LIQUOR STORES N.A. LTD.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Year Ended December 31, 2016

Dated as at March 7, 2017

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1. Basis of Presentation

Management's Discussion and Analysis ("MD&A") provides a comparison of Liquor Stores N.A. Ltd.'s performance for the three months and year ended December 31, 2016 with the three months and year ended December 31, 2015. This discussion should be read in conjunction with the Company's annual audited consolidated financial statements and notes thereto (the "financial statements") for the years ended December 31, 2016 and 2015, and the Annual Information Form of the Company, each of which is available on SEDAR at www.sedar.com**.** The information in this MD&A is current to March 7, 2017, unless otherwise noted.

In this MD&A, unless the context otherwise requires, all references to "we", "us", "our", "Liquor Stores", and "the Company" refer to Liquor Stores N.A. Ltd. and its subsidiaries, and 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 Chartered Professional Accountants – Part I ("CPA Handbook"), for financial statements. 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 same-store sales, operating profit before amortization, operating profit before amortization as a percentage of sales, adjusted operating profit before amortization, adjusting items, adjusted net earnings, and adjusted basic and diluted earnings per share. A description of these measures and their limitations are discussed under *"Non-IFRS Financial Measures",* along with a reconciliation to the nearest IFRS financial measure.

Additional information relating to Liquor Stores can be found at www.liquorstoresna.ca. The Company's continuous disclosure materials, including its annual and quarterly MD&A, audited annual and unaudited interim financial statements, its Annual Information Form, Information Circulars, and various news releases issued by the Company are also available on its website or directly through the SEDAR system at www.sedar.com.

2. Executive Summary

The following section summarizes our business strategy and the resulting key business highlights and overall financial performance of the Company over the past year.

As previously communicated, we are focused on executing against a Seven Point Plan (the "Plan") to build on our competitive position, invest in opportunities to support long-term profitability and drive growth across our business. The Plan is described in detail on page 33.

In 2016, the Company achieved or partially achieved its objectives against this Plan by investing in its store network and investing in people, brand awareness and loyalty, and product selection designed to increase operating profits. As a result, we increased operating profits while navigating challenging market conditions in our resource dependent markets, while at the same time have positioned the Company to withstand a period of prolonged economic pressure in Alberta and emerge from the downturn in a position of strength.

We increased operating profit in 2016

We increased our operating profit before amortization[1] by $3.5 million or 9.5% to $40.4 million for the current year (2015 - $36.9 million). We have done this by:

- Significantly increasing sales – an increase of $71.3 million or 9.6% compared to the prior year through the development and opening of new stores and an acquisition in the current period;
- Holding our gross margin rate essentially flat year over year (after removing the impact on our margin rate of the acquisition of a 51% interest in Birchfield Ventures LLC ("Birchfield") - Birchfield operates a high volume model with a lower gross margin rate);
- Optimizing pricing through detailed analytics to ensure our merchandise was priced right in light of local competitive factors. This partially offset the impact of customers trading down to less expensive, lower gross margin rate products in Alberta and Alaska as a result of the economic headwinds in those markets;
- Significantly increasing the penetration rate of our private label products, which generated a higher gross margin rate than competing national brands;
- Prudently applying cost containment measures – we found efficiencies to automate or streamline several business processes to reduce our total administrative expenses by $3.8 million or 14.2% in the current year. Our administrative expenses represented 2.8% of sales in 2016, compared to 3.6% in 2015. This is also very positive considering we entered two new US regions in the current year (New Jersey and Connecticut).

Difficult economic conditions in our largest market

We achieved increased operating profits despite depressed economic conditions in Alberta, a key market for the Company.

Approximately 71% of our stores are located in Alberta, which has been an economy impacted by unemployment levels[2] that have risen significantly over the last two years, starting fiscal 2015 at 4.6%, and finishing fiscal 2016 at 8.5%. To put it in context, unemployment levels hit a high of 7.3% during the global financial crisis/oil price depression in 2009/2010, and unemployment levels had not previously been above 8% in Alberta since 1994.

How these economic conditions impact our financial performance

Higher levels of unemployment reduce both the traffic to our stores and overall basket size of our customers, both of which impact our overall sales volumes.

We have seen declines in same-store sales in Alberta as a result. Since the costs of operating our stores is relatively fixed and does not fluctuate with sales volume (base level of labor to operate a store, rent, property tax, utilities, maintenance and janitorial costs remain relatively unchanged regardless of level of sales), a decline in same store sales reduces our operating profit and operating profit as percentage of sales, and increases our selling and distribution expenses as a percentage of sales.

[1] See the 'Non-IFRS Financial Measures' section of this MD&A
[2] Source: Statistics Canada

How geographic diversification has benefited the Company in light of the recession in Alberta

In the past two years, we have constructed and acquired several stores in the US. In 2016, this resulted in an increase of $47.9 million USD, or roughly $63.5 million in Canadian funds to our overall sales.

By diversifying our revenue base, it lessens the financial impact of a recession or of a potential adverse political or regulatory change in Alberta. Diversification of our revenue base also assists in maintaining overall financial performance when we are faced with an increase in competitive pressure impacting one of our markets, which is what we faced in Kentucky in the fourth quarter this year.

We took steps to solidify our balance sheet

Facing a significant recessionary environment in Alberta and Alaska, we took action to improve our overall financial position as follows:

- Reduction of our consolidated same store inventory levels by over $12 million compared to the prior year through improvements to our store ordering and procurement process.
- Implemented additional controls on our capital investments to manage our debt levels and improve our leverage. While our sales increased by 9.6% and our operating profit before amortization increased by 9.5%, our levels of long-term debt net of cash increased by only 2.4%.
- We raised capital pursuant to the issuance of a new series of subordinated convertible debentures at a favorable rate of interest (4.70%) in order to finance the redemption of our existing debentures that carry a much higher rate of interest (5.85%) and otherwise mature in 2018.

Through these actions as well as others taken by management to navigate the significant economic challenges faced in Alberta and Alaska in the past year, we believe the Company is currently well positioned to emerge from these headwinds and increase our profitability in the future.

3. Outlook

Economic Conditions

We have noted that many economists are predicting an upward trend in economic conditions and activity as the year progresses, with moderate GDP growth in Alberta, on balance, for 2017. With current unemployment levels in Alberta at 8.8%[3] for January 2017 (slightly worse than at December 31, 2016), Liquor Stores anticipates further downward pressure on same-store sales in the province at the start of 2017 but expects steady improvement as the year progresses. In addition, our renovated stores continue to perform strongly and we anticipate making investments in additional renovations in 2017 to counteract the economic challenges we are facing. Our strategy is designed to ensure that we will benefit when employment levels increase, core industries improve and consumer confidence returns.

We anticipate that our strong performance in British Columbia will continue into the next year, with growth in same-store sales from increased customer traffic as we complete renovations in this region in 2017 coupled with enhancements to our pricing and promotional strategies that we anticipate will continue to increase basket size and gross margin rate in this region.

In the U.S., the Alaskan economy, similar to Alberta's, continues to be impacted by lower crude oil prices, but like Alberta, we expect continued improvement in this market as 2017 progresses. In Kentucky, we have faced a higher level of competitive pressure from grocers and new entrants, which we expect to continue. However,

[3] Source: Statistics Canada

we are taking measures to counteract the impact of the foregoing through enhancements to our pricing and promotional activities and completing store renovations in the Kentucky market as appropriate.

Future Growth

As discussed earlier, Liquor Stores has been taking and will continue to take a measured approach to growth that will be scaled up or down dependent on market conditions. The goal is to continue to invest in our store network and pursue expansion, while ensuring that the Company has taken the appropriate measures to counteract economic and competitive pressures. Liquor Stores expects to drive increased levels of profitability of the business over both the near and long-terms primarily through store renovations in our core markets of Alberta and British Columbia along with measured new store growth in select Canadian markets, and through modest levels of expansion in the U.S. through the acquisition of existing stores and the opening of strategically placed stores developed by the Company.

More specifically:

- Liquor Stores currently expects to open and/or acquire between three to six new stores over the next 24 months, at an estimated aggregate cost of $5 million to $10 million, depending on format (convenience vs. destination sized). We plan to relocate two existing stores in British Columbia to better retail locations. We will evaluate opportunities to open new locations in Alberta to protect our competitive position and grow market share. We plan to open a new large format store in Calgary in fall 2017, subject to construction timing. We were awarded a liquor license to open a new store in Saskatoon, Saskatchewan and are currently finalizing plans and timing of our entrance to that new market. The Company will monitor economic conditions and evaluate potential new stores for 2018.
- We anticipate investing $4 to $6 million on store refurbishments in 2017, depending on economic conditions. Results from the $2.5 million invested in renovations in the last twelve months have been strong, with sales increases ranging between 10% and 25%, notwithstanding the economic headwinds.
- We will also continue to refine plans to implement a new enterprise resource planning ("ERP") system that will improve business operations, drive down costs, and provide a scalable growth platform. We will phase in implementation and test the system in a small number of stores in 2017 before proceeding with a roll out across the business.

Management believes that this approach reflects the most efficient and effective use of our capital to continue to realize our strategic growth objectives in light of current economic conditions. Management will continue to carefully manage our allocation of capital and believes that its cash flow from existing operations, its current available credit and access to new capital are sufficient to finance the execution of the Company's growth objectives as outlined above.

4. Performance Overview

The following table summarizes highlights of the Company's financial performance for the three months ended December 31, 2016 and 2015:

	Three months ended December 31,					
	2016		2015		Variance	
(Cdn $000's unless otherwise noted)	$	%	$	%	$	%
	(unaudited)		(unaudited)			
Sales						
Canadian same-stores[5]	123,586	54.3%	128,489	60.0%	(4,903)	-3.8%
Other Canadian stores [1]	10,916	4.8%	9,835	4.6%	1,081	11.0%
Canadian wholesale	8,085	3.5%	8,072	3.8%	13	0.2%
Total Canadian store sales	142,587	62.6%	146,396	68.4%	(3,809)	-2.6%
U.S. same-stores (US$)[5]	47,086	20.7%	50,029	23.4%	(2,943)	-5.9%
Other U.S. stores (US$)[3]	16,632	7.3%	724	0.3%	15,908	2197.2%
Foreign exchange on U.S. store sales	21,301	9.4%	17,017	7.9%	4,284	25.2%
Total U.S. store sales	85,019	37.4%	67,770	31.6%	17,249	25.5%
Total sales	227,606	100.0%	214,166	100.0%	13,440	6.3%
Gross margin	57,528	25.3%	54,638	25.5%	2,890	5.3%
Other income	(704)	-0.3%	-	0.0%	(704)	nm
Selling and distribution expenses	39,887	17.5%	34,797	16.2%	5,090	14.6%
Administrative expenses	5,080	2.2%	7,963	3.7%	(2,883)	-36.2%
Operating profit before amortization [5]	13,265	5.8%	11,878	5.5%	1,387	11.7%
Adjusted operating profit before amortization [5]	13,406	5.9%	13,971	6.5%	(565)	-4.0%
Net loss	(4,856)	-2.1%	(105,808)	-49.4%	100,952	95.4%
Adjusted net earnings [5]	5,887	2.6%	6,589	3.1%	(702)	-10.7%
Cash provided by operating activities	31,954	14.0%	15,680	7.3%	16,274	103.8%
Dividends paid in cash to shareholders	2,249	1.0%	6,694	3.1%	(4,445)	-66.4%
Total assets	463,047		455,554		7,493	1.6%
Total equity	235,395		255,736		(20,341)	-8.0%
Basic and diluted loss per share	(0.22)		(3.86)		3.64	94.3%
Basic and diluted adjusted earnings per share [5]	0.17		0.24		(0.07)	-29.2%

nm – not meaningful

The following table summarizes highlights of the Company's financial performance for the year ended December 31, 2016 and 2015:

