LIQUOR STORES INCOME FUND

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

For the Quarter Ended March 31, 2007
As of May 1, 2007

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

This management's discussion and analysis ("MD&A") should be read in conjunction with the interim consolidated financial statements (the "Financial Statements") and accompanying notes of Liquor Stores Income Fund (the "Fund") for the three months ended March 31, 2007 and the annual consolidated financial statements and accompanying notes of the Fund for the year ended December 31, 2006. Results are reported in Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Certain dollar amounts have been rounded to the nearest hundred thousand dollars or thousand dollars. References to notes are to the notes to the Financial Statements unless otherwise stated.

Throughout this MD&A references are made to "distributable cash", "operating margin", "operating margin as a percentage of sales", "payout ratio" and other "Non-GAAP Measures". A description of these measures and their limitations are discussed below under "Non-GAAP Measures". See also "Risk Factors" and "Forward-Looking Statements" below.

References to the "Tax Fairness Plan" in this MD&A are to the Tax Fairness Plan announced by the Federal Minister of Finance on October 31, 2006, the related draft legislation included in Bill C-52 tabled by the Minister in the House of Commons on March 27, 2007 and the "safe harbour" growth guidelines issued in connection to the Tax Fairness Plan by the Federal Department of Finance on December 15, 2006.

This MD&A is dated May 1, 2007.

OVERVIEW OF THE FUND

Issuance of Units and Development of the Business

The Fund is an unincorporated open ended, limited purpose trust established under the laws of the Province of Alberta. The trust units ("Units") of the Fund trade on the Toronto Stock Exchange under the symbol LIQ.UN. Through its 75.6% ownership of Liquor Stores Limited Partnership ("Liquor Stores LP"), the Fund operates 106 retail liquor stores in Alberta and British Columbia and management believes it is the largest liquor store operator in Alberta by number of stores and one of the two largest by revenue.

The Fund commenced business operations on September 28, 2004, when it completed its initial public offering of Units and acquired the net assets of The Liquor Depot Corporation and Liquor World Group Inc. and other wholly owned subsidiaries or companies that were under common control (collectively, the "Vendors") for $97.4 million in cash and Subordinated and Exchangeable LP Units.

In March 2005, March 2006 and October 2006 the Fund issued 1,830,000, 1,600,000 and 1,600,000 Units, respectively, from treasury for aggregate net proceeds of $93.1 million. In conjunction with the March 2006 offering, the Vendors sold 827,132 Units by way of a secondary offering. As at May 1, 2007 there are 10,185,694 Units and 3,300,255 Subordinated and Exchangeable units outstanding. The Vendors now have a 24.4% non-controlling interest in Liquor Stores LP.

The net proceeds of the March 2005 and March 2006 issuances were used to acquire or develop 56 retail liquor stores and to temporarily repay bank financing. The net proceeds of the October 2006 issuance are also being used to temporarily repay bank financing related to inventory and will be used to fund future acquisitions and development of retail liquor stores. From inception to May 1, 2007, the aggregate cost to acquire and develop retail liquor stores, exclusive of working capital, is approximately $59.6 million.

On April 10, 2007, the Fund made an offer to acquire all of the outstanding trust units of Liquor Barn Income Fund ("Liquor Barn"). The Fund is offering Liquor Barn unitholders 0.53 of a Unit in exchange for each Liquor Barn trust unit. This transaction values the outstanding trust units of Liquor Barn at approximately $158 million. Convertible debentures of Liquor Barn in the principal amount of $15.7 million would be assumed. At April 16, 2007, Liquor Barn operated 61 retail liquor stores in Alberta and 11 in British Columbia. Unless extended or withdrawn, the offer will expire on May 17, 2007. Additional information concerning the offer can be found on the Fund's website at www.liquorstoresincomefund.ca.

During the three months ended March 31, 2007, the Fund completed the acquisition of one retail liquor store in Calgary, Alberta and closed a small store in the same market area. On April 30, 2007 the Fund acquired a 50% interest in one retail liquor store in

Nanaimo, British Columbia. The Fund has commitments in place to date that will see seven additional stores developed and opened in 2007 with several more currently under negotiation.

