

# **Liquor Stores Income Fund**

Consolidated Financial Statements  
**December 31, 2005 and 2004**

February 15, 2006

## **Auditors' Report**

### **To the Trustees of Liquor Stores Income Fund**

We have audited the consolidated balance sheets of **Liquor Stores Income Fund** as at December 31, 2005 and 2004 and the consolidated statements of earnings and cumulative undistributed earnings and cash flows for the year ended December 31, 2005 and for the period from August 10, 2004 to December 31, 2004. These financial statements are the responsibility of the company'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 company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

# Liquor Stores Income Fund

Consolidated Balance Sheets

As at December 31, 2005 and 2004

	2005 \$	2004 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash	2,047,400	1,003,804
Accounts receivable	1,102,634	666,130
Inventory	34,066,925	20,676,416
Prepaid expenses and deposits	1,552,731	413,585
	<hr/> 38,769,690	<hr/> 22,759,935
<b>Pre-opening costs</b>	471,903	164,954
<b>Equity investment</b> (note 6)	422,789	432,728
<b>Property and equipment</b> (note 7)	18,007,419	12,184,265
<b>Future income taxes</b> (note 8)	34,000	14,000
<b>Intangible assets</b> (note 9)	424,293	406,466
<b>Goodwill</b> (note 10)	82,676,117	66,943,639
	<hr/> 140,806,211	<hr/> 102,905,987
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 11)	15,492,652	12,222,372
Accounts payable and accrued liabilities (note 12)	3,628,182	1,629,896
Distributions payable to unitholders (note 17)	553,576	358,190
Distributions payable to non-controlling interest (note 17)	752,500	721,523
	<hr/> 20,426,910	<hr/> 14,931,981
<b>Long-term debt</b> (note 11)	11,352,466	7,397,917
	<hr/> 31,779,376	<hr/> 22,329,898
<b>Commitments</b> (note 13)		
<b>Non-controlling interest</b> (note 15)	41,700,230	42,376,480
<b>Unitholders' Equity</b>		
<b>Unitholders' equity</b>		
Fund Units (note 14)	66,990,066	37,814,172
Cumulative undistributed earnings	336,539	385,437
	<hr/> 67,326,605	<hr/> 38,199,609
	<hr/> 140,806,211	<hr/> 102,905,987

# Liquor Stores Income Fund

Consolidated Statements of Earnings and Cumulative Undistributed Earnings  
For the year ended December 31, 2005 and for the period from August 10, 2004, including  
operations from September 28, 2004 (date of commencement of business operations) to  
December 31, 2004

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	Year ended December 31, 2005 \$	Three-month period ended December 31, 2004 \$
<b>Sales</b>	157,443,781	35,542,909
<b>Cost of sales</b>	122,114,588	27,571,758
<b>Gross margin</b>	35,329,193	7,971,151
<b>Expenses</b>		
Operating	18,072,344	3,633,204
Administrative	3,843,880	851,521
Amortization of property and equipment	1,349,357	249,728
Acquisition and store development	457,223	-
Amortization of intangible assets	85,800	22,534
Amortization of pre-opening costs	82,566	-
	23,891,170	4,756,987
<b>Earnings before the undernoted items</b>	11,438,023	3,214,164
<b>Loss on disposal of property and equipment</b>	(267,400)	-
	11,170,623	3,214,164
<b>Interest expense</b>		
Interest on current debt	(604,096)	(171,302)
Interest on long-term debt	(254,874)	(86,236)
	(858,970)	(257,538)
<b>Earnings before non-controlling interest</b>	10,311,653	2,956,626
<b>Non-controlling interest</b>	(4,213,705)	(1,460,921)
<b>Net earnings for the year</b>	6,097,948	1,495,705
<b>Cumulative undistributed earnings – Beginning of year</b>	385,437	-
<b>Distributions declared</b>	(6,146,846)	(1,110,268)
<b>Cumulative undistributed earnings – End of year</b>	336,539	385,437
<b>Basic earnings per Unit (note 16)</b>	1.045	0.348
<b>Diluted earnings per Unit (note 16)</b>	1.029	0.348

