



LIQUOR STORES INCOME FUND

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

**For the Three and Six Months Ended June 30, 2009
As of August 11, 2009**

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 and six months ended June 30, 2009 and the annual consolidated financial statements and accompanying notes of the Fund for the year ended December 31, 2008. 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 notes of the Financial Statements unless otherwise stated.

Throughout this MD&A references are made to "EBITDA", "distributable cash", "distributable cash before non-recurring items", "operating margin", "operating margin before non-recurring items", "operating margin as a percentage of sales", "payout ratio" and other "Non-GAAP Measures". A description of these measures and their limitations are discussed on page 22 below under "Non-GAAP Measures".

See also "Risk Factors" on page 17 and "Forward-Looking Statements" on page 26 of this MD&A.

This MD&A is dated August 11, 2009.

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.

HIGHLIGHTS

Second quarter 2009 compared with second quarter 2008

- Distributable cash before non-recurring items up 46.2% to \$13.6 million from \$9.3 million.
- Distributable cash per unit before non-recurring items up 46.3% to \$0.60 per unit from \$0.41.
- Total sales increased 15.4% to \$140.3 million.
- Adjusted gross margin up 25.6% to \$36.8 million from \$29.3 million.
- Operating margin up 45.1% to \$14.8 million from \$10.2 million.

Six months ended June 30, 2009 compared with six months ended June 30, 2008

- Distributable cash before non-recurring items up 29.4% to \$17.6 million from \$13.6 million.
- Distributable cash per unit before non-recurring items up 30.0% to \$0.78 per unit from \$0.60 per unit.
- Total sales increased 14.2% to \$246.6 million.
- Adjusted gross margin up 20.9% to \$63.7 million from \$52.7 million.
- Operating margin up 31.8% to \$19.9 million from \$15.1 million.

OUTLOOK

Management expects overall sales to increase for 2009 compared with 2008 due to the increased number of stores operated by the Fund and its subsidiaries; however, same store sales may continue to be affected by the current economic environment. The downturn has had an impact on the Fund's geographic markets: Alberta, British Columbia and Alaska which are dependent on

resource industries such as oil and gas exploration, mining and forestry. It is unknown at this time what impact this will have on the Fund's operations for the remainder of the year.

On April 7, 2009 the Government of Alberta announced an increase to its liquor mark-up. As the Fund increased retail prices to reflect the increased mark-up, holding gains were realized as inventory purchased prior to April 7 was sold at higher prices which resulted in increased margins for the second quarter. The Alberta Government rescinded the liquor mark-up increase effective July 7, 2009. As a consequence, management expects the benefits of the mark-up increase in the second quarter will reverse in the third quarter as retail prices are lowered.

The Fund will continue to focus on its strategy of growth through acquisitions and new store development. The Fund currently has access to approximately \$33 million that may be used for growth and inventory financing.

The Fund has entered into a definitive agreement for the acquisition of a chain of liquor stores in Kentucky. The Fund, through a wholly-owned subsidiary, will acquire eight stores which comprise the Liquor Barn chain of liquor stores, operating in the cities of Louisville and Lexington. Liquor Barn is the largest independent liquor store chain in the state by revenue. The acquisition is subject to completion of due diligence, customary closing conditions, and regulatory approvals. Closing is anticipated to occur prior to December 2009 and the transaction will be funded with available credit facilities.

The Fund has opened two stores in 2009 in Alberta and has commitments to open an additional five stores.

OVERVIEW OF THE FUND

The Fund is an unincorporated open-ended, limited purpose trust established under the laws of the Province of Alberta. The Fund's trust units ("Units") and 6.75% convertible unsecured subordinated debentures ("6.75% Debentures") trade on the Toronto Stock Exchange under the symbols LIQ.UN and LIQ.DB, respectively. Through its 82.1% indirect interest in Liquor Stores Limited Partnership ("Liquor Stores LP"), the Fund operates or has investments in 225 retail liquor stores. Management believes the Fund is the largest liquor store operator in Alberta by number of stores and revenue.

Stores and Operations (as of August 11, 2009)

| | Alberta | | | British Columbia | | | Alaska | Other | Total |
|------------------|-------------------------|------------------------|----------------------|------------------|------------------|----------|-----------|-------|-------|
| | Edmonton ⁽¹⁾ | Calgary ⁽¹⁾ | Other ⁽²⁾ | Lower Mainland | Vancouver Island | Interior | Anchorage | | |
| Number of Stores | 78 | 45 | 47 | 13 | 11 | 11 | 19 | 1 | 225 |

Notes:

- (1) References to Edmonton and Calgary are to stores located in or near those urban centres.
- (2) Other communities served in Alberta include, by region, Northern (22), Southern (9), Central (14) and Resort communities (2).

Competitive Environment

The Province of Alberta is the only province in Canada that has a fully privatized retail distribution system for adult beverages. The Fund currently operates 170 liquor stores in Alberta where there are approximately 1,122 liquor stores and 88 agency stores as at March 31, 2009 [Source: Alberta Gaming and Liquor Commission].

The Fund operates 35 stores and five small associated pubs in British Columbia. The Province of British Columbia's model for liquor distribution is a blend of approximately 666 private stores and 199 government operated stores. There are also approximately 229 private agency stores that service small communities. [Source: British Columbia Liquor Distribution Branch].

The Fund currently operates 19 stores in the greater Anchorage area. In the state of Alaska there are approximately 380 retail liquor stores with approximately 90 stores in the greater Anchorage area. There are no government owned or operated liquor

stores and the state limits the number of liquor stores in the state to one per 3,000 people in urban areas [Source: Alaska's Alcoholic Beverage Control Board].

BUSINESS STRATEGY

Growth

The Fund's strategy is to continue to grow through new store development and acquisitions and by attracting more customers to existing locations. The Fund explores opportunities to acquire and/or develop stores in Alberta, British Columbia, and the United States where regulatory regimes permit private liquor stores. Management will continue to assess potential acquisitions and store development opportunities for their ability to add accretive cash flow and unitholder value.

Competitive Differentiation

Management focuses on differentiating the Fund's stores from the competition by promoting its broad selection of products by emphasizing the in-store customer experience, technology, and marketing and brand development. Many of our stores offer customer education events and merchandise presentations. As well, select stores have controlled dispensing equipment for wine samplings.

To improve efficiencies and enhance the customer experience, management is currently working on a number of information systems initiatives that include a point-of-sale system upgrade.

Management will continue to concentrate marketing efforts on the Fund's current brand structure: Liquor Depot, Liquor Barn and Brown Jug full service stores, as well as Grapes 'n Grains specialty stores.

DISTRIBUTABLE CASH

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. Cash available for distribution is adjusted for cash required for maintenance capital expenditures, pre-opening costs for new stores, working capital reserve, and other reserves considered advisable by the Fund, including provisions for the Fund's deferred compensation plans. The policy allows the Fund to make stable monthly distributions to its unitholders based on estimates of annual 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's distribution policy is based on annualized distributable cash flow; accordingly, the seasonality of the Fund's individual quarterly results must be assessed in the context of annualized distributable cash flows. Historically, approximately 46% of the Fund's sales have occurred in the first half of the year and 54% in the latter half. It is the Fund's policy to pay consistent regular monthly distributions throughout the year based on estimated annual cash flows. The Fund reviews its historic and expected results on a regular basis giving consideration to historical, current and expected future performance of existing and new stores, the competitive environment and economic conditions, including labour market trends. In the first half of the year, distributions typically exceed distributable cash and in the second half of the year, distributable cash typically exceeds distributions such that the Fund has historically distributed approximately 90% of distributable cash on an annualized basis.

Distributions declared during the three months ended June 30, 2009 were \$9.1 million or \$0.405 per Unit, consistent with a year earlier. On a weighted average basis, for the three months ended June 30, 2009, distributable cash before non-recurring items was \$13.6 million or \$0.60 per Unit, compared with \$9.3 million or \$0.41 per Unit for the same period in 2008. For the six months ended June 30, 2008, distributable cash before non-recurring items per weighted average unit was \$17.6 million or \$0.78 compared to \$13.6 million or \$0.60 for the same period in 2008. Non-recurring items for the three and six months ended June 30, 2009 were largely comprised of professional and consulting fees for litigation matters related to the Liquor Barn acquisition.

