EST^D 2004

Liquor Stores Income Fund

A SOLID YEAR

TWO THOUSAND AND EIGHT 08 TWO THOUSAND AND EIGHT

THE RIGHT BLEND OF DEPTH AND CHARACTER

EST^D LIQUOR DEPOT 2004

LIQUOR STORES INCOME FUND • ANNUAL REPORT 2008

A SOLID YEAR

President's Message

We are pleased to present our annual report to Unitholders for the fiscal year ending December 31, 2008.

For Liquor Stores Income Fund, 2008 was a solid year. Throughout the year while many companies faced challenges arising from economic uncertainty and the volatility of capital markets, the Fund continued to grow and generate strong operating results.

Financial results for the Fund were solid as we went from $383 million in sales in 2007 to $483 million in 2008 – an increase of 26%. In 2008, operating margins increased from $34.6 million to $41.6 million. Distributable cash, excluding non-recurring items, increased 21.7% to $38.7 million or $1.72 per unit. Distributions remained constant throughout 2008 at $1.62 annually.

We are proud that the Fund has experienced nearly 350 percent growth in the number of stores from its IPO in September of 2004, growing from 50 stores to 223 stores at the end of 2008.

The second half of 2008 was demanding for everyone as investors and businesses were faced with steep declines in financial markets. Stock prices were sharply affected in 2008; even those stocks considered the safest suffered declines in their share price. This was not necessarily because they reported poor results, instead it reflected that investors simply did not want to own stocks in general. As a result, stock prices became disconnected from underlying asset values. Operating results and earnings for the Fund during this time period were strong and did not correlate with the unit price decrease.

We completed a convertible debenture offering of $57.5 million in late 2007 and early 2008 leaving us in a good position to finance future growth.

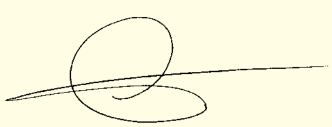
In 2008 we expanded into the United States through the acquisition of 19 Brown Jug liquor stores in the greater Anchorage area providing the Fund with greater market diversification. We also added 16 new stores in Alberta and British Columbia through acquisition and development.

We will maintain our focus on growth with the objective of expanding from the current 224 stores to 300 stores over the next three to four years. Liquor Stores Income Fund's strategy continues to propose further growth in British Columbia and maintenance of our current market share in Alberta. We are monitoring other areas of Canada as well as the United States where over 25 jurisdictions allow private liquor sales. We have opened one new store to date in 2009 and have current commitments to open an additional five stores.

We will continue to monitor the SIFT legislation and assess alternatives to the Fund's income trust structure to ensure that we act in the best interests of Unitholders.

As we look back on 2008, we are optimistic about our opportunities in 2009. We are privileged to have a committed team of employees who have shown tremendous drive and dedication. We are fortunate to be led by an excellent managerial team with the vision and skills to successfully guide us through uncertain economic times. We also believe industry fundamentals remain solid and management will continue to strive to create Unitholder value over the long-term.

In closing, I would like to thank the employees, management and Unitholders for their continued support.



Rick Crook
President and Chief Executive Officer
Liquor Stores GP Inc.

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, 2008. 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 notes of the Financial Statements unless otherwise stated.

Throughout this MD&A references are made to "EBITDA", "distributable cash", "distributable cash before non-recurring items", "operating margin", "operating margin before non-recurring items", "operating margin as a percentage of sales", "payout ratio" and other "Non-GAAP Measures". A description of these measures and their limitations are discussed on page 26 below under "Non-GAAP Measures".

See also "Risk Factors" on page 20 and "Forward-Looking Statements" on page 31 of this MD&A.

This MD&A is dated March 17, 2009.

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.

Highlights

Fourth quarter 2008 compared with fourth quarter 2007

- Operating margin before non-recurring items up 22.1% to $15.5 million from $12.7 million.
- Adjusted gross margin up 19.9% to $37.4 million from $31.2 million.
- Same store sales were consistent at $99.4 million.
- Distributable cash before non-recurring items up 23.2% to $13.8 million from $11.2 million.

Year ended December 31, 2008 compared with year ended December 31, 2007

- Distributable cash per unit excluding non-recurring items of $1.72 compared with $1.71 for 2007.
- On November 5, 2008, the Fund completed the acquisition of 19 Brown Jug liquor stores in Alaska.
- Operating margin before non-recurring items up 23.6% to $43.8 million from $35.5 million.
- Adjusted gross margin up 12.6% to $121.7 million from $108.1 million.
- Distributable cash before non-recurring items up 21.7% to $38.7 million from $31.8 million.

Outlook

Management expects sales to increase for 2009 compared with 2008 due to an increase in the number of stores. However, same store sales may decline due to the current recession. The Fund's geographic markets of Alberta, British Columbia and Alaska are all dependent on resource industries such as oil and gas exploration, mining and forestry. Given the recession's negative impact on these industries, management expects that customers may have less disposable income.

In order to adapt to the current economic environment, the Fund will pay particular attention to purchasing trends at the store level and will adjust inventory selection and levels accordingly. The Fund will concentrate on managing costs and taking action to achieve savings.

The Fund will continue to focus on its strategy of growth through acquisitions and new store development. The Fund's financial capacity, including proceeds from the issuance of convertible debentures in late 2007 and early

2008 and the Fund's current credit facilities, is sufficient to support growth as well as inventory financing. The Fund currently has access to approximately $31 million under its facilities.

Quarterly sales are generally influenced by calendar related issues such as the timing of holidays and the number of Fridays and Saturdays, the key selling days of the week. For the first quarter of 2009, such calendar issues are mainly expected to have an adverse impact for the following reasons:

- The Easter long weekend, a significant driver of liquor sales, will fall in Q2 2009 compared with Q1 2008. Management expects this will result in a shift of sales in 2009 to the second quarter.
- In February 2009 there was one less selling day than in February 2008, due to the 2008 leap year, for which the extra day was a Friday.
- In March 2009 there are only four weekends, compared with five weekends in March 2008. This factor may be only partially offset by the January calendar, with five weekends in 2009 compared with four weekends in 2008. In the Fund's experience, weekend sales in March tend to be higher than weekend sales in January.

Overview of the Fund

The Fund is an unincorporated open-ended, limited purpose trust established under the laws of the Province of Alberta. The Fund's trust units ("Units") and 6.75% Convertible Unsecured Subordinated Debentures ("6.75% Debentures") trade on the Toronto Stock Exchange under the symbols LIQ.UN and LIQ.DB, respectively. Through its 81.8% indirect interest in Liquor Stores Limited Partnership ("Liquor Stores LP"), the Fund operates or has investments in 224 retail liquor stores. Management believes the Fund is the largest liquor store operator in Alberta by number of stores and revenue.

Stores and Operations

(as of March 17, 2009)

	Alberta			British Columbia			Alaska		
	Edmonton(1)	Calgary(1)	Other(2)	Lower Mainland	Vancouver Island	Interior	Anchorage	Other	Total
Number of Stores	78	45	46	13	11	11	19	1	224

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 (21), Southern (9), Central (14) and Resort communities (2).

Competitive Environment

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 169 liquor stores in Alberta where there are approximately 1,117 liquor stores and 88 agency stores as at December 31, 2008 (Source: Alberta Gaming and Liquor Commission).

The Fund operates 35 stores and five small associated pubs in British Columbia. The Province of British Columbia's model for liquor distribution is a blend of approximately 666 private stores and 199 government operated stores. There are also approximately 229 private agency stores that service small communities. (Source: British Columbia Liquor Distribution Branch).

The Fund currently operates 19 stores in the greater Anchorage area. In the state of Alaska there are approximately 380 retail liquor stores with approximately 90 stores in the greater Anchorage area. There are no government owned or operated liquor stores and the state limits the number of liquor stores in the state to one per 3,000 people in urban areas (Source: Alaska's Alcoholic Beverage Control Board).

Business Strategy

Growth

The Fund's strategy is to continue to grow through new store development and acquisitions and by attracting more customers to existing locations. The Fund explores opportunities to acquire and/or develop stores in Alberta, British Columbia, and the United States where regulatory regimes permit private liquor stores. Management will continue to assess potential acquisitions and store development opportunities for their ability to add accretive cash flow and unitholder value.

Competitive Differentiation

Management focuses on differentiating the Fund's stores from the competition by promoting its broad selection of products through emphasis on the in-store customer experience, technology, and marketing and brand development. Many of our stores offer customer education events and merchandise presentations. As well, select stores have controlled dispensing equipment for wine samplings.

To improve efficiencies and enhance the customer experience, management is currently working on a number of information systems initiatives that include a point-of-sale system upgrade.

Management will continue to concentrate marketing efforts on the current brand structure: Liquor Depot, Liquor Barn and Brown Jug full service stores, Grapes 'n Grains specialty stores, and OK Liquor discount stores.

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. Cash available for distribution is after cash required for maintenance capital expenditures, working capital reserve, and other reserves considered advisable by the Fund, including provisions for the Fund's deferred compensation plans. The policy allows the Fund to make stable monthly distributions to its unitholders based on estimates of annual 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's distribution policy is based on distributable cash flow on an annualized basis; accordingly, the seasonality of the Fund's individual quarterly results must be assessed in the context of annualized distributable cash flows. Historically, approximately 46% of the Fund's sales have occurred in the first half of the year and 54% in the latter half. It is the Fund's policy to pay consistent regular monthly distributions throughout the year based on estimated annual cash flows. The Fund reviews its historic and expected results on a regular basis giving consideration to historical, current and expected future performance of existing and new stores, the competitive environment and economic conditions, including labour market trends. In the first half of the year distributions typically exceed distributable cash and in the second half of the year distributable cash typically exceeds distributions such that the Fund has historically distributed approximately 90% of distributable cash on an annualized basis.