# Liquor Stores Income Fund

## Consolidated Statements of Cash Flows

For the year ended December 31, 2005 and for the period from August 10, 2004, including operations from September 28, 2004 (date of commencement of business operations) to December 31, 2004

	Year ended December 31, 2005 \$	Three-month period ended December 31, 2004 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net earnings for the year	6,097,948	1,495,705
Items not affecting cash		
Amortization	1,517,723	272,262
Future income taxes	(20,000)	6,000
Equity (earnings) loss	(54,973)	1,942
Loss on disposal of property and equipment	267,400	-
Accrued interest	-	122,217
Non-controlling interest	4,213,705	1,460,921
	<u>12,021,803</u>	<u>3,359,047</u>
Net change in non-cash working capital items	<u>(7,458,694)</u>	<u>(2,696,092)</u>
	<u>4,563,109</u>	<u>662,955</u>
<b>Financing activities</b>		
Net proceeds from the issuance of Units	28,679,064	37,814,172
Increase in bank indebtedness	3,270,280	12,166,973
Proceeds of long-term debt	11,454,549	7,331,099
Repayment of long-term debt	(7,500,000)	-
Distributions paid to unitholders	(5,951,460)	(752,078)
Distributions paid to non-controlling interest	(4,362,147)	(362,918)
	<u>25,590,286</u>	<u>56,197,248</u>
<b>Investing activities</b>		
Business acquisitions (note 5)	(26,218,005)	(55,445,706)
Cash acquired on acquisitions	51,150	38,413
Purchase of property and equipment	(2,618,341)	(115,786)
Proceeds on disposal of property and equipment	-	1,350
Pre-opening costs	(389,515)	-
Advances from (to) equity investee	64,912	(334,670)
	<u>(29,109,799)</u>	<u>(55,856,399)</u>
<b>Increase in cash</b>	1,043,596	1,003,804
<b>Cash – Beginning of year</b>	<u>1,003,804</u>	<u>-</u>
<b>Cash – End of year</b>	<u>2,047,400</u>	<u>1,003,804</u>
<b>Supplementary information</b>		
Interest paid	<u>882,318</u>	<u>135,321</u>

# Liquor Stores Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2005 and 2004

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#### 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 4) 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, 2005, Liquor Stores LP operated seventy (2004 – forty-nine) retail liquor stores in Alberta and five (2004 – one) retail liquor stores 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.

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 inter-entity balances and transactions have been eliminated on consolidation.

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.

# Liquor Stores Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2005 and 2004

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c) Cash

Cash consists of cash on hand and balances with banks.

d) Inventory

Inventory 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 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. These costs are amortized over the two years after a developed store commences operations. Costs related to acquired stores are capitalized at the time of possession. 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. Amortization is provided for 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.

g) 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 assessed 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 CICA handbook section 3062.27 to determine if there is impairment in the carrying value of goodwill. The Fund uses a combination of the discounted cash flow model and the market comparable approach for determining the fair value of its reporting units.

h) Intangible assets

Intangible assets represent management's estimate of the fair value at the time of acquisition. Intangible assets consist 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.

# Liquor Stores Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2005 and 2004

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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 no longer 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 no longer recoverable and exceeds its fair value.

i) 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.

j) Long-term incentive plan

The Fund has adopted a long-term incentive plan (the "Plan") to provide eligible employees fund bonuses, in the form of units of the Fund, where the distributable cash of the Fund exceeds certain specified threshold amounts. The cost is accrued as an expense for the period if the distributable cash flow per unit exceeds the thresholds established by the Plan.

### 3 Adoption of recent Canadian accounting pronouncements

#### Variable interest entities

Effective January 1, 2005, the Fund adopted Accounting Guideline 15, Consolidation of Variable Interest Entities. This guideline requires the consolidation of certain entities that are subject to control on a basis other than the ownership of voting interest. The adoption of this guideline did not have a significant impact on the consolidated financial statements of the Fund.



# Liquor Stores Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2005 and 2004

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#### 4 Issuance of Units

On March 2, 2005, the Fund issued 1,830,000 Fund Units at \$16.40 per Fund Unit for aggregate proceeds of \$30,012,000. The costs of issuance of the units were \$1,332,936 resulting in net proceeds of \$28,679,064. The Fund used the net proceeds from the issuance to acquire new stores as described in note 5, to repay existing indebtedness and for general corporate purposes.

