# Liquor Stores Income Fund

Consolidated Financial Statements

**December 31, 2008 and 2007**
(expressed in thousands of Canadian dollars)

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## Auditors' Report

**To the Unitholders of**
**Liquor Stores Income Fund**

We have audited the consolidated balance sheets of **Liquor Stores Income Fund** as at December 31, 2008 and 2007 and the consolidated statements of earnings, comprehensive income, changes in unitholders' equity and cash flows for the years ended December 31, 2008 and 2007. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants**

# Liquor Stores Income Fund

Consolidated Balance Sheets
As at December 31, 2008 and 2007
**(expressed in thousands of Canadian dollars)**

| | 2008 | 2007 (restated) (note 3) |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 3,530 | $ 19,498 |
| Accounts receivable | 1,928 | 3,474 |
| Inventory (at cost) | 114,072 | 84,856 |
| Prepaid expenses and deposits (note 6) | 1,846 | 1,348 |
| | 121,376 | 109,176 |
| **Pre-opening costs** | 1,297 | 773 |
| **Deposits on future acquisitions** (note 6) | 10 | 647 |
| **Note receivable** | 310 | - |
| **Property and equipment** (note 7) | 46,743 | 41,707 |
| **Intangible assets** (note 8) | 48,198 | 37,784 |
| **Goodwill** (note 9) | 271,533 | 259,638 |
| | $ 489,467 | $ 449,725 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Bank indebtedness (note 10 (a)) | $ 31,172 | $ - |
| Accounts payable and accrued liabilities | 21,033 | 10,498 |
| Distributions payable to unitholders (note 11) | 2,478 | 2,470 |
| Distributions payable to non-controlling interest (note 11) | 557 | 1,094 |
| Current portion of long-term debt (note 10 (b)) | 28,000 | - |
| | 83,240 | 14,062 |
| **Long-term debt** (note 10 (b)) | 51,742 | 74,014 |
| **Future income tax liability** (note 12) | 10,616 | 8,632 |
| **Non-controlling interest** (note 13) | 48,279 | 50,637 |
| | 193,877 | 147,345 |
| **Unitholders' Equity** | | |
| Fund Units (note 16) | 309,730 | 308,694 |
| Equity component of convertible debentures (note 10 (b)) | 4,970 | 4,340 |
| Contributed surplus (note 17) | 1,156 | 558 |
| Accumulated other comprehensive income (note 18) | 1,404 | - |
| Cumulative undistributed earnings (excess distributions) | (21,670) | (11,212) |
| | 295,590 | 302,380 |
| | $ 489,467 | $ 449,725 |

# Liquor Stores Income Fund

Consolidated Statements of Earnings and Comprehensive Income
For the years ended December 31, 2008 and 2007
(**expressed in thousands of Canadian dollars, except for per unit amounts**)

| **Consolidated Statement of Earnings** | **2008** | **2007 (restated) (note 3)** |
|---|---|---|
| Sales | $ 482,915 | $ 383,063 |
| Cost of sales | 361,630 | 291,543 |
| **Gross margin** | 121,285 | 91,520 |
| Operating and administrative expense | 80,126 | 59,112 |
| **Operating earnings before amortization and interest** | 41,159 | 32,408 |
| **Amortization** | | |
| Property and equipment | 6,269 | 4,004 |
| Intangible assets | 3,219 | 1,912 |
| Pre-opening costs | 735 | 562 |
| | 10,223 | 6,478 |
| | 30,936 | 25,930 |
| **Interest expense and other** | | |
| Bank indebtedness | 931 | 1,785 |
| Long-term debt | 859 | 665 |
| Convertible debentures (note 10 (b)) | 5,088 | - |
| Gain on foreign exchange | (3,247) | - |
| Goodwill adjustment for store closures (note 5) | 624 | - |
| | 4,255 | 2,450 |
| **Earnings before income tax and non-controlling interest** | 26,681 | 23,480 |
| Future income tax expense | 2,194 | 7,990 |
| **Earnings before non-controlling interest** | 24,487 | 15,490 |
| Non-controlling interest (note 13) | 5,228 | 5,510 |
| **Net earnings for the year** | $ 19,259 | $ 9,980 |
| **Earnings per Unit** (note 20) | | |
| Basic | $ 1.05 | $ 0.68 |
| Diluted | $ 1.05 | $ 0.68 |

| **Consolidated Statements of Comprehensive Income** | | |
|---|---|---|
| **Net earnings for the year** | $ 19,259 | $ 9,980 |
| **Other comprehensive income** | | |
| Net gain on translation of self-sustaining foreign operations | 1,404 | - |
| **Comprehensive income for the year** | $ 20,663 | $ 9,980 |

# Liquor Stores Income Fund

Consolidated Statements of Changes in Unitholders' Equity
For the years ended December 31, 2008 and 2007
(**expressed in thousands of Canadian dollars**)

| | 2008 | 2007 (restated) (note 3) |
|---|---|---|
| **Fund Units** (note 16) | $ 309,730 | $ 308,694 |
| **Equity component of convertible debentures** (note 10 (b)) | 4,970 | 4,340 |
| **Contributed surplus** (note 17) | 1,156 | 558 |
| Cumulative undistributed earnings (excess distributions), beginning of year | (11,307) | 997 |
| Change in accounting policy (note 3) | 95 | - |
| Cumulative undistributed earnings (excess distributions), as restated | (11,212) | 997 |
| Net earnings for the year | 19,259 | 9,980 |
| Distributions declared on Fund Units (note 11) | (29,717) | (22,189) |
| **Cumulative undistributed earnings (excess distributions), end of year** | (21,670) | (11,212) |
| **Accumulated other comprehensive income** | | |
| Accumulated other comprehensive income, beginning of year | - | - |
| Cumulative translation adjustments | 1,404 | - |
| **Accumulated other comprehensive income, end of year** | 1,404 | - |
| **Unitholders' equity, end of year** | $ 295,590 | $ 302,380 |

# Liquor Stores Income Fund

Consolidated Statements of Cash Flows
For the years ended December 31, 2008 and 2007
(**expressed in thousands of Canadian dollars**)

| | 2008 | 2007 (restated) (note 3) |
|---|---|---|
| **Cash provided by (used in)** | | |
| **Operating activities** | | |
| Net earnings for the year | $ 19,259 | $ 9,980 |
| Items not affecting cash | | |
| Amortization | 10,223 | 6,478 |
| Amortization of inventory fair value adjustment | 399 | 2,247 |
| Goodwill adjustment for store closures (note 5) | 624 | - |
| Non-cash interest on convertible debentures (note 10 (b)) | 1,173 | - |
| Future income tax | 2,194 | 7,990 |
| Non-controlling interest (note 13) | 5,228 | 5,510 |
| Unit-based compensation (note 21) | 894 | 558 |
| | 39,994 | 32,763 |
| Net change in non-cash working capital items (note 23) | (2,988) | (17,096) |
| | 37,006 | 15,667 |
| **Financing activities** | | |
| Increase (decrease) in bank indebtedness | 31,172 | (29,544) |
| Proceeds of long-term debt (note 10 (b)) | 7,185 | 77,651 |
| Repayment of long-term debt | (2,000) | - |
| Distributions paid to unitholders (note 11) | (29,709) | (20,912) |
| Distributions paid to non-controlling interest (note 11) | (7,234) | (5,693) |
| Dividends paid to non-controlling interest by subsidiaries (note 13) | (392) | (238) |
| Cash distributions from long-term incentive plans (note 16) | (12) | - |
| Units acquired | - | (950) |
| Proceeds from sale of forfeited units | - | 22 |
| | (990) | 20,336 |
| **Investing activities** | | |
| Business acquisitions (note 4) | (43,760) | (15,228) |
| Net deposits on future acquisitions (note 6) | 50 | 253 |
| Notes receivable | (310) | - |
| Purchase of property and equipment | (6,320) | (4,411) |
| Pre-opening costs | (1,259) | (516) |
| | (51,599) | (19,902) |
| **Foreign exchange loss on cash held in foreign currency** | (385) | - |
| **(Decrease) increase in cash and cash equivalents** | (15,968) | 16,101 |
| **Cash and cash equivalents balance, beginning of year** | 19,498 | 3,397 |
| **Cash and cash equivalents balance, end of year** | $ 3,530 | $ 19,498 |