Distributions declared during the year ended December 31, 2008 were $36.4 million or $1.62 per Unit, compared with $28.1 million or $1.49 per Unit a year earlier. On a weighted average basis, for the year ended December 31, 2008 distributable cash before non-recurring items was $38.7 million or $1.72 per Unit, compared with $31.8 million or $1.71 per Unit for 2007, an increase of 0.6%. Distributable cash was $39.6 million or $1.76 per Unit for 2008, compared with $31.0 million or $1.67 per Unit for 2007. In 2008, non-recurring items caused an increase in distributable cash; whereas in 2007, non-recurring items caused distributable cash to decrease. Non-recurring items in 2008 were largely comprised of a foreign exchange gain related to the acquisition of Brown Jug stores of $3.2 million offset by professional and consulting fees for litigation matters related to the Liquor Barn acquisition and store closure costs which included operating lease obligations.

The following table provides a reconciliation of distributable cash to its nearest GAAP measure, which is cash provided by operating activities:

	Three months ended December 31,		Twelve months ended December 31,	
(expressed in thousands of Canadian dollars)	2008	2007	2008	2007
Cash provided by operating activities	$ 20,241	$ 1,308	$ 37,006	$ 15,667
Net change in non-cash working capital	(4,545)	9,794	2,988	17,096
Incentive plan provisions	–	(241)	–	(1,060)
Provision for non-growth property and equipment	(88)	(45)	(353)	(707)
Distributable cash	15,608	10,816	39,641	30,996
Non-recurring items[1]	(1,763)	341	(968)	800
Distributable cash before non-recurring items	$ 13,845	$ 11,159	$ 38,673	$ 31,796
Weighted average units outstanding	# 22,556,969	# 22,507,820	# 22,547,973	# 18,597,892
Distributable cash before non-recurring items per Unit	$ 0.61	$ 0.50	$ 1.72	$ 1.71
Distributable cash per Unit[2]	$ 0.69	$ 0.48	$ 1.76	$ 1.67
Distributions declared per Unit	$ 0.41	$ 0.39	$ 1.62	$ 1.49

Notes:

[1] Non-recurring items for the three and 12 months ended December 31, 2008 include foreign exchange gains realized on the settling of foreign currency contracts relating to the Brown Jug acquisition offset by professional and consulting fees for litigation matters related to the 2007 acquisition of Liquor Barn Income Fund and store closure costs, which include operating lease obligations.

[2] The GAAP measure comparable to distributable cash per unit is earnings per unit. Diluted earnings per Unit for the three months ended December 31, 2008 were $0.53 compared to $0.50 in the same period of 2007. Diluted earnings per Unit for the twelve months ended December 31, 2008 were $1.05 compared to $0.68 for the twelve months ended December 31, 2007.

Distributable cash is a non-GAAP measure. See supplemental liquidity information on page 26 for a detailed discussion of distributable cash.

Operating Results

The retail liquor industry is subject to seasonal variations with respect to sales. Sales are typically lowest early in the year and increase in the latter half. In 2008, 20% (2007 – 20%) of annual same store sales occurred in the first quarter, 26% (2007 – 26%) in the second quarter, 26% (2007 – 26%) in the third quarter and 28% (2007 – 28%) in the last quarter.

Policy on Same Store Sales Comparisons

Comparable same store sales is calculated to include sales for stores that have been open 12 full months at the beginning of the reporting period. Same stores sales exclude stores which have significant wholesale business and seven non-performing stores that were closed during the fourth quarter of 2008. Sales for five existing Liquor Depot stores have also been excluded from same store sales where new Liquor Depot stores were opened within close proximity to existing stores.

During the last half of 2008, the Fund opened five new stores which are located in close proximity to existing Liquor Depot stores. Over the last half of the year, and specifically in the last quarter, a significant shift occurred as sales from the existing stores migrated to the new stores. As a result, management believes that excluding these five stores provides a better comparison of same store sales performance. It is management's intention to continue to operate both the existing and new locations. Same store sales for this group of existing stores will be included in the same store sales analysis when the new stores qualify as same stores in the latter part of 2009.

The following table summarizes the number of same stores:

	Three months ended December 31, 2008	Twelve months ended December 31, 2008 (2007 Proforma results comparisons)(2)	Twelve months ended December 31, 2008 (2007 Actual result comparisons)
Liquor Depot(1)	96	91	91
Liquor Barn(2)	69	54	–
Total	165	145	91

Notes:
(1) Liquor Depot includes Liquor Depot, Grapes ‘n Grains and OK Liquor branded stores.
(2) Management has chosen to compare the Fund’s results for the year ended December 31, 2008 to a 2007 Fund Proforma derived by combining the results of the Fund and Liquor Barn Income Fund for the twelve months ended December 31, 2007.

Fourth Quarter 2008 Operating Results

The following table summarizes the operating results for the three months ended December 31, 2008 and 2007.

	Three Months ended December 31,			
	2008		**2007**	
(expressed in thousands of Canadian dollars)	**$**	**%**	$	%
	(unaudited)		(unaudited)	
Number of stores at December 31(1)	**223**		195	
Sales	**143,015**	**100.00%**	125,920	100.00%
Adjusted gross margin(2)	**37,408**	**26.16%**	31,235	24.81%
Operating and administrative expense	**23,398**	**16.36%**	18,885	15.00%
Operating margin(3)	**14,010**	**9.80%**	12,350	9.81%
Non-recurring items(4)	**1,485**	**1.03%**	341	0.27%
Operating margin(4) before non-recurring items	**15,495**	**10.83%**	12,691	10.08%

Notes:
(1) The number of stores and corresponding results for 2008 includes partial months of operations for 22 stores (2007 – two) opened or acquired and seven (2007 – nil) stores closed during the three months ended December 31, 2008.
(2) Adjusted gross margin for 2008 excludes $0.4 million in respect of an inventory fair value adjustment related to the Brown Jug acquisition.
(3) Operating margin has been calculated as described under “Non-GAAP Measures”.
(4) Non-recurring items include professional and consulting fees for litigation matters relating to the 2007 acquisition of Liquor Barn Income Fund and operating leases for stores closed during the period.

Fourth Quarter 2008 Operating Results Compared to Fourth Quarter 2007 Operating Results

Sales

For the three months ended December 31, 2008 sales were $143.0 million, up 13.6 % from $125.9 million in the same period last year. The sales increase comprises:

- Stores opened or acquired subsequent to December 31, 2007, including 19 Brown Jug stores in Alaska, accounted for a $20.7 million increase.
- Wholesale business sales were $18.0 million, down 10.0% from $20.0 million in the prior year. Sales to wholesale customers generate significantly lower margins than retail, and have higher administrative and credit risk costs associated with them. As a result, the Fund plans to curtail growth of this business segment and expects further declines in wholesale business sales in 2009.

- Sales for stores closed during the period were $0.9 million, down $0.7 million from 2007; however, these stores were not all operational for the entire three month period ended December 31, 2008.
- Sales for stores excluded from same store sales due to their close proximity to new stores were $3.5 million, down $0.9 million or 20.5% for the three months ended December 31 2008.

Same Store Sales

- For the three months ended December 31, 2008, total same store sales remained consistent at $99.4 million. There was an increase of $0.6 million for 96 Liquor Depot stores and a decrease of $0.6 million for 69 Liquor Barn stores.

Adjusted Gross Margin

For the three months ended December 31, 2008 adjusted gross margin was $37.4 million, up 19.9% from $31.2 million for the same period last year. The margin increase includes:

- An increase of $0.8 million or 5.2% in Liquor Depot same store gross margin.
- An increase of $0.3 million or 3.4% in Liquor Barn same store gross margin.

As a result of retail price increases in Liquor Barn stores to levels consistent with Liquor Depot stores (“sales price harmonization”), blended gross margin was up substantially to 27.5% of same store sales in the fourth quarter of 2008 from 26.4% of same store sales a year earlier.

Operating and Administrative Expense

Operating and administrative expense for the three months ended December 31, 2008 was $23.4 million, up 23.8% from $18.9 million a year earlier. During 2008, there was an increase of 28 stores operated over the number operated at the end of the fourth quarter of 2007. For the three months ended December 31, 2008, operating and administrative expenses also included $1.5 million in non-recurring consulting and professional fees for litigation related to the 2007 acquisition of Liquor Barn Income Fund and operating lease costs for stores closed during the period. For the three months ended December 31, 2007 operating and administrative expense included $0.3 million in non-recurring items including expenses associated with the Liquor Barn acquisition.

Operating Margin

Operating margin was 9.8% or $14.0 million for the fourth quarter of 2008, consistent with the same period in 2007.

Operating margin before non-recurring items for the three months ended December 31, 2008 was 10.8% or $15.5 million, up from 10.1% or $12.7 million from the same period last year.

Future Income Taxes (a Non-cash Charge)

The Fund, in accordance with GAAP, follows the asset and liability method of accounting. With the substantive enactment of the SIFT Rules in 2007, the asset and liability method of accounting requires the Fund to record a non-cash future tax provision. 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 in 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.

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 EIC abstract required retroactive application, which resulted in an increase to cumulative undistributed earnings of $94,834.

In the quarter ended December 31, 2008, the Fund updated its estimate of temporary differences pertaining primarily to certain goodwill, property, plant and equipment, and intangible assets, which resulted in a net decrease in future income taxes of $1.4 million. Changes to future income tax estimates represent a non-cash charge against net earnings.

Net Earnings before Non-controlling Interest and Net Earnings

Net earnings before non-controlling interest increased to $11.8 million for the three months ended December 31, 2008, up 1.7% from $11.6 million for the same period in 2007. Included in net earnings for the three months ended December 31, 2008 is $2.5 million in foreign exchange gains realized in relation to the acquisition of the Brown Jug stores in November 2008. The Fund recorded charges related to the closure of seven stores of $0.6 million for a goodwill write-down and $0.9 million for operating lease obligations in the fourth quarter. The Fund also recorded an expense of $0.3 million for a write-down of a GST receivable in the 2008 fourth quarter.