	Year ended December 31,					
	2016		2015		Variance	
(Cdn $000's, unless otherwise noted)	$	%	$	%	$	%
	(unaudited)		(unaudited)			
Sales						
Canadian same-stores(5)	448,755	54.9%	457,983	61.4%	(9,228)	-2.0%
Other Canadian stores (2)	51,319	6.3%	42,098	5.6%	9,221	21.9%
Canadian wholesale	31,620	3.9%	28,639	3.8%	2,981	10.4%
Total Canadian store sales	531,694	65.0%	528,720	70.8%	2,974	0.6%
U.S. same-stores (US$)(5)	142,518	17.4%	143,971	19.3%	(1,453)	-1.0%
Other U.S. stores (US$)(4)	73,537	9.0%	25,623	3.4%	47,914	187.0%
Foreign exchange on U.S. store sales	69,924	8.6%	48,070	6.5%	21,854	45.5%
Total U.S. store sales	285,979	35.0%	217,664	29.2%	68,315	31.4%
Total sales	817,673	100.0%	746,384	100.0%	71,289	9.6%
Gross margin	206,599	25.3%	191,389	25.6%	15,210	7.9%
Other income	(704)	-0.1%	-	0.0%	(704)	nm
Selling and distribution expenses	143,792	17.6%	127,554	17.1%	16,238	12.7%
Administrative expenses	23,145	2.8%	26,965	3.6%	(3,820)	-14.2%
Operating profit before amortization (5)	40,366	4.9%	36,870	4.9%	3,496	9.5%
Adjusted operating profit before amortization (5)	42,456	5.2%	40,894	5.5%	1,562	3.8%
Net earnings (loss)	2,953	0.4%	(99,392)	-13.3%	102,345	103.0%
Adjusted net earnings (5)	15,129	1.9%	15,722	2.1%	(593)	-3.8%
Cash provided by operating activities	47,729	5.8%	16,373	2.2%	31,356	191.5%
Dividends paid in cash to shareholders	13,315	1.6%	26,994	3.6%	(13,679)	-50.7%
Total assets	463,047		455,554		7,493	1.6%
Total equity	235,395		255,736		(20,341)	-8.0%
Basic and diluted earnings (loss) per share	0.02		(3.64)		3.66	100.5%
Basic and diluted adjusted earnings per share (5)	0.46		0.57		(0.11)	-19.3%

nm – not meaningful

Notes:

(1) *Sales for Other Canadian stores for the three months ended December 31, 2016 and 2015 include those of six stores opened, and three stores closed subsequent to October 1, 2015, two stores in close proximity to the new and closed stores, one store closed due to a fire in the previous year, and seven stores that were closed for a significant portion of Q2 2016 due to the evacuation of the Fort McMurray area due to a fire.*

(2) *Sales for Other Canadian stores for the year ended December 31, 2016 and 2015 include those of ten stores opened, one store acquired, and five stores closed subsequent to January 1, 2015, three stores in close proximity to the new and closed stores, one store closed due to a fire in the previous year, and seven stores that were closed for a significant portion of Q2 2016 due to the evacuation of the Fort McMurray area due to a fire.*

(3) *Sales for Other U.S. stores for the three months ended December 31, 2016 and 2015 include the following changes subsequent to October 1, 2015: (i) Kentucky: one new store opened and one store closed; (ii) New Jersey: two new stores acquired, and (iii) Connecticut: one new store opened.*

(4) *Sales for Other U.S. stores for the year ended December 31, 2016 and 2015 include the following changes subsequent to January 1, 2015: (i) Kentucky: three new stores opened, one store closed and two stores within close proximity to the opened stores; (ii) Alaska: one store closed and one store within close proximity to the closed store; (iii) New Jersey: two new stores acquired, and (iv) Connecticut: one new store opened.*

(5) *Same-store sales, operating profit before amortization, adjusting items, adjusted operating profit before amortization, adjusted net earnings (loss), and adjusted earnings per share are non-IFRS measures that do not have standardized meaning prescribed by IFRS. For more information and a reconciliation of non-IFRS measures to the closest IFRS measure see the 'Non-IFRS Financial Measures' section of this MD&A.*

Fourth Quarter 2016 Operating Results Compared to Fourth Quarter 2015 Operating Results

Sales

Total sales increased by $13.4 million or 6.3% to $227.6 million in the fourth quarter of 2016 (Q4 2015 - $214.2 million). The increase is primarily the result of the sales contribution from the Birchfield acquisition (two stores in New Jersey), the addition of a new large format store in Connecticut, new store expansion in the United States and Canada offsetting store closures, and a $4.3 million positive change in foreign exchange on the translation of U.S. dollar denominated sales to Canadian dollars.

Same-Store Sales[4]

- Canadian same-store sales decreased by $4.9 million, or 3.8%.
  - Same-store sales in British Columbia continued to grow in the fourth quarter of 2016 compared to the same period in 2015. In particular, we had strong growth in stores that were renovated during the previous two years.
  - Sales at our stores located in Edmonton and Calgary have continued to be impacted in Q4 2016 by the economic slowdown that has persisted in Alberta, and as a result, we saw a decline in same store sales in both of these centres.
  - Unemployment levels in Alberta increased throughout the quarter, setting a new 20+ year high by hitting 9.0%[5] in the month of November before finishing the year at 8.5% at December 31, 2016. While basket size was relatively stable, we saw declines in transaction counts compared to the same period in the prior year.
  - Our stores located in the resource dependent markets like Grande Prairie and Fort McMurray and rural markets of Alberta continued to face increased pressure in the fourth quarter from the weak

[4] See the 'Non-IFRS Financial Measures' section of this MD&A

[5] Source: Statistics Canada

economic conditions in these markets, with regional same-store sales declines of between 5% and 15% depending on the market.

- U.S. same-store sales decreased by $2.9 million or 5.9%.
  - o Same-store sales in Alaska were negatively impacted by a continued slowdown in the Alaska economy as a result of a decline in oil and gas exploration activity coupled with a 50% reduction in the permanent fund dividend (from $2,200 in the prior year to $1,100 in the current year for each Alaska resident) paid by the state of Alaska during the quarter.
  - o Same-store sales in Kentucky declined compared to the same quarter in the prior year. In the previous quarter, Harrodsburg County moved from dry (no retail sales of alcohol) to wet (retail sale of alcohol permitted) which continued to significantly impact one of our large format stores in Kentucky due to close proximity to the affected county. We also observed a higher level of competitive pressure in the Lexington and Louisville markets. In response, we have been adjusting our pricing and promotional strategies to compete more effectively in these markets, and have completed the renovation of one of our key store locations. We will continue to evaluate the need for further renovations in this market.

<u>Other Sales</u>

- Canadian wholesale sales, which include sales to licensee customers in Alberta (restaurants, lounges, hotels, etc.), were $8.1 million for the three months ended December 31, 2016, which was unchanged from the prior year (2015 - $8.1 million). Although we experienced sales growth resulting from the addition of new licensee customer accounts over the past year, the increase in sales was offset by declines in sales to existing customers due to the economic slowdown in Alberta.
- Sales for the Other Canadian stores have increased $1.1 million compared to the prior year, primarily as a result of the sales from the six new stores opened contributing more than the lost contribution from the three stores closed since October 1, 2015, also taking into account the impact on sales from two of our stores that are in close proximity to the new and closed stores.
- Sales for Other U.S. stores have increased by $15.9 million compared to 2015, primarily as a result of the Birchfield acquisition (a 51% interest in two new high volume retail liquor stores in New Jersey) and the opening of a new large format store in Norwalk, Connecticut in October 2016.

Gross Margin

For the three months ended December 31, 2016, gross margin was $57.5 million, up $2.9 million or 5.3% from $54.6 million for the same period last year. The increase in our gross margin was primarily attributable to the margin increase from new stores net of store closures ($3.9 million) and a positive change in foreign exchange on translation of the U.S dollar denominated gross margin to Canadian dollars ($1.0 million), offset by the gross margin impact of the decline in same store sales in the current quarter ($1.9 million) and the impact of a slight decline in gross margin % in our same stores ($0.1 million).

Gross margin as a percentage of sales for the period has decreased marginally to 25.3% (2015 – 25.5%), which was primarily attributable to the addition of the newly acquired 51% interest in our Birchfield stores, which operate a high volume model with slightly lower gross margins. The impact of including Birchfield in our Q4 2016 gross margin was a decline of roughly 25 basis points in our gross margin rate. Excluding the impact of Birchfield, our gross margin rate slightly increased in the remainder of our business. We have been mindful of our pricing strategy to ensure our products remained priced appropriately considering the economic slowdown being experienced in Alberta and Alaska which has reduced our gross margin percentage, but have more than offset this impact with increased penetration of our private label products.

Other income

Other income recognized in the current quarter, of $0.7 million, is attributable to the expected settlement of our insurance claim related to the business interruption experienced as a result of the forest fires in Fort McMurray during Q2 2016. The claim of $0.7 million was settled with our insurers subsequent to December 31, 2016.

Selling and distribution expenses

Selling and distribution expenses for the three months ended December 31, 2016 were $39.9 million or 17.5% of sales, up $5.1 million or 14.6% from $34.8 million, or 16.2% of sales a year earlier. Significant components of this expense include the following items:

	Three months ended December 31,				
	2016		2015		Variance
(Cdn $000's unless otherwise noted)	$	% of sales	$	% of sales	$
Salaries, wages, and benefits	15,681	6.9%	13,998	6.5%	1,683
Rent and property tax	11,653	5.1%	10,810	5.1%	843
Marketing and promotion	3,732	1.6%	2,837	1.3%	895
Merchant processing fees	2,459	1.1%	2,075	1.0%	384
Utilities	1,414	0.6%	1,321	0.6%	93
Maintenance, janitorial, and supplies	1,407	0.6%	1,380	0.6%	27
Store closure costs	845	0.4%	245	0.1%	600
Other	2,696	1.2%	2,131	1.0%	565
Total selling and distribution expenses	39,887	17.5%	34,797	16.2%	5,090

- The increase in salaries, wages and benefits was as a result of the impact of the increase in minimum wage in Alberta and British Columbia that took effect in the fourth quarter and the impact of adding labor costs from our 51% interest in Birchfield (acquired in Q1 2016). On a percentage of sales basis, the cost of in-store labor also increased due to the impact of the decline in same store sales in the quarter given the relatively fixed in-store labor cost of our convenience format locations.
- Rent costs increased compared to the same quarter last year by $0.8 million as a result of the rent costs from new stores opened and acquired in the last year exceeding the rent saved from stores closed over this period. Through proactive negotiations with our landlords, our same store rent costs decreased by $0.1 million compared to the same period last year.
- Marketing and promotion costs increased compared to the same period last year primarily as a result of the grand opening campaign run for the opening of our new store in Norwalk, Connecticut in the fourth quarter.
- Merchant processing fees for soft-pay transactions (credit and debit card) increased at a level commensurate with our sales, with the slight increase on a percentage of sales basis as a result of a higher usage of these forms of payment compared to the same period in the prior year.

- Store closure costs contain costs related to the early termination of leases in conjunction with store closures and the exit of the lease for a planned new store in Berlin, Massachusetts. Management will not open this location, and the planned investment in the capital and inventory to open that store will be allocated to other projects that Management believes will generate a higher return on capital.
- Utilities, maintenance, janitorial, supplies and other selling and distribution expenses remained relatively consistent with the same period last year on a percentage of sales basis.

Administrative expenses

Administrative expenses for the three months ended December 31, 2016 were $5.1 million or 2.2% of sales, down $2.9 million or 36.2% from $8.0 million, or 3.7% of sales a year earlier. Significant components of this expense include the following items:

	Three months ended December 31,				
	2016		2015		Variance
(Cdn $000's unless otherwise noted)	$	% of sales	$	% of sales	$
Salaries, wages, and benefits	3,403	1.5%	3,386	1.6%	17
Share based payments	557	0.2%	118	0.1%	439
Information technology costs	227	0.1%	1,965	0.9%	(1,738)
Travel	250	0.1%	626	0.2%	(376)
Legal and accounting fees	78	0.0%	670	0.3%	(592)
Rent and property tax	221	0.1%	222	0.1%	(1)
Consulting fees	82	0.1%	816	0.4%	(734)
Other	262	0.1%	160	0.1%	102
Total administrative expenses	5,080	2.2%	7,963	3.7%	(2,883)

- Administrative salaries, wages and benefits were flat year over year, and down slightly on a percentage of sales basis. We controlled our administrative headcount carefully throughout the year and leveraged our existing headcount despite the increase in sales and entrance into two new jurisdictions in 2016 (New Jersey and Connecticut).
- Share based payments increased in Q4 2016 compared to the prior year. In the fourth quarter, our share price remained stable throughout the quarter. In the prior year, our share price declined from $10.95 at September 30, 2015 to close at $8.37 per share at December 31, 2015. This resulted in a recovery being recognized from the re-measurement of several outstanding awards in the prior year that reduced the overall share based payments expense.
- Information technology costs declined by $1.7 million or 88.4% compared to the same quarter in the prior year, as we recognized $1.7 million of costs related to the implementation of a new ERP system in the prior year. In 2016, we temporarily suspended work on the implementation project in the current year.
- Administrative travel costs declined in Q4 2016 by $0.4 million or 60.1% as compared to the same period in the prior year. Earlier in the year, we re-organized our operational leadership by appointing Chief Operating Officers of both Canada and the US, which significantly reduced cross-border travel costs.
- Legal fees declined by $0.6 million or 88.4% in Q4 2016 due to a higher level of regulatory and legal activity being undertaken in the same quarter in the prior year.

- Consulting fees declined by $0.7 million or 90.0% compared to the same quarter in the prior year, primarily as a result of incurring $0.5 million of costs in Q4 2015 related to acquisition of our 51% interest in Birchfield Ventures LLC, which closed early in Q1 2016.

Operating profit before amortization

Operating profit before amortization[6] for the three months ended December 31, 2016 increased by $1.4 million to $13.3 million or 5.8% as a percentage of sales (Q4 2015 – 5.5%). However, adjusted operating profit before amortization[5] for the three months ended December 31, 2016 decreased by $0.6 million to $13.4 million due to the increases in gross margin and decrease in administrative expenses being more than offset by the increases in the selling and distribution expenses as explained above.