## 1 Nature of operations and organization

Liquor Stores Income Fund (the "Fund") is an unincorporated, open ended, limited purpose trust established under the laws of the Province of Alberta pursuant to a Declaration of Trust dated August 10, 2004.

As at December 31, 2008, the Fund operated 222 retail liquor stores, of which 168 (2007 – 163) were in Alberta, 35 (2007 - 32) were in British Columbia and 19 (2007 – nil) were in Alaska, and had an interest in one store in Eastern Canada (2007 – nil). Of the stores operated, 196 (2007 – 179) were acquired by the Fund and 26 (2007 - 16) were developed by the Fund.

## 2 Significant accounting policies and basis of presentation

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP").

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. For example, goodwill is assessed for impairment based on estimates of fair value and amortization of property and equipment is based on their estimated useful lives. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in income in the period in which they become known.

(a) Basis of presentation

These consolidated financial statements include the accounts of the Fund, its wholly owned subsidiaries Liquor Stores Operating Trust, Liquor Barn Operating Trust, Liquor Barn GP Inc. and controlling interests in Liquor Stores Limited Partnership, Liquor Barn Limited Partnership, Liquor Stores GP Inc., and several operating subsidiaries thereof, its 50% owned subsidiary Vines of Riverbend Limited Partnership ("Vines"), its 80% owned subsidiary Corinthia Liquor Store Limited Partnership, its 50% owned subsidiary Crossroads Liquor Depot and its 80% owned subsidiary Vin Art Limited Partnership. All inter-entity balances and transactions have been eliminated on consolidation.

(b) Revenue recognition

Revenue is generated from sales to customers through retail stores and licensee sales to commercial customers. Revenue from retail sales is recognized at the point of sale and from commercial sales at the time of shipment.

(c) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks.

(d) Inventory

Inventory, consisting primarily of liquor for resale, is valued at the lower of cost, determined on the first in, first out basis, and net realizable value.

(e) Pre-opening costs

Pre-opening costs represent incremental direct costs incurred in acquiring and developing new retail liquor stores. The Fund defers such expenditures incurred during the pre-operating period. These costs are amortized over the 24 months after a developed store commences operations. Costs related to acquired retail liquor stores are added to the cost of the purchase at the date of acquisition. Costs incurred relating to locations that are subsequently abandoned are expensed in the period of abandonment.

(f) Property and equipment

Property and equipment is recorded at cost, which is amortized over the estimated useful lives of assets on a straight-line basis at annual rates disclosed in note 7. The Fund will test its property and equipment for impairment when events and circumstances warrant such a review. An impairment loss is recorded when it is determined that the carrying amount is no longer recoverable and exceeds its fair value.

(i) Goodwill

Goodwill represents the excess of the cost of an acquired business over the fair value of the identifiable net assets acquired. Goodwill is not amortized, but is assessed for impairment at least annually or when events and circumstances indicate the carrying value may not be recoverable. The Fund uses the two step impairment test as outlined in the CICA Handbook to determine if there is impairment in the carrying value of goodwill.

(j) Intangible assets

Intangible assets, consisting of acquired customer relationships, retail liquor licenses and business permits, tradenames and property leases acquired at less than market rates, are recorded at cost.

The amount attributed to customer relationships is amortized over five years and the amount attributed to property leases is amortized over the remaining terms of the leases ranging from one to 12 years.

Certain retail liquor licenses and business permits to operate a retail liquor store have an indefinite life and are therefore not amortized. Other retail liquor licenses are amortized based on license expiry terms ranging from 5 to 37 years. Tradenames have an indefinite life and are not amortized.

The Fund will assess the carrying value of limited life intangible assets for impairment when events or circumstances warrant such a review. An impairment loss is recorded when it is determined that the carrying amount of the assets is no longer recoverable and exceeds their fair value. The Fund will assess the carrying value of indefinite life intangible assets for impairment annually, or more frequently, if events or changes in circumstances indicate that their carrying value may not be recoverable. The amortization method and estimated useful life of amortizing intangible assets are reviewed on an annual basis.

(k) Income taxes

Future income taxes are recognized at substantively enacted tax rates for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period that includes the date of substantive enactment.

(l) Unit-based compensation

The Fund’s unit-based compensation plans consist of a Long Term Incentive Plan and a 2007 Incentive Plan for the benefit of certain employees and a Deferred Share Unit Plan for the benefit of Fund directors as further described in note 21. The Fund accounts for unit-based compensation using the fair value method, in which the fair value of compensation is measured at the grant date and recognized over the service period.

(m) Financial instruments

The Fund has designated its cash and cash equivalents as held for trading, which are measured at fair value. Accounts receivable and the note receivable are 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.

Transaction costs related to the issuance of financial liabilities are capitalized on initial recognition and are recognized in income using the effective interest method.

(n) Convertible debentures

The Fund's convertible debentures have been classified as debt with a portion of the proceeds representing the value of the conversion option bifurcated to equity. The debt balance accretes over time to the amount owing on maturity. Upon conversion, portions of debt and equity are transferred into Fund Units.

(o) Translation of foreign currencies

The Fund has a foreign subsidiary in the United States that is considered to be self-sustaining. Assets and liabilities of the foreign subsidiary are translated into Canadian dollars using the current rate method of translation. Accordingly, foreign exchange gains and losses arising from the translation of the foreign subsidiary's accounts into Canadian dollars are reported as a component of other comprehensive income.

Transactions denominated in foreign currencies are recorded at the rate of exchange on the transaction date. Monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date, with any resulting gain or loss being included in earnings.

**Adoption of new accounting standards**

Effective January 1, 2008, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook sections 1400 – General Standards of Financial Statement Presentation, 1535 – Capital Disclosures, 3862 – Financial Instruments – Disclosures, 3863 – Financial Instruments – Presentation, and 3031 – Inventories.

The adoption of section 1400 required management to make an assessment of the entity's ability to continue as a going concern. Management has made this assessment on the basis of projected cash flows and concluded that there are currently no material uncertainties that cast significant doubt on the Company's ability to continue as a going concern.

While the adoption of sections 1535, 3862, 3863 and 3031 resulted in additional financial statement presentation and disclosures, which are included in notes 19 and 24 and the statements of earnings, no accounting policy changes or adjustments to amounts recorded in prior periods were necessary.

The Emerging Issues Committee of the CICA issued Abstract 171 on August 28, 2008, which resulted in a retrospective change in the Fund's accounting policy for future income taxes (see note 3).