As at May 1, 2007, the Fund operates 106 retail liquor stores located as follows:

	Alberta			British Columbia		
	Edmonton(1)	**Calgary(1)**	**Other(2)**	**Lower Mainland**	**Other(3)**	**Total**
Number of Stores	42	35	20	3	6	106

Notes:

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

(2) Other communities served in Alberta include Red Deer (3), Lethbridge (1), Fort McMurray (5), Slave Lake (3), Banff (1), Canmore (2), Grande Prairie (2), Edson (2) and High River (1).

(3) In British Columbia other communities served include Victoria (1), Kamloops (1), Kelowna (2), Chilliwack (1) and Nanaimo (1). The Fund also operates a pub connected to a retail liquor store in British Columbia.

Business of the Fund

The Province of Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. With 97 liquor stores operating in Alberta, where there are approximately 1,050 liquor stores, the Fund is the largest liquor store operator by number of stores. We believe that the Fund is one of the two largest liquor store operators in Alberta by revenue.

The Fund also operates nine stores and a pub in British Columbia. The Province of British Columbia's model for liquor distribution is a blend of approximately 600 private stores and 208 government operated stores. There are also approximately 400 agency stores that service small communities.

Distributable Cash and Cash Distributions

The Fund's policy is to distribute available cash from operations to unitholders to the extent determined prudent by the trustees of the Fund. Cash available for distribution is after cash required for maintenance capital expenditures, working capital reserve, and other reserves considered advisable by the trustees, including a provision for awards related to the Fund's long-term incentive plan (the "LTIP"). The policy allows the Fund to make stable monthly distributions to its unitholders based on estimates of distributable cash. The Fund pays cash distributions on or about the 15th of each month to unitholders of record on the last business day of the previous month.

The Fund reviews its historic and expected results on a regular basis. This review includes consideration of the expected performance of existing and new stores, the competitive environment and economic conditions, including labour market trends.

Cash distributions have been made as follows from the inception of the Fund:

Payment Dates	Monthly	Annualized
November 15, 2004 to May 16, 2005	$0.08333	$1.000
June 16, 2005 to January 16, 2006	$0.08958	$1.075
February 15, 2006 to October 16, 2006	$0.10000	$1.200
November 15, 2006 to March 15, 2007	$0.11667	$1.400
Commencing April 13, 2007(1)	$0.12500	$1.500

Notes:

(1) *On February 7, 2007, the Fund announced an increase in the level of its cash distributions from $0.1167 per month to $0.125 per month commencing with the April 13, 2007 distribution.*

Distributions declared during the three months ended March 31, 2007 were $4,843,600 or $0.3584 per Unit. On a weighted average basis, distributable cash per Unit was $0.21 for the period. The liquor retail industry is subject to seasonal variations with approximately 40% of sales occurring in the first half of the year and 60% occurring in the second half. As a result, distributable cash will be less than actual distributions early in the year, but will exceed distributions for the later portion of the year. Since inception, cash distributions have totalled $32,372,095 and distributable cash has totalled $34,213,462 resulting in distributable cash exceeding cash distributions by $1,841,367 and a cumulative payout ratio of approximately 95%.

For 2006, the tax deferred portion of distributions for Canadian federal income tax purposes was approximately 28%. It is proposed under the Tax Fairness Plan that the taxable income distributed by the Fund be taxed commencing in 2011 or earlier in some circumstances more fully described under the heading "Tax Fairness Plan" below. In this regard, the Fund is reviewing the current and long-term implications to unitholders of various alternatives with respect to elective tax deductions until the new regime is in place. As such, the Fund cannot now determine the portion, if any, of the 2007 distributions that will be tax deferred.