On September 28, 2004, the Fund completed the IPO for aggregate proceeds of \$43,000,000. The cost 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 and contributions by the Vendors, to acquire, through a series of transactions, 100% of the net business assets of the Vendors as described in Note 5.

#### 5 Business Acquisitions

##### a) 2005 Acquisitions

During the year ended December 31 2005, the Fund completed the acquisition of 22 retail liquor store businesses. 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 allocated to the assets acquired and the liabilities assumed, based on their fair values, is as follows:

	\$
Property and equipment	4,821,570
Goodwill	15,732,478
Intangible assets	<u>103,627</u>
	20,657,675
Net working capital	<u>5,560,330</u>
Cash paid	<u>26,218,005</u>

For two agreements entered into for the purchase of certain stores, the Fund may be required to make contingent payments as follows: i) \$100,000 each year for the next six years provided that certain store sales threshold are achieved; and ii) 1% of gross sales of certain stores payable quarterly for the next five years to a maximum of \$450,000.

These payments, if any, will be recorded as an additional cost of the purchase as they are resolved.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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b) 2004 Acquisitions

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	<u>121,975</u>
	79,814,172
Net working capital	<u>17,631,534</u>
	<u>97,445,706</u>
	\$
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	<u>21,250,000</u>
	<u>97,445,706</u>

## 6 Equity investment

	2005	2004
	\$	\$
Shares – 50%	1	1
Equity earnings (loss)	53,031	(1,942)
Advances	<u>369,757</u>	<u>434,669</u>
	<u>422,789</u>	<u>432,728</u>

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

**Liquor Stores Income Fund**  
Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

**7 Property and equipment**

				<b>2005</b>
	<b>Rate %</b>	<b>Cost \$</b>	<b>Accumulated amortization \$</b>	<b>Net book value \$</b>
Leasehold improvements	7	14,904,491	1,085,941	13,818,650
Operating equipment	10	1,773,400	165,453	1,607,947
Office equipment and fixtures	10	696,971	75,055	621,916
Computer equipment	20	676,159	101,789	574,370
Automotive	20	307,386	50,987	256,399
Signage	10	683,564	67,374	616,190
Shelving and racking	10	570,601	58,654	511,947
		<b>19,612,572</b>	<b>1,605,253</b>	<b>18,007,419</b>
				<b>2004</b>
	<b>Rate %</b>	<b>Cost \$</b>	<b>Accumulated amortization \$</b>	<b>Net book value \$</b>
Leasehold improvements	7	9,876,931	183,362	9,693,569
Operating equipment	10	1,012,416	20,405	992,011
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
Signage	10	433,081	7,890	425,191
Shelving and racking	10	401,394	10,447	390,947
		<b>12,433,993</b>	<b>249,728</b>	<b>12,184,265</b>

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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## 8 Future income taxes

The Fund has recognized future income taxes related to non-capital losses of \$312,000 (2004 – \$63,078) available in a subsidiary to offset income of future years. If not utilized, the losses will expire in 2015.

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 taxable (deductible) temporary differences relating to assets (liabilities) of the Fund for which income taxes are not recorded are as follows:

	2005 \$	2004 \$
Goodwill	31,912,977	26,491,523
Property and equipment	7,558,034	6,650,993
Deferred lease inducements	(8,498)	(9,486)
Issue costs	(4,344,003)	(4,163,694)
	<u>35,118,510</u>	<u>28,969,336</u>

## 9 Intangible assets

	<b>2005</b>		
	<b>Cost</b> \$	<b>Accumulated amortization</b> \$	<b>Net</b> \$
Customer relationships	139,058	24,874	114,184
Retail liquor licenses and business permits	11,000	-	11,000
Leases	382,569	83,460	299,109
	<u>532,627</u>	<u>108,334</u>	<u>424,293</u>
	<b>2004</b>		
	<b>Cost</b> \$	<b>Accumulated amortization</b> \$	<b>Net</b> \$
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
	<u>429,000</u>	<u>22,534</u>	<u>406,466</u>

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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## 10 Goodwill

	2005 \$	2004 \$
Balance – Beginning of year	66,943,639	-
Business acquisitions (note 5)	15,732,478	66,943,639
Balance – End of year	<u>82,676,117</u>	<u>66,943,639</u>

The Fund performed an annual goodwill impairment test and determined there was no impairment to the carrying value of goodwill at December 31, 2005.

