

LIQUIDATION WORLD INC.

LIQUIDATION WORLD

ANNUAL REPORT
1998



ENTREPRENEUR
OF THE YEAR

COMPANY PROFILE

Liquidation World Inc. is a Calgary, Alberta based company specializing in marketing merchandise from distress situations, such as bankruptcies, receiverships, close-outs, inventory overruns and insurance claims. To date our 74 retail outlets are located in Alberta, B.C., Ontario, Saskatchewan, Manitoba, Washington State, Idaho and Ohio.

Liquidation World operates with a commitment to providing our clients with a direct, professional approach to solving their problems. This may involve the purchase or consignment of quality merchandise at a discount to manufacturers' wholesale prices and passing those savings on to our value-oriented retail customers. Those purchase situations have involved Canadian, United States and Caribbean businesses as well as businesses in the Far East.

Corporate buyers and buyers located in every outlet have the autonomy to make quick purchase decisions for thousands of dollars should the opportunity arise. This flexibility allows us to evaluate business situations as they are presented, and thereby maximize our ability to obtain premium value merchandise.

Liquidation World's approach to merchandise acquisition and retailing allows it to acquire any and all types of merchandise and to sell to the retail customer while providing a responsible business alternative to clients with distress situations.

MISSION STATEMENT

Liquidation World strives to help organizations with their inventory problems through a commitment to:

OUR SHAREHOLDERS: We have an obligation to provide our shareholders with a superior return on investment, to ensure honesty and integrity is a part of everything we do, and to encourage initiative from our people at all times.

OUR CUSTOMERS: We have a partnership with our Customers that demands value and the lowest prices in the market, a friendly shopping experience in well-maintained facilities, and an ability to exceed Customers' expectations. We are committed to developing long-term relationships with each and every Customer.

OUR PEOPLE: We treat everyone with fairness and respect and demand honesty and integrity in everything we do. We require hard work and teamwork, a commitment to controlling costs and an acute spirit of customer service. We will provide an entrepreneurial environment where advancement is based on superior performance.

SUMMARY OF SELECTED FINANCIAL DATA

| | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 | 1991 | 1990 | 1989 | 1988 | 1987 |
|-------------------------|---------|--------|--------|--------|--------|--------|--------|--------|--------|-------|-------|------|
| Sales (\$,000) | 134,691 | 96,574 | 71,705 | 56,268 | 35,912 | 24,313 | 18,980 | 13,173 | 11,319 | 5,204 | 1,781 | 790 |
| Cost of Sales (\$,000) | 81,229 | 57,877 | 43,627 | 35,708 | 22,084 | 14,971 | 11,707 | 7,631 | 6,730 | 3,265 | 947 | 502 |
| Gross Margin (\$,000) | 53,462 | 38,697 | 28,078 | 20,560 | 13,828 | 9,342 | 7,273 | 5,542 | 4,589 | 1,939 | 834 | 288 |
| Expenses (\$,000) | 42,981 | 31,493 | 21,805 | 16,042 | 12,047 | 7,940 | 6,232 | 4,897 | 3,667 | 1,538 | 765 | 278 |
| EBIT (\$,000) | 10,481 | 7,204 | 6,273 | 4,518 | 1,781 | 1,402 | 1,041 | 645 | 922 | 401 | 69 | 10 |
| Interest (\$,000) | 213 | 53 | 169 | 280 | 128 | 189 | 250 | 280 | 227 | 77 | 4 | — |
| Income Taxes (\$,000) | 4,474 | 3,067 | 2,584 | 1,867 | 755 | 511 | 369 | 171 | 305 | 132 | 37 | 2 |
| Net Earnings (\$,000) | 5,794 | 4,084 | 3,520 | 2,371 | 898 | 702 | 422 | 194 | 390 | 192 | 28 | 8 |
| Earnings per Share (\$) | | | | | | | | | | | | |
| Basic | 0.73 | 0.53 | 0.51 | 0.39 | 0.15 | 0.16 | 0.12 | 0.06 | 0.12 | 0.06 | 0.01 | 0.01 |
| Fully diluted | 0.69 | 0.49 | 0.46 | 0.36 | 0.14 | 0.14 | 0.11 | 0.05 | 0.11 | 0.06 | 0.01 | 0.01 |
| % Increase in Sales | 39% | 35% | 27% | 57% | 48% | 28% | 44% | 16% | 118% | 193% | 126% | — |
| Number of Outlets | | | | | | | | | | | | |
| at year end | 67 | 58 | 39 | 29 | 22 | 14 | 10 | 7 | 5 | 4 | 2 | 1 |
| Inventory | | | | | | | | | | | | |
| at year end (\$,000) | 41,031 | 27,734 | 18,427 | 15,527 | 11,027 | 6,425 | 5,435 | 3,745 | 3,357 | 2,430 | 673 | 286 |

NOTE:

The above information has been retroactively re-stated to reflect the Company's current accounting policies and share structure.