Distributable Cash per Unit (Fund Units, Exchangeable and Subordinated LP Units)

The Fund views distributable cash as an important supplementary measure to assist unitholders in evaluating the Fund's performance as the Fund's objective is to provide a stable and sustainable flow of distributable cash to unitholders. The following table provides the calculation of the distributable cash of the Fund for the three months ended March 31, 2007 and 2006:

	Three months ended March 31,		**Since inception**
	2007	**2006**	**of the Fund**
Cash provided by operating activities	$ 2,446,889	$ 1,036,897	$ 15,885,853
Net change in non-cash working capital	717,256	521,196	21,060,239
Incentive plan provisions	(273,000)	–	(1,273,000)
Unit-based compensation	45,763	–	45,763
Provision for non-growth property and equipment	(133,341)	(108,013)	(1,505,393)
Distributable cash	$2,803,567	$ 1,450,080	$ 34,213,462
Weighted average units outstanding	13,525,040	10,614,445	10,971,195
Distributable cash per weighted average Unit	$0.21	$0.14	$3.12
Distributions declared per unit	$0.36	$0.30	$2.91
Basic earnings per unit	$0.17	$0.10	$2.92
Diluted earnings per unit	$0.17	$0.10	$2.88

Distributable cash is a Non-GAAP Measure. Adjustments related to non-cash working capital, equity earnings, obligations in respect of the LTIP, unit based compensation and provision for non-growth property and equipment are necessary to reconcile distributable cash to its nearest GAAP measure, cash provided by operating activities.

Net Change in Non-cash Working Capital

The Fund's investment in non-cash working capital is primarily related to increased inventory levels. This increase includes the cost of purchasing inventory for stores the Fund develops and opens, the cost of increasing inventory in acquired stores subsequent to their acquisition date, and an increase in current inventory purchased at times when favourable buying conditions exist. Other changes in non-cash working capital are relatively insignificant. The net change in non-cash working capital is added back to cash provided by operating activities to reflect fairly the Fund's historic and prospective ability to pay cash distributions.

Incentive Plan Provisions

Funding for the Fund's incentive plans occurs subsequent to the approval of the Fund's annual financial statements. For accounting purposes, the compensation expense related to the incentive plan is recognized as awards vest. Awards under the LTIP are calculated with reference to distributable cash per Unit. Although incentive plan awards have no impact on current cash provided by operating activities, the likelihood of those awards requiring a cash payment is such that management believes they should be included in the calculation of distributable cash.

Unit-Based Compensation

Unit-based compensation reflects the expense recognized in the period with respect to the LTIP and Deferred Performance Bonus provisions established at December 31, 2006. This is a non-cash expense and is therefore added back for the calculation of distributable cash.

Provision for Non-growth Property and Equipment

Non-growth property and equipment expenditures refer to capital expenditures that are necessary to sustain current productive capacity, comprised principally of store renovations and equipment replacement, together with reserves for further expenditures to maintain productive capacity. Routine repairs and maintenance are expensed as incurred. Management believes that maintenance non-growth property and equipment expenditures should be funded with cash provided by operating activities and therefore included in the calculation of distributable cash. Capital spending for growth initiatives is expected to improve future distributable cash or is funded as part of the financing plan for specific acquisition or development initiatives and as such is not deducted from cash provided by operating activities.

The following table provides an analysis of the total expenditures on property and equipment, the amounts reserved for further non-growth expenditures and the amounts charged to expense in the Fund's accounts for repairs and maintenance:

	Three months ended March 31,		**Since inception**
	2007	**2006**	**of the Fund**
Purchase of property and equipment including business acquisitions	$976,467	$ 687,552	$ 22,449,003
Growth expenditures including amounts relating to development and acquired stores	(843,126)	(579,539)	(21,219,164)
Purchase of non-growth property and equipment	133,341	108,013	1,229,839
Provision for further non-growth property and equipment expenditures	–	–	275,554
Total provision for non-growth property and equipment	133,341	108,013	1,505,393
Repairs and maintenance expense	112,744	71,240	676,171
Total expenditures for non-growth property and equipment purchases and repairs and maintenance expense	$ 246,085	$ 179,253	$2,181,564

Amounts relating to the development and acquisition of stores are considered growth expenditures. Growth expenditures are not included in the calculation of distributable cash.

SELECTED FINANCIAL INFORMATION AND RESULTS FROM OPERATIONS

Operating Results

The liquor retail industry is subject to seasonable variations with respect to sales. Sales are typically slowest early in the year and increase in the latter half with the highest sales occurring in the last quarter. In 2006, 17% of sales occurred in the first quarter, 24% in the second quarter, 27% in the third quarter and 32% in the last quarter.

