LIQUOR STORES INCOME FUND

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

For the period ended December 31, 2004

As of March 24, 2005

(Including business operations from September 28, 2004 – December 31, 2004)

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

This management's discussion and analysis should be read in conjunction with the audited consolidated financial statements and accompanying notes of Liquor Stores Income Fund (the "Fund") for the initial period from August 10, 2004 to December 31, 2004, which includes business operations from September 28, 2004 to December 31, 2004. 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 dollar, while other amounts have been rounded to the nearest thousand dollars. References to notes are to the notes to the December 31, 2004 audited consolidated financial statements of the Fund.

This Management Discussion and Analysis is dated March 24, 2005.

OVERVIEW OF THE FUND

Issuance of Fund Units and Acquisition

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. The costs of issuance of the units were $5,185,828 resulting in an addition to Unitholders Equity of $37,814,172. Concurrent with the closing of the IPO, the Fund used the proceeds from the IPO to acquire a 50.6% indirect interest in Liquor Stores Limited Partnership ("Liquor Stores LP") (note 3) and Liquor Stores LP used such net proceeds and funds from the new credit facilities (note 8 and note 10) to acquire the net assets (the "Acquired Business") of The Liquor Depot Corporation ("Liquor Depot") and Liquor World Group Inc. ("Liquor World") and other wholly owned subsidiaries or companies that were under common control (collectively, the "Vendors"). The capital contributed by the Vendors is represented by the Subordinated LP Units and Exchangeable LP Units more fully described in note 13.

Working Capital amounts as at September 28, 2004 have been finalized and pursuant to the purchase agreements the purchase price has been adjusted to reflect the actual amount of working capital purchased. The Fund has also finalized its estimate of the fair value of assets acquired and liabilities assumed. 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
Total assets	79,814,172
Net working capital	17,631,534
	$97,445,706

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

On March 2, 2005, the Fund completed a private placement of 1,830,000 Fund units at $16.40 per unit for gross proceeds of $30,012,000 (note 18 b) and increased its interest in Liquor Stores LP to 59.34%.

The Fund Units trade on the Toronto Stock Exchange under the symbol LIQ.UN.

The Business of the Fund

The Fund is the largest liquor store retailer in Alberta by number of stores and the second largest by revenue. The fund currently operates 63 stores, 50 of which are located in or near the urban centres of Calgary and Edmonton, and one of which is in British Columbia. Two additional stores are currently under construction in British Columbia. As of December 31, 2004 the Fund operated 50 Stores.

The Province of Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. The Province of British Columbia's model for liquor distribution is a blend of private and government operated retail outlets.

Distributable Cash and Cash Distributions

The Fund's policy is to distribute annually to unitholders available cash from operations after cash required for capital expenditure, working capital reserve, growth capital reserve and other reserves considered advisable by the Trustees of the Fund. The policy allows the Fund to make stable monthly distributions to its Unitholders based on its estimate of distributable cash for the year. 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 following table summarizes the distributions for the period:

		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

Distributions are paid on Fund Units, Liquor Stores LP Exchangeable LP Units and Liquor Stores LP Subordinated LP Units. As of December 31, 2004 the following Units were outstanding:

Fund Units (note 12)	4,300,000
Liquor Stores LP Exchangeable LP Units (note 13)	2,075,000
Liquor Stores LP Subordinated LP Units (note 13)	2,125,000
	8,500,000

During the period, the Fund approved distributions of $0.2582 per Fund Unit to Unitholders. Distributions during the period were consistent with the distributions contemplated in the Fund's IPO prospectus. The prospectus contemplated monthly distributions of $0.0833 per unit or $1.00 per year in aggregate. On February 14, 2005 the Fund announced that it intends to increase its annual distribution by $0.075 per unit from $1.00 to $1.075 ($0.08958 per month), commencing with the distribution to be paid to Unitholders of record on May 31, 2005, subject to the completion of the acquisition of 10 additional stores announced at that time. These acquisitions have now been completed. 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 (note 18b).

It is the Fund's policy to review the monthly distributions on a periodic basis.

Distributable cash per unit (Fund Units, Exchangeable and Subordinated LP Units)

Earnings from operations	$ 3,214,164
Add: Amortization of property and equipment	249,728
Add: Amortization of intangible assets	22,534
Add: Proceeds on disposal of property and equipment	1,350
Add: Future Income taxes	6,000
Less: Interest paid	(135,321)
Less: Purchase of property and equipment	(115,786)
Distributable cash	$ 3,239,969
Distributable cash per unit	0.3812
Distributions declared	$ 2,194,709
Distributions declared per unit	0.2582
Amount available for future distributions and not distributed as of December 31, 2004 ($0.3812 per unit less $0.2582)	$ 1,045,260

For the period, the Fund had distributable cash $0.3812 per unit, as calculated above, and declared distributions of $0.2582 per unit. Basic and diluted earnings per unit were $0.348 per unit for the period.