PRESIDENT'S REPORT

1998 was another year of tremendous growth for Liquidation World. Eighteen new outlets were opened and nine outlets were closed for a net increase to nine stores. Taking into account seven new outlets opened in the first quarter of fiscal 1999, Liquidation World operates a total of 74 outlets at the time of this writing.

Financially, sales increased 39% on the year to \$135 million from \$97 million in fiscal 1997. Net earnings increased 42% to \$ 5.8 million during the year ended October 4, 1998 from \$4.1 million during the year ended October 5, 1997.

The new outlets opened during 1998 strengthened the Company's presence in existing markets, such as Southern Ontario, British Columbia, Alberta, Idaho and the Puget Sound region of Washington State. During the first quarter of 1999, Liquidation World has expanded to new market areas to further expose the Company's concept to bargain conscious consumers in Swan River, Manitoba and in Middletown and Dayton, Ohio. In all markets, Liquidation World has met with favourable customer response. As a recent news headline quoted "it's chic to shop cheap".

The forces of Mother Nature continued to have an impact on Liquidation World. Major inventory acquisitions came about as a direct result of the December and January ice storms in eastern Canada. Hurricanes, tornados and floods also presented new inventory opportunities. We are very proud of the fact that Liquidation World has developed a reputation for dealing with these types of insurance situations in a professional and timely manner. We are committed to providing the best possible recovery.

The auction arm of Liquidation World also enjoyed an exciting 1998. Liquidation World's on-site Auction Team was awarded the contract to auction the remaining assets of the Harvey Barracks military base which closed down operations in Calgary. The demolition contractor was very pleased with the service provided and the final auction results. Auctions on behalf of a major equipment rental company and national retailers closing locations were also conducted during 1998 with very positive results.

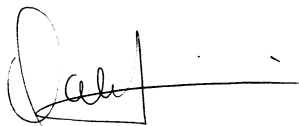
The Liquidation World buying network extended its reach further than ever before in 1998. Numerous inventories were discovered and acquired from the Asian market as a result of the financial crisis there. This is an area the Company will continue to develop. Our buying team grew stronger in 1998 with the addition of new deal hunters with different areas of expertise including softgoods and Asian dealings.

The Liquidation World family of Associates has become a truly international group and I want to express my thanks and appreciation for their continued hard work.

It has been an exciting time over the past twelve years for Liquidation World Associates and the Management Team. We will continue to dedicate ourselves to improving all aspects of our Company as we head towards the new millennium.

We were thrilled to announce a 2 for 1 stock split in April of 1998, and we look ahead with equal anticipation to what the future will bring. We thank you, our shareholders, for your support and we want you to know that your belief in Liquidation World will drive us forward with the determination to make this Company the very best it can be.

Sincerely



Dale Gillespie,
President & C.E.O.
December 9, 1998

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The Company's fiscal year end is the first Sunday in October and ended October 4, 1998 comprising 52 weeks of operations. The prior year also comprised 52 weeks of operations and ended October 5, 1997. The 1996 fiscal year comprised 53 weeks of operations and ended October 6, 1996.

Sales:

Sales of merchandise totaled \$134,691,000 for the year ended October 4, 1998, an increase of 39.5% from \$96,574,000 in fiscal 1997. The increase was the result of 9 new outlets opened (net of 9 being closed) during the year and a full year of operations from 20 stores opened in 1997. Sales increased 34.7% to \$96,574,000 in 1997 from \$71,705,000 in 1996 primarily on the strength of the new stores opened in 1997 and a full year's operations of 10 outlets opened in 1996.

Sales increases in 1999 as a result of stores opened in 1998 operating for a full year will approximate 5%. The Company expects to open 12 stores in 1999, however, this will vary depending upon opportunities available in real estate.

Gross Margin

Gross margin as a percentage of sales decreased in 1998 to 39.7% compared to 40.1% in 1997 and 39.2% in 1996. Small fluctuations in gross margin occur from year to year as a result of changes in the product mix throughout the stores. Liquidation World's pricing policy obliges the Company to use selling prices that are lower than any other in the market including discount stores, warehouse-type outlets and special promotions.

Selling and Store Operations

Selling and store operations, which includes all costs of occupying and operating the outlets and opening new outlets, decreased as a percentage of sales in fiscal 1998 to 28.2% (\$37,990,000) compared to 28.6% (\$27,620,000) in fiscal 1997. The improvement is a result of opening fewer outlets in 1998 than in 1997.

Selling and store operations increased as a percentage of sales in 1997 to 28.6% (\$27,620,000) from 25.9% (\$18,602,000) in 1996. The increase in the percentage of sales is the result of opening 20 new outlets during the year, many of which were larger than average, and therefore incurred start up costs greater than normal. Pre-opening costs are expensed as incurred.

