed through increased bank borrowings.

#### ***Cash Flow Used In Investing Activities***

On a year to date basis, capital expenditures were \$3,515 in 2010 as compared to \$1,546 in 2009. During the fourth quarter of 2010 the Company incurred capital expenditures of \$1,130 as compared to \$802 in the fourth quarter of 2009. Expenditures in 2010 were focused mainly on new and converted store investments as compared to expenditures for information technology projects and investment in existing store refurbishments in 2009.

#### ***Cash Flow From Financing Activities***

In 2010, there was cash provided through an increase in bank indebtedness of \$7,039 and lease inducement receipts of \$979, reduced by repayment of capital leases of \$728.

In addition, on March 19, 2010, the Company received gross proceeds of \$2,000 (net \$1,953 after transaction costs) from the completion of a private placement financing arrangement involving the issuance of units consisting of subordinated notes (repayable no later than March 19, 2013) and 1,583,228 non-transferable Series 2010-I warrants.

On June 4, 2010, the Company completed a non-brokered private placement, resulting in the issuance of units consisting of 2,205,883 common shares of the Company priced at \$0.68 per common share (for aggregate proceeds of \$1,500 - net \$1,481 after transaction costs) and 1,102,941 non-transferrable Series 2010-II warrants.

On August 6, 2010, the Company completed a brokered private placement, resulting in the issuance of 11,765,000 common shares of the Company priced at \$0.85 per common share (for aggregate proceeds of \$10,000 - net \$8,954 after transaction costs) and 882,375 broker warrants.

Additional details on the three new 2010 sources of financing referred to above are presented below under "Liquidity and Capital Resources".

### **LIQUIDITY AND CAPITAL RESOURCES**

Bank borrowings and cash flow from operations have been the primary funding sources of working capital and capital expenditures over the past several years. Cash flow consumed by operations prior to working capital totaled \$8,579 in 2010 compared to cash consumed in operating activities of \$13,635 in 2009. Working capital consumed cash flow of \$7,460 in 2010 versus a source of cash flow of \$15,655 in 2009. As a result, cash consumed in operating activities totaled \$16,039 in 2010 compared to cash generated of \$2,020 in 2009.

Working capital increased \$50, or 0.5%, to \$10,404 at the end of 2010 compared to \$10,354 at the end of fiscal 2009. The increase in inventory (net of the reduction in accounts receivable) was offset by the increase in bank indebtedness (net of a reduction in accounts payable and the reduction in the current portion of obligations under capital leases).

On October 17, 2008, the Company entered into an asset-based lending facility with a Canadian Chartered Bank for a maximum of \$20,000 to replace the former demand facility with the same bank. The agreement was subject to certain amendments in fiscal 2009. On June 17, 2010 the Company and its senior lender agreed to amend certain of its ongoing financial covenants in the Company's asset based lending facility to reflect the most current business plan prepared by the Company which includes the effect of the two private placements on March 19 and June 4, aggregating \$3,500. The capital infusion facilitated the Company's ability to pursue more opportunistic inventory purchases, to generally allow for the expansion of the breadth of inventory in the Company's stores and to convert the Liquidation World stores to the new "LW-Everybody's Outlet Store" format. The Company concluded a fourth amending agreement to the operating line credit facility on August 13, 2010 which provided several modifications to financial covenant, reflecting the Company's equity financing on August 6, 2010 which raised gross proceeds of approximately \$10,000. Effective September 9, 2010 the maximum credit facility was increased by \$5,000 to \$25,000. The changes to the credit facility were part of the Company's initiative, supported by the Company's operating lender, to rebrand its stores, including opening new stores and expanding and converting legacy Liquidation World stores to the Company's new banner. This agreement which expires on October 17, 2011, if not renewed, is collateralized with the assets of the Company. The Company also has a \$5,000 capital lease provision under this facility. The bank, at its discretion, may effectively decrease the borrowing base and thereby funding availability. As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. Further details are outlined below under the caption on Liquidity.

At the end of 2010, \$17,270 had been drawn on this facility, with a corresponding borrowing base of \$18,033. The Company had net cash on hand of \$1,473 resulting in net bank indebtedness of \$15,797 compared with \$11,858 drawn (borrowing base of \$13,179), \$3,100 of net cash on hand and net bank indebtedness of \$8,758 at the end of 2009.

On March 19, 2010, the Company completed a private placement financing, with Talon Mezzanine Partners LLC and Oakwest Corporation Limited. The \$2,000 aggregate financing involved the purchase by each of the two subscribers of one unit issued by the Company, with each unit consisting of (i) \$1,000 principal amount of newly issued secured non-convertible subordinated notes (the "Notes") of the Company with a three year term due on March 19, 2013; and (ii) non-transferable common share purchase warrants (the Series 2010-I "Warrants")



exercisable into 791,614 common shares of the Company, with a five year term and an exercise price of \$0.66 per share. The Notes are not negotiable instruments, ranking equally and ratably with each other and are subordinate to all of the Company's obligations from time to time to its operating lender. The Notes bear interest at a rate of 12% per annum, calculated and payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, and in the event of default at a rate of 18% per annum. The Notes are collateralized with a subordinated interest in the assets of the Company and also contain certain provisions with respect to default interest, prepayment rights, and a subsidiary guarantee of the obligations under the Notes. Total interest expense related to the Notes for fiscal 2010 is \$214 (including accretion of \$83). There was no corresponding amount in 2009.

On March 31, 2010, the Company's senior lender delivered a notification of breach of the loan agreement dated October 17, 2008 as a result of the private placement financing which closed on March 19, 2010. As a result of that breach, the Company delayed the interest payment due on March 31, 2010 to the subordinated notes holders which resulted in a breach of the subordinated notes. On April 9, 2010 the Company, its senior lender and subordinated notes holders signed a priorities agreement which cured the breach without adjustment or financial consideration.

On June 4, 2010, the Company completed a non-brokered private placement, resulting in the issuance of units consisting 2,205,883 common shares of the Company priced at \$0.68 per common share (for aggregate proceeds of \$1,500) and 1,102,941 non-transferrable warrants (Series 2010-II). Each warrant entitles the holder to acquire a common share of the Company before the close of business on June 4, 2013 for an exercise price of \$0.85 per share. Both the common shares and warrants issued pursuant to this placement were subject to a four month holding period from the June 4 closing date. Accordingly, the common shares can be traded and the warrants exercised at any time after October 4, 2010. The warrants are exercisable prior to the expiry date (June 4, 2013) if there is a change in control of the Company. If at any time during the term of the warrants, the common shares of the Company trade at a price of \$1.70 per share or greater for a period of 20 consecutive trading days, the Company has the option to accelerate the expiry date of the warrants.

On August 6, 2010, the Company completed a brokered private placement, resulting in the issuance of 11,765,000 common shares of the Company priced at \$0.85 per common share (for aggregate proceeds of \$10,000) and 882,375 broker warrants (representing 7.5% of the aggregate number of common shares sold pursuant to the offering). The transfer of broker warrants is restricted. Each broker warrant is exercisable for one common share at a price of \$0.95 for a period of twenty four months following the August 6 closing date. Both the common shares and broker warrants issued pursuant to this placement were subject to a four month holding period from the August 6 closing date. Accordingly, the common shares can be traded and the warrants exercised at any time after December 6, 2010.

Each of the three warrant series contain standard anti-dilution provisions including adjustment to the exercise price and the number of common shares issuable upon the exercise of the warrants where there is a common share reorganization, rights offering, distribution, reclassification or other capital reorganization. Any adjustment is intended to place the holder in the same position as if the holder had been a registered holder of common shares on the effective date of the event.

In addition, each series contains a provision in which the Company will not enter into any transaction whereby all or substantially all of the property and assets would become the property of a successor corporation, unless the warrants remain a valid and binding obligation of the successor.

### **Exercise**

Only the Series I warrants were exercisable at October 3, 2010. No warrants were exercised in 2010. There were no warrants issued or outstanding in 2009.

### **Liquidity**

At the end of 2010, the Company had total liquidity of \$2,075, net of two outstanding letters of credit and inclusive of cash on hand, compared to \$4,421 at the end of 2009. At the end of 2010, there is additional availability under the \$25,000 facility of \$7,730 that could be utilized in the partial funding of any further increases in inventory levels.

Dependent upon the financial performance of the Company, there is the potential for additional liquidity of \$2,821 in the future through the exercise of outstanding warrants and \$1,178 related to outstanding stock options.

As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. The Company continued to breach these covenants in Q1, 2011 and anticipates further violations in 2011 unless or until negotiations with the bank result in changes to the covenants or the Company's operating results improve sufficiently or additional financing is secured. The Company has obtained a letter from the bank agreeing to temporarily waive, for up to a period of 60 days from December 30, 2010 (the date of the letter), the violations at year-end and through Q1 2011. The bank has continued to provide funding under the terms of this facility. Discussions between the Company and the bank are ongoing; however, there can be no assurance, at this time, that a satisfactory resolution will be reached.

## Contractual Obligations

Payments due by period (\$'000's)	Less than 1 year	1 to 3 years	4 to 5 years	After 5 years	Total
<b>Financial Commitments</b>					
Capital leases	\$ 127	\$ -	\$ -	\$ -	\$ 127
Subordinated notes	-	2,000	-	-	2,000
<b>Contractual Obligations</b>					
Store, vehicle and equipment leases	\$ 13,786	\$ 25,855	\$ 20,527	\$ 28,327	\$ 88,495
Total	\$ 13,913	\$ 27,855	\$ 20,527	\$ 28,327	\$ 90,622

## SENIOR MANAGEMENT CHANGES

The Company's Senior Executive Vice President and Chief Financial Officer resigned, effective March 12, 2010. The Company's Vice-President of Finance, who has been with the Company since May 2008, was appointed to the role of Chief Financial Officer effective March 5, 2010.

On April 30, 2010, the Company announced the transition of the Chief Operating Officer to the role of Operations Advisor to Liquidation World (effective May 3, 2010). The current Vice President of Store Operations, assumed additional responsibility within the organization.

The Company announced the appointment of Charlie Brunjes to the position of Chief Merchandising Officer, effective September 27, 2010. Mr. Brunjes joins the Company from a private off price retail company in the U.S. Mr. Brunjes has senior executive retail leadership experience in both private and public companies. He has held roles including Vice President and Executive Vice President. Mr. Brunjes has extensive experience in closeout and off-price retail procurement, strategic planning, retail operations and new store openings.

## RISKS AND UNCERTAINTIES

The Company is principally engaged in the sale of merchandise through 92 leased retail stores located across Canada and one store in the US. The Company's business is subject to a number of factors which directly impact retail sales over which it has no control, namely fluctuations in general economic conditions, weather patterns, swings in consumer confidence and buying habits, and changes in goods available for purchase.

Geographically, the Company's stores are located in cities and towns of various sizes. The Company has good relationships with its landlords and suppliers and has no reason to believe that it is exposed to any material risk that would prevent the Company from acquiring, distributing and/or selling its merchandise on an ongoing basis.

### Recent Changes in Economic Conditions, Consumer Confidence and Consumer Spending

The Company's performance is subject to general economic conditions and their impact on levels of consumer confidence and consumer spending. Consumer confidence and consumer spending have deteriorated and could remain depressed for an extended period. Some of the factors influencing this deterioration include credit availability, fluctuating commodity prices, higher levels of unemployment, higher consumer debt levels, reductions in net worth based on market declines and general uncertainty regarding the overall future economic environment. Consumer purchases of discretionary items, including some of the Company's merchandise, can decline during periods when disposable income is adversely affected or there is economic uncertainty. This has recently adversely impacted, and could in the future adversely impact, the Company's business, cash flow and results of operations. The Company monitors economic developments in the markets in which it operates and uses this information in its continuous strategic and operational reviews in an effort to adjust its business in response to changing economic conditions.

### Customer Shopping Patterns and Preferences

Changes in customer shopping patterns could affect sales. Most of the Company's stores are located in enclosed shopping malls and power centres. The ability to sustain or increase the level of sales depends in part on the continued popularity of malls and/or power centres as shopping destinations and the ability of malls and/or power centres tenants and other attractions to generate a high volume of customer traffic. Many factors that are beyond the control of the Company may decrease shopping mall and/or power centre traffic, including economic downturns, a general softening of consumer demand, increased customer price sensitivity, rising unemployment rates, closing of anchor department stores, weather conditions, construction and accessibility, and alternative shopping formats such as e-commerce, discount stores and lifestyle centres, among other factors. Any changes in consumer shopping patterns could adversely affect the Company's financial condition and operating results.

