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

For the Year Ended December 31, 2007
As of February 28, 2008

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

This management's discussion and analysis ("MD&A") should be read in conjunction with the consolidated financial statements (the "Financial Statements") and accompanying notes of Liquor Stores Income Fund (the "Fund") for the year ended December 31, 2007. Results are reported in Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain dollar amounts have been rounded to the nearest hundred thousand dollars or thousand dollars. References to notes are to the notes to the Financial Statements unless otherwise stated.

Throughout this MD&A references are made to "distributable cash", "operating margin", "operating margin as a percentage of sales", "payout ratio" and other "Non-GAAP Measures". A description of these measures and their limitations are discussed below under "Non-GAAP Measures". See also "Risk Factors" and "Forward-Looking Statements" below.

This MD&A is dated February 28, 2008.

OVERVIEW OF THE FUND

The Fund's Business and Recent Developments

The Fund is an unincorporated open ended, limited purpose trust established under the laws of the Province of Alberta. The trust units ("Units") of the Fund trade on the Toronto Stock Exchange under the symbol LIQ.UN. The Fund's 6.75% Convertible Unsecured Subordinated Debentures ("6.75% Debentures) trade on the Toronto Stock Exchange under the symbol LIQ.DB. Through its ownership of Liquor Stores Limited Partnership ("Liquor Stores LP"), the Fund operates 198 retail liquor stores in Alberta and British Columbia and management believes it is the largest liquor store operator in Alberta by number of stores and revenue.

On June 8, 2007, the Fund issued 6,817,533 Units to acquire a 75.96% indirect interest in Liquor Barn Limited Partnership ("Liquor Barn LP") the operator of 62 retail liquor stores in Alberta and 19 retail liquor stores in British Columbia. During the period June 8, 2007 to December 31, 2007, the Fund issued an additional 1,290,010 Units to increase its indirect interest in Liquor Barn LP to 90.33%. On January 1, 2008, Liquor Stores LP issued 867,789 Series 1 Exchangeable LP Units as consideration for the outstanding minority interest in Liquor Barn LP and the Fund merged its 75.61% indirect interest in Liquor Stores LP with its indirect interest in Liquor Barn LP to hold an 81.48% indirect interest in the merged Liquor Stores LP. Since January 1, 2008, the Fund has issued 26,572 Units to increase its indirect interest in Liquor Stores LP to 81.60%.

In addition to the acquisition of the Liquor Barn stores Liquor Stores LP opened or acquired six retail liquor stores in Alberta and four in British Columbia during the year. As a consequence of a restrictive covenant related to a liquor store in Calgary, Alberta, one retail liquor store was closed.

On December 21, 2007, the Fund completed the issue and offering of $50 million principal amount 6.75% Debentures. On January 15, 2008, the underwriters of this issue exercised their over-allotment option resulting in the issue of an additional $7.5 million principal amount 6.75% Debentures.

To date in 2008, Liquor Stores LP has acquired or opened three retail liquor stores and currently has commitments to open a further 10 new stores in 2008.

Liquor Barn LP Integration

The integration of Liquor Barn was largely completed by September 30, 2007. The point of sale software for the 81 Liquor Barn stores was replaced by software used by Liquor Stores LP. Liquor Barn head office and field supervisory staff had been integrated into Liquor Stores LP. At the time of the acquisition, Liquor Stores LP and Liquor Barn had a combined complement of 95 head office and field supervisory staff. By September 30, 2007, this number was reduced to 69. As well, an investment was made to increase the levels of inventory in the stores and to broaden product selection. Further changes to Liquor Barn operations are anticipated to provide modest incremental improvements to their operating performance.

Stores and Operations

As at February 28, 2008, the Fund operates 198 retail liquor stores located as follows:

	Alberta			British Columbia			
	Edmonton[(1)]	Calgary[(1)]	Other[(2)]	Lower Mainland	Vancouver Island	Interior	Total
Number of Stores	75	46	46	12	11	8	198

Notes:

(1) References to Edmonton and Calgary are to stores located in or near those urban centres.

(2) Other communities served in Alberta include, by region, Northern (23), Southern (6), Central (13) and Resort communities (4).

Business of the Fund

The Province of Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. The Fund currently operates 167 liquor stores in Alberta where there are approximately 1,050 liquor stores and 86 agency stores. Management believes the Fund is the largest liquor store operator in Alberta by both number of stores and sales.

The Fund also operates 31 stores and three small associated pubs in British Columbia. The Province of British Columbia's model for liquor distribution is a blend of approximately 630 private stores and 200 government operated stores. There are also approximately 230 agency stores that service small communities.

