LIQUOR STORES N.A. LTD.

MANAGEMENT'S DISCUSSION AND ANALYSIS
For the Year Ended December 31, 2012

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

This Management's Discussion and Analysis ("MD&A") for the year ended December 31, 2012 is supplemental to, and should be read in conjunction with, the audited Consolidated Financial Statements and Notes thereto (the "financial statements") of Liquor Stores N.A. Ltd. (the "Company" or "Liquor Stores") for the years ended December 31, 2012 and 2011, and the unaudited interim consolidated financial statements for the periods ended March 31, 2012, June 30, 2012 and September 30, 2012. In this MD&A, all references to "we", "us", "our", and "the Company" refer to Liquor Stores N.A. Ltd. and its subsidiaries. All references to "Management" refer to the directors and senior officers of the Company.

Unless otherwise stated, financial information is expressed in Canadian dollars and has been prepared in accordance with International Financial Reporting Standards ("IFRS"), as set out in the Handbook of the Canadian Institute of Chartered Accountants – Part I ("CICA Handbook"). Certain dollar amounts have been rounded to the nearest hundred thousand dollars or thousand dollars.

Throughout this MD&A references are made to non-IFRS financial measures, including "operating margin", "operating margin as a percentage of sales", "adjusted operating margin", "adjusted net earnings", "adjusted earnings per share", "adjusting items" and "cash provided by operating activities before changes in non-cash working capital and adjusting items". A description of these measures and their limitations are discussed on page 32 under "Non-IFRS Financial Measures".

Management is responsible for the information contained in this MD&A and its consistency with information presented to the Audit Committee and Board of Directors. In accordance with its terms of reference, the Audit Committee of the Company's Board of Directors reviews the contents of the MD&A and recommends its approval by the Board of Directors on a quarterly basis. The Board of Directors has approved this MD&A as of March 5, 2013.

Additional information relating to the Company, including our Annual Information Form ("AIF") and discussions of our 2012 quarterly results, is available on SEDAR (www.sedar.com) and on the Company's website at www.liquorstoresna.ca.

FORWARD LOOKING STATEMENTS

In the interest of providing current shareholders and potential investors with information regarding current results and future prospects, this MD&A contains forward-looking statements or information. All statements and information other than statements of historical fact contained in this MD&A are forward-looking statements, including, without limitation, statements regarding the future financial position and performance of the Company, business strategy, projected store openings, costs, as well as plans and objectives of or involving the Company. You can identify many of these statements by looking for words such as "believes", "expects", "will", "intends", "projects", "anticipates", "estimates", "continues", "forecasts" 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 dividends of the Company. There is no assurance that the plans, intentions or expectations upon which these forward-looking statements are based will occur and such forward-looking statements included in this MD&A should not be unduly relied upon. Forward-looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, those discussed elsewhere in this MD&A. There is 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 MD&A include, among others, the future payment and timing of dividends, the anticipated opening dates of new stores, and management's general expectations that the Company will have sufficient funds to complete store acquisitions, develop new stores and finance inventory.

The information contained in this MD&A, including the information set forth under "Risk Factors" identifies additional factors that could affect the operating results and performance of the Company.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this MD&A are made as of the date of this MD&A and the Company assumes no obligation to update or revise them to reflect new events or circumstances except as expressly required by applicable securities law.

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HIGHLIGHTS

Three months ended December 31, 2012

- Opened or acquired 5 convenience-focused stores in Canada (2011 – 4) and opened 1 large-format store in Kentucky (2011 - 1)
- Consolidated sales increased 6.6% to $179.4 million (2011 - $168.2 million)
- Same-store sales increased by 0.3% ($0.4 million) in Canada and decreased by 1.5% ($0.6 million) in the US
- Gross margin increased to 25.4% (2011 – 24.9%)
- Adjusted operating margin was $14.4 million (2011 - $15.7 million)

Year ended December 31, 2012

- Opened 2 new concept/large-format stores in Alberta ("Wine and Beyond"), opened or acquired 6 convenience-focused stores in Canada (2011 – 4), opened 1 large-format store in Kentucky (2011-1), and acquired 1 convenience-focused store in Kentucky
- Consolidated sales increased 6.5% to $630.1 million (2011 - $591.5 million)
- Same-store sales increased by 3.0% in Canada and 1.1% in the US
- Gross margin increased to 25.3% (2011 – 24.8%)
- Adjusted operating margin increased by 4.9% to $49.2 million (2011 - $46.9 million)

Our financial performance for the year ended December 31, 2012 was highlighted by strong increases in sales, gross margin and adjusted operating margin.

The 6.5% sales increase in 2012 compared to 2011 was attributable to same-store sales increases in both Canada and the United States, and growth in the Company's store count. The Company has recorded nine consecutive quarters of 'quarter-over-quarter' same-store sales increases in Canada as at Q4 2012.

The Company added a total of ten (10) new stores in Alberta, British Columbia and Kentucky in 2012 and has added fifteen (15) new stores since the beginning of Q4 2011. This significant increase in store count as compared to recent prior years (2011 – net 2 new stores; 2010 – net 1 new store) is the result of the successful execution of the Company's growth strategy.

The 10 new stores in 2012 included one (1) large-format Liquor Barn store in Kentucky that was opened in December 2012 and two (2) new concept/large-format liquor stores in Alberta branded as "Wine and Beyond" (each in excess of 17,000 square feet) that were opened during the last week of September 2012. Wine and Beyond are upscale stores that have a strong focus on wine and customer service. Management believes that these stores carry the largest selection of wines, spirits and beers in Canada. Fashioned similar to our large-format stores in the US, these destination-type stores complement the Company's convenience-focused Liquor Depot and Liquor Barn stores in Alberta. The financial results for the Wine and Beyond stores in the fourth quarter exceeded Management's expectations.

The 0.3% increase in Canadian same-store sales in the fourth quarter of 2012 as compared to 2011 was less than the increases recorded during the first three quarters of 2012. Management believes that fourth quarter Canadian same-store sales compared to 2011 were impacted by the following: (i) the success of Wine and Beyond drew customers away from our convenience-focused Liquor Depot/Liquor Barn stores in the greater Edmonton region due to their uniqueness in the market place and seasonal holiday shopping (although the decrease in the greater Edmonton region's same-store sales was more than offset by the sales recorded by Wine and Beyond), (ii) the unfavourable calendar shift experienced for the Christmas and New Year's Eve holiday season (mid-week in 2012 vs. on weekends in 2011), (iii) the delayed start of the 2012-2013 National Hockey League season, and (iv) the impact of Alberta's new impaired driving legislation, which took effect just prior to the fourth quarter of 2012. Management believes that Canadian same-store sales were impacted in Q4 2012 as compared to 2011 by approximately $2.0 million to $2.5 million as a result of opening Wine and Beyond.

Same-store sales in the United States in 2012 were primarily impacted (a decrease of 1.5% or $0.6 million) by certain counties in Kentucky going from 'dry' to 'wet' throughout 2012 (i.e. certain counties in close proximity to the Company's stores that did not previously permit retail package liquor sales are now permitting these sales) and, to a lesser extent, unfavourable weather in Kentucky during the month of November 2012. To counteract the impact of 'dry' to 'wet', the Company has been actively sourcing potential acquisitions or opportunities to develop new stores in counties that have gone 'wet' or in counties where we do not yet have a presence; late in the fourth quarter of 2012 the Company opened one large-format store in Bowling Green, Kentucky.

The year ended December 31, 2012 and the fourth quarter of 2012 were highlighted by continued strong increases in gross margin percentages. Consolidated gross margin increased from 24.8% to 25.3% for the year and 24.9% to 25.4% in Q4 2012 compared to 2011. The increase in Q4 2012 represents the fifth consecutive quarter that the gross margin has increased over the comparative quarter. Management attributes these positive results primarily to our focus on improved merchandising, category management and purchasing strategies, including expanding our selection and marketing of control brands/private label and exclusive products.

Adjusted operating margin for the three months ended December 31, 2012 decreased by $1.3 million to $14.4 million, primarily due to a decline in US same-store sales and the relatively flat increase in Canadian same-store sales, inflation of operating expenses, investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy, and pre-opening costs associated with new stores.

OUTLOOK

Management is extremely pleased with the successful execution of our strategic growth plan, which has resulted in ten (10) new stores being added during 2012 and fifteen (15) in the last 15 months. We continue to source new growth opportunities for 2013 and beyond. However, new store openings are contingent upon a number of factors, primarily the availability of prime commercial development opportunities and construction timing. We anticipate that the rate of store growth in 2013 will slow compared to 2012, and then accelerate in 2014. Neither the timing nor the degree of likelihood of success of developing new stores can be stated with any degree of accuracy.

Management expects sales in 2013 to increase compared with 2012 as a result of the maturation of the stores added in 2012 and an increase in the number of stores. However, our financial results in 2013 may face pressure from certain uncontrollable factors including: (i) the slower economic growth forecasted in 2013, with particular emphasis on Alberta as a result of the uncertainty in the energy sector, (ii) the continued impact of Alberta's impaired driving legislation, especially on the second and third quarters of 2013 compared to 2012, and (iii) increasing competition from retail liquor stores that open in counties in Kentucky that went from 'dry' to 'wet' throughout 2012. In addition to these factors, there is the potential for changes to the licensing regime in Kentucky during 2013, as further discussed in the '*Competitive Environment*' section on this MD&A, which could have a negative impact on the Company's operations and financial results in Kentucky (US operating segment) should these changes be implemented.

In 2013, the Company will continue to execute its growth strategy, which is discussed further in the '*Business Strategy*' section on this MD&A, and will pay particular attention to purchasing trends at the store level so that inventory selection and pricing can be adjusted accordingly to maintain sales growth and gross margins.