### Source of Supply of Inventory

The majority of inventory is acquired from opportunistic situations, so those conditions must exist to provide an occasion to acquire inventory. While surpluses of inventory exist in the global economy, the Company must successfully identify each opportunity and negotiate a price that enables the inventory to be sold for a profit. Certain brands, categories and sources of inventory are more desirable and create more customer traffic in the stores.



### **Valuation of Inventory**

The Company routinely buys merchandise resulting from closeouts, bankruptcies and insurance claims, at times without the benefit of complete product details. Company representatives typically view the merchandise and, based on their expertise, draw subjective conclusions about its liquidated value and potential realizable value at retail.

Over time, the Company's realized revenue and margin, in conjunction with periodic physical inventory counts, serve to validate its assumptions about inventory value. On a historic basis, these measures have proven the Company's inventory valuations to be reasonably accurate; however, it still remains a possibility that in the future realizable inventory value may differ from its recorded value.

### **Weather**

Extreme changes in weather can affect the planned receipt of inventory, distribution of merchandise and/or the timing of consumer spending and may have an adverse effect upon the Company's business and results of operations. In particular, harsh or unusual weather conditions, especially during the Company's peak selling season, may have an adverse effect on the Company's sales.

### **Seasonality**

The Company's business is seasonal, as are most retail businesses. Historically, 29% of the Company's total annual sales have been generated during its first fiscal quarter, which includes the holiday selling season. The Company's results of operations depend significantly upon the sales generated during this period. Any material decrease in sales for such period could have a material adverse effect upon the Company's business and profitability. The Company's quarterly results of operations may also fluctuate as a result of a variety of other factors, including the timing of new store openings and net sales contributed by new stores, the impact of new stores on existing stores within the same trade area, the impact of selected store closures, the timing of redemption of gift cards, the merchandise mix, the timing and level of markdowns and promotions initiated by the Company, the timing and level of markdowns and promotions initiated by competitors and consumer shopping patterns and preferences. Any significant decline in sales during a particular period or a decrease in sales over a prolonged period of time could have a material adverse impact on the Company's business, cash flow and results of operations.

### **Competition**

The retail industry is highly competitive with price, quality, service, selection, fashion, location and store environment being the principal competitive factors. The Company competes with numerous national and international mass merchandisers, discounters, and department stores, some of which are significantly larger and have substantially greater resources than the Company. The Company faces a variety of competitive challenges including: (a) anticipating and quickly responding to changing consumer demands; (b) competitively pricing products and achieving customer perception of value; and (c) maintaining high levels of consumer traffic. Increased competition may reduce sales, increase operating expenses decrease profit margins which negatively affect the Company's ability to maintain or obtain site locations, and to attract and retain sales associates and other employees.

This risk is mitigated somewhat by the scale, scope and reputation of the Company. The liquidation industry is characterized by numerous small regional players. Liquidation World's country-wide base of retail stores gives it the scale to purchase very large deals and the channel to effectively liquidate them. Its core Canadian operations enable the Company to move goods away from US suppliers' local markets. Liquidation World's 24-year history of respecting its suppliers' brands along with its status as a public company provide a level of comfort and transparency that makes the Company an attractive business partner over lesser known startups and regional players. The unique opportunistic circumstances under which Liquidation World acquires its products enable the Company to purchase inventory at lower cost than other retailers. This cost advantage allows the Company to discount its prices further than most competitors when necessary.

### **Real Estate Leases**

All of Liquidation World's properties, including its head office, distribution centers and store locations are leased. Competition for prime locations within shopping malls, power centres and for street-front locations is intense and there can be no assurance that Liquidation World will be able to obtain new locations, relocate existing stores, or renew its leases in respect of existing locations at existing or favourable terms. Any increase in retail rental rates or occupancy costs may result in an adverse effect upon the Company's results of operations. In addition, any factors which materially affect the Company's ability to renovate existing locations or the Company's ability to close or relocate undesirable locations, if any, could adversely impact the Company's operations.

### **Foreign Currency Risk**

A significant portion of the Company's products purchases are denominated in US dollars. Accordingly, the Company's foreign currency exposure is mainly related to fluctuations between the Canadian and US dollar. A sudden increase in the US dollar could result in higher costs to the Company which could in turn result in increased prices and reduced sales, decreased profit margins and negatively impact the Company's business and results of operations.

The Company has assets in its US subsidiaries that, when converted to Canadian dollars on consolidation, are impacted by changes in the exchange rate, creating gains or losses. The Company has historically not adopted a hedging strategy to mitigate foreign exchange risks.

### **Senior Management**

Liquidation World's success depends largely on the efforts and abilities of the current senior management team. In particular Mr. Seth Marks, President and Chief Executive Officer, who has been with the Company since February 2009, has extensive experience and relationships. The senior management team and Mr. Mark's experience and contacts in the industry significantly benefit the Company. If the Company were to lose the benefit of senior managers' experience and contacts, the Company could be adversely affected.

## **Management Information Systems**

In order to support the current and future requirements of the business, the Company is reliant on information technology systems and vendors to support, maintain and periodically upgrade merchandise, distribution, design, accounting and financial reporting packages which are essential in providing management with the appropriate information for decision making. The inability of these vendors to continue to support, maintain and/or upgrade these software programs could disrupt operations if the Company were unable to maintain adequate systems and reporting or convert to alternate systems in an efficient and timely manner.

## **Financing Risk**

There is no guarantee that the Company's anticipated cash flow will prove to be adequate or that its existing credit facilities will continue to be available or sufficient in the event of any unanticipated contingencies. Additionally, the Company will likely need additional financing, likely in the form of equity, to continue its growth strategy and sustain operations. Material factors that could result in the Company being unable to fund its working capital needs and planned capital investment program include, (i) a material default or breach of a bank covenant that results in the Company's existing credit facilities being withdrawn, (ii) decreases in sales from existing stores, (iii) changes in consumer shopping patterns that result in lower traffic to the Company's stores or decreased sales, (iv) continued deterioration of economic conditions, consumer confidence or consumer spending, and (v) any material disruption to or contraction of the Company's operations. In addition, the current unfavourable financial market conditions have resulted in diminished availability of external funding and increased related costs. There can be no assurance that our current levels of liquidity will continue or that our ability to access the credit or capital markets, if required, will not be adversely affected by changes in the financial markets and the global economy.

Under the asset based lending facility started in October 2008 and amended in 2009 and 2010, the bank at its discretion may effectively decrease the borrowing base and thereby funding availability. The Company is also required to maintain certain financial covenants.

As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. The Company continued to breach these covenants in Q1, 2011 and anticipates further violations in 2011 unless or until negotiations with the bank result in changes to the covenants or the Company's operating results improve sufficiently or additional financing is secured. The Company has obtained a letter from the bank agreeing to temporarily waive, for up to a period of 60 days from December 30, 2010 (the date of the letter), the violations at year-end and through Q1 2011. The bank has continued to provide funding under the terms of this facility. Discussions between the Company and the bank are ongoing; however, there can be no assurance, at this time, that a satisfactory resolution will be reached.

The Company was in compliance with its financial debt covenants through 2009, having successfully reached an agreement with its lender that remedied the breach of the tangible net worth covenant at July 5, 2009, which had the effect of waiving the lenders' rights under the breach, and provided amendments to its asset based lending facility terms and covenants effective August 18, 2009.

## **Concentration of Head Office and Distribution Centre**

Liquidation World's corporate office and main distribution centre are in one location. Operations could be materially and adversely affected if a catastrophic or other event (such as, but not limited to, a fire, tornado, flood, earthquake, or act of terrorism) impacts the use of this facility.

## **Risks of Business Strategy**

There can be no assurance that the Company's business strategy will be successful or that the Company's overall net revenue will increase as a result of an increase in the number of retail stores, the relocation of existing stores or a change in the merchandise offering and/or marketing strategy. The Company's future growth and profitability may be restricted if it is unable to open new stores on a profitable basis, relocate or close underperforming stores, increase sales at existing stores, identify, consummate and integrate strategic acquisitions, renew leases in respect of existing locations at existing or favourable terms, identify, negotiate, lease and open stores in suitable locations on a profitable and timely basis, obtain necessary capital to operate the business and hire, train and retain qualified personnel, including management, executives and sales associates. Additionally, the Company's business strategy and its ability to implement its business plans are dependent upon the availability of cash from the Company's operations and under the Company's credit arrangements to finance such strategies along with its working capital needs. Factors that could negatively impact the Company's availability of cash include any inability to renew its existing credit facilities or to obtain an alternative acceptable credit facility or financing arrangement, decreases in sales from existing stores, changes in consumer shopping patterns that result in lower traffic in the Company's stores, or decreased sales or any other material disruption in the Company's operations. The occurrence of any of the foregoing factors could have a material adverse effect on the Company's business and financial condition.

## **Legal Proceedings**

In the course of its business, the Company may from time to time become involved in various claims and legal proceedings. The results of any such claims or proceedings cannot be predicted with certainty. To the extent any such claims or proceedings are of a material nature, and the Company is unable to resolve the disputes favourably, it may have a material adverse impact on the Company's business, financial condition and results of operations.



## **TRANSACTIONS WITH RELATED PARTIES**

During 2009, the Company entered into certain agreements with members of the Board of Directors and executive management, or parties related thereto, for the provision of goods and services in connection with the normal course of operations. The Board of Directors was aware of these arrangements and satisfied that the value, terms and conditions were comparable to similar third party agreements. The value of the services invoiced during 2010 was \$272 (2009- \$102), measured at the exchange amount, and has been reflected as prepaid expenses or selling, general and administrative expenses, of which \$2 was outstanding as at October 3, 2010 (2009 - \$63), included in accounts payable and accrued liabilities, The outstanding related party contractual commitment as at October 3, 2010 was \$339 (2009 -\$492) related to services to be provided over the next four years.

In addition, the Company compensated the members of the Special Committee of the Board of Directors, which was formed in 2008 to investigate and evaluate strategic alternatives available to the Company to increase shareholder value, resulting in the Talon investment and acquisition. Total compensation of \$125 was paid to these Board members in 2009, with a portion reflected in selling, general and administrative expenses and the balance charged directly to share capital, in connection with the fees related to the issuance of common shares.

During 2010, there was one related party transaction entered into for \$2 related to store upgrades. In addition, on March 19, 2010 the Company completed a private placement financing with Talon Mezzanine Partners LLC, and Oakwest Corporation Limited. Principals of these entities are members of the Board of Directors of the Company. The \$2,000 aggregate Financing involved the purchase by each of the Subscribers of one unit (each a "Unit") issued by the Company, with each Unit consisting of (i) \$1,000 principal amount of newly issued secured non-convertible subordinated notes of the Company with a three year term; and (ii) non-transferable common share purchase warrants exercisable into 791,614 common shares of the Company, with a five year term and an exercise price of \$0.66 per share. This transaction did not materially affect the control of the Company. These securities have been recognized at their relative fair value net of transaction costs.

The Company also compensated the Special Committee of the Board of Directors, which was formed in 2010 to investigate strategic financing alternatives available to the Company, resulting in the issuance of common shares of the Company on August 6. Total compensation of \$125 was charged directly to share capital, in connection with the fees related to the issuance of common shares. A payment of \$80 was made during 2010 with the balance of \$45 due in January 2011.

In addition, a Special Finance Committee of the Board of Directors was formed in August 2010 to assist the Board and management in creating appropriate compensation plans for the Company, assist with the 2011 budget process and the Company's adoption of the new IFRS accounting rules. Total compensation for this Committee has been approved at \$36, with \$8 paid prior to the end of fiscal 2010 and \$2 included in accounts payable and accrued liabilities on October 3, 2010. The balance is to be paid bi-weekly through the end of the term on December 31, 2010.

There is also an outstanding advance to a senior executive of the Company, principally related to certain employment costs. The balance outstanding at October 3, 2010 was \$101 (2009 - \$37) and is included in accounts receivable.

