

# **Liquor Stores Income Fund**

Interim Consolidated Financial Statements  
(unaudited)

**September 30, 2008**  
(expressed in thousands of Canadian dollars)

# Liquor Stores Income Fund

Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

	September 30, 2008	December 31, 2007 (restated) (note 3)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 810	\$ 19,498
Accounts receivable	2,905	3,474
Inventory	92,005	84,856
Prepaid expenses and deposits (note 5)	1,491	1,348
	97,211	109,176
<b>Pre-opening costs</b>	1,000	773
<b>Deposits on future acquisitions</b> (note 5)	1,074	647
<b>Notes receivable</b>	306	-
<b>Property and equipment</b>	43,614	41,707
<b>Intangible assets</b> (note 4)	39,145	37,784
<b>Goodwill</b> (note 4)	260,599	259,638
	\$ 442,949	\$ 449,725
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 13,298	\$ -
Accounts payable and accrued liabilities	8,629	10,498
Distributions payable to unitholders (note 7)	2,477	2,470
Distributions payable to non-controlling interest (note 7)	558	1,094
Current portion of long-term debt (note 6)	15,000	-
	39,962	14,062
<b>Long-term debt</b> (note 6)	51,425	74,014
<b>Future income tax liability</b> (note 8)	11,996	8,632
<b>Non-controlling interest</b> (note 9)	48,079	50,637
	151,462	147,345
<b>Unitholders' Equity</b>		
Fund Units (note 10)	309,642	308,694
Equity component of convertible debentures (note 6)	4,970	4,340
Contributed surplus (note 11)	889	558
Cumulative undistributed earnings (excess distributions)	(24,014)	(11,212)
	291,487	302,380
	\$ 442,949	\$ 449,725

# Liquor Stores Income Fund

Consolidated Statements of Earnings, Comprehensive Income and Cumulative Undistributed Earnings (Excess Distributions)

(expressed in thousands of Canadian dollars, except for per unit amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007 (restated) (note 3)	2008	2007 (restated) (note 3)
Sales	\$ 123,913	\$ 122,097	\$ 339,902	\$ 257,142
Cost of sales	92,357	93,353	255,627	196,859
<b>Gross margin</b>	31,556	28,744	84,275	60,283
Operating and administrative expense	19,146	17,768	56,730	40,227
<b>Operating earnings before amortization and interest</b>	12,410	10,976	27,545	20,056
<b>Amortization</b>				
Property and equipment	1,434	1,235	3,808	2,865
Intangible assets	796	919	2,341	1,256
Pre-opening costs	578	107	1,056	411
	2,808	2,261	7,205	4,532
	9,602	8,715	20,340	15,524
<b>Interest expense and other</b>				
Bank indebtedness	432	380	604	807
Long-term debt	45	212	474	212
Convertible debentures (note 6)	1,297	-	3,791	-
Unrealized loss (gain) on foreign currency contracts	(616)	-	(696)	-
Realized loss (gain) on foreign currency contracts	7	-	(88)	-
	1,165	592	4,085	1,019
<b>Earnings before income tax and non-controlling interest</b>	8,437	8,123	16,255	14,505
Future income tax expense	587	685	3,580	10,597
<b>Earnings before non-controlling interest</b>	7,850	7,438	12,675	3,908
Non-controlling interest (note 9)	1,622	1,838	3,192	3,479
<b>Net earnings and comprehensive income for the period</b>	6,228	5,600	9,483	429
Cumulative undistributed earnings (excess distributions), beginning of period	(22,905)	(12,620)	(11,307)	997
Change in accounting policy (note 3)	94	54	95	-
Cumulative undistributed earnings (excess distributions), as restated	(22,811)	(12,566)	(11,212)	997
Distributions declared on Fund Units (note 7)	(7,431)	(6,755)	(22,285)	(15,147)
<b>Cumulative undistributed earnings (excess distributions), end of period</b>	\$ (24,014)	\$ (13,721)	\$ (24,014)	\$ (13,721)
<b>Earnings per Unit (note 13)</b>				
Basic	\$ 0.34	\$ 0.31	\$ 0.52	\$ 0.03
Diluted	\$ 0.34	\$ 0.31	\$ 0.52	\$ 0.03