The execution of the Company's growth strategy, including the development of new large-format stores and sourcing expansion opportunities in new regions, requires upfront investment and new stores require time to achieve sales maturity. However, Management believes that cash flow from existing operations and its available credit are sufficient to finance expansion and sustain its dividends at the current level.

Update on the Search for a New Chief Executive Officer

The Company's Board of Directors is presently completing a formal search for a new Chief Executive Officer and anticipates a successful conclusion of this search in the second quarter of 2013. Until a candidate has been appointed by the Board, Jim Dinning, current Chairman of the Board (and Board member since 2004), will continue to serve as Interim Chief Executive Officer.

OVERVIEW OF THE COMPANY

The Company's principal activity is the retailing of wines, beers and spirits in Canada (Alberta and British Columbia) and the United States (Alaska and Kentucky). The Company was incorporated on November 8, 2010 under the Canada Business Corporations Act ("CBCA") and is the successor entity to Liquor Stores Income Fund, which became a publicly traded entity in September 2004. The Company's common shares and convertible unsecured subordinated debentures trade on the Toronto Stock Exchange (the "TSX") under the symbols LIQ and LIQ.DB.A, respectively.

As at December 31, 2012, the Company operated 249 (2011 - 239) retail liquor stores. Management believes the Company is the largest liquor store operator in Alberta, Canada's largest private liquor retailer and North America's largest publicly-traded liquor retailer (based upon number of store and revenue).

The Company operates under the brand names "Liquor Depot", "Liquor Barn" and "Wine and Beyond" in Alberta, "Liquor Depot", "Liquor Barn", and "Wine Cellar" in British Columbia, "Brown Jug" in Alaska, and "Liquor Barn, The Ultimate Party Source" and "Liquor Barn Express" in Kentucky.

Stores and Operations

As of March 5, 2013, the Company had 247 stores in the following regions:

Alberta			British Columbia			Alaska	Kentucky			Total
Edmonton(1)	**Calgary(1)**	**Other(2)**	**Lower Mainland**	**Vancouver Island**	**Interior**	**Anchorage**	**Lexington**	**Louisville**	**Other(3)**	
82	46	51	13	11	12	20	6	4	2	247
179			36			20	12			

Notes:

(1) References to Edmonton and Calgary are to stores located in or near those urban centres. Note that two underperforming stores in the Edmonton region were closed in early 2013.

(2) Other communities served in Alberta include, by region, Northern (25), Southern (9), Central (15) and resort communities (2).

(3) Other communities served in Kentucky include Danville and Bowling Green.

Competitive Environment

The Province of Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. The Company currently operates 179 liquor stores in Alberta where there are 1,313 liquor stores and 93 agency stores [Source: Alberta Gaming and Liquor Commission, as at December 2012].

The Company operates 36 stores in British Columbia. The Province of British Columbia's model for liquor distribution is a blend of 694 private stores and 195 government operated stores. There are also 224 private agency stores that service small communities. [Source: British Columbia Liquor Distribution Branch, as at February 2013].

The Company currently operates 18 stores in the greater Anchorage, Alaska area and 2 stores in Wasilla, Alaska. In the state of Alaska there are 398 retail liquor stores with 92 stores in the greater Anchorage and Wasilla areas. Save for limited community liquor stores that are operated by certain municipal governments, 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, as at February 2013]. The Company's "Brown Jug" trade name is well recognized throughout the state as the leading alcoholic beverage retailer.

The Company operates 12 stores in Kentucky of which seven are large format stores. In the State of Kentucky there are no government owned or operated liquor stores. Liquor licenses are permitted based on whether the sale of alcoholic beverages is allowed in each county (wet or dry). The Alcoholic Beverage Control Board limits the number of retail liquor package licenses issued in wet counties to one per 2,300 persons with the exception of counties containing cities of first class such as Louisville, where liquor licenses are limited to one for every 1,500 persons. Grocery stores and gas stations are able to sell beer, but a retail liquor package license is required to sell beer, wine and spirits. There are 863 package retail license stores in Kentucky with 257 in Jefferson County, 79 in Fayette County, 8 in Boyle County, and 27 in Warren Count [Source: Kentucky's Alcoholic Beverage Control Board, as at February 2013]. The Company currently operates 6 stores in Lexington (Fayette County), 4 stores in Louisville (Jefferson County), 1 store in Danville (Boyle County), and 1 store in Bowling Green (Warren County).

A coalition of grocers in Kentucky were recently successful at the trial court level in a court challenge to the state statute which prohibits the sale of wine and distilled spirits within grocery stores and gas stations (these retailers are presently only permitted to sell beer). In August 2012 the United States District Court, Western District of Kentucky ruled that the state statute violates the equal protection clause of the United States Constitution and the Commonwealth of Kentucky Constitution. The decision is currently under appeal in the U.S. Court of Appeals and it is anticipated a decision in the matter will be released in the third or fourth quarter of 2013. In the event the appeal is unsuccessful, the Company anticipates there will be a rapid proliferation of grocers, gas stations and convenience store operators adding wine and distilled spirits to their product offerings, substantially increasing competition for retail liquor store operators. An unsuccessful appeal may have a material negative impact on the Company's operations and financial results in Kentucky.

BUSINESS STRATEGY

Growth

The Company has implemented a five-year growth strategy designed to drive sales, further improve profitability and deliver shareholder value by focusing on:

- Expanding geographically through new store development and/or acquisitions to capitalize on opportunities in new regions and to reduce the concentration risk of any particular region. Based on a proven track record of success, the Company will be investing significantly in large-format expansion in both Canada and the United States.

- Developing new destination-focused/large-format stores in our current regions to complement our existing convenience-focused store network and expand market share.

- Strategically investing in new square footage in our existing regions (Alberta, British Columbia, Alaska, and Kentucky) as a result of population growth and, in the case of Kentucky, capitalizing on opportunities as a result of certain counties going from 'dry' to 'wet'.

- Strengthening our retail proposition to attract more customers to existing locations and increase sales per customer through an improved in-store experience, having the right product assortment, and competitive pricing. This will include investments in employee training, including both at the manager and staff level, enhancing our marketing strategies, investing in our existing store portfolio to refresh our stores, and an investment to enhance our information systems to support the Company's growth plan.

The Company 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 shareholder value. Neither the timing nor the degree of likelihood of success of developing new stores can be stated with any degree of accuracy.

Competitive Differentiation

Management focuses on differentiating the Company's stores from the competition by promoting its broad selection of products, by emphasizing the in-store customer experience, and through continued marketing and development of its well-known industry-leading brands. Management is also confident that its emphasis on establishing and maintaining a range of stores from large-format/destination-type stores (focus on product selection, customer experience, etc.) to convenience-focused stores (convenient and high-traffic locations) assists the Company in differentiating it from industry competitors. The introduction of Wine and Beyond to the Alberta marketplace was primarily for competitive differentiation.

Management will continue to concentrate marketing efforts on the Company's current brand structure: "Liquor Depot", "Liquor Barn" and "Wine and Beyond" in Alberta, "Liquor Depot", "Liquor Barn", and "Wine Cellar" in British Columbia, "Brown Jug" in Alaska, and "Liquor Barn, The Ultimate Party Source" and "Liquor Barn Express" in Kentucky.

DIVIDENDS

Policy

The payment of dividends by the Company is subject to the discretion of the Board of Directors and may vary depending upon a variety of factors, including (but not limited to) the prevailing economic and competitive environment, the Company's results of operations and earnings, and fluctuations in working capital and ongoing capital requirements. Presently, the Board of Directors has approved a monthly dividend of $0.09 per share ($1.08 annually).

Dividends are declared payable each month to the Company's Shareholders on the last business day of each month and are paid by the 15th of the following month. For Canadian residents, the Company's dividends are considered to be "eligible dividends" for income tax purposes (subject to gross up and the enhanced dividend tax credit).

Cash Provided by Operating Activities before Changes in Non-cash Working Capital

In reviewing the Company's financial statements, investors should consider that the statement of comprehensive income includes significant provisions for amortization of property and equipment and for intangible assets resulting from store acquisitions, deferred taxes and non-cash interest. Amortization and non-cash transactions have a major impact on the basic and diluted earnings per share calculation.

Cash provided by operating activities before changes in non-cash working capital is an additional IFRS measure which the Company believes provides useful information to investors and management by providing an indication of cash flow available for sustaining its current annual dividend of $1.08 per share, investment in working capital, replacement or purchase of new fixed assets, acquisitions, and debt repayment. Investors often compare basic and diluted earnings per share amounts to the Company's annual dividend. Basic and diluted earnings per share for the three months and the year ended December 31, 2012 were $0.23 and $0.82, respectively (2011 - $0.35 and $1.08). The Company believes that cash provided by operating activities before changes in non-cash working capital provides a better indicator of the Company's ability to sustain its current annual dividend than basic and diluted earnings per share.

Cash provided by operating activities before changes in non-cash working capital and adjusting items and the calculation of this measure and the additional IFRS measure on a per share basis are all non-IFRS financial measures (see Non-IFRS Financial Measures). Please refer to the Earnings per Share note in the Company's financial statements for the most directly comparable measured calculated in accordance with IFRS.

