



## **LIQUOR STORES INCOME FUND**

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

**For the Three and Nine Months Ended September 30, 2009  
As of November 10, 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 nine months ended September 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 27 of this MD&A.

This MD&A is dated November 10, 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](http://www.sedar.com)) and on the Fund's website at [www.liquorstoresincomefund.com](http://www.liquorstoresincomefund.com).

### **RESULTS**

On April 7, 2009, the Government of Alberta announced a liquor mark-up increase. Following the increase, the Fund raised retail sales prices, which resulted in increased margins in the second quarter as products purchased for lower cost prior to April 7 were sold at higher prices. On July 7, 2009 the Government of Alberta rescinded the liquor mark-up increase. Immediately following the announcement, the Fund reduced retail sales prices to reflect the decrease in liquor mark-up. This impacted third quarter margins as products purchased at higher cost between April 7 and July 7 were sold for lower retail sales prices in the third quarter. Due to the retail price reductions which accompanied the Government's liquor mark-up reduction in July, gross margin for the quarter was down 0.9%, but still higher on a year-to-date basis than 2008 with an increase of 0.6% as a percentage of sales. Distributable cash per unit before non-recurring items was up \$0.16 or 14.5% for the nine months ended September 30, 2009 despite a decrease of \$0.03 for the third quarter.

#### **Nine months ended September 30, 2009 compared with nine months ended September 30, 2008**

- Total sales increased 13.4% to \$385.5 million.
- Adjusted gross margin up 16.0% to \$97.8 million from \$84.3 million.
- Distributable cash before non-recurring items up 14.1% to \$28.3 million from \$24.8 million.
- Distributable cash per unit before non-recurring items up 14.5% to \$1.26 per unit from \$1.10 per unit.

#### **Third quarter 2009 compared with third quarter 2008**

- Total sales increased 12.1% to \$138.9 million.
- Adjusted gross margin up 7.9% to \$34.1 million from \$31.6 million.
- Distributable cash before non-recurring items down 4.5% to \$10.7 million from \$11.2 million.
- Distributable cash per unit before non-recurring items down 6.0% to \$0.47 per unit from \$0.50.

## OUTLOOK

Management expects overall sales for 2009 to surpass 2008 due to the increased number of stores operated by the Fund. Same store sales may continue to be affected by the current economic environment impacting markets dependent on resource development in Alberta, British Columbia and Alaska. It is unknown at this time what impact this will have on the Fund's operations for the remainder of the year, specifically through the Holiday Season which is typically the busiest sales season.

The Government of Alberta's liquor mark-up decrease in July had an impact on the third quarter margins which is expected to continue into the fourth quarter. Management believes the liquor mark-up changes in 2009 will have a neutral impact on the Fund's annual results for 2009.

In October 2009, the Fund acquired the Liquor Barn chain of eight liquor stores in Kentucky operating in the cities of Louisville and Lexington. Liquor Barn is the largest independent liquor store chain in the state by revenue and management expects that with the addition of these stores, revenue from US business will approximately double in 2010. Results from the Brown Jug stores in Alaska acquired in the fourth quarter of 2008 have had a positive impact on results and distributable cash for 2009.

The Fund has acquired one store and opened three stores in 2009 in Alberta and has commitments to open an additional six stores in Alberta, British Columbia and Alaska.

The Fund will continue to focus on its strategy of growth through acquisitions and new store development. The Fund currently has access to approximately \$30 million that may be used for growth and inventory financing.

## 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 234 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 November 10, 2009)

	Alberta			British Columbia			Alaska	Kentucky		Total
	Edmonton <sup>(1)</sup>	Calgary <sup>(1)</sup>	Other <sup>(2)</sup>	Lower Mainland	Vancouver Island	Interior	Anchorage	Lexington	Louisville	
Number of Stores	79	46	47	13	11	11	19	3	5	234

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 172 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].

In the state of Kentucky there are no government owned or operated liquor stores. Liquor licenses are permitted based on the alcoholic status of each county (wet or dry). The Alcoholic Beverage Control Board limits the number of retail liquor package licenses issued in wet counties to one per 2,300 persons with the exception of counties containing cities of first class such as Louisville where liquor licenses are limited to one for every 1,500 persons. Grocery stores and gas stations are able to sell beer, but a retail liquor package license is required to sell wine and spirits. There are approximately 730 package retail license stores in Kentucky with 208 in Jefferson County and 68 in Fayette County [Source: Kentucky's Alcoholic Beverage Control Board]. The Fund currently operates three stores in Lexington (Fayette County) and five stores in Louisville (Jefferson County).

