Liquor Stores Income Fund

Consolidated Financial Statements
December 31, 2004

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March 10, 2005
(except for note 18(a), which is as of March 14, 2005)

Auditors' Report

To the Trustees of
Liquor Stores Income Fund

We have audited the consolidated balance sheet of **Liquor Stores Income Fund** as at December 31, 2004 and the consolidated statements of earnings and cash flows for the period from August 10, 2004 to December 31, 2004. 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 audit.

We conducted our audit 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, 2004 and the results of its operations and its cash flows for the period then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Liquor Stores Income Fund

Consolidated Balance Sheet

As at December 31, 2004

	$
Assets	
Current assets	
Cash	178,672
Accounts receivable	666,130
Inventory	20,676,416
Pre-opening costs	164,954
Prepaid expenses and deposits	413,585
	22,099,757
Equity investment (note 4)	432,728
Property and equipment (note 5)	12,184,265
Future income taxes (note 6)	14,000
Intangible assets (note 7)	406,466
Goodwill (note 3)	66,943,639
	102,080,855
Liabilities	
Current liabilities	
Bank indebtedness (note 8)	11,397,240
Accounts payable and accrued liabilities (note 9)	1,629,896
Distributions payable to unitholders (note 12)	358,190
Distributions payable to non-controlling interest (note 13)	721,523
	14,106,849
Long-term debt (note 10)	7,397,917
	21,504,766
Commitments (note 11)	
Non-controlling interest (note 13)	42,376,480
Unitholders' Equity	
Unitholders' equity (note 12)	
Fund units	37,814,172
Cumulative earnings	
Net earnings for the period	1,495,705
Distributions declared (note 14)	(1,110,268)
	385,437
	38,199,609
	102,080,855

Liquor Stores Income Fund

Consolidated Statement of Earnings

For the period from August 10, 2004, including operations from September 28, 2004 (date of commencement of business operations) to December 31, 2004

	$
Sales	35,542,909
Cost of sales	27,571,758
Gross margin	7,971,151
Expenses	
Operating	3,633,204
Administrative	851,521
Amortization of property and equipment	249,728
Amortization of intangible assets	22,534
	4,756,987
Earnings from operations	3,214,164
Interest expense	(257,538)
Earnings before non-controlling interest	2,956,626
Non-controlling interest	(1,460,921)
Net earnings for the period	1,495,705
Basic and diluted earnings per unit (note 12)	0.348

Liquor Stores Income Fund

Consolidated Statement of Cash Flows

For the period from August 10, 2004, including operations from September 28, 2004 (date of commencement of business operations) to December 31, 2004

	$
Cash provided by (used in)	
Operating activities	
Net earnings for the period	1,495,705
Items not affecting cash	
Amortization	272,262
Future income taxes	6,000
Equity loss	1,942
Accrued interest	122,217
Non-controlling interest	1,460,921
	3,359,047
Net change in non-cash working capital items	(2,696,092)
	662,955
Financing activities	
Net proceeds from the issuance of Units	37,814,172
Proceeds of long-term debt	7,331,099
Bank indebtedness	11,341,841
Distributions paid to unitholders	(752,078)
Distributions paid to non-controlling interest	(362,918)
	55,372,116
Investing activities	
Business acquisitions (note 3)	(55,445,706)
Cash acquired on acquisition	38,413
Purchase of property and equipment	(115,786)
Proceeds on disposal of property and equipment	1,350
Advances to equity investee	(334,670)
	(55,856,399)
Increase in cash and cash at end of the period	178,672
Supplementary information	
Interest paid	135,321

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.

The Fund commenced business operations on September 28, 2004, when it completed an initial public offering (the "IPO") of 4,300,000 trust units ("Fund Units"), at a price of $10 per unit, for aggregate gross proceeds of $43,000,000. Concurrent with the closing of the IPO, the Fund acquired a 50.6% indirect interest in Liquor Stores Limited Partnership ("Liquor Stores LP") (note 3) and Liquor Stores LP acquired the net assets (the "Acquired Business") of The Liquor Depot Corporation and Liquor World Group Inc. and other wholly owned subsidiaries or companies that were under common control (collectively, the "Vendors"). As at December 31, 2004, Liquor Stores LP operated 49 retail liquor stores in Alberta and one retail liquor store in British Columbia.