For the quarter ended December 31, 2008, net earnings were $9.8 million, up 3.2% from $9.5 million in 2007.

Year Ended December 31, 2008 Operating Results

Basis of Comparison

Management has chosen to compare the Fund's results for the year ended December 31, 2008 to a proforma derived by combining the results of the Fund and Liquor Barn Income Fund for the twelve months ended December 31, 2007. As all comparisons to the year ended December 31, 2007 contain partial month results for the stores acquired in 2007, management believes the proforma provides a more informative comparison and thus is the basis of commentary of performance in this MD&A.

The following table summarizes the operating results for year ended December 31, 2008, 2007 proforma operating results which include results based on proforma financial statements for the year ended December 31, 2007 for Liquor Barn stores, and actual 2007 Fund results which include operating results for Liquor Barn stores for the period June 8 to December 31, 2007.

Year Ended December 31, 2008 Operating Results

(expressed in thousands of Canadian dollars)

	Year ended December 31,					
	2008 Fund Results		2007 Fund Proforma Full Year(1)		2007 Fund Results	
	$	%	$	%	$	%
	(unaudited)		(unaudited)		(unaudited)	
Number of stores at December 31(2)	**223**		195		195	
Sales	**482,915**	**100.00%**	448,545	100.00%	383,063	100.00%
Adjusted gross margin(3)	**121,683**	**25.20%**	108,148	24.11%	93,767	24.48%
Operating and administrative expense	**80,126**	**16.59%**	74,554	16.62%	59,112	15.43%
Operating margin(4)	**41,557**	**8.61%**	33,594	7.49%	34,655	9.05%
Non-recurring items(5, 6)	**2,280**	**0.47%**	4,815	1.07%	800	0.21%
Operating margin(4) before non-recurring items	**43,837**	**9.08%**	38,409	8.56%	35,455	9.26%

Notes:

(1) **2007 Fund Proforma** refers to the results of the Fund for the year ended December 31, 2007, which include results from Liquor Barn stores for the period June 8 to December 31, 2007 and Liquor Barn Income Fund for the period January 1 to June 7, 2007.

(2) For the year ended December 31, 2008, **2008 Fund Results** include partial year operations for 35 stores opened or acquired or closed in 2008. 2007 Fund Proforma results contain partial year operations for ten Fund stores opened, acquired in 2007. **2007 Fund Results** contain partial year operations for 81 Liquor Barn stores and ten Fund stores opened or acquired in 2007 and are not a good basis for comparison. By including the sales for 81 Liquor Barn stores in the 2007 Fund Results for only the last seven months of the year, which are the highest in sales, the operating margin is skewed upward.

(3) Adjusted gross margin for the 2008 Fund Results excludes $0.4 million in respect of the amortization of an inventory fair value adjustment related to the Brown Jug acquisition. The **2007 Fund Proforma** and **2007 Fund Results** excludes $2.2 million in respect of the amortization of an inventory fair value adjustment related to the Liquor Barn acquisition.

(4) Operating margin has been calculated as described under "Non-GAAP Measures".

(5) Non-recurring items for the year ended December 31, 2008 include professional and consulting fees for litigation relating to the 2007 acquisition of Liquor Barn Income Fund and operating lease provisions for stores closed during the year.

(6) Non-recurring items for the **2007 Fund Proforma** were expenses incurred by Liquor Barn Income Fund that related to their defence against the Fund's acquisition offer; and for the **2007 Fund Results**, non-recurring items were head office relocation and Liquor Barn acquisition expenses.

Year Ended December 31, 2008 Operating Results Compared to Year Ended December 31, 2007 Proforma Full Year Operating Results

2007 Proforma full year operating results include results of operations for Liquor Barn stores for January 1, 2007 to December 31, 2007 on a proforma basis.

Sales

For the year ended December 31, 2008, sales were $482.9 million, up 7.7% from $448.5 million for the same period in 2007. The sales increase comprises:

- Sales of $14.3 million for 19 Brown Jug stores acquired in November 2008.
- Sales for stores acquired during 2007, including 15 Liquor Barn stores, were $48.2 million for the year ended December 31, 2008, up 51.7% from $31.8 million for the same period in 2007.
- Sales for stores opened or acquired in 2008 were $12.2 million.
- Sales for stores closed were $4.8 million, down from $6.0 million in 2007. As the stores were closed during the year, 2008 sales amounts do not reflect a full 12 months of operations.
- Sales for stores with significant wholesale business activity were $69.7 million, down $3.9 million from $73.6 million.
- Sales for stores located in close proximity to new stores opened during 2008 were $14.8 million, down $1.4 million or 8.6% from $16.2 million.

Same Store Sales

- For the year ended December 31, 2008, total same store sales were $318.9 million, down 0.6% from $320.9 million. The decrease comprises:
  - An increase of $4.0 million or 2.0% in same store sales for 91 Liquor Depot stores.
  - A decrease of $6.0 million or 5.1% in same store sales for 54 Liquor Barn stores.

Management believes that same store sales for the year ended December 31, 2008 were negatively impacted primarily by the following (prioritized by their impact):

- Retail sales price harmonization for Liquor Barn stores resulted in a substantive increase in margin of 2.4% which offset a drop in sales for the twelve months ended December 31, 2008 compared with the same period in 2007;
- Reduced natural gas and oil exploration throughout northern Alberta, including Grande Prairie and Slave Lake and reduced forestry activities in northern Alberta and the Vancouver Island region of British Columbia;
- Winter storms experienced by the Lower Mainland and Vancouver Island in British Columbia over the Christmas season;
- Extensive construction activities in the southern part of Edmonton interrupted traffic routes around several stores; and
- Drop in tourism in resort areas in the earlier months of the year.

Same store sales increased in many stores in Edmonton and Calgary due to expanding residential development near existing stores.

Adjusted Gross Margin

For the year ended December 31, 2008 adjusted gross margin was $121.7 million, up 12.6% from $108.1 million on a proforma basis from 2007. The increase includes:

- An increase of $1.2 million or 2.2% in Liquor Depot same store gross margin.
- An increase of $1.3 million or 4.7% in Liquor Barn same store gross margin.

Adjusted gross margin as a percentage of sales for the year ended December 31, 2008 was 25.2% compared with 24.1% on a proforma basis for the same period in 2007.

The improvement in adjusted gross margin as a percentage of sales relates principally to sales price harmonization in Liquor Barn stores.

Operating and Administrative Expense

Operating and administrative expense before non-recurring items was $77.8 million, up 11.6% from $69.7 million for the years ended December 31, 2008 and 2007, respectively. For the year ended December 31, 2008, operating and administrative expense including non-recurring items was $80.1 million, up 7.4% or $5.5 million from $74.6 million on a proforma basis for the same period in 2007 due to an increase in the number of stores operated and a provision made for future rent of stores closed during the year.

Operating Margin

For the year ended December 31, 2008 operating margin before non-recurring items was $43.8 million up 14.1% from $38.4 million on a proforma basis for the same period in 2007.

Year Ended December 31, 2008 Operating Results Compared to Year Ended December 31, 2007 Operating Results

2007 Fund results include results of operations for Liquor Barn stores from June 8, 2007 to December 31, 2007.

Sales

For the year ended December 31, 2008 sales were $482.9 million up 26.1% from $383.1 million for the same period in 2007. The sales increase comprises:

- Sales increase of $64.5 million for 77 Liquor Barn stores, including those with significant wholesale sales, acquired on June 7, 2007.
- Sales of $14.3 million for 19 Brown Jug stores acquired in the fourth quarter of 2008.
- Sales for Liquor Depot stores with significant wholesale activity were down $1.4 million.
- Sales for stores that were closed during the year were $4.8 million, up $0.1 from 2007. The stores closed include four Liquor Barn stores acquired on June 7, 2007. The sales for several of the closed stores do not include 12 full months as they were closed during the fourth quarter of 2008.
- Sales for other new stores opened during 2007 and 2008 were $19.7 million.
- Stores that are located within close proximity to new Liquor Depot stores opened during the year were $14.8 million, down $1.4 million or 8.7% from 2007.

Same Store Sales

For the year ended December 31, 2008, there was an increase in same store sales for 91 liquor stores to $207.2 million from $203.2 million or 2.0% compared to the prior year.

Adjusted Gross Margin

For the year ended December 31, 2008 adjusted gross margin was $121.7 million, up 29.7% from $93.8 million for the same period in 2007.

Operating and Administrative Expense

Operating and administrative expense including non-recurring items for the year ended December 31, 2008 was $80.1 million, up $21.0 million or 35.5% from $59.1 million in 2007 mainly due to the increased number of stores operated. Operating and administrative expense in 2008 reflects a full year of operations for 81 Liquor Barn stores acquired on June 7, 2007, whereas for December 31, 2007, the results reflect operations from June 8, 2007 onwards. As well, the Fund grew by 28 net additional stores in 2008.

For the year ended December 31, 2008 operating and administrative expense included $2.3 million in non-recurring items. Non-recurring items for the year ended December 31, 2008 include professional and consulting fees for litigation relating to the 2007 acquisition of Liquor Barn Income Fund and a provision for future rent and operating costs of stores closed during the year. For the year ended December 31, 2007 operating and administrative expense included $0.8 million in non-recurring items including expenses associated with the Liquor Barn acquisition as well as the Fund's head office move.

Operating Margin

For the year ended December 31, 2008 operating margin before non-recurring items was 9.1% or $43.8 million compared with 9.3% or $35.5 million in 2007.

The acquisition of the Liquor Barn stores in the second quarter of 2007 and the measures subsequently taken to improve the performance of these stores has had a significant effect, as expected, on the operating results of the Fund resulting in an overall blended operating margin of 8.6%.