## **CRITICAL ACCOUNTING ESTIMATES**

### **Change in Accounting Policy**

In March 2007, the CICA approved Handbook Section 3031, Inventories, which replaces the existing Handbook Section 3030, Inventories. This standard is effective for the Company in the fiscal year beginning October 6, 2008. The standard establishes guidance on the determination of cost and its subsequent recognition as an expense including any write down to net realizable value. It also provides guidance in the cost formulas that are used to assign costs to inventories. The Company has adopted this standard in the first quarter of fiscal 2009. The impact of this change was an increase in opening inventories of \$1,558 and an increase in opening retained earnings of \$1,558 as at the beginning of fiscal 2009 due to the allocation of distribution centre costs to inventory.

### **Inventory Reserves**

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the consolidated financial statements. A significant area requiring the use of estimates is the inventory valuation reserve. The process involves a determination of valuation reserves based on the estimated net realizable value of inventory on hand compared to its carrying value. Actual results could differ from those estimates.

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

IFRS will replace Canadian GAAP for publicly accountable profit-oriented enterprises. These new standards are applicable to fiscal years beginning on or after January 1, 2011 with comparative figures presented on the same basis. The company will be required to report under IFRS beginning with the first quarter of fiscal 2012 at which time an opening IFRS balance sheet will be presented with appropriate notes and reconciliations to current Canadian GAAP. The company expects the transition to IFRS to impact accounting, financial reporting, internal control over financial reporting, taxes, and information systems.

Given the magnitude of the effort involved in this conversion, the project (which employs formal project management practices) has been developed in three main phases:

### Phase One: Preliminary Scoping and Diagnostic Impact Assessment

This phase consisted of a high-level assessment to identify key areas of Canadian GAAP-IFRS differences that were most likely to impact the Company. The assessment was completed in 2009 and was integral in prioritizing and resourcing potential work streams identified below to enable the subsequent steps in the process. Activities in this phase also included the recruitment and training of core internal technical resources to be deployed on the conversion project and retained afterwards to support ongoing training of other finance personnel dealing with the more complex technical accounting requirements of IFRS.

### Phase Two: Detailed Analysis and Design

This phase, commenced in Q4 of 2010, involves the detailed assessment, from an accounting, reporting and business perspective, of the changes that will be caused by the conversion to IFRS. This phase will initiate the launch of 11 accounting topic-specific "work streams" that are most relevant to the Company and 4 general work streams as highlighted below. This phase also included the standardization of criteria used to assess the appropriateness of accounting policy choices in cases where choices are permissible under IFRS.

Accounting specific work streams will include revenue recognition, tangible assets (including leases), impairments, provisions, contingent liabilities and contingent assets, business combinations, consolidations, borrowing costs, financial instruments, income taxes, and financial statement presentation and disclosure. General work streams will include contracts review, employee education and training, information systems and communication. The design deliverables coming out of these accounting specific work streams include the documentation of the rationale supporting accounting policy choices, new disclosure requirements and their sources and implementation guidance on execution. The deliverables for the 11 accounting specific work streams are expected to be completed in Q2 and Q3 of 2011. These will include the selection of accounting policies under IFRS as currently enacted, including transitional elections. Some of the general work streams, such as the education and training and communication work streams will continue throughout the conversion project. The latter will involve not only key finance employees but also other staff and management as well as the Audit Committee, Board and external parties such as the company's lenders, investors and analysts.

### Phase Three: Execution

This phase will involve executing the work completed in phase two by making changes to business and accounting processes and supporting information systems and will include formal documentation of the final approved accounting policies and procedures compliant with IFRS. A quantification of anticipated business impacts will be undertaken as well as a drafting of the pro-forma financial statement formats and notes thereto that will be existent under IFRS. Details surrounding the collection of comparative financial and other data in 2011 will also be finalized during this stage. This stage will also involve the implementation of a training plan including all staff having key accounting, reporting and investor relations functions. This phase is expected to be completed by Q4 2011.

The following table summarizes the Company's progress to date against the milestones contained in the key elements of the transition plan:

#### IFRS Transition Progress

<b>1. Project Governance</b>	<ul style="list-style-type: none"><li>steering committee formation</li><li>project resourcing</li><li>progress reporting</li><li>project management practices</li></ul>
Milestones/Target Dates	<ul style="list-style-type: none"><li>August 2010</li></ul>
Progress to Oct 3/10	<ul style="list-style-type: none"><li>governance practices established</li><li>program office, steering committee formed</li><li>project status reporting developed and implemented</li></ul>
<b>2. Financial Statement Preparation</b>	<ul style="list-style-type: none"><li>identification of differences in Canadian GAAP/IFRS accounting policies and choices</li><li>selection of entity's continuing accounting IFRS policies</li><li>selection of IFRS 1 accounting policy choices</li><li>financial statement format, including alternative performance measures</li><li>changes in note disclosure</li><li>quantification of IFRS 1 disclosures for 2011</li></ul>
Milestones/Target Dates	<ul style="list-style-type: none"><li>Ready for commencement for 2012 financial year</li><li>quantification of effects of change to IFRS 1 disclosures and comparative 2011 financial statements including note disclosure by the end of Q1 2012</li></ul>
Progress to Oct 3/10	<ul style="list-style-type: none"><li>Fundamental CGAAP/IFRS differences identified</li><li>Criteria for accounting policy choice selection established</li><li>Critical work stream teams dealing with individual policy selection recommendations in progress</li></ul>



3.	<b>Infrastructure: IFRS expertise</b>	<ul style="list-style-type: none"> <li>retraining of key finance and operational staff</li> <li>education of management, Audit Committee and external constituents regarding IFRS implications</li> </ul>
	Milestones/Target Dates	<ul style="list-style-type: none"> <li>Internal education and communication ready for issuance in Q3 2011</li> <li>External education and communication ready for issuance in Q4 2011</li> </ul>
	Progress to Oct 3/10	<ul style="list-style-type: none"> <li>Resource requirements identified</li> <li>Internal and recruited resources deployed</li> <li>Initial training of core project staff and Senior management underway and ongoing</li> </ul>
4.	<b>Infrastructure</b>	<ul style="list-style-type: none"> <li>Information system changes to support IFRS requirements</li> </ul>
	Milestones/Target Dates	<ul style="list-style-type: none"> <li>Ready for capturing 2011 comparative data in Q3 2011</li> <li>ready for capturing 2012 data by the end of Q4 2011</li> </ul>
	Progress to Oct. 3/10	<ul style="list-style-type: none"> <li>Assessment of impact on systems is on-going as requirements are still being developed</li> </ul>
5.	<b>Business Implication assessment: Financial Covenants and Practices</b>	<ul style="list-style-type: none"> <li>Business contract review/renegotiation</li> <li>Financial debt covenant assessment</li> </ul>
	Milestones/target dates	<ul style="list-style-type: none"> <li>GAAP-based clauses to be identified for renegotiation with counterparties by Q4 2011</li> <li>Renegotiation is a business matter that is outside the scope of the conversion project</li> </ul>
	Progress to Oct. 3/10	<ul style="list-style-type: none"> <li>Process to review contracts is in the development stage</li> </ul>
6.	<b>Control environment</b>	<ul style="list-style-type: none"> <li>Internal control over financial reporting</li> </ul>
	Milestones/target dates	<ul style="list-style-type: none"> <li>Approval and sign-off of all accounting changes</li> <li>CEO/CFO certification process completed by end of Q4 2011</li> </ul>
	Progress to Oct. 3/10	<ul style="list-style-type: none"> <li>Not yet commenced</li> </ul>

#### OUTSTANDING COMMON SHARE, STOCK OPTION, AND WARRANT DATA

As of October 3, 2010, the Company has authorized for issuance unlimited common shares of which 29,819,005 were issued and outstanding, which includes the increase of 2,205,883 common shares arising from the June 4, 2010 private placement, and the 11,765,000 common shares arising from the August 6, 2010 private placement. Further, in 2010, the Company increased the number of stock options reserved to acquire common shares from 1,584,812 to 2,981,900 which included an increase of 220,588 on June 4, and 1,176,500 on August 6.

As of October 3, 2010, 1,242,800 stock options were outstanding (October 4, 2009, 1,218,200 options outstanding).

As of October 3, 2010, there were 3,568,544 warrants outstanding (nil in 2009). Only the Series I warrants, referred to below, were exercisable at October 3, 2010. No warrants were exercised in 2010. There were no warrants issued or outstanding in 2009.

The warrants outstanding at October 3, 2010 were related to three financing transactions entered into during the year:

In connection with the private placement financing which closed on March 19, 2010, the Company created a warrant (Series 2010-I) to purchase common shares of the Company. There are presently two certificates issued under this series each comprising of 791,614 warrants, issued to the holders of the notes on March 19, 2010. The warrants are non-transferable. Each warrant entitles the holder to acquire a common share of the Company at any time after July 19, 2010 and before the close of business on March 19, 2015 for an exercise price of \$.66 per share.

In connection with the private placement financing which was completed on June 4, 2010, each of the 1,102,941 Series 2010-II warrants entitles the holder to acquire a common share of the Company at any time after October 4, 2010 and before the close of business on June 4, 2013 for an exercise price of \$0.85 per share. The warrants are also exercisable prior to the expiry date (June 4, 2013). If at any time during the term of the warrants, the common shares of the Company trade at a price of \$1.70 per share or greater for a period of 20 consecutive trading days, the Company has the option to accelerate the expiry date of the warrants to the date which is 10 days following the date upon which the Company provides notice to the holders thereof of such accelerated expiry date.

In connection with the private placement financing which was completed on August 6, 2010, the agents for the offering were reimbursed for certain costs incurred related to the transaction and received compensation consisting of approximately \$750 (representing 7.5% of the gross proceeds of the offering) and 882,375 of Company issued broker warrants (representing 7.5% of the aggregate number of common shares sold pursuant to the offering). The transfer of broker warrants is restricted. Each broker warrant is exercisable for one common share at a price of \$0.95 for a period of twenty four months following the August 6 closing date. Both the common shares and broker warrants issued pursuant to this placement are subject to a four month holding period from the August 6 closing date.

Each of the warrant series contain standard anti-dilution provisions including adjustment to the exercise price and the number of common shares issuable upon the exercise of the warrants where there is a common share reorganization, rights offering, distribution

or reclassification. In addition, there are provisions whereby the Company will not enter into any transaction whereby all or substantially all of the property and assets would become the property of a successor corporation, unless the warrants remain a valid and binding obligation of the successor.

## **DISCLOSURE CONTROLS AND PROCEDURES**

Disclosure controls and procedures (as defined in National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings) are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer and the Chief Financial Officer (the "Certifying Officers"), on a timely basis so that appropriate decisions can be made regarding public disclosure within the required time periods specified under securities legislation. The Certifying Officers are responsible for establishing and maintaining the Company's disclosure controls and procedures.

The Company's management, inclusive of the Certifying Officers, does not expect that the Company's disclosure controls and procedures will prevent or detect all error and fraud. The inherent limitations in all control systems are such that they can provide only reasonable, not absolute, assurance that all control issues and instances of fraud or error within the Company, if any, have been detected. Based on the evaluation of the Company's disclosure controls and procedures, the Certifying Officers have concluded that, subject to the inherent limitations referred to above, these controls are appropriately designed and were operating effectively as at October 3, 2010.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Internal control over financial reporting ("ICFR") is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in accordance with Canadian GAAP. The Certifying Officers are responsible for establishing and maintaining adequate ICFR for the Company.

The Certifying Officers evaluated the effectiveness of the Company's ICFR as at October 4, 2009, in consultation with a third party advisor. Based on that evaluation, the Certifying Officers have concluded that the ICFR, as defined in National Instrument 52-109, are appropriately designed and operating effectively and that no material weaknesses were identified. It is recognized that in reaching this conclusion internal controls over financial reporting, no matter how well designed have inherent limitations. Therefore, internal controls over financial reporting can only provide reasonable, not absolute assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes.

During the year-end process for fiscal 2010, management determined that the design of internal control over financial reporting could be strengthened by better segregation of duties over certain analysis and recording of inventory transactions. The Company is reviewing the roles and responsibilities within the finance department to address these matters going forward.

## **CHANGES IN INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Certifying Officers have evaluated whether there were any changes in the Company's ICFR that occurred during the year ended October 3, 2010 that have materially affected, or are reasonably likely to materially affect, its ICFR. Other than addressing the segregation of duties noted above, no other changes were identified through their evaluation.