The following table provides a reconciliation of distributable cash to its nearest GAAP measure, which is cash provided by operating activities:

| (expressed in thousands of Canadian dollars) | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|--------------------------------|---------------------------|--------------------------------|
| | 2009 | 2008 (Restated – note 1) | 2009 | 2008 (Restated – note 1) |
| Cash provided by operating activities | \$ 3,772 | \$ 2,722 | \$ 19,078 | \$ 5,412 |
| Net change in non-cash working capital | 9,663 | 6,021 | (1,827) | 6,957 |
| Provision for non-growth property and equipment | (133) | (79) | (181) | (191) |
| Provision for pre-opening costs | 64 | 478 | 116 | 727 |
| Distributable cash | 13,366 | 9,142 | 17,186 | 12,905 |
| Non-recurring items (note 2) | 242 | 205 | 437 | 705 |
| Distributable cash before non-recurring items | \$ 13,608 | \$ 9,347 | 17,623 | \$ 13,610 |
| Weighted average units outstanding | # 22,556,969 | # 22,556,969 | # 22,556,969 | # 22,538,878 |
| Distributable cash before non-recurring items per Unit | \$ 0.60 | \$ 0.41 | \$ 0.78 | \$ 0.60 |
| Distributable cash per Unit (note 3) | \$ 0.59 | \$ 0.41 | \$ 0.76 | \$ 0.57 |
| Distributions declared per Unit | \$ 0.41 | \$ 0.41 | \$ 0.81 | \$ 0.81 |

- (1) *Comparative information from 2008 has been restated in accordance with the adoption of CICA Handbook Section 3064 – Goodwill and intangible assets and the withdrawal of Emerging Issues Committee Abstract #27 – Revenues and Expenditures during the Pre-Operating Period.*
- (2) *Non-recurring items for the three and six months ended June 30, 2009 and 2008 include professional and consulting fees for litigation matters related to the 2007 acquisition of Liquor Barn Income Fund.*
- (3) *The GAAP measure comparable to distributable cash per unit is earnings per unit. Diluted earnings per Unit for the three months ended June 30, 2009 were \$0.44 compared to diluted earnings per Unit of \$0.24 in the same period of 2008. Diluted earnings per Unit for the six months ended June 30, 2009 were \$0.51 compared to diluted earnings per Unit of \$0.17 in the same period of 2008.*

Distributable cash is a non-GAAP measure. See supplemental liquidity information on page 23 for a detailed discussion of distributable cash.

OPERATING RESULTS

The retail liquor industry is subject to seasonal variations with respect to sales. Sales are typically lowest early in the year and increase in the latter half. In 2008, 20% (2007 - 20%) of annual same store sales occurred in the first quarter, 26% (2007 - 26%) in the second quarter, 26% (2007 - 26%) in the third quarter and 28% (2007 - 28%) in the last quarter.

Policy on Same Store Sales Comparisons

Comparable same store sales is calculated to include sales for stores that have been open 12 full months at the beginning of the reporting period and exclude stores which have significant wholesale business and stores where same store sales have shifted to closely-located Liquor Depot stores opened in 2008. For the three and six months ended June 30, 2009, there were 172 and 167 same stores respectively, including Liquor Depot, Liquor Barn, and Grapes 'n Grains stores. Stores included as same stores for the three months ended June 30, 2009 were acquired or opened prior to April 1, 2008. Same stores for the six months ended June 30, 2009 include stores that were acquired or opened prior to January 1, 2008.

For the three months ended June 30, 2009 three existing stores are excluded from the same store sales comparison due to their close proximity to existing Liquor Depot stores. As it is management's intention to continue to operate both the existing and new locations, these stores will return to the same store sales comparison in the same period in which the corresponding new store is open 12 full months at the beginning of that reporting period. For the three months ended June 30, 2009, two such stores were returned to the same store sales comparison.

As none of the closely-located stores was open at January 1, 2008, five existing stores continue to be excluded from the same store sales comparison for the six months ended June 30, 2009.

Second Quarter 2009 Operating Results

The following table summarizes the operating results for the three months ended June 30, 2009 and 2008.

| (expressed in thousands of Canadian dollars) | Three Months ended June 30, | | | |
|--|-----------------------------|---------|-------------|---------|
| | 2009 | | 2008 | |
| | \$ | % | \$ | % |
| | (unaudited) | | (unaudited) | |
| Number of stores at June 30 (note 1) | 224 | | 204 | |
| Sales | 140,253 | 100.00% | 121,567 | 100.00% |
| Gross margin | 36,811 | 26.25% | 29,277 | 24.08% |
| Adjusted operating and administrative expense (note 2) | 21,969 | 15.66% | 19,106 | 15.72% |
| Operating margin (note 3) | 14,842 | 10.58% | 10,171 | 8.36% |
| Non-recurring items (note 4) | 242 | 0.17% | 205 | 0.17% |
| Operating margin before non-recurring items | 15,084 | 10.75% | 10,376 | 8.53% |

Notes:

- (1) *As no stores were opened or acquired during the three months ended June 30, 2009, the results for this period do not contain partial months of operations for any stores. The number of stores and corresponding results for the three months ended June 30, 2008 includes partial months of operations for six stores opened or acquired during the three month period. The results for 2008 also include seven stores which were closed prior to December 31, 2008.*
- (2) *For the three months ended June 30, 2009, adjusted operating and administrative expense excludes \$0.06 million (2008 - \$0.5 million) in pre-opening costs charged to operating and administrative expense.*
- (3) *Operating margin has been calculated as described under "Non-GAAP Measures".*
- (4) *Non-recurring items for the second quarter of 2009 and 2008 include professional and consulting fees for litigation matters relating to the 2007 acquisition of Liquor Barn Income Fund.*

Second Quarter 2009 Operating Results Compared to Second Quarter 2008 Operating Results

Sales

For the three months ended June 30, 2009 sales were \$140.3 million, up 15.4% from \$121.6 million in the same period last year. The sales increase comprises:

- Stores opened or acquired subsequent to June 30, 2008 (including 19 Brown Jug stores in Alaska) accounted for a \$23.9 million increase in sales. Sales for stores that were opened or acquired in the second quarter of 2008 comprised \$0.4 million of the sales increase.
- Wholesale business sales were \$16.3 million, down 10.4% from \$18.2 million for the second quarter of the prior year. Sales to wholesale customers generate significantly lower margins than retail, and have higher administrative and credit risk costs associated with them. As a result, the Fund plans to further reduce its wholesale business sales in 2009.
- During the fourth quarter of 2008, the Fund closed seven stores. Second quarter sales in 2008 for these stores were \$1.4 million.
- Sales for stores excluded from same store sales due to their close proximity to new stores were \$2.5 million for the three months ended June 30, 2009, down \$0.6 million or 19.4% from \$3.1 million for the same period in 2008.

- Same store sales decreased \$1.7 million as explained below.

Same Store Sales

Same store sales, down \$1.7 million or 1.7% for the three months ended June 30, 2009, were impacted by the following, in order of their assumed effect on same store sales:

- Unseasonably cool temperatures and increased precipitation across Alberta during the spring months and specifically during the May long-weekend and Canada Day. The sales decrease for the May long-weekend and Canada Day more than offset the increased sales from Easter.
- A liquor mark-up increase on alcoholic beverages imposed by the Alberta Government on April 7, 2009, just prior to the Easter long weekend, resulted in reduced customer traffic and sales for the second quarter. The mark-up was rescinded in July 2009. Increased retail prices softened the impact of the reduced customer traffic.
- Economic conditions which continued to impact resource industries in Alberta and British Columbia including oil and gas exploration, mining and forestry.

Gross Margin

For the three months ended June 30, 2009, gross margin was \$36.8 million, up 25.6% from \$29.3 million for the same period last year. There were 27 more stores operated in the second quarter of 2009 than in 2008, including 19 stores in Alaska.

Gross margin was up 2.2% as a percentage of sales to 26.3% for Q2 2009 compared with 24.1% for Q2 2008 mainly due inventory holding gains realized as inventory purchased at lower cost prior to April 7 was sold at increased prices following the Alberta Government's mark-up increase.

Adjusted Operating and Administrative Expense

Adjusted operating and administrative expense for the three months ended June 30, 2009 was \$22.0 million, up 15.2% from \$19.1 million a year earlier mainly due to the increase in the number of stores operated. Operating and administrative expense for the three months ended June 30 for both 2009 and 2008 included \$0.2 million in non-recurring consulting and professional fees for litigation related to the acquisition of Liquor Barn Income Fund in 2007.

As a percentage of sales, adjusted operating and administrative expense is consistent with the second quarter of 2008 at just under 16%.

Operating Margin

Operating margin was \$14.8 million for the second quarter of 2009, up 45.1% from \$10.2 million in 2008. As a percentage of sales, operating margin was 10.6% for Q2 2009 compared with 8.4% for Q2 2008. The 2009 operating margin percentage is up due to the contribution of stores acquired and developed in 2008, including 19 Brown Jug stores, and to a lesser extent, holding gains realized on inventory resulting from the Alberta Government liquor mark-up increase that took effect in early April. The liquor mark-up increase was rescinded in July 2009.

Operating margin before non-recurring items for the three months ended June 30, 2009 was 10.8% or \$15.1 million, up from 8.5% or \$10.4 million for the same period last year due to the same reason as discussed above.