Future Income Taxes (a Non-cash Charge)

The Fund updated its estimate of temporary differences pertaining primarily to certain goodwill, property, plant and equipment, and intangible assets, resulting in future tax expense of $2.2 million for the year ended December 31, 2008.

Net Earnings before Non-controlling Interest and Net Earnings

Net earnings before non-controlling interest increased to $24.5 million for the year ended December 31, 2008, up 58.1% from $15.5 million for the same period in 2007. Included in 2008 is a foreign exchange gain of $3.2 million relating to the acquisition of 19 Brown Jug liquor stores. The Fund recorded a non-cash future income tax expense of $2.2 million for 2008 compared with $8.0 million during the year ended December 31, 2007.

For the year ended December 31, 2008 net earnings increased to $19.3 million, up 93.0% from $10.0 million for the same period in 2007.

Condensed Annual Information

(expressed in thousands of Canadian dollars, except per Unit amounts)

	2008	2007[1]	2006	2005	2004[2]
Balance Sheet					
Cash and cash equivalents	**$ 3,530**	$ 19,498	$ 3,397	$ 2,047	$ 1,004
Total assets	**489,467**	449,725	187,097	140,796	102,906
Bank indebtedness	**31,172**	-	5,455	15,493	12,222
Total current liabilities	**83,240**	14,062	12,896	20,416	14,107
Long-term debt	**51,742**	74,014	-	11,352	7,398
Unitholders' equity	**295,590**	302,380	140,706	67,327	38,200
Non-controlling interest	**48,279**	50,637	33,496	41,700	42,377
Statement of Earnings					
# stores	**223**	195	105	70	50
Sales	**482,915**	383,063	221,997	157,444	35,543
Future income tax expense	**2,194**	7,990	28	40	–
Earnings before non-controlling interest	**24,487**	15,490	15,978	10,312	2,957
Net earnings for the period	**19,259**	9,980	11,515	6,098	1,496
Basic earnings per Unit	**$ 1.05**	$ 0.68	$ 1.35	$ 1.04	$ 0.35
Diluted earnings per Unit	**$ 1.05**	$ 0.68	$ 1.32	$ 1.03	$ 0.35
Distributable cash per Unit	**$ 1.76**	$ 1.67	$ 1.39	$ 1.14	$ 0.38
Distributable cash before non-recurring items per Unit	**$ 1.72**	$ 1.71	$ 1.39	$ 1.14	$ 0.38
Distributions declared per Unit	**$ 1.62**	$ 1.49	$ 1.24	$ 1.05	$ 0.26

Notes:

(1) 2007 information has been restated in accordance with the adoption of CICA Emerging Issues Committee Abstract #171 Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through.

(2) 2004 Statement of Earnings amounts are from September 28, 2004 to December 31, 2004.

Condensed Quarterly Information

(expressed in thousands of Canadian dollars, except per Unit amounts)

	2008				2007			
	Dec 31	Sept 30	June 30 (restated)[1]	March 31 (restated)[1]	Dec 31 (restated)[1]	Sept 30 (restated)[1]	June 30 (restated)[1]	March 31
Balance Sheet								
Cash and cash equivalents	$ 3,530	$ 810	$ 754	$ 768	$ 19,498	$ 6,891	$ 3,391	$ 1,715
Total assets	489,467	442,949	439,961	434,784	449,725	427,986	412,403	188,311
Bank indebtedness	31,172	13,298	9,902	–	–	37,198	35,107	11,893
Total current liabilities	83,240	39,962	36,812	14,098	14,062	55,403	54,916	17,489
Long-term debt	51,742	51,425	51,108	65,859	74,014	15,562	562	–
Statement of Earnings								
# stores	223	208	204	198	195	193	188	105
Sales	$ 143,013	$ 123,913	$ 121,567	$ 94,422	$ 125,920	$ 122,097	$ 83,236	$ 51,809
Future tax expense (recovery)	(1,387)	587	493	2,499	(2,607)	685	9,909	–
Earnings (loss) before non-controlling interest	11,813	7,850	5,684	(857)	11,581	7,438	(5,913)	2,383
Net earnings (loss) for the period	9,777	6,228	4,466	(1,211)	9,550	5,600	(6,937)	1,766
Basic earnings (loss) per Unit	$ 0.53	$ 0.34	$ 0.24	$ (0.07)	$ 0.52	$ 0.31	$ (0.58)	$ 0.17
Diluted earnings (loss) per Unit	$ 0.53	$ 0.34	$ 0.24	$ (0.07)	$ 0.50	$ 0.31	$ (0.58)	$ 0.17
Distributable cash per Unit	$ 0.69	$ 0.49	$ 0.41	$ 0.17	$ 0.48	$ 0.49	$ 0.41	$ 0.20
Distributable cash before non-recurring items per Unit	$ 0.61	$ 0.50	$ 0.41	$ 0.19	$ 0.50	$ 0.50	$ 0.41	$ 0.20
Distributions declared per Unit	$ 0.405	$ 0.405	$ 0.405	$ 0.405	$ 0.385	$ 0.375	$ 0.375	$ 0.358

Note:
[1] Information for the quarters has been restated in accordance with the adoption of CICA Emerging Issues Committee Abstract #171 Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through.

LIQUIDITY AND CAPITAL RESOURCES

Unitholders' Equity and Non-controlling Interest

The following units were outstanding as of March 17, 2009:

	Units
Fund Units[1]	18,443,909
Liquor Stores LP Exchangeable LP Units	3,267,651
Liquor Stores LP Series 1 Exchangeable LP Units	845,409
	22,556,969

Note:
[1] Includes 44,270 Treasury Units held in respect of long-term incentive plans.

The Liquor Stores Limited Partnership Exchangeable and Series 1 Exchangeable LP Units represent a non-controlling interest in the Fund. 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 an Exchange Agreement. Each Exchangeable LP Unit and Series 1 Exchangeable LP Unit entitles the holder to receive distributions pro rata with distributions made on Fund Units.

Capital Expenditures

During the year ended December 31, 2008, the Fund acquired 24 stores and opened 11 new stores. All acquisitions were funded with proceeds from convertible debenture issues that were temporarily used to repay bank indebtedness during 2008. Subsequent to December 31, 2008, the Fund has opened one new store.

The Fund will continue to pursue acquisition opportunities and to open new stores in 2009.

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 "Risk Factors".

The Fund's market capitalization, including that of Liquor Barn Income 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. There is $161.7 million available for 2009 and $59.6 available for 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.

Credit Facilities

The Fund has 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 available credit facilities is $127.5 million. The Fund also has a $7.5 million USD facility with a US bank.

There was $28.0 million drawn on the long-term Capital/Acquisition facility at December 31, 2008 with a term expiring May 31, 2009. Based on discussions with the lender, management believes that the facility will be renewed on or before May 31, 2009. As at March 16, 2009, there was $27.8 million outstanding on the operating line.

Management believes that as the bank's prime lending rate falls, interest rate spreads will increase in 2009, but the net cost of borrowing will be reasonably consistent with rates experienced in 2008.

The Fund's indebtedness is subject to a number of external covenants, but none are capital related. Under the terms of the Fund's credit facility, the following ratios are monitored: adjusted debt to EBITDAR, current ratio and fixed coverage ratio. For the three and twelve months ended December 31, 2008, the Fund continues to be in compliance with all covenants.

The Fund also has $57.5 million in 6.75% Debentures maturing on December 31, 2012 and $0.5 million in 8.00% Debentures maturing on December 31, 2011. Proceeds of the 6.75% Debentures were temporarily used to pay down amounts outstanding on credit facilities with the intent of redrawing on the facilities to finance the Fund's growth objectives as acquisition opportunities were identified and new stores developed. The Fund currently has access to approximately $31 million under its facilities.

Liquidity Risk

The Fund has a variety of alternatives available to fund acquisitions, new store development and ongoing operations, including cash provided by operations, bank indebtedness, issuance of new equity or debt instruments or a combination thereof. The decision to utilize a specific alternative is dependant upon capital market conditions and interest rate levels. The degree to which the Fund is leveraged may impact its ability to obtain additional financing for working capital or to finance acquisitions.

To manage liquidity risk, the Fund has historically renewed credit terms prior to maturity dates and maintained 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. Management measures liquidity risk through comparisons of current financial ratios with financial covenants contained in the credit facility agreement. Management believes the Fund has the resources to meet obligations as they come due in 2009.

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 Canadian prime rate, at short term banker's acceptance rates or at US LIBOR, which may be negatively impacted by increases in interest rates resulting in increased interest expense. If interest rates decrease, interest expense would be reduced. The Fund manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans.

The following table presents a sensitivity analysis to changes in market interest rates and their potential annual impact on the Fund as at December 31, 2008, assuming a combined outstanding bank indebtedness and long-term debt balance of $59.2 million.

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

Credit Risk

The Fund's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts 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 wholesale customers in Alberta whose purchases represent approximately 5% of the Fund's sales. Risk associated with accounts receivable is mitigated by credit management policies. Historically, bad debts from these accounts have been insignificant. 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 industry. There was $57,003 in bad debts recorded for the three and twelve months ended December 31, 2008.

Foreign Exchange Risk

The Fund is subject to fluctuations in the value of the Canadian dollar relative to the US dollar in the normal course of business. A portion of cash flows are realized in US dollars and as such, fluctuations in the exchange rate between the Canadian dollar and US dollar may have an effect on financial results.

The Fund's US subsidiary is considered to be a self-sustaining operation and the 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. The US subsidiary operates 19 stores out of the Fund's 224 stores.

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.

Contractual Obligations

The table below sets forth, as of December 31, 2008, the contractual obligations of the Fund due in the years indicated and relates to various premises operating leases, long-term debt and convertible unsecured subordinated debentures.