**Accounting standards issued but not yet effective**

(a) Section 3064 - 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. Concurrent with the adoption of this standard, EIC 27 – Revenues and Expenditures during the Pre-operating period, will be withdrawn. This will result in a change to the Fund's accounting for store pre-opening costs as these costs will no longer be capitalized as an asset, but will be expensed as incurred.

(b) International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed on February 13, 2008, that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for the financial statements of publicly accountable enterprises effective January 1, 2011. The Fund is presently evaluating the impact these standards will have on the financial statements.

## 3 Change in accounting policy

The Fund has adopted CICA Emerging Issues Committee Abstract #171 ("EIC-171") Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through. EIC-171 states that future taxes related to temporary differences associated with the assets and liabilities attributable to the exchangeable interests should not be recorded prior to the conversion of the exchangeable interest. The future income taxes should be accounted for as a capital transaction at the time of conversion.

The Fund has retrospectively applied EIC-171 with restatement of prior periods as required by the standard's transitional provisions. The impact of retroactively adopting EIC-171 for future taxes related to temporary differences associated with the assets and liabilities attributable to exchangeable interests is as follows:

| (expressed in thousands of Canadian dollars) | **2007 (restated)** | **2007 (as originally presented)** |
|---|---|---|
| Balance sheet | | |
| Future income tax liability | $ 8,632 | $ 10,300 |
| Non-controlling interest | 50,637 | 49,671 |
| Fund Units | 308,694 | 308,087 |

The impact on reported earnings is as follows:

| (expressed in thousands of Canadian dollars) | **2007** |
|---|---|
| Decrease in future income tax expense | $ 2,372 |
| Increase in non-controlling interest | (2,277) |
| Increase in net earnings | 95 |
| Increase in basic and diluted earnings per unit | $ 0.00 |

The cumulative impact of the changes to December 31, 2007 is an increase of $94,834 to unitholders' equity.

## 4 Business acquisitions

The business acquisitions have been accounted for using the purchase method, whereby the purchase consideration was allocated to the estimated fair values of the assets acquired and liabilities assumed at the effective date of the purchase. The purchase price allocations are preliminary and subject to amendment once final valuations are completed.

(a) 2008 Acquisitions

On November 5, 2008, the Fund completed the acquisition of 19 retail liquor stores and one liquor license in Anchorage, Alaska. The operating results of the 19 stores are included in the results of the Fund from November 5, 2008.

During the year ended December 31, 2008, the Fund acquired 5 retail liquor stores and one liquor license. The operating results of the acquisitions are included in the results of the Fund from the acquisition date. During the year, an addition to intangible assets of $750,000 was made for the final instalment payment related to a 2007 liquor license purchase.

During the year ended December 31, 2008, adjustments were made to goodwill and intangible assets of $116,450 and $256,788 respectively, related to transaction costs, contingent payments and the finalization of third party valuations for prior year acquisitions. Of the goodwill acquired for retail liquor store acquisitions during the year ended December 31, 2008, $12,028,424 is expected to be deductible for tax purposes.

The purchase price was allocated to the assets acquired as follows:

| (expressed in thousands of Canadian dollars) | **Acquisition of liquor stores in Alaska** | **Other acquisitions** | **Total** |
|---|---|---|---|
| Net assets acquired: | | | |
| Working capital | $ 14,042 | $ 1,001 | $ 15,043 |
| Property and equipment | 3,150 | 1,451 | 4,601 |
| Intangible assets | 9,354 | 3,828 | 13,182 |
| Goodwill | 10,968 | 1,060 | 12,028 |
| | 37,514 | 7,340 | 44,854 |
| Consideration: | | | |
| Cash deposit paid in prior year | - | 587 | 587 |
| Cash consideration during year | 37,514 | 6,753 | 44,267 |
| | 37,514 | 7,340 | 44,854 |
| Cash paid consists of the following: | | | |
| Total cash consideration | 37,514 | 6,753 | 44,267 |
| Less: | | | |
| Amounts payable at December 31 | (470) | (37) | (507) |
| | $ 37,044 | $ 6,716 | $ 43,760 |

Acquired intangible assets are summarized as follows:

| (expressed in thousands of Canadian dollars) | Acquisition of liquor stores in Alaska | Other acquisitions | Total |
|---|---|---|---|
| Finite life intangible assets: | | | |
| Retail liquor license | $ - | $ 359 | $ 359 |
| Customer relationships | - | 110 | 110 |
| Leases | 20 | 314 | 334 |
| | 20 | 783 | 803 |
| Indefinite life intangible assets: | | | |
| Retail liquor licenses | 8,657 | 3,045 | 11,702 |
| Tradename | 677 | - | 677 |
| | 9,334 | 3,045 | 12,379 |
| | $ 9,354 | $ 3,828 | $ 13,182 |

(b) 2007 Acquisitions

On June 8, 2007, the Fund completed the acquisition of all issued and outstanding units of Liquor Barn, an operator of 81 retail liquor store locations. The operating results of Liquor Barn are included in the results of the Fund from June 8, 2007.

During the year ended December 31, 2007, the Fund acquired six retail liquor stores and purchased two liquor licenses. The operating results of the acquisitions are included in the results of the Fund from the acquisition date.

During the year ended December 31, 2007, $2,623,515 related to prior year acquisitions was reclassified from goodwill to retail liquor licenses and favourable market leases in intangible assets as a result of finalizing third party valuations. There were adjustments to goodwill for $754,431 for prior year acquisitions relating to contingent payments and transaction costs. Of the goodwill acquired for retail liquor store acquisitions during the year ended December 31, 2007, $80,787,788 is expected to be deductible for tax purposes.

The purchase price allocated to the assets acquired and the liabilities assumed is as follows:

| (expressed in thousands of Canadian dollars) | Acquisition of Liquor Barn | Other acquisitions | Total |
|---|---|---|---|
| Net assets acquired: | | | |
| Working capital | $ 16,238 | $ 2,031 | $ 18,269 |
| Property and equipment | 16,478 | 1,490 | 17,968 |
| Intangible assets | 32,248 | 4,020 | 36,268 |
| Goodwill | 152,938 | 4,370 | 157,308 |
| Bank indebtedness assumed | (24,089) | - | (24,089) |
| Convertible debentures | (703) | - | (703) |
| Liquor Barn non-controlling interest | (45,292) | - | (45,292) |
| | 147,818 | 11,911 | 159,729 |
| Consideration: | | | |
| Cash deposit paid in prior year | - | 733 | 733 |
| Cash consideration during year | 4,718 | 11,178 | 15,896 |
| Fund Units issued in Liquor Barn | 143,100 | - | 143,100 |
| | 147,818 | 11,911 | 159,729 |
| Cash paid consists of the following: | | | |
| Total cash consideration | 4,718 | 11,178 | 15,896 |
| Less: | | | |
| Amounts payable at December 31 | (163) | - | (163) |
| Cash acquired | (505) | - | (505) |
| | $ 4,050 | $ 11,178 | $ 15,228 |

Acquired intangible assets are summarized as follows:

| (expressed in thousands of Canadian dollars) | Acquisition of Liquor Barn | Other acquisitions | Total |
|---|---|---|---|
| Finite life intangible assets: | | | |
| Retail liquor license | $ 26,556 | $ - | $ 26,556 |
| Customer relationships | 1,366 | - | 1,366 |
| Leases | 3,871 | 206 | 4,077 |
| Tradename | - | 4 | 4 |
| | 31,793 | 210 | 32,003 |
| Indefinite life intangible assets: | | | |
| Retail liquor licenses | 13 | 3,810 | 3,823 |
| Tradename | 442 | - | 442 |
| | 455 | 3,810 | 4,265 |
| | $ 32,248 | $ 4,020 | $ 36,268 |

(c) Contingent consideration

For three agreements entered into in 2005 for the purchase of certain retail liquor stores, the Fund may be required to make contingent payments as follows: i) $100,000 each year for the next three years from December 31, 2008 provided that certain sales thresholds are achieved; ii) 1% of gross sales of certain stores payable quarterly for the next two years to a cumulative maximum of $450,000; and iii) on March 15, 2009, a payment equal to 50% times a multiple of earnings less payments to date.