The following table provides a reconciliation of cash provided by operating activities before changes in non-cash working capital and adjusting items to its nearest IFRS alternative, cash provided by operating activities before changes in non-cash working capital:

	Three months ended December 31,		**Year ended December 31,**	
(expressed in thousands, except per share amounts)	**2012**	**2011**	**2012**	**2011**
Cash provided by operating activities	$ 17,799	$ 8,380	$ 30,225	$ 31,776
Changes in non-cash working capital (1)	5,806	(5,554)	(6,139)	(10,643)
Cash provided by operating activities before changes in non-cash working capital	11,993	13,934	36,364	42,419
Adjusting items (2)	372	-	3,568	(2,971)
Cash provided by operating activities before changes in non-cash working capital and adjusting items	$ 12,365	$ 13,934	$ 39,932	$ 39,448
Weighted average number of common shares outstanding - basic	22,911,068	22,651,069	22,815,607	22,614,334
Per share amount	0.52	0.62	1.59	1.88
Per share amount before adjusting items	0.54	0.62	1.75	1.74
Cash dividends per share	0.27	0.27	1.08	1.08

(1) Changes in non-cash working capital is excluded from the calculation as Management believes that it would introduce significant cash flow variability and affect underlying cash flow from operating activities. Significant variability can be caused by such things as timing of disbursements (such as the payment for large inventory purchases, income taxes, etc.). As well, significant increases in working capital are generally required when new stores are developed or acquired.

(2) See the 'Operating and Administrative Expense' sections on pages 12 and 16 for a description of the adjusting items for the three months and year ended December 31, 2012, respectively. For the year ended December 31, 2011, adjusting items include cash proceeds on the settlement of litigation relating to the 2007 acquisition of Liquor Barn Income Fund less related professional and consulting fees for litigation matters, margin adjustment and severance.

The $1.6 million decrease in cash provided by operating activities before changes in non-cash working capital and adjusting items for the three months ended December 31, 2012 is primarily due to a decline in US same-store sales and the relatively flat increase in Canadian same-store sales, inflation of operating expenses, investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy, and pre-opening costs associated with new stores.

The $0.5 million increase in cash provided by operating activities before changes in non-cash working capital and adjusting items for the year ended December 31, 2012 results primarily from an increase in adjusted operating margin for the year ended December 31, 2012, offset by approximately $2.2 million of current income tax expense for the year ended December 31, 2012.

Seasonality

The retail liquor industry is subject to seasonal variations with respect to sales and consequently operating results and the Company's results regularly exhibit this seasonality. The Company's sales are typically lowest early in the year and increase in the latter half. In 2012, 20% (2011 - 19%) of annual same store sales occurred in the first quarter, 26% (2011 - 26%) in the second quarter, 27% (2011 - 27%) in the third quarter, and 27% (2011 - 28%) in the last quarter. Over the course of a year, the Company expects that cash provided by operating activities before changes in non-cash working capital will exceed dividends.

Dividend Reinvestment Plan

The Company has a Dividend Reinvestment Plan (the "DRIP" or the "Plan") which provides shareholders with a cost-effective and convenient method of reinvesting their monthly cash dividends into additional common shares of the Company. Presently, shares issued pursuant to the DRIP are issued at a discount of 3% from the market price (as such term is defined in the Plan) and no brokerage or administration fees are charged by the Company for participating in the Plan.

As at February 28, 2013, shareholders enrolled in the DRIP held approximately 1.9 million shares.

Further information concerning the DRIP and enrolment forms for the Plan is available on the Company's website at www.liquorstoresna.ca.

POLICY ON SAME-STORE SALES COMPARISONS

Comparable same-store sales, a measure that is generally used by retailers, includes sales for stores that have been open 12 full months at the beginning of the reporting period. This is one of the key metrics that we use to assess our performance and provides a useful comparison between periods. Stores which have significant wholesale business have been excluded. On an annual basis, as at January 1st, management reviews the classification of store locations to assess the significance of the wholesale business at each store location. As at January 1, 2012, management determined that there were seven stores in Canada (2011 - eighteen stores) that had significant wholesale business.

ANALYSIS OF FINANCIAL RESULTS - THREE MONTHS ENDED DECEMBER 31, 2012

The following table summarizes the operating results for the three months ended December, 2012 and 2011.

	Three months ended December 31,			
	2012		2011	
(Cdn $000's, unless otherwise stated)	$	%	$	%
	(unaudited)		(unaudited)	
Sales				
Canadian same-stores [1]	118,583	66.1%	118,207	70.3%
Canadian wholesale operations [1]	6,812	3.8%	6,548	3.9%
Other Canadian stores [2]	11,367	1.6%	1,138	0.7%
Total Canadian store sales	136,762	76.3%	125,893	74.8%
US same-stores (US$)	40,101	22.4%	40,714	24.2%
Other US stores (US$) [3]	2,865	1.6%	685	0.4%
Foreign exchange on US store sales	(370)	(0.2)%	952	0.6%
Total US store sales	42,596	23.7%	42,351	25.2%
Total sales	179,358	100.0%	168,244	100.0%
Gross margin	45,504	25.4%	41,842	24.9%
Operating and administrative expense	31,489	17.6%	26,144	15.6%
Operating margin	14,015	7.8%	15,698	9.3%
Adjusting items[4]	372	0.2%	-	-
Adjusted operating margin	14,387	8.0%	15,698	9.3%

Notes:

(1) *Sales for stores comprising Canadian wholesale operations include sales to both wholesale and retail customers from these stores. As at January 1, 2012, management determined that there were seven stores in Canada (2011 - eighteen stores) that had significant wholesale business. The comparative sales figures have been adjusted to reflect the eleven stores that were reclassified from Canadian wholesale operations to Canadian same-stores.*

(2) *Sales for the three months ended December 31, 2012 and 2011 include those of 12 stores opened and 1 store closed subsequent to September 30, 2011.*

(3) *Sales for the three months ended December 31, 2012 and 2011 include those of 3 stores opened in Kentucky subsequent to September 30, 2011.*

(4) *Adjusting items for the three months ended December 31, 2012 primarily relate to fees paid to an executive recruiting firm that is assisting in the search for a new Chief Executive Officer for the Company.*

Fourth Quarter 2012 Operating Results Compared to Fourth Quarter 2011 Operating Results

Sales

Total sales increased by $11.1 million or 6.6% to $179.4 million in the fourth quarter of 2012 (2011 - $168.2 million). The increase is primarily the result of new store expansion in Canada and the United States (10 new stores opened in 2012), offset by a $1.3 million decrease in the Canadian currency equivalent for US sales as a result of foreign exchange rate differences.

Same-Store Sales

- Canadian same-store sales increased by $0.4 million or 0.3%.
  - Same-store sales for the three months ended December 31, 2012 compared to 2011 were negatively impacted by the success of the two Wine and Beyond stores opened in the greater Edmonton region during the last week of September 2012. In addition to drawing customers away from our competitors, these destination-type stores also drew customers away from our convenience-focused stores during the fourth quarter due to their uniqueness in the marketplace and for seasonal holiday shopping as a result of their larger selection of product.
  - Canadian same-store sales were, to a lesser extent, impacted by: (i) the unfavourable calendar shift experienced for the Christmas and New Year's Eve holiday season (mid-week in 2012 vs. on weekends in 2011), (ii) the impact of Alberta's new impaired driving legislation and (iii) the delayed start of the 2012-2013 National Hockey League season.
- US same store sales decreased by $0.6 million or 1.5%.
  - Same-store sales in the United States have continued to be negatively impacted by certain counties in Kentucky going from 'dry' to 'wet' throughout 2012 (i.e. certain counties in close proximity to the Company's stores that did not previously permit retail package liquor sales are now permitting these sales).
  - To a lesser extent, the decline was due to: (i) the unfavourable calendar shift experienced for the Christmas and New Year's Eve holiday season and (ii) unfavourable weather experienced in Kentucky during November 2012.

Other Sales

- Sales for the Canadian wholesale operations, which include sales to both licensee and retail customers from stores included in this segment, were $6.8 million for the three months ended December 31, 2012, which is an increase of $0.3 million or 4.0% from the prior year (2011 - $6.5 million) as a result of increases in both licensee and retail sales.
- Sales for the Other Canadian and US stores have increased compared to 2011 as a result of the ten (10) new stores opened in 2012, including the two Wine and Beyond stores opened in Canada during the last week of September 2012, and the five stores that were opened in the fourth quarter of 2011. Sales for these new stores have exceeded internal projections.

Gross Margin

For the three months ended December 31, 2012, gross margin was $45.5 million, up 8.8% from $41.8 million for the same period last year. Gross margin as a percentage of sales increased to 25.4% from 24.9% in 2011. The quarter over quarter increase in gross margin percentage represents the fifth consecutive quarterly increase. Gross margin as a percentage of sales has increased primarily as a result of continued focus on merchandising techniques, category management and purchasing strategies, including expanding our selection and marketing of control brands/private label and exclusive products.

Operating and Administrative Expense

Operating and administrative expenses before adjusting items for the three months ended December 31, 2012 were $31.1 million, up 19.0% from $26.1 million a year earlier. Operating and administrative expense before adjusting items, as a percentage of sales, for the period increased to 17.4% compared to the prior year (2011 – 15.6%). This increase was attributable, in part, to pre-opening costs of approximately $0.3 million related to new stores opened in the period, higher overall costs associated with additional store locations that have been opened in the past twelve months (e.g. rent, payroll, utilities, etc.), rent escalations and increased marketing costs for existing stores, and as a result of investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy. The 2012 fourth quarter adjusting items primarily related to $0.3 million in costs associated with the Company's search for a new Chief Executive Officer.

Operating Margin

Adjusted operating margin was $14.4 million for the three months ended December 31, 2012, a decrease of 8.3% from $15.7 million in 2011. As a percentage of total sales, adjusted operating margin was 8.0%, down from 9.3%. Operating margin also decreased 10.7% from $15.7 million in the prior year.