## **OTHER ITEMS**

Additional information relating to Liquidation World is available on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## **OUTLOOK**

While the net loss in fiscal 2010 of \$12,331 was disappointing, it did represent a significant improvement over the \$17,581 net loss reported in fiscal 2009. The improvement is a function of several factors, including inventory selection, procurement and distribution practices and a new merchandising strategy combining a store conversion program (the "LW - Everybody's Outlet Store" banner) with a revamped advertising plan, including our flyer program.

As we head into 2011, the cornerstones of the Company's strategy continue to be focused on:

- merchandising efforts to acquire a more attractive product selection at prices which will result in improved consumer value;
- better management of markdowns, shrink, and inventory control;
- the selective addition of new "LW-Everybody's Outlet Store" locations;
- continued store conversion efforts to the new "LW-Everybody's Outlet Store" format;
- a more consistent, value focused marketing message and brand awareness initiatives through such avenues as the flyer program;
- monitoring the existing store portfolio and focusing on stores and markets with the most profit potential;
- evaluating and upgrading personnel in key areas of the business.

During fiscal 2010, the Company converted twenty-seven existing and opened six new stores under the new "LW-Everybody's Outlet Store" banner. Early performance numbers from same store sales indicate significant improvements from converted stores vs. existing stores as it relates to revenue, point of sale margin and average basket from the year over year perspective. The Company's plan to renovate and rebrand other existing Liquidation World stores and add additional new "LW -Everybody's Outlet Store" locations, will continue into 2011. Further conversions, beyond the three new store openings, four relocations and four store conversions announced after year-end, will be evaluated based on Company profitability. Existing sites will continue to be critically reviewed and optimized. The recently implemented flyer program has contributed to increased store traffic since its inception and year over year same store sales



and will continue into 2011. The Company will continue to closely monitor the same store sales trend which improved over last quarter and is expected to demonstrate continued improvement in future quarters.

We believe that the Company's message has been well received by the investor community as evidenced by the additional \$1,500 third party private placement financing which was completed during the third quarter and the \$10,000 equity placement which concluded in August. These additional funding programs, combined with the positive changes negotiated with our lenders to our operating line, are signs of the support that both our investors and our lender have regarding the future of the Company and will allow the Company the opportunity to pursue its current strategic plan.

General economic conditions remain challenging in the world and specifically in North America. While this provides opportunities for the Company in the procurement of merchandise, these conditions have had a negative impact on the level of consumer spending combined with a greater emphasis on value received. The Company remains committed to continue to aggressively pursue a larger, stronger and more compelling mix of merchandise and continue to offer the greatest possible value proposition available to consumers in all the markets it serves.

#### **FORWARD LOOKING STATEMENTS**

The foregoing includes forward-looking statements and potential future circumstances and developments. Forward-looking statements regarding future performance are subject to risks and uncertainties and actual results may differ materially.

See accompanying notes to consolidated financial statements.

# MANAGEMENT & AUDITORS' REPORTS

## Management's Report

Preparation of the consolidated financial statements accompanying this annual report and the presentation of all other information in this report are the responsibility of management. The financial statements have been prepared in accordance with appropriate and generally accepted accounting principles and reflect management's best estimates and judgements. All other financial information presented in this report is consistent with that contained in the financial statements. The Company maintains appropriate systems of internal control, policies and procedures which provide management with reasonable assurance that assets are safeguarded and that financial records are reliable and form a proper basis for preparation of financial statements.

The Board of Directors ensures that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee composed of non-executive directors. The Audit Committee reviewed the consolidated financial statements with management and external auditors and recommended their approval by the Board of Directors.

The consolidated financial statements have been audited by Ernst & Young, LLP, Chartered Accountants. Their report stating the scope of their audit and their opinion on the consolidated financial statement is presented alongside.



Seth Marks  
President and CEO  
December 31, 2010



Chris Rath  
CFO  
December 31, 2010

## Auditors' Report

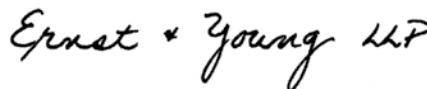
To the Shareholders of  
Liquidation World Inc.

We have audited the consolidated balance sheets of Liquidation World Inc. as at October 3, 2010 and October 4, 2009 and the consolidated statements of loss and comprehensive loss and retained earnings (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company'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 Company as at October 3, 2010 and October 4, 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

London, Canada,  
December 31, 2010



Ernst & Young LLP  
Chartered Accountants  
Licensed Public Accountants



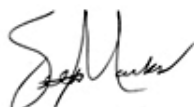
# CONSOLIDATED FINANCIAL STATEMENTS

**Consolidated Balance Sheets** - see note 1  
 As at October 3, 2010 and October 4, 2009  
 (in thousands of Canadian dollars)

	2010	2009
<b>Assets</b>		
Current assets		
Accounts receivable	\$ 533	\$ 1,554
Deposits	120	113
Inventory (note 5)	39,619	33,941
Prepaid expenses	1,679	1,622
	41,951	37,230
Lease deposits	376	247
Property and equipment (note 6)	9,074	8,613
Intangibles (note 7)	-	653
	\$ 51,401	\$ 46,743
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Bank indebtedness (note 8)	\$ 15,797	\$ 8,758
Accounts payable and accrued liabilities	15,623	17,408
Current portion of obligations under capital leases (note 9)	127	710
	31,547	26,876
Obligations under capital leases	-	145
Subordinated notes (note 10)	1,557	-
Deferred lease inducements (note 11)	2,272	2,321
Shareholders' equity (note 12)		
Share capital	32,224	22,330
Warrants	1,020	-
Contributed surplus	1,595	1,554
Deficit	(18,814)	(6,483)
	16,025	17,401
	\$ 51,401	\$ 46,743

See accompanying notes.

On behalf of the Board:



Director



Director

**Consolidated Statements Of Loss And Comprehensive Loss  
And Retained Earnings (Deficit)** - see note 1

For the years ended October 3, 2010 and October 4, 2009

(in thousands of Canadian dollars, except per share amounts)

	2010	2009
Revenue	\$ 153,399	\$ 157,809
Cost of sales	98,812	109,965
Gross margin	54,587	47,844
Expenses		
Selling, general and administrative	61,918	60,877
Depreciation and amortization	3,021	3,345
Impairment of intangibles (note 7)	618	-
Impairment of goodwill (note 4)	-	233
Interest		
Short term	1,300	582
Long term	163	74
Foreign exchange (gain) loss	(102)	314
	66,918	65,425
Net loss	(12,331)	(17,581)
Net loss and comprehensive loss	(12,331)	(17,581)
Retained earnings (deficit), beginning of year (note 2(t))	(6,483)	11,098
Deficit, end of year	\$ (18,814)	\$ (6,483)
Basic and diluted loss per share	\$ (0.67)	\$ (1.32)

See accompanying notes.



**Consolidated Statements Of Cash Flows** - see note 1  
For the years ended October 3, 2010 and October 4, 2009  
(in thousands of Canadian dollars)

	2010	2009
Cash provided by (used in):		
Operating activities		
Net loss		
Add (deduct) non-cash items:	\$ (12,331)	\$ (17,581)
Depreciation and amortization	3,021	3,345
Impairment of intangibles (note 7)	618	-
Goodwill impairment charge (note 4)	-	233
Leasehold inducements	(74)	132
Loss (gain) on disposal of capital assets	63	89
Stock based compensation (note 12(e))	41	147
Accretion on long term debt (note 10)	83	-
Changes in non-cash working capital items (note 14)	(7,460)	15,655
	(16,039)	2,020
Investment activities		
Purchase of capital assets	(3,515)	(1,546)
Business acquisition (note 4)	-	(140)
Proceeds on disposal of capital assets	5	5
Change in non-cash working capital items (note 14)	-	(1,006)
	(3,510)	(2,687)
Financing activities		
Increase (decrease) in bank indebtedness	7,039	(2,668)
Repayment of capital leases	(728)	(1,203)
Deposits	(129)	(174)
Lease inducements	979	750
Proceeds from subordinated notes and warrant financing (note 10)	2,000	-
Fees for issue of subordinated notes and warrant financing (note 10)	(47)	-
Proceeds on issuance of common shares and warrants (note 12)	11,500	4,750
Fees for issuance of common shares and warrants (note 12)	(1,065)	(788)
	19,549	667
Increase (decrease) in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$ -	\$ -
Supplemental disclosure of cash paid (received) for:		
Income taxes - net	\$ -	\$ 5
Interest paid	1,373	648
	\$ 1,373	\$ 653

See accompanying notes.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended October 3, 2010 and October 4, 2009  
(amounts in thousands of Canadian dollars, except per share amounts)

## 1. BASIS OF PRESENTATION AND GOING CONCERN

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which assumes that the future operations will allow for the realization of assets and discharge of liabilities in the normal course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and meet its liabilities as they become due.

In the most recent fiscal year, the Company experienced declining revenues and has incurred a loss before income taxes of \$12,331 and experienced a net use of cash in operations of \$16,039. The losses have been primarily funded through the net proceeds from financing arrangements and the use of available lending facilities.

As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. The Company continued to breach these covenants in Q1, 2011 and anticipates further violations in 2011 unless or until negotiations with the bank result in changes to the covenants or the Company's operating results improve sufficiently or additional financing is secured. The Company has obtained a letter from the bank agreeing to temporarily waive, for up to a period of 60 days from December 30, 2010 (the date of the letter), the violations at year-end and through Q1 2011. The bank has continued to provide funding under the terms of this facility. Discussions between the Company and the bank are ongoing; however, there can be no assurance, at this time, that a satisfactory resolution will be reached.

The Company's ability to continue as a going concern is uncertain and is dependent on its ability to improve its operating results in its next fiscal year and/or obtain additional financing. The outcome of these matters cannot be predicted at this time. These consolidated financial statements do not include any adjustments to the carrying value and classification of assets and liabilities that might be necessary should the Company be unable to continue as a going concern, and any such adjustments could be material.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The following is a summary of the significant accounting policies followed in the preparation of these consolidated financial statements.

### (a) Basis of presentation:

These consolidated financial statements include the accounts of the Company and those of its wholly owned subsidiaries. All significant intercompany balances and transactions are eliminated on consolidation.

The consolidated balance sheet, as at October 4, 2009, reflects the acquisition of assets and assumption of liabilities of the US wholesale business ("Wholesale Business") purchased from Talon Merchant Capital, LLC on February 4, 2009 ("Talon Acquisition"). The purchase price has been allocated based upon management's best estimate of the fair values of the identifiable assets acquired and liabilities assumed in accordance with the guidance in CICA Handbook Section 1581, "Business Combinations" (see Note 4).

### (b) Fiscal year:

The Company's fiscal year ends on the first Sunday of October. Accordingly, the 2010 year end was on October 3, 2010. The 2009 year end was on October 4, 2009 and both comprised 52 weeks of operations.

### (c) 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 at the date of the consolidated financial statements. Significant areas requiring the use of estimates relate to the determination of future tax assets and liabilities, provisions relating to sales returns, inventory shrink and valuation, the remaining useful life of capital assets and future cash flows used to assess impairment of long-lived assets. Actual results could differ from those estimates.

### (d) Revenue recognition:

Retail sales revenue is recognized when a customer purchases and takes delivery of the product.

Sales revenue from wholesale operations is recognized when the risks of ownership have been transferred to the customer



and reasonable assurance exists regarding the measurement of the sales consideration, provided that ultimate collection is reasonably assured. The risks of ownership are transferred when title passes at the time of shipment and sales consideration is recognized to the extent it is fixed and determinable.

Fee revenue is recognized as the related services are rendered.

**(e) Inventory:**

Merchandise inventories are carried at the lower of cost and net realizable value. The cost of inventories and the net realizable value are determined as follows:

Effective the beginning of the fiscal year 2009, the Company changed from the retail inventory method of costing inventory at a total company level to inventory costing as follows: (a) for SKU inventory, the Company tracked inventory receipts based on landed invoice cost and determined cost, including cost of sales based on weighted average landed invoice cost, and (b) for lots inventory, the Company tracked inventory receipts based on landed invoice cost and determined cost, including cost of sales based on the ratio of cost to retail value of inventory for each individual lot. The lot inventory was sold or converted to SKU's in 2009.