For an agreement entered into during 2007 for the purchase retail liquor store, the Fund may be required to make contingent payments of $65,000, provided that certain sales thresholds are achieved.

Given the uncertainty with respect to the amount and timing of such payments, no amounts were recorded with respect to this contingent consideration at the time of the respective acquisitions. The Fund will recognize additional consideration payable and goodwill when the outcome of these contingencies becomes determinable.

## 5 Store Closures

During the fourth quarter, the Fund closed seven retail liquor stores. Two stores were closed due to lease expirations and five stores were closed due to under performance.

The Fund reduced goodwill by $624,065 and accelerated amortization for intangible assets of $79,389 and property and equipment for these stores of $927,567.

Additional costs include net rent obligation, equipment removal, and loss of tenant improvement allowance. These items total $907,999 and are included in operating and administrative expense.

## 6 Deposits on future acquisitions

Deposits represent refundable and non-refundable amounts paid for the acquisition of retail liquor stores where the purchase transaction is incomplete at the balance sheet date. Deposits for the acquisition of inventory and working capital are included in prepaid expenses and deposits.

Current year activity is as follows:

| (expressed in thousands of Canadian dollars) | | **Non-current Deposits** | | **Current Deposits** |
|---|---|---|---|---|
| Balance – December 31, 2006 | $ | 1,633 | $ | 421 |
| Deposits tendered | | 1,017 | | 962 |
| Acquisitions completed | | (983) | | (984) |
| Holdbacks released and refunds received | | (1,020) | | (239) |
| Balance – December 31, 2007 | $ | 647 | $ | 160 |
| Deposits tendered | | 3,274 | | 416 |
| Acquisitions completed | | (3,701) | | (250) |
| Holdbacks released and refunds received | | (210) | | (103) |
| Balance – December 31, 2008 | $ | 10 | $ | 223 |

## 7 Property and Equipment

| (expressed in thousands of Canadian dollars) | | | | 2008 |
|---|---|---|---|---|
| | Rate % | Cost | Accumulated amortization | Net book value |
| Leasehold improvements | 7 - 8 | $ 43,388 | $ 10,152 | $ 33,236 |
| Operating equipment | 10 | 4,668 | 1,091 | 3,577 |
| Office equipment and fixtures | 10 | 2,470 | 676 | 1,794 |
| Computer equipment | 20 | 5,612 | 2,067 | 3,545 |
| Automotive | 20 | 689 | 329 | 360 |
| Signage | 10 | 2,575 | 537 | 2,038 |
| Shelving and racking | 10 | 2,554 | 739 | 1,815 |
| Building | 4 | 387 | 9 | 378 |
| | | $ 62,343 | $ 15,600 | $ 46,743 |

| (expressed in thousands of Canadian dollars) | | | | 2007 |
|---|---|---|---|---|
| | Rate % | Cost | Accumulated amortization | Net book value |
| Leasehold improvements | 7 | $ 37,287 | $ 7,139 | $ 30,148 |
| Operating equipment | 10 | 3,641 | 715 | 2,926 |
| Office equipment and fixtures | 10 | 2,409 | 440 | 1,969 |
| Computer equipment | 20 | 4,357 | 1,188 | 3,169 |
| Automotive | 20 | 487 | 217 | 270 |
| Signage | 10 | 1,886 | 313 | 1,573 |
| Shelving and racking | 10 | 2,172 | 520 | 1,652 |
| | | $ 52,239 | $ 10,532 | $ 41,707 |

## 8 Intangible Assets

| (expressed in thousands of Canadian dollars) | | | **2008** |
|---|---|---|---|
| | **Cost** | **Accumulated amortization** | **Net book value** |
| Finite life | | | |
| Customer relationships | $ 1,615 | $ 591 | $ 1,024 |
| Retail liquor licenses | 26,920 | 2,064 | 24,856 |
| Leases | 5,899 | 2,571 | 3,328 |
| Indefinite life | | | |
| Retail liquor licenses | 17,830 | - | 17,830 |
| Tradenames | 1,160 | - | 1,160 |
| | $ 53,424 | $ 5,226 | $ 48,198 |

| (expressed in thousands of Canadian dollars) | | | **2007** |
|---|---|---|---|
| | **Cost** | **Accumulated amortization** | **Net book value** |
| Finite life | | | |
| Customer relationships | $ 1,505 | $ 251 | $ 1,254 |
| Retail liquor licenses | 26,556 | 732 | 25,824 |
| Leases | 5,719 | 1,179 | 4,540 |
| Indefinite life | | | |
| Retail liquor licenses | 5,717 | - | 5,717 |
| Tradenames | 449 | - | 449 |
| | $ 39,946 | $ 2,162 | $ 37,784 |

## 9 Goodwill

| (expressed in thousands of Canadian dollars) | 2008 | 2007 |
|---|---|---|
| Balance – beginning of year | $ 259,638 | $ 104,954 |
| Retail Liquor Store acquisitions (note 4) | 12,028 | 157,308 |
| Goodwill adjustment due to store closures (note 5) | (624) | - |
| Goodwill reclassification (note 4 (b)) | - | (2,624) |
| Foreign currency translation | 491 | - |
| Balance – end of year | $ 271,533 | $ 259,638 |

The Fund tests goodwill for impairment as of September 30 every year, and determined that goodwill was not impaired as of September 30, 2008 or 2007. Due to the continued downturn in equity market conditions, the Fund re-performed step one of the goodwill impairment test as of December 31, 2008 and determined that goodwill was not impaired. Significant assumptions included in this test include management's expectations regarding future revenues, expenses, and other factors impacting cash flow, as well as various inputs to determine the Fund's weighted average cost of capital. While the assumptions reflect management's best estimates, they are subject to the measurement uncertainty associated with the current challenging economic environment and material estimates generally. As a result, material revisions could be required to these estimates in future periods.

## 10 Bank indebtedness and long-term debt

### a) Bank indebtedness

The Fund's credit facilities with a syndicate of Canadian chartered banks comprise a demand revolving $90 million operating facility ("Operating Facility"), a $30 million capital/acquisition line ("Capital/Acquisition Facility"), a $3.5 million demand non-revolving loan to cover electronic fund transfer payments ("EFT Facility"), and a $4.0 million bank guarantee facility to be used in day to day issuance of letters of guarantee for operations ("Guarantee Facility"). During the year the Fund entered into a $10 million USD operating facility with a US bank ("US operating facility").