# Liquor Stores Income Fund

## Consolidated Statements of Cash Flows

(expressed in thousands of Canadian dollars)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007 (restated) (note 3)	2008	2007 (restated) (note 3)
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net earnings for the period	\$ 6,228	\$ 5,600	\$ 9,483	\$ 429
Items not affecting cash				
Amortization	2,808	2,261	7,205	4,532
Amortization of inventory fair value adjustment	-	947	-	2,247
Non-cash interest on convertible debentures	317	-	856	-
Future income tax	587	685	3,580	10,597
Unrealized loss (gain) on foreign currency contracts	(616)	-	(696)	-
Non-controlling interest	1,622	1,838	3,192	3,479
Unit-based compensation (note 14)	255	156	677	375
	11,201	11,487	24,297	21,659
Net change in non-cash working capital items	(736)	(12,436)	(7,531)	(7,299)
	10,465	(949)	16,766	14,360
<b>Financing activities</b>				
Increase (decrease) in bank indebtedness	3,397	2,040	13,298	7,654
Proceeds of long-term debt	-	15,000	7,185	15,000
Repayment of long-term debt	-	-	(15,000)	-
Distributions paid to unitholders (note 7)	(7,431)	(6,684)	(22,277)	(14,086)
Distributions paid to non-controlling interest (note 7)	(1,672)	(1,739)	(5,563)	(4,096)
Dividends paid to non-controlling interest by subsidiaries (note 9)	(79)	(102)	(321)	(157)
Cash distributions from long-term incentive plans (note 10)	-	-	(12)	-
Units acquired	-	-	-	(950)
Proceeds from forfeited units	-	22	-	22
	(5,785)	8,537	(22,690)	3,387
<b>Investing activities</b>				
Acquisition of Liquor Barn	-	(928)	-	(1,679)
Business acquisitions (note 4)	(2,363)	(1,679)	(4,478)	(9,748)
Net deposits on future acquisitions (note 5)	(1,064)	(190)	(3,064)	540
Notes receivable	(4)	-	(306)	-
Purchase of property and equipment	(795)	(1,277)	(3,727)	(3,077)
Pre-opening costs	(398)	(14)	(1,284)	(289)
Proceeds on currency forward contract	-	-	95	-
	(4,624)	(4,088)	(12,764)	(14,253)
<b>Increase (decrease) in cash and cash equivalents</b>	56	3,500	(18,688)	3,494
<b>Cash and cash equivalents balance, beginning of period</b>	754	3,391	19,498	3,397
<b>Cash and cash equivalents balance, end of period</b>	\$ 810	\$ 6,891	\$ 810	\$ 6,891

### Supplemental disclosure of cash flow information (note 16)

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

September 30, 2008

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## 1 Nature of operations and organization

Liquor Stores Income Fund (the "Fund") is an unincorporated, open ended, limited purpose trust established under the laws of the Province of Alberta pursuant to a Declaration of Trust dated August 10, 2004.

As at September 30, 2008, the Fund operated 207 retail liquor stores, of which 174 (2007 – 162) were in Alberta and 33 (2007 - 31) were in British Columbia, and had an interest in one store in Eastern Canada (2007 – nil). Of the stores operated, 183 (2007 – 177) were acquired by the Fund and 24 (2007 - 11) were developed by the Fund.

## 2 Significant accounting policies and basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited financial statements for the year ended December 31, 2007, except as noted below. However, these interim consolidated financial statements do not include all information and footnote disclosures required under Canadian GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with the audited financial statements and notes thereto, for the year ended December 31, 2007.

### Adoption of new accounting standards

Effective January 1, 2008, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook sections 1535 – Capital Disclosures, 3862 – Financial Instruments – Disclosures, 3863 – Financial Instruments – Presentation, and 3031 – Inventories.

While the adoption of these standards resulted in additional financial statement presentation and disclosures, which are included in notes 12 and 17 and the statements of earnings, no accounting policy changes or adjustments to amounts recorded in prior periods were necessary.

The Emerging Issues Committee of the CICA issued Abstract 171 on August 28, 2008, which resulted in a retrospective change in the Fund's accounting policy for future income taxes (see note 3).

### Accounting standards issued but not yet effective

#### (a) Section 3064 - Goodwill and intangible assets

This new standard provides guidance over the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard is effective for fiscal periods beginning on or after October 1, 2008 and requires retrospective application to prior period financial statements. Concurrent with the adoption of this standard, EIC 27 – Revenues and Expenditures during the Pre-operating period, will be withdrawn. This will result in a change to the Fund's accounting for store pre-opening costs as these costs will no longer be capitalized as an asset.