2 Significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and reflect the following accounting principles.

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 the expected discounted future cash flows of the related operations, 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. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

a) Basis of presentation

These consolidated financial statements include the accounts of the Fund, Liquor Stores Operating Trust, Liquor Stores LP, Liquor Stores GP Inc. and several subsidiaries thereof. All significant inter-entity balances and transactions have been eliminated on consolidation.

Since the Fund commenced operations on September 28, 2004 with the purchase of the Acquired Business, no comparative information is provided.

The Fund accounts for investments in which it has significant influence, but not control, using the equity method.

b) Revenue recognition

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

c) Inventory

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

d) Pre-opening costs

Pre-opening costs represent direct costs incurred in acquiring and developing new stores in British Columbia and Alberta. The Fund defers such expenditures incurred during the pre-operating period for new stores. These costs are amortized over two years when the new store commences operations. Where costs have been incurred regarding locations that are subsequently abandoned, the costs are expensed in that period.

e) Property and equipment

Property and equipment is recorded at cost. Amortization is provided for over the estimated useful lives of assets on a straight-line basis at annual rates disclosed in note 5. 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.

f) Goodwill

Goodwill represents the excess of the cost of an acquired business over the estimated fair value of the identifiable net assets acquired. Goodwill is not amortized, but is tested at least annually for impairment. If the carrying value of the goodwill exceeds its fair value, an impairment loss is reported in income of the current period.

g) Intangible assets

Intangible assets acquired at the time of the IPO represent management's estimate of the fair value of customer relationships, existing retail liquor licenses and business permits, including zoning permissions to operate a retail liquor store and the value attributed to property leases acquired at less than market rates.

The amount attributable to customer relationships is amortized over five years and the amount attributable to property leases is amortized over the remaining term of the lease. 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 not recoverable and exceeds their fair value.

Retail liquor licenses and business permits to operate a retail liquor store have an indefinite life, therefore, the cost attributable to these items is not amortized. The Fund will assess the carrying value of this unlimited life intangible asset for impairment annually, or more frequently, if events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recorded when it is determined that the carrying amount is not recoverable and exceeds its fair value.

h) Future income taxes

Incorporated subsidiaries of the Fund use the asset and liability method of accounting for future income taxes. Under this method, future income tax assets and liabilities are recorded based on temporary differences between the carrying amount of balance sheet items and their corresponding tax bases. In addition, the future benefits of income tax assets, including unused tax losses, are recognized, subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized. Future income tax assets and liabilities are measured using enacted tax rates and laws expected to apply when the tax liabilities or assets are to be either settled or realized.

Income tax obligations relating to distributions of the Fund are the obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of the assets and liabilities of the Fund.

3 Issuance of Units and business acquisitions

On September 28, 2004, the Fund completed the IPO for aggregate proceeds of $43,000,000. The costs of issuance of the units was $5,185,828, resulting in net proceeds of $37,814,172. Concurrent with the closing of the IPO, the Fund used the net proceeds from the IPO to acquire an indirect 50.6% interest in Liquor Stores LP, represented by 4,300,000 Ordinary LP Units. Liquor Stores LP combined these funds with funds from new credit facilities (notes 8 and 10) and contributions by the Vendors, to acquire, through a series of transactions, 100% of the net business assets of the Vendors.

The acquisition of the Fund’s interest in the Acquired Business has been accounted for using the purchase method.

The purchase price allocated to the assets acquired and the liabilities assumed, based on their fair values, is as follows:

	$
Property and equipment	12,319,558
Goodwill	66,943,639
Intangible assets	429,000
Other assets	121,975
	79,814,172
Net working capital	17,631,534
	97,445,706

	$
Consideration, being cash from IPO and new credit facilities	55,445,706
Liquor Stores LP Exchangeable LP Units	20,750,000
Liquor Stores LP Subordinated LP Units	21,250,000
	97,445,706

4 Equity investment

	$
Shares – 50%	1
Equity (loss)	(1,942)
Advances	434,669
	432,728

The advances are non-interest bearing and have no specified repayment terms.