Interest on bank indebtedness related to the Operating Facility is payable at the lender's prime rate or the banker's acceptance discount rate plus a stamping fee of 1.50%. Interest on amounts outstanding on the Capital/Acquisition Facility is payable at the lender's prime rate plus 0.25% or the banker's acceptance discount rate plus a stamping fee of 1.75%. Interest on the EFT Facility is payable at the lender's prime rate plus 0.75%. Interest on the US operating facility is payable at three month LIBOR + 2.00%.

Effective January 1, 2009, an amendment was issued to the credit facilities agreement. Under the amendment, interest on the Operating Facility is payable at the lender's prime rate plus 0.50% or the banker's acceptance discount rate plus a stamping fee of 1.75%. Interest on the Capital/Acquisition Facility is payable at the lender's prime rate plus 0.75% or the banker's acceptance discount rate plus a stamping fee of 2.00%.

The bank indebtedness and long-term debt are collateralized by a general security agreement covering all present and after acquired personal property of Liquor Stores LP and Liquor Barn LP, subsidiaries of the Fund, and also by a floating charge over all of Liquor Stores LP's and Liquor Barn LP's present and after acquired real property and an assignment of Liquor Stores LP's and Liquor Barn LP's insurance. The assets of Liquor Stores LP and Liquor Barn LP represent substantially all of the Fund's assets.

As at December 31, 2008, $31 million was advanced under the operating facility and $28 million under the capital/acquisition facility. No principal amounts are due on the capital/acquisition facility until maturity. As at December 31, 2008, there was no amount outstanding on the US operating facility.

At December 31, 2008, the Fund had issued $3.7 million (2007 - $3.7 million) in letters of guarantee for day-to-day inventory purchases in Canada.

b) Long-term debt

Long-term debt comprises the following:

| (expressed in thousands of Canadian dollars) | **Maturity Date** | **2008 Effective Rate** | **December 31, 2008** | **December 31, 2007** |
|---|---|---|---|---|
| Capital/Acquisition Facility advance | May 31, 2009 | 3.75% | $ 28,000 | $ 30,000 |
| Convertible unsecured subordinated debentures: | | | | |
| 6.75% Debenture (i) | December 31, 2012 | 10.13% | 51,198 | 43,451 |
| 8.00% Debenture (ii) | December 31, 2011 | 4.85% | 544 | 563 |
| | | | 79,742 | 74,014 |
| Less: current portion of long-term debt | | | 28,000 | - |
| | | | $ 51,742 | $ 74,014 |

(i) 6.75% unsecured subordinated convertible debentures ("6.75% Debentures")

The 6.75% Debentures have a principal amount of $57.5 million and are convertible at the holder's option into fully paid and non-assessable Units at any time prior to the close of business on December 31, 2012 and the business day immediately prior to a date specified by the Fund for redemption of the 6.75% Debentures at a conversion price of $28.50.

The 6.75% Debentures are not redeemable by the Fund prior to January 1, 2011. On or after January 1, 2011 and prior to January 1, 2012, the 6.75% Debentures are redeemable in whole or part from time to time at the option of the Fund on not more than 60 days and less than 30 days notice at the principal amount thereof plus accrued and unpaid interest provided the current market price, as defined in the Indenture, of the Units on the date of the notice of redemption is not less than 125% of the conversion price of $28.50. On or after January 1, 2012, the 6.75% Debentures are redeemable in whole or part from time to time at the option of the Fund on not more than 60 days and less than 30 days notice at the principal amount thereof plus accrued and unpaid interest.

The value of the conversion feature was determined to be $4,830,000 and has been recorded as equity with the remaining $52,670,000 allocated to long-term debt, net of $2,663,951 in transaction costs. The debentures are being accreted such that the liability at maturity will be equal to the face value of $57,500,000. As at December 31, 2008, there were no conversions of these debentures.

(ii) 8.00% unsecured subordinated convertible debentures ("8.00% Debentures")

The 8.00% Debentures have a principal amount of $500,000. The 8.00% Debentures are convertible at the holder's option into fully paid and non-assessable Units at any time prior to the close of business on December 31, 2011 and the business day immediately prior to a date specified by the Fund for redemption of the 8.00% Debentures at a conversion price of $15.09.

The 8.00% Debentures are not redeemable by the Fund prior to December 31, 2009. On or after December 31, 2009 and prior to December 30, 2010, the 8.00% Debentures are redeemable in whole or part from time to time at the option of the Fund on not more than 60 days and less than 30 days notice at the principal amount thereof plus accrued and unpaid interest provided the weighted average trading price of the Units on the Toronto Stock Exchange during the 20 consecutive trading days ending on the fifth trading day preceding the date on which notice of redemption is not less than $18.86. On or after December 31, 2010 and prior to December 31, 2010, the 8.00% Debentures are redeemable in whole or part from time to time at the option of the Fund on not more than 60 days and less than 30 days notice at the principal amount thereof plus accrued and unpaid interest.

The fair value of the debenture was determined to be $703,000 as part of the acquisition of Liquor Barn. The value of the conversion feature was determined to be $140,000 and has been recorded as equity with the remaining $563,000 allocated to long term debt. The debentures are amortized such that the liability at maturity will be equal to the face value of $500,000. As at December 31, 2008, there were no conversions of these debentures.

Upon the occurrence of a change of control involving the acquisition of voting control or direction over 66-2/3% or more of the Units of the Fund, the Fund will be required to make an offer to purchase, within 30 days following the consummation of the change of control, all of the 6.75% Debentures and 8.00% Debentures at a price equal to 101% of the principal amount thereof plus accrued and unpaid interest. This is not effective if the transaction is undertaken as a consequence of the SIFT legislation in which a new parent entity is established, created, or adapted for, or in replacement of, the Fund and there is no change in ultimate ownership of the business of the Fund.

During the year ended December 31, 2008, interest on convertible debentures of $5,088,350 (2007 - $155,108) represents coupon interest of $3,914,886 and $1,173,464 pertaining to the impact of capitalized transaction costs and the accretion of the debt using the effective interest method.

## 11 Distributions

Distributions are determined in accordance with the Trust Indenture, and are based on earnings, before amortization and adjusted by capital expenditures. Distributions totalling $1.62 (2007 - $1.49) per Unit for each of Fund Units, Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units were declared by the Fund for the year ended December 31, 2008.

| | | | | | | | | **2008** |
|---|---|---|---|---|---|---|---|---|
| (expressed in thousands of Canadian dollars) | **Fund Units** | | **Liquor Stores Exchangeable LP Units** | | **Liquor Stores Series 1 Exchangeable LP Units** | | **Total** | |
| | **Declared** | **Paid** | **Declared** | **Paid** | **Declared** | **Paid** | **Declared** | **Paid** |
| Distributions | $ 29,717 | $ 27,239 | $ 5,324 | $ 4,882 | $ 1,373 | $ 1,258 | $ 36,414 | $ 33,379 |

| | | | | | | | | **2007** |
|---|---|---|---|---|---|---|---|---|
| (expressed in thousands of Canadian dollars) | **Fund Units** | | **Liquor Stores Exchangeable LP Units and Subordinated LP Units** | | **Liquor Barn Exchangeable LP Units and Subordinated LP Units** | | **Total** | |
| | **Declared** | **Paid** | **Declared** | **Paid** | **Declared** | **Paid** | **Declared** | **Paid** |
| Distributions | $ 22,189 | $ 19,719 | $ 4,929 | $ 3,952 | $ 976 | $ 859 | $ 28,094 | $ 24,530 |

## 12 Future income taxes

Prior to June 12, 2007, the Fund provided for current and future income taxes only for its incorporated subsidiaries. On June 22, 2007, Bill C-52, including provisions related to the taxation of income trusts commencing January 1, 2011 (or sooner in certain circumstances), received Royal Assent. As a consequence, Canadian income trusts are required to provide for future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011. The rate applicable to the determination of these taxes is 28.0%.