## **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, 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 (Canada and US) 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 September 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 September 30, 2009, distributable cash before non-recurring items was \$10.7 million or \$0.47 per Unit, compared with \$11.2 million or \$0.50 per Unit for the same period in 2008. For the nine months ended September 30, 2009, distributable cash before non-recurring items per weighted average unit was \$28.3 million or \$1.26 compared to \$24.8 million or \$1.10 for the same period in 2008. Non-recurring items for the three and nine months ended September 30, 2009 were largely comprised of professional and consulting fees for litigation matters related to the Liquor Barn Income Fund acquisition in 2007.

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 September 30,		Nine months ended September 30,	
	2009	2008 (Restated – note 1)	2009	2008 (Restated – note 1)
Cash provided by operating activities	\$ 17,886	\$ 10,067	\$ 36,963	\$ 15,482
Net change in non-cash working capital	(7,232)	1,035	(9,057)	7,989
Provision for financing charges	(108)	-	(108)	-
Provision for non-growth property and equipment	(129)	(75)	(309)	(266)
Provision for pre-opening costs	111	99	228	826
Distributable cash	10,528	11,126	27,717	24,031
Non-recurring items (note 2)	180	90	617	795
Distributable cash before non-recurring items	\$ 10,708	\$ 11,216	\$ 28,334	\$ 24,826
Weighted average units outstanding	# 22,556,969	# 22,556,969	# 22,556,969	# 22,544,952
Distributable cash before non-recurring items per Unit	\$ 0.47	\$ 0.50	\$ 1.26	\$ 1.10
Distributable cash per Unit (note 3)	\$ 0.47	\$ 0.49	\$ 1.23	\$ 1.07
Distributions declared per Unit	\$ 0.41	\$ 0.41	\$ 1.22	\$ 1.22

- (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 nine months ended September 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 September 30, 2009 were \$0.32 compared to diluted earnings per Unit of \$0.36 in the same period of 2008. Diluted earnings per Unit for the nine months ended September 30, 2009 were \$0.84 compared to diluted earnings per Unit of \$0.53 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 includes sales for stores that have been open 12 full months at the beginning of the reporting period. Certain stores have been excluded as follows: stores which have significant wholesale business and stores which operate within close proximity to Liquor Depot stores opened in 2008. It is management's intention to continue to operate both the existing and new locations.

### Third Quarter 2009 Operating Results

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

(expressed in thousands of Canadian dollars)	Three Months ended September 30,			
	2009		2008	
	\$	%	\$	%
	(unaudited)		(unaudited)	
Number of stores at September 30 (note 1)	225		208	
Sales	138,915	100.00%	123,913	100.00%
Gross margin	34,119	24.56%	31,556	25.46%
Adjusted operating and administrative expense (note 2)	21,842	15.72%	19,146	15.44%
Operating margin (note 3)	12,277	8.84%	12,410	10.02%
Non-recurring items (note 4)	180	0.13%	90	0.07%
Operating margin before non-recurring items	12,457	8.97%	12,500	10.09%

Notes:

- (1) *The number of stores and corresponding results for the three months ended September 30, 2009 contain partial months of operations for two stores opened or acquired (2008 – four) and one store sold 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 September 30, 2009, adjusted operating and administrative expense excludes \$0.1 million (2008 - \$0.1 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 third quarter of 2009 and 2008 include professional and consulting fees for litigation matters relating to the 2007 acquisition of Liquor Barn Income Fund.*

### Third Quarter 2009 Operating Results Compared to Third Quarter 2008 Operating Results

#### Sales

For the three months ended September 30, 2009 sales were \$138.9 million, up 12.1% from \$123.9 million in the same period last year. The sales increase comprises:

- Stores opened or acquired subsequent to September 30, 2008 (including 19 Brown Jug stores in Alaska) accounted for a \$21.0 million increase in sales.
- Sales for stores that were opened or acquired in the third quarter of 2008 comprised \$1.6 million of the sales increase.
- Same store sales, down \$3.4 million or 3.4% for the three months ended September 30, 2009, continue to be impacted by the economic environment. The key markets of the Fund - Alberta, British Columbia and Alaska - are dependent on resource industries, such as oil and gas exploration and forestry, which have been slow to recover from the economic downturn.
- Wholesale business sales were \$15.8 million, down \$2.7 million or 14.6% from \$18.5 million for the third 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. Third quarter sales in 2008 for these stores were \$1.3 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 September 30, 2009, down \$0.2 million or 7.4% from \$2.7 million for the same period in 2008.