The following table summarizes the operating results for the quarter ended March 31, 2007 with comparative figures for 2006:

	Three months ended March 31,	
	2007	**2006**
	(unaudited)	(unaudited)
Number of stores at March 31	105	76
Sales	$51,809,129	$ 38,020,724
Cost of sales, administrative, operating, and store acquisition and development expenses	48,584,722	36,120,331
Operating margin [(1)]	$3,224,407	$1,900,393
Operating margin as a percentage of sales	6.2%	5.0%

Note:

(1) *Operating margin has been calculated as described under "Non-GAAP Measures"*

Sales

Sales for the quarter ended March 31, 2007 increased to $51.8 million from $38.0 million in 2006. This increase is primarily due to the increase in the number of stores operated to 106 at March 31, 2006 compared to 76 at March 31, 2006. The $13.8 million increase is the result of:

- an increase in same store sales of $2.0 million or 5.7% to $37.0 million for the three months ended March 31, 2007;
- an increase of $10.8 million in sales to $11.0 million for the 29 stores acquired or opened in 2006, which are operating at March 31, 2007;
- sales of $1.2 million for the store acquired in March 2007 net of sales of a store closed in February 2007; and
- a decrease in wholesale licensee sales of $0.2 million or 8.8% to $2.6 million for the three months ended March 31, 2007 compared to same period in 2006. Due to the low product margins for licensee sales, the effect on operating margin is minimal.

Combined Cost of Sales, Administrative, Operating and Acquisition and Store Development Expense ("Operating Expense")

Operating Expense for three months ended March 31, 2007 increased to $48.6 million, which is $12.5 million higher than in 2006. These increases are consistent with the increase in number of stores being operated.

Operating expense includes the recognition of deferred unit-based compensation expense for the LTIP, the 2007 Incentive Plan and Deferred Share Unit Plan. During the three months ended March 31, 2007, the Fund recognized compensation expense of $2,288 for the LTIP, $43,475 for the 2007 Incentive Plan and $58,634 for the Deferred Share Unit Plan.

Operating Margin

Operating margin (as defined under "Non-GAAP Measures") increased to $3.2 million for the three months ended March 31, 2007 from $1.9 million in 2006. Operating margin as a percentage of sales was 6.2% for the three months ended March 31, 2007 compared to 5.0% for the same period last year.

Earnings before Non-controlling Interest and Net Earnings

Earnings before non-controlling interest for the three months ended March 31, 2007 of $2.4 million increased over the same period in 2006, which had earnings before non-controlling interest of $1.1 million.

Net earnings for the three months ended March 31, 2007 increased by $1.1 million over 2006 to $1.8 million.

Income Taxes

Under existing income tax legislation, the Fund deducts distributions to unitholders that are not a return of capital in the determination of its taxable income. For accounting purposes income tax provisions are only recorded in respect of incorporated subsidiaries. Consequently, income taxes recorded in the Fund's accounts have been nominal.

GAAP requires the effect of changes in income tax legislation on tax provisions to be recorded prospectively once the legislation has been substantively enacted. Since the legislation related to the Tax Fairness Plan has not been substantively enacted, the Fund has not provided for any related income tax effect in its March 31, 2007 financial statements. See "Tax Fairness Plan" below.

Condensed Quarterly Information

	2007	2006				2005		
	March 31	**Dec 31**	**Sept 30**	**June 30**	**March 31**	**Dec 31**	**Sept 30**	**June 30**
	(thousands of dollars except per Unit amounts)							
Balance Sheet								
Cash and cash equivalents	$ 1,715	$ 3,397	$ 1,683	$ 276	$ 2,935	$ 2,047	$ 172	$ 266
Total assets	188,311	187,097	173,736	165,812	141,511	140,806	127,114	118,425
Bank indebtedness	11,893	5,455	28,964	15,495	–	15,493	8,993	–
Total current liabilities	17,489	12,896	32,140	20,481	4,092	20,427	11,628	2,996
Long-term debt	–-	–	2,500	7,500	–	11,352	7,359	7,500
Unitholders' equity	137,922	140,709	105,974	105,115	104,775	67,327	66,648	66,167
Non-controlling interest	32,900	33,496	33,120	32,716	32,643	41,700	41,471	41,762
Statement of Earnings								
Sales	51,809	71,010	60,751	52,215	38,021	50,686	41,434	38,505
Earnings before non-controlling interest	2,383	6,206	4,678	3,992	1,101	3,676	2,966	2,760
Net earnings for the period	1,767	4,627	3,332	2,871	684	2,202	1,764	1,637
Basic earnings per Unit	$0.17	$0.45	$0.39	$0.33	$0.10	$0.38	$0.29	$0.27
Diluted earnings per Unit	$0.17	$0.45	$0.39	$0.33	$0.10	$0.37	$0.29	$0.27
Distributable cash per Unit	$0.21	$0.45	$0.43	$0.38	$0.14	$0.44	$0.29	$0.26