Determining future income taxes involves a number of assumptions and variables that could reasonably change in the period to January 1, 2011, including: the useful lives of recorded property, plant and equipment and intangible assets that determine the amount of amortization recorded thereon; the amount of discretionary tax deductions the Fund will claim from its existing tax depreciation pools, the rates of tax applicable to various jurisdictions in which the Fund is taxable and the allocation of taxable income to those jurisdictions; and the acceptance of the Fund's tax filing positions by the taxation authorities. Changes in these assumptions and variables, which are re-evaluated at each balance sheet date, could result in changes in the recorded amount of future income taxes, and these changes could be material.

Future income tax assets and liabilities are recognized based on temporary differences between accounting and tax bases of existing assets and liabilities as follows:

| (expressed in thousands of Canadian dollars) | **2008** | **2007 (restated – note 3)** |
|---|---|---|
| Future income tax liabilities: | | |
| Intangible assets | $ 6,312 | $ 4,330 |
| Property and equipment | 2,566 | 3,129 |
| Goodwill | 2,627 | 1,569 |
| Debentures | - | 130 |
| | 11,505 | 9,158 |
| Future income tax assets: | | |
| Issue costs | 549 | 375 |
| Deferred lease inducements | 198 | 83 |
| Long term incentive plans | 79 | - |
| Non-capital losses | 63 | 68 |
| | 889 | 526 |
| | $ 10,616 | $ 8,632 |

The above includes a net future income tax asset recorded by a wholly-owned US subsidiary of $84,528 (2007 – nil).

Future income taxes of $2,373,339 attributable to the Fund’s exchangeable interests are not recorded. During the year ended December 31, 2008, 46,721 (2007 – 1,291,435) units were exchanged resulting in an increase to future income taxes of $29,509 (2007 – $704,194).

The Fund has recognized future income taxes related to non-capital losses of $690,663 (2007 - $652,203) available in subsidiaries to offset income of future years. Realization of the non-capital losses is likely. If not utilized, $32,969 will expire in 2026, $196,985 will expire in 2027 and $460,709 will expire in 2028.

Future income taxes are not recorded on $103,745,778 of non tax-deductible goodwill.

## 13 Non-controlling interest

| | Liquor Stores Exchangeable LP Units | Liquor Barn Exchangeable LP Units | Series 1 Exchangeable LP Units | Total |
|---|---|---|---|---|
| Balance – December 31, 2006 | # 3,301,680 | # - | # - | # 3,301,680 |
| Liquor Barn Exchangeable Units at June 8, 2007 | - | 2,157,799 | - | 2,157,799 |
| Exchanged for Fund Units | (1,425) | (1,290,010) | - | (1,291,435) |
| Balance – December 31, 2007 | 3,300,255 | 867,789 | - | 4,168,044 |
| Issuance of Series 1 Exchangeable LP Units | - | (867,789) | 867,789 | - |
| Exchanged for Fund Units | (24,341) | - | (22,380) | (46,721) |
| Balance – December 31, 2008 | # 3,275,914 | # - | # 845,409 | # 4,121,323 |

| (expressed in thousands of Canadian dollars) | (restated – note 3) |
|---|---|
| Balance – December 31, 2006 | $ 33,348 |
| Liquor Barn Exchangeable Units at June 8, 2007 | 45,292 |
| Earnings | 5,184 |
| Liquor Stores Exchangeable Units exchanged for Fund Units | (14) |
| Liquor Barn Exchangeable Units exchanged for Fund Units | (26,799) |
| Exchangeable LP Unit conversion | (704) |
| Distributions declared | (5,905) |
| Balance – December 31, 2007 | 50,402 |
| Earnings | 4,813 |
| Exchanged for Fund Units | (707) |
| Series 1 Exchangeable LP Unit conversion | 210 |
| Distributions declared (note 11) | (6,697) |
| Balance – December 31, 2008 | $ 48,021 |
| **Subsidiaries** | |
| Balance - December 31, 2006 | $ 147 |
| Earnings | 326 |
| Dividends | (238) |
| Balance - December 31, 2007 | 235 |
| Earnings | 415 |
| Dividends | (392) |
| Balance – December 31, 2008 | $ 258 |
| **Total** | $ 48,279 |

**Liquor Stores LP Exchangeable LP Units ("Exchangeable LP Units") and Liquor Stores LP Series 1 Exchangeable LP Units ("Series 1 Exchangeable LP Units")**

On January 1, 2008, Liquor Stores LP issued 867,789 Series 1 Exchangeable LP Units as consideration for the outstanding non-controlling interest in Liquor Barn LP, which consisted of 867,789 Liquor Barn Exchangeable LP Units.

The Exchangeable LP Units and Series 1 Exchangeable LP Units issued by Liquor Stores LP have economic and voting rights equivalent to the Fund Units (note 16), except in connection with the exchangeability terms as described below. They are exchangeable, directly or indirectly, on a one-for-one basis for Fund Units at the option of the holder, under the terms of the Exchange Agreement. The Exchangeable LP Units are not required to be exchanged for Fund Units before transferring to third parties. Exchangeable LP Units and Series 1 Exchangeable Units have been treated as non-controlling interest.

Each Exchangeable LP Unit and Series 1 Exchangeable LP Unit entitles the holder to receive distributions pro rata with distributions made on Fund Units.

## 14 Contingencies

The Fund may, from time to time, be subject to claims and legal proceedings brought against it in the normal course of business. Such matters are subject to many uncertainties. Management believes that adequate provisions have been made in the accounts where required and the ultimate resolution of such contingencies will not have a material adverse effect on the consolidated financial position of the Fund.

## 15 Commitments

The Fund occupies its head office and retail locations under lease agreements with varying terms from five to twenty-five years, expiring from 2009 to 2021. The leases provide for minimum annual lease payments as follows:

| (expressed in thousands of Canadian dollars) | **Amount** |
|---|---|
| 2009 | $ 16,246 |
| 2010 | 14,395 |
| 2011 | 12,252 |
| 2012 | 10,470 |
| 2013 | 8,445 |
| Aggregate of all years thereafter | 18,270 |
| | $ 80,078 |

## 16 Unitholders' Equity

### Fund Units

Units outstanding and capital contributions are as follows:

| (expressed in thousands of Canadian dollars) | Number of units | Net capital contributions (restated – note 3) |
|---|---|---|
| Balance – December 31, 2006 | # 10,228,320 | $ 139,709 |
| Issued for Exchangeable Liquor Stores LP Units | 1,425 | 14 |
| Units issued on March 9, 2007 | 2,492 | 50 |
| Issued June 8, 2007 for the Liquor Barn acquisition | 6,817,533 | 143,100 |
| Issued for Exchangeable Liquor Barn LP Units | 1,290,012 | 26,799 |
| Treasury Units | (45,504) | (978) |
| Balance – December 31, 2007 | 18,294,278 | 308,694 |
| Issued for Exchangeable Units | 46,721 | 707 |
| Vested Units (note 21 (a)) | 15,997 | 341 |
| Cash distributions on vested Units | - | (12) |
| Treasury Units issued on March 7, 2008 (note 21 (a)) | 49,143 | 1,060 |
| Vested Treasury Units issued on March 7, 2008 (note 21 (a)) | (695) | (15) |
| Treasury Units | (48,448) | (1,045) |
| Balance – December 31 ,2008 | # 18,356,996 | $ 309,730 |

An unlimited number of Fund Units may be created and issued pursuant to the Declaration of Trust. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. All Fund Units entitle the holder thereof to one vote and each Fund Unit has equal voting rights and privileges.