### **Gross Margin**

For the three months ended September 30, 2009, gross margin was \$34.1 million, up 7.9% from \$31.6 million for the same period last year. The increase is due to an increase in the number of stores operated in 2009 and the reduction of store overhead costs associated with stores closed in late 2008.

Gross margin was down 0.9% as a percentage of sales to 24.6% for Q3 2009 compared with 25.5% for Q3 2008. The decrease is due to the reduction of retail sales prices following the Government of Alberta's rescinding of the liquor mark-up increase that went into effect in April 2009.

### **Adjusted Operating and Administrative Expense**

Adjusted operating and administrative expense for the three months ended September 30, 2009 was \$21.8 million, up 14.1% from \$19.1 million a year earlier mainly due to the increase in the number of stores operated including Brown Jug operations in Alaska. Operating and administrative expense for the three months ended September 30 for both 2009 and 2008 included non-recurring consulting and professional fees for litigation related to the acquisition of Liquor Barn Income Fund in 2007 of \$0.2 million and \$0.1 million, respectively.

As a percentage of sales, adjusted operating and administrative expense for the third quarter of 2009 was 15.7% as compared with 15.4% for the same period in 2008.

### **Operating Margin**

Operating margin was \$12.3 million for the third quarter of 2009, down 0.8% from \$12.4 million in 2008. As a percentage of sales, operating margin was 8.8% for Q3 2009 compared with 10.0% for Q3 2008. The third quarter 2009 operating margin percentage is down mainly due to retail sales price reductions associated with the Government of Alberta's liquor mark-up as discussed above.

Operating margin before non-recurring items for the three months ended September 30, 2009 was 9.0% or \$12.5 million, compared with 10.1% or \$12.5 million a year earlier.

### **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 September 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 \$0.4 million, compared with an increase of \$0.6 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 decreased to \$7.5 million for the three months ended September 30, 2009, down from \$8.3 million for the same period in 2008 primarily due to the reversal of inventory holding gains as discussed above. Net earnings for the three months ended September 30, 2009 included a non-cash future income tax expense of \$0.4 million compared with \$0.6 million for the three months ended September 30, 2008.

For the quarter ended September 30, 2009, net earnings were \$6.0 million, down \$0.6 million from \$6.6 million in 2008.

### ***Nine Months Ended September 30, 2009 Operating Results***

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

(expressed in thousands of Canadian dollars)	<b>Nine Months ended September 30,</b>			
	<b>2009</b>		<b>2008</b>	
	<b>\$</b>	<b>%</b>	<b>\$</b>	<b>%</b>
	<b>(unaudited)</b>		<b>(unaudited)</b>	
Number of stores at September 30 (note 1)	<b>225</b>		<b>208</b>	
Sales	385,520	100.00%	339,902	100.00%
Adjusted gross margin (note 2)	97,789	25.37%	84,275	24.79%
Adjusted operating and administrative expense (note 3)	65,609	17.02%	56,730	16.69%
Operating margin (note 4)	32,180	8.35%	27,545	8.10%
Non-recurring items (note 5)	617	0.16%	795	0.23%
Operating margin before non-recurring items	32,797	8.51%	28,340	8.33%

Notes:

- (1) *The number of stores and corresponding results for the nine months ended September 30, 2009 includes partial months of operations for three stores (2008 - 13) opened or acquired and one store sold 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 nine months ended September 30, 2009, adjusted operating and administrative expense excludes \$0.2 million (2008 - \$0.8 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 nine months ended September 30, 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.*

### **Nine months ended September 30, 2009 Operating Results Compared to Nine months ended September 30, 2008 Operating Results**

#### **Sales**

For the nine months ended September 30, 2009 sales were \$385.5 million, up 13.4% from \$339.9 million in the same period last year. The sales increase comprises:

- Stores opened or acquired subsequent to September 30, 2008 (including 19 Brown Jug stores in Alaska) accounted for a \$61.5 million increase in sales.
- Sales for stores that were opened or acquired during the first nine months of 2008 comprised \$8.0 million of the sales increase.
- Wholesale business sales for the nine months ended September 30, 2009 were \$44.8 million, down \$6.9 million or 13.3% from \$51.7 million a year earlier. 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.