LIQUIDITY AND CAPITAL RESOURCES

Unitholders' Equity and Non-controlling Interest

The following units were outstanding as of May 1, 2007:

	Units
Fund Units	10,185,694
Liquor Stores LP Exchangeable LP Units	1,175,255
Liquor Stores LP Subordinated LP Units	2,125,000
	13,485,949

The Liquor Stores Subordinated and Exchangeable LP Units represent a non-controlling interest in the Fund.

In the first three months of 2007, 1,425 Liquor Stores LP Exchangeable LP Units were exchanged for Fund Units resulting in an increase in Unitholders' Equity of $14,231. The Fund also issued 2,492 Units from treasury to the LTIP in this period.

Tax Fairness Plan

On October 31, 2006 the Federal Minister of Finance proposed to apply a tax at the trust level on distributions of certain income from publicly traded mutual fund trusts at rates of tax comparable to the combined federal and provincial corporate tax and to treat such distributions as dividends to the unitholders (the "Tax Fairness Plan"). On December 21, 2006 the Federal Minister of Finance released draft legislation to implement the Tax Fairness Plan pursuant to which, commencing January 1, 2011 (provided the Fund only experiences "normal growth" and no "undue expansion" before then) certain distributions from the Fund which would have otherwise been taxed as ordinary income generally will be characterized as dividends in addition to being subject to tax at corporate rates at the Fund level. On March 27, 2007, a Notice of Ways and Means Motion was tabled to enact the Tax Fairness Plan. Assuming the Tax Fairness Plan is ultimately enacted in its present form, the implementation of such legislation would be expected to result in adverse tax consequences to the Fund and certain unitholders (including most particularly unitholders that are tax deferred or non-residents of Canada) and may affect cash distributions from the Fund.

The Tax Fairness Plan provides that, while there is no intention to prevent "normal growth" during the transitional period, any "undue expansion" could result in the transition period being "revisited", presumably with the loss of the benefit to the Fund of that transitional period. As a result, the adverse tax consequences resulting from the Tax Fairness Plan could be realized sooner than January 1, 2011. On December 15, 2006, the Department of Finance issued guidelines with respect to what is meant by "normal growth" in this context. Specifically, the Department of Finance stated that "normal growth" would include equity growth within certain "safe harbour" limits, measured by reference to a specified investment flow-through trust or partnership's ("SIFT") market capitalization as of the end of trading on October 31, 2006 (which would include only the market value of the SIFT's issued and outstanding publicly-traded trust units, and not any convertible debt, options or other interests convertible into or exchangeable for trust units). These guidelines have been incorporated into the March 27, 2006 Notice of Ways and Means Motion discussed above. Those safe harbour limits are the greater of $50 million or 40% of the market capitalization benchmark for the period from November 1, 2006 to December 31, 2007, and 20% each for calendar 2008, 2009 and 2010. Moreover, these limits are cumulative (other than the $50 million annual limit), so that any unused limit for a period carries over into the subsequent period. Additional details of the Department of Finance's guidelines include the following:

(a) new equity for these purposes includes units and debt that is convertible into units (and may include other substitutes for equity if attempts are made to develop those);

(b) replacing debt that was outstanding as of October 31, 2006 with new equity, whether by a conversion into trust units of convertible debentures or otherwise, will not be considered growth for these purposes and will therefore not affect the safe harbour; and

(c) the exchange, for trust units, of exchangeable partnership units or exchangeable shares that were outstanding on October 31, 2006 will not be considered growth for these purposes and will therefore not affect the safe harbour where the issuance of the trust units is made in satisfaction of the exercise of the exchange right by a person other than the SIFT.