Canadian operating margin before the $0.3 million in adjusting items referenced above was $11.5 million or 8.3% as a percentage of Canadian sales (2011 - $12.8 million or 10.1% as a percentage of sales). The US operating margin for the fourth quarter of 2012 was $2.9 million or 6.9% as a percentage of US sales compared with $3.2 million and 7.6% as a percentage of US sales for the comparable period in 2011.

The decrease in Canada was primarily due to the relatively flat increase in Canadian same-store sales, inflation of operating expenses, investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy, and pre-opening costs associated with new stores. The decrease in the United States was primarily due to the decline in US same-store sales and inflation of operating expenses.

Finance Costs

Finance costs are comprised of cash interest on bank indebtedness, long term debt and convertible debentures of $1.9 million (2011 - $2.5 million); non-cash interest of $0.1 million (2011 - $0.5 million), an unrealized gain of $0.1 million as a result of mark-to-market adjustments related to an interest rate swap (2011 - $0.4 million loss), and foreign exchange gains of $nil (2011 - $0.1 million). Cash interest expense has declined compared to the comparative quarter primarily as a result of lower borrowing costs on the new unsecured convertible debentures issued in Q2 2012 and on the new credit facility that was entered into in February 2012.

Impairment

During the three months ended December 31, 2012, the Company recorded a $2.5 million impairment loss (2011 - $nil) on retail liquor licenses, which are classified as indefinite life intangible assets, related to five stores on Vancouver Island, British Columbia (Canadian operating segment). The impairment primarily related to a change in Management's forecasted sales and profitability as a result of changing demographics and increased competition in the areas that these stores operate. The ability for the

Company to relocate these retail liquor licenses to more favourable locations is limited due to licensing regulations that restrict where retail liquor stores can operate.

Income Taxes

Income taxes for the fourth quarter of 2012 were $1.9 million (2011 - $3.1 million), which equates to an effective income tax rate of approximately 26% (the effective rate for the year ended December 31, 2011 was approximately 23%). The decrease in income taxes compared to the prior year was primarily a result of a decrease in earnings before tax, offset by an increase in the effective income tax rate. The increase in the rate is primarily related to a change in the relative proportions of income earned in the various tax jurisdictions that the Company operates in compared to the prior year and an increase in non-temporary differences.

Net Earnings

Net earnings for the three months ended December 31, 2012 were $5.4 million compared to $7.9 million for the same period in 2011. The decrease in net earnings is primarily the result of the $2.5 million non-cash impairment loss related to indefinite life intangible assets, a decline in US same-store sales and the relatively flat Canadian same-store sales, inflation of operating expenses, adjusting items associated with the Company's search for a new Chief Executive Officer, investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy, and pre-opening costs associated with new stores, offset by lower financing costs and income tax expense.

ANALYSIS OF FINANCIAL RESULTS - YEAR ENDED DECEMBER 31, 2012

The following table summarizes the operating results for the year ended December 31, 2012 and 2011.

	Year ended December 31,			
	2012		2011	
(Cdn $000's, unless otherwise stated)	$	%	$	%
	(unaudited)		(unaudited)	
Sales				
Canadian same-stores (1)	439,462	69.7%	426,574	72.1%
Canadian wholesale operations (1)	24,486	3.9%	24,088	4.1%
Other Canadian stores (2)	17,133	2.7%	1,728	0.3%
Total Canadian store sales	481,081	76.3%	452,390	76.5%
US same-stores (US$)	141,153	22.4%	139,638	23.6%
Other US stores (US$) (3)	8,011	1.3%	679	0.1%
Foreign exchange on US store sales	(139)	(0.0)%	(1,205)	(0.2)%
Total US store sales	149,025	23.7%	139,112	23.5%
Total sales	630,106	100.0%	591,502	100.0%
Gross margin	159,511	25.3%	146,528	24.8%
Operating and administrative expense	113,840	18.0%	100,629	17.0%
Operating margin	45,671	7.3%	45,899	7.8%
Adjusting items(4)	3,568	0.5%	1,029	0.1%
Adjusted operating margin	49,239	7.8%	46,928	7.9%

Notes:

(1) *Sales for stores comprising Canadian wholesale operations include sales to both wholesale and retail customers from these stores. As at January 1, 2012, management determined that there were seven stores in Canada (2011 - eighteen stores) that had significant wholesale business. The comparative sales figures have been adjusted to reflect the eleven stores that were reclassified from Canadian wholesale operations to Canadian same-stores.*

(2) *Sales for the year ended December 31, 2012 and 2011 include those of 12 stores opened and 3 stores closed subsequent to December 31, 2010.*

(3) *Sales for the year ended December 31, 2012 and 2011 include those of 3 stores opened in Kentucky subsequent to December 31, 2010.*

(4) *See the 'Operating and Administrative Expense' section on page 16 for a description of the adjusting items for the year ended December 31, 2012. For the year ended December 31, 2011, adjusting items include professional and consulting fees for litigation matters related to the 2007 acquisition of Liquor Barn Income Fund, margin adjustment and severance.*

Year ended December 31, 2012 Operating Results Compared to Year Ended December 31, 2011 Operating Results

Sales

Total sales grew by $38.6 million or 6.5% to $630.1 million for the year ended December 31, 2012 (2011 - $591.5 million). The increase is primarily the result of new store expansion, same-store sales growth in both Canada and the U.S., and a $1.1 million increase in the Canadian currency equivalent for US sales as a result of foreign exchange rate differences.

Same-Store Sales

- Canadian same-store sales increased by $12.8 million or 3.0%.
    - The increases in same-store sales were primarily realized during the first three quarters of 2012. Management attributes these increases primarily to the continued success of the Company's expanded store hours program (with stores in selected markets open until 2 am) and continued management focus on the execution of operational initiatives related to merchandising techniques, category management and purchasing strategies.
- US same store sales increased by $1.5 million or 1.1%.
    - Both regions in the US had positive results during 2012, which Management believes were attributable primarily to continued focus on the execution of operational initiatives related to merchandising techniques, category management, purchasing strategies and the enhanced customer experience at the Alaska stores arising as a result of store renovations.
    - However same-store sales in the United States have continued to be negatively impacted by certain counties in Kentucky going from 'dry' to 'wet' throughout 2012 (i.e. certain counties in close proximity to the Company's stores that did not previously permit retail package liquor sales are now permitting these sales). To a lesser extent, US same-store sales were also negatively impacted by unfavourable weather conditions in Kentucky during the months of September and November 2012.

Other Sales

- Sales for the Canadian wholesale operations, which include sales to both licensee and retail customers from stores included in this segment, were $24.5 million for the year ended December 31, 2012, an increase of 1.7% from the prior year (2011 - $24.1 million) as a result of increases in both licensee and retail sales.
- Sales for the Other Canadian and US stores have increased compared to 2011 as a result of the ten (10) new stores opened in 2012, including the two Wine and Beyond stores opened in Canada during the last week of September 2012, and the five stores that were opened in the fourth quarter of 2011. Sales for these new stores have exceeded internal projections.

Gross Margin

For the year ended December 31, 2012, gross margin was $159.5 million, up 8.9% from $146.5 million for the same period last year. Gross margin as a percentage of sales increased to 25.3% from 24.8% in 2011. Gross margin as a percentage of sales has increased primarily as a result of continued focus on merchandising techniques, category management, and purchasing strategies, including expanding our selection and marketing of control brands/private label and exclusive products.

Operating and Administrative Expense

Operating and administrative expenses before adjusting items for the year ended December 31, 2012 were $110.3 million, up 10.7% from $99.6 million a year earlier. Operating and administrative expense before adjusting items, as a percentage of sales, for the period increased by 70 basis points to 17.5% compared to the prior year (2011 – 16.8%). This increase was attributable, in part, to pre-opening costs of approximately $1.0 million related to new stores opened in the period, higher overall costs associated with additional store locations that have been opened in the past twelve months (e.g. rent, payroll, utilities, etc.), rent escalations and increased marketing costs for existing stores, and as a result of investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy.

Adjusting items primarily related to a payment of $2.3 million made to the Company's former President and Chief Executive Officer upon his departure effective August 31, 2012 (of which $2.0 million has been classified as an adjusting item), $1.3 million expensed in the second quarter for costs associated with a store investment (with a prospective partner) that was not completed, and $0.3 million in fees paid to an executive search firm to assist the Company in finding a new Chief Executive Officer.

Operating Margin

Adjusted operating margin was $49.2 million for the year ended December 31, 2012, up 4.9% from $46.9 million in 2011. As a percentage of total sales, adjusted operating margin was 7.8%, down from 7.9% a year earlier. Operating margin was down 0.5% from $45.9 million in the prior period.

Canadian adjusted operating margin for the year ended December 31, 2012 was $39.8 million or 8.3% as a percentage of Canadian sales. Operating margin for Canadian stores for the year ended December 31, 2012 was $37.5 million or 7.8% as a percentage of Canadian sales compared with $38.0 million and 8.4% as a percentage of Canadian sales for the comparable period in 2011. US adjusted operating margin (US adjusting items were related to the $1.3 million in costs associated with a store investment that was not completed in the second quarter) for the year ended December 31, 2012 was $9.4 million or 6.5% as a percentage of US sales. The US operating margin for the year ended December 31, 2012 was $8.2 million or 5.6% as a percentage of US sales compared with $7.9 million and 5.7% as a percentage of US sales for the comparable period in 2011.