- During the fourth quarter of 2008, the Fund closed seven stores. Sales in the first nine months of 2008 for these stores were \$3.8 million.
- Sales for stores excluded from same store sales due to their close proximity to new stores were \$9.7 million for the nine months ended September 30, 2009, down \$1.6 million or 14.2% from \$11.3 million for the same period in 2008.
- Same store sales decreased \$11.5 million as explained below.

### **Same Store Sales**

- Total same store sales were \$255.2 million for the nine months ended September 30, 2009, down 4.3% from \$266.7 million for the same period in 2008. Same store sales were impacted by the following (prioritized by their impact):
  - Resource dependent markets in Alberta, British Columbia and Alaska which continue to be impacted by current economic conditions.
  - 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, which resulted in reduced customer traffic and sales. The mark-up increase was rescinded in July 2009, but customer traffic did not immediately pick up.

### **Adjusted Gross Margin**

For the nine months ended September 30, 2009, adjusted gross margin was \$97.8 million, up 16.0% from \$84.3 million for the same period last year. There was an increase in number of stores operated in 2009, including 19 Brown Jug stores in Alaska, compared with the first nine months of 2008.

Gross margin was up 0.6% as a percentage of sales to 25.4% for 2009 compared with 24.8% for 2008.

### **Adjusted Operating and Administrative Expense**

Adjusted operating and administrative expense for the nine months ended September 30, 2009 was \$65.6 million, up 15.7% from \$56.7 million a year earlier mainly due to an increase in the number of stores. For the nine months ended September 30, 2009, operating and administrative expenses included \$0.6 million in non-recurring consulting and professional fees for litigation related to the acquisition of Liquor Barn Income Fund in 2007. For the nine months ended September 30, 2008, operating and administrative expense included \$0.8 million in non-recurring items including consulting and professional fees for Liquor Barn Income Fund 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 17.0%.

### **Operating Margin**

Operating margin was \$32.2 million for the nine months ended September 30, 2009, up 17.1% from \$27.5 million in 2008. As a percentage of sales, operating margin was 8.4% for the first nine months of 2009 compared with 8.1% for 2008. The 2009 operating margin percentage is up due the effective management of costs.

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 nine months ended September 30, 2009 was 8.5% or \$32.8 million, up from 8.3% for the same period last year due to the same factors as discussed above.

### **Future Income Taxes**

In the nine months ended September 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 \$0.2 million, compared with \$3.6 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 \$19.2 million for the nine months ended September 30, 2009, up from \$12.9 million for the same period in 2008. Net earnings for the nine months ended September 30, 2009 included a non-cash future income tax expense of \$0.2 million. Included in net earnings for the nine months ended September 30, 2008 was a \$3.6 million future income tax expense charge.

For the nine months ended September 30, 2009, net earnings were \$15.5 million, up \$5.8 million from \$9.7 million in 2008.

## Condensed Quarterly Information

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

	2009				2008			2007
	Sep 30	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)
<b>Balance Sheet</b>								
Cash and cash equivalents	\$ 9,078	\$ 1,338	\$ 2,139	\$ 3,530	\$ 810	\$ 754	\$ 768	\$ 19,498
Total assets	474,583	474,963	470,646	488,256	442,460	438,993	434,006	449,006
Bank indebtedness	26,427	25,862	24,159	31,172	13,298	9,902	-	-
Total current liabilities	47,229	44,571	72,600	83,240	39,962	36,812	14,098	14,062
Long-term debt	85,563	85,188	52,056	51,742	51,425	51,108	65,859	74,014
<b>Statement of Earnings</b>								
# stores, end of period	225	224	224	223	208	204	198	195
Sales	\$ 138,915	\$ 140,253	\$ 106,352	\$ 143,013	\$ 123,913	\$ 121,567	\$ 94,422	\$ 125,920
Future tax expense (recovery)	423	576	(803)	(1,387)	587	493	2,499	(2,607)
Earnings (loss) before non-controlling interest	7,466	10,091	1,655	11,090	8,329	5,493	(916)	11,547
Net earnings (loss) for the period	5,951	8,072	1,486	9,187	6,619	4,310	(1,258)	9,525
Basic earnings (loss) per Unit	\$ 0.32	\$ 0.44	\$ 0.08	\$ 0.50	\$ 0.36	\$ 0.24	\$ (0.07)	\$ 0.52
Diluted earnings (loss) per Unit	\$ 0.32	\$ 0.44	\$ 0.07	\$ 0.50	\$ 0.36	\$ 0.24	\$ (0.07)	\$ 0.52
Distributable cash per Unit	\$ 0.47	\$ 0.59	\$ 0.17	\$ 0.69	\$ 0.49	\$ 0.41	\$ 0.17	\$ 0.48
Distributable cash before non-recurring items per Unit	\$ 0.47	\$ 0.60	\$ 0.18	\$ 0.61	\$ 0.50	\$ 0.41	\$ 0.19	\$ 0.50
Distributions declared per Unit	\$ 0.405	\$ 0.405	\$ 0.405	\$ 0.405	\$ 0.405	\$ 0.405	\$ 0.405	\$ 0.385