Future Income Taxes

The Fund, in accordance with GAAP, follows the asset and liability method of accounting. With the substantive enactment of Bill C-52 in 2007, including the provisions related to the taxation of income trusts (the "SIFT Rules"), the asset and liability method of accounting requires the Fund to record a non-cash future tax provision. For a detailed discussion of the SIFT Rules, see pages 12 and 20. 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 in 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.

In the quarter ended June 30, 2009, the Fund updated its estimate of temporary differences pertaining primarily to certain goodwill, property, plant and equipment, and intangible assets, which resulted in a net increase in future income taxes of \$0.6 million, compared with an increase of \$0.5 million for the same period in 2008. Changes to future income tax estimates represent a non-cash charge against net earnings.

Net Earnings before Non-controlling Interest and Net Earnings

Net earnings before non-controlling interest increased to \$10.1 million for the three months ended June 30, 2009, up from \$5.5 million for the same period in 2008. Net earnings for the three months ended June 30, 2009 included a non-cash future income tax expense of \$0.6 million compared with \$0.5 million for the three months ended June 30, 2008.

For the quarter ended June 30, 2009, net earnings were \$8.1 million, up \$3.8 million from \$4.3 million in 2008.

Six Months Ended June 30, 2009 Operating Results

The following table summarizes the operating results for the six months ended June 30, 2009 and 2008.

| (expressed in thousands of Canadian dollars) | Six Months ended June 30, | | | |
|--|----------------------------------|--------------|--------------------|--------------|
| | 2009 | | 2008 | |
| | \$ | % | \$ | % |
| | (unaudited) | | (unaudited) | |
| Number of stores at June 30 (note 1) | 224 | | 204 | |
| Sales | 246,605 | 100.00% | 215,989 | 100.00% |
| Adjusted gross margin (note 2) | 63,669 | 25.82% | 52,720 | 24.41% |
| Adjusted operating and administrative expense (note 3) | 43,766 | 17.75% | 37,584 | 17.40% |
| Operating margin (note 4) | 19,903 | 8.07% | 15,136 | 7.01% |
| Non-recurring items (note 5) | 437 | 0.18% | 705 | 0.33% |
| Operating margin before non-recurring items | 20,340 | 8.25% | 15,841 | 7.34% |

Notes:

- (1) *The number of stores and corresponding results for the six months ended June 30, 2009 includes partial months of operations for one store (2008 - nine) opened or acquired during the period. The results for 2008 also include seven stores which were closed prior to December 31, 2008.*
- (2) *Adjusted gross margin for 2009 excludes \$0.16 million (2008- \$nil) in respect of an inventory fair value adjustment related to the Brown Jug acquisition.*
- (3) *For the six months ended June 30, 2009, adjusted operating and administrative expense excludes \$0.1 million (2008 - \$0.7 million) in pre-opening costs charged to operating and administrative expense.*
- (4) *Operating margin has been calculated as described under "Non-GAAP Measures".*
- (5) *Non-recurring items for the first half of 2009 and 2008 include professional and consulting fees for litigation matters relating to the 2007 acquisition of Liquor Barn Income Fund. Non-recurring items for 2008 also include recruitment and relocation expenses.*

Six months ended June 30, 2009 Operating Results Compared to Six months ended June 30, 2008 Operating Results

Sales

For the six months ended June 30, 2009 sales were \$246.6 million, up 14.2% from \$216.0 million in the same period last year. The sales increase comprises:

- Stores opened or acquired subsequent to June 30, 2008 (including 19 Brown Jug stores in Alaska) accounted for a \$44.6 million increase in sales. Sales for stores that were opened or acquired in the first half of 2008 comprised \$2.1 million of the sales increase.
- Wholesale business sales were \$29.0 million, down 12.4% from \$33.1 million for the first half of the prior year. Sales to wholesale customers generate significantly lower margins than retail, and have higher administrative and credit risk costs associated with them. As a result, the Fund plans to further reduce its wholesale business sales in 2009.
- During the fourth quarter of 2008, the Fund closed seven stores. Sales in the first six months of 2008 for these stores were \$2.5 million.

- Sales for stores excluded from same store sales due to their close proximity to new stores were \$5.9 million for the six months ended June 30, 2009, down \$1.4 million or 19.2% from \$7.3 million for the same period in 2008.
- Same store sales decreased \$8.1 million as explained below.

Same Store Sales

- Total same store sales were \$162.4 million for the six months ended June 30, 2009, down 4.8% from \$170.5 million for the same period in 2008. Same store sales were impacted by the following (prioritized by their impact):
 - Unseasonably cool temperatures and increased precipitation across Alberta during the spring months and specifically during the May long-weekend and Canada Day.
 - A liquor mark-up increase on alcoholic beverages imposed by the Alberta Government on April 7, 2009, just prior to the Easter long weekend, resulted in reduced customer traffic and sales. The mark-up increase was rescinded in July 2009.
 - Economic conditions continue to impact resource industries in Alberta and British Columbia including oil and gas exploration, mining and forestry.
 - 2008 included an extra Friday in February for Leap Year.

Adjusted Gross Margin

For the six months ended June 30, 2009, adjusted gross margin was \$63.7 million, up 20.9% from \$52.7 million for the same period last year. There was an increase of 27 stores operated in 2009, including 19 Brown Jug stores in Alaska, compared with the first six months of 2008.

Gross margin was up 1.4% as a percentage of sales to 25.8% for 2009 compared with 24.4% for 2008.

Adjusted Operating and Administrative Expense

Adjusted operating and administrative expense for the six months ended June 30, 2009 was \$43.8 million, up 16.5% from \$37.6 million a year earlier mainly due to an increase in the number of stores. For the six months ended June 30, 2009, operating and administrative expenses included \$0.4 million in non-recurring consulting and professional fees for litigation related to the acquisition of Liquor Barn Income Fund in 2007. For the six months ended June 30, 2008, operating and administrative expense included \$0.7 million in non-recurring items including consulting and professional fees for Liquor Barn litigation and recruitment and relocation expenses.

As a percentage of sales, adjusted operating and administrative expense for the period is consistent with the prior year at approximately 17.5%.

Operating Margin

Operating margin was \$19.9 million for the first half of 2009, up 31.8% from \$15.1 million in 2008. As a percentage of sales, operating margin was 8.1% for the first half of 2009 compared with 7.0% for 2008. The 2009 operating margin percentage is up due primarily to the increase in number of stores operated in the first six months of 2009 compared with 2008 and to a lesser extent holding gains realized on inventory resulting from the Alberta Government liquor mark-up increase that took effect in early April. The liquor mark-up increase was rescinded in July 2009.

Overall return on investment is comparable between Canadian and US operations. Although US operating margins are lower than Canadian operating margins, they are consistent with management's expectations at the time of the Brown Jug acquisition and were reflected in the purchase price.

Operating margin before non-recurring items for the six months ended June 30, 2009 was 8.3% or \$20.3 million, up from 7.3% for the same period last year due to the same factors as discussed above.

Future Income Taxes

In the six months ended June 30, 2009, the Fund updated its estimate of temporary differences pertaining primarily to certain goodwill, property, plant and equipment, and intangible assets, which resulted in a net decrease in future income taxes of \$0.2 million, compared with an increase of \$3.0 million for the same period in 2008. Changes to future income tax estimates represent a non-cash charge (or recovery) against net earnings.

Net Earnings before Non-controlling Interest and Net Earnings

Net earnings before non-controlling interest increased to \$11.7 million for the six months ended June 30, 2009, up from \$4.6 million for the same period in 2008. Net earnings for the six months ended June 30, 2009 included a non-cash future income tax recovery of \$0.2 million. Included in net earnings for the six months ended June 30, 2008 was a \$3.0 million future income tax expense charge.

For the six months ended June 30, 2009, net earnings were \$9.6 million, up \$6.5 million from \$3.1 million in 2008.