Distributable Cash and Cash Distributions

The Fund's policy is to distribute available cash from operations to unitholders to the extent determined prudent by the trustees of the Fund. Cash available for distribution is after cash required for maintenance capital expenditures, working capital reserve, and other reserves considered advisable by the trustees, including a provision for awards related to the Fund's long-term incentive plan (the "LTIP") and other deferred compensation plans. The policy allows the Fund to make stable monthly distributions to its unitholders based on estimates of distributable cash. The Fund pays cash distributions on or about the 15th of each month to unitholders of record on the last business day of the previous month.

The Fund reviews its historic and expected results on a regular basis. This review includes consideration of the expected performance of existing and new stores, the competitive environment and economic conditions, including labour market trends.

Per Unit cash distributions have been made as follows from the inception of the Fund:

Payment Dates	Monthly	Annualized
November 15, 2004 to May 16, 2005	$0.08333	$1.000
June 16, 2005 to January 16, 2006	$0.08958	$1.075
February 15, 2006 to October 16, 2006	$0.10000	$1.200
November 15, 2006 to March 15, 2007	$0.11667	$1.400
April 13, 2007 to December 14, 2007	$0.12500	$1.500
Commencing January 15, 2008	$0.13500	$1.620

Distributions declared during the year ended December 31, 2007 were $28.1 million or $1.49 per Unit. On a weighted average basis, for the year ended December 31, 2007 distributable cash was $1.64 compared to $1.39 for 2006, an increase of 18%. Since inception, distributable cash has exceeded cash distributions by $5.9 million resulting in a cumulative payout ratio of approximately 90%.

As a consequence of the acquisition of Liquor Barn, the deferred portion of distributions for Canadian federal income tax purposes is not consistent throughout the year. For the five months ended May 31, 2007, the deferred portion of distributions for Canadian federal income tax purposes was 0%. Thereafter the deferred portion of distributions for Canadian federal income tax purposes was approximately 50.5%.

The retail liquor industry is subject to some seasonal variations. Historically, approximately 40% of the Fund's sales occurred in the first half of the year and 60% occurred in the second half. As a result, distributable cash was typically less than actual distributions early in the year, but exceeded distributions for the latter portion of the year.

Effect of Trust Tax Legislation

On June 22, 2007, Bill C – 52, including the provisions related to the taxation of income trusts (the "SIFT Rules"), received Royal Assent. Pursuant to the SIFT Rules, commencing in 2011 earnings of the Fund distributed to unitholders will be subject to tax at a rate of 28% (currently zero). Taxable distributions (other than return of capital) to unitholders will be characterized as eligible dividends, a change from their current treatment as ordinary income. For discussion of SIFT Rules and limitations on growth and expansion see "Capital Expenditures" below.

Distributable Cash

The Fund views distributable cash as an important supplementary measure to assist unitholders in evaluating the Fund's performance as the Fund's objective is to provide a stable and sustainable flow of distributable cash to unitholders. When evaluating the cash available for distribution to unitholders the Fund takes into consideration the following factors:

Financing Strategy

The Fund finances its acquisitions, store development costs and betterments with the proceeds of the issuance of Units from treasury or through long-term debt. Financing of the Fund's investment in inventory is done through bank indebtedness. When proceeds from the issuance of Units or long-term debt are received prior to being used to finance growth, bank indebtedness is temporarily repaid.

Maintenance of Productive Capacity

In order to maintain its productive capacity the Fund incurs expenses for routine maintenance and makes expenditures for the replacement of long lived assets. In the determination of distributable cash, provisions are made for anticipated replacements of long lived assets not yet recorded in the accounts of the Fund.

Net Change in Non-cash Working Capital

The Fund's investment in non-cash working capital is primarily related to increased inventory levels. This increase includes the cost of purchasing inventory for stores the Fund develops and opens, the cost of increasing inventory in acquired stores subsequent to their acquisition date, and an increase in current inventory purchased at times when favourable buying conditions exist. Inventory levels are also influenced by seasonal investments in inventory.

Long Term Incentive Plans

Funding for the Fund's long term incentive plans occurs subsequent to the approval of the Fund's annual financial statements. For accounting purposes, the compensation expense related to the incentive plans are recognized as awards vest. Awards under the LTIP are calculated with reference to distributable cash per Unit.

Distributable cash

The following table provides the calculation of the distributable cash of the Fund for the three and twelve months ended December 31, 2007 and 2006 and since inception:

	Three months ended December 31,		Twelve months ended December 31,		Since inception
	2007	**2006**	**2007**	**2006**	**of the Fund**
Cash provided by operating activities	$1,308	$6,166	$15,667	$9,339	$29,107
Net change in non-cash working capital	9,794	676	17,094	9,000	37,437
Equity earnings	-	-	-	28	79
Incentive plan provisions	(241)	(600)	(1,060)	(1,000)	(2,060)
Provision for non-growth property and equipment	(45)	(212)	(707)	(600)	(2,079)
Distributable cash	$10,816	$6,030	$30,994	$16,739	$62,484
Weighted average units outstanding	22,507,820	13,495,218	18,597,892	12,000,137	13,560,394
Distributable cash per weighted average Unit	$0.48	$0.45	$1.67	$1.39	$4.61
Distributions declared per unit	$0.39	$0.35	$1.49	$1.24	$4.05

Comparable GAAP Measures

Distributable cash is a Non-GAAP Measure. Adjustments and provisions related to non-growth property and equipment, incentive plan provisions and non-cash working capital are necessary to reconcile distributable cash to its nearest GAAP measure, cash provided by operating activities.

