

# QUARTERLY REPORT



Liquidation World Inc.

Q1 2011

## 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.



## PRESIDENT'S MESSAGE

The fiscal 2011 first quarter financial results demonstrate Liquidation World's continued investment in its planned evolution from a liquidator of close out goods to Canada's premier destination for extreme value. The road has continued to be challenging and at times rough. We have learned a great deal about what works well in our business and continue to believe strongly in LW's ability to grow and fill an underserved market within the Canadian retail landscape.

In the last 24 months, we believe that we have identified a strategy that works and that we have proven that our revised core business model can generate same store sales increases and improved profitability at the store level. We are pursuing an operational improvement plan that synchronizes our supply chain with our merchandising processes, resulting in a 12% post conversion growth rate in our "LW - Everybody's Outlet Store" converted stores.

The growth of our business is dependent on our ability to have access to enough capital to fund the conversion of all locations and to sustain necessary inventory levels. In early January, David Becker was appointed Interim CFO. David's previous experience as Chairman of the Audit Committee and as a Board Member, combined with his expertise as both a start up and turnaround CFO, affords LW a great advantage in raising adequate capital to complete our store conversions, open new stores under our new banner and increase our inventory base.

During this time period LW's capital investment has largely been focused on building and improving its platform from which to grow, including its supply chain infrastructure and merchandising systems, and then applying these tools to new store openings and existing store conversions. Positive gains have been made in the supply chain function, as we are now able to replenish a specific set of stock-keeping units (SKUs) which serve to build traffic and increase sales per square foot by maintaining an in-stock position on certain everyday items. The Company now has the ability to automate the re-ordering of "Always In" SKUs and has efforts underway to scale this offering and accelerate the cost savings opportunities that come from the automation of buying processes.

One of our most critical next steps is developing the right inventory base and flow in terms of composition and assortment. Significant inventory improvement efforts are underway and are fueling our rebuilding efforts through inventory based initiatives in fiscal 2011. These include markdown optimization, rationalization of underperforming SKUs and more strategic buying processes and disciplines. In conjunction with our ability to replenish everyday value items, LW is performing a cull, cleanse and purge of our overall SKU base to deliver improvement in returns on our investment in inventory. Better control and enhancement of our SKU universe allows us to focus on the high volume selling items at the same time, delivering on our motto of "Miss a Day Miss a Deal" to keep customers coming back to LW to look for unique value opportunities. The flow of seasonal goods, everyday living items, and opportunistic bargains require the Company to have higher amounts of capital than the Company has historically been able to access.

SKU lifecycle management is one important key to generating profit and shareholder value. In conjunction with refining our SKU base, our vendor community is also migrating from a one-time close out exclusive arrangement to a more sustainable base of vendors that can continuously supply LW with brand name goods at extreme value pricing. The development of our vendor partnerships allows for more cash flow favorable payment terms.

The adjustment and enhancement of our inventory requires additional capital. Deal launches are also large users of capital through media print and the financing of inventory in preparation for the event. Investment in our advertising program has enhanced our understanding of the requisite inventory levels to support current year sales targets and plans for expansion. Executing a flyer, conversion of legacy sites and DC consolidation efforts were investments in operational performance for the future.

In the past year we have observed non-Canadian mature, seasoned retail players transact agreements to enter the Canadian marketplace. The improvements we have made to our base business, in particular, building a supply chain function from the ground up, likely enhances our value to potential investors. As we prepare to expand and accelerate our growth, we believe that we have become a more attractive to other retailers seeking a growth vehicle which would establish a strong store presence in the Canadian market.

In summary, we have spent significant capital and time improving LW. At times, the challenges of fixing the nuts and bolts of our retail operations distracted us from what we know best - the buying of great deals that bring customers into our stores. Wowing our customers with great deals is the essence of our existence and what differentiates us from other Canadian retailers. I have personally committed to refocusing on sourcing continuous product supply and sourcing opportunistic buys. I rededicate myself to being fully engaged in the management of our inventory and deal pipeline to ensure a continued assortment of treasure hunt bargains.

As LW continues to expand I'd like to acknowledge and thank our customers for their support and our employees for their day-to-day commitment and passion for the growth of our business.



Seth Marks  
President & CEO



# 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 13 weeks ended January 2, 2011.

This MD&A is dated as of February 14, 2011 and should be read in conjunction with the unaudited Interim 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 February 14, 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 sells 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 the end of the first quarter 2011, the Company had a total of 92 stores in Canada and 1 store in the US.

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 network of vendors, the Company capitalizes on inventory opportunities as they arise.

## OVERALL PERFORMANCE

A summary of results of operations for the first quarter of 2011 comprising the 13 weeks ended January 2, 2011 is as follows:

- The Company began fiscal year 2011 with 88 stores in Canada and 1 store in Chicago, IL. During first quarter 2011, the Company closed 2 stores and opened 7 new stores. Four of the new stores replaced stores that the Company closed in the same geographic market during the last seven months. All the Company's new stores were opened under its "LW - Everybody's Outlet Store" banner.
- In addition to the 7 store openings during the first seven weeks of fiscal 2011, the Company converted 4 "Liquidation World" banner stores to its new "LW - Everybody's Outlet Store" banner.