Consideration for units issued on exchange of Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units during the period ended December 31, 2008 was recorded at the carrying amount of the Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units.

The monthly cash distributions received by the Long Term Incentive Plan and the 2007 Incentive Plan are remitted to the participants when the associated Units vest.

Treasury Units represent unvested Units held in the LTIP (note 21 (a)).

## 17 Contributed Surplus

The table below summarizes the changes in contributed surplus:

| (expressed in thousands of Canadian dollars) | | Amount |
|---|---|---|
| Balance – December 31, 2006 | $ | - |
| Vested Units | | - |
| Unit-based compensation expense | | 558 |
| Balance – December 31, 2007 | | 558 |
| Vested Units (note 21 (a)) | | (341) |
| Unit-based compensation expense | | 939 |
| Balance – December 31, 2008 | $ | 1,156 |

The Fund manages two unit-based incentive plans under which certain senior management receives a portion of their compensation (note 21 (a)). Awarded Units vest evenly over a period of three years. As the Units vest, they are transferred to the plan participant and recorded against contributed surplus.

## 18 Accumulated Other Comprehensive Income

The following table outlines the components of accumulated other comprehensive income as at December 31, 2008:

| (expressed in thousands of Canadian dollars) | | Amount |
|---|---|---|
| Balance – January 1 and December 31, 2007 | $ | - |
| Foreign currency translation adjustment (i) | | 1,404 |
| Balance – December 31, 2008 | $ | 1,404 |

(i) Net of income tax expense of $nil.

## 19 Capital

The Fund views capital as the combination of its convertible debentures and Unitholders' equity balances. In general, the overall capital of the Fund is evaluated and determined in the context of its financial objectives when managing capital, which are to ensure the Fund has capital and capacity to support its growth strategy, provide investors with stable returns and ensure the Fund has the financial capacity to support its operations.

The Fund's capital structure reflects the requirements of a company focused on growth, both through development of new stores and through acquisition. Management continually monitors the adequacy of the Fund's capital structure and adjusts the structure accordingly either by accessing credit facilities, issuing debt instruments, or issuing new units.

There were no changes to the Fund's objectives, policies or processes for managing capital from the prior fiscal period.

The Fund's indebtedness is subject to a number of financial covenants, but none are capital related. Under the terms of the Fund's credit facility, the following ratios are monitored (all as defined in the credit agreement): adjusted debt to EBITDAR, current ratio and fixed coverage ratio. For the year ended December 31, 2008, the Fund is in compliance with all covenants.

With respect to equity, the current level of capital is considered adequate with regards to operations and the strategic plan of the Fund. The equity component of capital changes primarily based upon the income of the Fund less distributions paid.

The Fund will review its level of equity in the context of the change in taxation impacting the Fund in 2011 as described in note 12.

## 20 Earnings per Unit

| (expressed in thousands of Canadian dollars, except per unit amounts) | **2008** | **2007 (restated – note 3)** |
|---|---|---|
| Net earnings (numerator utilized in basic and diluted Earnings per Unit) | $ 19,259 | $ 9,980 |
| Units outstanding, beginning of period | # 18,294,278 | # 10,228,320 |
| Weighted average of Units issued less treasury Units acquired | 48,918 | 4,363,360 |
| Denominator utilized in basic earnings per unit | 18,343,196 | 14,591,680 |
| Potential units under unit-based compensation plans (note 21 (a)) | 14,414 | 9,590 |
| Denominator utilized in diluted earnings per unit | # 18,357,610 | # 14,601,270 |
| Earnings per Unit – Basic | $ 1.05 | $ 0.68 |
| Earnings per Unit – Diluted | $ 1.05 | $ 0.68 |

Non-controlling interest earnings related to exchangeable units, exchangeable units and potential units for convertible debentures have not been included in the diluted earnings per unit calculation due to their anti-dilutive effect.

## 21 Unit-based compensation plans

(a) Long-term incentive plan ("LTIP") and 2007 Incentive Plan ("2007 Plan")

The following table summarizes the status of the Plans:

| | | LTIP | | 2007 Plan | | Total |
|---|---|---|---|---|---|---|
| Unvested Units December 31, 2006 | # | 492 | # | - | # | 492 |
| Granted | | 2,492 | | 43,851 | | 46,343 |
| Vested Units transferred to participants | | (292) | | - | | (292) |
| Forfeited Units | | - | | (1,039) | | (1,039 |
| Unvested Units December 31, 2007 | | 2,692 | | 42,812 | | 45,504 |
| Granted | | 49,143 | | - | | 49,143 |
| Vested Units transferred to participants | | (1,726) | | (14,271) | | (15,997) |
| Unvested Units, December 31, 2008 | # | 50,109 | # | 28,541 | # | 78,650 |

On March 7, 2008, 49,143 Units were granted under the LTIP and issued from treasury at a price of $21.57 per Unit for a total cost of $1,060,015. Of these units granted, 695 vested during the year ended December 31, 2008 and compensation expense for these units has been fully recognized and expensed. For the remaining units granted, the compensation expense will be recognized over the vesting period of three years or sooner under certain circumstances.

Compensation expense for the LTIP for the year ended December 31, 2008 was $654,641 (2007 - $28,507). Compensation expense of $284,713 (2007 - $529,052) was recorded for the 2007 Plan for the year ended December 31, 2008.

Effective May 8, 2008 the unitholders approved the adoption of the Unit Award Incentive Plan (the "UAIP"). This will replace the LTIP and 2007 Plan for future awards. The Board of Directors of Liquor Stores GP Inc. has complete discretion over the granting of units and timing of any and all awards made under the UAIP and has not granted any awards under the UAIP for 2008.

(b) Trustee and director deferred unit plan ("DSU Plan")

During the year ended December 31, 2008, awards accruing to DSU Plan participants were reduced by $45,586 (2007 – compensation expense of $227,312), which was recorded as a reduction to compensation expense in the period. As at December 31, 2008 participants have accumulated an entitlement to the equivalent cash value of 26,938 Units under the DSU Plan (December 31, 2007 – 13,629).

## 22 Related party transactions

A director of a subsidiary of the Fund is a partner in a law firm to which the Fund incurred professional fees during the year ended December 31, 2008 of $281,860 (2007 - $287,202). Further, the Fund paid fees and expenses to a company controlled by the Chief Executive Officer of the Fund for tax services in the amount of $53,529 (2007 - $31,454) during the year ended December 31, 2008. Rent paid to companies controlled by the Chief Executive Officer of the GP amounted to $493,862 (2007 - $275,204) for the year ended December 31, 2008. These operating and administrative expenses are incurred in the normal course of business at terms similar with unrelated parties and are measured at the exchange amount. There was $15,000 included in accounts payable and accrued liabilities (2007 - $5,689) relating to these transactions.