Condensed Quarterly Information

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

| | 2009 | | | 2008 | | | 2007 | |
|--|------------|------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
| | Jun 30 | Mar 31 | Dec 31 (restated) (note 1) | Sep 30 (restated) (note 1) | Jun 30 (restated) (note 1) | Mar 31 (restated) (note 1) | Dec 31 (restated) (note 1) | Sep 30 (restated) (note 1) |
| Balance Sheet | | | | | | | | |
| Cash and cash equivalents | \$ 1,338 | \$ 2,139 | \$ 3,530 | \$ 810 | \$ 754 | \$ 768 | \$ 19,498 | \$ 6,891 |
| Total assets | 474,963 | 470,646 | 488,256 | 442,460 | 438,993 | 434,006 | 449,006 | 427,301 |
| Bank indebtedness | 25,862 | 24,159 | 31,172 | 13,298 | 9,902 | - | - | 37,198 |
| Total current liabilities | 44,571 | 72,600 | 83,240 | 39,962 | 36,812 | 14,098 | 14,062 | 55,403 |
| Long-term debt | 85,188 | 52,056 | 51,742 | 51,425 | 51,108 | 65,859 | 74,014 | 15,562 |
| Statement of Earnings | | | | | | | | |
| # stores | 224 | 224 | 223 | 208 | 204 | 198 | 195 | 193 |
| Sales | \$ 140,253 | \$ 106,352 | \$ 143,013 | \$ 123,913 | \$ 121,567 | \$ 94,422 | \$ 125,920 | \$ 122,097 |
| Future tax expense (recovery) | 576 | (803) | (1,387) | 587 | 493 | 2,499 | (2,607) | 685 |
| Earnings (loss) before non-controlling interest | 10,091 | 1,655 | 11,090 | 8,329 | 5,493 | (916) | 11,547 | 7,505 |
| Net earnings (loss) for the period | 8,072 | 1,486 | 9,187 | 6,619 | 4,310 | (1,258) | 9,525 | 5,651 |
| Basic earnings (loss) per Unit | \$ 0.44 | \$ 0.08 | \$ 0.50 | \$ 0.36 | \$ 0.24 | \$ (0.07) | \$ 0.52 | \$ 0.31 |
| Diluted earnings (loss) per Unit | \$ 0.44 | \$ 0.07 | \$ 0.50 | \$ 0.36 | \$ 0.24 | \$ (0.07) | \$ 0.52 | \$ 0.31 |
| Distributable cash per Unit | \$ 0.59 | \$ 0.17 | \$ 0.69 | \$ 0.49 | \$ 0.41 | \$ 0.17 | \$ 0.48 | \$ 0.49 |
| Distributable cash before non-recurring items per Unit | \$ 0.60 | \$ 0.18 | \$ 0.61 | \$ 0.50 | \$ 0.41 | \$ 0.19 | \$ 0.50 | \$ 0.50 |
| Distributions declared per Unit | \$ 0.405 | \$ 0.405 | \$ 0.405 | \$ 0.405 | \$ 0.405 | \$ 0.405 | \$ 0.385 | \$ 0.375 |

(1) *Information for the quarters has been restated in accordance with the adoption of CICA Emerging Issues Committee Abstract #171 Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through and CICA Handbook Section 3064 – Goodwill and intangible assets (see note 3 to the Financial Statements).*

LIQUIDITY AND CAPITAL RESOURCES

Unitholders' Equity and Non-controlling Interest

The following units were outstanding as of August 11, 2009:

| | Units |
|---|--------------|
| Fund Units ⁽¹⁾ | 18,510,605 |
| Liquor Stores LP Exchangeable LP Units | 3,200,955 |
| Liquor Stores LP Series 1 Exchangeable LP Units | 845,409 |
| | <hr/> |
| | 22,556,969 |

Note:

(1) *Includes 44,270 Treasury Units held in respect of long-term incentive plans*

The Liquor Stores Limited Partnership Exchangeable and Series 1 Exchangeable LP Units represent a non-controlling interest in the Fund. 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 an Exchange Agreement. Each Exchangeable LP Unit and Series 1 Exchangeable LP Unit entitles the holder to receive distributions pro rata with distributions made on Fund Units.

Capital Expenditures

During the six months ended June 30, 2009, the Fund opened one new store. The new store was funded with proceeds from the issuance of the 6.75% debentures that were temporarily used to repay bank indebtedness.

The Fund will continue to pursue acquisition opportunities and has commitments in place to open additional Canadian stores in the remainder of 2009 and has entered into an agreement to purchase eight stores in Kentucky subject to customary closing conditions and due diligence.

Effect of Trust Tax Legislation

On June 22, 2007, Bill C – 52, including the provisions related to the taxation of income trusts (the “SIFT Rules”), received Royal Assent. Pursuant to the SIFT Rules, in 2011 earnings of the Fund distributed to unitholders will be subject to tax at a rate of 26.5% (currently zero). In 2012 the tax rate decreases to 25%. Taxable distributions (other than return of capital) to unitholders will be characterized as eligible dividends, a change from their current treatment as ordinary income. For discussion of SIFT Rules and limitations on growth and expansion see “Risk Factors”.

The Fund's market capitalization, including that of Liquor Barn Income Fund, as of the close of trading on October 31, 2006, based on only issued and outstanding publicly-traded units, was approximately \$298 million.

The Fund believes that while the application of the “safe harbour” guidelines are not a practical constraint on its ordinary growth prior to 2011, they could adversely affect the cost of raising capital and the Fund's ability to undertake more significant acquisitions. Under the “safe harbour” guidelines, the Fund could issue new equity of \$221.3 million and still be within the “safe harbour” limits. See Tax Related Risks; SIFT Legislation on page 20. The long-term effect of the SIFT Rules on the Fund is yet to be determined.

Credit Facilities

The Fund renewed its credit facility with a syndicate of banks effective June 30, 2009 for a two year period. There is a total of \$143 million available under the new facility, consisting of an available \$110 million extendible revolving operating loan (the “Operating Line Facility”) and a \$33 million extendible revolving term loan (the “Term Loan Facility”). The Fund also has a \$5 million USD facility with a US bank.

There was \$33 million drawn on the Term Loan Facility and \$24.3 million outstanding on the Operating Line Facility as at August 10, 2009, both available until June 30, 2011.

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, funded debt to EBITDA ratio and fixed coverage ratio. For the three and six months ended June 30, 2009, the Fund continues to be in compliance with all covenants.

The Fund also has \$57.5 million in 6.75% Debentures maturing on December 31, 2012 and \$0.5 million in 8.00% Debentures maturing on December 31, 2011. Unused proceeds of the 6.75% Debentures are temporarily used to pay down amounts outstanding on credit facilities with the intent of redrawing on the facilities to finance the Fund's growth objectives as acquisition opportunities are identified and new stores are developed.

Liquidity Risk

Liquidity ensures the Fund has sufficient financial resources available at all times to meet its obligations. The Fund 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 dependant upon capital market conditions and interest rate levels. The degree to which the Fund is leveraged may impact its ability to obtain additional financing for working capital or to finance acquisitions.

Management believes the Fund has the resources to meet obligations as they come due in 2009.

Interest Rate Risk and Sensitivity

The Fund's indebtedness in respect of its credit facility bears interest at floating rates, which may be negatively impacted by increases in interest rates. If interest rates decrease, interest expense would be reduced. The Fund manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans.

The following table presents a sensitivity analysis to changes in market interest rates and their potential annual impact on the Fund as at June 30, 2009, assuming a combined outstanding bank indebtedness and long-term loan facility debt for a balance of \$58.9 million.

| (expressed in thousands of Canadian dollars) | + 1.00% | - 1.00% |
|--|---------|----------|
| Increase (decrease) in interest expense | \$ 589 | \$ (589) |
| Increase (decrease) in net earnings before income tax and non-controlling interest | (589) | 589 |

An increase/decrease of 1.00% in market interest rates would result in a decrease/increase in the Fund's net earnings before income tax and non-controlling interest of \$0.03 on a per unit basis.

Credit Risk

The Fund's financial assets that are exposed to credit risk consist primarily of cash and cash equivalents and accounts 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 wholesale customers in Alberta whose purchases represent approximately 5% of the Fund's sales. Risk associated with accounts receivable is mitigated by credit management policies. Historically, bad debts from these accounts have been insignificant. The Fund 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. There was approximately \$90,000 and \$110,000 in bad debts recorded for the three and six months ended June 30, 2009, respectively.

Foreign Exchange Risk

The Fund is subject to fluctuations in the value of the Canadian dollar relative to the US dollar in the normal course of business. A portion of cash flows are realized in US dollars and as such, fluctuations in the exchange rate between the Canadian dollar and US dollar may have an effect on financial results.

The Fund's US subsidiary is considered to be a self-sustaining operation and the assets and liabilities of the foreign subsidiary are translated into Canadian dollars using the current rate method of translation. Accordingly, foreign exchange gains and losses arising from the translation of the foreign subsidiary's accounts into Canadian dollars are reported as a component of other comprehensive income. The US subsidiary operates 19 stores out of the Fund's 225 stores.

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.

Contractual Obligations

The table below sets forth, as of June 30, 2009, the contractual obligations of the Fund due in the years indicated and relates to various premises operating leases, long-term debt and convertible unsecured subordinated debentures.

| (expressed in thousands of Canadian dollars) | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 and thereafter |
|--|-----------------|------------------|------------------|------------------|-----------------|---------------------|
| Operating leases | \$ 8,418 | \$ 15,549 | \$ 13,347 | \$ 11,530 | \$ 9,530 | \$ 20,162 |
| Long-term debt | - | - | 33,000 | - | - | - |
| Debentures | - | - | 500 | 57,500 | - | - |
| Total | \$ 8,418 | \$ 15,549 | \$ 46,847 | \$ 69,030 | \$ 9,530 | \$ 20,162 |

OFF BALANCE SHEET ARRANGEMENTS

As at August 11, 2009, the Fund does not have 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 allocation of the purchase price for acquisitions involves determining the fair values assigned to the tangible and intangible assets acquired. The Fund uses independent valuers 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.