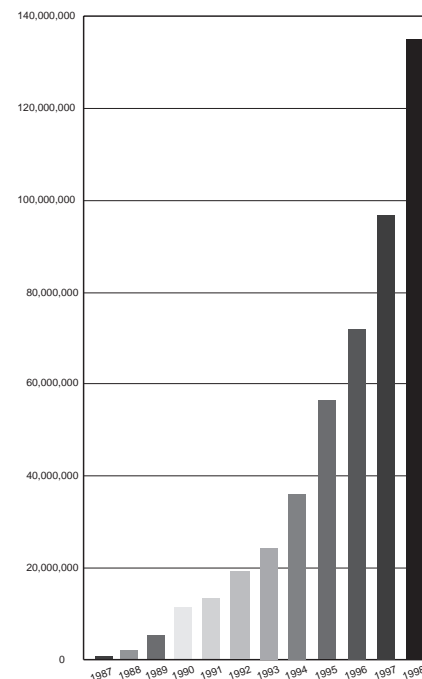
General and Administrative Expenses

General and administrative expenses decreased as a percentage of sales in fiscal 1998 to 3.0% (\$4,100,000) from 3.4% (\$3,260,000) in fiscal 1997 and 4.0% (\$2,844,000) during fiscal 1996 as a result of the infrastructure growing at a slower rate than sales.

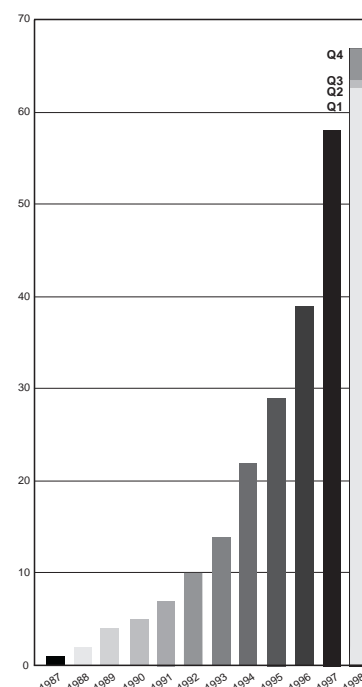
Depreciation and Amortization

Depreciation and amortization increased 45.4% to \$891,000 compared to \$613,000 in 1997. The 1997 increase was 70.8% from \$359,000 in 1996. Both increases reflect the increases in the underlying capital assets of 30.2% and 46.8% in 1998 and 1997 respectively. The corollary increases are not perfect due to the timing within each year of store openings. The growth in expenditures on capital and other assets exceeded the growth in the number of outlets in each year because, as the number of fixtures sought increases, the availability of inexpensive fixtures decreases. Further, additional fixtures and equipment were purchased during 1996 in anticipation of new outlets to be opened in 1997.

SALES



NUMBER OF OUTLETS



Interest

Interest increased 301.9% in 1998 to \$213,000 from \$53,000 in 1997. New store expansion was financed partially by increased bank indebtedness which resulted in increased interest costs.

Interest decreased 68.6% in 1997 from \$169,000 in 1996. This decrease is a result of share capital issued netting \$3.8 million in March 1996 and, \$3.7 million in June 1996 (net of related expenses). Accordingly, bank indebtedness was low during the third quarter of 1996 and the Company had cash surpluses during the fourth quarter of 1996 through the third quarter of 1997.

Income Taxes

The effective income tax rates of 43.6% in 1998, 42.9% in 1997 and 42.3% in 1996 approximate statutory tax rates in effect during each year (44.6% each year) except for small timing differences, non-deductible expenditures and other items.

Liquidity and Capital Resources

Liquidation World is continuing to carry out its plan for growth through opening new outlets. Eighteen outlets were opened in fiscal 1998 and nine were closed for a net increase of nine outlets. Twenty outlets were opened and one was closed in fiscal 1997. The Company incurred capital expenditures, net of disposals, of \$1,507,000 during fiscal 1998 (\$1,505,000 during fiscal 1997 and \$1,373,000 in fiscal 1996) to provide fixtures and equipment and make necessary leasehold improvements to new outlets and upgrade or provide equipment in existing locations. Additional working capital required to provide inventory for the locations ranged between \$250,000 and \$600,000 depending on the size of the outlet. Cash flow from operations before working capital requirements totalled \$6,659,000 in fiscal 1998 (1997 - \$4,624,000; 1996 - \$3,783,000). Working capital requirements for expansion totalled \$10,105,000 in fiscal 1998 (1997 - \$8,502,000; 1996 - \$2,374,000). Accordingly, net cash flow consumed in operations totalled \$3,446,000 during fiscal 1998. This net cash shortfall along with expenditures for capital assets were financed from cash generated from operations and short term borrowings totalling \$4,629,000

at year end. During 1997 net cash flow consumed in operations totalled \$4,902,000. This net cash shortfall along with expenditures for capital assets were financed from cash on hand at the beginning of the year, cash generated from operations and short term borrowings totalling \$495,000 at year end.