#### (b) International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed on February 13, 2008, that International Financial Reporting Standards will replace Canada's current generally accepted accounting principles for the financial statements of publicly accountable enterprises effective January 1, 2011. The Fund is presently evaluating the impact these standards will have on the financial statements.

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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### 3 Change in accounting policy

The Fund has adopted CICA Emerging Issues Committee Abstract #171 (“EIC-171”) Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through. EIC-171 states that future taxes related to temporary differences associated with the assets and liabilities attributable to the exchangeable interests should not be recorded prior to the conversion of the exchangeable interest. The future income taxes should be accounted for as a capital transaction at the time of conversion.

The Fund has retrospectively applied EIC-171 with restatement of prior periods as required by the standard’s transitional provisions. The impact of retroactively adopting EIC-171 for future taxes related to temporary differences associated with the assets and liabilities attributable to exchangeable interests is as follows:

	December 31, 2007 (restated)	December 31, 2007 (as originally presented)
(expressed in thousands of Canadian dollars)		
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Balance sheet		
Future income tax liability	\$ 8,632	\$ 10,300
Non-controlling interest	50,637	49,671
Fund Units	308,694	308,087

The impact on reported earnings is as follows:

	Nine months ended September 30,	
	2008	2007
(expressed in thousands of Canadian dollars)		
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Decrease in future income tax expense	\$ 674	\$ 2,808
(Increase) in non-controlling interest	(675)	(2,478)
Increase (decrease) in net earnings	(1)	330
Increase in basic and diluted earnings per unit	\$ 0.00	\$ 0.02

The cumulative impact of the changes to December 31, 2007 is an increase of \$94,834 to unitholders’ equity.

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 4 Business acquisitions

The business acquisitions have been accounted for using the purchase method, whereby the purchase consideration was allocated to the estimated fair values of the assets acquired and liabilities assumed at the effective date of the purchase. The purchase price allocations are preliminary and subject to amendment once final valuations are completed.

### (a) Retail liquor store acquisitions

During the three and nine month periods ended September 30, 2008, the Fund acquired one (2007 – 2) and five (2007 – 86) retail liquor stores. The operating results of the acquisitions are included in the results of the Fund from the acquisition date.

During the three month period ended September 30, 2008, adjustments to goodwill and intangible assets of \$18,402 and \$167,055, respectively, related to transaction costs and the finalization of third party valuations for prior period acquisitions (2007 - \$47,574). During the quarter, an addition to intangible assets of \$750,000 for the final instalment payment related to a 2007 liquor license purchase. During the nine month period ended September 30, 2008, adjustments to goodwill and intangible assets of \$240,852 and \$174,218, respectively, related to transaction costs, contingent payments and the finalization of third party valuations for prior period acquisitions (2007 - \$314,387).

Of the goodwill acquired for retail liquor store acquisitions during the three and nine month periods ended September 30, 2008, \$520,522 and \$960,791, respectively are expected to be deductible for tax purposes.

### (b) Liquor license acquisitions

There were no (2007 – 2) liquor licenses acquired during the three month period ended September 30, 2008 and one (2007 -3) liquor license acquired during the nine month period ended September 30, 2008 for cash consideration of \$1,730,000 (2007 – \$1,628,398).

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

September 30, 2008

The purchase price allocated to the assets acquired and the liabilities assumed, based on their preliminary fair values, is as follows:

(expressed in thousands of Canadian dollars)	<b>Three months ended September 30, 2008</b>	<b>Nine months ended September 30, 2008</b>
Purchase price:		
Cash deposit paid in prior year	\$ -	\$ 587
Cash deposit paid during period ended June 30, 2008	-	2,050
Cash paid during period	2,363	4,478
	2,363	7,115
Net assets acquired:		
Working capital	75	1,001
Property and equipment	281	1,451
Intangible assets	1,487	3,702
Goodwill	520	961
	\$ 2,363	\$ 7,115

Acquired intangible assets are summarized as follows:

(expressed in thousands of Canadian dollars)	<b>Three months ended September 30, 2008</b>	<b>Nine months ended September 30, 2008</b>
Finite life intangible assets:		
Retail liquor licenses	\$ 31	\$ 358
Customer relationships	-	110
Leases	-	44
	31	512
Indefinite life intangible assets:		
Retail liquor licenses	1,456	3,190
	\$ 1,487	\$ 3,702



# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 5 Deposits on future acquisitions

Deposits represent refundable and non-refundable amounts paid for the acquisition of retail liquor stores where the purchase transaction is incomplete at the balance sheet date. Deposits for the acquisition of inventory and working capital are included in prepaid expenses and deposits.