Future Income Taxes

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.

CHANGES IN ACCOUNTING POLICIES

Goodwill and Intangible Assets

CICA Handbook Section 3064 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, was withdrawn. This has resulted in a change to the Fund's accounting for store pre-opening costs as these costs will no longer be capitalized as an asset.

Effective January 1, 2009, the Fund retrospectively applied Section 3064 with a restatement of prior periods. The cumulative impact of the restatement resulted in a decrease of \$0.9 million to unitholders' equity (see note 3 to the Financial Statements).

Future Income Taxes

Effective September 30, 2008, the Fund 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 retrospectively applied EIC-171 with a restatement of prior periods. The cumulative impact of the restatement resulted in an increase of \$0.1 million to unitholders' equity (see note 3 to the Financial Statements).

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

International Financial Reporting Standards

The Accounting Standards Board (“AcSB”) confirmed that International Financial Reporting Standards (“IFRS”) will replace Canadian GAAP for publicly accountable enterprises beginning January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP; however, there are significant differences in accounting policies that must be evaluated.

The Fund’s IFRS implementation plan consists of three phases:

Phase 1: Diagnostic – This phase includes an assessment of the differences between current Canadian GAAP and IFRS, with focus on areas that may have a significant impact on the Fund.

Phase 2: Evaluation and Design – This phase includes a detailed review of all relevant IFRSs to identify differences with current accounting policies and practices under Canadian GAAP and development of solutions to address the differences identified. This includes detailed analysis of alternatives available for the first-time adoption of IFRS (“IFRS 1”) and policy choices available following the implementation of IFRS. During this phase information systems, business processes and internal controls over financial reporting will be analyzed to ensure they can adequately support required disclosures under IFRS.

Phase 3: Implementation – This is the final phase of the implementation plan and includes the execution of changes to information systems and business processes identified in phase 2, formal approval of accounting policies including exemptions under IFRS 1, and the development of training programs for impacted areas.

Phase 1 of the project was completed in 2008. Management determined that the most significant impacts of IFRS conversion relate to business combinations, property and equipment, asset impairment and the assessment of alternatives available under IFRS 1. Phase 2 work is underway with detailed reviews completed for many of the more complex accounting items for the Fund. Appropriate resources have been allocated to complete the implementation project in a timely manner. A reporting and governance structure is in place to support and communicate the changeover impact, including providing quarterly updates to the Audit Committee.

The AcSB may continue to issue Canadian accounting standards that are converged with IFRS prior to 2011, thus reducing the impact of adopting IFRS at the changeover date. As well, the Internal Accounting Standards Board (“IASB”) is also expected to issue new accounting standards during the conversion period. Therefore, the impact of adoption of IFRS on the financial statements and operating performance measures will not be known until closer to the changeover date.

FINANCIAL INSTRUMENTS

The Fund, as part of its operations, is party to a number of financial instruments. These 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, and long-term debt including convertible unsecured subordinated debentures. Financial assets are classified as available for sale, held to maturity, held for trading, or loans and receivables. Financial liabilities are classified as other financial liabilities.

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 three and six months ended June 30, 2009, the Fund incurred professional fees of \$65,455 and \$131,216, respectively, 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 a director of the GP amounted to \$154,555 and \$306,588 for the three and six months ended June 30, 2009. The Fund paid fees and expenses to a company controlled by the Executive Chairman of the Fund for consulting services of \$2,077 and \$2,427 for the three and six months ended June 30, 2009. These operating and administrative expenses are incurred in the normal course of business at terms similar with unrelated parties (see note 14 to the Financial Statements).

INTERNAL CONTROLS AND PROCESSES

Disclosure Controls and Procedures and Internal Control Over Financial Reporting

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

Internal control over financial reporting ("ICFR") is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and of the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles. Management, including the Chief Executive Officer and Chief Financial Officer, are responsible for establishing and maintaining adequate ICFR, as such term is defined in National Instrument 52-109 to provide reasonable, but not absolute, assurance regarding the reliability of the Fund's financial reporting. A material weakness in ICFR exists if the deficiency is such that there is a reasonable possibility that a material misstatement of the Fund's annual or interim consolidated financial statements will not be prevented or detected on a timely basis.

Management limited the scope of the design of disclosure controls and procedures and ICFR to exclude controls, policies and procedures of a business acquired by the Fund during the fourth quarter of 2008. Summary financial information for the Fund's Alaska subsidiary for the three and six months ended June 30, 2009 that has been consolidated in the Fund's financial statements is provided below.

| (expressed in thousands of Canadian dollars) | As at and for the three months ended June 30, 2009 | As at and for the six months ended June 30, 2009 |
|--|--|--|
| Current assets | \$ 12,867 | \$ 12,867 |
| Total assets | 36,827 | 36,827 |
| Current liabilities | 8,190 | 8,190 |
| Sales | 20,237 | 38,586 |

The chief executive and chief financial officers certified that disclosure controls and procedures and internal controls over financial reporting were effective for the year ended December 31, 2008. There have been no changes in the design of the Fund's disclosure controls and procedures or internal control over financial reporting that occurred during the three or six months ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Fund's disclosure controls and procedures or internal control over financial reporting.

RISK FACTORS

The Fund's results of operations, business prospects, financial condition, cash distributions to Unitholders and the trading price of the Units are subject to a number of risks. 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 in the Fund's Annual Information Form, which is available at www.sedar.com and the documents incorporated by reference herein. Unitholders and potential Unitholders should consider carefully the information contained herein and, in particular, the following risk factors.

These risks and uncertainties are not the only ones facing the Fund. Additional risks and uncertainties not currently known to the Fund, or that the Fund currently considers immaterial, may also impair the operations of the Fund. If any such risks actually occur, the business, financial condition, or liquidity and results of operations of the Fund, and the ability of the Fund to make distributions on the Units, could be materially adversely affected.

State of Economy

The Fund's success depends on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. The Fund can provide no assurance that consumer spending patterns will

not change. Adverse changes in these factors could reduce customer traffic or impose practical limits on pricing, either of which could reduce sales and EBITDA, which in turn could adversely affect the availability of distributable cash.

Unpredictability and Volatility of Unit Price

A publicly traded income trust will not necessarily trade at values determined by reference to the underlying value of its business. The prices at which the Units will trade cannot be predicted. The market price of the Units could be subject to significant fluctuations in response to variations in the market environment and in quarterly operating results and other factors. The annual yield on the Units as compared to the annual yield of other financial instruments may also influence the price of Units in the public trading markets. An increase in market interest rates will result in higher yield on other financial instruments, which could adversely affect the market price of the Units.

In addition, the securities markets are experiencing significant market wide and sectoral price and volume fluctuations that have been unrelated or disproportionate to the operating performance of particular issuers. Such fluctuations may adversely affect the market price of the Units.

Growth Strategy Restriction

The Fund presently has capital and unused credit facilities available for growth and inventory in the amount of approximately \$33 million as at August 10, 2009, which Management believes will provide it with sufficient funds to complete additional acquisitions and/or new store development and financing for inventory.

However, the ability of the Fund to make acquisitions, develop new stores and acquire inventory beyond the amount of its current excess capital and unused credit facilities depends on the Fund being able to raise additional financing in the future through equity and/or debt capital markets. If the Fund is unable to obtain equity and/or debt financing, either at all or on favourable terms, it may not be able to complete additional acquisitions or new store developments, which could have an adverse effect on the future growth prospects of the Fund.

Current Cash Distributions

Although the Fund intends to distribute the cash it receives, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by the Fund. The actual amounts of distributions paid by the Fund to the Unitholder will depend upon numerous factors, including profitability, debt covenants and obligations, the availability and cost of acquisitions, fluctuations in working capital, the timing and amount of capital expenditures, deductibility for tax purposes of interest payments on the Liquor Stores Operating Trusts Notes and the Liquor Barn Operating Trust Notes (“Operating Trust Notes”), applicable law and other factors beyond the control of the Fund. Cash distributions are not guaranteed and will fluctuate with the Fund’s performance. There can be no assurance as to the levels of cash distributions to be paid by the Fund, if any. The market value of the Units may deteriorate if the Fund is unable to maintain current distribution levels in the future, and such deterioration may be material.

Government Regulation

The Fund operates primarily in the highly regulated retail liquor industry in the Provinces of Alberta and British Columbia and the State of Alaska. Decisions by the Alberta Gaming and Liquor Commission (“AGLC”), British Columbia Liquor Control and Licensing Branch (“BCLCLB”) and Alcohol Beverage Control Board (“ABCB”) and rules enacted by them, and new legislation and regulations or changes to existing legislation and regulations can impact the operations of Liquor Stores LP both favourably and unfavourably. There is no assurance that new legislation and regulations or changes to existing legislation and regulations or decisions of the AGLC, the BCLCLB and ABCB will not adversely affect the operations or distributable cash of the Fund.