5 Property and equipment

	Rate %	Cost $	Accumulated amortization $	Net book value $
Leasehold improvements	7	11,067,903	205,060	10,862,843
Operating equipment	10	254,525	6,597	247,928
Office equipment and fixtures	10	360,933	9,461	351,472
Computer equipment	20	216,075	11,232	204,843
Automotive	20	133,163	6,931	126,232
Shelving and racking	10	401,394	10,447	390,947
		12,433,993	249,728	12,184,265

6 Future income taxes

The Fund has recognized future income taxes related to non-capital losses of $63,078 available in a subsidiary to offset income of future years. If not utilized, the losses will expire in 2011.

The Fund records income taxes relating to temporary differences and income earned by corporate subsidiaries of the Fund. The Fund does not record income taxes relating to the remaining temporary differences nor the remaining income earned by the Fund. Unitholders of the Fund will be responsible for these income taxes. The temporary differences relating to assets and liabilities of the Fund for which income taxes are not recorded are as follows:

	$
Goodwill	(26,491,523)
Property and equipment	(6,650,993)
Deferred lease inducements	9,486
	(33,133,030)

7 Intangible assets

	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Customer relationships	93,000	4,650	88,350
Retail liquor licenses and business permits	11,000	-	11,000
Leases	325,000	17,884	307,116
	429,000	22,534	406,466

8 Bank indebtedness

The Fund has credit facilities with a Canadian chartered bank consisting of:

	$
Bankers' acceptances	11,341,841
Accrued interest	55,399
	11,397,240

The bank indebtedness is collateralized by a general security agreement covering all present and after acquired personal property of Liquor Stores LP and also by a floating charge over all of Liquor Stores LP's present and after acquired real property and an assignment of Liquor Stores LP's insurance. Interest is payable at the lender's prime rate plus 0.25% or at the banker's acceptance rate plus 1.50%. As of December 31, 2004, bank indebtedness consists of bankers' acceptances of $6,500,000 at an effective rate of 4.34% expiring on April 18, 2005 and $5,000,000 at an effective rate of 4.13% expiring on February 3, 2005.

9 Related party transactions

During the period, the Fund incurred professional fees of $9,400 to a law firm where one of the partners is a director of a subsidiary of the Fund. Rent paid to companies controlled by directors of a subsidiary of the Fund amounted to $17,600. Included in accounts payable and accrued liabilities is $7,100 relating to these transactions.

Included in accounts payable and accrued liabilities is $427,373 in amounts owing to the Vendors related to the acquisition of the assets at the time of the IPO. No interest is charged on these amounts.

10 Long-term debt

	$
Non-revolving bank loan	
Bankers' acceptance	7,331,099
Accrued interest	66,818
	7,397,917

Interest is payable at the lender's prime rate plus 0.50% or at the bankers' acceptance rate plus 1.75%. As of December 31, 2004, the Fund had borrowed the entire amount by way of a bankers' acceptance at an effective rate of 4.59%, which matures on April 18, 2005 for $7,500,000. The loan does not require principal repayments and is due on April 29, 2006. Interest expense on long-term debt is $86,236.

The long-term debt is collateralized by a general security agreement covering all present and after acquired personal property of Liquor Stores LP and also by a floating charge over all of Liquor Stores LP's present and after acquired real property and an assignment of Liquor Stores LP's insurance.

11 Commitments

The Fund occupies its retail locations under lease agreements with varying terms from five to fifteen years, expiring from March 2005 to October 2019. The leases provide for minimum annual lease payments over the next five years as follows:

	$
Years ending December 31	
2005	3,340,113
2006	3,250,575
2007	2,948,816
2008	2,774,691
2009	1,992,303
Thereafter	4,556,771
	18,863,269

12 Unitholders' equity

Fund Units

Units outstanding and capital contributions are as follows:

	Number of units #	Issue costs $	Net capital contributions $
Fund Units	4,300,000	5,185,828	37,814,172

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.