Finance Costs

Finance costs are comprised of cash interest on bank indebtedness, long term debt and convertible debentures of $7.7 million (2011 - $9.0 million); non-cash interest of $2.4 million (2011 - $1.6 million), an unrealized gain of $0.4 million as a result of mark-to-market adjustments related to an interest rate swap, and foreign exchange gains of $nil (2011 - $0.2 million). Non-cash interest expense increased by $1.2 million as compared to the comparative year primarily as a result of accelerating the accretion of the Company's 6.75% convertible unsecured subordinated debentures to their principal amount of $57.5 million as they were redeemed on May 28, 2012, which was in advance of their original maturity date. Cash interest expense has declined compared to the comparative year primarily as a result of lower borrowing costs on the new unsecured convertible debentures issued in Q2 2012 and on the new credit facility that was entered into in February 2012. These savings were partially offset by higher interest expense as a result of carrying two debentures that overlapped for approximately one month during the second quarter.

Impairment

During the year ended December 31, 2012, the Company recorded a $2.5 million impairment loss (2011 - $nil) on retail liquor licenses, which are classified as indefinite life intangible assets, related to five stores on Vancouver Island, British Columbia (Canadian operating segment). The impairment primarily related to a change in Management's forecasted sales and profitability as a result of changing demographics and increased competition in the areas that these stores operate. The ability for the Company to relocate these retail liquor licenses to more favourable locations is limited due to licensing regulations that restrict where retail liquor stores can operate.

Income Taxes

Income taxes for the year ended December 31, 2012 were $6.7 million (2011 - $7.7 million), which equates to an effective income tax rate of approximately 26% (the effective rate for the year ended December 31, 2011 was approximately 24%). The increase in income taxes compared to the prior year was primarily a result of an increase in earnings before tax and the approximate 2% increase in the effective income tax rate. The increase in the rate is primarily related to a change in the relative proportions of income earned in the various tax jurisdictions that the Company operates in compared to the prior year and an increase in non-temporary differences.

Net Earnings

Net earnings for the year ended December 31, 2012 was $19.1 million compared to $24.8 million for the same period in 2011. The decrease in net earnings is primarily the result of the 2011 adjusting items, which included proceeds from a litigation settlement of $4.9 million, expenses in 2012 of $2.0 million related to the departure of the Company's former President and Chief Executive Officer, $1.3 million of costs associated with a store investment not completed in Q2 2012, the $2.5 million non-cash impairment loss related to indefinite life intangible assets, inflation of operating expenses, investments being made to the Company's information technology infrastructure and head office staffing complement to support the Company's growth strategy, and pre-opening costs associated with new stores, offset by higher gross margin from same-stores and new stores, and lower financing costs and income tax expense.

CONDENSED ANNUAL INFORMATION

(expressed in thousands of Canadian dollars, except per Share amounts and number of stores)

	2012	2011	2010	2009	2008	2007
Statement of Financial Position						
Cash and cash equivalents	$ 5,130	$ 1,707	$ 2,815	$ 5,288	$ 3,530	$ 19,498
Total assets	533,087	503,147	495,393	509,809	488,256	449,006
Bank indebtedness	3,891	40,424	41,468	41,094	31,172	-
Total current liabilities	46,633	123,013	71,839	68,688	83,240	14,062
Long-term debt	146,566	46,469	100,417	100,126	51,742	74,014
Total liabilities	215,337	185,947	181,206	178,068	145,598	96,708
Shareholders' equity	317,750	317,200	314,187	286,165	294,645	301,837
Non-controlling interest	92	85	285	45,576	48,013	50,461
Statement of Earnings						
# stores, end of year	249	239	237	236	223	195
Sales	630,106	591,502	579,700	541,049	482,915	383,063
Net earnings	19,056	24,802	20,337	29,048	23,995	15,544
Basic earnings per share*	$ 0.82*	$ 1.08*	$ 1.08	$ 1.29	$ 1.03	$ 0.69
Diluted earnings per share*	$ 0.82*	$ 1.08*	$ 1.08	$ 1.27	$ 1.03	$ 0.69
Dividends declared per share	$ 1.08	$ 1.08	$ 1.62	$ 1.62	$ 1.62	$ 1.49

**** Adjusted basic and diluted earnings per share were $1.02 for the year ended December 31, 2012 (2011 - $0.96). Adjusted basic and diluted earnings per share are non-IFRS measures; refer to the Non-IFRS Measures section of the MD&A for further discussion.***

The primary driver of the year-over-year changes in the above information is the growth in the number of stores operated by the Company. The following table summarizes the Company's store acquisitions, developments and closures for the past five years.

	Acquired	Built	Closed	Net Increase
2008	24	11	(7)	28
2009	9	5	(1)	13
2010	1	4	(4)	1
2011	-	5	(3)	2
2012	3	7	-	10

CONDENSED QUARTERLY INFORMATION

(expressed in thousands of Canadian dollars, except per Share amounts and number of stores)

	2012				2011 (1)			
	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Statement of Financial Position								
Cash and cash equivalents	5,130	1,825	765	1,725	1,707	895	1,558	2,106
Total assets	533,087	516,929	502,315	500,674	503,147	494,444	488,748	492,029
Current Bank indebtedness	3,891	-	96	2,178	40,424	39,605	47,706	54,075
Total current liabilities	46,633	28,121	29,483	79,687	123,013	62,150	70,327	75,503
Long-term debt	146,566	150,702	135,673	92,196	46,469	101,699	101,248	100,878
Total liabilities	215,337	199,603	183,608	187,291	185,947	177,641	182,408	185,448
Shareholders' equity	317,750	317,300	318,707	313,383	317,200	316,799	306,340	306,581
Non-controlling interest	92	26	83	38	85	(15)	258	186
Statement of Earnings								
# stores, end of period	249	243	241	240	239	236	236	236
Sales	179,359	164,490	159,621	126,636	168,244	157,080	150,210	115,967
Adjusted operating margin	14,387	14,588	13,330	6,934	15,662	13,648	12,390	5,216
Net earnings	5,403	6,481	4,766	2,406	7,904	10,970	5,783	145
Basic and diluted earnings per share*	$ 0.23*	$ 0.28*	$ 0.21	$ 0.10	$ 0.35	$ 0.48	$ 0.25	$ 0.00
Dividends declared per share	$ 0.27	$ 0.27	$ 0.27	$ 0.27	$ 0.27	$ 0.27	$ 0.27	$ 0.27

**** Adjusted basic and diluted earnings per share were $0.33 for the three months ended December 31, 2012 (2011 - $0.35). Adjusted basic and diluted earnings per share are non-IFRS measures; refer to the Non-IFRS Measures section of the MD&A for further discussion.***

(1) As was previously disclosed in the Company's December 31, 2011 annual MD&A, in the process of completing impairment models under IFRS in Q4 2011, it was determined that goodwill in the Kentucky CGU was impaired by $2.4 million as of January 1, 2010 and as a consequence, deferred tax assets were understated by $0.9 million as at January 1, 2010. This adjustment was not included in quarterly filings in 2011. The information in this table includes the necessary adjustments in respect of goodwill, deferred tax assets and shareholders' equity.

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

Historically, capital expansion has been financed by cash provided from operating activities, proceeds raised through equity and debt offerings or by utilizing existing long-term credit facilities. The Company believes existing credit facilities are adequate to finance new store developments and acquisitions expected to occur in 2013. The Company would require additional capital or financing for a larger acquisition.

The Company opened three convenience-format stores in Alberta and one large-format store in Kentucky and acquired one store in Alberta during the three months ended December 31, 2012; opened two large-format stores in Alberta during the three months ended September 30, 2012; acquired one store in Edmonton, Alberta during the quarter ended June 30, 2012; and one store in Lexington, Kentucky during the quarter ended March 31, 2012. The Company did not close any stores during the year ended December 31, 2012.

The Company will continue to pursue acquisition opportunities and to open and develop new stores in 2013. The Company currently has commitments to open a new store in US, which is expected to open for business in early Q2 2013, with an estimated aggregate cost of $1.0 million. The timing of the store opening is subject to, among other things, delays in the completion of store construction and/or fixturing.

As discussed in the 'Business Strategy' section of this MD&A, the Company will be investing in our current store portfolio through a store refreshment program and in our information systems. Management estimates that capital expenditures related to the store refurbishment program and information systems upgrade for 2013 will be approximately $5.1 million.

Credit Facilities and Subordinated Debentures

The Company has a credit facility with a syndicate of Canadian banks, which is effective until February 10, 2015 and consists of a $150 million extendible revolving operating loan, and a US$5.0 million facility with a U.S. bank. At March 4, 2013 there was approximately $100 million drawn on the Canadian credit facility and $nil drawn on the US credit facility. The Company has a US$5.0 million letter of credit that has been issued pursuant to the Canadian credit facility to secure the US credit facility. Pursuant to the terms of the Canadian credit facility, the Company has the ability to request an additional $50 million (to be provided by the lenders on a best-effort basis).

On April 23, 2012, the Company issued $67,500,000 aggregate principal amount of convertible unsecured subordinated debentures due April 30, 2018 (the "2012 Debentures"). The 2012 Debentures bear interest at a rate of 5.85% per annum, payable semi-annually in arrears on April 30 and October 31 of each year, which commenced on October 31, 2012. The 2012 Debentures are convertible at any time at the option of the holders into common shares of the Company at a conversion price of $24.90 per share. The Company used a portion of the proceeds from the issue of the 2012 Debentures to redeem the outstanding 6.75% convertible unsecured subordinated debentures (the "2007 Debentures") with a principal amount of $57.5 million and accrued interest of approximately $1.5 million effective May 28, 2012.