All of the Fund’s Alberta stores are operated pursuant to licenses issued by the AGLC, which must be re-applied for annually. Since its inception in 2004, the Fund has never had a store license revoked or not reissued. Management is not aware of any retail liquor store licensee having a license revoked.

In British Columbia to operate a retail liquor store, an operator must have a licensee retail liquor store (“LRS”) license, which must be associated with a primary license. The status of this LRS license is contingent upon the associated primary license being maintained, which in certain circumstances may be controlled by arms length interests. In order to mitigate this risk, where possible, the Fund has negotiated the right to self help with the primary license holders.

All of the Fund’s Alaska stores are operated pursuant to licenses issued by the ABCB, which must be renewed bi-annually.

The AGLC, the BCLCLB, and the ABCB have certain discretion in the granting or revocation of a license to operate a liquor store.

Commodity Taxes

Changes in tax rates, and their corresponding effect on product pricing, could affect sales and or earnings. If taxes increase and the Fund raises prices by the full amount of the tax, sales volumes could be adversely impacted. If the Fund is not able to pass the full amount of the tax increase on to consumers, then margins and earnings could be adversely impacted. There can be no assurance that governments will not change tax rates in the future.

Competition

The private retail distribution of alcoholic beverages in the jurisdictions in which the Fund operates is competitive and fragmented. Competition exists mainly on a local basis with the main competitive factors being location and convenience and to a lesser degree price and service.

In Alberta, the Fund competes with other local single store operators, other local and regional chain operators, and liquor stores associated with national and regional grocery store chains. Certain of these competitors have greater financial resources than the Fund. 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. Any change in this regulatory regime could materially adversely affect the Fund's business and the results of its operations.

In British Columbia, the Fund competes with government owned and operated liquor stores, local independent stores, and wine stores. Under the current regulatory environment, a LRS store cannot operate without an associated primary liquor license being in place. In order to establish a liquor store, an operator must enter into an arrangement with an eligible primary liquor license holder to obtain the associated LRS. This arrangement limits the number of entrants who are able to enter into the market.

In Alaska, the Fund competes with local single store operators, other local and regional chain operators and liquor stores associated with US national grocery store chains. Under the Alaska regulatory environment, stores purchase product directly from distributors and are able to negotiate volume discounts with suppliers. Organizations with greater financial resources are able to maintain a competitive advantage over smaller operators.

Acquisition and Development Risks

Acquisitions have been a significant part of the Fund's growth strategy. The Fund expects to continue to selectively seek strategic acquisitions in Canada and the US. The Fund's 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 the Fund's resources and, to the extent necessary, the Fund's ability to obtain financing on satisfactory terms for larger acquisitions, if at all. Acquisitions may expose the Fund 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 the Fund's stores; entry into markets in which the Fund has little or no direct prior experience; difficulties in retaining key employees of the acquired operations; disruptions to the Fund's ongoing business; and diversion of management time and resources.

The Fund expects that new store development will also continue to be a significant part of the Fund's growth strategy. The development of new stores is subject to many of the same risks as acquisitions including limitations on the number of attractive development opportunities and competition for such opportunities and internal demands on the Fund's resources. The rate of new store developments may be impacted by factors outside of the Fund's control such as the availability of suitable site locations if real estate development declines or the availability of contractors to perform development work. In addition, the development of new stores requires an outlay of capital based on Management's projections of future store performance, which may prove to be incorrect.

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

The success of the Fund's liquor stores is significantly influenced by location. There can be no assurance that current locations will continue to be attractive, or that additional locations can be located and secured, as demographic patterns change. It is possible that the current locations or economic conditions where the Fund's liquor stores are located could decline in the future including as a result of the opening of stores by competitors, resulting in potentially reduced sales in those locations. There is also

no assurance that future store locations will produce the same results as existing locations. To the extent that the Fund enters into long-term leases for its store locations, the Fund's ability to respond in a timely manner to changes in the demographic or retail environment at any location may be limited.

Key Personnel

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

Labour Costs and Shortages and Labour Relations

The success of the Fund's business depends on a large number of both hourly and salaried employees. Changes in the general conditions of the employment market could affect the ability of the Fund to hire or retain staff at current wage levels. The occurrence of either of these events could have an adverse effect on the Fund's results of operations.

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

Supply Interruption or Delay

Liquor store operators in Alberta are dependent on Connect Logistics Services ("CLS") warehouse and Brewers Distributor Ltd. ("BDL") 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. Any significant disruption in the operations of these companies, for example as a result of an organized work stoppage, and resulting interruption in supply may have a material adverse effect on liquor store operations including the operations of the Fund and its subsidiaries.

Importance of Information and Control Systems

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

Tax Related Risks; SIFT Legislation

The income of the Fund must be computed and will be taxed in accordance with Canadian tax laws, all of which may be changed in a manner that could adversely affect the amount of distributable cash. There can be no assurance that Canadian federal income tax laws respecting the treatment of mutual fund trusts will not be changed in a manner that adversely affects the holders of Units. If the Fund ceases to qualify as a "mutual fund trust" under the Tax Act, the income tax consequences could materially and adversely affect Unitholders. Further, interest on the Operating Trust Notes and other debt accrues at the Fund level for income tax purposes whether or not actually paid. The amended and restated declaration of trust dated August 10, 2004 pursuant to which the Fund was established ("Declaration of Trust") provides that an amount equal to the taxable income of the Fund will be distributed each year to Unitholders in order to eliminate the Fund's taxable income and provides that additional Units may be distributed to Unitholders in lieu of cash distributions. Unitholders will generally be required to include an amount equal to the fair market value of those Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

If the Fund ceases to qualify as a "mutual fund trust" under the Tax Act, the Units will cease to be qualified investments for Deferred Income Plans and RESPs ("Exempt Plans"). The Fund will endeavour to ensure that the Units continue to be qualified investments for Exempt Plans. The Tax Act imposes penalties for the acquisition or holding of non-qualified investments in such plans and there is no assurance that the conditions prescribed for such qualified investments will be adhered to at any particular time. If the Fund ceases to qualify as a mutual fund trust for purposes of the Tax Act, the Fund may be required to pay tax under Part XII.2 of the Tax Act. The payment of Part XII.2 tax by the Fund will affect the amount of cash available for distribution by the Fund and may have adverse consequences for Unitholders.

The SIFT Rules, first announced on October 31, 2006, have been enacted and may significantly change the taxation of most publicly traded trusts and partnerships, including income trusts such as the Fund, and distributions and allocations from these entities to their investors. Existing trusts, such as the Fund, will have a transition period and, subject to the qualification below, will not be subject to the new rules until January 1, 2011. No assurance can be given that Canadian federal income tax law

respecting the taxation of income trusts and other flow-through entities will not be further changed in a manner that adversely affects the Fund and its Unitholders. The SIFT Rules apply an entity level tax on certain income (other than taxable dividends) earned by a SIFT trust, and treats the distributions of such income received by unitholders of a SIFT trust as taxable dividends received from a taxable Canadian corporation. Unitholders subject to the highest marginal rate of tax would receive an after-tax return approximately equal to the after-tax return if pre-tax distributions had been distributed directly to and taxed in the hands of the Unitholders. However, the incidence of entity level tax will be a cost to other types of Unitholders including but not limited to, pension funds and non-residents who would not benefit from the characterization of distributions as eligible dividends.

The Fund will constitute a SIFT trust and, as a result, the Fund and its Unitholders will be subject to the SIFT Rules commencing in 2011.

On December 15, 2006, the Department of Finance issued the Normal Growth Guidelines (the "**Guidelines**"). The Guidelines indicate that the 2011 date will continue to apply in respect of any SIFT trust or partnership whose equity capital grows as a result of issuances of new equity (which includes trust units and debt that is convertible into trust units and may include other substitutes for such equity) before 2011, by an amount that does not exceed the greater of \$50 million annually and a "safe harbour" amount that is a percentage of the SIFT's market capitalization as of the end of trading on October 31, 2006 (measured in terms of the value of a SIFT's issued and outstanding publicly-traded units, not including debt, options or other interests that were convertible into SIFT units). For the period from November 1, 2006 to the end of 2007, the Guidelines provide that a SIFT's safe harbour will be 40% of the October 31, 2006 benchmark. If the Fund issues additional Units, convertible debt or other equity substitutes on or before 2011, it may become subject to the SIFT Rules prior to 2011. No assurance can be provided that the SIFT Rules will not apply to the Fund prior to 2011. On December 4, 2008, the Department of Finance announced changes to the Guidelines to allow a SIFT Trust to accelerate the utilization of the SIFT Trust's annual safe harbour amount for each of 2009 and 2010 so that the aggregate safe harbour amount for 2009 and 2010 is available on and after December 4, 2008. This change does not alter the maximum permitted expansion for a SIFT Trust, but allows a SIFT Trust to use its normal growth room remaining as of December 4, 2008 in a single year, rather than utilizing portions of the permitted normal growth over the 2009 and 2010 years.