The GAAP measure comparable to distributable cash per unit is earnings per unit. Basic and diluted earnings per unit are as follows:

Basic earnings per unit	$0.54	$0.45	$0.68	$1.35
Diluted earnings per unit	$0.52	$0.45	$0.68	$1.32

Diluted earnings per unit for the year ended December 31, 2007 were $0.68 compared to $1.32 in 2006. For the year $10.4 million ($0.56 per diluted unit – a non-cash expense) was charged to earnings in respect of future income taxes, $2.2 million ($0.12 for the amortization of a fair value adjustment recorded at the time of the Liquor Barn acquisition and $0.8 million ($0.04 per diluted unit) for administrative costs related to the integration of Liquor Barn.

The following table provides an analysis of the total expenditures on property and equipment, the amounts reserved for further non-growth expenditures and the amounts charged to expense in the Fund's accounts for repairs and maintenance:

	Three months ended December 31,		Twelve months ended December 31,		Since inception
	2007	**2006**	**2007**	**2006**	**of the Fund**
Purchase of property and equipment	$1,333	$1,688	$4,411	$3,837	$10,981
Growth expenditures including amounts relating to developed stores	(1,262)	(1,551)	(3,528)	(3,512)	(9,002)
Purchase of non-growth property and equipment	71	137	883	325	1,979
Provision for further non-growth property and equipment expenditures	(26)	75	(176)	275	100
Total provision for non-growth property and equipment	45	212	707	600	2,079
Repairs and maintenance expense	209	127	612	311	1,175
Total expenditures for non-growth property and equipment purchases and repairs and maintenance expense	$254	$340	$1,319	$912	$3,255

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Operating Results

The retail liquor industry is subject to some seasonable variations with respect to sales. Sales are typically slowest early in the year and increase in the latter half. In 2007, 20% (2006 - 20%) of same store sales occurred in the first quarter, 26% (2006 - 25%) in the second quarter, 26% (2006 - 26%) in the third quarter and 28% (2006 - 29%) in the last quarter.

The following table summarizes the operating results for the quarter and year ended December 31, 2007 with comparative figures for 2006 including those of Liquor Barn LP since June 8, 2007:

	Three months ended December 31,		Year ended December 31,	
	2007	2006	2007	2006
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Number of stores at December 31	195	105	195	105
Sales	$125,920	$71,010	$383,063	$221,997
Cost of sales, operating, administrative, acquisition and store development	(113,571)	(63,869)	(350,655)	(202,497)
Add back amortization of inventory fair value adjustment	-	-	2,247	-
Operating margin [(1)]	$12,349	$7,141	$34,655	$19,500
Operating margin as a percentage of sales	9.81%	10.06%	9.05%	8.78%

Note:

(1) *Operating margin has been calculated as described under "Non-GAAP Measures"*

Operating Margin

Operating margin (as defined under "Non-GAAP Measures") increased to $34.7 million for the year ended December 31, 2007 from $19.5 million for the same period in 2006. Operating margin as a percentage of sales was 9.05% for the year ended December 31, 2007 compared to 8.78% in the same period in 2006.

Operating margin increased to $12.3 million for the three months ended December 31, 2007 from $7.1 million for the same period last year.

The Fund has successfully integrated the 81 Liquor Barn stores acquired in June 2007. For the three months ended December 31, 2007, Liquor Barn stores operating margin as a percentage of sales improved significantly resulting in a blended rate with Liquor Depot of 9.81%. For the last quarter of 2006, Liquor Barn's operating margin as a percentage of sales was 5.9%.

Historically, the Fund's stores and operating margin as a percentage of sales has been strongest in the fourth quarter of the year. The sales mix of the Liquor Barn stores is more heavily weighted to beer than the Fund's other locations with higher sales in the third quarter than the fourth. Consequently, management expects there to be minor variations from the Fund's historic seasonality pattern.

Sales

Sales for the year ended December 31, 2007 increased by $161.0 million to $383.0 million from $222.0 million for the year ended December 31, 2006. The increase is primarily due to the increase in number of stores operated from 105 at December 31, 2006 to 195 at December 31, 2007. The $161.0 million increase comprises:

- an increase in same store sales of $5.3 million or 2.92% to $186 million for the year ended December 31, 2007;
- an additional $29.7 million in sales to $56.6 million for the 30 stores acquired or opened in 2006;
- sales of $113.4 million for the 81 Liquor Barn stores acquired in 2007;
- sales of $10.4 million for 10 stores acquired or opened in 2007 net of the sales of a store closed in 2007;

- an increase in sales of $2.2 million to licensees.