- At the end of Q1 2011, the Company was operating a total of 92 stores in Canada and 1 store in Chicago, IL. Of its 92 Canadian stores, 44 are operating under the "LW - Everybody's Outlet Store" banner and 48 are operating under the "Liquidation World" banner.
- Total revenue for the first quarter of fiscal 2011, comprising 13 weeks of operations ended January 2, 2011, decreased approximately \$709 or 1.6% to approximately \$43,421 from \$44,130 during the first quarter of fiscal 2010. The variance was attributable to several factors:
  - During the first quarter of fiscal 2011, same store sales increased approximately 12.0%, or approximately \$1,897 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 approximately 4.5%, or approximately \$1,001, for legacy "Liquidation World" banner stores.
  - In total, same store sales increased 1.3% or \$539 during the first quarter of fiscal 2011. Other factors causing a variance in the Company's first quarter fiscal 2011 revenue versus its first quarter fiscal 2010 revenue include (i) a decline of \$321 attributable to US wholesale revenue, (ii) an increase of \$1,917 from new store openings, (iii) a decline of \$2,731 from store closures and, (iv) a decline in warehouse sales of \$113.
- Gross margin decreased to \$12,739 or 29.3% of sales from \$17,278 or 39.2% of sales in the prior year.
- Selling, general and administrative expenses of \$17,384 (40.0% of sales) compared to \$15,558 (35.3% of sales) in the same quarter of 2010, included:
  - advertising costs totaling \$1,464 compared to \$814 in Q1 2010 reflecting the Company's renewed emphasis on consumer awareness, focused on the store rebranding and product promotions.
  - restructuring, and other costs of \$680 (consisting of new store expenses of \$282, conversion and store relocation expenses of \$228, closed store and DC costs of \$76, severances of \$43, and financing of \$51) compared to \$392 of restructuring costs in Q1 2010 (consisting of new store expenses of \$39, closed store and DC costs of \$250, severances of \$177, and other cost recoveries of \$74).
- A net loss of \$5,999 was recorded for the quarter, including a \$5,460 net loss from Canadian operations and a \$539 net loss from US operations. In Q1 2010, the Company recorded a net income of \$719, including a net income from Canadian operations of \$1,212 and a net loss of \$493 from US operations.
- EBITDA for the first quarter of 2011 was a loss of \$4,589 or 10.6% of sales, as compared to an income of \$1,754 or 4.0% of sales in the comparable quarter of 2010.

## RESULTS OF OPERATIONS

### Revenue

Revenue, which includes sales of merchandise and fee revenue, totaled \$43,421 for Q1 2011 versus \$44,130 in Q1 2010, representing a decrease of \$709 or 1.6%. The decrease was attributable to i) an increase in same store sales (defined as sales from stores open a full 14 months or more) of 1.3% or \$539, ii) a favourable impact of \$1,917 from new store openings iii) an unfavourable impact of \$2,731 from store closures iv) a decrease of \$321 attributable to US wholesale sales and v) a decline in warehouse sales of \$113.

In Canada, revenue for the quarter decreased by 0.8% to \$43,243 from \$43,587 in the corresponding quarter of 2010. In the United States, revenue decreased by 67.2% to \$178 from \$543, comprised of a decline in store revenue from \$209 in 2010 to \$165 in 2011 and a decrease in non-store revenue from \$334 in 2010 to \$13 in 2011.

At the end of Q1 2011, the Company had a total of 92 stores in Canada and 1 store in the US. Of the Company's 92 Canadian stores, 44 were operating under the "LW-Everybody's Outlet Store" banner and 48 were operating under the "Liquidation World" banner.

Inventory at the end of the first quarter increased \$1,107 (3.0%) to \$38,511 from \$37,404 in the comparable quarter in 2010. Total valuation allowances against inventory were \$1,612 and \$446 at January 2, 2011 and January 3, 2010, respectively.



## Gross Margin

Gross margin was \$12,739 in Q1 2011 or 29.3% of sales versus \$17,278 or 39.2% of sales in Q1 2010. The reduction in gross margin can be attributed to further markdowns taken during the quarter on slow moving inventory, increased distribution costs, shrink, and net realizable value.

Distribution centre costs increased to \$1,887 (4.4% of sales) in the quarter over last year's \$1,309 (3.0% of sales). The Company recorded shrink and valuation adjustments of \$1,247 (2.9% of sales) versus \$855 (1.9% of sales) in the same quarter last year. The Company increased provisions for declines in expected net realizable value of slow moving inventory by \$623 (1.4% of sales) vs \$212 (0.5% of sales) in the same quarter last year.