## 11 Bank indebtedness and long-term debt

Interest on bank indebtedness is payable at the lender's prime rate plus 0.25% or at the banker's acceptance rate plus 1.50%. As at December 31, 2005, there were no banker's acceptances. As at December 31, 2004, included in bank indebtedness are banker's acceptances of \$6,500,000 at an effective rate of 4.34% and \$5,000,000 at an effective rate of 4.13%.

Interest on long-term debt is payable at the bank's prime rate plus 0.50%. As of December 31, 2005, the effective long-term debt rate of interest was 5.50% (2004 – 4.59%). The loan matures on April 30, 2006. The loan does not require principal repayments, but the bank has the right to demand the loan to be repaid in full, three hundred and sixty four days from the maturity of the current term. Therefore the loan is due on April 29, 2007.

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 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.

## 12 Related party transactions

During the year, the Fund incurred professional fees of \$257,197 (2004 – \$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 \$81,193 (2004 – \$17,600). During the year, the Fund paid fees and expenses to a company controlled by the President of the Fund, relating to the supervision of construction of developed stores, in the amount of \$83,647 (2004 – \$nil). These transactions are incurred in the normal course of business at terms similar with unrelated parties and are measured at the exchange amount. Included in accounts payable and accrued liabilities is \$94,848 (2004 – \$7,100) relating to these transactions.

As at December 31, 2004, accounts payable and accrued liabilities included \$427,373 owing to the Vendors relating to the acquisition of assets at the time of the IPO. No interest is charged on these amounts. There were no amounts owing to the Vendors at December 31, 2005.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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## 13 Commitments

The Fund occupies its retail locations under lease agreements with varying terms from five to fifteen years, expiring from November 2006 to October 2019. The leases provide for minimum annual lease payments as follows:

	\$
Years ending December 31, 2006	5,223,950
2007	4,902,253
2008	4,590,708
2009	3,564,509
2010	2,657,771
Aggregate of all years thereafter	<u>7,708,193</u>
	<u>28,647,384</u>

## 14 Unitholder's equity

### Fund Units

Units outstanding and capital contributions are as follows:

	Number of units #	Issue costs \$	Net capital contributions \$
Balance – September 28, 2004 and December 31, 2004	4,300,000	5,185,828	37,814,172
Units issued on March 2, 2005	1,830,000	1,332,936	28,679,064
Exchangeable LP Units exchanged during 2005	49,683	-	496,830
	<u>6,179,683</u>	<u>6,518,764</u>	<u>66,990,066</u>

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.

**Liquor Stores Income Fund**  
Notes to Consolidated Financial Statements  
**December 31, 2005 and 2004**

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**15 Non-controlling interest**

	Liquor Stores LP Exchangeable LP Units	Liquor Stores LP Subordinated LP Units	Total
	#	#	#
<b>Liquor Stores LP Units</b>			
Balance – September 28, 2004 and December 31, 2004	2,075,000	2,125,000	4,200,000
Exchange for Fund Units	(49,683)	-	(49,683)
	<hr/>	<hr/>	<hr/>
Balance – December 31, 2005	2,025,317	2,125,000	4,150,317
	<hr/>	<hr/>	<hr/>
	\$	\$	\$
Balance – September 28, 2004	20,750,000	21,250,000	42,000,000
Earnings	721,765	739,156	1,460,921
Distributions declared	(535,766)	(548,675)	(1,084,441)
	<hr/>	<hr/>	<hr/>
Balance – December 31, 2004	20,935,999	21,440,481	42,376,480
Earnings	2,074,922	2,138,783	4,213,705
Units exchanged for Fund Units	(496,830)	-	(496,830)
Distributions declared	(2,162,215)	(2,230,910)	(4,393,125)
	<hr/>	<hr/>	<hr/>
Balance – December 31, 2005	20,351,876	21,348,354	41,700,230
	<hr/>	<hr/>	<hr/>
	#	#	#
<b>Fund Special Voting Units</b>			
Balance – September 28, 2004 and December 31, 2004	2,075,000	2,125,000	4,200,000
Exchange for Fund Units	(49,683)	-	(49,683)
	<hr/>	<hr/>	<hr/>
Balance – December 31, 2005	2,025,317	2,125,000	4,150,317
	<hr/>	<hr/>	<hr/>
	\$	\$	\$
Balance – September 28, 2004, December 31, 2004 and December 31, 2005	-	-	-
	<hr/>	<hr/>	<hr/>