Current period activity is as follows:

(expressed in thousands of Canadian dollars)	Non-current Deposits	Current Deposits
Balance – December 31, 2007	\$ 647	\$ 160
Deposits tendered	3,274	416
Acquisitions completed	(2,637)	(175)
Holdbacks released and refunds received	(210)	(66)
Balance – September 30, 2008	\$ 1,074	\$ 335

## 6 Long-term debt

Long-term debt comprises the following:

(expressed in thousands of Canadian dollars)	Maturity Date	2008 Effective Rate	September 30, 2008	December 31, 2007
Capital/Acquisition Facility advance	May 31, 2009	5.00%	\$ 15,000	\$ 30,000
Convertible unsecured subordinated debentures:				
6.75% Debenture	December 31, 2012	10.13%	50,878	43,451
8.00% Debenture	December 31, 2011	4.85%	547	563
			66,425	74,014
Less: current portion of long-term debt			(15,000)	-
			\$ 51,425	\$ 74,014

On January 15, 2008, the underwriters for the 6.75% unsecured subordinated convertible debentures exercised their over-allotment option to purchase 7,500 additional debentures for gross proceeds of \$7.5 million, bringing the total principal amount of debentures to \$57.5 million. The conversion feature value on the over-allotment option is \$630,000 and has been recorded as equity. The remaining \$6,870,000 was allocated to long-term debt, net of \$313,475 in transaction costs.

During the three month period ended September 30, 2008, interest on convertible debentures of \$1,297,478 (2007 - \$nil) represents coupon interest of \$980,312 and \$317,166 pertaining to the impact of capitalized transaction costs and the accretion of the debt using the effective interest rate method. For the nine months ended September 30, 2008, interest on convertible debentures was \$3,790,872 (2007 - \$nil), of which \$2,934,574 represents coupon interest and \$856,298 pertains to the impact of capitalized transaction costs and the accretion of debt using the effective interest rate method.

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 7 Distributions

Distributions are determined in accordance with the Trust Indenture, and are based on earnings, before amortization and adjusted by capital expenditures. Distributions totalling \$0.405 (2007 - \$0.375) per Unit for each of Fund Units, Liquor Stores Exchangeable LP Units and Liquor Stores Series 1 Exchangeable LP Units were declared by the Fund for the three months ended and \$1.215 (2007 - \$1.108) per Unit for the nine months ended September 30, 2008.

(expressed in thousands of Canadian dollars)		Fund Units		Liquor Stores Exchangeable LP Units		Liquor Stores Series 1 Exchangeable LP Units		Total	
Date distribution declared	Date distribution paid	Declared	Paid	Declared	Paid	Declared	Paid	Declared	Paid
Jan 15, 2008	Feb 15, 2008	\$ 2,472	\$ 2,472	\$ 446	\$ 446	\$ 117	\$ 117	\$ 3,035	\$ 3,035
Feb 15, 2008	Mar 14, 2008	2,476	2,476	445	445	114	114	3,035	3,035
Mar 14, 2008	Apr 15, 2008	2,476	2,476	445	445	114	114	3,035	3,035
Apr 15, 2008	May 15, 2008	2,476	2,476	444	444	114	114	3,034	3,034
May 15, 2008	Jun 13, 2008	2,477	2,477	443	443	114	114	3,034	3,034
Jun 13, 2008	Jul 15, 2008	2,477	2,477	443	443	114	114	3,034	3,034
Jul 15, 2008	Aug 15, 2008	2,477	2,477	443	443	114	114	3,034	3,034
Aug 15, 2008	Sep 15, 2008	2,477	2,477	444	444	114	114	3,035	3,035
Sep 15, 2008		2,477		444		114		3,035	
		\$ 22,285	\$ 19,808	\$ 3,997	\$ 3,553	\$ 1,029	\$ 915	\$ 27,311	\$ 24,276

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 8 Future income taxes

Prior to June 12, 2007, the Fund provided for current and future income taxes only for its incorporated subsidiaries. On June 22, 2007, Bill C-52, including provisions related to the taxation of income trusts commencing January 1, 2011 (or sooner in certain circumstances), received Royal Assent. As a consequence, Canadian income trusts are required to provide for future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011. The rate applicable to the determination of these taxes is 28.0%.