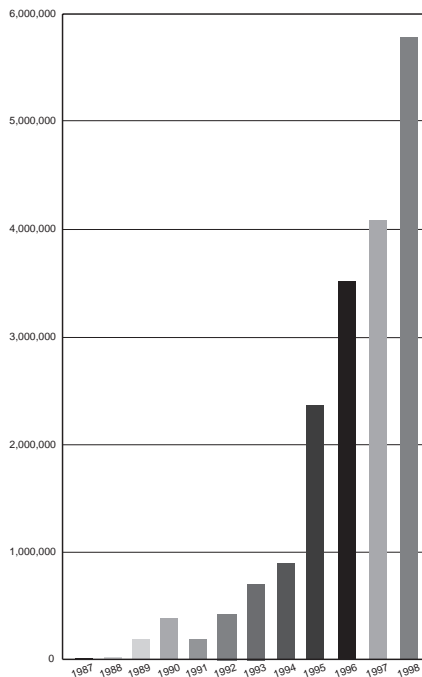
During 1996 net cash flow provided from operations totalled \$1,409,000. Accordingly, sufficient cash flow was provided by operations to finance expansion and equipment improvements.

Working capital improved to \$28,964,000 at the end of fiscal 1998 (1997 - \$22,993,000; 1996 - \$19,392,000). The Company currently has short-term borrowing facilities established totalling \$12,000,000 which is sufficient for planned expansion in 1999 including a reserve for any potential inventory acquisitions.

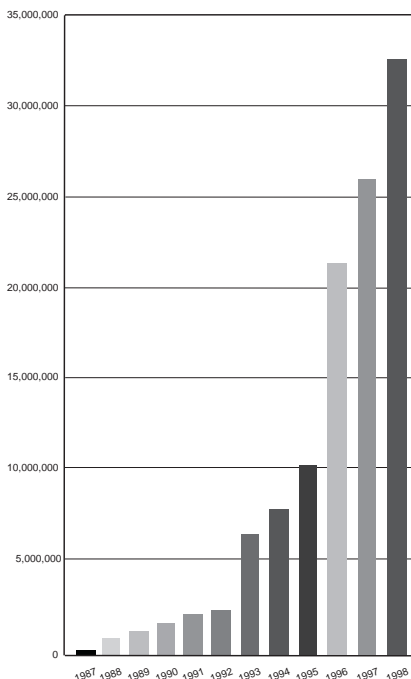
Year 2000

Liquidation World has implemented a process to identify and test information systems and their components to ensure their continued functioning in and through the year 2000. To date most of the Company's hardware and software has been tested and modifications have been made where necessary. The Company expects that process to be finished by mid 1999. It is not anticipated that total expenditures relating to this process will be significant but this cannot be assured. Liquidation World is currently attempting to assess the Year 2000 readiness of key non-inventory suppliers. The Company is developing contingency plans for a number of areas of operations. Due to the nature of the computer systems and the preponderance of processors in equipment and other systems, the Company may be adversely affected by the failure of a system or a supplier's system in the year 2000.

NET EARNINGS



SHAREHOLDERS' EQUITY



JULY 1998 REPORT ON BUSINESS MAGAZINE

THE TOP 1000
Canada's Power Book™

50 TOP PERFORMING STOCKS

SOFTWARE MAKER PC DOCS WAS THE TOP PERFORMER, THOUGH ITS PRICE HAS DECLINED LATELY

| RANK | COMPANY AND YEAR END | 5-YEAR SHARE % APPRECIATION | | RETURN ON COMMON EQUITY | | MARKET PRICE | |
|------|----------------------------------|-----------------------------|-------------|-------------------------|----------|--------------|--|
| | | ONE-YEAR % | FIVE-YEAR % | CURRENT | YEAR END | | |
| 1 | PC DOCS Group International(A97) | 50,185.71 | 4.90 | 20.33 | 7.85 | 8.80 | |
| 2 | American Eco Corp.(N97)† | 37,775.00 | 20.98 | 18.98 | 10.35 | 15.15 | |
| 3 | Liquidation World(O97) | 36,433.34 | 17.09 | 18.50 | 38.71 | 13.88 | |
| 4 | Breakwater Resources(D97) | 28,175.96 | 8.77 | 54.26 | 2.40 | 4.10 | |
| 5 | Bonanza Inc.(S97)† | 27,268.42 | 2.60 | 3.93 | 5.20 | 5.20 | |
| 6 | — | 22,322.22 | 34.77 | 87 | 20.30 | 8.00 | |
| 7 | — | 21,718.18 | 18.09 | 16.84 | 24.05 | 24.00 | |
| 8 | — | 18,850.00 | 2.43 | 31.12 | 3.50 | 3.75 | |
| 9 | — | — | — | — | 37.50 | 38.00 | |
| 10 | — | — | — | — | — | 0.00 | |

TODAY'S ECONOMIC REPORT

BarterSource AG, which owns BarterSource House, will buy a 50 percent stake in Barter & Noble Inc.'s on-line venture barterandnoble.com, aiming to create a book-selling powerhouse on the Internet.

BUSINESS

LOOKING BACK: 20 years ago...

Owner George Riggs announced the new Paros Restaurant will open at First Avenue and Main Street in the former King's Hitchco.