# **Liquor Stores Income Fund**

Notes to Consolidated Financial Statements  
**December 31, 2005 and 2004**

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## **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 14), 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.

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 14), 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.

Distributions are to be made monthly on the Fund Units (note 14) and Exchangeable LP Units 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.



# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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## 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.

## 16 Earnings per Unit

	2005 \$	2004 \$
Net earnings – numerator utilized in basic Earnings per Unit	6,097,948	1,495,705
Non-controlling interest	4,213,705	1,460,921
	<hr/>	<hr/>
Earnings – numerator utilized in diluted Earnings per Unit	10,311,653	2,956,626
	<hr/>	<hr/>
	\$	\$
Equivalent units outstanding – Beginning of period	4,300,000	4,300,000
Weighted average of equivalent Units issued	1,537,614	-
	<hr/>	<hr/>
Denominator utilized in basic Earnings per Unit	5,837,614	4,300,000
Exchangeable and Subordinated Units	4,186,551	4,200,000
	<hr/>	<hr/>
Denominator utilized in diluted Earnings per Unit	10,024,165	8,500,000
	<hr/>	<hr/>
Earnings per Unit – Basic	1.045	0.348
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Earnings per Unit – Diluted	1.029	0.348
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# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
December 31, 2005 and 2004

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## 17 Distributions

Distributions are determined based on earnings, before amortization, but reduced by capital expenditures. Distributions totalling \$1.05 (2004 – \$0.2582) per Unit for each of Fund Units, Exchangeable LP Units and Subordinated LP Units were declared by the Fund Unit for the year:

						<b>2005</b>	
		<b>Exchangeable LP Units and Subordinated LP Units</b>		<b>Total</b>			
		<b>Fund Units</b>		<b>Fund Units</b>			
		<b>Declared \$</b>	<b>Paid \$</b>	<b>Declared \$</b>	<b>Paid \$</b>	<b>Declared \$</b>	<b>Paid \$</b>
Distributions		6,146,846	5,593,270	4,393,125	3,640,625	10,539,971	9,233,895

  

						<b>2004</b>	
		<b>Exchangeable LP Units and Subordinated LP Units</b>		<b>Total</b>			
		<b>Fund Units</b>		<b>Fund Units</b>			
		<b>Declared \$</b>	<b>Paid \$</b>	<b>Declared \$</b>	<b>Paid \$</b>	<b>Declared \$</b>	<b>Paid \$</b>
Distributions		1,110,268	752,078	1,084,411	362,918	2,194,709	1,114,996

At December 31, 2005, distributions payable to unitholders was \$553,576 (2004 – \$358,190). Distributions outstanding as at December 31, 2004 were paid in 2005.

At December 31, 2005, distributions payable to non-controlling interest was \$752,500 (2004 – \$721,523). Distributions outstanding as at December 31, 2004 were paid in 2005.

## 18 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.

# Liquor Stores Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2005 and 2004

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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. Generally, one-third of these units will vest equally in each of the three years following the grant of these awards. Threshold amounts and participation rates are as follows:

<b>Excess percentage</b>	<b>Proportion of excess percentage paid to plan Trustee</b>
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 year ended December 31, 2005, the distributable cash flow per unit exceeded the base distribution by \$0.05 per Unit (2004 – \$nil). Accordingly the Fund has recorded a liability to the Plan of \$17,217 (2004 – \$nil), with the acquisition of units to be completed in early 2006.

## 19 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 note 11, 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.

# **Liquor Stores Income Fund**

Notes to Consolidated Financial Statements  
**December 31, 2005 and 2004**

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## **20 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.

## **21 Comparative figures**

Certain comparative figures have been reclassified to conform with the current year presentation.