Certain inventory is purchased under a revenue sharing program whereby the vendor and the Company share in the net revenue from retail sales. On hand inventory is valued based on the expected vendor portion of future sales, net of shared costs.

**(f) Property and equipment:**

Property and equipment is recorded at cost. Depreciation and amortization is provided as follows:

Furniture and equipment	20% to 30% diminishing balance basis
Software	30% diminishing balance basis
Computer equipment	30% diminishing balance basis
Leasehold improvements	Straight line over the lesser of 5 years or the term of the lease
Equipment held under capital leases	30% diminishing balance basis

**(g) Intangible assets**

Intangible assets of the Company were related to customer lists arising from the Talon Acquisition (see Note 4). Amortization was being recorded on a straight-line basis over an estimated useful life of 10 years beginning from the February 4, 2009 acquisition date until the second quarter of 2010 when it was determined that the balance was fully impaired (see Note 2(i) and Note 7). Amortization related to the intangible assets is included in depreciation and amortization expense in the consolidated statements of loss and comprehensive loss.

**(h) Goodwill**

Goodwill was the excess of cost over the estimated fair market value of the assets acquired and liabilities assumed by the Company in connection with the Talon Acquisition in fiscal 2009. Goodwill is considered to have an indefinite life and accordingly was not amortized. Goodwill was subject to impairment testing in the fourth quarter of 2009 (see Note 2(ii)) which resulted in a the recognition of an impairment charge equal to the total carrying value of the goodwill at that time ( see Note 4).

**(i) Impairment of long-lived assets and goodwill:**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When indicators of impairment of the carrying value of assets exists, and the carrying value is greater than the total undiscounted future cash flows expected from its use and eventual disposition, an impairment loss is recognized to the extent the fair value is below the carrying value (see Notes 6 and 7).

Goodwill is tested for impairment whenever events or changes in circumstances indicate that the carrying amount of goodwill may exceed its fair value and at least annually in the fourth quarter of a fiscal year. If the fair value of the reporting unit, using typical valuation models such as the discounted cash flow method, is less than the carrying value of goodwill an impairment charge equal to the difference would be recognized in the period (see Note 4).

**(j) Stock-based compensation plans:**

The Company has a stock-based compensation plan, which is described in Note 12 (d). Any consideration paid on the exercise of stock options is credited to share capital.

The Company applies the fair value method to all stock-based payments and awards. Under the fair value method, the Company calculates the fair value of stock option grants or direct awards of stock and records that fair value as compensation expense over the vesting period of those grants and awards, and an equal amount is recorded in contributed surplus. Upon exercise of stock options, the proceeds received are credited to share capital and the amount of related compensation expense previously recorded in contributed surplus is reclassified to share capital.

**(k) Capital lease and deferred lease inducement policy:**

The Company classifies leases that transfer substantially all of the risks and benefits of ownership of the leased property as

capital leases, subject to amortization as described in Note 2(f).

All other leases are accounted for as operating leases, with the lease payments expensed on a straight line basis over the term of the lease, including rent-free periods.

Inducements to enter into certain store leases, such as rent free periods and cash received at the inception of a lease are deferred and recognized as a reduction of lease expense on a straight line basis over the term of the related lease which presently ranges from 1 to 12 years (see Note 11).

**(l) Pre-opening costs:**

Pre-opening costs, including rent, associated with the opening of new locations are expensed as incurred.

**(m) Foreign currency translation:**

The accounts of the Company's US subsidiaries are translated into Canadian dollars using the temporal method whereby monetary assets and liabilities are translated at the year end exchange rates, non-monetary items, valued at cost, at historical rates and revenues and expenses at the average rate for the year. Gains or losses arising from exchange translations are included in the net loss from operations.

**(n) Income taxes:**

The Company follows the liability method of tax allocation in accounting for income taxes. Under this method, future income tax assets and future income tax liabilities are recorded based on temporary differences - the difference between the carrying amount of an asset and liability in the consolidated balance sheet and its tax basis, and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

**(o) Comprehensive loss:**

Comprehensive loss measures changes in shareholders' equity during a period arising from such items as unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, unrealized gains and losses on available for-sale investments, and changes in the fair value of the effective portion of cash flow hedging instruments. The application of this standard did not result in comprehensive loss being different from net loss for the periods presented.

**(p) Per share data:**

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated using the treasury stock method to account for the dilutive effect of options and similar instruments, as discussed in Note 12(f).

**(q) Financial Instruments:**

CICA Handbook Section 3862, "Financial Instruments - Disclosures" and Handbook Section 3863, "Financial Instruments - Presentation" contain presentation standards and increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The application of sections 3862 and 3863 do not have any material impact on the Company's consolidated financial statements. These disclosures are discussed in Note 18.

**(r) Hedges:**

CICA Handbook Section 3865, "Hedges", establishes the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value and cash flow hedges. Hedge accounting is discontinued prospectively when (a) the derivative offsetting the hedged item no longer qualifies as an effective hedge, (b) the derivative is terminated or sold or (c) the hedged item is terminated or sold. The Company has not applied hedge accounting during this and previous reporting periods.

**(s) Capital Disclosures:**

CICA Handbook Section 1535, "Capital Disclosures" specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. This disclosure is discussed in Note 19.

**(t) Change in Accounting Policy:**

The impact of the 2009 accounting policy change on opening retained earnings for 2009 is as follows:

Opening retained earnings	\$	12,393
Section 3031 inventory adjustment (see Note 2(u))		1,558
Inventory costing method adjustment (see Note 2(e))		(2,853)
Adjusted retained earnings	\$	11,098



**(u) Recent Accounting Pronouncement:**

CICA Handbook Section 3031, Inventories, establishes guidance on the determination of cost and its subsequent recognition as an expense, including any write down to net realizable value. It also provides guidance in the cost formulas that are used to assign costs to inventories. The Company adopted this standard in the first quarter of fiscal 2009. The impact of this change was an increase in opening inventories of \$1,558 and an increase in opening retained earnings of \$1,558 as at the beginning of fiscal 2009 due to the allocation of distribution centre costs to inventory. Prior periods were not restated as permitted by the standard. Distribution centre costs include mainly salaries, wages and occupancy costs, excluding costs related to storage, for receiving, processing and shipping merchandise to stores.

**3. FUTURE CHANGES IN ACCOUNTING POLICIES**

In February 2008, the CICA announced that Canadian GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. Accordingly, the conversion from Canadian GAAP to IFRS will be applicable to the Company's reporting for its first fiscal quarter of 2012, for which the current and comparative information will be prepared under IFRS. The Company expects that the transition to IFRS will impact accounting, financial reporting, internal control over financial reporting, income taxes, IT systems and processes as well as certain contractual arrangements. The Company has engaged the services of outside consultants to assist with the conversion process, including project management. A diagnostic report has been completed and the Company is currently reviewing the requirements and elections available under IFRS 1 and concurrently developing work plans on specific areas. Accordingly, it is too early at this time to assess the financial impact of the conversion.

In January 2009, the CICA issued CICA Handbook 1582, "Business Combinations", which replaces CICA Handbook Section 1581, "Business Combinations". The CICA also issued CICA Handbook Section 1601, "Consolidated Financial Statements" and CICA Handbook Section 1602, "Non-Controlling Interests", which replaces CICA Handbook Section 1600, "Consolidated Financial Statements". These new sections are based on the International Accounting Standards Board's ("IASB") Revised International Financial Reporting Standard 3, "Business Combinations". The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and US accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with earlier application permitted. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. The Non-Controlling Interests standard should be applied retrospectively except for certain items.

**4. BUSINESS ACQUISITION**

On February 4, 2009, the Company completed a private equity placement and purchase transaction with Talon Merchant Capital, LLC ("Talon") and its affiliate, TCP Co-Investment Partners, LLC ("TCP"). Collectively, Talon and TCP acquired ownership of 7,600,000 common shares of the Company for an aggregate purchase price of \$4,750 in cash and the sale by Talon to the Company of Talon's Wholesale Business valued at \$2,850 representing a value of \$1.00 per common share. In the fourth quarter of 2009, the Company was required to pay \$140 in cash, under the terms of the purchase agreement, in finalizing the acquisition value of the Talon Wholesale Business.

The Company accounted for the Talon Acquisition following the guidance in CICA Handbook Section 1581, "Business Combinations" and accordingly allocated the purchase price based upon management's best estimate of the fair values of the identifiable assets acquired and liabilities assumed using the purchase method. The result of this allocation, based on the foreign exchange rate in effect on the date of closing, was as follows:

Accounts receivable	\$ 450
Inventory	2,854
Prepaid expenses	209
Intangible assets	700
Goodwill	233
Accounts payable and accrued liabilities	(1,456)
Share capital issued and cash paid	\$ 2,990

Results of operation from February 4, 2009 have been included in the consolidated statements of loss and comprehensive loss and retained earnings (deficit).

During the balance of fiscal 2009, negative operating results in the wholesale business and the uncertainty regarding future forecasts combined to significantly reduce the valuation of the Company's Talon subsidiary. As a result, the Company recorded a total goodwill impairment charge of \$233 in the fourth quarter of 2009. After this impairment charge, there was no goodwill remaining on the Company's consolidated balance sheet.

The goodwill impairment charge was non-cash in nature and did not affect the Company's liquidity, cash flows from operations,

or debt covenants and did not have an impact on future operations. This impairment charge was not deductible for income tax purposes in 2009; therefore, there was no corresponding tax benefit in 2009.

## 5. INVENTORIES

The amount of inventories charged to cost of sales during 2010 was \$98,812 (2009 - \$109,965). The Company recorded an increase in the valuation reserve against inventory from \$185 at the end of 2009 to \$989 at the end of 2010. No reversals of previously written down amounts occurred in the year. Approximately \$34,601 of inventory was pledged as collateral under the bank's credit facility at October 3, 2010. The subordinated note holders have a subordinated interest in the inventory collateral (see Note 10).

## 6. PROPERTY AND EQUIPMENT

October 3, 2010	Cost	Accumulated depreciation and amortization	Net book value
Furniture and equipment	\$ 9,976	\$ 6,331	\$ 3,645
Computer equipment	4,489	3,249	1,240
Software	2,351	1,911	440
Equipment held under capital leases	5,855	4,438	1,417
Leasehold improvements	8,971	6,639	2,332
	\$ 31,642	\$ 22,568	\$ 9,074

October 4, 2009	Cost	Accumulated depreciation and amortization	Net book value
Furniture and equipment	\$ 8,772	\$ 5,714	\$ 3,058
Computer equipment	4,152	2,896	1,256
Software	2,124	1,691	433
Equipment held under capital leases	5,855	3,928	1,927
Leasehold improvements	7,710	5,771	1,939
	\$ 28,613	\$ 20,000	\$ 8,613

Amortization of equipment held under capital leases was \$511 in 2010 (\$677 in 2009).

For 2010, it was determined that there was an impairment charge of \$139 (nil in 2009), related to long-lived assets classified as property and equipment, which has been included in depreciation and amortization expense.

## 7. INTANGIBLES

Following the guidance under CICA Handbook Section 1581 - "Business Combinations" in the allocation of the \$2,990 purchase price in connection with the acquisition of the Talon Wholesale Business on February 4, 2009 (see Note 4), it was determined in the fourth quarter of 2009 that \$700 was related to intangible assets. Accordingly, amortization commenced in the fourth quarter of 2009, reflecting a year to date adjustment of \$47. During the first half of 2010, additional amortization of \$35 was recognized in depreciation and amortization expense.

The continuing negative operating results in the wholesale business during the first half of fiscal 2010, and the uncertainty regarding future forecasts, combined to significantly reduce the valuation of the Company's Talon subsidiary. As a result, at the end of the second quarter of 2010 the Company recorded an impairment charge in the wholesale business of \$618 related to the long lived assets classified as intangibles (nil- 2009). After this impairment charge, there were no net intangible assets remaining on the Company's consolidated balance sheet.

The continuity of the intangible assets is summarized below:

	October 3, 2010	October 4, 2009
Balance - beginning of year	\$ 653	\$ -
Additions	-	700
Less: amortization	35	47
Less: impairment	618	-
Balance - end of year	\$ -	\$ 653

The intangible asset impairment charge is non-cash in nature and did not affect the Company's liquidity, cash flows from operations,



or debt covenants and will not have an impact on future operations. This impairment charge is not deductible for income tax purposes in 2010; therefore, there was no corresponding tax benefit in 2010.