BUSINESS DIGEST

Market in brief

| | | |
|----------|-----------|---|
| TSX 100 | 10,112.12 | ↑ |
| TSX 300 | 1,812.12 | ↓ |
| TSX 600 | 1,212.12 | ↓ |
| TSX 900 | 1,112.12 | ↓ |
| TSX 1200 | 1,012.12 | ↓ |
| TSX 1500 | 912.12 | ↓ |
| TSX 1800 | 812.12 | ↓ |
| TSX 2100 | 712.12 | ↓ |
| TSX 2400 | 612.12 | ↓ |
| TSX 2700 | 512.12 | ↓ |
| TSX 3000 | 412.12 | ↓ |

NYSE Story

| | | | |
|------------|-------|-----------------|-------|
| Advances | 1,212 | New highs | 112 |
| Declines | 1,112 | Down lows | 102 |
| Unchanged | 102 | Vol. (millions) | 1,112 |
| Net change | +100 | NYSE | 1,112 |

Liquidation World opens Middletown store



Like all Liquidation World stores for liquidation in other markets, this new store in Middletown, Ontario, is a store in a store. The store is located in a former grocery store, which was once owned by a chain of stores at 300 St. John St. in Middletown.

It's a perfect example of the company's strategy of buying up distressed assets at low prices and selling them at a profit. The store is located in a former grocery store, which was once owned by a chain of stores at 300 St. John St. in Middletown.

The Financial Post

Hot Stock Retail 'undertaker' a winner in good times and bad

Liquidation World Inc.
2000: Best Investor
Fisher: LGF
Lester: 19E
Head office: Calgary
Tel: (403) 250-1233
Fax: (403) 250-1233
Listed on the TSX

Earnings

| | 2000 | 1999 | 1998 | 1997 | 1996 | 1995 | 1994 | 1993 | 1992 |
|-----------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Operating inc. \$000s | 21,157 | 24,925 | 28,031 | 24,183 | 21,414 | 22,590 | 20,039 | 17,076 | 14,008 |
| Net income \$000s | 812 | 1,820 | 1,209 | 891 | 749 | 1,347 | 1,424 | 678 | 608 |
| Earnings per share | 0.12* | 0.26 | 0.17 | 0.13 | 0.10 | 0.15 | 0.20 | 0.09 | 0.08 |

Ratios

| | 96.3 | 96.4 | 96.1 | 96.2 | 96.1 |
|--------------------|-------|-------|-------|-------|-------|
| | 1997 | 1998 | 1999 | 1998 | 1999 |
| Net profit margin | 4.23 | 4.95 | 4.23 | 3.10 | 3.19 |
| Return on equity | 17.83 | 21.86 | 24.84 | 14.34 | 15.90 |
| Return on assets | 14.25 | 16.72 | 16.50 | 10.93 | 13.90 |
| Total debt/capital | 0.82 | n/a. | 0.31 | 0.32 | n/a. |

Technical Analysis By Ronen Frank



Liquidation World shares have performed strongly in the past year.

Best of Business
Readers' Choice
AWARDS
GOLD
DISCOUNT STORE

1998
Kootenay District, B.C.

Readers' Choice
Awards
1998

1998
First Choice
Uxbridge, Ont.

GOLD
1997
Calgary Herald
READERS' CHOICE
AWARDS
Discount Store

1997
Calgary, Alberta

FIRST CHOICE
Calgary Herald
READERS' CHOICE
AWARDS 1996
DISCOUNT STORE

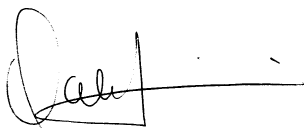
1996
Calgary, Alberta

MANAGEMENT'S REPORT TO THE SHAREHOLDERS


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

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

The consolidated financial statements have been audited by KPMG LLP, Chartered Accountants. Their report stating the scope of their audit and their opinion on the consolidated financial statements is presented below.



Dale Gillespie
President, C.E.O.



Andrew Searby, C.A.
Chief Financial Officer

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Liquidation World Inc. as at October 4, 1998 and October 5, 1997 and the consolidated statements of earnings and retained earnings and changes in financial position for each of the years in the three year period ended October 4, 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at October 4, 1998 and October 5, 1997 and the results of its operations and the changes in its financial position for each of the years in the three year period ended October 4, 1998, in accordance with generally accepted accounting principles.



Chartered Accountants

Calgary, Canada

November 20, 1998

LIQUIDATION WORLD INC.