(expressed in thousands of Canadian dollars)	2009	2010	2011	2012	2013	2014 and thereafter
Operating leases	$ 16,246	$ 14,395	$ 12,252	$ 10,470	$ 8,445	$ 18,270
Long-term debt	28,000	–	–	–	–	–
Debentures	–	–	500	57,500	–	–
Total	$ 44,246	$ 14,395	$ 12,752	$ 67,970	$ 8,445	$ 18,270

OFF BALANCE SHEET ARRANGEMENTS

As at March 17, 2009, the Fund does not have 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.

The Fund tests goodwill as of September 30 every year, and determined that goodwill was not impaired as of September 30, 2008. Due to the continued downturn in equity market conditions, the Fund reperformed 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 these 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.

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 allocation of the purchase price for acquisitions involves 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.

Future Income Taxes

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.

CHANGES IN ACCOUNTING POLICIES

Capital Disclosures, Financial Instruments, and Inventories

New accounting standards are in effect for fiscal years beginning on or after January 1, 2008 for capital disclosures, financial instruments and inventories. Effective January 1, 2008, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook sections 1535 – Capital Disclosures, 3862 – Financial Instruments – Disclosures, 3863 – Financial Instruments – Presentation, and 3031 – Inventories.

While the adoption of these standards 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.

Future Income Taxes

Effective September 30, 2008, 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. The cumulative impact of the restatement resulted in an increase of $0.1 million to unitholders' equity (see note 3 to the Financial Statements).

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

Goodwill and Intangible Assets

This new standard, CICA Handbook section 3064, 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.

International Financial Reporting Standards

International Financial Reporting Standards ("IFRS") will be effective for publicly accountable enterprises beginning January 1, 2011. The Fund has developed an implementation plan to ensure compliance with the IFRS implementation timelines. Management is currently performing an assessment of the impact on the organization with specific emphasis on policy choices and elections available under IFRS 1, which is mandatory for all first-time adopters of IFRS. In conjunction with this preliminary diagnostic assessment, management is considering reporting implications and limitations on its current information technology systems and will be factoring IFRS requirements into new software purchases and implementations.

Management will be monitoring the impact of changes brought about by IFRS on its internal controls over financial reporting and disclosure controls and procedures.

FINANCIAL INSTRUMENTS

The Fund, as part of its operations, is party to a number of financial instruments. These financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, bank indebtedness, accounts payable and accrued liabilities, distributions payable to Unitholders and non-controlling interest, and long-term debt including convertible unsecured subordinated debentures. Financial assets are classified as available for sale, held to maturity, held for trading, or loans and receivables. Financial liabilities are classified as other financial liabilities. See "Liquidity Risk".

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 and twelve months ended December 31, 2008, the Fund incurred professional fees of $7,562 and $281,860 respectively to a law firm of which a director of Liquor Stores GP Inc. ("Liquor Stores GP"), a subsidiary of the Fund, is a partner. Rent paid to a partnership owned 50% by the Executive Chairman for head office was $139,710 and $460,110 for the three and twelve months ended December 31, 2008, respectively. Rent for other premises paid to a partnership owned 50% by the Executive Chairman of Liquor Stores GP amounted to $24,748 and $33,751. The Fund paid fees and expenses to a company controlled by the Executive Chairman of the GP for tax consulting services of $15,067 and $53,529 for the three and twelve months ended December 31, 2008 (see note 22 to the Financial Statements).

INTERNAL CONTROLS AND PROCESSES

Disclosure Controls and Procedures

The Fund's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Fund is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws and include controls and procedures designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2008, an evaluation was carried out under the supervision of and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Fund's disclosure controls and procedures as defined in National Instrument 52-109 ("NI 52-109") of the Canadian Securities Administrators. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded the disclosure controls and procedures were effective for the year ended December 31, 2008.

Internal Control Over Financial Reporting

Internal control over financial reporting ("ICFR") is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and of the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management, including the Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate ICFR, as such term is defined in NI 52-109 to provide reasonable, but not absolute, assurance regarding the reliability of the Fund's financial reporting. A material weakness in ICFR exists if the deficiency is such that there is a reasonable possibility that a material misstatement of the Fund's annual or interim consolidated financial statements will not be prevented or detected on a timely basis.

As of December 31, 2008 management assessed the effectiveness of the Fund's ICFR using the criteria contained in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Management limited the scope of the design of disclosure controls and procedures and ICFR to exclude controls, policies and procedures of a business acquired by the Fund during the fourth quarter of 2008. Summary financial information for the acquired business that has been consolidated in the Fund's financial statements for the year ended December 31, 2008 is provided below.

(expressed in thousands of Canadian dollars)		Amount
Current assets	$	16,783
Total assets		41,932
Current liabilities		10,190
Sales		14,337

Based on the above evaluation of ICFR, management has concluded that ICFR was operating effectively for the year ended December 31, 2008. Management has concluded that the Fund's Financial Statements fairly present the Fund's consolidated financial position and consolidated results of operations as of and for the fiscal year ended December 31, 2008.

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. The following information is a summary only of certain risk factors and is qualified in its entirety by reference to, and must be read in conjunction with, the detailed information appearing in the Fund's Annual Information Form, which is available at www.sedar.com and the documents incorporated by reference herein. Unitholders and potential Unitholders should consider carefully the information contained herein and, in particular, the following risk factors.

These risks and uncertainties are not the only ones facing the Fund. Additional risks and uncertainties not currently known to the Fund, or that the Fund currently considers immaterial, may also impair the operations of the Fund. If any such risks actually occur, the business, financial condition, or liquidity and results of operations of the Fund, and the ability of the Fund to make distributions on the Units, could be materially adversely affected.

State of Economy

The Fund's success depends on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. The Fund recognizes that the current economic events are unprecedented and can provide no assurance that consumer spending patterns will not change. Adverse changes in these factors could reduce customer traffic or impose practical limits on pricing, either of which could reduce sales and EBITDA, which in turn could adversely affect the availability of distributable cash.

Unpredictability and Volatility of Unit Price

A publicly traded income trust will not necessarily trade at values determined by reference to the underlying value of its business. The prices at which the Units will trade cannot be predicted. The market price of the Units could be subject to significant fluctuations in response to variations in the market environment and in quarterly operating results and other factors. The annual yield on the Units as compared to the annual yield of other financial instruments may also influence the price of Units in the public trading markets. An increase in market interest rates will result in higher yield on other financial instruments, which could adversely affect the market price of the Units.

In addition, the securities markets are experiencing significant market wide and sectoral price and volume fluctuations that have been unrelated or disproportionate to the operating performance of particular issuers. Such fluctuations may adversely affect the market price of the Units.

Growth Strategy Restriction

The Fund presently has capital and unused credit facilities available for growth in the amount of approximately $30 million at December 31, 2008, which Management believes will provide it with sufficient funds to complete additional acquisitions and/or new store development and have sufficient financing available for inventory.

However, the ability of the Fund to make acquisitions beyond the amount of its current excess capital and unused credit facilities depends on the Fund being able to raise additional financing in the future through equity and/or debt capital markets. If the Fund is unable to obtain equity and/or debt financing, either at all or on favourable terms, it may not be able to complete additional acquisitions, which could have an adverse effect on the future growth prospects of the Fund.

Current Cash Distributions

Although the Fund intends to distribute the cash it receives, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by the Fund. The actual amounts of distributions paid by the Fund to the Unitholder will depend upon numerous factors, including profitability, debt covenants and obligations, the availability and cost of acquisitions, fluctuations in working capital, the timing and amount of capital expenditures, deductibility for tax purposes of interest payments on the Liquor Stores Operating Trusts Notes and the Liquor Barn Operating Trust Notes (“Operating Trust Notes”), applicable law and other factors beyond the control of the Fund. Cash distributions are not guaranteed and will fluctuate with the Fund’s performance. There can be no assurance as to the levels of cash distributions to be paid by the Fund, if any. The market value of the Units may deteriorate if the Fund is unable to maintain current distribution levels in the future, and such deterioration may be material.

Government Regulation

The Fund operates primarily in the highly regulated retail liquor industry in the Provinces of Alberta and British Columbia and the State of Alaska. Decisions by the Alberta Gaming and Liquor Commission (“AGLC”), British Columbia Liquor Control and Licensing Branch (“ BCLCLB”) or Alcohol Beverage Control Board (“ABCB”) or rules enacted by them, new legislation or regulations or changes to existing legislation or regulations can impact the operations of Liquor Stores LP both favourably and unfavourably. There is no assurance that new legislation or regulations or changes to existing legislation or regulations or decisions of the AGLC, the BCLCLB or ABCB will not adversely affect the operations or distributable cash of the Fund.

All of the Fund’s Alberta stores are operated pursuant to licenses issued by the AGLC, which must be re-applied for annually. Since its inception in 2004, the Fund has never had a store license revoked or not reissued. Management is not aware of any retail liquor store licensee having a license revoked.

In British Columbia to operate a retail liquor store, an operator must have a LRS license, which must be associated with a primary license. The status of this LRS license is contingent upon the associated primary license being maintained, which in certain circumstances may be controlled by arms length interests. In order to mitigate this risk, where possible, the Fund has negotiated the right to self help with the primary license holders.

All of the Fund’s Alaska stores are operated pursuant to licenses issued by the ABCB, which must be renewed bi-annually.

The AGLC, the BCLCLB, and the ABCB have certain discretion in the granting or revocation of a license to operate a liquor store.

Excise Taxes

Changes in tax rates, and their corresponding effect on product pricing, could affect sales and or earnings. If taxes increase and the Fund raises prices by the full amount of the tax increase, sales volumes could be adversely impacted. If the Fund is not able to pass the full amount of the tax increase on to consumers, then margins and earnings could be adversely impacted. There can be no assurance that governments will not change tax rates in the future.

Competition

The private retail distribution of alcoholic beverages in the Provinces of Alberta and British Columbia is competitive and fragmented. Competition exists mainly on a local basis with the main competitive factors being location and convenience and to a lesser degree price and service.