## 8. BANK INDEBTEDNESS

At October 3, 2010, the Company has an operating line of credit facility at a Canadian chartered bank in the maximum amount of \$25,000 (subject to a maximum determined by inventory levels and certain reserves). Interest on this facility was charged at the bank's prime rate plus 500 basis points. The prime rate of this chartered bank was 3.0% at October 3, 2010 (2.25% at October 4, 2009). At the end of fiscal 2010, \$17,270 had been drawn on this facility with a corresponding borrowing base of \$18,033. The Company had net cash on hand of \$1,473 resulting in net bank indebtedness of \$15,797 compared to a draw down of \$11,858 at the end of fiscal 2009 (with a corresponding borrowing base of \$13,179) and net cash on hand of \$3,100 resulting in net bank indebtedness of \$8,758. The Company had two outstanding letter of credit issued from the above line of credit at the end of fiscal 2010 for \$160 (2009 - nil), as collateral to third parties relative to certain obligations of the Company. The Company also has a \$5,000 capital lease provision under this facility. This agreement expires on October 17, 2011 if not renewed, is collateralized with the assets of the Company and contains certain financial covenants. An assignment of book debts, inventory, insurance, leases on retail premises and a general security agreement providing a charge over all assets has been provided as collateral. This debt is repayable on demand as the bank, at its discretion, may effectively decrease the borrowing base and thereby funding availability.

On March 31, 2010, the Company's senior lender delivered a notification of breach of the loan agreement dated October 17, 2008 as a result of the private placement financing which closed on March 19, 2010 (see Note 10). As a result of that breach, the Company delayed the interest payment due on March 31, 2010 to the subordinated notes holders which resulted in a breach of the subordinated notes. On April 9, 2010 the Company, its senior lender and subordinated notes holders signed a priorities agreement which cured the breach without adjustment or financial consideration.

On June 7, 2010, the Company announced an agreement with its senior lender to amend certain of its ongoing financial covenants in the Company's asset-based lending facility to reflect the most current business plan prepared by the Company which included the effect of the two private placements on March 19 and June 4, 2010 aggregating \$3,500 (see Notes 10 and 12(b)). The capital infusion facilitated the Company's ability to pursue more opportunistic inventory purchases, to generally allow for the expansion of the breadth of inventory in the Company's stores and to convert the Liquidation World stores to the new "LW-Everybody's Outlet Store" format.

The Company concluded a fourth amending agreement to the operating line credit facility with its Canadian chartered bank lender on August 13, 2010. Several modifications to financial covenants were made, reflecting the Company's equity financing on August 6, 2010 (see Note 12(b)). In addition, effective September 9, 2010, the agreement also provides the Company with up to a \$25,000 facility which represents an increase of \$5,000 over the prior limit.

As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. The Company continued to breach these covenants in Q1, 2011 and anticipates further violations in 2011 unless or until negotiations with the bank result in changes to the covenants or the Company's operating results improve sufficiently or additional financing is secured. The Company has obtained a letter from the bank agreeing to temporarily waive, for up to a period of 60 days from December 30, 2010 (the date of the letter), the violations at year-end and through Q1 2011. The bank has continued to provide funding under the terms of this facility. Discussions between the Company and the bank are ongoing; however, there can be no assurance, at this time, that a satisfactory resolution will be reached.

## 9. OBLIGATIONS UNDER CAPITAL LEASES

The following comprise the Company's obligations under capital leases:

	2010	2009
Obligation under capital lease, bearing interest at prime, payable in monthly installments of \$70 including interest, due on March 31, 2010	\$ -	\$ 413
Obligation under capital lease, bearing interest at prime, payable in monthly installments of \$2 including interest, due on May 26, 2011	52	75
Obligation under capital lease, bearing interest at prime, payable in monthly installments of \$10 including interest, due on March 1, 2010	-	38
Obligation under capital lease, bearing 6.694% interest, payable in monthly installments of \$3 including interest, due on October 4, 2010	38	78
Obligation under capital lease, bearing 6.006% interest, payable in monthly installments of \$19 including interest, due on December 12, 2010	37	251
	127	855
Less: current portion	127	710
	\$ -	\$ 145

Minimum payments on capital lease obligations due in each of the next three fiscal years are as follows:

	Principal	Interest	Minimum Payment
2011	\$ 127	\$ 2	\$ 129
2012	-	-	-
2013	-	-	-
	\$ 127	\$ 2	\$ 129

#### 10. SUBORDINATED NOTES

On March 19, 2010, the Company completed a private placement financing, with Talon Mezzanine Partners LLC and Oakwest Corporation Limited as the subscribers (see Note 15). Principals of these entities are members of the Board of Directors of the Company. The \$2,000 aggregate financing involved the purchase by each of the subscribers of one unit issued by the Company, with each unit consisting of (i) \$1,000 principal amount of newly issued secured non-convertible subordinated notes (the "Notes") of the Company with a three year term due on March 19, 2013; and (ii) non-transferable common share purchase warrants (the Series 2010-I warrants) exercisable into 791,614 common shares of the Company, with a five year term and an exercise price of \$0.66 per share (see Note 12(c)).

The Notes are not negotiable instruments, ranking equally and ratably with each other and are subordinated to all of the Company's obligations to its operating lender (See Note 8).

The Notes bear interest at a rate of 12% per annum, calculated and payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, and in the event of default at a rate of 18% per annum.

The Company has the right on any interest payment date to prepay any portion of the principal balance, without any bonus or penalty payment, on 30 days written notice being given to the holder of the note provided that all amounts of interest which are due and payable under the note have been paid. At any time and from time to time the holder of the note may use the principal balance and any interest thereon as the subscription price for the purchase of any warrants pursuant to the warrant certificate.

The Company has granted a general and continuing security interest in all of its property, assets and undertaking, including without limitation, all property, equipment, goods, chattel and inventory of any kind of the Company whether now owned or hereafter acquired. In addition, a wholly owned subsidiary of the Company has also provided a joint and several guarantee of the Company's obligations under the Notes.

The Company allocated \$1,506 of the face value of the Notes to the liability component and \$494 to the equity component using the relative fair value method. The fair value of the liability component was estimated by discounting the future payments of interest and principal. The carrying value of the liability will be accreted to the \$2,000 face value over the term of the subordinated notes resulting in an effective interest rate of 20.8%. Total proceeds of \$2,000 equate to \$479 of equity and \$1,474 of liability components, net of transaction costs of \$47. Total interest expense related to the Notes for fiscal 2010 is \$214 (including accretion of \$83).

On March 31, 2010, the Company's senior lender delivered a notification of breach of the loan agreement dated October 17, 2008 as a result of the private placement financing which closed on March 19, 2010 (see Note 8). As a result of that breach, the Company delayed the interest payment due on March 31, 2010 to the subordinated notes holders which resulted in a breach of the subordinated notes. On April 9, 2010 the Company, its senior lender and subordinated notes holders signed a priorities agreement which cured the breach without adjustment or financial consideration.

#### 11. DEFERRED LEASE INDUCEMENTS

The Company has entered into certain store leases, which involved the receipt of inducements, including cash payment and/or rent-free periods. These inducements are recognized as a reduction of lease expense on a straight-line basis over the term of the related leases, which presently range from 1-12 years. The current portion of these inducements is included in accounts payable and accrued liabilities:

	2010	2009
Deferred lease inducements	\$ 2,504	\$ 2,578
Less: current portion	232	257
Long term	\$ 2,272	\$ 2,321



## 12. SHARE CAPITAL

### (a) Authorized:

Unlimited number of common shares without par value.

### (b) Issued:

	Number of Shares	Amount
Balance, October 4, 2009	15,848,122	\$ 22,330
June 4, 2010 private placement	2,205,883	1,208
August 6, 2010 private placement	11,765,000	8,686
Balance October 3, 2010	29,819,005	\$ 32,224

On June 4, 2010, the Company completed a non-brokered private placement, resulting in the issuance of units consisting of 2,205,883 common shares of the Company priced at \$0.68 per common share (for aggregate proceeds of \$1,500) and 1,102,941 non-transferrable Series 2010-II warrants (see Note 12(c)). As a result of this financing, the number of common shares outstanding increased from 15,848,122 at the beginning of the year to 18,054,005 as at June 4, 2010.

On August 6, 2010, the Company completed a second, brokered, private placement, resulting in the issuance of 11,765,000 common shares of the Company priced at \$0.85 per common share (for aggregate proceeds of \$10,000) and 882,375 broker warrants (see Note 12(c)). As a result of this financing, there was a 65.2% increase in the number of common shares outstanding from 18,054,005 as at June 4, 2010 to 29,819,005 as at October 3, 2010.

### (c) Common Share Purchase Warrants

The following summarizes the warrant activity in fiscal 2010 and the number of warrants outstanding as at October 3, 2010:

	Number of Warrants	Exercise Price	Expiry	Carrying Value
Series 2010-I	1,583,228	\$ 0.66	19-Mar-15	\$ 479
Series 2010-II	1,102,941	\$ 0.85	4-Jun-13	273
Balance June 4, 2010	2,686,169			752
Broker warrants	882,375	\$ 0.95	6-Aug-12	268
Balance October 3, 2010	3,568,544			\$ 1,020

#### **Series 2010- I**

In connection with the private placement financing which closed on March 19, 2010 (see Note 10), the Company created a warrant (Series 2010-I) to purchase common shares of the Company. There are presently two certificates issued under this series each comprising of 791,614 warrants, issued to the holders of the notes on March 19, 2010. The warrants are non-transferable. Each warrant entitles the holder to acquire a common share of the Company at any time after July 19, 2010 and before the close of business on March 19, 2015 for an exercise price of \$.66 per share.

In addition, in the event of a change of control transaction, the holder has the option to elect to receive common shares determined under a specified formula.

The allocation of the proceeds, net of transaction costs, between the liability component (the Notes) and the equity component (the warrants) is described in Note 10.

#### **Series 2010-II**

In connection with the private placement financing which was completed on June 4, 2010 (see Note 12(b)), each of the 1,102,941 non-transferrable Series 2010-II warrants entitles the holder to acquire a common share of the Company before the close of business on June 4, 2013 for an exercise price of \$0.85 per share. Both the common shares and warrants issued pursuant to this placement are subject to a four month holding period from the June 4 closing date. Accordingly, the common shares can be traded and the warrants exercised at any time after October 4, 2010. The warrants are also exercisable prior to the expiry date (June 4, 2013) if there is a change of control of the Company. If at any time during the term of the warrants, the common shares of the Company trade at a price of \$1.70 per share or greater for a period of 20 consecutive trading days, the Company has the option to accelerate the expiry date of the warrants to the date which is 10 days following the date upon which the Company provides notice to the holders thereof of such accelerated expiry date.

The Company has allocated \$277 to the warrants and \$1,223 to the common shares. The total issue cost of \$19 has been

prorated against the warrants and the common shares resulting in a residual carrying value of \$273 for the warrants and \$1,208 for the common shares.

### **Broker Warrants**

In connection with the private placement financing which was completed on August 6, 2010 (see Note 12(b)), the agents for the offering were reimbursed for certain costs incurred related to the transaction and received compensation consisting of approximately \$750 (representing 7.5% of the gross proceeds of the offering) and 882,375 of Company issued broker warrants (representing 7.5% of the aggregate number of common shares sold pursuant to the offering). The transfer of broker warrants is restricted. Each broker warrant is exercisable for one common share at a price of \$0.95 for a period of twenty four months following the August 6 closing date. Both the common shares and broker warrants issued pursuant to this placement are subject to a four month holding period from the August 6 closing date. Accordingly, the common shares can be traded and the warrants exercised at any time after December 6, 2010.

The Company has allocated \$298 to the warrants and \$9,702 to the common shares. The total issue cost of \$1,046 has been prorated against the warrants and the common shares resulting in a residual carrying value of \$268 for the warrants and \$8,686 for the common shares.

Each of the three warrant series contain standard anti-dilution provisions including adjustment to the exercise price and the number of common shares issuable upon the exercise of the warrants where there is a common share reorganization, rights offering, distribution, reclassification or other capital reorganization. Any adjustment is intended to place the holder in the same position as if the holder had been a registered holder of common shares on the effective date of the event.