Distributions payable to Unitholders

Distributions to Unitholders are determined based on earnings, before amortization, but reduced by capital expenditures. Distributions totalling $0.2582 per Fund Unit ($1,110,268) were declared by the Fund for the period ended December 31, 2004. Distributions of $752,078 were paid and distributions of $358,190 were payable for the period ended December 31, 2004.

13 Non-controlling interest

	Liquor Stores LP Exchangeable LP Units	Liquor Stores LP Subordinated LP Units	Total
	#	#	#
Number of Units	2,075,000	2,125,000	4,200,000
Fund Special Voting Units	2,075,000	2,125,000	4,200,000
	$	$	$
Units – Amount	20,750,000	21,250,000	42,000,000
Fund Special Voting Units – Amount	-	-	-
Non-controlling interest	721,765	739,156	1,460,921
Distributions declared	(535,766)	(548,675)	(1,084,441)
	20,935,999	21,440,481	42,376,480

Liquor Stores LP Exchangeable LP Units (“Exchangeable LP Units”)

The Exchangeable LP Units issued by Liquor Stores LP have economic and voting rights equivalent to the Fund Units (note 12), 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. As a result, they have been treated as non-controlling interest, in accordance with the CICA Emerging Issues Committee Abstract #151, dated January 19, 2005.

Each Exchangeable LP Unit entitles the holder to receive distributions from Liquor Stores LP pro rata with distributions made by Liquor Stores LP on Fund Units.

Liquor Stores LP Subordinated LP Units ("Subordinated LP Units")

The Subordinated LP Units have economic and voting rights equivalent to the Fund Units (note 12), except in connection with the subordination terms as described below. As a result, they have been treated as non-controlling interest, in accordance with the CICA Emerging Issues Committee Abstract #151, dated January 19, 2005.

Distributions are to be made monthly on the Ordinary LP Units (note 12) and Exchangeable LP Units equal to $0.0833 per Unit to the extent cash is available to make cash distributions. Distributions on the Subordinated LP Units are subordinated and are made quarterly in an amount equal to the amount distributed per Ordinary LP Units and Exchangeable LP Units during such fiscal quarter, only after the distributions have been made on the Ordinary LP Units and Exchangeable LP Units and to the extent cash is available to make such distributions.

The Subordinated LP Units will be automatically exchanged for Exchangeable LP Units on a one-for-one basis (and the subordination provisions will only apply until) as at the end of any fiscal year ending on or after December 31, 2007 if, for that fiscal year, the Fund has earned EBITA (earnings before interest, taxes and amortization) of at least $9.836 million and the Fund has paid distributions of at least $1.00 per LP Unit for such fiscal year.

In the event that a take-over bid by a person acting at arm's length to the holders of the Subordinated LP Units is accepted by holders of the Fund Units representing 20% or more of the issued and outstanding Units of the Fund on a fully diluted basis, or in the event of certain other acquisition transactions in respect of the Fund, the subordination provisions will terminate and the Subordinated LP Units will automatically convert into Exchangeable LP Units on a one-for-one basis.

Fund Special Voting Units

Fund Special Voting Units are non-participating and are used solely for providing voting rights to persons holding Exchangeable LP Units and Subordinated LP Units. Fund Special Voting Units are not transferable separately from Exchangeable LP Units and Subordinated LP Units to which they relate. Fund Special Voting Units will automatically be transferred upon a transfer of the Exchangeable LP Units or the Subordinated LP Units to which they relate. The Fund Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund or in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Fund Special Voting Unit entitles the holder thereof to one vote at all meetings of Unitholders.

If the Exchangeable LP Units or the Subordinated LP Units are purchased in accordance with the Exchange Agreement, a like number of Fund Special Voting Units will be redeemed by the Fund for a nominal amount. The Fund issued 4,200,000 Fund Special Voting Units relating to the 2,075,000 Exchangeable LP Units and 2,125,000 Subordinated LP Units that were issued at the time of the IPO.

Distributions payable to non-controlling interest

Distributions to non-controlling interest are determined based on earnings, before amortization, but reduced by capital expenditures. Distributions totalling $0.2582 per Exchangeable LP Unit ($535,766) and Subordinated LP Unit ($548,675) were declared by the Fund for the period ended December 31, 2004. Distributions of $362,918 were paid and distributions of $721,523 were payable for the period ended December 31, 2004.