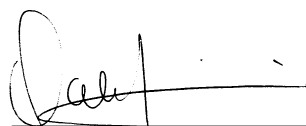
Consolidated Balance Sheets

(In thousands of dollars, except per share amounts)

| | October 4, 1998 | October 5, 1997 |
|--------------------------------------------|--------------------|--------------------|
| Assets | | |
| Current assets: | | |
| Accounts receivable | \$ 308 | \$ 372 |
| Inventory | 41,031 | 27,734 |
| Prepaid expenses | 972 | 609 |
| | <u>42,311</u> | <u>28,715</u> |
| Capital assets (note 2) | 3,791 | 3,175 |
| Investment in affiliate | 120 | 94 |
| | <u>\$ 46,222</u> | <u>\$ 31,984</u> |
| Liabilities and Shareholders Equity | | |
| Current liabilities: | | |
| Bank indebtedness (note 3) | \$ 4,629 | \$ 495 |
| Accounts payable and accrued liabilities | 7,897 | 4,912 |
| Income taxes payable | 821 | 315 |
| | <u>13,347</u> | <u>5,722</u> |
| Shareholders equity: | | |
| Share capital (note 4) | 14,324 | 13,505 |
| Retained earnings | 18,551 | 12,757 |
| | <u>32,875</u> | <u>26,262</u> |
| Commitments (note 7) | | |
| | <u>\$ 46,222</u> | <u>\$ 31,984</u> |

See accompanying notes to consolidated financial statements.

On behalf of the Board:



Dale Gillespie

Director



Azriel Presma

Director

LIQUIDATION WORLD INC.

Consolidated Statements of Earnings and Retained Earnings

(In thousands of dollars, except per share amounts)

| | Years ended | | |
|--------------------------------------|--------------------|--------------------|--------------------|
| | October 4, 1998 | October 5, 1997 | October 6, 1996 |
| Sales | \$ 134,691 | \$ 96,574 | \$ 71,705 |
| Cost of sales | 81,229 | 57,877 | 43,627 |
| | 53,462 | 38,697 | 28,078 |
| Expenses: | | | |
| Selling and store operations | 37,990 | 27,620 | 18,602 |
| General and administrative | 4,100 | 3,260 | 2,844 |
| Depreciation and amortization | 891 | 613 | 359 |
| Interest | 213 | 53 | 169 |
| | 43,194 | 31,546 | 21,974 |
| Earnings before income taxes | 10,268 | 7,151 | 6,104 |
| Income taxes, current (note 5) | 4,474 | 3,067 | 2,584 |
| Net earnings | 5,794 | 4,084 | 3,520 |
| Retained earnings, beginning of year | 12,757 | 8,673 | 5,153 |
| Retained earnings, end of year | \$ 18,551 | \$ 12,757 | \$ 8,673 |
| Earnings per share: | | | |
| Basic | \$.73 | \$.53 | \$.51 |
| Fully diluted | \$.69 | \$.49 | \$.46 |

See accompanying notes to consolidated financial statements.

LIQUIDATION WORLD INC.

Consolidated Statements of Changes in Financial Position

(In thousands of dollars, except per share amounts)

| | Years ended | | |
|------------------------------------------------|--------------------|--------------------|--------------------|
| | October 4, 1998 | October 5, 1997 | October 6, 1996 |
| Cash provided by (used in): | | | |
| Operations: | | | |
| Net earnings | \$ 5,794 | \$ 4,084 | \$ 3,520 |
| Add (deduct) non-cash items: | | | |
| Depreciation and amortization | 891 | 613 | 359 |
| Gain on disposal of capital assets | — | (46) | (70) |
| Equity in income of affiliate | (26) | (27) | (26) |
| | 6,659 | 4,624 | 3,783 |
| Changes in non-cash operating working capital: | | | |
| Accounts receivable | 64 | (178) | (3) |
| Inventory | (13,297) | (9,308) | (2,899) |
| Accounts payable and accrued liabilities | 2,985 | 1,632 | 682 |
| Prepaid expenses | (363) | (44) | (84) |
| Income taxes payable | 506 | (604) | (70) |
| | (3,446) | (3,878) | 1,409 |
| Investments: | | | |
| Purchase of capital assets | (1,507) | (1,570) | (1,843) |
| Proceeds on disposal of capital assets | — | 65 | 470 |
| | (1,507) | (1,505) | (1,373) |
| Financing: | | | |
| Proceeds on issuance of common shares | 819 | 481 | 7,663 |
| Increase (decrease) in cash position | (4,134) | (4,902) | 7,699 |
| Cash (bank indebtedness), beginning of year | (495) | 4,407 | (3,292) |
| Cash (bank indebtedness), end of year | \$ (4,629) | \$ (495) | \$ 4,407 |

See accompanying notes to consolidated financial statements.

LIQUIDATION WORLD INC.

Notes to Consolidated Financial Statements

Years ended October 4, 1998, October 5, 1997 and October 6, 1996

(In thousands of dollars, except per share amounts)

1. Significant accounting policies:

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Company and those of its wholly-owned subsidiary. The Company also has a 50% interest in an affiliate company which is accounted for using the equity method.

(b) Inventory:

Merchandise inventories are carried at the lower of cost and net realizable value less normal profit margins. The cost of inventories is determined principally on an average basis by the use of the retail inventory method.

(c) Capital assets:

Capital assets are recorded at cost. Depreciation is provided on furniture and equipment on a diminishing balance basis at annual rates of 20% to 30%. Leasehold improvements are amortized on a straight-line basis over the term of the lease.