It is expected that the SIFT Rules will subject the Fund to trust level taxation beginning on January 1, 2011, which will reduce the amount of cash available for distributions to Unitholders. The Fund estimates that the SIFT Rules will, commencing on January 1, 2011, reduce the amount of cash available to the Fund to distribute to its Unitholders by an amount equal to 25.0% of the pre-tax income available for distribution by the Fund. A reduction in distributions could adversely affect the value of the Units. A reduction in the value of the Units would be expected to increase the cost to the Fund of raising capital in the public capital markets. There can be no assurance that the Fund will be able to reorganize its legal and tax structure to reduce the expected impact of the SIFT Legislation. In addition, there can be no assurance that the Fund will maintain its "grandfathered" status under the SIFT Legislation until 2011. The Fund does not expect to exceed "normal growth" in the transition period. If the Fund exceeds "normal growth" during the transitional period from October 31, 2006 to December 31, 2010, the SIFT Legislation would become effective on a date earlier than January 1, 2011. Loss of grandfathered status could have a material and adverse effect on the value of the Units.

On February 26, 2008, the Minister of Finance announced (the "**Provincial SIFT Tax Proposal**") that instead of basing the provincial component of the SIFT tax on a flat rate of 13%, the provincial component will instead be based on the general provincial corporate income tax rate in each province in which the SIFT has a permanent establishment. For purposes of calculating this component of the tax, the general corporate taxable income allocation formula will be used. Specifically, the Fund's taxable distributions will be allocated to provinces by taking half of the aggregate of:

- that proportion of the Fund's taxable distributions for the year that the Fund's wages and salaries in the province are of its total wages and salaries in Canada; and
- that proportion of the Fund's taxable distributions for the year that the Fund's gross revenues in the province are of its total gross revenues in Canada.

Under the Provincial SIFT Tax Proposal the Fund would be considered to have permanent establishments in Alberta and British Columbia. As proposed in recent provincial budgets, the Alberta and British Columbia provincial tax rates are expected to be 10% in 2011. Taxable distributions that are not allocated to any province would instead be subject to a 10% rate constituting the provincial component. The Provincial SIFT Tax Proposal was enacted on March 4, 2009.

The Fund continues to review the impact of the SIFT Rules on its business strategy and to evaluate strategic alternatives that it could elect to pursue in response to the SIFT Rules. No assurance can be provided that the Fund will not undertake actions in the future that could cause the SIFT Rules to apply to it prior to 2011.

Leverage and Restrictive Covenants

The Fund has third party debt service obligations under the Credit Facility and any replacement or other credit facilities and the 6.75% Debentures and the 8.00% Debentures. The degree to which the Fund is leveraged could have important consequences to the holders of the Units, including: (i) a portion of the Fund's cash flow from operations is dedicated to the payment of interest on its indebtedness, thereby reducing funds available for distribution; (ii) certain of the Fund's borrowings are at variable rates of interest, which exposes the Fund to the risk of increased interest rates. The Fund's 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.

The 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 the Fund to incur additional indebtedness, to create liens or other encumbrances, to pay distributions or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity. A failure to comply with the obligations in the agreements in respect of the Credit Facility could result in an event of default which, if not cured or waived, could permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facility were to be accelerated, there can be no assurance that the Fund's assets would be sufficient to repay in full that indebtedness.

NON-GAAP MEASURES

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization and 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, EBITDA and distributable cash are useful supplemental measures 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 trust 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 and Exchangeable Units)".

Adjusted gross margin has been derived by adding back an inventory fair value adjustment to gross margin as per Canadian GAAP.

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

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

Same store sales include sales for stores that have been open 12 full months at the beginning of the reporting period and exclude stores which have significant wholesale business and stores where same stores sales have shifted to closely-located Liquor Depot stores opened in 2008. Sales for three existing Liquor Depot stores for the three months ended June 30, 2009 and five stores for the six months ended June 30, 2009 are excluded from same store sales where new Liquor Depot stores were opened within close proximity to existing stores.

Operating margin, operating margin as a percentage of sales, distributable cash, EBITDA, payout ratio and same store sales 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, EBITDA, payout ratio and same store sales 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, EBITDA, payout ratio and same store sales may differ from the methods used by other issuers. Therefore, the Fund's operating margin, operating margin as a percentage of sales, distributable cash, EBITDA, payout ratio and same store sales may not be comparable to similar measures presented by other issuers.

SUPPLEMENTAL LIQUIDITY INFORMATION

Distributable cash is a non-GAAP measure that provides an indication of the Fund's ability to sustain distributions while maintaining productive capacity. In addition to comparing distributable cash to its nearest GAAP measure, cash provided by operating activities, a comparison can be made to earnings before non-controlling interest. The following table compares cash provided by operating activities, earnings before non-controlling interest and distributable cash before non-recurring items to cash distributions declared on Units combined with cash distributions in respect of non-controlling interests in the Fund's subsidiaries.

| (expressed in thousands of Canadian dollars) | Three months ended June 30, | Six months ended June 30, | Year ended December 31, | |
|--|--------------------------------|------------------------------|--------------------------------|--------------------------------|
| | 2009 | 2009 | 2008 (restated – note 1) | 2007 (restated – note 1) |
| Cash flow provided by operating activities | \$ 3,772 | \$ 19,078 | \$ 35,747 | \$ 15,151 |
| Earnings before non-controlling interest | 10,091 | 11,746 | 23,994 | 15,544 |
| Distributable cash before non-recurring items | 13,608 | 17,623 | 38,673 | 31,796 |
| Actual cash distributions declared relating to the period | (9,189) | (18,488) | (36,806) | (28,332) |
| Excess (deficiency) of cash provided by operating activities over cash distributions declared | \$ (5,417) | \$ 590 | \$ (1,059) | \$ (13,181) |
| Excess (deficiency) of earnings before non-controlling interest over cash distributions declared | \$ 902 | \$ (6,742) | \$ (12,812) | \$ (12,788) |
| Excess (deficiency) of distributable cash before non-recurring items over cash distributions declared | \$ 4,419 | \$ (865) | \$ 1,867 | \$ 3,464 |

(1) *Comparative information for 2007 and 2008 has been restated in accordance with the adoption of CICA Handbook Section 3064 – Goodwill and intangible assets.*

Approximately 20% of annual sales occur in the first quarter of the year and 26% in the second quarter. Sales are generally stronger in the latter part of the year making up approximately 54% of annual sales. Consequently in the first quarter, the Fund typically reduces inventory levels resulting in increased cash flow provided by operating activities. As sales increase throughout the year and inventory levels rise accordingly, cash flow provided by operating activities typically declines.

On an annualized basis and subsequent to the 2007 enactment of legislation concerning the taxation of income trusts, the Fund's cash distributions have exceeded both cash flow from operating activities and earnings before non-controlling interest. Taking into consideration the Fund's distribution policies and assuming continued growth of the Fund's operations, it is unlikely that cash flow from operating activities or earnings before non-controlling interest would exceed its cash distributions in the foreseeable future.

Excess or Deficiency of Cash Flow from Operating Activities Over Cash Distributions

For the reasons explained below, the Fund believes distributable cash before non-recurring items provides a better indication of the Fund's ability to sustain cash distributions while maintaining its productive capacity than does the GAAP measure cash provided by operating activities.

Net Change in Non-Cash Working Capital

The Fund's investments in working capital relate to the Fund's growth, commercial terms with the Fund's suppliers of alcoholic beverages and seasonal fluctuations in inventory levels.

Between January 1, 2006 and June 30, 2009, the Fund developed 25 stores. Under GAAP, the purchases of inventory to open these stores are treated as uses of cash from operating activities rather than as expenditures necessary for the Fund's growth.

Under GAAP, significant investments in inventory following the acquisition of stores are also treated as a use of cash from operating activities rather than as expenditures necessary for the Fund's growth. Between January 1, 2006 and June 30, 2009 the Fund acquired 132 stores. With the exception of the Brown Jug stores, the majority of the stores acquired did not have sufficient inventory to meet the Fund's operating standards related to selection and profitability.

The Fund's major suppliers of alcoholic beverages in Canada require payment prior to delivery of inventory. As a consequence the Fund has a strategy of financing inventory with the use of its credit facilities. Under GAAP, the use of the credit facilities to finance inventory is treated as a financing activity.