In Alberta, the Fund competes with other local single store operators, other local and regional chain operators, and liquor stores associated with national and regional grocery store chains. Certain of these competitors have greater financial resources than the Fund. The current regulatory regime in Alberta limits certain of the potential competitive advantages of large scale retailers by, among other things, requiring liquor stores to be operated as a separate business and prohibiting the sale of liquor in stores selling other goods and by requiring all retailers to pay the same wholesale price and a uniform "postage stamp" delivery charge. Any change in this regulatory regime could materially adversely affect the Fund's business and the results of its operations.

In British Columbia, the Fund competes with government owned and operated liquor stores, local independent stores, and wine stores. Under the current regulatory environment, a LRS store cannot operate without an associated primary liquor license being in place. In order to establish a liquor store, an operator must enter into an arrangement with an eligible primary liquor license holder to obtain the associated LRS. This arrangement limits the number of entrants who are able to enter into the market.

In Alaska, the Fund competes with local single store operators, other local and regional chain operators and liquor stores associated with US national grocery store chains. Under the Alaska regulatory environment, stores purchase product directly from distributors and are able to negotiate volume discounts with suppliers. Organizations with greater financial resources are able to maintain a competitive advantage over smaller operators.

Acquisition and Development Risks

Acquisitions have been a significant part of the Fund's growth strategy. The Fund expects to continue to selectively seek strategic acquisitions in Canada and the US. The Fund's ability to consummate and to integrate effectively any future acquisitions on terms that are favourable to it may be limited by the number of attractive acquisition targets, internal demands on the Fund's resources and, to the extent necessary, the Fund's ability to obtain financing on satisfactory terms for larger acquisitions, if at all. Acquisitions may expose the Fund to additional risks, including: difficulties in integrating administrative, financial reporting, operational and information systems and managing newly acquired operations and improving their operating efficiency; difficulties in negotiating lease renewal terms, difficulties in maintaining uniform standards, controls, procedures and policies through all of the Fund's stores; entry into markets in which the Fund has little or no direct prior experience; difficulties in retaining key employees of the acquired operations; disruptions to the Fund's ongoing business; and diversion of management time and resources.

The Fund expects that new store development will also continue to be a significant part of the Fund's growth strategy. The development of new stores is subject to many of the same risks as acquisitions including limitations on the number of attractive development opportunities and competition for such opportunities and internal demands on the Fund's resources. The rate of new store developments may be impacted by factors outside of the Fund's control such as the availability of suitable site locations if real estate development declines or the availability of contractors to perform development work. In addition, the development of new stores requires an outlay of capital based on Management's projections of future store performance, which may prove to be incorrect.

Ability to Locate, Secure and Maintain Acceptable Store Sites and to Adapt to Changing Market Conditions

The success of the Fund's liquor stores is significantly influenced by location. There can be no assurance that current locations will continue to be attractive, or that additional locations can be located and secured as demographic patterns change. It is possible that the current locations or economic conditions where the Fund's liquor stores are located could decline in the future, including as a result of the opening of stores by competitors, resulting in potentially reduced sales in those locations. There is also no assurance that future store locations will produce the same results as existing locations. To the extent that the Fund enters into long-term leases for its store locations, the Fund's ability to respond in a timely manner to changes in the demographic or retail environment at any location may be limited.

Key Personnel

The Fund's success depends on the skills, experience and effort of its key employees. The loss of services of one or more members of the Fund's key employees could significantly weaken the Fund's management expertise and its ability to deliver its services efficiently and profitably.

Labour Costs and Shortages and Labour Relations

The success of the Fund's business depends on a large number of both hourly and salaried employees. Changes in the general conditions of the employment market could affect the ability of the Fund to hire or retain staff at current wage levels. The occurrence of either of these events could have an adverse effect on the Fund's results of operations.

The Fund does not currently have any unionized staff however, there is no assurance that some or all of the employees of the Fund will not unionize in the future. Such an occurrence could increase labour costs and thereby have an adverse effect on the Fund's results of operations.

Supply Interruption or Delay

Liquor store operators in Alberta are dependent on Connect Logistics Services ("CLS") warehouse and Brewers Distributor Ltd. ("BDL") for the substantial majority of their products. In British Columbia, liquor store operators are dependent on the BCLDB and BDL for the majority of their products. Any significant disruption in the operations of these companies, for example as a result of an organized work stoppage, and resulting interruption in supply may have a material adverse effect on liquor store operations including the operations of the Fund and its subsidiaries.

Importance of Information and Control Systems

Information and control systems play an important role in the support of the Fund's core business processes, including store operations, finance, human resources, supply and inventory management and loss prevention. The Fund's ability to maintain and upgrade its information systems capabilities is important to its future performance.

Tax Related Risks; SIFT Legislation

The income of the Fund must be computed and will be taxed in accordance with Canadian tax laws, all of which may be changed in a manner that could adversely affect the amount of distributable cash. There can be no assurance that Canadian federal income tax laws respecting the treatment of mutual fund trusts will not be changed in a manner that adversely affects the holders of Units. If the Fund ceases to qualify as a "mutual fund trust" under the Tax Act, the income tax consequences could materially and adversely affect Unitholders. Further, interest on the Operating Trust Notes and other debt accrues at the Fund level for income tax purposes whether or not actually paid. The amended and restated declaration of trust dated August 10, 2004 pursuant to which the Fund was established ("Declaration of Trust") provides that an amount equal to the taxable income of the Fund will be distributed each year to Unitholders in order to eliminate the Fund's taxable income and provides that additional Units may be distributed to Unitholders in lieu of cash distributions. Unitholders will generally be required to include an amount equal to the fair market value of those Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

If the Fund ceases to qualify as a "mutual fund trust" under the Tax Act, the Units will cease to be qualified investments for Deferred Income Plans and RESPs ("Exempt Plans"). The Fund will endeavour to ensure that the Units continue to be qualified investments for Exempt Plans. The Tax Act imposes penalties for the acquisition or holding of non-qualified investments in such plans and there is no assurance that the conditions prescribed for such qualified investments will be adhered to at any particular time. If the Fund ceases to qualify as a mutual fund trust for purposes of the Tax Act, the Fund may be required to pay tax under Part XII.2 of the Tax Act. The payment of Part XII.2 tax by the Fund will affect the amount of cash available for distribution by the Fund and may have adverse consequences for Unitholders.

The SIFT Rules, first announced on October 31, 2006, have been enacted and may significantly change the taxation of most publicly traded trusts and partnerships, including income trusts such as the Fund, and distributions and allocations from these entities to their investors. Existing trusts, such as the Fund, will have a transition period and, subject to the qualification below, will not be subject to the new rules until January 1, 2011. No assurance can be given that Canadian federal income tax law respecting the taxation of income trusts and other flow-through entities will not be further changed in a manner that adversely affects the Fund and its Unitholders. The SIFT Rules apply an entity level tax on certain income (other than taxable dividends) earned by a SIFT trust, and treat the distributions of such income received by unitholders of a SIFT trust as taxable dividends received from a taxable Canadian corporation. Unitholders subject to the highest marginal rate of tax would receive an after-tax return approximately equal to the after-tax return if pre-tax distributions had been distributed directly to and taxed in the hands of the Unitholders. However, the incidence of entity level tax will be a cost to other types of Unitholders including but not limited to, pension funds and non-residents who would not benefit from the characterization of distributions as eligible dividends.

The Fund will constitute a SIFT trust and, as a result, the Fund and its Unitholders will be subject to the SIFT Rules commencing in 2011.

On December 15, 2006, the Department of Finance issued the Normal Growth Guidelines (the **"Guidelines"**). The Guidelines indicate that the 2011 date will continue to apply in respect of any SIFT trust or partnership whose equity capital grows as a result of issuances of new equity (which includes trust units and debt that is convertible into trust units and may include other substitutes for such equity) before 2011, by an amount that does not exceed the greater of $50 million annually and a "safe harbour" amount that is a percentage of the SIFT's market capitalization as of the end of trading on October 31, 2006 (measured in terms of the value of a SIFT's issued and outstanding publicly-traded units, not including debt, options or other interests that were convertible into SIFT units). For the period from November 1, 2006 to the end of 2007, the Guidelines provide that a SIFT's safe harbour will be 40% of the October 31, 2006 benchmark. If the Fund issues additional Units, convertible debt or other equity substitutes on or before 2011, it may become subject to the SIFT Rules prior to 2011. No assurance can be provided that the SIFT Rules will not apply to the Fund prior to 2011. On December 4, 2008, the Department of Finance announced changes to the Guidelines to allow a SIFT Trust to accelerate the utilization of the SIFT Trust's annual safe harbour amount for each of 2009 and 2010 so that the aggregate safe harbour amount for 2009 and 2010 is available on and after December 4, 2008. This change does not alter the maximum permitted expansion for a SIFT Trust, but allows a SIFT Trust to use its normal growth room remaining as of December 4, 2008 in a single year, rather than staging a portion of the normal growth room over the 2009 and 2010 years.

It is expected that the SIFT Rules will subject the Fund to trust level taxation beginning on January 1, 2011, which will reduce the amount of cash available for distributions to Unitholders. The Fund estimates that the

SIFT Rules will, commencing on January 1, 2011, reduce the amount of cash available to the Fund to distribute to its Unitholders by an amount equal to 28% of the pre-tax income available for distribution by the Fund. A reduction in distributions could adversely affect the value of the Units. A reduction in the value of the Units would be expected to increase the cost to the Fund of raising capital in the public capital markets. There can be no assurance that the Fund will be able to reorganize its legal and tax structure to reduce the expected impact of the SIFT Legislation. In addition, there can be no assurance that the Fund will maintain its "grandfathered" status under the SIFT Legislation until 2011. The Fund does not expect to exceed "normal growth" in the transition period. If the Fund exceeds "normal growth" during the transitional period from October 31, 2006 to December 31, 2010, the SIFT Legislation would become effective on a date earlier than January 1, 2011. Loss of grandfathered status could have a material and adverse effect on the value of the Units.