Adjusted operating profit before amortization[5] as a percentage of sales was 5.9%, down from 6.5% in the prior year. Due to the relatively fixed cost base of many of our store locations, the declines in same store sales in Canada and the U.S. reduced our operating profit percentage in Q4 2016.

In addition, since October 1, 2015, the Company has opened eight newly developed stores in Canada and the United States. New stores generally take up to three years to mature and fully contribute to operating profit, and as such, these new stores have contributed to the decline in the adjusted operating profit as a percentage of sales. Management believes that this impact is temporary and that these new stores will positively contribute to adjusted operating profit as a percentage of sales as they mature. The Company has also closed four stores since October 1, 2015, which has impacted operating profits due in part to costs associated with closing the stores.

Amortization

Amortization expense of $3.1 million for the fourth quarter of 2016 was roughly consistent with the prior year (Q4 2015 - $2.9 million), which contained the impact of accelerated depreciation on several stores renovated in the fourth quarter in the prior year.

Finance Costs

Finance costs have increased by $1.0 million to $3.2 million in Q4 2016 (Q4 2015 - $2.2 million). The acquisition of our 51% interest in Birchfield in the first quarter of 2016 was funded by advances under our credit facility, which increased our long-term debt balance and finance costs throughout the year. This increase was partially offset through ongoing efforts to reduce our inventory levels and overall leverage as the year closed.

We also issued a new series of convertible subordinated debentures in the aggregate amount of $77.6 million in Q4 2016, which will temporarily increase finance costs in the interim pending the redemption of our existing 5.85% convertible subordinated debentures on or around April 30, 2017 (our earliest opportunity available under the terms of the debentures). The proceeds from the debenture raise were applied to temporarily reduce the Company's borrowings under our credit facility, which are at a lower rate of interest than the debentures, until such redemption.

Impairment

During the three months ended December 31, 2016, the Company recorded an impairment charge of $12.8 million to the goodwill and $1.9 million to the intangible assets (retail liquor license for Massachusetts)

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[6] See the 'Non-IFRS Financial Measures' section of this MD&A

allocated to the USA South cash generating unit grouping ("CGU"). The estimated recoverable amount of the CGU declined in 2016 primarily related to a change in Management's forecasted sales and profitability as a result of, among other factors, increased competition in the areas that these stores operate. A reversal of previously recorded impairment charges was also recorded during the quarter in the amount of $1.1 million. This reversal related to retail liquor licenses of five stores in British Columbia where Management's forecasted sales and profitability increased due to a sustained improvement in operating results.

Also see the 'Risk Factors' section later in this MD&A and our Annual Information Form for further discussion of potential changes in the regulatory, competitive and economic environment for all regions that we operate in.

The Company also recorded a charge of $2.6 million to remove the intangible asset previously recorded as capitalized software and development costs. As discussed in the Outlook section, we are continuing to refine plans to implement a new ERP system which will likely result in a change in the chosen software solution to one that is less costly.

Fair value adjustments

Fair value adjustments are comprised of unrealized losses recorded on the non-controlling interest put option liability of $0.1 million (2015 – $nil) and a purchase option of $0.3 million (2015 – $nil) both of which relate to the remaining 49% of Birchfield Ventures not currently owned by the Company. These were offset by an unrealized gain of $0.6 million recorded for an interest rate swap (2015 – $0.4 million unrealized loss).

Income Taxes

In the fourth quarter of 2016, we recorded an income tax recovery of $4.3 million due to the impairment charge recognized in the U.S. during the current quarter (Q4 2015 - $18.6 million recovery).

Our annual effective rate of tax will fluctuate based on the estimated proportion of income/loss attributable to each jurisdiction that the Company operates in for 2016 compared to 2015.

Net Earnings

For the three months ended December 31, 2016, a net loss of $4.9 million was recorded (Q4 2015 – loss of $105.8 million). On a per share basis, loss per share was $0.22 for Q4 2016 (Q4 2015 – loss of $3.86 per share). The losses in both periods were driven by the non-cash impairment charges as discussed above, which were a total of $16.1 million for Q4 2016 (Q4 2015 - $130.3 million).

Excluding after-tax adjusting items (which included the impairments discussed above), adjusted net earnings[7] were $5.9 million, a decrease of $0.7 million or 10.7% compared to Q4 2015.

The decrease in adjusted net earnings is due to the decrease in adjusted operating profit before amortization and increases in amortization expense and finance costs as discussed above. On a per share basis, adjusted earnings per share were $0.17 per share in Q4 2016 (Q4 2015 - $0.24 per share). The decline in earnings per share was as a result of decrease in adjusted net earnings as discussed above. Earnings available to common

[7] See the 'Non-IFRS Financial Measures' section of this MD&A

shareholders was also reduced by the $1.1 million of net earnings attributable to the 49% non-controlling interest of Birchfield in Q4 2016.

Year ended December 31, 2016 Operating Results Compared to the Year ended December 31, 2015 Operating Results

Sales

Total sales increased by $71.3 million or 9.6% to $817.7 million in 2016 (2015 - $746.4 million). The increase is primarily the result of the sales contribution from the Birchfield acquisition, increase in same-store sales, new store expansion in the United States and Canada offsetting store closures, and a $21.9 million positive change in foreign exchange on the translation of U.S. dollar denominated sales to Canadian dollars.

Same-Store Sales[8]

- Canadian same-store sales decreased by $9.2 million, or 2.0%.
  - After progressing through much of the year on a flat trend on same store sales, we have seen a continued worsening in the Alberta economy and increase in the unemployment rate as the year progressed. The negative impact on our same store sales in Alberta began primarily in our rural and resource dependent markets, but expanded to negatively impact our performance in urban centres like Edmonton and Calgary.
  - These declines in same-store sales in Alberta were partially offset by an increase in same-store sales in British Columbia.
- U.S. same store sales decreased by $1.5 million, or 1.0%.
  - Our same-store sales in Kentucky finished the year on a downward trend as a result of a county moving from dry to wet and increased competitive pressure, as discussed earlier in this MD&A. We are continuing to adjust our pricing and promotional strategies to compete more effectively in these markets, and we are evaluating completing renovations of key store locations.
  - We experienced a slight decrease in same-store sales in Alaska during the year. This market has been negatively impacted by a slowdown in the economy as a result of a decline in oil and gas exploration activity as previously discussed in this MD&A.

Other Sales

- Canadian wholesale sales, which include sales to licensee customers in Alberta, were $31.6 million for the year ended December 31, 2016, representing an increase of $3.0 million or 10.4% from the prior year (2015 - $28.6 million), primarily due to adding new licensee customer accounts in the current year. This increase was partially offset by the declines we have seen to our existing wholesale customer base who have been impacted by the economic slowdown in Alberta.
- Sales for the Other Canadian stores have increased $9.2 million compared to the prior year, primarily as a result of the sales from the ten new stores opened and one store acquired contributing more than the lost contribution from the five stores closed since January 1, 2015, also taking into account the sales increases from the three stores in close proximity to the closed stores. Offsetting this increase

[8] See the 'Non-IFRS Financial Measures' section of this MD&A

was the decline in sales from our seven Fort McMurray stores being closed for a significant portion of time in the second quarter of 2016 due to a forest fire.

- Sales for Other U.S. stores have increased by $47.9 million compared to 2015, primarily as a result of the Birchfield acquisition. The remainder was as a result of the sales from the three stores opened in Kentucky more than offsetting the sales decline in the two stores in close proximity and the closed stores in Alaska and Kentucky since January 1, 2015. We also opened a large format store in Norwalk, Connecticut in the fourth quarter of 2016 which increased our sales.

Gross Margin

For the year ended December 31, 2016, gross margin was $206.6 million, up $15.2 million or 7.9% from $191.4 million for the same period last year. The increase in our gross margin was primarily attributable to the margin contribution from the newly acquired 51% interest in our Birchfield stores and the margin increase from our other new stores net of store closures ($12.8 million), the increase in our Canadian wholesale sales ($0.6 million), and a positive change in foreign exchange on translation of the U.S dollar denominated gross margin to Canadian dollars ($5.0 million). The increases in gross margin were offset by margin decline from our same-stores sales decrease ($2.8 million), and the impact of the decline in our gross margin rate ($0.4 million).

Gross margin as a percentage of sales for the period has decreased to 25.3% (2015 – 25.6%), which was attributable to the addition of the newly acquired 51% interest in our Birchfield stores, which operate a high volume model with slightly lower gross margins. The impact of including Birchfield in our gross margin for the year was a decline of approximately 25 basis points in our gross margin rate. We have been mindful of our pricing strategy in the other regions of the Company to ensure our products remained priced appropriately considering the economic slowdown being experienced in Alberta and Alaska, which was offset by increases in our gross margin rate through significantly increasing our penetration of our private label and exclusive products in the past year.

Selling and distribution expenses

Selling and distribution expenses for the year ended December 31, 2016 were $143.8 million or 17.6% of sales, up $16.2 million or 12.7% from $127.6 million, or 17.1% of sales a year earlier. Significant components of this expense include the following items:

	Year ended December 31,				
	2016		2015		Variance
(Cdn $000's unless otherwise noted)	$	% of sales	$	% of sales	$
Salaries, wages, and benefits	59,178	7.2%	54,117	7.3%	5,061
Rent and property tax	46,327	5.7%	39,433	5.3%	6,894
Marketing and promotion	9,085	1.1%	8,845	1.2%	240
Merchant processing fees	8,440	1.0%	7,023	0.9%	1,417
Utilities	5,745	0.7%	5,617	0.8%	128
Maintenance, janitorial, and supplies	4,765	0.6%	4,530	0.6%	235
Store closure costs	1,199	0.2%	245	0.0%	954
Other	9,053	1.1%	7,744	1.0%	1,309
Total selling and distribution expenses	143,792	17.6%	127,554	17.1%	16,238

- The increase in salaries, wages and benefits was as a result of the increase in store locations in the current year and the labor cost added from the acquisition of our 51% interest in Birchfield. Our cost of in-store labor declined on a percentage of sales basis as we tightly controlled this expense throughout the year and strategically recalibrated our operating hours and shift schedules in preparation for the increase in minimum wage enacted in Alberta and British Columbia in the fourth quarter.
- Rent costs increased compared to last year by $5.6 million as a result of the rent costs from new stores opened and acquired in the last year exceeding the rent saved from stores closed over this period. We also had rent escalations of $1.3 million related to the renewal of long-term lease arrangements in the past twelve months.
- Marketing and promotion costs were relatively flat year-over-year despite a significant increase in sales compared to the prior year.
- Merchant processing fees for soft-pay transactions (credit and debit card) increased at a level commensurate with our sales, with the slight increase on a percentage of sales basis as a result of a higher usage of these forms of payment by our customers compared to the prior year.
- Store closure costs contain costs related to the early termination of leases in conjunction with store closures and exits of leases for planned new stores.
- Utilities, maintenance, janitorial, supplies and other selling and distribution expenses remained relatively consistent with the prior year on a percentage of sales basis.

Administrative expenses

Administrative expenses for the year ended December 31, 2016 were $23.1 million or 2.8% of sales, down $3.8 million or 14.2% from $27.0 million, or 3.6% of sales a year earlier. Significant components of this expense include the following items:

	Year ended December 31,				
	2016		2015		Variance
(Cdn $000's unless otherwise noted)	$	% of sales	$	% of sales	$
Salaries, wages, and benefits	14,691	1.8%	14,590	2.0%	101
Share based payments	1,946	0.2%	752	0.1%	1,194
Information technology costs	1,218	0.2%	4,143	0.6%	(2,925)
Travel	1,101	0.1%	1,689	0.2%	(588)
Legal and accounting fees	1,038	0.1%	2,191	0.3%	(1,153)
Rent and property tax	873	0.1%	861	0.1%	12
Consulting fees	856	0.1%	1,624	0.2%	(768)
Other	1,422	0.2%	1,115	0.1%	307
Total administrative expenses	23,145	2.8%	26,965	3.6%	(3,820)

- Administrative salaries, wages and benefits were flat year over year, and down by 20 basis points on a percentage of sales basis. We controlled our administrative headcount carefully throughout the year and leveraged our existing headcount despite the increase in sales and entrance into two new jurisdictions in the current year (New Jersey and Connecticut).
- Share based payments increased in the current year. In the current year, the trading price of our shares increased from $8.37 at January 1, 2016 to $10.53 at December 31, 2016, resulting in an increase in the share based payment expense in the current year. In the prior year, our share price declined from $15.26 at January 1, 2015 to close at $8.37 per share at December 31, 2015. This resulted in a recovery being recognized from the re-measurement of several outstanding awards in the prior year that reduced the overall share based payments expense.
- Information technology costs declined by $2.9 million or 70.6% compared to the same quarter in the prior year, as we recognized $2.4 million of costs related to the implementation of a new ERP system in the prior year. We temporarily suspended work on the implementation project in 2016.
- Administrative travel costs declined year-over-year by $0.6 million or 34.8%. Earlier in the year, we re-organized our operational leadership by appointing Chief Operating Officers of both Canada and the US, which significantly reduced cross-border travel costs.
- Legal fees declined by $1.2 million or 52.6% year-over-year due to a higher level of regulatory and legal activity being undertaken by outside counsel in the prior year.
- Consulting fees declined by $0.8 million or 47.3% compared to the same quarter in the prior year, primarily as a result of incurring $0.5 million of costs in 2015 related to the acquisition of our 51% interest in Birchfield Ventures LLC, which closed early in Q1 2016.