(d) Pre-opening costs:

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

(e) Foreign currency translation:

The accounts of the Company's U.S. subsidiary are translated into Canadian dollars using the temporal method whereby monetary assets and liabilities are translated at the year end exchange rates, non-monetary items at historical rates and revenues and expenses at the average rate for the year. Gains or losses arising from exchange translations are included in the statement of earnings and retained earnings.

(f) Earnings per share:

Basic earnings per share are calculated using the weighted average number of common shares and common share equivalents outstanding during the year. Fully diluted earnings per share reflect the exercise of options as if issued at the beginning of the year.

The imputed interest rate used for purposes of calculating fully diluted earnings per share in the current year is 3% (1997 — 2.5%, 1996 — 5.5%)

(g) Fiscal year:

The Company's fiscal year ends on the first Sunday of October. Accordingly, the 1998 year end was on October 4, 1998 and comprised 52 weeks of operations. The 1997 year end was on October 5, 1997 and comprised 52 weeks of operations, and the 1996 year end was on October 6, 1996 and comprised 53 weeks of operations.

(h) Measurement uncertainty:

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. In determining the cost amount of inventories, management uses the retail inventory method which is by its nature subjective and therefore actual results could differ from those estimates.

(i) Deferred income taxes:

The Company follows the deferral method of tax allocation accounting under which the provision for corporate income taxes is based on the earnings reported in the accounts and takes into account the tax effects of timing differences between financial statement income and taxable income.

Notes to Consolidated Financial Statements (Continued)
(In thousands of dollars, except per share amounts)

2. Capital assets:

| | Cost | Accumulated depreciation and amortization | Net book value |
|-------------------------|----------|-------------------------------------------------|-------------------|
| October 4, 1998 | | | |
| Furniture and equipment | \$ 4,716 | \$ 1,733 | \$ 2,983 |
| Leasehold improvements | 1,383 | 575 | 808 |
| | \$ 6,099 | \$ 2,308 | \$ 3,791 |
| October 5, 1997 | | | |
| Furniture and equipment | \$ 3,612 | \$ 1,154 | \$ 2,458 |
| Leasehold improvements | 1,071 | 354 | 717 |
| | \$ 4,683 | \$ 1,508 | \$ 3,175 |

3. Bank indebtedness:

The Company has an operating line of credit facility at a Canadian bank in the maximum amount of \$12,000 (reviewed annually), bearing interest at the bank's prime rate plus 1/4% (7.25% at October 4, 1998). The facility is secured by an assignment of book debts, inventory, insurance, leases on retail premises and a general security agreement providing a charge over all assets.

The Company has an operating line of credit facility at a United States bank in the maximum amount of \$500 U.S. (reviewed annually), bearing interest at the bank's prime rate less 1/4% (8.25% at October 4, 1998). The facility is secured by a letter of credit issued by the Company's Canadian lender. This facility was not utilized at year end.

4. Share capital:

(a) Authorized:
Unlimited number of common shares.

(b) Issued:

| | Number | Amount |
|-----------------------------------------------------------------------|-----------|-----------|
| Balance, October 1, 1995 | 6,124,020 | \$ 5,361 |
| Issued on exercise of special warrants net of issue costs of \$634 | 1,300,000 | 7,492 |
| Issued on exercise of share options | 124,880 | 171 |
| Balance, October 6, 1996 | 7,548,900 | 13,024 |
| Issued on exercise of share options | 222,440 | 481 |
| Balance, October 5, 1997 | 7,771,340 | 13,505 |
| Issued on exercise of share options | 293,680 | 819 |
| Balance, October 4, 1998 | 8,065,020 | \$ 14,324 |

(c) Stock split:

On April 17, 1998 the Company split its common shares on a 2-for-1 basis. The above information has been restated to give retroactive application of the split.

(d) Stock options:

Stock options are held by officers, directors and employees of the Company and are exercisable at prices ranging from \$1.625 to \$14.50 per share and expire at various dates to 2003. Options outstanding at the end of the fiscal year are as follows:

| | Years ended | | |
|---------------------------------|--------------------|--------------------|--------------------|
| | October 4, 1998 | October 5, 1997 | October 6, 1996 |
| Outstanding, beginning of year | 848,640 | 923,080 | 795,960 |
| Granted | 215,800 | 148,000 | 260,000 |
| Exercised | (293,680) | (222,440) | (124,880) |
| Cancelled | (14,200) | — | (8,000) |
| Outstanding, end of year | 756,560 | 848,640 | 923,080 |

5. Income Taxes:

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

| | Years ended | | |
|--------------------------------|--------------------|--------------------|--------------------|
| | October 4, 1998 | October 5, 1997 | October 6, 1996 |
| Statutory income tax rate | 44.6% | 44.6% | 44.6% |
| Calculated tax expense | \$ 4,580 | \$ 3,189 | \$ 2,722 |
| Capital taxes | 60 | 40 | 25 |
| Variation in foreign tax rates | (125) | (61) | (15) |
| Other items | (41) | (101) | (148) |
| | \$ 4,474 | \$ 3,067 | \$ 2,584 |

6. Related party transactions:

The Company leases three buildings (20,000 square feet, 22,000 square feet and 34,000 square feet) for three of its retail locations from a company owned by an officer of the Company and a partnership of which the same company is a partner. Base rents approximate \$45 per year to 2003 and \$52 per year to 2000 and \$111 per year to 2008, respectively.