### Q1 Gross Margin Analysis

	2011		2010		Variance	
	\$	%	\$	%	\$	%
Sales	43,421	100%	44,130	100%		
Landed Cost	26,925	62.0%	24,476	55.4%	2,449	6.6%
Distribution Centre Cost	1,887	4.4%	1,309	3.0%	578	1.4%
Shrink & Valuaton	1,247	2.9%	855	1.9%	392	1.0%
Net Realizable Value	623	1.4%	212	0.5%	411	0.9%
Total Cost of Sales	30,682	70.7%	26,852	60.8%	3,830	9.9%
Gross Margin	12,739	29.3%	17,278	39.2%	(4,539)	-9.9%

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. 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, as well as all head office general and administrative costs, increased to \$17,384 (40.0% of sales) in Q1 2011 from \$15,558 (35.3% of sales) in Q1 2010. Certain expenses, totaling \$680 in the first quarter of 2011, arose primarily from severances, store relocations and conversions, closure costs and financing fees, compared to \$392 incurred in Q1 2010. Q1 2010 costs were principally related to severances, closure costs, and new store costs. Additional detail is provided above under Overall Performance.

Included in selling, general and administrative costs are advertising expenses totaling \$1,464 in Q1 2011 (3.4 % of sales), an increase of \$650 (79.9%) over the total incurred in Q1 2010 of \$814 (1.8% 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 increased in Q1 2011 by \$190 (25.5%) to \$936 from \$746 in Q1 2010. The increase was primarily attributable to an impairment charge related to property and equipment of \$192 (nil in Q1 2010).

## Interest

Total interest expense in Q1 2011 increased to \$474 as compared to \$289 in Q1 2010 due to higher borrowing levels, higher effective interest rates, and the additional interest cost of \$100 related to the subordinated notes issued in March 2010.

## Foreign Exchange

During the quarter, the Company recorded a net foreign exchange gain of \$56 compared to a foreign exchange gain of \$34 in Q1 2010. Exchange gains or losses are incurred on US dollar transactions and period end balances.

## Income Taxes

The statutory income tax rate in effect in Q1 2011 was 30.2% (Q1 2010 - 31.8%). The Company recorded no income tax provision in Q1 2011 and Q1 2010. As a result of income tax losses in the current and prior periods, the Company has accumulated income tax loss carry-forwards of approximately \$42,206 in Canada and \$9,518 in the US, at the end of Q1 2011.

## Net Income (Loss)

The Company recorded a net loss for Q1 2011 of \$5,999 or \$0.20 per share compared with a net income of \$719 or \$0.05 per share in Q1 2010. The change in results from Q1 2010 to Q1 2011 was primarily attributable to lower gross margins, higher interest and selling, general and administration costs.

## EBITDA

EBITDA for the first quarter of 2011 was a loss of \$4,589 or 10.6% of sales, as compared to an income of \$1,754 or 4.0% of sales in the comparable quarter of 2010.

## CASH FLOW, FINANCIAL RESOURCES AND LIQUIDITY

### Cash Flow

During the first quarter of 2011, the Company generated funds, primarily through an increase in accounts payable and a reduction in inventory which were used to offset operating losses, capital expenditures and a reduction in bank indebtedness.

### Cash Flow From Operating Activities

Cash flow consumed in operating activities in the quarter ended January 2, 2011, before changes in non-cash working capital, was \$4,914 compared to cash generated of \$1,514 for the same quarter in 2010.

Changes in non-cash working capital in the quarter was a source of cash of \$12,086 compared to a use of cash of \$5,556 in the first quarter of 2010. The quarterly changes in non-cash working capital were comprised of the following:

	13 weeks ended January 2, 2011	13 weeks ended January 3, 2010
Accounts receivable	\$ 81	\$ 41
Inventory	1,108	(3,463)
Prepaid expenses	26	(22)
Accounts payable and accrued liabilities	10,871	(2,112)
Total	\$12,086	\$(5,556)

The inventory decreased \$1,108 in the quarter from \$39,619 at October 3, 2010 to \$38,511 at January 2, 2011, as compared to the inventory balance of \$37,404 as at January 3, 2010. The level of inventory at the end of the first quarter 2011 was appropriate to support the existing number of stores.

### Cash Flow Used In Investing Activities

During the quarter, the Company incurred capital expenditures of \$1,430 as compared to \$999 in the first quarter of 2010. Expenditures in 2011 were focused mainly on information technology assets, and new, conversion, and relocated stores (including furniture and equipment and leasehold improvements) as compared to expenditures on information technology assets and new stores in 2010.

### Cash Flow From Financing Activities

In Q1 2011, cash was used to decrease bank indebtedness by \$5,713 which was primarily funded by an increase in accounts payable and accrued liabilities.



## 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 \$4,914 in Q1 2011 compared with cash generated of \$1,514 in Q1 2010. Working capital generated cash flow of \$12,086 in Q1 2011 versus a use of cash of \$5,556 in Q1 2010. As a result, cash generated in operating activities totaled \$7,172 in Q1 2011 compared to cash consumed of \$4,042 in Q1 2010.

Working capital decreased \$5,565, or 53.5%, to \$4,839 at the end of Q1 2011 compared to \$10,404 at the end of fiscal 2010. The change was largely attributable to an increase in accounts payable and accrued liabilities of \$10,871, partially offset by a reduction in bank indebtedness of \$5,713. Bank indebtedness declined as a result of a reduction in the borrowing base which arose from a lower level of eligible inventory.

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 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. The Company continued to be in breach of these covenants at the end of Q1, 2011. Further details are outlined below under the caption on Liquidity.