Unitholders' Equity and Non-controlling Interest

Fund Units outstanding as of December 31, 2004 is as follows:

	Units	Issue Costs	Unitholders' Equity	Non-controlling Interest
Fund Units	4,300,000	$5,185,828	$37,814,172	-
Special Voting Units	4,200,000	-	-	-
Non-controlling Interest	4,200,000	-	-	$42,376,480

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 unitholder's equity (note 18 b).

SELECTED FINANCIAL INFORMATION

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 is a useful supplemental measure of performance and cash available for distribution before debt service, changes in working capital, capital expenditures and income taxes. Specifically, management believes that EBITDA is the appropriate measure from which to make adjustments to determine the distributable cash of the Fund. 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 prospective investors is the cash distributed by the Fund relative to the price of the Units, management believes that distributable cash of the Fund is a useful supplemental measure that may assist prospective investors in assessing an investment in the Fund.

EBITDA and distributable cash are not earnings measures recognized by GAAP and do not have standardized meanings prescribed by GAAP. Investors are cautioned that EBITDA and distributable cash should not replace net income 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 methods of calculating EBITDA and distributable cash may differ from the methods used by other issuers. Therefore, the Fund's EBITDA and distributable cash may not be comparable to similar measures presented by other issuers.

Earnings from operations for purposes of disclosure under "Fourth Quarter Operating Results" has been calculated as described below. In the case of the Fund, earnings from operations have been derived by adding interest expense and amortization of property and equipment and intangibles to net earnings for the period. In the case of Liquor Depot and Liquor World, earnings from operations have been derived by adding amortization expense, charitable donations, management salaries to directors, officers and shareholders, interest expense, income tax expense and non-controlling interest to the net income for the period and subtracting from the resulting total income taxes recovered and income arising from subsidiaries accounted for on an equity basis.

Earnings from operations as so calculated is not a measure recognized by GAAP and does not have a standardized meaning prescribed by GAAP. Investors are cautioned that earnings from operations as so calculated should not replace net income 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 earnings from operations as so calculated may differ from the methods used by other issuers. Therefore, the Fund's earnings from operations as so calculated may not be comparable to similar measures presented by other issuers.

Basis of Management's Discussion and Analysis

The Fund was established on August 10, 2004 and acquired indirectly the Acquired Business on September 28, 2004. Accordingly, the Fund's year end reporting includes three days of business operations from the third quarter and a complete fourth quarter.

To provide more meaningful information, the following MD & A refers to the fourth quarter operating results of the Fund compared to the results for the Vendors for similar operating accounts combined for the fourth quarter 2003 (See "Non-GAAP Measures"). It is management's belief that charitable donations and management salaries and bonuses incurred by Liquor Depot and Liquor World are not relevant when compared to the Fund's operations because of differences between the structure and policies of the Fund to those of the Vendors.

Fourth Quarter Operating Results

The following table show the audited results of the Fund from August 10, 2004 to December 31, 2004 (which includes results of operations from September 28, 2004 to December 31, 2004), the unaudited results of the Fund for the period from October 1, 2004 to December 31, 2004 (the fourth quarter of 2004) and unaudited results for Liquor Depot and Liquor World for the period from October 1, 2003 to December 31, 2003. Combined sales, cost of sales and administrative and operating expenses of Liquor Depot and Liquor World for the period from October 1, 2003 to December 31, 2003 have been derived from the unaudited combined consolidated financial statements of Liquor World, and the unaudited combined consolidated statements of Liquor Depot. The results of operations for these periods are not necessarily indicative of the results of operations to be expected in any given period.

	Fund December 31, 2004 (95 days of operations)	Vendors 4th Quarter 2003	Fund 4th Quarter 2004	Change Q4 2003 to Q4 2004
Sales	$35,542,909	$33,545,313	$34,736,150	$1,190,837
Cost of Sales	27,571,758	26,648,433	26,921,763	273,330
Gross Margin	7,971,151	6,896,880	7,814,388	917,508
Administrative and Operating Expenses	4,484,725	4,006,844	4,349,900	343,056
Earnings from operations, as defined below*	$ 3,486,426	$2,890,036	$3,464,487	$574,451

*Earnings from operations have been calculated as follows. In the case of the Fund, earnings from operations has been derived by adding interest expense, amortization of property and equipment and amortization of intangible assets to earnings before non-controlling interest for the period. In the case of Liquor Depot and Liquor World, earnings from operations has been derived by adding amortization expense, charitable donations, management salaries to directors, officers, and shareholders, any loss arising from subsidiaries accounted for on an equity basis, interest expense, income tax expense and non-controlling interest to the net income for the period and subtracting from the resulting total income taxes recovered and income arising from subsidiaries accounted for on an equity basis (See "Non-GAAP Measures").