In addition, each series contains a provision in which the Company will not enter into any transaction whereby all or substantially all of the property and assets would become the property of a successor corporation, unless the warrants remain a valid and binding obligation of the successor.

### **Exercise**

Only the Series I warrants were exercisable at October 3, 2010. No warrants were exercised in 2010. There were no warrants issued or outstanding in 2009.

### **(d) Stock options:**

The plan, under which options will be granted to directors, officers, employees, key consultants and agents of the Company, is subject to certain terms and conditions. The granting of options and the related vesting period are at the discretion of the Board of Directors. Stock options granted have graded vesting over a period of up to five years and expire at various dates through September 2015.

During the second quarter of 2009, the Company increased the number of stock options reserved by 833,128 to 1,584,812. In accordance with the terms of the stock option plan, the number of stock options reserved was increased on June 4, 2010 by 220,588 and on August 6, 2010 by 1,176,500 as a result of the private placement financings which occurred on those dates and involved the issuance of common shares of the Company (see Note 12 (b)). This brings the total number of stock options reserved to 2,981,900 as at October 3, 2010.

The Company granted 1,037,500 stock options during 2010 (2009 - 1,572,500). The estimated weighted average fair value of these options was \$0.51 (2009 - \$.53) per option, which is being expensed over their vesting period, and has been determined using the Black-Scholes option-pricing model. At October 3, 2010, the exercise price of outstanding stock options ranged from \$.66 to \$5.95 per common share.

Compensation cost related to stock option awards granted during the year under the fair value based approach was calculated using the following weighted average assumptions:

	2010	2009
Expected option life	5 years	5 years
Risk-free interest rate	1.6-2.5%	1.6-2.5%
Expected stock price volatility	70 to 79%	70 to 74%
Average dividend yield	nil	nil

A summary of the status of the Company's stock option plan as of October 3, 2010 and October 4, 2009 and changes during



these fiscal years is presented below:

	October 3, 2010		October 4, 2009	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	1,218,200	\$ 1.07	632,684	\$ 4.06
Granted	1,037,500	.80	1,572,500	.89
Forfeited/expired	(1,012,900)	.95	(986,984)	2.69
Stock options outstanding, end of year	1,242,800	\$ .95	1,218,200	\$ 1.07

The 2010 grants include 957,500 issued to senior executives of the Company. Of this total 757,500 vest over the next four years. The remaining 200,000 are performance based options, which vest no later than January 4, 2011, if performance is met.

There were 700,000 options forfeited in the third quarter of 2010, related to two former senior executives of the Company.

The following table summarizes information about stock options outstanding at October 3, 2010:

Options outstanding			Options exercisable		
Range of exercise price outstanding	Number outstanding at October 3, 2010	Weighted average remaining contractual life (months)	Weighted average exercise price	Number exercisable at October 3, 2010	Weighted average exercise price
\$.66 - .99	1,045,000	57	\$ .80	3,000	\$ .72
1.00 - 2.49	177,500	37	1.24	143,000	1.20
3.00 - 4.49	-	-	-	-	-
4.50 - 5.99	20,300	10	5.92	14,880	5.92
	1,242,800	53	\$ .95	160,880	\$ 1.63

**(e) Contributed Surplus**

The Company recognizes stock-based compensation expense using the fair value method, when options are granted to employees. Such cost is recorded as an expense and an increase to contributed surplus, using a straight-line expense allocation method, over the vesting period related to such options. The amount is included in contributed surplus on the consolidated balance sheets and selling, general and administrative expenses on the consolidated statements of loss and comprehensive loss. For the year ended October 3, 2010 the Company recognized stock-based compensation expense of \$41 (2009 - \$147).

The following is a continuity schedule of contributed surplus:

	2010	2009
Balance, beginning of year	\$1,554	\$1,407
Stock-based compensation expense	41	147
Balance, end of year	\$1,595	\$1,554

**(f) Per share amounts**

Per share amounts have been calculated on the weighted average number of shares outstanding during the year. The weighted average shares outstanding for the year ended October 3, 2010 was 18,493,214, taking into account the common shares issued in connection with the private placement financings completed on June 4 and August 6, 2010 (see Note 12(b)). The weighted average shares outstanding for the year ended October 4, 2009 was 13,300,789, taking into account the share issuance in connection with the acquisition of the Talon Wholesale Business on February 4, 2009 (see Note 4).

Diluted loss per share is equal to the basic loss per share for the periods presented since common stock equivalents of options and warrants to acquire common shares outstanding at October 3, 2010 and October 4, 2009 are anti-dilutive; they may be dilutive in the future. The number of shares that could potentially dilute basic earnings per share in the future but that were not included in the computation of diluted earnings per share because they were anti-dilutive, as at October 3, 2010, are 4,811,344 (based on 1,242,800 options and 3,568,544 warrants outstanding), compared to 1,218,200 at October 4, 2009 (based on options outstanding).

The provision for income taxes differs from the amount obtained by applying the combined applicable income tax rate to loss from continuing operations before income taxes. The difference relates to the following items:

	Years ended	
	October 3, 2010	October 4, 2009
Statutory income tax rate	32.6%	32.9 %
Calculated tax recovery	\$ (4,017)	\$ (5,789)
Change in inventory accounting policy	-	(426)
Stock option benefit	13	48
Accretion on subordinated notes	26	-
Goodwill impairment charge	-	77
Change in valuation allowance	3,408	5,392
Other items	570	698
	\$ -	\$ -

The tax effects of temporary differences that give rise to significant portions of the future tax asset at October 3, 2010 are presented below:

	Assets		Total	
	Canada	United States	2010	2009
Non-capital loss carry forwards	\$ 10,065	\$ 3,694	\$ 13,759	\$ 11,451
Capital assets	229	(26)	203	133
Deferred financing costs	984	528	1,512	482
	11,278	4,196	15,474	12,066
Valuation allowance	(11,278)	(4,196)	(15,474)	(12,066)
Net future tax asset	\$ -	\$ -	\$ -	-

As at October 3, 2010, the Company has non-capital income tax loss carry-forwards that expire as follows:

	Amount	Expiry
Canada	36,719	2027-2030
United States	9,234	2027-2030

#### 14. CASH FLOWS - CHANGES IN NON-CASH WORKING CAPITAL

The following table details the components of non-cash working capital for operating and investing activities. The 2009 acquisition of Talon's wholesale business was a non-cash transaction, involving the issuance of common shares only. Certain post-acquisition changes in the related non-cash working capital components are included on the 2009 Consolidated Statements of Cash Flows as related to investment activities, as noted below:

	2010	2009
Accounts receivable	\$ 42	\$ 46
Inventory	(5,678)	11,797
Prepaid expenses	(64)	118
Accounts payable and accrued liabilities	(1,760)	2,688
	(7,460)	14,649
Operating non-cash working capital items	(7,460)	15,655
Investing	-	(1,006)
	\$ (7,460)	\$ 14,649



## 15. RELATED PARTY TRANSACTIONS

During 2009, the Company entered into certain agreements with members of the Board of Directors and executive management, or parties related thereto, for the provision of goods and services in connection with the normal course of operations. The Board of Directors was aware of these arrangements and satisfied that the value, terms and conditions were comparable to similar third party agreements. The value of the services invoiced during 2010 was \$272 (2009- \$102), measured at the exchange amount, and has been reflected as prepaid expenses or selling, general and administrative expenses, of which \$2 was outstanding as at October 3, 2010 (2009 - \$63), included in accounts payable and accrued liabilities. The outstanding related party contractual commitment as at October 3, 2010 was \$339 (2009 -\$492) related to services to be provided over the next four years.

In addition, the Company compensated the members of the Special Committee of the Board of Directors, which was formed in 2008 to investigate and evaluate strategic alternatives available to the Company to increase shareholder value, resulting in the Talon investment and acquisition. Total compensation of \$125 was paid to these Board members in 2009, with a portion reflected in selling, general and administrative expenses and the balance charged directly to share capital, in connection with the fees related to the issuance of common shares.

During 2010, there was one related party transaction entered into for \$2 related to store upgrades. In addition, on March 19, 2010 the Company completed a private placement financing with Talon Mezzanine Partners LLC, and Oakwest Corporation Limited as the subscribers. Principals of these entities are members of the Board of Directors of the Company. The \$2,000 aggregate financing involved the purchase by each of the subscribers of one unit issued by the Company, with each unit consisting of (i) \$1,000 principal amount of newly issued secured non-convertible subordinated notes of the Company with a three year term; and (ii) non-transferable common share purchase warrants exercisable into 791,614 common shares of the Company, with a five year term and an exercise price of \$0.66 per share. This transaction did not materially affect the control of the Company. These securities have been recognized at their relative fair value net of transaction costs, as described in Note 10 and Note 12(c).

The Company also compensated the Special Committee of the Board of Directors, which was formed in 2010 to investigate strategic financing alternatives available to the Company, resulting in the issuance of common shares of the Company on August 6. Total compensation of \$125 was charged directly to share capital, in connection with the fees related to the issuance of common shares. A payment of \$80 was made during 2010 with the balance of \$45 due in January 2011.

In addition, a Special Finance Committee of the Board of Directors was formed in August 2010 to assist the Board and management in creating appropriate compensation plans for the Company, assist with the 2011 budget process and the Company's adoption of the new IFRS accounting rules. Total compensation for this Committee has been approved at \$36, with \$8 paid prior to the end of fiscal 2010 and \$2 included in accounts payable and accrued liabilities on October 3, 2010. The balance is to be paid bi-weekly through the end of the term on December 31, 2010.

There is also an outstanding advance to a senior executive of the Company, principally related to certain employment costs. The balance outstanding at October 3, 2010 was \$101 (2009 - \$37) and is included in accounts receivable.

## 16. COMMITMENTS AND CONTINGENCIES

The Company leases properties and equipment under operating leases covering various years up to 2037. The minimum future payments, excluding tenant operating costs, under these leases in each of the next five years are approximately as follows:

Fiscal	2011	\$ 13,786
	2012	13,650
	2013	12,205
	2014	10,878
	2015	9,649
	Thereafter	28,327
	Total	\$ 88,495

In addition to minimum annual rentals, the Company may be liable for its share of common area maintenance costs and property taxes. Contingent rentals may also be payable under certain store leases on the basis of sales in excess of stipulated amounts.

The Company is involved and potentially subject to various claims by third parties arising out of the normal course and conduct of its business. Management assesses such claims and where it is considered likely that the claim will result in a material loss and where the amount of the loss is quantifiable, provisions for loss are made based on management's assessment of the likely outcome. The Company does not provide for claims that are considered unlikely to result in a significant loss, claims for which the outcome is not determinable or claims where the amount of the loss cannot be reasonably estimated. Any settlements or awards under such claims are provided for when reasonably determinable. Although such matters cannot be predicted with certainty, management currently considers the exposure to such claims and litigation, to the extent not covered by the Company's insurance policies or otherwise provided for, not to be material to these consolidated financial statements.

## 17. SEGMENTED INFORMATION

2010	Canada	U.S.	Total
Revenue	\$ 151,308	\$ 2,091	\$ 153,399
Capital assets	\$ 8,538	\$ 536	\$ 9,074

2009			
Revenue	\$ 153,132	\$ 4,677	\$ 157,809
Capital assets	\$ 8,537	\$ 76	\$ 8,613

## 18. FINANCIAL INSTRUMENTS

### Classification and fair value of financial instruments

- (i) Bank indebtedness is classified as "Held for Trading" as the fair value can be readily measured. Bank indebtedness is measured at fair value and transaction costs are recorded directly in net income. Assets and liabilities held for trading are revalued on the reporting date based on relevant market information and information about the financial instrument. The gains or losses resulting from the re-measurement at the end of each period are recognized in net income.
- (ii) Accounts receivable are classified as "Loans and Receivables". They are recorded at cost, which upon their initial measurement is equal to their fair value. The carrying amounts of accounts receivable approximate their fair values due to the relatively short periods to maturity.
- (iii) Accounts payable and accrued liabilities and subordinated notes are designated as "Other Financial Liabilities". These financial instruments are initially measured at fair value, net of transaction costs. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest rate method. The carrying amounts of accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity. As the subordinated notes are held by related parties, the fair value has not been disclosed as fair value cannot be reliably measured.