At the end of Q1 2011, \$14,007 had been drawn on this facility, with a corresponding borrowing base of \$14,615. The Company had net cash on hand of \$3,923 resulting in net bank indebtedness of \$10,084 compared with \$14,318 drawn (borrowing base of \$14,883), \$559 of net cash on hand and net bank indebtedness of \$13,759 at the end of Q1 2010.

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 Q1 2011 is \$100 (including accretion of \$40). There was no corresponding amount in Q1 2010.

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 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.

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.

Subsequent to the end of Q1 2011, the Company announced its intention to raise additional financing by way of a non-brokered private placement which is expected to close on or about February 21, 2011. This financing is subject to obtaining all required regulatory and other customary approvals, including the approval of the TSX.

On February 10, 2011, the Company's board of directors initiated a plan to evaluate other options which could lead to an acceleration towards profitability. These options may include additional financings, strategic partnerships, and merger and acquisition opportunities, including acquisition and divestiture transactions.

### **Exercise**

All warrants were exercisable at January 2, 2011. There were 50,000 of the Series-II warrants exercised during Q1, 2011 at \$0.85 per common share. There were no warrants issued or outstanding in 2010.

### **Liquidity**

At the end of Quarter 1, 2011, the Company had total liquidity of \$4,530, inclusive of cash on hand, compared to total liquidity of \$1,092 at the end of Q1 2010. At the end of Q1 2011, there was additional availability under the \$25,000 facility of \$10,993 that could be utilized



in the partial funding of any further increases in inventory levels as compared to \$5,682 of available liquidity under the \$20,000 facility at the end of Q1, 2010.

Dependent upon the financial performance of the Company, there is the potential for additional liquidity of \$2,778 in the future through the exercise of outstanding warrants and \$2,681 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
Financial Commitments					
Subordinated notes	\$ -	\$ 2,000	\$ -	\$ -	\$ 2,000
Capital leases	46	-	-	-	46
Contractual Obligations					
Store leases	14,100	25,537	19,841	26,485	85,963
Vehicle and equipment leases	12	-	-	-	12
Total	\$ 14,158	\$ 27,537	\$ 19,841	\$26,485	\$88,021

### SENIOR MANAGEMENT CHANGES

On January 10, 2011 the Company announced the appointment of David Becker as interim Chief Financial Officer of the Company. Mr. Becker continues to serve on the Board of Directors; however, he has relinquished his role as Chair of the Company's Audit Committee. This changed the positions of both Mr. Becker as well as Chris Rath, the Company's previous Chief Financial Officer. Mr. Rath has transitioned from this role into a contractual consulting role with the Company.

Mr. Becker previously held the positions of Chief Financial Officer at two NASDAQ listed companies located in the United States.

### OUTLOOK

The net loss of \$5,999 for the first quarter of fiscal year 2011 is disappointing, however, we remain committed to executing our strategy of improving our inventory selection, streamlining our procurement and distribution practices, adding new stores and converting the majority of our remaining legacy Liquidation World stores to the "LW - Everybody's Outlet Store" banner. We will continue to refine our advertising plan and streamline the use of flyers to generate the maximum sales benefit.

As we head into the balance of fiscal 2011, we will be focused on:

- merchandising efforts to acquire a more attractive product selection at prices which will result in improved customer value;
- aggressively take markdowns on aged inventory items to free up cash resources for redeployment into our merchandising efforts with "fresh inventory";
- capital raising activities to ensure the appropriate level of liquidity to execute our plan;
- expense management initiatives looking into every cost activity of our business;

- continued store conversion efforts to the new “LW - Everybody’s Outlet Store” format based upon available capital resources;
- and, the selective addition of new “LW - Everybody’s Outlet Store” locations based upon available capital resources.

Our same store sales trends for the converted “LW - Everybody’s Outlet Store” formats has shown positive results in the fourth quarter of fiscal 2010 and our first quarter just ended. We believe this supports the further investment into our conversion strategy. We will refresh our inventory with everyday items that will be procured on a replenishment basis so that customers know they can rely on us for key items at fantastic prices. Everyday items will be augmented by strategic close outs designed to fulfill customers expectations of a “treasure hunt shopping experience”. This implementation will result in us taking markdowns on older inventory items to make room for our new merchandising 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.

## **RISKS AND UNCERTAINTIES**

The Company is principally engaged in the sale of merchandise through 92 leased retail stores located across Canada and 1 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. While relationships with suppliers have been negatively impacted by the Company’s recent cash situation which has resulted in payment delays, the Company 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. The experience and contacts in the industry that Mr. Seth Marks', the Company's President and Chief Executive Officer, and the other members of the senior management team has, significantly benefits 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 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 current levels of liquidity will continue or that the Company's 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.

#### **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 expensed during Q1 2011 was \$91 (Q1 2010- \$49), measured at the exchange amount, and has been reflected in selling, general and administrative expenses, of which \$5 represents a reduction in prepaid expenses (Q1 2010-\$20), with the balance of \$68 included in accounts payable and accrued liabilities as at January 2, 2011 (2010 - \$29), , The outstanding related party contractual commitment as at January 2, 2011 was \$308 (2010 -\$438) related to services to be provided over the next four years.