Other income

Other income recognized in 2016 of $0.7 million is attributable to the expected settlement of our insurance claim related to the business interruption experienced as a result of the forest fires in Fort McMurray during Q2 2016. The claim of $0.7 million was settled with our insurers subsequent to December 31, 2016.

Operating profit before amortization

Operating profit before amortization[9] for the year ended December 31, 2016 increased by $3.5 million to $40.4 million or 4.9% as a percentage of sales (2015 – $36.9 million or 4.9% as a percentage of sales). Adjusted operating profit before amortization[8] for the year ended December 31, 2016 increased by $1.6 million to $42.5 million. This increase was primarily due to the acquisition of our 51% interest in Birchfield in Q1 2016 and a reduction in our administrative expenses, which was partially offset by the increases in the selling and distribution expenses as explained above.

Adjusted operating profit before amortization[9] as a percentage of sales was 5.2%, down from 5.5% in the prior year. Due to the relatively fixed cost base of many of our store locations, the declines in same store sales in Canada and the U.S. reduced our operating profit percentage in 2016.

In addition, since January 1, 2015, the Company has opened 14 new stores in Canada and the United States. New stores generally take up to three years to mature and fully contribute to operating profit, and as such, these new stores have contributed to the decline in the adjusted operating profit as a percentage of sales. Management believes that this impact is temporary and that these new stores will positively contribute to adjusted operating profit as a percentage of sales as they mature. The Company has also closed seven stores since January 1, 2015, which has impacted operating profits due in part to costs associated with closing the stores.

Amortization

Amortization expense of $12.7 million for 2016 increased by $1.6 million from the prior year (2015 - $11.1 million). Additional amortization in the current year related to the new stores opened subsequent to January 1, 2015, the acquisition of Birchfield, and accelerated amortization recorded for store closures.

Finance Costs

Finance costs during the year ended December 31, 2016 have increased by $3.0 million compared to the prior year. In Q1 2016, we completed the acquisition of our 51% interest in Birchfield which was funded through our credit facilities and increased our borrowings and finance costs. This resulted in an increase in long-term debt compared to the prior year, resulting in an increase in finance costs compared to the same period last year.

Impairment

During the year ended December 31, 2016, the Company recorded an impairment charge of $12.8 million to the goodwill and $1.9 million to the intangible assets (retail liquor license for Massachusetts) allocated to the USA South cash generating unit grouping ("CGU"). The recoverable amount of the CGU declined in 2016 primarily related to a change in Management's forecasted sales and profitability as a result of, among other factors, increased competition in the areas that these stores operate. A reversal of previously recorded impairment charges was also recorded during the year in the amount of $1.1 million. This reversal related to

[9] See the 'Non-IFRS Financial Measures' section of this MD&A

retail liquor licenses of five stores in British Columbia where Management's forecasted sales and profitability increased due to a sustained improvement in operating results.

Also see the 'Risk Factors' section later in this MD&A and our Annual Information Form for further discussion of potential changes in the regulatory, competitive and economic environment for all regions that we operate in.

The Company also recorded a charge of $2.6 million to remove the intangible asset previously recorded as capitalized software and development costs. As discussed in the Outlook section, we are continuing to refine plans to implement a new ERP system which will likely result in a change in the chosen software solution to one that is less costly.

Fair value adjustments

Fair value adjustments are comprised of unrealized losses recorded on the non-controlling interest put option liability of $0.4 million (2015 – $nil), the purchase option of $1.1 million (2015 – $nil) for the remaining 49% of Birchfield Ventures not owned by the Company, and an unrealized gain on the interest rate swap of $0.5 million (2015 - $0.5 million unrealized loss).

Income Taxes

In 2016, an income tax recovery of $2.0 million (2015 - $14.7 million recovery) was recorded due to the impact of a significant impairment charge recorded primarily in the U.S. (higher rate jurisdiction) as discussed above.

Our estimated annual effective rate of tax will fluctuate based on the estimated proportion of income/loss attributable to each jurisdiction that the Company operates in for 2016 compared to 2015. In addition, a one-time re-measurement of our deferred income tax liability arising from the Alberta corporate income tax rate increase of $1.3 million was recorded in the prior year.

Net Earnings

For the year ended December 31, 2016, net earnings of $3.0 million were recorded (2015 – $99.4 million loss). On a per share basis, earnings per share was $0.02 for 2016 (2015 – loss of $3.64 per share). Earnings in both periods were negatively impacted by the non-cash impairment charges as discussed above, which were a total of $16.1 million for 2016 (2015 - $130.3 million).

Excluding after-tax adjusting items, adjusted net earnings[10] were $15.1 million, a decrease of $0.6 million or 3.8% compared to 2015. The decrease in adjusted net earnings is due to the increases in amortization expense and finance costs, partially offset by the increase in adjusted operating profit before amortization as discussed above. On a per share basis, adjusted earnings per share were $0.46 per share in 2016 (2015 - $0.57 per share). The decline in adjusted earnings per share was as a result of the decrease in adjusted net earnings as discussed above. Earnings available to common shareholders was also reduced by the $2.1 million of net earnings attributable to the 49% non-controlling interest of Birchfield in 2016.

[10] See the 'Non-IFRS Financial Measures' section of this MD&A

5. Liquidity and Capital Resources

Summary of Consolidated Cash Flows

(expressed in thousands)	Three months ended December 31, 2016 (unaudited)	Three months ended December 31, 2015 (unaudited)	Year ended December 31, 2016	Year ended December 31, 2015
Cash provided by operating activities	$31,954	$15,680	$47,729	$16,373
Cash used in investing activities	(3,832)	(10,432)	(34,934)	(30,557)
Cash provided by (used in) financing activities	(25,214)	(4,490)	(9,253)	14,502
Effect of exchange rate on changes in cash	116	242	(312)	469
Net increase in cash	3,024	1,000	3,230	787

Operating activities

For the three months ended December 31, 2016, cash provided by operating activities was $32.0 million, a $16.3 million increase from $15.7 million provided for the same period in the prior year. For the year ended December 31, 2016, cash provided by operating activities was $47.7 million, a $31.3 million increase from $16.4 million provided for the same period in the prior year.

For both periods, the significant increase in cash provided by operating activities was primarily a result of a decline in our overall same-store inventory levels compared to the prior year. Management has been focused on increasing inventory turns and strategically managing working capital levels.

Investing activities

For the three months ended December 31, 2016, cash used in investing activities was $3.8 million, a $6.6 million decrease from $10.4 million used for the same period in the prior year. Cash used for investing activities primarily related to assets acquired for the construction of new stores and renovations. There were fewer stores under construction in the fourth quarter of 2016 compared to the same period in 2015.

For the year ended December 31, 2016, cash used in investing activities was $34.9 million, a $4.3 million increase from $30.6 million used for the prior year, which related to the following:

- Cash used for the purchase of property and equipment of $13.4 million (2015 - $25.9 million) primarily related to assets acquired for the construction of new stores and renovations, and the settlement in Q1 2016 of accounts payable and accrued liabilities at December 31, 2015 related to property and equipment additions in 2015. While we incurred construction costs for a similar number of renovations in the current year (10 completed with four in progress at December 31, 2016) compared to the prior year (15), we constructed fewer stores in 2016 (two) compared to 2015 (12).
- Total cash consideration to acquire the 51% interest in Birchfield was $15.0 million USD, or $20.9 million CAD.
- Cash used for the purchase of intangible assets during the period was $0.7 million primarily related to capitalized software development costs to drive efficiencies in the Company's administrative processes.

Financing activities

For the three months ended December 31, 2016, cash used for repayment of debt and return of capital to shareholders was $25.2 million, compared to $4.5 million from the same period a year ago. This change primarily relates to higher operating cash flows generated in 2016 compared to the same period in 2015 being used to repay long-term debt, and a reduction of $4.5 million in cash dividends paid to shareholders.

For the year ended December 31, 2016, cash used for repayment of debt and return of capital to shareholders was $9.3 million, compared to cash provided by financing activities of $14.5 million from the same period a year ago. This is primarily as a result of:

- Higher net repayments on long term debt as a result of the repayments made on the credit facility with proceeds from the debenture offering in Q3 2016. This is slightly offset by additional borrowing required due to the acquisition of Birchfield for cash consideration of $20.9 million (US$ 15 million) in Q1 2016.
- In 2015, we generated proceeds of $5.7 million as a result of a sale-leaseback transaction related to our store in Fairbanks, Alaska.
- Reduction of $13.7 million in cash dividends paid to shareholders.

Foreign currency translation gain on cash

The accounts of the Company's subsidiaries with a U.S. dollar functional currency are translated into Canadian dollars as follows:

- Assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and
- Revenue and expense items (including amortization) are translated at the average rate of exchange for the period.

The resulting unrealized exchange gains and losses from these translation adjustments are included as a separate component of shareholders' equity in accumulated other comprehensive income. The effect of exchange rate changes on cash balances held in foreign currencies is separately reported as part of the reconciliation of the change in cash balances for the period. The U.S. dollar experienced increases and decreases against the Canadian dollar at times during the three and twelve months ended December 31, 2016, and based on the timing and level of cash held in U.S. dollars, the Company has recorded a $0.1 million gain and $0.3 million loss on cash held in foreign currency in the three and twelve months ended December 31, 2016, respectively.

Due to a decrease in the rate of exchange to translate the assets and liabilities of the Company's subsidiaries with a U.S. dollar functional currency at the current year-end date (2016 – 1.34; 2015 – 1.38), the Company recorded a $4.7 million currency translation loss in other comprehensive income (2015 - $16.8 million gain), which was offset by a $0.8 million currency translation gain on our net investment hedge.

Credit Facilities and Subordinated Debentures

On August 31, 2016, the Company and a syndicate group of lenders agreed to amend and restate the credit facility available to the Company. The primary purpose of the amendment was to extend the maturity date of the credit facility to September 30, 2019, and to increase the total size of the credit facility to $165 million plus $15 million USD. At March 7, 2017, there was approximately $22 million drawn on the credit facility. Pursuant to the terms of the credit facility, the Company has the ability to request an additional $50 million of loan availability (to be provided by the lenders on a best-effort basis).

The Company’s credit facility is subject to a number of financial covenants. Under the terms of the Company’s credit facility, the following ratios are monitored: funded debt to EBITDA, adjusted debt to EBITDAR, and fixed coverage ratio. The amendment resulted in an increase in the fixed charge coverage ratio covenant of greater than or equal to 1.05:1.00 commencing April 1, 2017 (from 1.00:1.00). The remaining financial covenants were unchanged. There are no financial covenants attributable to the Company’s convertible unsecured subordinated debentures due April 30, 2018 or January 31, 2022.

Funded debt to EBITDA ratio

Funded debt is defined as all of the Company’s obligations, liabilities and indebtedness which would, in accordance with IFRS, be classified on a consolidated statement of financial position 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 $4.5 million in any fiscal year, write downs of goodwill and intangible assets, restructuring charges for stores, 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. We are also permitted to include a trailing twelve months of estimated EBITDA for any new acquisitions.

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, 2016, the Company was in compliance with all financial covenants, as set forth below:

Ratio	**Covenant**	**As at December 31, 2016**
Funded debt to EBITDA	< 3.50:1.00	0.01
Adjusted debt to EBITDAR	< 5.00:1.00	3.12
Fixed charge coverage	> or = 1.00:1.00	1.31

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.

5.85% Debentures

The Company has $67.5 million in aggregate principal amount of convertible unsecured subordinated debentures due April 30, 2018 (the "5.85% Debentures"). The 5.85% 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, the first interest payment having been paid on October 31, 2012. The 5.85% 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.

On and after April 30, 2015 and prior to April 30, 2017, the 5.85% Debentures may be redeemed by the Company, in whole or in part from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided that the volume-weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending five trading days prior to the date on which notice of redemption is provided is at least 125% of the Conversion Price. On or after April 30, 2017 and prior to the maturity date, the Company may, at its option, redeem the 5.85% Debentures by way of cash payment or through the issuance of common shares, in whole or in part, from time to time at par plus accrued and unpaid interest.