In order to provide more meaningful information to the reader, the following Management's Discussion and Analysis will compare the results of the Fund's operations for the fourth quarter of 2004 to the Vendor's fourth quarter results for 2003.

Fourth Quarter Sales

Fourth quarter sales increased to $34.7 from $33.5 million when compared to the same period in 2003, although same store sales declined from $33.0 to $31.5 million. Management believes that the decline in same store sales arose from a variety of factors including: the implementation of a more stringent discount and credit policy resulting in some sales loss but a significant increase in margins; cancellation of a third party customer affinity program; a Christmas season where customers had fewer holiday days for shopping; increased competition at some locations; and the impact of no 2004-2005 NHL season.

Notwithstanding the drop in same store sales gross margins improved by $918,000.

Fourth Quarter Cost of Sales and Gross Margin

Gross margin increased by approximately $918,000 from $6.9 million to $7.8 million or 13.3%. The gross margin increase was the result of a 3.5% increase in sales and a 1.94% increase in gross margin percentage. Factors that contributed to the increase in gross margin included; a more stringent credit and discount policy, elimination of a third party affinity program, and the harmonization of retail pricing.

Fourth quarter cost of sales increased from approximately $26.6 million to $26.9 million. New stores and stores that were open for less than 12 months contributed an additional $577,000 to gross margin on $2.6 million of sales in the fourth quarter of 2004.

Combined Administrative and Operating Expense

Administrative and operating expenses increased by approximately $385,000 from $3.96 million to $4.35 million. The components of the increase administrative and operating costs are as follows:

Additional expenses relating to 8 stores not open for the entire fourth quarter of 2003	$330,000
Savings obtained on same store operating costs	(200,000)
Additional Administrative expenses	220,000
Net increase in administrative and operating expenses	$350,000

A significant portion of the increased administrative and operating costs that were incurred by the Fund in the fourth quarter of 2004 were expensed over 95 days of operations but in the future will be expensed over a full year.

Earnings from Operations (as defined)

Earnings from operations (as defined above) increased by approximately $574,000 from $2.9 million to $3.5 million or 19.8%. The earnings increase is as a result of higher gross margin, the addition of new stores, and the savings achieved through synergies on combination of Liquor World and Liquor Depot.

Financial Position	**December 31, 2004**
Total assets	$102,080,855
Total current liabilities	14,106,849
Long-term debt	7,397,917
Unitholders' equity	38,199,609
Non-controlling interest	42,376,480

LIQUIDITY AND CAPITAL RESOURCES

Distributable Cash and Cash Distributions

The Fund's policy is to make stable monthly distributions to its Unitholders based on its estimate of distributable cash for the year. It has a policy to pay cash distributions on or about the 15th of each month to Unitholders of record on the last business day of the previous month.

During the period, the Fund approved distributions of $0.2582 per Fund Unit to Unitholders. The total distributions declared on Fund Units for the period from closing of the IPO on September 28, 2004 to December 31, 2004, was $1,110,268. These distributions are consistent with the distributions contemplated in the Fund's IPO prospectus. On February 14, 2005 the Fund announced that it intends to increase its annual distribution by $0.075 per unit from $1.00 to $1.075 ($0.08958 per month) commencing with the distribution of May 31, 2005, subject to the completion of the acquisition of 10 additional stores announced at that time. These acquisitions have now been completed. 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 (note 18b).

Credit Facilities

At the time of its IPO, the Fund established credit facilities with a Canadian chartered bank. These credit facilities consisted of an $18 million demand revolving operating loan, a $7.5 million committed non-revolving capital loan (due April 29, 2006) and a $10 million committed non-revolving acquisition loan. As a result of the various acquisitions the Fund completed in February of 2005 the $18 million demand revolving operating loan was increased to $24 million. As of December 31, 2004, total indebtedness under all credit facilities has increased to $18.8 million.

At the closing of the IPO, $7.5 million was drawn on the non-revolving capital loan and $10.1 million was drawn on the demand revolving operating loan in order to fund the purchase of the net working capital of the Vendors. Under the purchase and sale agreements between Liquor Stores LP and the Vendors, the purchase price was adjusted to reflect the actual working capital acquired.