Inventory levels are subject to fluctuations related to the timing of opportunities to purchase inventory when favourable buying conditions arise. Historically, these opportunities have followed a seasonal pattern where inventory levels increase in the final quarter of the year and decrease in the first quarter of the year.

The acquisition of the Brown Jug stores in Alaska is a departure from the Fund's historic experience. When the Brown Jug stores were acquired no liabilities were assumed and no additional investment in inventory was required. In Alaska trade terms are available and accounts payable finance a portion of inventory. Subsequent to the acquisition, there was an increase in accounts payable related to the Brown Jug operation. The Fund believes that its determination of distributable cash before non-recurring items is more indicative of its second quarter and 2009 year-to-date results.

Provision for Non-Growth Property and Equipment

Maintenance of Productive Capacity

In order to maintain its productive capacity, the Fund incurs expenses for routine maintenance and makes expenditures for the replacement of long lived assets ("non-growth property and equipment"). In the determination of distributable cash, provisions may be made for anticipated replacements of long lived assets not yet recorded in the accounts of the Fund.

The following table provides an analysis of the total expenditures on property and equipment and the amounts reserved for further non-growth expenditures:

| (expressed in thousands of Canadian dollars) | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|----------|---------------------------|----------|
| | 2009 | 2008 | 2009 | 2008 |
| Purchase of property and equipment | \$ 748 | \$ 1,499 | \$ 1,087 | \$ 2,932 |
| Growth expenditures including amounts relating to developed stores | (615) | (1,420) | (906) | (2,641) |
| Purchase of non-growth property and equipment | 133 | 79 | 181 | 291 |
| Provision for further non-growth property and equipment expenditures | - | - | - | (100) |
| Total provision for non-growth property and equipment | \$ 133 | \$ 79 | \$ 181 | \$ 191 |

Provision for Pre-Opening Costs

Pre-opening costs represent incremental direct costs incurred in acquiring and developing new retail liquor stores. For GAAP, effective January 1, 2009, these expenditures are treated as uses of cash from operating activities rather than as investments in store growth. The Fund views these costs as necessary for growth and has added them back for purposes of distributable cash.

The following table provides an analysis of the total expenditures on pre-opening costs:

| (expressed in thousands of Canadian dollars) | Three months ended June 30, | | Six months ended June 30, | |
|---|-----------------------------|--------|---------------------------|--------|
| | 2009 | 2008 | 2009 | 2008 |
| Pre-opening cost expenditures | \$ 64 | \$ 487 | \$ 117 | \$ 774 |
| Pre-opening cost expenditures for subsequently abandoned transactions | - | (9) | - | (47) |
| Total provision for pre-opening costs | \$ 64 | \$ 478 | \$ 117 | \$ 727 |

Excess of Distributions Over Earnings Before Non-Controlling Interest

Earnings before non-controlling interest includes a number of non-cash charges which result in distributions exceeding earnings before non-controlling interest. Non-cash charges include: vesting of awards under unit-based compensation plans, amortization of property and equipment, intangible assets, inventory fair value adjustments, non-cash interest and future income tax expense. These non-cash charges are added back in the determination of cash provided by operating activities.

Unit Based Compensation Plans

In 2008, the Fund adopted a new incentive plan, the Unit Award Incentive Plan (“UAIP”) to replace its existing long term incentive plans. In determining distributable cash the Fund’s practice was to provide for the cost of awards under the former plans when the amount of the awards and the conditions under which the awards would vest were reasonably determinable. Under GAAP, the expense related to the awards is recognized over the vesting period.

No new Unit awards are being granted under the former plans and there are currently 44,270 Units scheduled to vest in 2010 and 2011. Once the remaining Units vest management intends to eliminate these plans.

The Fund has historically utilized long-term incentive plan awards to reward certain employees for significant performance and associated per Unit cash flow growth and has taken into consideration awards under Unit based compensation plans in its determination of distributable cash. When the amount of the award and the conditions under which the awards will vest were reasonably determinable, the Fund deducted the full amount of the award from distributable cash. As a consequence, the recognition of this expense for financial statement purposes had already been taken into consideration in the determination of distributable cash.

Under the UAIP, the Compensation Committee of the Board of Directors of Liquor Stores GP Inc. has complete discretion over the granting of Units, the timing of any and all awards as well as the circumstances under which the Units granted will vest. The Compensation Committee has authority to grant restricted Units which vest only as to time and performance awards for which performance criteria and scalable multipliers can be designed to reward plan participants for the Fund’s performance. The Compensation Committee did not grant any awards under the UAIP for 2008.

On June 16, 2009 the Unitholders of the Fund approved the adoption of the Unit Option Plan (“UOP”) which is intended to aid in attracting, retaining and motivating directors, officers, employees and other eligible service providers of the Fund and its subsidiaries, and to provide such persons with an incentive to continue in the long term service of the Fund and its subsidiaries, and to create in such persons a direct interest in the future success of the operations of the Fund and its subsidiaries by tying incentive compensation to increases in the value of the Trust Units of the Fund. Options granted pursuant to the UOP will have a term not exceeding five years and vest in such manner as determined by the Board. The exercise price of options granted will be determined by the Board at the time of grant, provided that in no event shall the exercise price be less than the last closing price of the Trust Units on the TSX preceding the time of grant. No awards have been granted under the UOP.

Inventory Fair Value Adjustments

Inventory fair value adjustments arise from acquisitions. Valuation principles require that the element of profit related to inventory buying and associated activities be recognized in the cost of inventory at the date of acquisition. The Fund amortizes inventory fair value adjustments over a three-month period, which represents the average time it takes for inventory to turn over. The amortization of the inventory adjustment has no impact on future cash flows of the Fund as they are part of the purchase price allocation done at the time of acquisition.

Amortization of Property and Equipment

The Fund does not believe that amortization of property and equipment, namely leasehold improvements, as reflected in its GAAP financial statements reflects the economic cost to sustain its operations. This belief is based on the results of independent appraisals conducted at the time the Fund acquires stores. Generally, the result of these appraisals is that the values assigned to leasehold improvements at the time of acquisition exceed the carrying value of these assets in the accounts of the acquired business, indicating that amortization provided on a GAAP basis exceeds the economic cost of the assets consumed.

The principal reasons that amortization of property and equipment exceeds maintenance capital is that amortization of leasehold improvements is determined based on the initial term of the lease plus one lease renewal period. Leasehold improvements generally have an economic life longer than this period. Amortization of leasehold improvements represented a substantial portion of the Fund’s amortization of property and equipment during the period from January 1, 2006 to June 30, 2009.

Leases and Licenses

These items relate to fair value adjustments at the time the Fund completes acquisitions.

Favourable and unfavourable leases represent market value rents for the term of the leases assumed by the Fund. While rent escalations on renewal or for an option period have an impact on Fund's earnings and cash flow from operations, the amortization of these items does not. The Fund leases the locations for virtually all of its stores and lease renewals are staggered.

At the time of a store acquisition a fair value is assigned to the licenses acquired. The cost of definite life licenses is amortized over the life of the lease and all renewal terms.

Given the life of the favourable and unfavourable leases and the licenses, the amortization of these items has limited impact on the sustainability of current distributions and no impact on the Fund's productive capacity in the foreseeable future.

Non-cash Interest

The non-cash interest relates to the Fund's convertible subordinated debentures and primarily to the \$57.5 million principal amount 6.75% Debentures issued by the Fund in December 2007 and January 2008. The amount of the liability initially recorded in the Fund's accounts with respect to the 6.75% Debentures was approximately \$50.0 million. The issue costs and the value of the conversion feature comprise the difference between the amount recorded in the Fund's accounts and the principal amount of the debentures. The non-cash interest represents the accretion of the debt balance to the amount owing at maturity.

The contractual requirement to repay the principal amount of the debentures is reflected in the table on page 14.

Future Income Taxes

The provisions for future income taxes in the Fund's accounts are to provide an estimate of what the future tax liability may be on January 1, 2011. These provisions do not result in cash taxes payable in the periods presented as current legislation will not result in the Fund being taxable until 2011.

It is expected that the foregoing non-cash charges will continue to cause distributions to exceed net earnings for the foreseeable future. The non-cash non-recurring items include: professional and consulting costs related to the Liquor Barn acquisition, store closure costs, rent obligations, amortization, a goodwill adjustment, foreign exchange gains resulting from the acquisition of Brown Jug stores, and other non-significant charges.

Non-recurring Items

In the first six months of 2009, non-recurring items reduced earnings before non-controlling interest by approximately \$0.4 million. The Fund does not believe that this reduction is meaningful in evaluating the sustainability of its cash distributions.

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 or recent acquisitions and the benefits to be derived therefrom, budgets, litigation, projected costs and plans and objectives of or involving the Fund. 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". Specific forward-looking statements contained in this management's discussion and analysis include, among others, the management's expectations that the Fund will have sufficient funds to complete store acquisitions, develop new stores and finance inventory.

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.

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.