## 23 Supplemental disclosure of cash flow information

Changes in non-cash working capital items:

| (expressed in thousands of Canadian dollars) | 2008 | 2007 |
|---|---|---|
| Accounts receivable | $ 1,546 | $ (1,522) |
| Inventory | (14,244) | (11,214) |
| Prepaid expenses and deposits | (441) | 875 |
| Accounts payable and accrued liabilities | 10,151 | (5,235) |
| | $ (2,988) | $ (17,096) |

| (expressed in thousands of Canadian dollars) | 2008 | 2007 |
|---|---|---|
| Interest paid | $ 5,779 | $ 2,199 |
| Income taxes paid | 238 | 65 |

## 24 Financial Instruments

### Recognition and measurement

The Fund's financial instruments consist of cash and cash equivalents, accounts receivable, note receivable, bank indebtedness, accounts payable and accrued liabilities, distributions payable to Unitholders and non-controlling interest and long-term debt.

The following table shows the carrying amounts and fair values of the Fund's financial instruments at December 31:

| | December 31, 2008 | | December 31, 2007 | |
|---|---|---|---|---|
| (expressed in thousands of Canadian dollars) | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Held for trading (i) | | | | |
| Cash and cash equivalents | $ 3,350 | $ 3,350 | $ 19,498 | $ 19,498 |
| Loans and receivables (ii) | | | | |
| Accounts receivable | 1,928 | 1,928 | 3,474 | 3,474 |
| Note receivable | 310 | 310 | - | - |
| Other financial liabilities (iii) | | | | |
| Bank indebtedness | 31,172 | 31,172 | - | - |
| Accounts payable and accrued liabilities | 21,033 | 21,033 | 10,498 | 10,498 |
| Distributions payable to unitholders | 2,478 | 2,478 | 2,470 | 2,470 |
| Distributions payable to non-controlling interest | 557 | 557 | 1,094 | 1,094 |
| Capital/acquisition facility advance | 28,000 | 28,000 | 30,000 | 30,000 |
| Convertible debentures | 51,742 | 56,350 | 44,014 | 50,750 |

(i) **Held for trading**

For cash and cash equivalents, the fair value represents cost plus accrued interest. Due to the short-term nature of the instruments, the carrying value approximates fair value.

(ii) **Loans and receivables**

The carrying value less impairment provision of trade receivables approximates fair value due to the short-term nature of the instruments.

The note receivable is an interest-bearing loan at market rates with repayment terms that extend beyond one year. Carrying value is the amortized cost of the notes determined by using the effective interest method. Due to the interest being at market rates, fair value approximates carrying value.

(iii) **Other financial liabilities**

The carrying value of trade payables is assumed to approximate fair value due to the short-term nature of the instruments. The carrying value of bank indebtedness and long-term debt, excluding convertible debentures, approximates the fair value as the interest rate affecting these instruments is at a variable market rate. Convertible debentures have been recorded at amortized cost using the effective interest method. The fair value of the debentures was determined based on market trading values at December 31.

## Credit risk

Credit risk is the risk that a third party to a financial instrument might fail to meet its obligations under the terms of the financial instrument. The Fund's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents, accounts receivable and notes receivable. The Fund maintains its cash and cash equivalents with a major Canadian chartered bank. The Fund, in its normal course of operations, is exposed to credit risk from its customers. Risk associated with respect to accounts receivable is mitigated by credit management policies. The Fund is not subject to significant concentration of credit risk with respect to its customers; however, all trade receivables are due from organizations in the Alberta and British Columbia hospitality industries. There was $57,003 recorded for bad debts or significant past due accounts for the year ended December 31, 2008. Notes receivable are secured by interests in retail liquor stores. There have been no loan impairments for the year ended December 31, 2008.

### Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as market prices change.

(i) Interest rate risk

The Fund is subject to interest rate risk as its credit facilities bear interest rates that vary in accordance with borrowing rates.

The following table presents a sensitivity analysis to changes in market interest rates and their potential annual impact on the Fund, assuming an outstanding bank indebtedness and long-term debt balance of $59,172,000.

| (expressed in thousands of Canadian dollars) | **+ 1.00%** | **- 1.00%** |
|---|---|---|
| Increase (decrease) in interest expense | $ 592 | $ (592) |
| Increase (decrease) in earnings before income tax and non-controlling interest | $ (592) | $ 592 |

The Fund manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans.

(ii) Foreign exchange risk

The Fund commenced operations in the United States in 2008 giving rise to foreign exchange risk arising from exposure to the US dollar. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities, and the Fund's net investment in foreign operations. The Fund does not actively manage this exposure. At December 31, 2008, a weakening/strengthening of the Canadian dollar by 10% against the US dollar with all other variables held constant, would result in an increase/decrease of the Fund's net assets of $140,355, as a result of translation of the US operations.

**Liquidity risk**

The Fund's liabilities have maturities which are summarized below:

| (expressed in thousands of Canadian dollars) | **Current** | **Non-current** |
|---|---|---|
| Bank indebtedness | $ 31,172 | $ - |
| Accounts payable and accrued liabilities | 21,033 | - |
| Distributions payable to unitholders | 2,478 | - |
| Distributions payable to non-controlling interest | 557 | - |
| Long-term debt | 28,000 | - |
| 6.75% debenture | - | 51,198 |
| 8.00% debenture | - | 544 |

The Fund has long-term indebtedness with a maturity date of May 31, 2009, 8.00% convertible debentures maturing on December 31, 2011 and 6.75% convertible debentures maturing on December 31, 2012. The degree to which the Fund is leveraged may reduce its ability to obtain additional financing for working capital and to finance growth acquisitions. The Fund may be unable to extend the maturity date of the credit facilities or to refinance outstanding indebtedness.

To manage liquidity risk, the Fund has historically renewed credit terms prior to maturity dates and maintains financial ratios that are conservative compared to financial covenants applicable to the credit facilities. In addition, a portion of the Fund's short and long-term credit facilities remain undrawn. The Fund is currently in negotiations to renew its credit facilities.

Management monitors liquidity risk through comparisons of current financial ratios with financial covenants contained in its credit facility agreements.

## 25 Segmented information

The Fund identifies operating segments based on business activities and management responsibility. The Fund operates within a single operating segment, being the operation of retail liquor stores in Canada and the United States.

| (expressed in thousands of Canadian dollars) | **Canada** | **US** | **Total** |
|---|---|---|---|
| Total external sales [(i)] | $ 468,578 | $ 14,337 | $ 482,915 |
| Goodwill | 260,074 | 11,459 | 271,533 |
| Property and equipment | 42,938 | 3,805 | 46,743 |

(i) Sales are allocated to countries based on location of store.

## 26 Economic dependence

Under Alberta provincial legislation the Fund is required to purchase liquor and related products from the Alberta Gaming and Liquor Commission. As the Fund's income is derived entirely from the sale of liquor and related products, its ability to continue viable operations is dependent upon maintaining its relationship with this main supplier.

The Fund is dependent on Connect Logistics Services Inc. and Brewers Distributor Ltd. in Alberta and the Liquor Distribution Branch in British Columbia for the substantial majority of its products. Any significant disruption in the operations of these organizations resulting in interruption in supply would have a material adverse effect on liquor store operations including the operations of the Fund.