Sales for the fourth quarter ended December 31, 2007 increased by $54.9 million to $125.9 million from $71.0 million in the fourth quarter of 2006. The $54.9 million increase comprises:

- a decrease in same store sales of $0.5 million or 1.0%. Management believes that the Liquor Barn stores gained market share from Liquor Depot stores as a consequence of adopting the Fund's advertising and promotional practices;
- an increase of $1.1 million for stores acquired or opened in 2006;
- sales from the Liquor Barn LP stores of $48.6 million;
- an increase in sales of $2.5 million for stores acquired or opened in 2007;
- an increase in sales of $1.0 million to licensees.

Combined Cost of Sales, Administrative, Operating and Acquisition and Store Development Expense ("Operating Expenses")

Operating expenses for 2007 increased to $350.7 million from $202.5 million in 2006. For the three months ended December 31, 2007 operating expenses were $113.6 million compared to $63.9 million in the same period of 2006. These increases are consistent with the increase in number of stores being operated.

Operating expense includes the recognition of deferred unit-based compensation expense for the LTIP, the 2007 Incentive Plan and the Deferred Share Unit Plan. During the quarter and year ended December 31, 2007 respectively, the Fund recognized compensation expense of $263,768 and $784,871 for the plans.

Operating Expenses for the year ended December 31, 2007 includes $2.2 million amortization of an inventory fair value adjustment recorded as part of the purchase price allocation of the Liquor Barn acquisition. As of December 31, 2007, the inventory fair value adjustment has been fully amortized.

Future Income Taxes *(a Non-cash Charge)*

Prior to substantive enactment of the SIFT Rules, income tax provisions were only recorded in respect of incorporated subsidiaries. Consequently, income taxes recorded in the Fund's accounts had been nominal.

The Fund, in accordance with GAAP, follows the asset and liability method of accounting. With the substantive enactment of the SIFT Rules, the asset and liability method of accounting required the Fund to record a non-cash future tax provision. This provision relates principally to the difference between the value of intangible assets, property and equipment, and goodwill assigned at the time of acquisitions in the accounts of the Fund and their value for tax purposes. At September 30, 2007 $13.4 million was recorded, however, as a result of a change in tax rate, change in estimates and accounting classifications, an adjustment has been recorded to reduce the future tax provision by $3.0 million for the fourth quarter of 2007.

Net Earnings before Non-controlling Interest and Net Earnings and Comprehensive Income (Loss)

After recording a future tax expense of $10.4 million resulting from the substantive enactment of Bill C-52, the net earnings before non-controlling interest decreased by $2.8 million to $13.1 million for the year ended December 31, 2007 compared to 2006. After recording a future income tax recovery of $3.0 million for the three months ended December 31, 2007, net earnings before non-controlling interest increased by $5.8 million to $12.0 million over the same period in 2006. Net earnings and comprehensive income decreased by $1.6 million to $9.9 million compared to 2006 for the year ended December 31, 2006 and increased $5.2 million to $9.8 million compared to the same period in prior year for the three months ended December 31, 2007.

Condensed Annual Information

	2007	2006	2005	2004 (1)
	(thousands of dollars except per Unit amounts)			
Balance Sheet				
Cash and cash equivalents	$19,498	$ 3,397	$ 2,047	$ 1,004
Total assets	449,725	187,097	140,796	102,906
Bank indebtedness	-	5,455	15,493	12,222
Total current liabilities	14,062	12,896	20,416	14,107
Long-term debt	74,014	-	11,352	7,398
Unitholders' equity	301,678	140,706	67,327	38,200
Non-controlling interest	49,671	33,496	41,700	42,377
Statement of Earnings				
# stores	195	105	70	50
Sales	383,063	221,997	157,444	35,543
Future income tax expense	10,362	28	40	-
Earnings before non-controlling interest	13,118	15,978	10,312	2,957
Net earnings for the period	9,885	11,515	6,098	1,496
Basic earnings per Unit	$0.68	$1.35	$1.04	$0.35
Diluted earnings per Unit	$0.68	$1.32	$1.03	$0.35
Distributable cash per Unit	$1.67	$1.39	$1.14	$0.38
Distributions declared per Unit	$1.49	$1.25	$1.05	$0.26

(1) 2004 Statement of Earnings amounts are from September 28, 2004 to December 31, 2004