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, included in accrued liabilities as noted above.

In addition, a Special 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 was 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 January 2, 2011 was \$113 (Q1 2010 - \$52) and is included in accounts receivable.

There were no additional related party transactions entered into during the first quarter of 2011.

## **NEW CICA ACCOUNTING PRONOUNCEMENTS**

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") 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.

### **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. Two significant areas requiring the use of estimates are the inventory shrink and valuation reserves. The process of determining the shrink reserve involves an estimate based on the last full physical inventory, adjusted for anticipated and known changes arising from subsequent events such as cycle counts. The determination of valuation reserves is 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:

1.	<b>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 Jan. 2/11	<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>
2.	<b>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 Jan. 2/11	<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 Jan. 2/11	<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 Jan. 2/11	<ul style="list-style-type: none"> <li>Assessment of impact in 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 Jan. 2/11	• Process to review contracts is in the development stage
6.	<b>Control Environment</b>	• Internal control over financial reporting
	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 Jan. 2/11	• Not yet commenced

## OUTSTANDING COMMON SHARE, STOCK OPTION AND WARRANT DATA

As of January 2, 2011, the Company has authorized for issuance unlimited common shares of which 29,869,005 (January 3, 2010 - 15,848,122) were issued and outstanding, which includes the increase of 50,000 common shares arising from the November, 2010 exercise of Series-II warrants at \$0.85 per common share.

The Company also increased the number of stock options reserved to acquire common shares from 2,981,900 as at October 3, 2010 to 2,986,900 as at January 2, 2011. The increase of 5,000 options in the quarter is based upon 10% of the new shares issued on exercise of the warrants referred to above. As of January 2, 2011, there were 1,242,800 stock options issued and outstanding and an additional 1,342,500 stock options granted in November 2010, principally to senior Company executives, which have not been issued or priced as the Company has been in a continuous blackout since that date. The balance available for issuance as at January 2, 2011 is 401,600.

As at January 3, 2010, the total number of stock options reserved to acquire common shares of the Company was 1,584,812 of which 1,065,400 were issued and outstanding, leaving a balance available for issuance of 519,412.

As of January 2, 2011 there were 3,518,544 warrants outstanding (nil in 2010), which represents a 50,000 reduction from October 3, 2010, due to the exercise of Series-II warrants in November 2010. All three warrant series referred to below, were exercisable as at January 2, 2011. No warrants were issued or exercised in Q1 2010.

The warrants outstanding at January 2, 2011 were related to the following three financing transactions entered into during fiscal 2010.

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 were 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 January 2, 2011.

## **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 implemented a temporary solution during the Q1 2011 closing process and continues to review 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 quarter ended January 2, 2011 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.

## SUPPLEMENTARY DATA

### SELECTED QUARTERLY FINANCIAL 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	January 2 2011	October 3 2010	July 4 2010	April 4 2010
Total Revenue	\$ 43,421	\$ 34,722	\$ 36,662	\$ 37,885
Net loss and comprehensive loss	(5,999)	(7,863)	(2,269)	(2,918)
Net loss per common share Basic and Fully Diluted	(0.20)	(0.31)	(0.14)	(0.18)

  

Quarter ended	January 3 2010	October 4 2009	July 5 2009	April 5 2009
Total Revenue	\$ 44,130	\$ 35,564	\$ 37,044	\$ 38,142
Net income (loss) loss and comprehensive income (loss)	719	(3,388)	(5,457)	(7,927)
Net income (loss) per common share Basic and Fully Diluted	0.05	(0.21)	(0.34)	(0.60)

# CONSOLIDATED FINANCIAL STATEMENTS

## CONSOLIDATED BALANCE SHEETS - see note 1 As at January 2, 2011 and October 3, 2010

Unaudited

(in thousands of Canadian dollars)

	2011	2010
Assets		
Current assets		
Accounts receivable	\$ 1,285	\$ 533
Deposits	104	120
Inventory (note 3)	38,511	39,619
Prepaid expenses	1,669	1,679
	41,569	41,951
Lease deposits	379	376
Property and equipment (note 4)	9,550	9,074
Intangibles (note 5)	-	-
	\$ 51,498	\$ 51,401
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 6)	\$ 10,084	\$ 15,797
Accounts payable and accrued liabilities	26,600	15,623
Current portion of obligations under capital leases	46	127
	36,730	31,547
Subordinated notes (note 7)	1,597	1,557
Deferred lease inducements (note 8)	3,032	2,272
Shareholders' equity (note 9)		
Share capital	32,278	32,224
Warrants	1,008	1,020
Contributed surplus	1,666	1,595
Deficit	(24,813)	(18,814)
	10,139	16,025
	\$ 51,498	\$ 51,401

See accompanying notes.



**CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) AND DEFICIT** - see note 1

For the thirteen weeks ended January 2, 2011 and January 3, 2010

Unaudited

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

	2011	2010
Revenue	\$ 43,421	\$ 44,130
Cost of sales	30,682	26,852
Gross margin	12,739	17,278
Expenses		
Selling, general and administrative	17,384	15,558
Depreciation and amortization	936	746
Interest		
Short term	376	281
Long term	98	8
Foreign exchange gain	(56)	(34)
	18,738	16,559
Net comprehensive income (loss)	(5,999)	719
Deficit, beginning of period	(18,814)	(6,483)
Deficit, end of period	\$ (24,813)	\$ (5,764)
Basic and diluted earnings (loss) per share	\$ (0.20)	\$ 0.05

See accompanying notes.

**CONSOLIDATED STATEMENTS OF CASH FLOWS** - see note 1  
For the thirteen weeks ended January 2, 2011 and January 3, 2010

Unaudited

(in thousands of Canadian dollars)

	2011	2010
Cash provided by (used in):		
Operating activities		
Net income (loss)	\$ (5,999)	\$ 719
Add (deduct) non-cash items:		
Depreciation and amortization	936	746
Leasehold inducements	32	5
Loss on disposal of capital assets	6	8
Stock based compensation (note 9(d))	71	36
Accretion on long term debt	40	-
Changes in non-cash working capital items (note 10)	12,086	(5,556)
	7,172	(4,042)
Investment activities		
Purchase of capital assets	(1,430)	(999)
Proceeds on disposal of capital assets	12	-
	(1,418)	(999)
Financing activities		
Increase (decrease) in bank indebtedness	(5,713)	5,001
Repayment of capital leases	(81)	(291)
Deposits	(3)	112
Lease inducements	-	219
Proceeds on exercise of warrants (note 9(b))	43	-
	(5,754)	5,041
Increase (decrease) in cash	-	-
Cash, beginning of period	-	-
Cash, end of period	\$ -	\$ -
Supplemental disclosure of cash paid for:		
Income taxes	\$ -	\$ -
Interest paid	259	184
	\$ 259	\$ 184

See accompanying notes.



# NOTES TO INTERIM FINANCIAL STATEMENTS

Unaudited

January 2, 2011

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

## 1. Basis of Presentation and Going Concern

The accompanying unaudited interim consolidated financial statements for Liquidation World Inc. (the "Company") have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements. These interim financial statements follow the same accounting policies and methods of application as the most recent annual audited consolidated financial statements dated October 3, 2010. These interim consolidated financial statements should be read in conjunction with the annual statements. References in these notes to quarterly and year to date amounts are based on the Company's fiscal periods.

These unaudited interim 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 fiscal 2010, the Company experienced declining revenues and incurred a loss before income taxes of \$12,331 and experienced a net use of cash in operations of \$16,039. The losses were primarily funded through the net proceeds from financing arrangements and the use of available lending facilities. For the three month period ending January 2, 2011, the Company incurred a net loss of \$5,999. The losses were primarily funded through delayed payments to vendors.

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 this 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. Significant Accounting Policies

### (a) Basis of presentation:

These unaudited 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.

### (b) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements.

Significant areas requiring the use of estimates relate to the determination of future tax assets and liabilities, provisions relating to returns, inventory shrink and valuation, the remaining useful life of property and equipment and future cash flows used to assess impairment of long-lived assets. Actual results could differ from those estimates.

### **(c) 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") 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.

### **3. Inventories**

The amount of inventories charged to cost of sales the first quarter of 2011 was \$30,682 compared to \$26,852 in the corresponding quarter of 2010. The Company recorded an increase in the valuation reserve against inventory from \$989 at the end of fiscal 2010 to \$1,612 at the end of the first quarter of 2011. No reversals of previously written down amounts occurred in the quarter. Approximately \$32,703 of inventory was pledged as collateral under the bank's credit facility at January 2, 2011. The subordinated note holders have a subordinated interest in the inventory collateral (See Note 7).

### **4. Property and Equipment**

Amortization of equipment held under capital leases was \$107 in the first quarter of 2011 compared to \$142 in the corresponding quarter of 2010.

In the first quarter in 2011, there was an impairment charge of \$192 (nil in 2010) related to long-lived assets classified as property and equipment, which has been included in depreciation and amortization expense.



## 5. Intangibles

There was no amortization related to the intangible assets in the first quarter of 2011 as a result of the impairment charge recognized in the second quarter of 2010 (see below), compared to \$17 in the corresponding quarter of 2010. Amortization relating to intangible assets is included in depreciation and amortization expense. The continuity of the intangible assets is as follows:

	January 2 2011	October 3 2010
Balance - beginning of year	\$ -	\$653
Less amortization	-	35
Less: impairment	-	618
Balance - end of period	\$ -	\$ -

## 6. Bank Indebtedness

At January 2, 2011, 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). In the first quarter of 2011 and 2010, 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 January 2, 2011 (2.25% at January 3, 2010). At the end of Q1 2011, \$14,007 had been drawn on this facility with a corresponding borrowing base of \$14,615. The Company had net cash on hand of \$3,923 resulting in net bank indebtedness of \$10,084 compared to a draw down of \$14,318 at the end of Q1 2010 (with a corresponding borrowing base of \$14,883) and net cash on hand of \$559 resulting in net bank indebtedness of \$13,759. The Company had no outstanding letters of credit at the end of Q1 2011. There was one outstanding letter of credit in Q1 2010 (\$32) as collateral to a third party 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.