### Financial Risk Management

#### (a) Credit risk:

The Company does not grant credit in the normal course of its retail operations. The maximum exposure to credit risk at October 3, 2010 is best represented by the carrying amount of the accounts receivable on the balance sheet. The Company believes its exposure to credit risk is minimal.

#### (b) Interest rate risk:

The Company has an asset based lending facility with a Canadian chartered bank in the maximum amount of \$25,000 as at October 3, 2010 (see Note 8). The interest rate on this facility is based on the prime rate of a Canadian chartered bank which is a floating rate. Based on the Company's average fiscal 2010 bank borrowings, fluctuations of +/-1% in the average prime rate would have an effect on the loss before income taxes of approximately \$173.

#### (c) Foreign currency risk:

The Company is exposed to foreign currency fluctuations in relation to its operations in the United States. Foreign exchange risk arises because the amount of the local payable for transactions denominated in foreign currencies may vary due to changes in exchange rates ("transaction exposures") and because the non-Canadian dollar denominated financial statements of the Company may vary on revaluation into the Canadian dollar reporting currency ("translation exposures"). The Company's exposure relates to the fact that a significant portion of its inventory purchases is transacted in US dollars. As a result, the Company may experience transaction and translation exposures because of the volatility in the exchange rate between the US dollar and the Canadian dollar. Based on the Company's US dollar denominated purchases in fiscal 2010, fluctuations of +/- 5% in the US dollar against the Canadian dollar would have an effect on the loss before income taxes of approximately \$1,608. The Company does not use derivatives to manage its foreign currency risk.

#### (d) Liquidity risk:

Liquidity risk addresses the Company's ability to meet its financial obligations when they come due. The Company manages the liquidity risk of forecasted anticipated cash flows from operations by ensuring that there are available cash resources to meet these needs.



The undiscounted contractual maturities of the Company's financial liabilities as at October 3, 2010 are as follows:

Fiscal	2011	2012	2013
Bank indebtedness-net of cash	\$ 15,797	\$ -	\$ -
Subordinated notes	\$ -	\$ -	\$ 2,000

(e) *Financing Risk:*

Under the asset based lending facility (see Note 8) the bank at its discretion may effectively decrease the borrowing base and thereby funding availability. The Company is also required to maintain certain financial covenants. The Company manages its financing risk by having ongoing contact with its lenders and closely monitoring compliance with its lending covenants.

As at October 3, 2010, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. Further details are provided in Note 8.

## 19. CAPITAL MANAGEMENT

The Company's capital consists of debt and share capital. The Company's objective when managing its capital is to safeguard the Company's assets while at the same time maximizing the growth of its business and the returns to its shareholders. This objective is achieved by prudently managing the capital generated through internal growth, optimizing the use of lower cost capital (capital leases and bank debt) and raising share capital when required to fund growth initiatives. Short term borrowings are managed through managing inventory purchases, scheduling payments and balancing inventory levels and reducing inventory levels to reduce debt when prudent.

The Company is subject to margining requirements under its bank credit facility which limit its borrowings to the lesser of its credit limit and its available borrowing base that is determined mainly by eligible inventory on hand. As at October 3, 2010, the Company was in compliance with these margining requirements.

The Company monitors capital on the basis of the ratio of debt to shareholders' equity (debt divided by the book value of shareholders' equity). The Company has no mandated range or ceiling for its ratio of debt to equity. The Company's ratio of debt to shareholders' equity on a book and current value basis is as follows:

	2010	2009
Bank indebtedness, net of cash	\$ 15,797	\$ 8,758
Subordinated notes	1,557	-
Capital leases	127	855
Debt	17,481	9,613
Capital stock	32,224	22,330
Warrants	1,020	-
Contributed surplus	1,595	1,554
Deficit	(18,814)	(6,483)
Shareholders' equity	16,025	17,401
Debt to equity ratio	1.09:1	.55:1

## 20. COMPARATIVE INFORMATION

Certain 2009 comparative figures have been reclassified to conform to the current consolidated financial statement presentation adopted in 2010.

# CORPORATE INFORMATION

## DIRECTORS

### **William E. Wolf**, MBA, Chairman

Bill is the Chief Operating officer of Talon Asset Management, LLC and serves as a portfolio manager for Talon's TalCap public equity product and oversees Talon's private equity investments. Bill began his career as an investment banker at Salomon Brothers Inc., before moving to William Blair & Company. Later, he became the founder and CEO of Crown Golf Properties, L.P. Bill currently serves on the Board of Directors of Answers Media LLC, Compliance 11, Inc., Lava Lite, LLC, Mindcrest, Inc., PlayNetwork, Inc., and the National Strategy Forum.

### **David Becker**

Mr. Becker is currently a self-employed business consultant. He has previously held the title of Chief Financial Officer at two NASDAQ listed companies located in the United States. He has previously served as a business consultant with an emphasis on financial and merger and acquisition projects. Mr. Becker earned a bachelor's degree in accounting in 1990 from the University of Southern Mississippi.

### **Eric Beutel**

Eric is a Director, Vice President and Secretary of Oakwest Corporation Limited, a private investment company in Toronto. Mr. Beutel also sits on the Board of Directors and Investment Committee of The Equitable Group, a TSX listed company.

### **Craig Graham**

Craig is currently a director and investor in a number of companies including Executive Risk Services Limited, Norsim Equipment Limited, and Twenty First Century Investments Inc. Mr. Graham is also a trustee of Specialty Food Income Fund.

### **Jeffrey Mandel**

Jeffrey is the President of AMR Securities Services Inc. and Vice President, Israel Opportunity Inc. He also is Executive Chairman of Mitec Telecom (TSX) - MTM, and a director of The Futura Loyalty Group Inc. (TSX-V) - FUT.

### **Seth Marks**, President and CEO

Seth joined Liquidation World in February 2009 as President, CEO, and member of the board. Seth is a consumer products veteran and has a long successful track record in retail and wholesale liquidation environments. Prior to joining Liquidation World, Seth founded Talon Merchant Capital, which was subsequently acquired by Liquidation World and co-founded Big Lots Capital (the Liquidation arm of Big Lots Stores), and Hilco Wholesale Trading.



**SOLICITORS**

Aird & Berlis LLP  
181 Bay St., Suite 1800  
Toronto, ON M5J 2T9

**AUDITORS**

Ernst & Young, LLP, Chartered Accountants  
One London Place Suite 1800  
255 Queens Ave.  
London, ON N6A 5S7

**HEAD OFFICE**

225 Henry Street, Building #1  
Brantford, ON N3S 7R4  
Phone: 519-758-8878  
Fax: 866-237-3778

Web: [www.lwstores.com](http://www.lwstores.com)

**BANK**

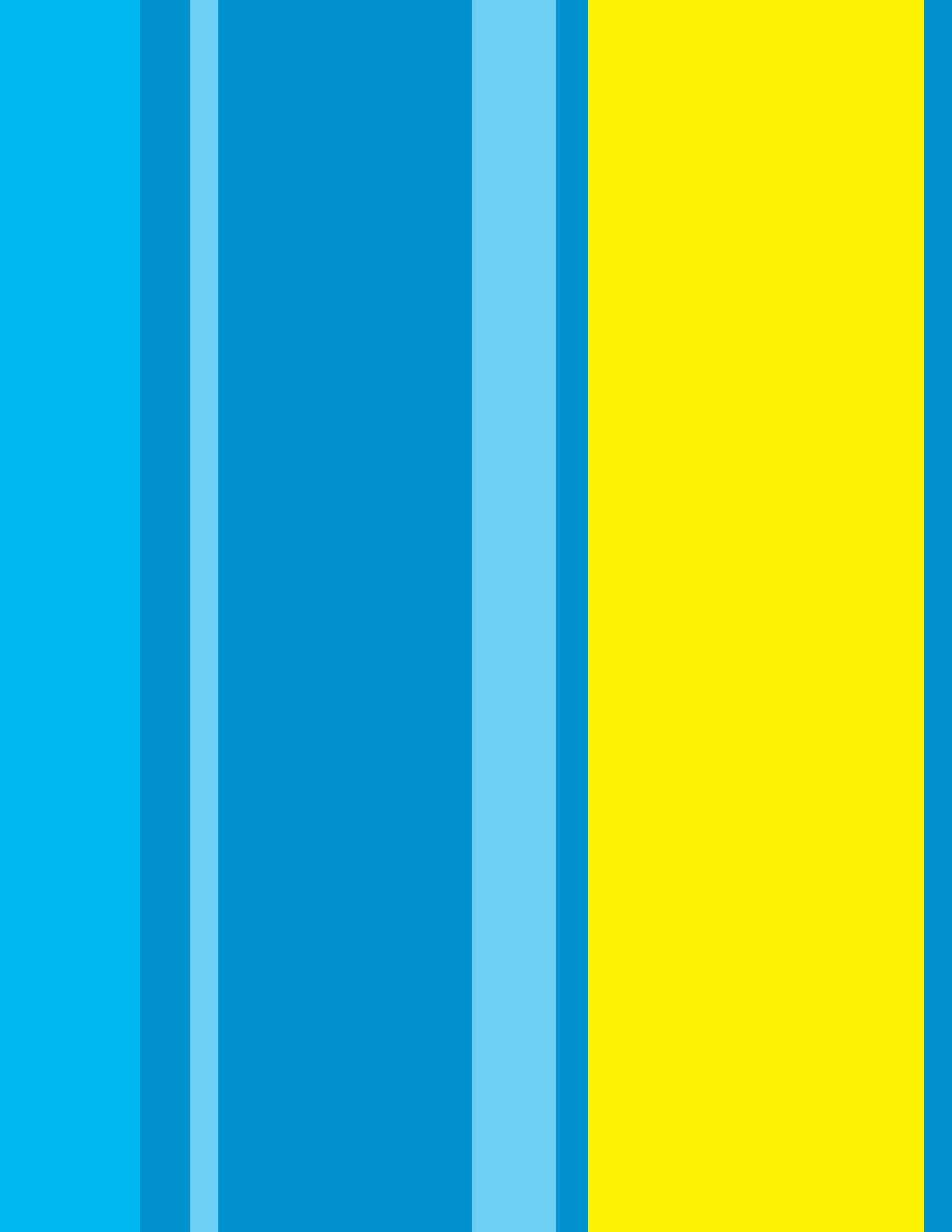
Royal Bank of Canada  
P.O. Box 50, 200 Bay Street  
Toronto, ON M5J 2W7

**TRANSFER AGENT**

Computershare Investor Services  
100 University Ave, 8th Floor  
Toronto, ON M5J 2Y1

Shares are listed on the Toronto Stock Exchange under the symbol LQW.





## Outlet Locations

### ALBERTA

Calgary (3)  
Camrose  
Edmonton  
Hinton  
Lethbridge  
Medicine Hat  
Peace River  
Ponoka  
St. Paul  
Westlock  
Wetaskiwin

### MANITOBA

Steinbach  
Swan River  
Winnipeg (2)

### NOVA SCOTIA

Amherst  
Dartmouth  
Halifax  
Truro

### NEW BRUNSWICK

Fredericton  
Saint John  
St. Stephen

### SASKATCHEWAN

Moose Jaw  
Prince Albert  
Regina  
Saskatoon  
Swift Current  
Yorkton

### YUKON

Whitehorse

### ONTARIO

Ajax  
Arthur  
Aurora  
Barrie  
Belleville  
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Hamilton (2)  
Ingersoll  
Keswick  
Kingston  
Leamington  
London  
Mississauga  
Niagara Falls  
Oakville  
Orillia  
Paris  
Petawawa  
Port Colborne  
Prescott  
Sarnia  
Sault Ste. Marie  
Scarborough  
Smiths Falls  
St. Catharines (2)  
Sudbury  
Thunder Bay  
Trenton  
Wallaceburg  
Welland  
Windsor (3)

### BRITISH COLUMBIA

Abbotsford  
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Coquitlam  
Courtenay  
Cranbrook  
Duncan  
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Kamloops  
Langley  
Maple Ridge  
Mission  
Nanaimo  
Penticton  
Prince George  
Powell River  
Richmond  
Surrey  
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Vernon

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Chicago

### HOME OFFICE

225 Henry Street, Bldg #1  
Brantford, ON N3S 7R4  
Tel: 519-758-8878  
Fax: 866-237-3778



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