Determining future income taxes involves a number of assumptions and variables that could reasonably change in the period to January 1, 2011, including: the useful lives of recorded property, plant and equipment and intangible assets that determine the amount of amortization recorded thereon; the amount of discretionary tax deductions the Fund will claim from its existing tax depreciation pools, the rates of tax applicable to various jurisdictions in which the Fund is taxable and the allocation of taxable income to those jurisdictions; and the acceptance of the Fund's tax filing positions by the taxation authorities. Changes in these assumptions and variables, which are re-evaluated at each balance sheet date, could result in changes in the recorded amount of future income taxes, and these changes could be material.

Future income tax assets and liabilities are recognized based on temporary differences between accounting and tax bases of existing assets and liabilities as follows:

(expressed in thousands of Canadian dollars)	September 30, 2008	December 31, 2007 (restated – note 3)
Future income tax liabilities:		
Intangible assets	\$ 6,092	\$ 4,330
Property and equipment	3,376	3,129
Goodwill	3,127	1,569
Debentures	-	130
	12,595	9,158
Future income tax assets:		
Issue costs	368	375
Deferred lease inducements	144	83
Non-capital losses	87	68
	599	526
	\$ 11,996	\$ 8,632

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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Future income taxes of \$2,689,170 attributable to the Fund's exchangeable interests are not recorded. During the three months ended September 30, 2008 no units were exchanged. During the nine months ended September 30, 2008, 37,456 (2007 – 1,046,699) units were exchanged resulting in an increase to future income taxes of \$23,863 (2007 – \$506,491).

The Fund has recognized future income taxes related to non-capital losses of \$597,412 (2007 - \$652,203) available in a subsidiary to offset income of future years. If not utilized, \$400,526 will expire in 2026 and \$196,886 will expire in 2027.

Future income taxes are not recorded on \$103,745,778 of non tax-deductible goodwill.

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 9 Non-controlling interest

	Exchangeable LP Units	Series 1 Exchangeable LP Units	Total
Balance – December 31, 2007	# 3,300,255	# 867,789	# 4,168,044
Exchanged for Fund Units	(15,076)	(22,380)	(37,456)
Balance – September 30, 2008	# 3,285,179	# 845,409	# 4,130,588

(expressed in thousands of Canadian dollars)

(restated – note 3)

Balance – December 31, 2007	\$ 50,402
Earnings	2,937
Exchanged for Fund Units	(619)
Series 1 Exchangeable LP Unit conversion	216
Distributions declared (note 7)	(5,026)
Balance – September 30, 2008	\$ 47,910

### Subsidiaries

Balance - December 31, 2007	\$ 235
Earnings	255
Dividends	(321)
Balance – September 30, 2008	\$ 169
<b>Total</b>	<b>\$ 48,079</b>

### Liquor Stores LP Exchangeable LP Units (“Exchangeable LP Units”) and Liquor Stores LP Series 1 Exchangeable LP Units (“Series 1 Exchangeable LP Units”)

On January 1, 2008, Liquor Stores LP issued 867,789 Series 1 Exchangeable LP Units as consideration for the outstanding non-controlling interest in Liquor Barn LP, which consisted of 867,789 Liquor Barn Exchangeable LP Units.

The Exchangeable LP Units and Series 1 Exchangeable LP Units issued by Liquor Stores LP have economic and voting rights equivalent to the Fund Units (note 10), except in connection with the exchangeability terms as described below. They are exchangeable, directly or indirectly, on a one-for-one basis for Fund Units at the option of the holder, under the terms of the Exchange Agreement. The Exchangeable LP Units are not required to be exchanged for Fund Units before transferring to third parties. Exchangeable LP Units and Series 1 Exchangeable Units have been treated as non-controlling interest, in accordance with the CICA Emerging Issues Committee Abstract #151.

Each Exchangeable LP Unit and Series 1 Exchangeable LP Unit entitles the holder to receive distributions pro rata with distributions made on Fund Units.

# Liquor Stores Income Fund

Notes to the Consolidated Financial Statements

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## 10 Unitholders' Equity

### Fund Units

Units outstanding and capital contributions are as follows:

(expressed in thousands of Canadian dollars)	Number of units	Issue costs	Net capital contributions (restated – note 3)
Balance – December 31, 2007	# 18,294,278	\$ 10,271	\$ 308,694
Issued for Exchangeable Units	37,456	-	619
Vested Units (note 14 (a))	15,997	-	341
Cash distributions on vested Units	-	-	(12)
Treasury Units issued on March 7, 2008 (note 14 (a))	49,143	-	1,060
Vested Treasury Units issued on March 7, 2008 (note 14 (a))	(695)	-	(15)
Treasury Units	(48,448)	-	(1,045)
Balance – September 30 ,2008	# 18,347,731	\$ 10,271	\$ 309,642

An unlimited number of Fund Units may be created and issued pursuant to the Declaration of Trust. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. All Fund Units entitle the holder thereof to one vote and each Fund Unit has equal voting rights and privileges.