4.70% Debentures

On September 29, 2016 the Company issued $67.5 million principal amount of convertible unsecured subordinated debentures and on October 4, 2016 the Company issued an additional $10.1 million upon exercise of the over-allotment option of the underwriters (collectively, the "4.70% Debentures") for a total aggregate principal amount of $77.6 million. The 4.70% Debentures are due January 31, 2022 and bear interest at a rate of 4.70% per annum, payable semi-annually in arrears on January 31 and July 31 of each year, commencing July 31, 2017. The 4.70% Debentures are convertible at any time at the option of the holders into common shares of the Company at a conversion price of $14.60 per share.

The 4.70% Debentures will not be redeemable prior to January 31, 2020. On or after January 31, 2020 and prior to January 31, 2021, the 4.70% Debentures may be redeemed by the Company, in whole or in part from time to time, on not more than 60 days and not less than 30 days prior notice at a redemption price equal to their principal amount plus accrued and unpaid interest, if any, up to but excluding the date set for redemption, provided that the volume-weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending five trading days prior to the date on which notice of redemption is provided is at least 125% of the Conversion Price. On or after January 31, 2021 and prior to the maturity date, the Company may, at its option, redeem the 4.70% Debentures by way of cash payment or through the issuance of common shares, in whole or in part, from time to time at par plus accrued and unpaid interest.

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 7, 2017, the Company has undrawn credit of approximately $130 million under its credit facility available to finance operating requirements, growth opportunities and for general corporate purposes.

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 entered into a forward starting interest rate swap effective on December 14, 2015 and expiring December 14, 2019, to fix the effective interest rate on a notional $60 million of principal debt with a rate equivalent to 1.23% plus the applicable credit spread determined with reference to the credit facility. At March 7, 2017, the fixed rate paid by the Company on the notional amount of the interest rate swap is 2.73% per annum after taking into account the applicable credit spread determined with reference to the credit facility. 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.

Due to the nil amount drawn on the Company's credit facilities and the fixed rate of interest on the Company's subordinated convertible debentures, an increase/decrease of 1.00% in market interest rates would result in a nominal decrease/increase in the Company's finance expense, net earnings, and net earnings per share.

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; 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. Refer to the Performance Overview section of this MD&A where we highlight the impact that translating our U.S. dollar denominated sales into Canadian dollars have had on our consolidated sales of the Company.

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. This exposure primarily relates to U.S. intercompany management fees, interest payments, and dividends which totalled US$3.7 million for the year ended December 31, 2016.

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

Contractual Obligations

The table below sets forth, as of December 31, 2016, the contractual obligations of the Company due in the years indicated and relate to various premises operating leases, finance leases for a portion of our vehicles, software licenses and maintenance, long-term debt (no amounts were drawn at December 31, 2016) and convertible unsecured subordinated debentures.

(expressed in thousands)	**2017**	**2018**	**2019**	**2020**	**2021**	**2022 and thereafter**
Operating leases	32,902	30,363	26,444	23,060	20,030	56,274
Finance leases	323	290	276	95	9	-
5.85% Debentures	-	67,500	-	-	-	-
4.70% Debentures	-	-	-	-	-	77,625
Software licenses and maintenance	297	-	-	-	-	-
Total	33,522	98,153	26,720	23,155	20,039	133,899

6. Analysis of Consolidated Financial Position

Selected accounts (Cdn $000's)	**As at December 31, 2016**	**As at December 31, 2015**
Cash	7,020	3,790
Accounts receivable	3,184	6,020
Inventory	155,425	157,102
Total current assets	176,009	178,000
Property and equipment	63,674	64,781
Intangible assets	46,690	43,312
Goodwill	158,318	158,987
Total assets	463,047	455,554
Accounts payable and accrued liabilities	67,857	61,628
Dividends payable	830	2,470
Total current liabilities	69,461	64,795
Long-term debt	135,838	129,566
Total liabilities	227,652	199,818

The Company has a significant investment in working capital that is primarily due to the Company being required, consistent with other liquor retailers, to pay for inventory prior to receiving it in Alberta and British Columbia. As we do not have traditional payment terms on our inventory in those jurisdictions, our working capital is higher in these regions compared to that in Kentucky, Alaska and other jurisdictions in the US where we operate, where we generally have 30-day trade payment terms. At December 31, 2016, net working capital (current assets, excluding cash, less current liabilities) was $99.5 million, a $9.9 million or 9.0% decrease from the comparative period last year (2015 - $109.4 million). This decrease is primarily attributable to the reduction in inventory levels on a same-store basis in the current year.

Effective January 4, 2016, the Company acquired a 51% ownership interest in Birchfield Ventures LLC ("Birchfield") for USD $15 million and obtained the right to acquire the remaining 49% interest at pre-negotiated terms. The acquisition was funded using the Company's existing credit facilities. This acquisition increased our assets and liabilities as discussed further below.

The discussion below analyzes certain changes in the Company's consolidated financial position compared to December 31, 2015:

- Accounts receivable decreased by $2.8 million to $3.2 million as at December 31, 2016 primarily as a result of decrease in income taxes recoverable and tenant improvement allowances receivable related to new stores and store renovations completed in 2015.

- Inventory decreased by $1.7 million to $155.4 million as at December 31, 2016 primarily due to a $12.1 million decrease in inventory levels on a same store basis, partially offset by a $10.4 million increase for inventory for new stores that opened and were acquired during the year, net of store closures. The decrease in inventory on a same store basis was as a result of Management's focus on increasing inventory turns.

- The carrying value of property and equipment was $63.7 million, a $1.1 million decrease from the prior year end (December 31, 2015 - $64.8 million). Additions during the period of $10.7 million (2015 - $27.1 million) were related to the construction costs for new stores which were under development in the period in Lethbridge, Alberta and Norwalk, Connecticut, store renovations and maintenance capital expenditures. The acquisition of our 51% interest in Birchfield in Q1 2016 added $1.2 million of property and equipment. Disposals during the year were $0.1 million (2015 - $5.5 million related to the disposition of property in Fairbanks, Alaska, and $0.3 million of disposals in the normal course of operations). Amortization during the period was $12.3 million (2015 - $10.8 million). Foreign exchange differences on property and equipment assets held in the U.S. resulted in a decrease in the carrying value of $0.6 million (2015 – $3.3 million increase).

- Intangible assets increased by $3.2 million to $46.4 million as at December 31, 2016 primarily due to the intangible assets recognized from the Birchfield acquisition in Q1 2016 and impairment charges of $3.6 million as previously discussed in this MD&A.

- Goodwill decreased by $0.7 million to $158.3 million as at December 31, 2016 primarily due to $12.8 million of impairment charges as previously discussed in this MD&A being nearly offset by the goodwill recognized related to the Birchfield acquisition in Q1 2016.

- Accounts payable and accrued liabilities increased by $6.2 million to $67.9 million as at December 31, 2016 primarily due to the addition of Birchfield's accounts payable.

- Long-term debt was $135.8 million at December 31, 2016, a $6.2 million increase from the prior year end (December 31, 2015 - $129.6 million). This increase is the result of additional debt required to finance the Birchfield acquisition, net of repayments that have occurred throughout the year as a result of higher operating cash flows.

As at December 31, 2016 and March 7, 2017, the Company did not have any off-balance sheet arrangements in place, other than the operating leases identified under the heading Contractual Obligations.

7. Shareholders' Equity

At December 31, 2016, the Company had 27,664,070 common shares outstanding. The basic and diluted weighted average number of common shares outstanding for the year ended December 31, 2016 was 27,594,903 and 27,751,063, respectively (compared to 27,329,145 and 27,376,270, respectively, for the comparative period for both basic and diluted weighted average number of common shares outstanding). As at March 7, 2017, 27,678,592 common shares of the Company were issued and outstanding.

8. Dividends

Dividend Policy

Up to and including the dividend declared on February 15th, 2016, the Company paid a monthly dividend of $0.09 per Common Share. On March 9, 2016 the Company announced a reduction in its dividend to $0.03 per Common Share. Dividends are paid, if declared, on or about the 15th day of each month to Shareholders of record at the end of the previous month.

The amount of future cash dividends, if any, will be subject to the discretion of the Board of Directors and may vary depending on a variety of factors and conditions existing from time to time, including the prevailing economic and competitive environment, Liquor Stores' results of operations and earnings, financial requirements for Liquor Stores' operations and the execution of its growth strategy, fluctuations in working capital, capital expenditures and debt service requirements, contractual restrictions and financing agreement covenants, the satisfaction of solvency tests imposed by the CBCA for the declaration and payment of dividends, and other factors and conditions existing from time to time. Depending on these and various other factors, many of which are beyond the control of the Board and Liquor Stores' management team, the Board may change our dividend policy from time to time, and as a result, future cash dividends could be reduced or suspended entirely. The market value of the Common Shares may deteriorate if the Board reduces or suspends the amount of cash dividends that Liquor Stores pays in the future and such deterioration may be material. See "*Risk Factors*".

Although it is expected that dividends declared and paid by us will qualify as "eligible dividends" for the purposes of the *Income Tax Act* (Canada), and thus qualify for the enhanced gross-up and tax credit regime available to certain holders of Common Shares, no assurances can be given that all dividends will be designated as "eligible dividends" or qualify as "eligible dividends".

The agreement governing Liquor Stores' Credit Facility contains provisions which restrict its ability to pay dividends to Shareholders in the event of the occurrence of certain events of default. The full text of the agreement governing Liquor Stores' Credit Facility is available on SEDAR at www.sedar.com. For additional information regarding the Credit Facility, see note 10 to Liquor Stores' audited consolidated financial statements for the year ended December 31, 2016, and "Liquidity and Capital Resources" section within this MD&A.

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 from treasury 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, 2017, shareholders enrolled in the DRIP held approximately 2,378,392 million shares.

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

9. Related Party 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, 2016, the Company incurred expenses in the normal course of business for professional fees of $50 thousand (2015 - $86 thousand) paid to a law firm of which a director of the Company was a partner and recognized professional fees of $34 thousand (2015 - $50 thousand) from this same firm in the carrying value of long-term debt. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. Subsequent to December 31, 2016, the director is no longer a partner of this law firm.

10. 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.

11. Business Overview

Liquor Stores is a leading liquor retailer in the North American marketplace. We have a strong base in western Canada and we are a market leader in Kentucky and Alaska. 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 (in each case based upon number of stores and revenue). We have positioned our business to attract both customers who are focused on convenience and those who are looking for a destination-type shopping experience.

The Company's common shares and convertible unsecured subordinated debentures trade on the Toronto Stock Exchange (the "TSX") under the symbols "LIQ", "LIQ.DB.A" and "LIQ.DB.B".

The Company primarily 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; "Liquor Barn, and The Ultimate Party Source" and "Liquor Barn Express" in Kentucky; "Joe Canal's Discount Liquor Outlet" in New Jersey and "LQR MKT" in Connecticut.

As of March 7, 2017, the Company operated or had an interest in 252 stores in Alberta, British Columbia, Alaska, Kentucky, New Jersey and Connecticut, comprised of 17 destination/large-format stores, 233 full liquor stores, and two wine only stores. Product selection is tailored to each location. Stores in Canada generally range in size, on average, from 2,000 to 5,000 square feet. Our U.S. stores are larger in size. The Company's stores in Alaska range in size from 1,400 to 14,000 square feet and we have one combined store and warehouse in excess of 40,000 square feet. Our Kentucky stores range in size from 2,700 to 30,000 square feet along with a flagship store of 44,000 square feet. Our New Jersey stores, of which we hold a 51% interest are destination/large format stores with areas of approximately 17,000 and 25,000 square feet, respectively. Our destination/large format store in Connecticut is approximately 20,000 square feet. Our two large Wine & Beyond stores, our destination/large format stores in Alberta, with areas of approximately 17,000 and 20,000 square feet, respectively, are the largest liquor retail stores in western Canada. We added a third Wine & Beyond store in Alberta in Q4 2015, with a slightly smaller footprint than our existing Wine & Beyond stores.

The following provides a summary of the Company's locations as at March 7, 2017 (the only change from December 31, 2016 being the closure of one location in Calgary as discussed in footnote 5 below):

	January 1/16 to March 7/17				
	1-Jan-16	**Opened**	**Acquired**	**Closed[5]**	**7-Mar-17**
Alberta					
Edmonton[1]	83	-	-	-	83
Calgary[1]	45	-	-	(2)	43
Other[2]	52	1	-	(1)	52
	180	1	-	(3)	178
British Columbia					
Interior	11	-	-	(1)	10
Lower Mainland	13	-	-	-	13
Vancouver Island	11	-	-	-	11
	35	-	-	(1)	34
Alaska					
Anchorage	18	-	-	-	18
Other[3]	4	-	-	-	4
	22	-	-	-	22
Kentucky					
Lexington	6	-	-	-	6
Louisville	6	-	-	-	6
Other[4]	3	-	-	-	3
	15	-	-	-	15
New Jersey					
Lawrenceville	-	-	1	-	1
Woodbridge	-	-	1	-	1
	-	-	2	-	2
Connecticut					
Norwalk	-	1	-	-	1
	-	1	-	-	1
Total	**252**	**2**	**2**	**(4)**	**252**

Notes:

(1) References to Edmonton and Calgary are to stores located in or near those urban centres.