Condensed Quarterly Information

	2007				2006			
	Dec 31	**Sept 30**	**June 30**	**March 31**	**Dec 31**	**Sept 30**	**June 30**	**March 31**
Balance Sheet								
Cash and cash equivalents	$ 19,498	$ 6,891	$ 3,391	$ 1,715	$ 3,397	$ 1,683	$ 276	$ 2,935
Total assets	449,725	427,986	412,403	188,311	187,097	173,736	165,812	141,511
Bank indebtedness	-	37,198	35,107	11,893	5,455	28,964	15,495	–
Total current liabilities	14,062	55,403	54,916	17,489	12,895	32,140	20,481	4,092
Long-term debt	74,014	15,562	562	–	–	2,500	7,500	–
Statement of Earnings								
# stores	195	193	188	105	105	99	86	71
Sales	125,920	122,097	83,236	51,809	71,010	60,751	52,215	38,021
Future tax expense	(3,043)	943	12,460	-	-	-	-	-
Earnings before non-controlling interest	12,017	7,182	(8,465)	2,383	6,206	4,677	3,992	1,101
Net earnings for the period	9,784	5,325	(6,992)	1,767	4,627	3,332	2,871	684
Basic earnings per Unit	$0.54	$0.30	($0.59)	$0.17	$0.45	$0.39	$0.33	$0.10
Diluted earnings per Unit	$0.52	$0.30	($0.59)	$0.17	$0.45	$0.39	$0.33	$0.10
Distributable cash per Unit	$0.48	$0.49	$0.41	$0.21	$0.45	$0.40	$0.38	$0.14
Distributions declared per Unit	$0.385	$0.375	$0.375	$0.358	$0.34	$0.30	$0.30	$0.30

LIQUIDITY AND CAPITAL RESOURCES

Unitholders' Equity and Non-controlling Interest

The following units were outstanding as of February 28, 2008:

	Units
Fund Units [(1)]	18,366,354
Liquor Stores LP Exchangeable LP Units	3,296,063
Liquor Stores LP Series 1 Exchangeable LP Units	845,407
	22,507,824

Note:
(1) *Includes 30,202 treasury Units*

The Liquor Stores Exchangeable and Series 1 Exchangeable LP Units represent a non-controlling interest in the Fund.

Credit Facilities

At December 31, 2007, the Fund had an available $90 million operating line and an available $30 million long-term Capital/Acquisition line. The Fund also has available a $3.5 million demand non-revolving loan to cover electronic funds transfer payments, and a $4 million bank guarantee facility to be used in day to day issuance of letters of guarantee for operations. The total of all credit facilities is $127.5 million.

As of December 31, 2007, there was no amount outstanding on the operating line. There was $30 million drawn on the long term Capital/Acquisition line repayable on May 31, 2009. Subsequent to December 31, 2007, the Fund repaid $15 million on the Capital/Acquisition line. As acquisitions occur and new stores are opened, credit facilities will be utilized as required.

Capital Expenditures

During the three months ended December 31, 2007, the Fund opened two stores. Subsequent to December 31, 2007, three additional developed stores were opened.

The Fund will continue to pursue acquisition opportunities and to open new stores.

The SIFT Rules provide that, while there is no intention to prevent "normal growth" during the transitional period, any "undue expansion" could result in the transition period being "revisited", presumably with the loss of the benefit to the Fund of that transitional period. As a result, the adverse tax consequences resulting from the SIFT Rules could be realized sooner than January 1, 2011. On December 15, 2006, the Department of Finance issued guidelines with respect to what is meant by "normal growth" in this context. Specifically, the Department of Finance stated that "normal growth" would include equity growth within certain "safe harbour" limits, measured by reference to a specified investment flow-through trust or partnership's ("SIFT") market capitalization as of the end of trading on October 31, 2006 (which would include only the market value of the SIFT's issued and outstanding publicly-traded trust units, and not any convertible debt, options or other interests convertible into or exchangeable for trust units). These guidelines have been incorporated into the SIFT Rules. Those safe harbour limits are the greater of $50 million or 40% of the market capitalization benchmark for the period from November 1, 2006 to December 31, 2007, and 20% each for calendar 2008, 2009 and 2010. Moreover, these limits are cumulative (other than the $50 million annual limit), so that any unused limit for a period carries over into the subsequent period. Additional details of the Department of Finance's guidelines include the following:

(a) new equity for these purposes includes units and debt that is convertible into units (and may include other substitutes for equity if attempts are made to develop those);

(b) replacing debt that was outstanding as of October 31, 2006 with new equity, whether by a conversion into trust units of convertible debentures or otherwise, will not be considered growth for these purposes and will therefore not affect the safe harbour; and

(c) the exchange, for trust units, of exchangeable partnership units or exchangeable shares that were outstanding on October 31, 2006 will not be considered growth for these purposes and will therefore not affect the safe harbour where the issuance of the trust units is made in satisfaction of the exercise of the exchange right by a person other than the SIFT.

(d) the merger of SIFT's not resulting in the issuance of additional units do not affect the safe harbour limits.