Consideration for units issued on exchange of Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units during the period ended September 30, 2008 was recorded at the carrying amount of the Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units in accordance with EIC-151.

The monthly cash distributions received by the Long Term Incentive Plan and the 2007 Incentive Plan are remitted to the participants when the associated Units vest.

Treasury Units represent unvested Units held in the LTIP (note 14 (a)).

## 11 Contributed Surplus

The table below summarizes the changes in contributed surplus:

(expressed in thousands of Canadian dollars)	Amount
Balance – December 31, 2007	\$ 558
Vested Units (note 14 (a))	(341)
Unit-based compensation expense	672
Balance – September 30, 2008	\$ 889

The Fund manages two unit-based incentive plans under which certain senior management receives a portion of their compensation (note 14 (a)). Awarded Units vest evenly over a period of three years. As the Units vest, they are transferred to the plan participant and recorded against contributed surplus.

# Liquor Stores Income Fund

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## 12 Capital

The Fund views capital as the combination of its convertible debentures and Unitholders' equity balances. In general, the overall capital of the Fund is evaluated and determined in the context of its financial objectives when managing capital, which are to ensure the Fund has capital and capacity to support its growth strategy, provide investors with stable returns and ensure the Fund has the financial capacity to support its operations.

The Fund's capital structure reflects the requirements of a company focused on growth, both through development of new stores and through acquisition. Management continually monitors the adequacy of the Fund's capital structure and adjusts the structure accordingly either by accessing credit facilities, issuing debt instruments, or issuing new units.

There were no changes to the Fund's objectives, policies or processes for managing capital from the prior fiscal period.

The Fund's indebtedness is subject to a number of financial covenants, but none are capital related. Under the terms of the Fund's credit facility, the following ratios are monitored: adjusted debt to EBITDAR, current ratio and fixed coverage ratio. For the three months ended September 30, 2008, the Fund is in compliance with all covenants.

With respect to equity, the current level of capital is considered adequate with regards to operations and the strategic plan of the Fund. The equity component of capital changes primarily based upon the income of the Fund less distributions paid.

The Fund will review its level of equity in the context of the change in taxation impacting the Fund in 2011 as described in note 8.

# Liquor Stores Income Fund

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## 13 Earnings per Unit

(expressed in thousands of Canadian dollars, except per unit amounts)	Three months ended September 30, 2008	Three months ended September 30, 2007 (restated – note 3)	Nine months ended September 30, 2008	Nine months ended September 30, 2007 (restated – note 3)
Net earnings (numerator utilized in basic and diluted Earnings per Unit)	\$ 6,228	\$ 5,600	\$ 9,483	\$ 429
Units outstanding, beginning of period	#18,347,730	#17,521,291	#18,294,278	#10,228,320
Weighted average of Units issued less treasury Units acquired	-	460,964	45,864	3,139,384
Denominator utilized in basic earnings per unit	18,347,730	17,982,255	18,340,142	13,367,704
Potential units under unit-based compensation plans (note 14 (a))	1,294	2,507	14,838	5,027
Denominator utilized in diluted earnings per unit	#18,349,024	#17,984,762	#18,354,980	#13,372,731
Earnings per Unit – Basic	\$ 0.34	\$ 0.31	\$ 0.52	\$ 0.03
Earnings per Unit – Diluted	\$ 0.34	\$ 0.31	\$ 0.52	\$ 0.03

Non-controlling interest earnings related to exchangeable units, exchangeable units and potential units for convertible debentures have not been included in the diluted earnings per unit calculation due to their anti-dilutive effect.