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 (see Note 18 b). The amounts borrowed under the acquisition loan in February, and a portion of the operating line was then repaid with the net proceeds received from the issuance of 1,830,000 Fund Units from treasury.

A portion of the proceeds from the March 2, 2005 issue of Fund Units was used to retire the acquisition debt. The Fund now has funds available from the issue of the new units and its acquisition credit facility to fund future acquisitions.

Capital Expenditures

On September 28, 2004, the Fund indirectly acquired property and equipment $12,319,558 (note 3) from the Vendors. During the period from September 28 to December 31, 2004, the Fund incurred $115,786 in capital expenditures and received $1,350 from the sale of property and equipment. Future capital expenditures (other than acquisitions) will be funded from cash flow generated from operations or from available credit facilities.

From February 18, 2005 to March 14, 2005 the Fund purchased the assets of 13 additional retail liquor stores (note 18 a) with cash from existing credit facilities and the proceeds from the issuance of Fund Units (note 18 b). Two additional retail liquor stores are currently under construction in British Columbia.

Interest Rate Risk and Sensitivity

The Fund is not significantly impacted by interest rate changes. The Fund's bank indebtedness and long-term debt (notes 8 and 10), bear interest with floating rates based on bank prime rate or at short term banker's acceptance rates, thus exposing the Fund to some interest rate fluctuations. As a result of the acquisition of the new stores subsequent to year-end (note 18 a); the Fund increased the amount available under its operating line from $18 million to $24 million and now has total credit facilities of $41.5 million. Based on operating 65 stores, management estimates that the Fund would normally have approximately $24 million of debt ($16.5 million of which would be operating debt) on average outstanding throughout a year. Excess funds from the March 2, 2005 issue of Fund Units will be used to fund future acquisitions and will temporarily reduce the amount of debt outstanding. A 1.0% increase in interest rates would have an impact of less than $240,000 on distributable cash based on $24 million of debt outstanding on average throughout the year.

Contractual Obligations

The table below sets forth the contractual obligations of the Fund as of December 31, 2004 due in the years indicated, which relate to various premises operating leases and the $7,500,000, non-revolving loan that is repayable in April of 2006.

	2005	**2006**	**2007**	**2008**	**2009 and thereafter**
Operating Leases	3,340,113	3,250,575	2,948,816	2,774,691	6,549,074
Long Term Debt	-	7,500,000	-	-	-
Total	3,340,113	10,750,575	2,948,816	2,774,691	6,549,074

Off-Balance Sheet Arrangements

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

Critical Accounting Estimates

Because of the nature of the Fund's business and assets, management does believe that there are critical accounting policies that rely on estimates.

Changes in Accounting Policies

Management is not aware of any recent accounting pronouncements or developments that will affect the Fund's financial statements. As a result of the release of EIC-151 entitled "Exchangeable Securities Issued by Subsidiaries of Income Trusts" dated January 19, 2005 management reclassified the presentation of the Liquor Stores LP Exchangeable LP Units and Liquor Stores LP Subordinated LP Units from equity to non-controlling interest. Management will continue to monitor and assess the impact of accounting pronouncements on the financial statements of the Fund as they become available.

Financial Instruments

Due to the nature of its business, the Fund does not engage in activities or hold assets that would require the Fund to acquire financial instruments for hedging or speculative purposes. The financial instruments that are held by the Fund are held in the normal course of operations and as a result no significant accounting policies need to be adopted or assumptions made in reporting the Fund's financial instruments.

Transactions with Related Parties

Transactions with related parties include Liquor Stores LP's purchase of the assets of the business from the Vendors. As of December 31, 2004, $427,373 was due to the Vendors. This amount arose as a result of the difference between the September 17, 2004 estimated amount of working capital that would be purchased by the Fund as of September 28, 2004 and actual amount of working capital purchased.

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. The Fund also leases a warehouse from a company controlled by a director of a subsidiary and one retail location is leased from a company that two directors of a subsidiary are shareholders. Total lease payments under these agreements are $6,300 per month (see note 9).

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 decision making process.

Outlook

Management believes there will continue to be a trend of consolidation in the industry. The Fund expects continued sales and earnings growth in 2005 due to the accretive nature of acquisitions to date and the Fund's program of acquisition and new store development. To this end, the Fund has added additional staff to focus on acquisitions and new store development.

Additional information

Additional information relating to the Fund, including the Fund's Annual Information Form, which will be filed in March of 2004, and other public filings, is available on SEDAR (www.sedar.com) and at www.liquorstoresincomefund.com.