The Fund's market capitalization, including that of Liquor Barn Fund, as of the close of trading on October 31, 2006, having regard only to issued and outstanding publicly-traded units, was approximately $298 million, which means the Fund's "safe harbour" equity growth amount for the period ending December 31, 2007 is approximately $119 million. Of this amount, approximately $69 million was utilized by new equity issuances partially offset by debt replacement, leaving $50 million to be carried over to 2008. For 2008, the available amount is $109.6 million including $50 million carried over from 2007. To date, $7.5 million has been utilized leaving $102.1 million available for the remainder of the year. As a consequence, the Fund could issue new units for proceeds $102.1 million in 2008 and remain within the "safe harbour" guidelines. There is $59.6 million available for each of 2009 and 2010.

The Fund believes that while the application of the "safe harbour" guidelines are not a practical constraint on its ordinary growth prior to 2011, they could adversely affect the cost of raising capital and the Fund's ability to undertake more significant acquisitions. The long-term effect of the SIFT Rules on the Fund is yet to be determined. The Fund continues to review the impact of the SIFT Rules on its business strategy and to evaluate strategic alternatives that it could elect to pursue in response to the SIFT Rules. No assurance can be provided that the Fund will not undertake actions in the future that could cause the SIFT Rules to apply to it prior to 2011.

Interest Rate Risk and Sensitivity

The Fund's indebtedness in respect of its credit facility bears interest at floating rates based on the bank's prime rate or at short term banker's acceptance rates. Interest payments with respect to the convertible unsecured subordinated debentures are payable semi-annually based on the coupon rate of the debenture.

The Fund is not subject to significant exposure to interest rate fluctuations. Based on an assumed outstanding debt balance of $30 million, a 1.0% increase in interest rates would reduce distributable cash for the year by approximately $300,000 or $0.02 per Unit.

Foreign Exchange Risk

The Fund's business is not significantly affected by foreign exchange rate fluctuations. The majority of product cost is related to domestically sourced product and provincially regulated commodity taxes.

Contractual Obligations

The table below sets forth, as of December 31, 2007, the contractual obligations of the Fund, due in the years indicated, related to various premises operating leases, long term debt and convertible unsecured subordinated debentures.

	2008	**2009**	**2010**	**2011**	**2012**	**2013 and thereafter**
Operating leases	$14,228	$15,027	$15,586	$16,205	$16,962	$43,021
Long-term debt	-	30,000	-	-	-	-
Debentures	-	-	-	500	50,000	-
Total	$14,228	$45,027	$15,586	$16,705	$66,962	$43,021

OFF BALANCE SHEET ARRANGEMENTS

The Fund has not entered into any off-balance sheet arrangements.

CRITICAL ACCOUNTING ESTIMATES

Goodwill

Goodwill is not amortized and is assessed for impairment at the reporting unit level. The impairment test is done annually unless circumstances arise that would potentially impair the carrying value of goodwill. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, potential goodwill impairment has been identified and must be quantified by comparing the estimated fair value of the reporting unit's goodwill to its carrying value. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in earnings.

Amortization Policies and Useful Lives

The Fund amortizes property, equipment and intangible assets over the estimated useful service lives of the assets. In determining the estimated useful life of these assets, significant judgment by management is required. In determining these estimates, the Fund takes into account industry trends and Fund-specific factors, including changing technologies and expectation for the in-service period of these assets. The Fund assesses the estimated useful life of these assets on an annual basis to ensure they match the anticipated life of the asset from a revenue producing perspective. If the Fund determines that the useful life of an asset is different from the original assessment, changes to amortization will be applied prospectively.

Purchase Price Allocations

The allocations of the purchases price for acquisitions involve determining the fair values assigned to the tangible and intangible assets acquired. The Fund uses independent valuators to determine the fair value of the tangible assets and certain intangible assets of the acquired stores. Other intangible assets are allocated based on a calculation of fair values by management. A discounted cash flow analysis is prepared to determine these fair values. Goodwill is calculated based on the purchase price less the fair value of the net tangible and intangible assets stated above.

CHANGES IN ACCOUNTING POLICIES

Financial Instruments and Other Comprehensive Income

New accounting standards are in effect for fiscal years beginning on or after October 1, 2006 for recognition and measurement of financial instruments and disclosure of comprehensive income. Effective January 1, 2007, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook sections 1530 – Comprehensive Income, 3855 – Financial Instruments – Recognition and Measurement, 3861 – Financial Instruments – Disclosure and Presentation, and 3865 – Hedges. As the Fund has no items of other comprehensive income, net earnings for the period is equivalent to comprehensive income.

Upon adoption of these new standards, the Fund has designated its cash and cash equivalents held for trading, which are measured at fair value. Accounts receivable is classified as loans and receivables, which is measured at amortized cost. Bank indebtedness, accounts payable and accrued liabilities, distributions payable to unitholders and non-controlling interest and long-term debt are classified as other financial liabilities which are measured at amortized cost.