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.

## 7. 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 13). 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 9(b)).

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 6).

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 is being 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 the first quarter of 2011 is \$100 (including accretion of \$40). There was no corresponding amount in the first quarter of 2010.

## 8. Deferred Lease Inducements

The Company has entered into certain store leases, which involved the receipt of inducements, including cash payments 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 to 12 years. The current portion of these inducements is included in accounts payable and accrued liabilities:

	January 2 2011	October 3 2010
Deferred lease inducements	\$3,369	\$2,504
Less: current portion	337	232
Long term	\$3,032	\$2,272

## 9. Share Capital

### (a) Common Shares Issued

A summary of the Company's year to date share capital activity is as follows:

	Number of Shares	Amount
Balance, October 3, 2010	29,819,005	\$ 32,224
Exercise Series-II warrants	50,000	54
Balance January 2, 2011	29,869,005	\$ 32,278

In November 2010, 50,000 Series-II warrants were exercised at \$0.85 per common share. The proceeds on exercise, along with the proration of the net carrying value of the related warrants (see Note 9(b)) has been included in share capital as at January 2, 2011.



**(b) Common Share Purchase Warrants**

The following summarizes the warrants outstanding as at January 2, 2011:

	Number of Warrants	Exercise Price	Expiry	Carrying Value
Series 2010-I	1,583,228	\$ 0.66	19-Mar-15	\$ 479
Series 2010-II	1,052,941	\$ 0.85	4-Jun-13	\$ 261
Broker Warrants	882,375	\$ 0.95	6-Aug-12	\$ 268
Balance Jan. 2, 2011	3,518,544			\$1,008

**Series 2010-I**

In connection with the private placement financing which closed on March 19, 2010 (see Note 7), 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 7.

**Series 2010-II**

In connection with the private placement financing which was completed on June 4, 2010, 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 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. There were 50,000 Series-II warrants exercised in November 2010, reducing the number of outstanding warrants in this series from 1,102,941 to 1,052,941. The outstanding 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 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. As a result of the exercise of 50,000 warrants in November 2010, \$11 of the carrying value of the warrants has been reclassified to common shares, combined with \$43 of proceeds received upon exercise.

**Broker Warrants**

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 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.

The Company 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.

All of the outstanding warrants as at January 2, 2011 were exercisable. There were no warrants issued or outstanding in Q1 2010.

### (c) Stock Options

Under the terms of the stock option plan, the number of stock options reserved increased by 5,000 from 2,981,900 at October 3, 2010 to 2,986,900 at the end of Q1, 2011 ( Q1 2010-1,584,812) as a result of the increase in the number of common shares outstanding referred to in Note 9(a) above.

During the first quarter of 2011, the Company granted 1,342,500 stock options (1,282,500 to four executives and 60,000 to other employees), which vest over 3-5 years. As the Company was in a blackout period at the time of the grant in November and has remained in this position though the end of the first quarter of 2011, the exercise price has been estimated using the closing price at the end of Q1, 2011 (\$1.12 per option), with the related stock option expense calculated from the grant date. A final determination of the exercise price and fair value of the options will be made once the Company comes out of blackout and the options can be issued, at which time any adjustment to the expense previously recorded will be made. As at January 2, 2011, the fair value of the options granted during the quarter was \$0.7197 per option.

The compensation cost, related to stock option awards granted in the first quarter of 2011 under the fair value based approach, was calculated using the following assumptions:

Expected option life	5 years
Weighted average risk-free interest rate	2.24%
Expected stock price volatility	79%
Average dividend yield	Nil

A summary of the status of the Company's stock option plan as of January 2, 2011 and the year to date changes are presented below:

	Number of options	Weighted average exercise price
Balance outstanding October 3, 2010	1,242,800	\$0.95
Granted	1,342,500	1.12
Forfeited	-	-
Balance outstanding January 2, 2011	2,585,300	\$1.04



**(d) 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, on 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 Q1, 2011, the Company recognized stock-based compensation expense of \$71 (Q1 2010 - \$36).

	13 weeks ended January 2, 2011
Balance, beginning of year	\$1,595
Stock based compensation expense	71
Balance, end of period	\$1,666

**(e) Per share amounts**

Per share amounts have been calculated on the weighted average number of shares outstanding throughout the period. The weighted average shares outstanding for the quarter ended January 2, 2011 was 29,841,532, taking into account the common shares issued in connection with the exercise of 50,000 Series-II warrants on November 23 (see Note 9(b)). The weighted average shares outstanding for the quarter ended January 3, 2010 was 15,848,122. Common shares outstanding on a diluted basis are equal to basic common shares outstanding as stock options and warrants outstanding are currently 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 were not included in the computation of diluted earnings per share because they were anti-dilutive, as at January 2, 2011, are 6,103,844 (based on 2,585,300 stock options granted and 3,518,544 warrants outstanding), compared to 1,065,400 stock options outstanding as at January 3, 2010.