The Company's Canadian credit facility is subject to a number of financial covenants. Under the terms of the Company's Canadian credit facility, the following ratios are monitored: funded debt to EBITDA, adjusted debt to EBITDAR, and fixed coverage ratio. There are no financial covenants attributable to the Company's convertible unsecured subordinated debentures due April 30, 2019 or the U.S. credit facility.

Funded debt to EBITDA ratio

Funded debt is all the Company's obligations, liabilities and indebtedness which would, in accordance with IFRS, be classified on a consolidated balance sheet of the Company as indebtedness for borrowed money of the Company, but excludes subordinated debt, deferred taxes and accounts payable incurred in the ordinary course of the Company's business.

EBITDA is defined under the amended and restated credit facility as the net income of the Company plus the following: interest expense, provision for income taxes, any portion of expense in respect of non-cash items including any long-term incentive plan amounts not to be settled in cash, depreciation, amortization, deferred taxes, and non-recurring losses to a maximum of $3.5 million in any fiscal year, write down of goodwill and other restructuring charges for store closures, and amortization of inventory fair value adjustments. EBITDA is also less any non-recurring extraordinary or one-time gains from any capital asset sales or certain foreign currency transactions.

Adjusted debt to EBITDAR

Adjusted debt is defined as the Company's debt plus seven times aggregate rent expense. EBITDAR is defined as EBITDA plus aggregate rent expense.

Fixed charge coverage ratio

Fixed charge coverage ratio is the ratio of EBITDAR less the aggregate amount of unfunded capital expenditures and cash taxes divided by the sum of all interest expense and scheduled repayment of debt for the relevant period, cash dividends and rent.

As at December 31, 2012, the Company was in compliance with all financial covenants.

Ratio	**Covenant**	**As at December 31, 2012**
Funded debt to EBITDA	< 3.00:1.00	1.73:1.00
Adjusted debt to EBITDAR	< 5.00:1.00	3.30:1.00
Fixed charge coverage	> or = 1.00:1.00	1.20:1.00

The funded debt to EBITDA, adjusted debt to EBITDAR and fixed charge coverage ratios are calculated quarterly based on the latest rolling four quarter period completed, including acquired stores.

Liquidity Risk

Liquidity ensures the Company has sufficient financial resources available at all times to meet its obligations. The Company manages liquidity risk by ensuring it has a variety of alternatives available to fund acquisitions, new store development and ongoing operations, which include 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 dependent upon capital market conditions and interest rate levels. The degree to which the Company is leveraged may impact its ability to obtain additional financing for working capital or to finance acquisitions.

Management continuously monitors the marketplace for acquisitions and new store development opportunities and has developed financing strategies to support this growth in the current economic environment. Management believes the Company has managed liquidity risk appropriately and does not anticipate that the current economic environment will prevent the Company from being able to fund operating and liquidity needs in the near term. As at March 4, 2013, the Company has available credit of approximately $50 million to finance operating requirements and growth opportunities.

Interest Rate Risk and Sensitivity

The Company's indebtedness in respect of its credit facility bears interest at floating rates. The Company manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans. The Company is party to an interest rate swap with a Canadian Schedule I bank that matures December 14, 2015 whereby the interest rate paid by the Company on Cdn$60.0 million is equivalent to 1.388% per annum plus the applicable credit spread determined with reference to the credit facility. At March 5, 2013, the fixed rate paid by the Company under the interest rate swap is 3.238% per annum. The Company is not using hedge accounting for this swap and accordingly, its fair value is recorded on the statement of financial position, with changes in fair value recorded in earnings.

Assuming an outstanding bank indebtedness of $100 million, of which $60 million is subject to the interest rate swap, the following table presents a sensitivity analysis to changes in market interest rates on floating rate indebtedness and their potential annual impact on the Company as at December 31, 2012.

(expressed in thousands of Canadian dollars)	+ 1.00%	- 1.00%
Increase (decrease) in interest expense	$ 400	$ (400)
Increase (decrease) in net earnings	(300)	300

An increase/decrease of 1.00% in market interest rates would result in a decrease/increase in the Company's net earnings of approximately one cent on a per share basis.

Credit Risk

The Company's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company maintains its cash and cash equivalents with a major Canadian chartered bank. The Company, in its normal course of operations, is exposed to credit risk from its wholesale customers in Alberta, however wholesale customer purchases represent less than 5% of the Company's sales. Risk associated with accounts receivable is mitigated by credit management policies. Historically, bad debts from these accounts have been insignificant. The Company is not subject to significant concentration of credit risk with respect to its customers; however, primarily all receivables are due from businesses in the Alberta hospitality industry. Bad debts are insignificant in relation to total sales.

Foreign Exchange Risk

The Company is subject to fluctuations in the value of the Canadian dollar relative to the U.S. dollar in the normal course of business. A portion of cash flows are realized in U.S. dollars and as such, fluctuations in the exchange rate between the Canadian dollar and U.S. dollar may have an effect on financial results. The Company's foreign exchange cash flow exposure is limited to U.S. intercompany management fees and interest payments which totalled US$7.3 million for the twelve months ended December 31, 2012.

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. Other than as noted above, foreign currency transactions are generally not material.

Contractual Obligations

The table below sets forth, as of December 31, 2012, the contractual obligations of the Company due in the years indicated and relate to various premises operating leases, long-term debt and convertible unsecured subordinated debentures.

(expressed in thousands of Canadian dollars)	2013	2014	2015	2016	2017	2018 and thereafter
Operating leases	$ 23,056	$ 19,269	$ 15,797	$ 12,669	$ 8,697	$ 23,066
5.85% Debentures	-	-	-	-	-	67,500
Long-term bank indebtedness	-	-	86,321	-	-	-
Total	$ 23,056	$ 17,728	$ 102,118	$ 10,949	$ 10,949	$ 90,566

SHAREHOLDERS' EQUITY

At December 31, 2012, the Company had 22,924,591 common shares outstanding. Basic and diluted weighted average number of common shares outstanding for 2012 were 22,815,607 and 25,866,589 respectively (compared to 22,614,334 and 22,614,334 for the comparative 2011 period). As at March 5, 2013, 22,942,765 common shares of the Company were issued and outstanding.

OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2012 and March 5, 2013, the Company did not have any off-balance sheet arrangements in place, other than the operating leases identified under the heading Contractual Obligations.

FINANCIAL INSTRUMENTS

The Company, as part of its operations, is party to a number of financial instruments. These financial instruments consist of cash and cash equivalents, accounts receivable, foreign exchange currency contracts, an interest rate swap, bank indebtedness, accounts payable and accrued liabilities, dividends payable and long-term debt including convertible unsecured subordinated debentures. Financial assets are classified as loans and receivables. Financial liabilities are classified as other financial liabilities, other than derivatives which are held for trading. Refer to "Liquidity and Capital Resources" for discussion of risks associated with financial instruments.

RELATED PARTIES TRANSACTIONS

The Company 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 year ended December 31, 2012, the Company incurred expenses in the normal course of business for (i) professional fees of $105 thousand (2011 - $326 thousand) paid to a law firm of which a director of the Company is a partner and (ii) rent paid to companies controlled by a director (and former Executive Chairman) of the Company amounted to $581 thousand (2011 - $535 thousand). There was

$nil thousand included in accounts payable and accrued liabilities as at December 31, 2012 relating to these transactions (2011 - $9 thousand). The amounts charged are recorded at their exchange amounts and are subject to normal trade terms.

Compensation expensed for the Company's key executive management for the year ended December 31, 2012 was $5.2 million (2011 - $2.7 million). Included in the 2012 expense are payments of $2.3 million made to the Company's former President and Chief Executive Officer upon his departure effective August 31, 2012 and $0.1 million paid to the Chairman of the Board of Directors for his services provided as Interim Chief Executive Officer.

CRITICAL ACCOUNTING ESTIMATES

The Company's summary of significant accounting policies are contained in Note 3 to the audited consolidated financial statements.

The Company's financial statements include estimates and assumptions made by management in respect of operating results, financial conditions, contingencies, commitments, and related disclosures. Actual results may vary from these estimates. The following are, in the opinion of management, the Company's most critical accounting estimates, being those that involve the most difficult, subjective and complex judgements, requiring estimates that are inherently uncertain and which may change in subsequent reporting periods.

The Company has:

- Continuously refined and documented its management and internal reporting systems to ensure that accurate, timely, internal and external information is gathered and disseminated. Management also regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances.

- Hired individuals and consultants who have the skills required to make such estimates and ensures that individuals or departments with the most knowledge of the activity are responsible for the estimates. Furthermore, past estimates are reviewed and compared to actual results, and actual results are compared to budgets in order to make more informed decisions on future estimates.

- A mandate that includes ongoing development of procedures, standards and systems to allow staff to make the best decisions possible and ensuring those decisions are in compliance with the Company's policies.

Preparation of the Company's financial statements requires management to make estimates and assumptions that affect (i) goodwill and intangible assets at and subsequent to acquisition, (ii) amortization policies and useful lives, and (iii) deferred income taxes.

Business Combinations and Valuation of Goodwill and Intangible Assets

The Company accounts for intangible assets and goodwill in accordance with IFRS 3, Business Combinations and IAS 38, Intangible Assets. In a business combination, the Company may acquire the assets and assume certain liabilities of an acquired entity. The allocation of the purchase price for these transactions involves judgment in determining the fair values assigned to the tangible and intangible assets acquired and the liabilities assumed on the acquisition. The determination of these fair values involves a variety of assumptions, including revenue growth rates, expected operating income, discount rates, and earnings multiples. If the Company's estimates or assumptions change prior to finalizing the purchase price allocation for a transaction, a revision to the purchase price allocation or the carrying value of the related assets and liabilities acquired may impact our net income in future periods.