Effective January 1, 2007, the Fund adopted CICA Handbook section 1506, "Accounting Changes" providing standards for accounting treatment and disclosure of changes in accounting policies, accounting estimates and correction of errors.

The adoption of the new Financial Instrument sections is done retroactively without restatement of the consolidated financial statements of the prior periods. As at January 1, 2007, there was no significant impact on opening cumulative undistributed earnings as a result of the change in policies.

Capital Disclosures

This new standard establishes disclosure requirements concerning capital such as: qualitative information about its objectives, policies and processes for managing capital; quantitative data about what it regards as capital; whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance. This pronouncement has an effective date of January 1, 2008. The Fund is presently evaluating the impact of this new standard.

Financial Instruments - Disclosures and Financial Instruments - Presentation

These new standards replace Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. The effective date of the standard is January 1, 2008. The Fund is presently evaluating the impact of these new standards.

Inventories

This new standard provides guidance in determining the cost of inventory and its subsequent recognition as an expense. The standard is effective for fiscal periods beginning on or after January 1, 2008 and requires the retroactive application to prior period financial statements. The Fund is presently evaluating the impact of this new standard.

Goodwill and Intangible Assets

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

FINANCIAL INSTRUMENTS

Historically, due to the nature of its business, the Fund did not engage in activities or hold assets that would require the Fund to acquire financial instruments for hedging or speculative purposes. The financial instruments that were held by the Fund consisted of accounts receivable, bank indebtedness, accounts payable and accrued liabilities, distributions payable and long-term debt. These financial instruments are held in the normal course of operations.

The fair market value of the convertible unsecured subordinated debentures was calculated as the net present value of all scheduled interest and principal payments discounted using the market yield of the particular debenture as at December 31, 2007. Costs related to the issuance of convertible are netted against the carrying value of the debentures and amortized into earnings over the life of the convertible debenture using the effective interest rate method. The Fund's convertible debentures have been classified as debt with a portion of the proceeds representing the value of the conversion option classified to equity. The debt balance accretes over time to the amount owing on maturity and such increases in the debt balance are reflected as non-cash interest expense in the Consolidated Statement of Operations. Upon conversion, a portion of debt and equity are transferred to Unitholders' Equity.

TRANSACTIONS WITH RELATED PARTIES

The Fund has a conflict of interest policy that requires the disclosure of potential conflicts and excludes persons with a material conflict of interest from any related decisions.

During the three months and year ended December 31, 2007, the Fund incurred professional fees of $18,882 and $287,202 respectively to a law firm of which a director of Liquor Stores GP Inc. (the "Liquor Stores GP"), a subsidiary of the Fund, is a partner. Rent paid to companies controlled by directors of the GP amounted to $465,979 over the twelve months ended December 31, 2007. The Fund paid fees and expenses to a company controlled by the Chief Executive Officer of the GP relating to supervision of the construction of developed stores and tax services of $31,454 for the year ended December 31, 2007 (see note 18 to the Financial Statements).

The Fund entered into a lease for new office premises with a company associated with the Chief Executive Officer of the GP. The Fund has received independent fairness and legal opinions concerning the terms of the lease. Rent for the three months and year ended December 31, 2007 was $92,332 and $275,204.

OUTLOOK

On June 8, 2007, the Fund acquired 81 Liquor Barn stores and has achieved the majority of its objectives for the integration of these stores as well as the anticipated synergies. The Fund now expects to resume a more normal growth pattern targeting growth to 300 stores over the next three to five years.

The Fund will focus its growth on development of new stores in Alberta, acquisitions in British Columbia and is pursuing opportunities to expand its operation into the United States to those states where liquor legislation and regulation permit private retail distribution of alcoholic beverages.

Management believes that the return on investment for retail liquor stores in the United States is comparable to the Fund's experience in Alberta and British Columbia.

The Fund has the human and financial resources required to support its anticipated growth. On December 21, 2007 and January 14, 2008 the Fund issued 6.75%, convertible, unsecured, subordinated debentures. The aggregate $57.5 million principal amount is convertible into Fund Units at a conversion price of $28.50. The aggregate net proceeds from the issues were approximately $55 million. The Fund believes that these proceeds together with its credit facilities are sufficient to allow it to execute its growth strategy for some time.

Longer term, the Fund remains well within its "safe harbour" limits related to the SIFT Rules. While the need for funds is not anticipated, the Fund has room to raise approximately $100 million by equity or debt in the remainder of 2008 and an additional $60 million in each of 2009 and 2010. Cumulatively to December 31, 2010, the Fund has a "safe harbour" limit of approximately $220 million.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management of the Fund has evaluated the effectiveness of the Fund's disclosure controls and procedures (as defined under Multilateral Instrument 52-109 ("MI 52-109") of the Canadian Securities Administrators) as of December 31, 2007, and concluded that the design and effectiveness of these controls and procedures provides reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, will be made known to management on a timely basis to ensure adequate disclosure.