14 Distributions

		Fund Units		Exchangeable LP Units and Subordinated LP Units		Total	
Date distribution declared	**Date distribution paid**	**Declared $**	**Paid $**	**Declared $**	**Paid $**	**Declared $**	**Paid $**
October 19, 2004	November 15, 2004	393,886	393,886	190,070	190,070	583,956	583,956
November 9, 2004	December 15, 2004	358,192	358,192	172,848	172,848	531,040	531,040
December 15, 2004	January 17, 2005	358,190	-	721,523	-	1,079,713	-
		1,110,268	752,078	1,084,441	362,918	2,194,709	1,114,996

15 Long-term incentive plan

The Fund has adopted a long-term incentive plan (the Plan) to provide key senior management of the Fund with compensation opportunities that will enhance the ability of the Fund to attract, retain and motivate key personnel and reward these key employees for significant performance and associated per unit cash flow growth. Fund bonuses, in the form of units of the Fund, will be provided to eligible employees on an annual basis where the distributable cash of the Fund exceeds certain specified threshold amounts.

If the distributable cash flow per unit exceeds the base distribution, a percentage of the distributable cash (the participation rate) is contributed by the Fund into a long-term incentive pool. The funds in the pool are used to purchase units of the Fund in the open market, to be provided to eligible employees as bonus compensation. Threshold amounts and participation rates are as follows:

Excess percentage	**Proportion of excess percentage paid to plan Trustee**
5% or less	Nil
Greater than 5% and up to 10%	10% of any excess over 5%
Greater than 10% and up to 20%	10% of any excess over 5%, plus 20% of any excess over 10%
Greater than 20%	10% of any excess over 5%, plus 20% of any excess over 10%, plus 25% of any excess over 20%

The base distribution for the fiscal period ended December 31, 2004 is $0.2582 per Unit; for the fiscal years ending December 31, 2005 and 2006 is $1.00 per Unit and for the fiscal years ending December 31, 2007 and thereafter, the base distribution will be set by the compensation committee.

For the period ended December 31, 2004, the distributable cash flow per unit did not exceed the base distribution. Accordingly, no accrual has been made for any bonuses to be paid under the Plan.

16 Financial instruments

The Fund, as part of its operations, is party to a number of financial instruments. These financial instruments include accounts receivable, advances to equity investee, bank indebtedness, accounts payable and accrued liabilities, distributions payable and long-term debt. It is management's opinion that the Fund is not exposed to significant interest, currency or credit risk arising from these financial instruments, except as described below.

Interest rate risk

The Fund's bank indebtedness and its long-term debt, as described in notes 8 and 10, bear interest with floating rates over prime or the appropriate bankers' acceptance rate, thus exposing the Fund to interest rate fluctuations.

Fair value disclosure

The carrying amount of accounts receivable, bank indebtedness, accounts payable and accrued liabilities and distributions payable approximate their fair value either due to their relatively short-term maturities or interest rates which approximate market rates. The fair value of advances to equity investees cannot be determined since the advances do not have specified terms and no active market for the advances exists. The carrying values of long-term debt approximate the fair value of the long-term debt as the interest rate affecting this amount approximates market rates.

17 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.

18 Subsequent events

a) Business acquisitions

During the period from February 18, 2005 to March 10, 2005, the Fund completed the acquisition of the assets of 12 retail liquor store businesses. On March 14, 2005, the Fund completed the acquisition of the assets of an additional retail liquor store business. The aggregate purchase price of the assets of the 13 retail liquor store businesses (including inventory) was approximately $14,000,000 and was paid in cash from existing facilities and the proceeds from the issuance of Fund Units.

The purchase price will be allocated to the fair value of the acquired assets when determined.

b) Issuance of Fund Units

On March 2, 2005, the Fund issued 1,830,000 Fund Units at $16.40 per Fund Unit for gross proceeds of $30,012,000. The gross proceeds less issuance costs estimated at $1,500,000 will be recorded as unitholders' equity.