# Liquor Stores Income Fund

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## 14 Unit-based compensation plans

- (a) Long-term incentive plan (“LTIP”) and 2007 Incentive Plan (“2007 Plan”)

The following table summarizes the status of the Plans:

		LTIP		2007 Plan		2008 Total
Unvested Units December 31, 2007	#	2,692	#	42,812	#	45,504
Granted March 7, 2008		49,143		-		49,143
Vested Units transferred to participants		(1,726)		(14,271)		(15,997)
Unvested Units, end of period	#	50,109	#	28,541	#	78,650

On March 7, 2008, 49,143 Units were granted under the LTIP and issued from treasury at a price of \$21.57 per Unit for a total cost of \$1,060,015. Of these units granted, 695 vested during the nine month period ended September 30, 2008 and compensation expense for these units has been fully recognized and expensed. For the remaining units granted, the compensation expense will be recognized over the vesting period of three years or sooner under certain circumstances.

Compensation expense for the LTIP for the three month period ended September 30, 2008 was \$195,927 (2007 - \$8,771) and \$458,713 (2007 - \$19,735) for the nine month period ended September 30, 2008. Compensation expense of \$71,178 (2007 - \$146,932) was recorded for the 2007 Plan for the three month period ended September 30, 2008 and \$213,534 (2007 - \$355,249) for the nine month period ended September 30, 2008.

Effective May 8, 2008 the unitholders approved the adoption of the Unit Award Incentive Plan (the “UAIP”). This will replace the LTIP and 2007 Plan for future awards.

- (b) Trustee and director deferred unit plan (“DSU Plan”)

During the three month period ended September 30, 2008, awards accruing to DSU Plan participants were reduced by \$12,118 (2007 - recorded a compensation expense of \$52,664), which were recorded as a reduction to compensation expense in the period. For the nine months ended September 30, 2008, the total compensation expense related to the DSU Plan was \$4,413 (2007 - \$145,367). As at September 30, 2008 participants have accumulated an entitlement to the equivalent cash value of 22,399 Units under the DSU Plan (December 31, 2007 - 13,629).

## 15 Related party transactions

A director of a subsidiary of the Fund is a partner in a law firm to which the Fund incurred professional fees during the three and nine months ended September 30, 2008 of \$92,177 (2007 - \$107,242) and \$274,298 (2007 - \$268,321), respectively. Further, the Fund paid fees and expenses to a company controlled by the Chief Executive Officer of the Fund for tax services in the amount of \$3,253 (2007 - \$15,947) during the quarter and \$38,461 (2007 - \$31,453) during the nine month period ended September 30, 2008. Rent paid to companies controlled by directors of the GP amounted to \$99,613 (2007 - \$56,818) and \$329,404 (2007 - \$96,819) respectively for the three and nine months ended September 30, 2008. These operating and administrative expenses are incurred in the normal course of business at terms similar with unrelated parties and are measured at the exchange amount. There are no amounts included in accounts payable and accrued liabilities (December 31, 2007 - \$5,689) relating to these transactions.

# Liquor Stores Income Fund

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## 16 Supplemental disclosure of cash flow information

(expressed in thousands of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Interest paid	\$ 475	\$ 592	\$ 3,166	\$ 1,020
Income taxes paid	4	-	234	65

## 17 Financial Instruments

### Recognition and measurement

The Fund's financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, bank indebtedness, accounts payable and accrued liabilities, distributions payable to Unitholders and non-controlling interest, a currency forward contract, foreign currency options contracts, and long-term debt.

The following table shows the carrying values and fair values of the Fund's financial instruments at September 30, 2008:

(expressed in thousands of Canadian dollars)	September 30, 2008		December 31, 2007	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Held for trading <sup>(i)</sup>				
Cash and cash equivalents	\$ 810	\$ 810	\$ 19,498	\$ 19,498
Currency forward contract	494	494	-	-
Foreign currency option contracts	137	137	-	-
Loans and receivables <sup>(ii)</sup>				
Accounts receivable	2,274	2,274	3,474	3,474
Notes receivable	306	306	-	-
Other financial liabilities <sup>(iii)</sup>				
Bank indebtedness	13,298	13,298	-	-
Accounts payable and accrued liabilities	8,629	8,629	10,498	10,498
Distributions payable to unitholders	2,477	2,477	2,470	2,470
Distributions payable to non-controlling interest	558	558	1,094	1,094
Capital/acquisition facility advance	15,000	15,000	30,000	30,000
Convertible debentures	51,425	56,666	44,014	50,750

### (i) Held for trading

For cash and cash equivalents, the fair value represents cost plus accrued interest. Due to the short-term nature of the instruments, the carrying value approximates fair value.

The currency forward contract and foreign currency option contracts are carried at fair value, which represents the market value of the contracts at September 30, 2008. The currency forward contract and foreign currency option contracts have been included in accounts receivable for financial statement presentation purposes.