Sales to an affiliate company, of which the Company holds a 50% interest, were \$43 (October 5, 1997 – \$42; October 6, 1996 – \$75) for the year ended October 4, 1998. Receivables from that affiliated company totalled \$104 (October 5, 1997 – \$26; October 6, 1996 – \$31) at October 4, 1998.

Notes to Consolidated Financial Statements (Continued)
(In thousands of dollars, except per share amounts)

7. Commitments:

- a) The Company leases properties under operating leases covering various years up to 2009. The minimum future payments, excluding tenant operating costs, under these leases in each of the next five years are approximately as follows:

| | | |
|------|----|-------|
| 1999 | \$ | 4,652 |
| 2000 | | 3,614 |
| 2001 | | 3,263 |
| 2002 | | 2,870 |
| 2003 | | 2,347 |

In addition to minimum annual rentals, contingent rentals may be payable under certain store leases on the basis of sales in excess of stipulated amounts.

- b) The Company sells merchandise on a consignment basis and may guarantee a return to a consignor. At October 4, 1998, the total of such guarantees was \$nil (1997 – \$2,200; 1996 – \$nil).

8. Segmented information:

The Company's operations are conducted through one business segment which is retail sales. Information regarding the Company's operations by geographical area is as follows:

| 1998 | Canada | | U.S. | | Total |
|----------------|--------|---------|------|--------|------------|
| Sales | \$ | 105,138 | \$ | 29,553 | \$ 134,691 |
| Capital assets | \$ | 3,073 | \$ | 718 | \$ 3,791 |

| 1997 | Canada | | U.S. | | Total |
|----------------|--------|--------|------|--------|-----------|
| Sales | \$ | 84,273 | \$ | 12,301 | \$ 96,574 |
| Capital assets | \$ | 2,745 | \$ | 430 | \$ 3,175 |

| 1996 | Canada | | U.S. | | Total |
|----------------|--------|--------|------|-------|-----------|
| Sales | \$ | 66,862 | \$ | 4,843 | \$ 71,705 |
| Capital assets | \$ | 2,059 | \$ | 179 | \$ 2,238 |

9. Reconciliation to United States accounting principles:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). These financial statements conform, in all material respects, with United States generally accepted accounting principles ("U.S. GAAP"), except for the following:

- (a) During the year ended October 2, 1994, the Company granted stock options to officers, directors and employees with exercise prices at a discount to fair market value. Under Canadian GAAP, there is no effect on financial statement presentation for these transactions. Under U.S. GAAP, compensation expense is recorded for the difference between fair market value and the exercise price of the options. If the financial statements were shown on the U.S. GAAP basis, the increase in share capital would be \$226 and the decrease in retained earnings would be \$226.
- (b) Under U.S. GAAP, cash identified on the statement of changes in financial position excludes a reduction for short-term loans which is required under Canadian GAAP. If the statements of changes in financial position were shown on the U.S. GAAP basis, the increase (decrease) in short-term loans shown under financing activities and the cash, beginning of year and the cash, end of year would be as follows:

| | Years ended | | |
|-------------------------|--------------------|--------------------|--------------------|
| | October 4, 1998 | October 5, 1997 | October 6, 1996 |
| Short-term loans | \$ (4,629) | \$ (495) | \$ (3,292) |
| Cash, beginning of year | \$ — | \$ 4,407 | \$ — |
| Cash, end of year | \$ — | \$ — | \$ 4,407 |

- (c) Under U.S. GAAP it is not appropriate to disclose a sub-total for cash provided by operations before working capital requirements in the statements of changes in financial position. If the statements of changes in financial position were shown on the U.S. GAAP basis, these sub-totals would not appear.

10. Year 2000:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

CORPORATE INFORMATION

Board of Directors:

Dale Gillespie President C.E.O.
Richard T. Groomer President & C.E.O., Groomer Capital Advisory Inc.
Hubert Marleau President & Managing Director, Palos Capital Corporation
Azriel Presma Retired Businessman
Robert Aaron Roberts Managing Director, First Canadian

Senior Management Team:

Dale Gillespie President C.E.O.
Wayne Mantika Senior Vice-President
Andrew Searby, C.A. Chief Financial Officer
Derrick Gillespie Vice President, Corporate Purchasing
Ross Roberts Vice President, Prairie Operations
Darren Gillespie Vice President, Pacific Northwest Operations
Jonathan Hill Vice President, Eastern Operations

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Red Deer, Alberta, T4R 1M3
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Peace River, Alberta, T8S 1S5
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Hinton, Alberta, T7V 2A2
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218 — 10th Street
Wainwright, Alberta, T9W 1P5
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Shares are listed on
The Toronto Stock
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symbol — LQW
and on NASDAQ under
the symbol — LIQWF

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