There have been no changes in the Fund's internal controls over financial reporting (as defined under MI 52-109) that occurred during the year ended December 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Fund's internal controls over financial reporting.

ADDITIONAL INFORMATION

Additional information relating to the Fund, including the Fund's Annual Information Form and other public filings is available on SEDAR (www.sedar.com) and on the Fund's website at www.liquorstoresincomefund.com.

RISK FACTORS

The Fund's results of operations, business prospects, financial condition, cash distributions to unitholders and the trading price of the Units are subject to a number of risks. These risk factors include: risks relating to government regulation; competition; its ability to locate, secure and maintain acceptable store sites and to adapt to changing market conditions; risks relating to future acquisitions and development of new stores; failure to successfully integrate acquisitions; dependence on key personnel; the Fund's ability to hire and retain staff at acceptable wage levels; risks related to the possibility of future unionization; supply interruption or delays; reliance on information and control systems; dependence on capital markets to fund its growth strategy beyond its available credit facilities; dependence of the Fund on Liquor Stores LP; leverage and restrictive covenants in agreements relating to current and future indebtedness of Liquor Stores LP; restrictions on the potential growth of Liquor Stores LP as a consequence of the payment by Liquor Stores LP of a substantial amount of their respective operating cash flow and income tax related risks including the SIFT Rules.

For a discussion of these risks and other risks associated with an investment in Units, see "Risk Factors" detailed in the Fund's Annual Information Form, which is available at www.sedar.com.

NON-GAAP MEASURES

References to ''distributable cash'' are to cash available for distribution to unitholders in accordance with the distribution policies of the Fund. Management believes that, in addition to income or loss, cash available for distribution before debt service, changes in working capital, capital expenditures and income taxes is a useful supplemental measure of performance. Distributable cash of the Fund is a measure generally used by Canadian open-ended trusts as an indicator of financial performance. As one of the factors that may be considered relevant by unitholders and prospective investors is the cash distributed by the Fund relative to the price of the Fund's Units, management believes that distributable cash of the Fund is a useful supplemental measure that may assist unitholders and prospective investors in assessing an investment in the Fund. For a reconciliation of distributable cash to cash provided by operating activities please see "Distributable cash per unit (Fund Units, Exchangeable and Subordinated LP Units)"**.**

Operating margin for purposes of disclosure under "Operating Results" has been derived by adding interest expense, amortization of inventory fair value adjustments, amortization of property and equipment, intangibles and pre-opening costs to net earnings before non-controlling interest. Operating margin as a percentage of sales is calculated by dividing operating margin by sales.

"Payout ratio" is calculated by dividing cash distributions declared by distributable cash.

Operating margin, operating margin as a percentage of sales, distributable cash and payout ratio are not measures recognized by GAAP and do not have a standardized meaning prescribed by GAAP. Investors are cautioned that operating margin, operating margin as a percentage of sales, distributable cash and payout ratio should not replace net earnings or loss (as determined in accordance with GAAP) as an indicator of the Fund's performance, of its cash flows from operating, investing and financing activities or as a measure of its liquidity and cash flows. The Fund's method of calculating operating margin, operating margin as a percentage of sales, distributable cash and payout ratio may differ from the methods used by other issuers. Therefore, the Fund's operating margin, operating margin as a percentage of sales, distributable cash and payout ratio may not be comparable to similar measures presented by other issuers.

FORWARD LOOKING STATEMENTS

This management's discussion and analysis contains forward-looking statements. All statements other than statements of historical fact contained in this management's discussion and analysis are forward-looking statements, including, without limitation, statements regarding the future financial position, cash distributions, business strategy, proposed or recent acquisitions and the benefits to be derived therefrom, budgets, litigation, projected costs and plans and objectives of or involving the Fund, Liquor Stores LP or Liquor Barn LP. You can identify many of these statements by looking for words such as "believes", "expects", "will", "intends", "projects", "anticipates", "estimates", "continues" or similar words or the negative thereof. These forward-looking statements include statements with respect to the amount and timing of the payment of the distributions of the Fund. There can be no assurance that the plans, intentions or expectations upon which these forward-looking statements are based will occur. Forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, those discussed elsewhere in this management's discussion and analysis. There can be no assurance that such expectations will prove to be correct.

Some of the factors that could affect future results and could cause results to differ materially from those expressed in the forward-looking statements contained herein include, but are not limited to, those discussed under "Risk Factors".

The information contained in this management's discussion and analysis, including the information set forth under "Risk Factors", identifies additional factors that could affect the operating results and performance of the Fund, Liquor Stores LP and Liquor Barn LP.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this management's discussion and analysis is made as of the date of this management's discussion and analysis and the Fund assumes no obligation to update or revise them to reflect new events or circumstances except as expressly required by applicable securities law.