On February 26, 2008, the Minister of Finance announced (the **"Provincial SIFT Tax Proposal"**) that instead of basing the provincial component of the SIFT tax on a flat rate of 13%, the provincial component will instead be based on the general provincial corporate income tax rate in each province in which the SIFT has a permanent establishment. For purposes of calculating this component of the tax, the general corporate taxable income allocation formula will be used. Specifically, the Fund's taxable distributions will be allocated to provinces by taking half of the aggregate of:

- that proportion of the Fund's taxable distributions for the year that the Fund's wages and salaries in the province are of its total wages and salaries in Canada; and
- that proportion of the Fund's taxable distributions for the year that the Fund's gross revenues in the province are of its total gross revenues in Canada.

Under the Provincial SIFT Tax Proposal the Fund would be considered to have permanent establishments in Alberta and British Columbia. As proposed in recent provincial budgets, the Alberta provincial tax rate in 2011 is expected to be 10% and the British Columbia provincial tax rate in 2011 is expected to be 10%. Taxable distributions that are not allocated to any province would instead be subject to a 10% rate constituting the provincial component. There can be no assurance, however, that the Provincial SIFT Tax Proposal or provincial budgets will be enacted as proposed.

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.

Leverage and Restrictive Covenants

The Fund has third party debt service obligations under the Credit Facility and any replacement or other credit facilities and the 6.75% Debentures and the 8.00% Debentures. The degree to which the Fund is leveraged could have important consequences to the holders of the Units, including: (i) a portion of the Fund's cash flow from operations is dedicated to the payment of interest on its indebtedness, thereby reducing funds available for distribution; (ii) certain of the Fund's borrowings are at variable rates of interest, which exposes the Fund to the risk of increased interest rates. The Fund's ability to make scheduled payments of principal and interest on, or to refinance, its indebtedness depends on its future operating performance and cash flow, which are subject to prevailing economic conditions, prevailing interest rate levels, and financial, competitive, business and other factors, many of which are beyond its control.

The Credit Facility contains certain customary operating covenants that limit the discretion of Management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of the Fund to incur additional indebtedness, to create liens or other encumbrances, to pay distributions or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. A failure to comply with the obligations in the agreements in respect of the Credit Facility could result in an event of default which, if not cured or waived, could permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facility were to be accelerated, there can be no assurance that the Fund's assets would be sufficient to repay in full that indebtedness.

NON-GAAP MEASURES

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization and 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, EBITDA and distributable cash are useful supplemental measures 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 trust 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 and Exchangeable Units)".

Operating margin for purposes of disclosure under "Operating Results" has been derived by adding interest expense, amortization of inventory fair value adjustments, and 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. Operating margin before non-recurring items has been derived by adding non-recurring items to operating margin as described above.

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

Same store sales include sales for stores that have been open 12 full months at the beginning of the reporting period. Same store sales exclude stores which have significant wholesale business and seven non-performing stores that were closed during the fourth quarter of 2008. Sales for five existing Liquor Depot stores have also been excluded from same store sales where new Liquor Depot stores were opened within close proximity to existing stores.

Operating margin, operating margin as a percentage of sales, distributable cash, EBITDA, payout ratio and same store sales 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, EBITDA, payout ratio and same store sales 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, EBITDA, payout ratio and same store sales may differ from the methods used by other issuers. Therefore, the Fund's operating margin, operating margin as a percentage of sales, distributable cash, EBITDA, payout ratio and same store sales may not be comparable to similar measures presented by other issuers.

SUPPLEMENTAL LIQUIDITY INFORMATION

Distributable cash is a non-GAAP measure that provides an indication of the Fund's ability to sustain distributions while maintaining productive capacity. In addition to comparing distributable cash to its nearest GAAP measure, cash provided by operating activities, a comparison can be made to earnings before non-controlling interest. The following table compares cash provided by operating activities, earnings before non-controlling interest and distributable cash before non-recurring items to cash distributions declared on Units combined with cash distributions in respect of non-controlling interests in the Fund's subsidiaries.

(expressed in thousands of Canadian dollars)	Three months ended December 31, 2008	Year ended December 31, 2008	2007	2006
Cash flow provided by operating activities	$ **20,241**	$ **37,006**	$ 15,667	$ 9,339
Earnings before non-controlling interest	**11,813**	**24,487**	15,490	15,978
Distributable cash before non-recurring items	**13,845**	**38,673**	31,796	16,739
Actual cash distributions declared relating to the period	**(9,174)**	**(36,806)**	(28,332)	(15,202)
Excess (deficiency) of cash provided by operating activities over cash distributions declared	$ **11,067**	$ **200**	$ (12,665)	$ (5,863)
Excess (deficiency) of earnings before non-controlling interest over cash distributions declared	$ **2,639**	$ **(12,319)**	$ (12,842)	$ 776
Excess (deficiency) of distributable cash before non-recurring items over cash distributions declared	$ **4,671**	$ **1,867**	$ 3,464	$ 1,537

On an annualized basis and subsequent to the 2007 enactment of legislation concerning the taxation of income trusts, the Fund's cash distributions have exceeded both cash flow from operating activities and earnings before non-controlling interest. Taking into consideration the Fund's distribution policies and assuming continued growth of the Fund's operations, it is unlikely that cash flow from operating activities or earnings before non-controlling interest would exceed its cash distributions in the foreseeable future.

Excess or Deficiency of Cash Flow from Operating Activities Over Cash Distributions

For the reasons explained below, the Fund believes distributable cash before non-recurring items provides a better indication of the Fund's ability to sustain cash distributions while maintaining its productive capacity than does the GAAP measure cash provided by operating activities.

Net Change in Non-Cash Working Capital

The Fund's investments in working capital relate to the Fund's growth, commercial terms with the Fund's suppliers of alcoholic beverages and seasonal fluctuations in inventory levels.

Between January 1, 2006 and December 31, 2008, the Fund developed 24 stores. Under GAAP, the purchases of inventory to open these stores are treated as uses of cash from operating activities rather than as expenditures necessary for the Fund's growth.

Under GAAP, significant investments in inventory following the acquisition of stores are also treated as a use of cash from operating activities rather than as expenditures necessary for the Fund's growth. Between January 1, 2006 and December 31, 2008 the Fund acquired 132 stores. With the exception of the Brown Jug stores, the majority of the stores acquired did not have sufficient inventory to meet the Fund's operating standards related to selection and profitability.

The Fund's major suppliers of alcoholic beverages in Canada require payment prior to delivery of inventory. As a consequence the Fund has a strategy of financing inventory with the use of its credit facilities. Under GAAP, the use of the credit facilities to finance inventory is treated as a financing activity.

Inventory levels are subject to fluctuations related to the timing of opportunities to purchase inventory when favourable buying conditions arise. Historically, these opportunities have followed a seasonal pattern where inventory levels increase in the final quarter of the year and decrease in the first quarter of the year.

The acquisition of the Brown Jug stores in Alaska is a departure from the Fund's historic experience. When the Brown Jug stores were acquired, no liabilities were assumed and no additional investment in inventory was required. In Alaska trade terms are available and accounts payable finance a portion of inventory. Subsequent to the acquisition, there was an increase in accounts payable related to the Brown Jug operation. This increase in accounts payable and net non-recurring income in the fourth quarter caused cash from operating activities to exceed cash distributions by $11.1 million for the three months ended December 31, 2008. The Fund believes that its determination of distributable cash before non-recurring items is more indicative of its fourth quarter 2008 results.

Provisions for Non-Growth Property and Equipment

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 ("non-growth property and equipment"). 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.

The following table provides an analysis of the total expenditures on property and equipment and the amounts reserved for further non-growth expenditures:

	Three months ended December 31,		Twelve months ended December 31,	
(expressed in thousands of Canadian dollars)	**2008**	2007	**2008**	2007
Purchase of property and equipment	**$ 2,594**	$ 1,333	**$ 6,320**	$ 4,411
Growth expenditures including amounts relating to developed stores	**(2,506)**	(1,262)	**(5,867)**	(3,528)
Purchase of non-growth property and equipment[1]	**88**	71	**453**	883
Provision for further non-growth property and equipment expenditures	**–**	(26)	**(100)**	(176)
Total provision for non-growth property and equipment	**$ 88**	$ 45	**$ 353**	$ 707

Note

[1] 2007 non-growth amounts include $16,000 and $325,000 respectively for the three and 12 months ended December 31 relating to rebannering of Liquor World stores to Liquor Depot.

Excess of Distributions Over Earnings Before Non-Controlling Interest

Earnings before non-controlling interest includes a number of non-cash charges which result in distributions exceeding earnings before non-controlling interest. Non-cash charges include: vesting of awards under unit-based compensation plans, amortization of property and equipment, intangible assets, inventory fair value adjustments, goodwill written-off in respect of closed stores, non-cash interest and future income tax expense. These non-cash charges are added back in the determination of cash provided by operating activities.

Unit Based Compensation Plans

In 2008, the Fund adopted a new incentive plan, the Unit Award Incentive Plan ("UAIP") to replace its existing long-term incentive plans. In determining distributable cash the Fund's practice was to provide for the cost of awards under the former plans when the amount of the awards and the conditions under which the awards would vest were reasonably determinable. Under GAAP, the expense related to the awards is recognized over the vesting period.

No new Unit awards are being granted under the former plans and there are currently 44,270 Units scheduled to vest in 2010 and 2011. Once the remaining Units vest, management intends to eliminate these plans.

The Fund has historically utilized long-term incentive plan awards to reward certain employees for significant performance and associated per Unit cash flow growth and has taken into consideration awards under Unit based compensation plans in its determination of distributable cash. When the amount of the award and the conditions under which the awards will vest were reasonably determinable, the Fund deducted the full amount of the award from distributable cash. As a consequence, the recognition of this expense for financial statement purposes had already been taken into consideration in the determination of distributable cash.