At the date of the acquisition, the Company must estimate the value of acquired intangible assets that do not have a well-defined market value, such as the value of liquor licenses, leases, customer relationships, and non-competition agreements.

Valuing these assets involves estimates of the future net benefit to the Company and the useful life of such benefits and is based upon various internal and external factors. A change in those estimates could cause a material change to the value of the intangible assets.

Subsequent to acquisition, goodwill and intangible assets with indefinite lives are not amortized, however they are periodically assessed for impairment. The Company reviews goodwill and intangible assets with indefinite lives at least annually, and other non-financial assets when there is any indication that the asset may be impaired. The recoverable amounts of cash-generating units have been determined using discounted cash flow models that require assumptions about future cash flows, margins and discount rates.

Although intangible assets with definite lives are amortized over their useful life, if the estimated value of an intangible asset has declined below its amortized book value, a write-down would be recorded in the period in which the event causing the decline in value occurred, which would increase amortization expense and decrease the intangible assets balance.

At this time, the Company does not believe any goodwill or intangible assets have a book value in excess of their fair market value.

Amortization Policies and Useful Lives

The Company 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 Company takes into account industry trends and Company-specific factors, including changing technologies and expectations for the in-service period of these assets. The Company 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 Company determines that the useful life of an asset is different from the original assessment, changes to amortization will be applied prospectively.

Deferred income taxes

Determining deferred income taxes involves a number of assumptions and variables that could reasonably change, including: the useful lives of recorded property and equipment and intangible assets that determine the amount of amortization recorded thereon; the amount of discretionary tax deductions the Company will claim from its existing tax depreciation pools, the rates of tax applicable to various jurisdictions in which the Company is taxable and the allocation of taxable income to those jurisdictions; and the acceptance of the Company'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 deferred income taxes, and these changes could be material.

RECENT ACCOUNTING PRONOUNCEMENTS

There are new IFRS pronouncements that have been issued but are not effective and may have an impact on the Company. See Note 3 to the audited financial statements as at and for the year-ended December 31, 2012 for further discussion.

INTERNAL CONTROLS AND PROCESSES

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company 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.

Management, including the Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate internal controls over financial reporting, as such term is defined in National Instrument 52-109. A material weakness in internal controls over financial reporting exists if the deficiency is such that there is a reasonable possibility that a material misstatement of the Company's annual or interim consolidated financial statements will not be prevented or detected on a timely basis.

The Chief Executive and Chief Financial Officers certified that disclosure controls and procedures and internal controls over financial reporting were properly designed and effective for the year ended December 31, 2012. There have been no changes in the design of the Company's disclosure controls and procedures or internal control over financial reporting that occurred during the three months or year ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, the Company's disclosure controls and procedures or internal control over financial reporting.

RISK FACTORS

As at December 31, 2012, there are no material changes in the Company's risks or risk management activities since December 31, 2011. The Company's results of operations, business prospects, financial condition, cash dividends to Shareholders and the trading price of the Company's Shares are subject to a number of risks.

The following is a summary of certain risk factors relating to the affairs and business of the Company. 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 elsewhere in this MD&A, the Company's financial statements, and the Company's Annual Information Form for December 31, 2012 which is available at www.sedar.com or on the Company's website at www.liquorstoresna.ca. Shareholders and potential Shareholders (and other securityholders) 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 Company. Additional risks and uncertainties not currently known to the Company, or that the Company currently considers immaterial, may also impair the operations of the Company. If any of these risks actually occur, the business, sales, financial condition, liquidity or results of operations of the Company could be materially adversely affected, with a resulting decrease in dividends paid on, and the market price of, the Common Shares.

State of Economy

Liquor Stores' success depends on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce customer traffic or impose practical limits on pricing, either of which could reduce sales and other operating results, which in turn could adversely affect the availability of cash for the payment of dividends.

Unpredictability and Volatility of Share Price

A publicly traded company will not necessarily trade at values determined by reference to the underlying value of its business. The prices at which the Common Share will trade cannot be predicted. The market price of the Common Shares could be subject to significant fluctuations in response to variations in quarterly operating results and other factors. The annual yield on the Common Shares as compared to the annual yield on other financial instruments may also influence the price of Common Shares 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 Common Shares.

In addition, the securities markets have experienced significant market wide and sector price and volume fluctuations from time to time that often have been unrelated or disproportionate to the operating performance of particular issuers. Such fluctuations may adversely affect the market price of the Common Shares.

Restrictions on Potential Growth

The payout by Liquor Stores of a substantial amount of its operating cash flow makes additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of Liquor Stores and its cash flow.

Cash Dividends

The actual cash flow available for the payment of cash dividends to Shareholders can vary significantly from period to period for a number of reasons, including among other things: (i) our operational and financial performance; (ii) the amount of cash required or retained for debt service or repayment; (iii) amounts required to fund capital expenditures and working capital requirements. Certain of these amounts are, in part, subject to the discretion of the Board of Directors, which regularly evaluates Liquor Stores' dividend payout with respect to anticipated cash flows, debt levels, capital expenditures plans and amounts to be retained to fund acquisitions and expenditures. In addition, our level of dividend per Common Share will be affected by the number of outstanding Common Shares. Cash dividends may be increased, reduced or suspended entirely depending on our operations and financial performance. The market value of the Common Shares may deteriorate if we are unable to meet dividend expectations in the future, and that deterioration may be material

Government Regulation

Liquor Stores operates in the highly regulated retail liquor industry in the Provinces of Alberta and British Columbia and the States of Alaska and Kentucky. Decisions by the Alberta Gaming and Liquor Commission ("AGLC"), British Columbia Liquor Control and Licensing Branch ("BCLCLB"), Alaska Alcoholic Beverage Control Board ("ABCB"), and Kentucky Department of Alcoholic Beverage Control ("KYABC") and rules enacted by them or by other governmental authorities (including state, provincial, county, municipal or other local governments), new legislation, regulations, rules, or bylaws, or changes to existing legislation, regulations, rules, or bylaws, can materially impact the operations of Liquor Stores, both favourably and unfavourably. Changes in legislation, regulations, rules or bylaws may arise as a result of a multitude of factors, including but not limited to citizen referenda.

There is no assurance that the operations or licensing of Liquor Stores (or the amount of cash available to Liquor Stores for the payment of dividends) will not be adversely affected by: i) new legislation, regulations, rules, or bylaws; ii) changes and court challenges to existing legislation, regulations, rules, or bylaws; iii) new interpretations of existing legislation, regulations, rules or bylaws; or iv) decisions of the AGLC, the BCLCLB, the ABCB, the KYABC, or other governmental entities (including state, provincial, county, municipal, or other local governments) or applicable courts.

Of particular note, a coalition of grocers in Kentucky were recently successful at the trial court level in a court challenge to the state statute which prohibits the sale of wine and distilled spirits within grocery stores and gas stations (these retailers are presently only permitted to sell beer). In August 2012 the United States District Court, Western District of Kentucky ruled that the state statute violates the equal protection clause of the United States Constitution and the Commonwealth of Kentucky Constitution. The decision is currently under appeal in the U.S. Court of Appeals and it is anticipated a decision in the matter will be released in the third or fourth quarter of 2013. In the event the appeal is unsuccessful, Liquor Stores' anticipates there will be a rapid proliferation of grocers, gas stations and convenience store operators adding wine and distilled spirits to their product offerings, substantially increasing competition for retail liquor store operators. An unsuccessful appeal may have a material negative impact on Liquor Stores' operations and financial results in Kentucky.

All of Liquor Stores' Alberta stores are operated pursuant to licenses issued by the AGLC, which must be re-applied for annually. Similar to the process in Alberta, all B.C. stores are operated pursuant to licenses issued by the BCLCLB, which must be re-applied for annually.

All of Liquor Stores' Alaska stores are operated pursuant to licenses issued by the ABCB, which must be renewed bi-annually, and its Kentucky stores are operated pursuant to licenses issued by the KYABC, which are due for renewal on an annual basis.

Since its inception in 2004, Liquor Stores has never had a store license revoked or not reissued. Management is not aware of any retail liquor store licensee having a license revoked.

The AGLC, the BCLCLB, ABCB and KYABC have certain discretion in the granting or revocation of a license to operate a liquor store. See "Description of our Business" in the Company's Annual Information Form, which can be found at www.SEDAR.com or www.liquorstoresna.ca.

Commodity Taxes & Government Mark-Ups

Changes in tax rates or government mark-ups, and their corresponding effect on product pricing could affect sales and or earnings. If taxes or government mark-ups increase and Liquor Stores increases prices by the full amount of the tax or the mark-up, as the case may be, sales volumes could be adversely impacted. If Liquor Stores is not able to pass the full amount of the tax or mark-up increase on to consumers, then margins and earnings could be adversely impacted. There can be no assurance that governments will not change tax or mark-up rates in the future.

Competition

The private retail distribution of alcoholic beverages in the Provinces of Alberta and British Columbia and the States of Alaska and Kentucky is both competitive and fragmented. Competition exists mainly on a local basis with the main competitive factors being location, convenience, price and service. Changes in the regulatory regime in a particular jurisdiction may increase competition which in turn could materially adversely affect Liquor Stores' business and results of its operations.

In Alberta, Liquor Stores competes with other local single store operators, other local and regional chain operators, and liquor stores associated with national and regional grocery store chains. 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.

In British Columbia, Liquor Stores competes with government owned and operated liquor stores, local independent stores, and wine stores. In February 2010, the British Columbia government amended certain liquor control and licensing regulations, including an amendment that increased the relocation distance such that a retail liquor store is not permitted to be relocated anywhere within 1.0 kilometre of an existing retail liquor store, or the site of an application to license a new retail liquor store (subject to certain "grandfathering" exceptions). This arrangement limits the number of entrants who are able to enter into the market.