The Fund's market capitalization as of the close of trading on October 31, 2006, having regard only to its issued and outstanding publicly-traded Units, was approximately $227 million, which means the Fund's "safe harbour" equity growth amount for the period ending December 31, 2007 is approximately $90 million, and for each of calendar 2008, 2009 and 2010 is an additional approximately $45 million (in any case, not including equity, including convertible debentures, issued to replace debt that was outstanding on October 31, 2006, which was approximately $8 million).

It is not known at this time when the Tax Fairness Plan will be enacted by Parliament, if at all, or whether the Tax Fairness Plan will be enacted in the form currently proposed or new proposals will be proposed or enacted.

Credit Facilities

The Fund has a $32 million demand operating loan that can be increased to $38 million to accommodate seasonal inventory highs, a $14.5 million committed non-revolving capital loan and a $15 million committed non-revolving acquisition loan with a Canadian chartered bank. The total of all available credit facilities is $62 million.

As of May 1, 2007, total indebtedness under all credit facilities is approximately $10.4 million and is primarily related to inventory financing. As acquisitions occur and new stores are opened, credit facilities will be utilized as required.

Capital Expenditures

During the three months ended March 31, 2007, the Fund acquired one store. Since inception, the Fund has acquired or developed and opened 56 stores at an aggregate cost of $59.6 million exclusive of working capital.

The Fund will continue to pursue acquisition opportunities and to open new stores. In addition, the replacement of in-store information systems is anticipated to begin in 2007. The improvements in marketing and administrative processes related to this replacement are expected to reduce overhead costs and enhance the management of retail operations. The preliminary estimate of the cost to replace in-store systems is in the range of $2.0 to $2.5 million. This cost will be treated as growth capital when incurred.

Interest Rate Risk and Sensitivity

The Fund’s bank indebtedness and long-term debt bear interest at floating rates based on the bank’s prime rate or at short term banker’s acceptance rates.

The Fund is not subject to significant exposure to interest rate fluctuations. Based on an assumed outstanding debt balance of $32 million, a 1.0% increase in interest rates would reduce distributable cash for the year by approximately $320,000 or $0.02 per Unit.

Contractual Obligations

The table below sets forth, as of March 31, 2007, the contractual obligations of the Fund, due in the years indicated, related to various premises operating leases.

	2008	2009	2010	2011	2012	2013 and thereafter
Operating leases	$6,714,807	$5,547,801	$4,527,003	$3,938,231	$3,386,804	$8,333,361
Total	$6,714,807	$5,547,801	$4,527,003	$3,938,231	$3,386,804	$8,333,361

OFF BALANCE SHEET ARRANGEMENTS

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

CRITICAL ACCOUNTING ESTIMATES

Goodwill

Goodwill is not amortized and is assessed for impairment at the reporting unit level. The impairment test is done annually unless circumstances arise that would potentially impair the carrying value of goodwill. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, potential goodwill impairment has been identified and must be quantified by comparing the estimated fair value of the reporting unit's goodwill to its carrying value. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in earnings.

Amortization Policies and Useful Lives

The Fund amortizes property, equipment and intangible assets over the estimated useful service lives of the assets. In determining the estimated useful life of these assets, significant judgment by management is required. In determining these estimates, the Fund takes into account industry trends and Fund-specific factors, including changing technologies and expectation for the in-service period of these assets. The Fund assesses the estimated useful life of these assets on an annual basis to ensure they match the anticipated life of the asset from a revenue producing perspective. If the Fund determines that the useful life of an asset is different from the original assessment, changes to amortization will be applied prospectively.

Purchase Price Allocations

The allocations of the purchases price for acquisitions involve determining the fair values assigned to the tangible and intangible assets acquired. The Fund uses independent valuators to determine the fair value of the tangible assets and certain intangible assets of the acquired stores. Other intangible assets are allocated based on a calculation of fair values by management. A discounted cash flow analysis is prepared to determine these fair values. Goodwill is calculated based on the purchase price less the fair value of the net tangible and intangible assets stated above.