(2) Other stores in Alberta by region: Northern (25), Southern (10), Central (15) and resort communities (two).

(3) Other communities served in Alaska include Wasilla (three) and Fairbanks (one).

(4) Other communities served in Kentucky include Danville, Bowling Green and Elizabethtown.

(5) The stores closed by region:

  a. *Calgary – one store closed due to underperformance and one store closed due to a consolidation of the Company's warehousing operations (closed subsequent to December 31, 2016).*
  b. *Other Alberta – one store closed in Grande Prairie due to underperformance.*
  c. *Interior British Columbia – one store closed due redevelopment of the property to residential.*

Competitive Differentiation

Management focuses on differentiating the Company's stores from the competition by promoting a broad selection of products, by emphasizing our in-store customer experience, and through continued marketing and development of well-known industry-leading brands. Management believes that its emphasis on offering a range of stores from large-format/destination-type stores (with a strong focus on product selection and customer experience) to convenience-focused stores (convenient and high-traffic locations) assists the Company in differentiating itself from its competitors.

Seasonality

The retail liquor industry is subject to seasonal variations. The Company's sales are typically lowest early in the year and increase in the latter half. In 2016, 21% (2015 - 20%) of annual same store sales occurred in the first quarter, 25% (2015 - 26%) in the second quarter, 26% (2015 - 26%) in the third quarter, and 28% (2015 - 28%) in the fourth quarter. Our working capital requirements are greatest in the second and third quarters as we ramp up inventory for the summer and the holiday seasons, respectively.

Policy on Same-Store Sales Comparisons

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. Same-store sales exclude: (i) all sales to wholesale customers, (ii) stores where same-store sales have been negatively impacted due to sales being shifted to closely-located convenience-focused stores we have opened in the last 12 full months (iii) stores where same-store sales have increased due to the closure of closely-located stores in the last 12 full months, and (iv) stores where sales have been suspended due to a fire, evacuation, or natural disaster in the last 12 full months.

12. Business Strengths

We attribute our success to the following competitive strengths:

Our Brands - The retail liquor store industry in Alberta, British Columbia, Kentucky, Alaska, Connecticut and New Jersey is a fragmented market. We operate some of the leading liquor retail brands in our respective markets. Our brands include:

Liquor Depot/Liquor Barn – Convenience-focused stores located in Alberta and British Columbia, focused on convenient locations and store layouts, and great selection at fair prices.

Wine and Beyond – Destination/large-format stores located in Alberta that are dedicated to having a great selection of wine, spirits and beer and strong customer service.

Wine Cellar – Wine centric stores located in British Columbia, with a unique wine selection and a staff as passionate as our customers about the product that we sell.

Brown Jug - Convenience-focused stores located in Alaska, focused on convenient locations and store layouts, and great selection at fair prices.

Liquor Barn, The Ultimate Party Source - Destination/large-format stores located in Kentucky that are dedicated to having the best selection of wine, spirits, beer, and party supplies and strong customer service.

Liquor Barn Express - Convenience-focused stores located in Kentucky, focused on convenient locations and store layouts, and great selection at fair prices.

Joe Canal's Discount Liquor Outlets - Destination/large-format stores located in New Jersey, focused on high-traffic locations, dedicated to have a great selection of wine, spirits, beer at fair prices.

LQR MKT – Destination/large-format store located in Connecticut that is dedicated to having a great selection of wine, spirits and beer and strong customer service.

Location - Liquor Stores' business model is based on highly visible and accessible store locations. We endeavour to locate our stores in areas where access to customers is maximized such as near grocery stores or on main arteries in or near residential areas. Approximately 60% of Liquor Stores' Canadian outlets are located in or near shopping centres with major grocery stores or other anchor tenants. With respect to its U.S. operations, Management believes that location is a key factor in the success of a liquor store and consequently we endeavour to locate our stores in high-traffic areas and major thoroughfares. Although very few of Liquor Stores' U.S. outlets are located in or near shopping centers with grocery stores and large anchor tenants, Management believes its U.S. stores enjoy easy-customer access and enhanced street visibility.

Product Selection - Our stores offer an impressive selection of wine, spirits, coolers, liqueurs, beer, and specialty products. Product selection is individually tailored to our store brands and formats. In our convenience-focused stores, product selection varies between 1,000 and 4,000 wine, spirit, cooler and beer items, which management believes is a larger product selection and inventory than the industry average. Our Wine and Beyond large-format "destination" stores offer over 10,000 items. New, exclusive and private label varieties and products arrive in our stores throughout the year. Similar to our Wine and Beyond stores, our U.S. stores offer a significantly larger product selection than our convenience-focused stores, and although selection is again location-specific, alcoholic product selection in certain U.S. stores generally exceeds 7,000 items. In addition, we sell non-alcoholic beverages including pop, juice, bottled water and mixes, along with accessories for gift giving and everyday use such as gift bags, wine charms, bottle stoppers, aerators, bar supplies and unique items. In Kentucky, we have a specialty grocery offering focused on party and entertainment food items such as cheese, deli meats, olives, chips and crackers, desserts, and select frozen food items.

Effective Sales Staff - We pride ourselves on our customer service with employees who are well-versed in each liquor category to best serve our customers. We strive to have dedicated staff with product knowledge that they are enthusiastic to share. Liquor Stores endeavours to maintain product knowledgeable managers, assistant managers and line staff through frequent seminars and training. In 2013, we implemented a new company-wide training program called Liquor Stores University ("LSU") offered in person and online, with a goal of further fostering a customer-focused sales-driven culture in our stores. All new staff members receive training in Company policies and basic product knowledge, selling skills, operations overview, loss prevention and robbery prevention. Additionally, approximately 86% of employees have "graduated" from LSU's core courses. In the destination/large-format stores, store staff includes well-trained wine, beer, and spirits specialists. All store managers have received a more robust training in sales, customer service, workforce management, and store operational training, in addition to training on how to properly merchandise and sell our private label products.

Strategic Markets - Management's primary strategy in Canada and the United States is to focus on urban centres such as the Calgary, Edmonton, Vancouver, and the Anchorage, Louisville and Lexington metropolitan areas together with other urban areas in targeted markets in the United States for potential growth opportunities, primarily in the Northeast of the United States. Here we find the best opportunities for larger per store revenues and likelihood of population increases. While our focus is primarily on urban centres, we also have stores in other communities including rural or smaller urban centres where demographic and economic conditions warrant, such as those with resource-based economies. Such communities include Ft. McMurray, Alberta (seven stores), Grande Prairie, Alberta (eight stores) and our destination/large-format store in Fairbanks, Alaska.

Store Design and Format - Liquor Stores generally designs its stores to optimize traffic flow and present its products in an upscale environment. Management has recently initiated a store "refresh" program and intends to update, modernize and refurbish a large number of stores. Our stores feature wooden cases and tasteful shelving as a primary display mechanism. Innovative new store layouts feature a fresh, contemporary design and interactive experiences. In certain stores, we offer in-store tasting sessions, seminars, recipes, social events and other in-store initiatives to enhance our customers' experience and to promote new products.

Economies of Scale - Liquor Stores' leading market position, large-scale operations (relative to most other industry participants), and cross-border presence provide it with a number of competitive advantages including: the benefit of operating efficiencies relative to non-liquor expenses (including finance, marketing, human resources, and corporate); and greater access to capital. In our US markets, we benefit from purchasing efficiencies and we have the ability to negotiate volume-discounts on our liquor purchases in many jurisdictions. Connecticut law prohibits manufacturers and wholesalers from discriminating amongst purchasers when offering price discounts. However, in this context, "discrimination" only occurs if all retailers purchasing similar amounts were not offered the same discount. As such, in effect, volume discounts do exist. Connecticut law also prohibits manufacturers and wholesalers from allowing any discount, rebate, free goods, allowance, or other inducement to make sales or purchases. As we continue to expand in the U.S., we expect our competitive purchasing advantage to increase.

Stable and Growing Industry – The retail liquor business in our current geographic markets is characterized by relatively stable demand. Total sales in Alberta grew by 5.7%, and by 5.1% in British Columbia during the year ended March 31, 2016. Comparable annual sales information is not readily available for Alaska, Kentucky, New Jersey or Connecticut.

13. Company Strategy

As previously communicated, we are focused on the following Seven Point Plan (the "Plan") to build on our competitive position, invest in opportunities to support long-term profitability and drive growth across our business:

- Enhance the Senior Leadership Team
- Invest in our People
- Implement an Industry Leading Information Technology Platform
- Invest in our Store Network
- Increase Brand Awareness and Loyalty
- Increase Operating Profits
- Pursue Expansion

In 2016, the Company achieved or partially achieved its objectives against this plan. In 2017, Liquor Stores intends to build on our successes to date with expansion of initiatives related to investment in people, brand awareness and loyalty and product selection designed to increase operating profits.

Liquor Stores has also adopted a measured approach to growth that we can scale up or down depending on market conditions. The goal is to advance our Seven Point Plan initiatives to invest in the store network and pursue expansion, while ensuring that the Company can continue to withstand the current period of economic pressure in Alberta while being positioned to emerge from these headwinds and increase our profitability.

The following is a summary of our 2016 Seven Point Plan goals as included in our 2015 MD&A and our progress made in achieving them in 2016, along with a summary of our 2017 goals:

Business Strategy	Goals for 2016	2016 Progress	Goals for 2017
1. Enhance the Senior Leadership Team We have an opportunity to drive sales and further improve profitability of the current business, and further position the Company for growth in new markets by hiring certain key executives with deep retail experience in both Canada and the United States.	N/A – completed in 2015	N/A – completed in 2015	N/A – completed in 2015
2. Invest in our People We have an opportunity to attract more customers to existing locations and increase sales per customer by improving our customer	Program Expansion Deliver our sales, workforce management and store operational training programs to at least 90% of our store	**Status:** Achieved During the year we continued developing and delivered new training material to our staff and met our goal to deliver this training	Continued Program Expansion Deliver our sales, workforce management and store operational training programs to our remaining

service. Our investments will include enhancing our hiring and retention strategies, the introduction of industry leading training programs, implementing competitive store level compensation and benefit programs, and a focus on providing our employees with career and performance management.	managers by the end of 2016. Enhance our current store level incentive program to continue to further align our store teams with our strategy related to private label products by adding further stretch goals to increase our private label penetration even further.	program to over 90% of our store managers. We have also implemented an enhanced store level incentive program which adds further stretch goals to increase the penetration of our private label program.	store managers by the end of 2017. Make enhancements to our performance management process and coaching programs to improve employee engagement. Implement enhancements to our loss prevention strategies to continue to improve the safety and security of our employees.
3. Implement an Industry Leading Information Technology Platform We have an opportunity to build on our competitive position by implementing a new enterprise resource planning ("ERP") system that will drive new efficiencies into our organization, provide enhanced visibility into business operations that will drive down costs, and provide a scalable growth platform that will allow us to grow organically and smoothly integrate newly acquired business.	Deferred - Dependent on Market Conditions Continue to evaluate economic conditions throughout the year, and if they show a sustained improvement, develop a revised implementation schedule.	**Status: N/A – deferred due to market conditions**	Re-commence the project Develop a revised implementation schedule and software solution to reduce cost and complexity, and improve the return on investment of the project. Re-commence the project during 2017 through a phased implementation approach where a small number of stores will have an initial end-to-end implementation for further testing and optimization prior to the new system being rolled out across the Company.
4. Invest in our Store Network We have an opportunity to attract more customers to existing locations and increase sales per customer through renovating and refreshing our existing stores, and by implementing a consistent store layout and design across our network to further enhance our brand with our customers.	Measured Growth - Dependent on Market Conditions Invest approximately $2.5 million on store refurbishments. This investment could adjust higher or lower depending on volatility of economic conditions in our key markets. Continue to evaluate economic conditions throughout the year, and if they show a sustained improvement, develop a revised store renovation schedule.	**Status: Achieved** The Company has deployed the $2.5 million committed to store refurbishments. Ten renovations were completed prior to the end of 2016, with four additional renovations in progress and anticipated to be completed in Q1 2017.	Renovate/refresh 5% to 8% of our existing stores in 2017. This range has been set to allow for the number of projects to be scaled up or down depending on economic conditions and the Company's financial position.