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## (ii) Loans and receivables

The carrying value less impairment provision of trade receivables approximates fair value due to the short-term nature of the instruments.

Notes receivable are interest-bearing loans at market rates with repayment terms that extend beyond one year. Carrying value is the amortized cost of the notes determined by using the effective interest rate method. Due to the interest being at market rates, fair value approximates carrying value.

## (iii) Other financial liabilities

The carrying value of trade payables is assumed to approximate fair value due to the short-term nature of the instruments. The carrying value of bank indebtedness and long-term debt, excluding convertible debentures, approximates the fair value as the interest rate affecting these instruments is at market rate. Convertible debentures have been recorded at amortized cost using the effective interest method. The fair value of the debentures was determined based on trading values at September 30, 2008.

## Credit risk

Credit risk is the risk that a third party to a financial instrument might fail to meet its obligations under the terms of the financial instrument. The Fund's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents, accounts receivable and notes receivable. The Fund maintains its cash and cash equivalents with a major Canadian chartered bank. The Fund, in its normal course of operations, is exposed to credit risk from its customers. Risk associated with respect to accounts receivable is mitigated by credit management policies. The Fund is not subject to significant concentration of credit risk with respect to its customers; however, all trade receivables are due from organizations in the Alberta and British Columbia hospitality industries. There were no bad debts recorded or significant past due accounts for the three and nine months ended September 30, 2008. Notes receivable are secured by interests in retail liquor stores. There have been no loan impairments for the period ended September 30, 2008.

## Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as market prices change.

The Fund is subject to interest rate risk as its credit facilities bear interest rates that vary in accordance with borrowing rates.

The following table presents a sensitivity analysis to changes in market interest rates and their potential annual impact on the Fund as at September 30, 2008, assuming an outstanding bank indebtedness and long-term debt balance of \$28,298,000.

(expressed in thousands of Canadian dollars)	+ 1.00%	- 1.00%
Increase (decrease) in interest expense	\$ 283	\$ (283)
Increase (decrease) in earnings before income tax and non-controlling interest	\$ (283)	\$ 283

# Liquor Stores Income Fund

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The Fund manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans.

## Liquidity risk

The Fund has long-term indebtedness with a maturity date of May 31, 2009, 8.00% convertible debentures maturing on December 31, 2011 and 6.75% convertible debentures maturing on December 31, 2012. The degree to which the Fund is leveraged may reduce its ability to obtain additional financing for working capital and to finance growth acquisitions. The Fund may be unable to extend the maturity date of the credit facilities or to refinance outstanding indebtedness.

To reduce liquidity risk, the Fund has historically renewed credit terms prior to maturity dates and maintains financial ratios that are conservative compared to financial covenants applicable to the credit facilities. The Fund has made payments on outstanding long-term debt balances in advance of maturity dates. In addition, a portion of the Fund's short and long-term credit facilities remain undrawn.

Management measures liquidity risk through comparisons of current financial ratios with financial covenants contained in the credit facility agreement.

## Foreign exchange risk

The Fund has entered into forward currency and foreign currency options contracts and holds US dollar funds to minimize foreign exchange risk.

The Fund has a currency forward contract which is due in October 2008. The foreign currency option contracts are exercisable in October 2008. The fair values of the contracts have been recorded as an asset of the Fund at September 30, 2008. The Fund does not use hedge accounting.

## Other comprehensive income

As the Fund has no items of other comprehensive income, net earnings for the period is equivalent to comprehensive income.

## 18 Segmented information

The Fund identifies operating segments based on business activities, management responsibility, and geography. The Fund operates within a single operating segment, being the operation of retail liquor stores in Canada. All of the Fund's operating assets are currently located in Canada.

## 19 Seasonal nature of the business

The Fund historically experiences higher sales in the third and fourth quarters, while the first and second quarter typically experience lower sales levels due to seasonal shopping patterns. Occupancy related expenses, operating and administrative expense and amortization remain relatively steady throughout the year.

# Liquor Stores Income Fund

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## 20 Subsequent events

On November 5, 2008 the Fund acquired 19 retail liquor stores located in Alaska, USA. The aggregate purchase price (including inventory) was approximately \$36.3 million. In anticipation of entry into the US market, the Fund had entered into certain foreign exchange contracts. The Fund realized a foreign exchange gain of \$3.1 million from settling the currency contracts and holding the resulting US dollars to the acquisition date.