CHANGES IN ACCOUNTING POLICIES

Financial Instruments and Other Comprehensive Income

New accounting standards are in effect for fiscal years beginning on or after October 1, 2006 for recognition and measurement of financial instruments and disclosure of comprehensive income. Effective January 1, 2007, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook sections 1530 – Comprehensive Income, 3855 – Financial Instruments – Recognition and Measurement, and 3865 – Hedges. As the Fund has no items of other comprehensive income, net earnings for the period is equivalent to comprehensive income.

FINANCIAL INSTRUMENTS

Due to the nature of its business, the Fund does not engage in activities or hold assets that would require the Fund to acquire financial instruments for hedging or speculative purposes. The financial instruments that are held by the Fund consist of accounts receivable, bank indebtedness, accounts payable and accrued liabilities, distributions payable and long-term debt. The financial instruments are held in the normal course of operations and as a result no significant accounting policies need to be adopted or assumptions made in reporting the Fund's financial instruments.

TRANSACTIONS WITH RELATED PARTIES

The Fund has a conflict of interest policy that requires the disclosure of potential conflicts and excludes persons with a material conflict of interest from any related decisions.

During the quarter ended March 31, 2007, the Fund incurred professional fees of $89,417 to a law firm of which a director of Liquor Stores GP Inc. (the "Liquor Stores GP"), a subsidiary of the Fund, is a partner. Rent paid to companies controlled by directors of the GP amounted to $21,034. One such arrangement was terminated effective April 1, 2007. The Fund paid fees and expenses to a company controlled by the Chief Executive Officer of the GP relating to supervision of the construction of developed stores of $10,674 (see note 6 to the Financial Statements).

The Fund has entered into a lease for new office premises with a company associated with the Chief Executive Officer of the GP. The Fund has received independent fairness and legal opinions concerning the terms of the lease. Rent payments for this lease are scheduled to begin June 2007.

OUTLOOK

During the quarter ended March 31, 2007, the Fund focused on improving its operating performance posting a 5.7% increase in same store sales and an improvement in operating margin from 5.0% for the first quarter of 2007 to 6.2%.

Strategically, the Fund made an offer for all of the outstanding trust units of Liquor Barn, a transaction that values the Liquor Barn trust units at approximately $158 million. If the offer is accepted by 66 2/3% of Liquor Barn's unitholders and all other conditions to the offer are satisfied or waived by the Fund, the Fund would become the leading independent liquor retailer in Alberta and British Columbia with an estimated combined share of independent liquor store retail sales of over 16% in Alberta and British Columbia and approximately 19% in its core Alberta market. The combined entity will operate 177 liquor stores in Alberta and British Columbia with pro forma revenue greater than $320 million, providing a strong platform for future growth.

The Fund has also focused on its other growth opportunities following the acquisition and store development strategy that led to an increase in the number of stores to 106 from 75 in 2006. The Fund believes there will continue to be a consolidation trend in the industry, particularly in British Columbia, and that the Fund is well positioned with the capital and human resources to benefit from this trend.

In addition to the two stores the Fund acquired to date in 2007, the Fund has commitments to develop and open seven stores in 2007.

For 2007, we expect same store sales growth to be moderate and in the range of 2% to 4%.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management of the Fund has evaluated the effectiveness of the Fund's disclosure controls and procedures (as defined under Multilateral Instrument 52-109 ("MI 52-109") of the Canadian Securities Administrators) as of March 31, 2007, and has concluded that the design and effectiveness of these controls and procedures provides reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, will be made known to management on a timely basis to ensure adequate disclosure.

There have been no changes in the Fund's internal controls over financial reporting (as defined under MI 52-109) that occurred during the quarter ended March 31, 2007, that have materially affected, or are reasonably likely to materially affect, the Fund's internal controls over financial reporting.

ADDITIONAL INFORMATION

Additional information relating to the Fund, including the Fund's Annual Information Form and other public filings is available on SEDAR (www.sedar.com) and on the Fund's website at www.liquorstoresincomefund.com.