5. Increase Brand Awareness and Loyalty We will continue to increase our brand awareness and customer loyalty through investment in our store network, our marketing strategy, our digital marketing initiatives, and our brand advertising and public relations efforts.	Expansion Continue to enhance our customer relationship management strategy, and grow the number of customers enrolled in this program in 2016. Continue to increase selection and promotion of private label and control brands that customers enjoy and will only find in our stores.	**Status:** Achieved We continue to enhance our marketing and promotion strategies, with a focus on digital forms of advertising to increase our brand awareness and sign-ups in our customer relationship management program, the Celebration Members Club, which grew membership by over 20% in the current year. We added 73 new private label wine products in the current year, along with 34 new private label spirit products.	Continued Expansion Continue to enhance our customer loyalty program, and grow the number of customers enrolled in this program in 2017.
6. Increase Operating Profits We have the opportunity to continue to improve our operating profits by leveraging our fixed occupancy costs and scalable infrastructure.	Expansion Continue to implement product assortment plans (i.e. planograms) into our store locations in 2016. Continue to increase selection and promotion of private label and control brands that customers enjoy and will only find in our stores.	**Status:** Achieved We are currently implementing product assortment plans into all new and renovated stores, and into a selection of our existing stores. Our merchants have been focused on sourcing exclusive and control brands from our suppliers. Control/exclusive brand sales as a percentage of their respective categories continue to grow.	Expansion Continue to increase selection and promotion of private label and control brands that customers enjoy and will only find in our stores. Increase gross margin rates through dynamic price optimization strategies.
7. Pursue Expansion We plan to strategically expand our business in existing markets in Canada and the United States, and explore modest growth into select new markets in the United States over the next several years. We believe that brand positioning and emphasis on in-store experience for our customers will have a strong appeal.	To adjust to current economic conditions, the Company expects to open four to seven new stores over the next 24 months. The Company will continue to monitor economic conditions and evaluate plans for 2017 new store constructions in due course. Management will continue to evaluate and assess potential store acquisitions for their ability to add accretive cash flow and create shareholder value.	**Status:** Achieved We completed the acquisition of Birchfield, operating two large format stores in New Jersey. We opened our first LQR MKT location in Norwalk, CT in October 2016, a new region for the Company. In July 2016, we opened a new convenience format store in Lethbridge, Alberta. We were successful in the Request for Proposal process for a new private retail license granted for Saskatoon, Saskatchewan, which we expect to be constructed and open in 2018.	Continued expansion through new store growth in Canadian markets and through modest levels of expansion in the U.S. should the right opportunities arise. Relocate two existing British Columbia stores to more desirable locations. Open a new large format Wine and Beyond location in Calgary, AB in fall 2017. Evaluate opportunities to open 2-3 new locations in Alberta to protect our competitive position and grow market share.

14. Industry Regulation and Competitive Environment

Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. We currently operate 178 liquor stores in Alberta where there are 1,442 retail liquor stores[11]. Our "Liquor Depot" and "Liquor Barn" trade names are well recognized throughout the province as leading alcoholic beverage retailers.

We operate 34 stores in British Columbia. British Columbia's model for liquor distribution is a blend of 730 private stores and 200 government operated stores[12].

We operate 22 stores in Alaska, with 18 stores in the greater Anchorage area, three stores in Wasilla, and one in Fairbanks. Save for limited community liquor stores 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. In Alaska, there are 365 retail liquor stores with 114 stores in the greater Anchorage, Wasilla and Fairbanks areas[13]. The Company's "Brown Jug" trade name is well recognized throughout the state as a leading alcoholic beverage retailer.

We operate 15 stores in Kentucky of which seven are large format stores with six stores in Lexington (Fayette County), six stores in Louisville (Jefferson County), and one store in each of Danville (Boyle County), Bowling Green (Warren County), and Elizabethtown (Hardin County). In 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 1,005 package retail license stores in Kentucky with 289 in Jefferson County, 88 in Fayette County, 8 in Boyle County, 24 in Warren County, and 21 in Hardin County[14].

In Connecticut and New Jersey, retail alcohol sales are conducted by private industry. In these jurisdictions, the liquor retail market is competitive and ownership of private retail liquor stores is fragmented.

15. Critical Accounting Estimates and Accounting Policies

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 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

[11] Source: Alberta Gaming and Liquor Commission, as at February 2017.
[12] Source: British Columbia Liquor Distribution Branch, as at February 2017.
[13] Source: Alaska's Alcoholic Beverage Control Board, as at February 2017.
[14] Source: Kentucky's Alcoholic Beverage Control Board, as at February 2017.

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.

The Company's summary of significant accounting policies, estimates and critical judgments are contained in note 3 to the audited consolidated financial statements.

16. Non-IFRS Financial Measures

Same-store sales, operating profit before amortization, operating profit before amortization as a percentage of sales, adjusted operating profit before amortization, adjusting items, adjusted net earnings, and adjusted basic and diluted earnings per share are not measures recognized by IFRS and do not have a standardized meaning prescribed by IFRS. Investors are cautioned that these measures 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 the aforementioned non-IFRS measures may differ from the methods used by other issuers. Therefore, these measures may not be comparable to similar measures presented by other issuers.

- Same-store sales include 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. Same-store sales exclude: (i) all sales to wholesale customers, (ii) stores where same-store sales have been negatively impacted due to sales being shifted to closely-located convenience-focused stores we've opened in the last 12 full months, and (iii) stores where same-store sales have increased due to the closure of closely-located stores in the last 12 full months, and (iv) stores where sales have been suspended due to a fire, evacuation, or natural disaster in the last 12 full months.

- Operating profit before amortization for purposes of disclosure under "Operating Results" has been derived by subtracting selling and distribution expenses and administrative expenses from the aggregate of gross margin and other income. Operating profit before amortization as a percentage of sales is calculated by dividing operating profit before amortization by sales.
- Adjusted operating profit before amortization represents operating profit before amortization 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 *'Performance Overview'* section.
- Adjusted net earnings or loss is calculated as net earnings or loss 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 or loss per share is calculated as adjusted net earnings or loss divided by basic or diluted weighted average number of common shares outstanding.

Management believes the presentation of same-store sales, operating profit before amortization, adjusted operating profit before amortization, 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 of our recurring financial results. Management uses adjusted operating profit before amortization to set targets and assess performance of the Company.

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.

Refer below for a reconciliation of operating profit before amortization and net earnings (loss) to adjusted operating profit before amortization and adjusted net earnings:

	Three months ended December 31,		**Year ended December 31,**	
(expressed in thousands)	**2016** (unaudited)	**2015** (unaudited)	**2016**	**2015**
Operating profit before amortization	$13,265	$11,878	$40,366	$36,870
Adjusting items:				
Expected settlement of business interruption claim	(704)	-	-	-
Early termination of leases in conjunction with store closures and exits of leases for planned new stores	845	-	1,199	-
Restructuring costs in right-sizing operating and administrative spend	-	-	696	
Legal, professional and travel fees incurred in evaluating potential acquisitions	-	458	195	719
Costs associated with implementing a new enterprise resource system	-	465	-	1,240
Onerous contracts associated with delayed implementation of new enterprise resource management system	-	1,170	-	1,170
Payments to a former member of senior management team upon departure from the Company	-	-	-	675
Payments made to members of a regional operations team upon termination	-	-	-	220
Total adjusting items	141	2,093	2,090	4,024
Adjusted operating profit before amortization	$13,406	$13,971	$42,456	$40,894

	Three months ended December 31,		**Year ended December 31,**	
(expressed in thousands)	**2016** (unaudited)	**2015** (unaudited)	**2016**	**2015**
Net earnings (loss)	($4,856)	($105,808)	$2,953	($99,392)
Adjusting items:				
Total adjusting items impacting operating profit per above	141	2,093	2,090	4,024
Impairment loss related to goodwill and intangible assets	16,153	130,313	16,153	130,313
Tax effect of adjusting items	(5,551)	(20,009)	(6,067)	(20,513)
Re-measurement of opening net deferred tax liabilities for change in Alberta corporate tax rate on July 1, 2015	-	-	-	1,290
Adjusted net earnings	$5,887	$6,589	$15,129	$15,722

17. Risk Factors

The following is a summary of certain risk factors relating to the affairs and business of Liquor Stores. 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 and our Annual Information Form. Shareholders and potential Shareholders (and other security holders) should consider carefully the information contained herein and, in particular, the following risk factors. These risks and uncertainties are not the only ones facing Liquor Stores. Additional risks and uncertainties not currently known to Liquor Stores, or that Liquor Stores currently considers immaterial, may also impair the business and operations of Liquor Stores. If any of these risks actually occur, the business, sales, financial condition, liquidity or results of operations of Liquor Stores could be materially adversely affected, with a resulting decrease in or elimination of the dividends paid on, and the market price of, the Common Shares.

Risks Related to Liquor Stores' Business

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, Connecticut, Kentucky and New Jersey. Decisions by the Alberta Gaming and Liquor Commission ("AGLC"), British Columbia Liquor Control and Licensing Branch ("BCLCLB"), Alaska Alcoholic Beverage Control Board ("ABCB"), Connecticut Liquor Control Commission ("CLCC") ,the New Jersey Division of Alcoholic Beverage Control (the "NJABC") 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 CLCC, the KYABC, the NJABC or other governmental entities (including state, provincial, county, municipal, or other local governments) or applicable courts.

Of particular note:

Alberta

City of Edmonton

The pre-existing bylaw regulations required liquor stores to be located at least 500 metres (the "500m Zoning Bylaw") away from each other (subject to grandfathering).

On December 12th, 2016, Edmonton City Council approved changes to the way its planning Bylaw regulates the separation distance between liquor stores on and around larger commercial sites within certain areas in Edmonton (suburban). This change, in effect, creates an exemption area to the existing bylaw, if certain conditions are met, that required liquor stores be 500 metres apart. The changes to the Bylaw allow liquor stores to be within 500 metres each other if:

1. the liquor stores are located on separate “sites” (as that term is defined in the bylaw);
2. the liquor stores are located outside the boundary of the non-exemption area prescribed in the bylaw; and
3. at least one of the liquor stores is located on a site greater than 2.5 hectares in size and on a Direct Control or commercially zoned Site.

The exemption to the separation distance requirement will provide some opportunity to establish additional liquor stores to Liquor Stores and its competitors on and around large commercial sites in suburban areas, while maintaining the general requirement to have 500 metres between new liquor stores in identified central non-exempted neighbourhoods.

The 100 meter separation distance requirement remains unchanged for sensitive locations such as parks, schools, community league buildings and recreation centres.

British Columbia

As noted above, on April 1st, 2015, the 73 recommendations from the Liquor Policy Review Report were, or are in the process of being, implemented. Management believes these changes will assist in creating greater business efficiencies including: new rules permitting the warehousing of inventory, the ability to transfer inventory between stores, the retention of the existing “1 km rule” that requires that no new liquor retailer be located within 1 km of an existing liquor retailer, and the elimination of the existing “5 km rule” that currently limits liquor retailers from relocating their license outside of a 5 km radius of their current location. The Report also included recommendations that could lead to, over the long-term, increased competition for liquor retail sales in that province, including a recommendation to introduce liquor sales into grocery stores. While grocery stores have been permitted to sell liquor since April 1st, 2015, as noted above, as of the date hereof Liquor Stores is not aware of any currently doing so with a full service “store-within-store” concept. The impact thus far on Liquor Stores has not been significant. While this policy change will add to competition in the marketplace, Liquor Stores will also be in a position to participate in that limited expansion. In the near term, we continue to anticipate competition will not increase significantly as no new retail liquor licenses are expected to be issued by the province and therefore should grocery stores want to sell beer, wine and spirits, they will need to acquire licenses from existing operators and comply with the 1 km rule.

On Jan 23rd, 2017 the British Columbia Government announced the culmination of the BC Liquor Policy Review, which commenced in September 2013 and resulted in 73 recommendations to update applicable laws for British Columbians.

Approximately 90% of the Liquor Policy Review (73) recommendations have now been implemented. The remaining 10% of the Liquor Policy Review will require legislative changes and is anticipated to come into effect in the coming months.

In early 2017, the U.S. Trade Representative’s office announced it was taking Canada and the BC government to the World Trade Organization, for what it alleges is a discriminatory system in which only BC wine is allowed for sale alongside food in grocery stores. The result of this trade action could be that there is a greater selection of alcohol products at BC grocery stores.

Connecticut

In early 2017, Connecticut's Governor announced a legislative proposal to repeal the current law that requires package stores (retailers) to sell alcohol at minimum set pricing.

Kentucky

Last year we anticipated that a "Wine in Grocery Bill" (a law to allow wine sales in grocery stores) would be introduced that year (2016). It is unclear if such a bill will be introduced in the State Legislature during the 2017 legislative session due to it being a short legislative sitting (30 days). Given the uncertainties surrounding the actual timing of introduction of the legislation and the details of the regulatory model, it is difficult to quantify the potential impacts that this may have on our Kentucky stores at this time.

New Jersey

Pennsylvania Privatization

Relevant to New Jersey liquor retailers is the possibility of the privatization of the Liquor retail system in Pennsylvania. Considering Liquor Stores' acquisition of 51% of Birchfield, and the close proximity of its two Joe Canal's Discount Liquor Outlet stores to the Pennsylvania border, we believe that privatization in Pennsylvania would have an impact on sales in New Jersey. Privatization in Pennsylvania may negatively impact stores in New Jersey. However, this could also provide Liquor Stores with the opportunity to expand into a new market.