Under the UAIP, the Compensation Committee of the Board of Directors of Liquor Stores GP Inc. has complete discretion over the granting of Units, the timing of any and all awards as well as the circumstances under which the Units granted will vest. The Compensation Committee has authority to grant restricted Units which vest only as to time and performance awards for which performance criteria and scalable multipliers can be designed to reward plan participants for the Fund's performance. The Compensation Committee has not granted any awards under the UAIP for 2008. As a result, no UAIP provision has been made in the calculation of distributable cash in respect of the 2008 year.

Inventory Fair Value Adjustments

Inventory fair value adjustments arise from acquisitions. Valuation principles require that the element of profit related to inventory buying and associated activities be recognized in the cost of inventory at the date of acquisition. The Fund amortizes inventory fair value adjustments over a three-month period, which represents the average time it takes for inventory to turn over. The amortization of the inventory adjustment has no impact on future cash flows of the Fund as they are part of the purchase price allocation done at the time of acquisition.

Amortization of Property and Equipment

The Fund does not believe that amortization of property and equipment, namely leasehold improvements, as reflected in its GAAP financial statements reflects the economic cost to sustain its operations. This belief is based on the results of independent appraisals conducted at the time the Fund acquires stores. Generally, the result of these appraisals is that the values assigned to leasehold improvements at the time of acquisition exceed the carrying value of these assets in the accounts of the acquired business, indicating that amortization provided on a GAAP basis exceeds the economic cost of the assets consumed.

The principal reasons that amortization of property and equipment exceeds maintenance capital is that amortization of leasehold improvements is determined based on the initial term of the lease plus one lease renewal period. Leasehold improvements generally have an economic life longer than this period. Amortization of leasehold improvements represented a substantial portion of the Fund's amortization of property and equipment during the period from January 1, 2006 to December 31, 2008.

Leases and Licenses

These items relate to fair value adjustments at the time the Fund's completes acquisitions.

Favourable and unfavourable leases represent market value rents for the term of the leases assumed by the Fund. While rent escalations on renewal or for an option period have an impact on Fund's earnings and cash flow from operations, the amortization of these items does not. The Fund leases the locations for virtually all of its stores and lease renewals are staggered.

At the time of a store acquisition a fair value is assigned to the licenses acquired. The cost of definite life licenses is amortized over the life of the lease and all renewal terms.

Given the life of the favourable and unfavourable leases and the licenses, the amortization of these items has limited impact on the sustainability of current distributions and no impact on the Fund's productive capacity in the foreseeable future.

Non-cash Interest

The non-cash interest relates to the Fund's convertible subordinated debentures and primarily to the $57.5 million principal amount 6.75% Debentures issued by the Fund in December 2007 and January 2008. The amount of the liability initially recorded in the Fund's accounts with respect to the 6.75% Debentures was approximately $50 million. The issue costs and the value of the conversion feature comprise the difference between the amount recorded in the Fund's accounts and the principal amount of the debentures. The non-cash interest represents the accretion of the debt balance to the amount owing at maturity.

The contractual requirement to repay the principal amount of the debentures is reflected in the table on page 16.

Goodwill Adjustment for Store Closures

In 2008, the Fund expensed approximately $0.6 million in respect of a non-cash goodwill adjustment related to closed stores. The Fund does not believe that this expense is meaningful in evaluating the sustainability of its cash distributions because the stores closed did not significantly contribute to distributable cash prior to their closure.

Future Income Taxes

The provisions for future income taxes in the Fund's accounts are to provide an estimate of what the future tax liability may be on January 1, 2011. These provisions do not result in cash taxes payable in the periods presented as current legislation will not result in the Fund being taxable until 2011.

It is expected that the foregoing non-cash charges will continue to cause distributions to exceed net earnings for the foreseeable future. The non-cash non-recurring items include: professional and consulting costs related to the Liquor Barn acquisition, store closure costs rent obligations, amortization, a goodwill adjustment, foreign exchange gains resulting from the acquisition of Brown Jug stores, and other non-significant charges.

Non-recurring Items

In 2008, non-recurring items contributed to earnings before non-controlling interest by approximately $0.7 million. The Fund does not believe that this contribution is meaningful in evaluating the sustainability of its cash distributions.

FUTURE ORIENTED FINANCIAL INFORMATION

In this MD&A, management is updating certain forward looking statements provided in the Fund's MD&A dated November 13, 2008 for the three months ended September 30, 2008 and the Fund's MD&A dated May 8, 2008 for the three months ended March 31, 2008.

In its MD&A for the three months ended September 30, 2008, the Fund estimated that sales for 191 stores in operation in August 2007 would be approximately $460 million. For the year ended December 31, 2008, sales for these stores were approximately $450 million.

Although sales did not meet expectations, there was only a minor reduction in the operating margin for the 191 stores. An increase in gross margin as a percentage of sales, lower than anticipated labour costs and lower than anticipated operating costs offset the effect of the lower sales.

In its MD&A for the three months ended March 31, 2008, forward looking statements were made in respect of the year ended December 31, 2008 compared to the year ended December 31, 2007. These forward looking statements included:

- Distributable cash per weighted average unit for 2008 would grow by 3% to 5% compared to 2007.
- Operating margin as a percentage of sales for 2008 would be comparable to 2007.
- The payout ratio for 2008 would be comparable to 2007.

In 2008, the Fund restated it previous disclosure concerning non-recurring expenses incurred in 2007. The following is a comparison of the actual results for 2008 to the Fund's results as originally reported for 2007:

- Distributable cash per weighted average unit before non-recurring items for 2008 grew by 3% compared to distributable cash per weighted average unit of $1.67 in 2007.
- Operating margin as a percentage of sales before non-recurring items for 2008 was 9.08% compared to operating margin as a percentage of sales of 9.05% for 2007.
- The payout ratio for 2008, exclusive of non-recurring items, was 94% compared to a payout ratio of 89% in 2007.

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. 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". Specific forward-looking statements contained in this management's discussion and analysis include, among others, the anticipated renewal of the Fund's credit facility, the Fund's expectations regarding net borrowing costs in 2009, and management's expectations that the Fund will have sufficient funds to complete store acquisitions and development and finance inventory.

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.

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 are 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.

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.

PricewaterhouseCoopers LLP
Chartered Accountants

March 16, 2009

Management's Responsibility for Financial Statements

The accompanying financial statements of Liquor Stores Income Fund have been prepared by management in accordance with generally accepted accounting principles. Liquor Stores Income Fund's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. In recognizing that the Fund is responsible for both the integrity and objectivity of the financial statements, management is satisfied that the financial information throughout the balance of this annual report is consistent with the information presented in the financial statements.

PricewaterhouseCoopers LLP have been appointed to serve as the Fund's external auditors. They have examined the financial statements of the Fund for the period ending December 31, 2008.

The Audit Committee has reviewed these statements with management and the auditors, and has reported to the Board of Directors of Liquor Stores GP Inc., the administrator of the Fund. The Board of Directors of Liquor Stores GP Inc. has approved the information contained in the financial statements of Liquor Stores Income Fund which are included in this annual report.

Rick Crook
President & CEO
Edmonton, Alberta

Patrick de Grace
Vice President Finance & CFO
Edmonton, Alberta

March 17, 2009

Consolidated Balance Sheets

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

Consolidated Statements of Earnings and Comprehensive Income

For the years ended December 31, 2008 and 2007
(expressed in thousands of Canadian dollars, except per unit amounts)

	2008	2007 (restated) (note 3)
Consolidated Statements of Earnings		
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

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

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

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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.

2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

(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.

2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION (continued)

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

4. BUSINESS ACQUISITIONS (continued)

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.

4. BUSINESS ACQUISITIONS (continued)

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 acquisition	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

4. BUSINESS ACQUISITIONS (continued)

(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

8. INTANGIBLE ASSETS (continued)

(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%.

10. BANK INDEBTEDNESS AND LONG-TERM DEBT (continued)

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

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

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 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 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.

(expressed in thousands of Canadian dollars)								**2008**
	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**

(expressed in thousands of Canadian dollars)								2007
	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

13. NON-CONTROLLING INTEREST (continued)

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

24. FINANCIAL INSTRUMENTS (continued)

(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.

24. FINANCIAL INSTRUMENTS (continued)

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.

Corporate Information

ANNUAL GENERAL MEETING

Tuesday, June 16, 2009
10:00 a.m. at Union Bank Inn
10053 Jasper Avenue
Edmonton, Alberta

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STOCK EXCHANGE - THE TORONTO STOCK EXCHANGE

Trading symbols - LIQ.UN
- LIQ.DB

BOARD OF DIRECTORS - LIQUOR STORES GP INC.

Henry Bereznicki - Board Chairman
Irv Kipnes - Executive Chairman
Robert Green
David Margolus, Q.C.
Jim Dinning
R. John Butler, Q.C.
Glen Heximer, CA
Gary Collins
Richard Crook

OFFICERS

Irv Kipnes - Executive Chairman
Henry Bereznicki - Board Chairman and Director of Store Acquisitions and Development
Richard Crook - President and Chief Executive Officer
Patrick de Grace - Vice President Finance and Chief Financial Officer
Simon McCaffery - Chief Operating Officer
Craig Corbett - General Counsel and Corporate Secretary

TWO THOUSAND AND EIGHT 08 TWO THOUSAND AND EIGHT

Liquor Stores Income Fund

A SOLID YEAR

2008 is a year that will rewrite history for many companies and their employees. For the Liquor Stores Income Fund, 2008 will be remembered as a solid year. There have been challenges that the world-wide business community has faced and there are many stories of success, clarity and steadiness that have emerged. Our story is among them. Our optimism comes from our origins, the vision of our management, the commitment of our employees and how we envision growth in the future. We're proud to report we had a solid year in 2008 and look forward to success not only in 2009 but in the years ahead.

LIQUOR DEPOT