RISK FACTORS

The Fund's results of operations, business prospects, financial condition, cash distributions to unitholders and the trading price of the Fund's Units are subject to a number of risks. These risk factors include: risks relating to government regulation; competition; its ability to locate and secure acceptable store sites and to adapt to changing market conditions; risks relating to future acquisitions and development of new stores; failure to successfully integrate acquisitions; dependence on key personnel; the Fund's ability to hire and retain staff at acceptable wage levels, risks related to the possibility of future unionization; supply interruption or delays; reliance on information and control systems; dependence on capital markets to fund its growth strategy beyond its available credit facilities; dependence of the Fund on Liquor Stores Limited Partnership ("Liquor Stores LP") and

Liquor Stores GP; leverage and restrictive covenants in agreements relating to current and future indebtedness of the Liquor Stores LP restrictions on the potential growth of Liquor Stores LP as a consequence of the payment by Liquor Stores LP of a substantial amount of its operating cash flow; income tax related risks including the Tax Fairness Plan; and the Vendors' right to approve certain material transactions.

For a discussion of these risks and other risks associated with an investment in Fund Units, see "Risk Factors" detailed in the Fund's Annual Information Form, which is available at www.sedar.com.

NON-GAAP MEASURES

References to ''distributable cash'' are to cash available for distribution to unitholders in accordance with the distribution policies of the Fund. Management believes that, in addition to income or loss, cash available for distribution before debt service, changes in working capital, capital expenditures and income taxes is a useful supplemental measure of performance. Distributable cash of the Fund is a measure generally used by Canadian open-ended trusts as an indicator of financial performance. As one of the factors that may be considered relevant by unitholders and prospective investors is the cash distributed by the Fund relative to the price of the Fund's Units, management believes that distributable cash of the Fund is a useful supplemental measure that may assist unitholders and prospective investors in assessing an investment in the Fund. For a reconciliation of distributable cash to cash provided by operating activities please see "Distributable cash per unit (Fund Units, Exchangeable and Subordinated LP Units)".

Operating margin for purposes of disclosure under "Operating Results" has been derived by adding interest expense, amortization of property and equipment, intangibles and pre-opening costs to net earnings before non-controlling interest. Operating margin as a percentage of sales is calculated by dividing operating margin by sales.

"Payout ratio" is calculated by dividing cash distributions declared by distributable cash.

Operating margin, operating margin as a percentage of sales, distributable cash and payout ratio are not measures recognized by GAAP and do not have a standardized meaning prescribed by GAAP. Investors are cautioned that operating margin, operating margin as a percentage of sales, distributable cash and payout ratio should not replace net earnings or loss (as determined in accordance with GAAP) as an indicator of the Fund's performance, of its cash flows from operating, investing and financing activities or as a measure of its liquidity and cash flows. The Fund's method of calculating operating margin, operating margin as a percentage of sales, distributable cash and payout ratio may differ from the methods used by other issuers. Therefore, the Fund's operating margin, operating margin as a percentage of sales, distributable cash and payout ratio may not be comparable to similar measures presented by other issuers.

FORWARD LOOKING STATEMENTS

This management's discussion and analysis contains forward-looking statements. All statements other than statements of historical fact contained in this management's discussion and analysis are forward-looking statements, including, without limitation, statements regarding the future financial position, cash distributions, business strategy, proposed acquisitions (including the proposed acquisition of Liquor Barn and the benefits to be derived therefrom), budgets, litigation, projected costs and plans and objectives of or involving the Fund or Liquor Stores LP. You can identify many of these statements by looking for words such as "believes", "expects", "will", "intends", "projects", "anticipates", "estimates", "continues" or similar words or the negative thereof. These forward-looking statements include statements with respect to the amount and timing of the payment of the distributions of the Fund. There can be 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 management's discussion and analysis. There can be no assurance that such expectations will prove to be correct.

Some of the factors that could affect future results and could cause results to differ materially from those expressed in the forward-looking statements contained herein include, but are not limited to, those discussed under "Risk Factors".

The information contained in this management's discussion and analysis, including the information set forth under "Risk Factors", identifies additional factors that could affect the operating results and performance of the Fund and Liquor Stores LP.

The forward-looking statements contained herein are expressly qualified in their entirety by this cautionary statement. The forward-looking statements included in this management's discussion and analysis is made as of the date of this management's discussion and analysis and the Fund assumes no obligation to update or revise them to reflect new events or circumstances except as expressly required by applicable securities law.