Retail Licenses

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. New Jersey licenses are issued by the NJABC in conjunction with municipalities and must be renewed annually.

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".

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.

Deteriorating economic conditions in Alberta resulting from a sharp and rapid decline in the price of oil and increase in unemployment levels in the province (unemployment rate per Statistics Canada at January 2017: 8.8%; January 2016: 7.6%; January 2015: 4.6%), have had, and may continue to have, an impact on the Company.

Competition

The private retail distribution of alcoholic beverages in the Provinces of Alberta and British Columbia and the States of Alaska, Connecticut, New Jersey 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 that 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. As noted above, changes to the British Columbia regulatory regime may have significant changes on competition and value of licenses in that province. However, as noted above under "British Columbia Store Operations", Liquor Stores has not experienced any significant impact from the new British Columbia laws and regulations to date.

In each of Alaska, Connecticut, Kentucky and New Jersey, Liquor Stores competes with local single store operators, other local and regional chain operators (in so far as license caps permit in New Jersey) and liquor stores associated with U.S. national grocery store chains (and in some instances, with U.S. national drug store chains who also offer alcoholic products for sale). Under the Alaska, Connecticut, Kentucky and New Jersey 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.

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.

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.

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 and the availability of contractors to perform development work. In addition, the development of new stores requires an outlay of capital and profitability is based on management's projections of future store performance (which may prove to be incorrect).

Potential Acquisition, Investment and Disposition Opportunities

In the normal course, Liquor Stores evaluates and considers, and may be engaged in discussions with respect to, potential acquisition, investment and disposition opportunities that it believes may assist it in achieving its business and growth plans, and in connection therewith it may at any time have outstanding non-binding letters of intent or conditional agreements which may or may not be material. There can be no assurance that any of these discussions, non-binding letters of intent or conditional agreements will result in a definitive agreement with respect to an acquisition, investment or disposition, and, if they do, what the terms or timing of such would be or that such acquisition, investment or disposition will be completed by Liquor Stores. If Liquor Stores does complete any such transaction, it cannot assure investors that the transaction will ultimately strengthen Liquor Stores' financial or operating results, prospects or competitive position or that it will not be viewed negatively by customers, securities analysts or investors. Such transactions may also involve significant commitments of Liquor Stores' financial and other resources. Any such activity may not be successful in generating revenue, income or other returns to Liquor Stores, and the resources committed to such activities will not be available to Liquor Stores for other purposes.

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

The success of Liquor Stores' retail 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' retail stores are located could decline in the future including because 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 labour markets in which Liquor Stores operates 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.

On October 1, 2016 Alberta's minimum wage was raised to $12.20 per hour (up from $11.20) for most employees in Alberta. The current Government of Alberta has announced a notional target to reach $15.00 per hour by 2018 (with increases in the interim). As noted above, this change could have an effect on store level labour costs.

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

The Company has a credit facility with a syndicate of Canadian and US banks, which is effective until September 30, 2019, and consists of a $165 million CAD plus $15 million USD extendible revolving operating loan (the "Credit Facility"). At March 7, 2016 there was approximately $22 million drawn on the Credit Facility. Pursuant to the terms of the Credit Facility, the Company has the ability to request an additional $50 million CAD (to be provided by the lenders on a best-effort basis).

The Company's Credit Facility is subject to a number of financial covenants, all of which are met by Liquor Stores. Under the terms of the Company's Credit Facility, the following ratios are monitored: funded debt to EBITDA, adjusted debt to EBITDAR, and fixed coverage ratio.

The Company has $67.5 million aggregate principal amount of 2012 Debentures due April 30, 2018 and $77.6 million aggregate principal amount of 2016 Debentures due January 31, 2022. 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, and are convertible at any time at the option of the holder into Common Shares at a conversion price of $24.90 per share. The 2016 Debentures bear interest at a rate of 4.70% per annum, payable semi-annually in arrears on January 31 and July 31 of each year, and are convertible at any time at the option of the holder into Common Shares at a conversion price of $14.60 per share.

There are no financial covenants attributable to the Convertible Debentures.

In the event that our 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; and (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 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 that, 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 Company 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.

Cybersecurity

Cybersecurity has become an increasingly problematic issue many industries in Canada and around the globe are facing. Cyber-attacks are increasing in sophistication and are often focused on compromising sensitive data for inappropriate use or disrupting business operations. Such an attack could compromise our confidential information as well as that of our customers and third parties with whom we interact and may result in negative consequences, including remediation costs, loss of revenue, additional regulatory scrutiny, litigation and reputational damage. As a result, Liquor Stores continually monitors for malicious threats and adapts accordingly in an effort to ensure we maintain high privacy and security standards. Liquor Stores leverages and invests in advancements in cyber defense technologies to support our business model, protect our systems and enhance the experience of our customers on a global basis by employing industry best practices, considering where data and information is stored and considering whether and where to collect data and information. Our investments continue to manage the risks we face today. Particular sources and types of cyber security threats we have historically considered and taken steps to mitigate against include impersonation, phishing, sensitive document exfiltration, distributed denial of service, brute force attacks and endpoint compromise. Liquor Stores works with a "Qualified Security Assessor" to conduct threat and risk assessments, controls and practices and vulnerability scans.

Conflicts of Interest

Certain directors of Liquor Stores are associated with other companies or entities, including entities engaged in the commercial real estate development, leasing and services businesses, and during 2016 information technology, 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.

18. Internal Controls over Financial Reporting, Disclosure Controls, and Procedures

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, 2016. 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, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's disclosure controls and procedures or internal control over financial reporting.

19. Condensed Quarterly Information

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

	2016				2015			
	Dec 31	**Sep 30**	**June 30**	**Mar 31**	**Dec 31**	**Sep 30**	**Jun 30**	**Mar 31**
Statement of Financial Position								
Cash	$7,020	$ 3,996	$6,206	$ 4,276	3,790	$ 2,790	$4,057	$ 11,360
Total assets	463,047	470,877	487,483	483,696	455,554	562,400	546,351	545,810
Total current liabilities	69,461	56,054	58,766	56,410	64,795	52,522	44,458	45,872
Long-term debt	135,838	156,790	179,207	181,361	129,566	127,017	124,670	122,244
Total liabilities	227,652	230,984	253,483	251,694	199,818	198,145	186,244	182,466
Shareholders' equity	235,395	239,893	234,000	231,732	255,736	364,255	360,127	363,344
Non-controlling interest	4,506	3,812	4,268	3,969	77	15	60	(2)
Statement of Earnings								
# stores, end of period	253	252	253	254	252	247	247	246
Sales	227,606	208,760	209,273	172,034	214,166	194,186	190,606	147,426
Operating profit before amortization [1]	13,265	12,611	12,404	2,086	13,971	11,507	12,805	2,611
Net earnings (loss) attributable to owners of the parent	(6,094)	4,371	4,121	(1,743)	(105,897)	4,142	4,490	(2,322)
Net earnings (loss)	(4,856)	4,615	4,666	(1,472)	(105,808)	4,169	4,560	(2,313)
Basic earnings (loss) per share	(0.22)	$0.16	$0.15	($ 0.06)	($3.86)	$0.15	$0.16	($ 0.09)
Dividends declared per share	$0.09	$0.09	$0.09	$ 0.21	$0.27	$0.27	$0.27	$ 0.27

[1] Operating profit before amortization is a non-IFRS measure that does not have any standardized meaning prescribed by IFRS. For more information on non-IFRS measures see the 'Non-IFRS Financial Measures' section of this MD&A.

20. Condensed Annual Information

(expressed in thousands of Canadian dollars, except per share amounts, number of stores and US store sales)

	As at and for the year ended December 31,				
	2016	2015	2014	2013	2012
Statement of Financial Position					
Cash and cash equivalents	$7,020	$3,790	$ 3,003	$ 4,529	$ 5,724
Total current assets (excluding cash)	168,989	174,210	146,615	140,583	157,047
Total assets	463,047	455,554	525,865	512,676	533,681
Total current liabilities	69,461	64,795	51,124	46,498	47,227
Total non-current liabilities	158,191	135,023	109,983	154,256	168,704
Total liabilities	227,652	199,818	161,107	200,754	215,931
Shareholders' equity	235,395	255,736	364,758	311,922	317,750
Statement of Earnings					
# stores, end of year	253	252	243	246	249
Canadian store sales	531,694	528,720	513,957	503,527	481,081
US store sales (US$)	216,055	169,594	162,929	152,604	149,164
Total sales	817,673	746,384	694,186	660,979	630,106
Gross margin	206,599	191,389	176,351	165,824	159,511
Operating profit before amortization(1)	40,366	36,870	36,530	43,241	45,671
Amortization expense	12,693	11,068	10,276	9,759	7,744
Finance costs	11,041	9,545	9,115	8,979	10,052
Impairment provision	16,153	130,313	-	9,823	2,500
Net earnings (loss) attributable to owners of the parent	655	(99,587)	12,713	11,273	18,778
Net earnings (loss)	2,953	(99,392)	12,949	11,483	19,056
Statement of Cash Flow					
Cash provided by operating activities	47,729	16,373	20,834	50,802	30,819
Cash used in investing activities	(34,934)	(30,557)	(11,505)	(12,241)	(15,513)
Cash provided by (used in) financing activities	(9,253)	14,502	(11,178)	(40,076)	(11,385)
Basic earnings (loss) per share(2)	0.02	($3.64)	$ 0.54	$ 0.49	$ 0.82
Dividends declared per share	$0.48	$1.08	$ 1.08	$ 1.08	$ 1.08

(1) Operating profit before amortization is a non-IFRS measure that does not have any standardized meaning prescribed by IFRS. For more information on non-IFRS measures see the 'Non-IFRS Financial Measures' section of this MD&A.

(2) Adjusted earnings per share were $0.46 for the year ended December 31, 2016 (2015 - $0.57; 2014 - $0.59; 2013 - $0.90; 2012 - $1.02). Adjusted earnings per share is a non-IFRS measure that does not have any standardized meaning prescribed by IFRS. For more information on non-IFRS measures see the 'Non-IFRS Financial Measures' section of this MD&A.

21. Forward Looking Statements

This MD&A contains forward looking statements or information (collectively "forward-looking statements") within the meaning of the "safe harbour" provisions of applicable securities legislation. All statements and information other than statements of historical fact contained in this MD&A are forward-looking statements. In particular, this MD&A contains forward-looking statements, with respect to, without limitation, our future financial position, capital and liquidity, cash dividends, business strategy, proposed acquisitions, expansion plans, Seven Point Plan, budgets, government regulation and laws, projected costs, plans and objectives of or involving Liquor Stores. Prospective investors can identify many of these statements by looking for words such as "believes", "expects", "will", "intends", "projects", "anticipates", "estimates", "continues" or similar words and the negative thereof.

Forward-looking statements reflect the Company's current plans, intentions, and expectations, which are based on Management's perception of historical trends, current conditions and expected future developments, as well as other factors it believes are appropriate in the circumstances. The Company's plans, intentions, and expectations are inherently subject to significant business, economic, competitive and other uncertainties and contingencies regarding future events and as such, are subject to change. There is no assurance that the plans, intentions, or expectations upon which these forward-looking statements are based will occur. Forward looking statements are subject to risks, uncertainties and assumptions, including, but not limited to, those discussed elsewhere in this MD&A. Although Management believes that the expectations represented in such forward looking statements are reasonable there can be no assurance that such expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon.

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: risks relating to government regulation and changes thereto (whether by court decisions, citizen referenda, or otherwise); competition; the state of the economy including general economic conditions in Canada (including Alberta) and the U.S.; the unpredictability and volatility of Liquor Store's common share price; restrictions on potential growth; restrictions on the potential growth of Liquor Stores as a consequence of the payment of cash dividends by Liquor Stores representing a substantial amount of its operating cash flow; availability of sufficient financial resources to fund the Company's capital expenditures; changes in commodity tax rates and government mark-ups; risks relating to future acquisitions and development of new stores; the ability of management to execute the Company's business and strategic plans; Liquor Stores' ability to locate and secure acceptable store sites and to adapt to changing market conditions; poor weather conditions; dependence on key personnel; labour costs, shortages and labour relations including Liquor Stores' ability to hire and retain staff at current wage levels and the risk of possible future unionization; supply interruption or delays; dependence on suppliers; reliance on information and control systems; income tax changes; leverage and restrictive covenants in agreements relating to current and future indebtedness of Liquor Stores; credit risks arising from operations; dilution and future sales of Liquor Stores common shares; and the potential lack of an active trading market for Liquor Stores' common shares and convertible debentures. These factors should not be construed as exhaustive. The information contained in this MD&A, including the information set forth under "Risk Factors", and as disclosed in other filings made by the Company with Canadian securities regulatory authorities and available on SEDAR at www.sedar.com, identifies additional factors that could affect the operating results and performance of Liquor Stores. Readers are cautioned that this list of risk factors should not be construed as exhaustive.

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

Liquor Stores assumes no obligation to update or revise them to reflect new events or circumstances except as expressly required by applicable securities law.