**10. Cash Flows - Changes in Non-cash Working Capital**

The following table details the components of non-cash working capital for operating activities:

	13 weeks ended January 2, 2011	13 weeks ended January 3, 2010
Accounts receivable	\$ 81	\$ 41
Inventory	1,108	(3,463)
Prepaid expenses	26	(22)
Accounts payable and accrued liabilities	10,871	(2,112)
	\$ 12,086	\$ (5,556)

**11. Segmented Information**

For the 13 weeks ended January 2, 2011 and the 13 weeks ended January 3, 2010	Canada	US	Total
Revenue - 2011	\$ 43,243	\$ 178	\$ 43,421
Revenue - 2010	\$ 43,587	\$ 543	\$ 44,130
As at January 2, 2011 and the year ended October 3, 2010			
Capital assets - 2011	\$ 9,217	\$ 333	\$ 9,550
Capital assets - 2010	\$ 8,538	\$ 536	\$ 9,074

## 12. 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 January 2, 2011 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 January 2, 2011 (see Note 6). 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 first quarter 2011 bank borrowings, fluctuations of +/- 1% in the average prime rate would have an effect on the loss before income taxes in the quarter of approximately \$44.

#### (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 U.S. dollars. As a result, the Company may experience transaction and translation exposures because of the changes in the exchange rate between the U.S. dollar and the Canadian dollar. Based on the Company's U.S. dollar denominated purchases from operations in fiscal 2010, fluctuations of +/- 5% in the U.S. dollar against the Canadian dollar would have an effect on the quarterly loss from operations before income taxes of approximately \$402. The Company does not use derivatives to manage its foreign currency risk.

#### (d) Financing risk:

Under the asset based lending facility (see Note 6), 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 and January 2, 2011, the Company was in breach of the minimum tangible net worth and EBITDA covenants in the lending facility. Further details are provided in Note 6.

**(e) 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 January 2, 2011 are as follows:

Fiscal	2011	2012	2013
Bank indebtedness-net of cash	\$ 10,084	\$ -	\$ -
Subordinated notes	\$ -	\$ -	\$ 2,000

**13. 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 expensed during Q1 2011 was \$91 (Q1 2010- \$49), measured at the exchange amount, and has been reflected in selling, general and administrative expenses, of which \$5 represents a reduction in prepaid expenses (Q1 2010-\$20), with the balance of \$68 included in accounts payable and accrued liabilities as at January 2, 2011 (2010 - \$29), , The outstanding related party contractual commitment as at January 2, 2011 was \$308 (2010 - \$438) related to services to be provided over the next four years.

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, included in accrued liabilities as noted above.

In addition, a Special 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 was 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 January 2, 2011 was \$113 (Q1 2010 - \$52) and is included in accounts receivable.

There were no additional related party transactions entered into during the first quarter of 2011.

#### **14. Income Taxes**

The statutory income tax rate in effect in Q1 2011 was 30.2% (Q1 2010 - 31.8%). The Company recorded no income tax provision in Q1 2011 or Q1 2010. As a result of income tax losses in the current and prior periods, the Company has accumulated income tax loss carry-forwards of approximately \$42,206 in Canada and \$9,518 in the US, at the end of Q1 2011.

#### **15. Seasonality**

As a retailer, the Company experiences stronger sales in its first quarter (particularly in December) and lower sales in its second and third quarters due in part to consumer buying patterns over the holiday season. Additionally, large inventory deals may skew the results in any given quarter. Therefore, the performance of this thirteen week period is not necessarily indicative of the performance for the balance of the fiscal year.

#### **16. Comparative Information**

Certain comparative figures have been reclassified to conform to the current financial statement presentation.

#### **17. Subsequent Event**

Subsequent to the end of Q1 2011, the Company announced its intention to raise additional financing by way of a non-brokered private placement which is expected to close on or about February 21, 2011. This financing is subject to obtaining all required regulatory and other customary approvals, including the approval of the TSX.



# CORPORATE INFORMATION

## DIRECTORS

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

Mr. Wolf 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 and effective on January 11, 2011 was appointed as Interim CFO of the Corporation. 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**

Mr. Beutel 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**

Mr. Graham 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.

### **Thomas Kiley**

Mr. Kiley is currently a consultant to the Office of the President of ACO Hardware since 2007 and served as EVP with Kenny's Closeout Company 2003 to 2007. Prior to 2003, held senior management positions and Odd Job Stores, McCrory's Stores, and Jamesway Discount Stores and brings over 45 years retail experience in expansion, merchandising, warehousing and operations.

### **Jeffrey Mandel**

Mr. Mandel 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

Mr. Marks 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.

## MANAGEMENT

Seth Marks, President and CEO

David Becker, Interim CFO

Lynda Murray, EVP Marketing

**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



# 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  
Blenheim  
Bolton  
Brampton  
Brantford  
Cambridge  
Campbellford  
Cobourg  
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  
Campbell River  
Chilliwack  
Coquitlam  
Courtenay  
Cranbrook  
Duncan  
Gibsons  
Kamloops  
Langley  
Maple Ridge  
Mission  
Nanaimo  
Penticton  
Prince George  
Powell River  
Richmond  
Surrey  
Terrace  
Vernon

## US

Chicago

## HOME OFFICE

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



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