In each of Alaska and Kentucky, Liquor Stores competes with local single store operators, other local and regional chain operators and liquor stores associated with U.S. national grocery store chains (and in some instances in Kentucky, with U.S. national drug store chains who also offer alcoholic products for sale). Under the Alaska and Kentucky regulatory environments, stores purchase product directly from distributors and are able to negotiate large volume discounts with suppliers; as such, competitors 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 Liquor Stores' growth strategy. Liquor Stores expects to continue to selectively seek strategic acquisitions in both Canada and the U.S. Liquor Stores' 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 Liquor Stores' resources and, to the extent necessary, Liquor Stores' ability to obtain financing on satisfactory terms for larger acquisitions, if at all. Acquisitions may expose Liquor Stores 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 Liquor Stores' stores; entry into markets or development of new store formats in which Liquor Stores has little or no direct prior experience; difficulties in retaining key employees of the acquired operations; disruptions to Liquor Stores' ongoing business; and diversion of management time and resources.

Liquor Stores expects that new store development will also continue to be a significant part of Liquor Stores' growth strategy. The development of new stores is subject to many of the same risks as acquisitions including but not limited to limitations on the number of attractive development opportunities and competition for such opportunities and internal demands on Liquor Stores' resources. The rate of new store developments may be impacted by factors outside of Liquor Stores' 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 Company'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 Liquor Stores' 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 Liquor Stores enters into long-term leases for its store locations, Liquor Stores' ability to respond in a timely manner to changes in the demographic or retail environment at any location may be limited.

Weather

Weather conditions in Canada and the United States play an important role in Liquor Stores' success. Prolonged poor weather conditions in both the summer and winter months reduce overall customer counts and consequently may have a material effect on Liquor Stores' operating results.

Key Personnel

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

Labour Costs and Shortages and Labour Relations

The success of Liquor Stores' 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 Liquor Stores to hire or retain staff at current wage levels. The occurrence of either of these events could have an adverse effect on Liquor Stores' results of operations.

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

Supply Interruption or Delay

Liquor Stores is dependent upon a limited number of distributors for a substantial majority of its products. Specifically, liquor store operators in Alberta are dependent on the Connect Logistics Service warehouse and Brewers Distributor Ltd. 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. With respect to Liquor Stores' U.S. operations, a limited number of private distributors serve the jurisdictions in which Liquor Stores operates. Any significant disruptions in the operations of these companies (for example, an organized work stoppage) and a resulting interruption in supply may have a material adverse effect on liquor stores operations, including the operations of Liquor Stores and its subsidiaries.

Importance of Information and Control Systems

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

Changes in Income Tax Legislation and Other Laws

Income tax laws, such as the treatment of dividends, may in the future be changed or interpreted in a manner that adversely affects Liquor Stores and our Shareholders (both Canadian and U.S. Shareholders). Furthermore, tax authorities having appropriate jurisdiction over Liquor Stores or our Shareholders may disagree with how we calculate our income for tax purposes or could change administrative practises to our detriment or the detriment of our Shareholders (including, without limitation, the interpretation of certain cross-border tax rules).

Leverage and Restrictive Covenants

In the event that our Canadian credit facility is not extended past its current maturity date (or in the event the credit is renewed on different terms) it could adversely affect the Company's ability to fund our ongoing operations and, as repayment of such indebtedness has priority over the payment of dividends to Shareholders, to pay cash dividends to Shareholders.

The degree to which Liquor Stores is leveraged could have important consequences to the holders of the Common Shares, including: (i) a portion of Liquor Stores' cash flow from operations is dedicated to the payment of interest on its indebtedness, thereby reducing funds available for the payment of dividends; (ii) certain of Liquor Stores' borrowings are at variable rates of interest, which exposes Liquor Stores to the risk of increased interest rates. Liquor Stores' 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.

Our Canadian 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 Liquor Stores to incur additional indebtedness, to create liens or other encumbrances, to pay dividends 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 indebtedness. If the indebtedness under this credit facility were to be accelerated, there can be no assurance that Liquor Stores' assets would be sufficient to repay in full that indebtedness.

Credit Risk

Liquor Stores' financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts receivable. The Corporation maintains its cash and cash equivalents with a major Canadian chartered bank. Liquor Stores, in its normal course of operations, is exposed to credit risk from its wholesale customers in Alberta whose purchases represent less than 5% of the Company's sales. Risk associated with accounts receivable is mitigated by credit management policies. Historically, bad debts from these accounts have been insignificant. Liquor Stores is not subject to significant concentration of credit risk with respect to its customers; however, all trade receivables are due from businesses in the Alberta hospitality industry. Bad debts are insignificant in relation to total sales.

Dilution and Future Sales of Common Shares

Liquor Stores is authorized to issue an unlimited number of Common Shares for the consideration and on terms and conditions as are established by the Board of Directors without the approval of any Shareholders. In the normal course of making capital investments to maintain and expand our business operations, additional Common Shares may be issued. Additionally, from time to time, we may issue Common Shares from treasury in order to reduce debt and maintain a more optimal capital structure. As well, addition new common shares are issued on a monthly basis pursuant to the Company's dividend reinvestment plan. Conversely, to the extent that external sources of capital, including the issuance of additional Common Shares, becomes limited or unavailable, our ability to make the necessary capital investments to maintain or expand our business operations will be impaired. To the extent that we are required to use additional cash flow to finance capital expenditures or acquisitions, or to pay debt service charges or reduce debt, the amount of cash dividends paid to Shareholders could be reduced. Any further issuances of Common Shares will also dilute the interests of existing Shareholders. Shareholders have no pre-emptive rights in connection with such future issuances.

Active Trading Market for the Common Shares and/or the Convertible Debentures

While there is currently an active trading market for the Common Shares, we cannot guarantee that an active trading market will be sustained. If an active trading market in the Common Shares is not sustained, the trading liquidity of the Common Shares will be limited and the market value of the Common Shares may be reduced.

Although the Convertible Debentures trade on the Toronto Stock Exchange, there is not currently an active trading market for the Convertible Debentures, and we cannot guarantee that an active trading market will develop. If an active trading market in the Convertible Debentures does not develop, the trading liquidity of the Convertible Debentures will remain limited and the market value of the Convertible Debentures may be adversely affected.

Conflicts of Interest

Certain directors of Liquor Stores are associated with other companies or entities, including entities engaged in the commercial real estate development, services and leasing businesses, which may give rise to conflicts of interest. In accordance with the CBCA, directors who have a material interest in any person who is a party to a material contract or proposed material contract with Liquor Stores are required, subject to certain exceptions, to disclose that interest and abstain from voting on any resolution to approve that contract. In addition, the directors are required to act honestly and in good faith with a view to the best interests of Liquor Stores. See "Conflicts of Interest".

NON-IFRS FINANCIAL MEASURES

Operating margin, operating margin as a percentage of sales, adjusted operating margin, adjusted net earnings, adjusted basic and diluted earnings per share, adjusting items, cash provided by operating activities before changes in working capital and adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items on a per share basis, and same-store sales are not measures recognized by IFRS and do not have a standardized meaning prescribed by IFRS. Investors are cautioned that operating margin, operating margin as a percentage of sales, adjusted operating margin, adjusted net earnings, adjusted basic and diluted earnings per share, adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items on a per share basis, and same-store sales should not replace net earnings or loss (as determined in accordance with IFRS) as an indicator of the Company's performance, of its cash flows from operating, investing and financing activities or as a measure of its liquidity and cash flows. The Company's method of calculating operating margin, operating margin as a percentage of sales, adjusted operating margin, adjusted net earnings, adjusted basic and diluted earnings per share, adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items on a per share basis, and same-store sales may differ from the methods used by other issuers. Therefore, the Company's operating margin, operating margin as a percentage of sales, adjusted operating margin, adjusted net earnings, adjusted basic and diluted earnings per share, adjusting items, cash provided by operating activities before changes in non-cash working capital and adjusting items, cash provided by operating activities before changes in working capital and adjusting items on a per share basis, and same-store sales may not be comparable to similar measures presented by other issuers.

Operating margin for purposes of disclosure under "Operating Results" has been derived by subtracting Operating and Administrative expenses from Gross Margin. Operating margin as a percentage of sales is calculated by dividing operating margin by sales.

Adjusted operating margin represents operating margin adjusted for unusual, non-recurring or non-operating factors on both a consolidated and segmented basis. These factors, referred to as adjusting items, are reconciled and discussed in the *Highlights* and *Analysis of Financial Results* sections. Adjusted net earnings is calculated as net earnings less the tax effected adjusting items. The tax effect of the adjusting items is calculated by multiplying the adjusting items by the statutory rate of income tax of the applicable jurisdiction. Adjusted basic and diluted earnings per share is calculated as adjusted net earnings divided by basic or diluted weighted average number of common shares outstanding. Management believes the presentation of adjusted operating margin, adjusted net earnings, and adjusted basic and diluted earnings per share provides for useful information to investors and shareholders as it provides increased transparency and predictive value. Management uses adjusted operating margin to set targets and assess performance of the Company.

Cash provided by operating activities before changes in non-cash working capital and adjusting items is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS and therefore is unlikely to be comparable to similar measures presented by other issuers. Investors are cautioned that this should not be construed as an alternative measure of profitability.

EBITDA and EBITDAR, which are used by Management only with reference to the calculation of covenants under the Company's credit facility, have been defined in the *Liquidity and Capital Resources* section of this MD&A.