(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 November 10, 2009:

	<b>Units</b>
Fund Units <sup>(1)</sup>	18,513,499
Liquor Stores LP Exchangeable LP Units	3,198,061
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 nine months ended September 30, 2009, the Fund opened two new stores and acquired one store. The new stores were funded with existing credit facilities.

Subsequent to September 30, 2009, the Fund acquired eight liquor stores in Kentucky. The acquisition was funded using existing credit facilities. The Fund will continue to pursue acquisition opportunities and has commitments in place to open additional Canadian stores in the remainder of 2009 and 2010.

### 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 \$95 million extendible revolving operating loan (the “Operating Line Facility”) and a \$48 million extendible revolving term loan (the “Term Loan Facility”). The Fund also has a \$5 million USD facility with a US bank.

At November 9, 2009 there was \$45.4 million drawn on the Operating Line Facility and \$47.3 million drawn on the Term Loan Facility, 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. As at November 9, 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 continuously monitors the market place for acquisitions and new store development opportunities and has developed financing strategies to support this growth in the current economic environment. Management believes the Fund has managed liquidity risk appropriately and is well positioned to meet obligations as they come due in the remainder of 2009 and 2010.

### 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 September 30, 2009, assuming a combined outstanding bank indebtedness and long-term loan facility debt for a balance of \$60.0 million.

(expressed in thousands of Canadian dollars)	+ 1.00%	- 1.00%
Increase (decrease) in interest expense	\$ 600	\$ (600)
Increase (decrease) in net earnings before income tax and non-controlling interest	(600)	600

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. Bad debts are insignificant in relation to total sales.

## 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 subsidiaries are considered to be self-sustaining operations and the assets and liabilities of the foreign subsidiaries 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 subsidiaries' accounts into Canadian dollars are reported as a component of other comprehensive income. The US subsidiaries currently operate 27 stores out of the Fund's 234 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 September 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	\$ 4,327	\$ 16,301	\$ 14,035	\$ 12,198	\$ 10,194	\$ 20,500
Long-term debt	-	-	33,000	-	-	-
Debentures	-	-	500	57,500	-	-
Total	\$ 4,327	\$ 16,301	\$ 47,535	\$ 69,698	\$ 10,194	\$ 20,500

## OFF BALANCE SHEET ARRANGEMENTS

As at November 10, 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 is nearing completion with detailed reviews completed for many of the more complex accounting items for the Fund with the exception of areas for which IFRSs are expected to change prior to 2011. 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, 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 nine months ended September 30, 2009, the Fund incurred professional fees of \$60,708 and \$191,923, 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 \$140,633 and \$447,222 for the three and nine months ended September 30, 2009. The Fund paid fees and expenses to a company controlled by the Executive Chairman of the Fund for consulting services of \$2,427 for the nine months ended September 30, 2009. These operating and administrative expenses are incurred in the normal course of business at terms similar with unrelated parties (see note 16 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 nine months ended September 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 September 30, 2009	As at and for the nine months ended September 30, 2009
Current assets	\$ 12,417	\$ 12,417
Total assets	33,792	33,792
Current liabilities	7,975	7,975
Sales	19,626	58,212

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 nine months ended September 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](http://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 \$30 million as at November 9, 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. Sales for two existing Liquor Depot stores for the three months ended September 30, 2009 and five stores for the nine months ended September 30, 2009 have been 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.

	Three months ended September 30, 2009	Nine months ended September 30, 2009	Year ended December 31,	
			2008 (restated – note 1)	2007 (restated – note 1)
(expressed in thousands of Canadian dollars)				
Cash flow provided by operating activities	\$ 17,886	\$ 36,963	\$ 35,747	\$ 15,151
Earnings before non-controlling interest	7,466	19,212	23,994	15,544
Distributable cash before non-recurring items	10,708	28,334	38,673	31,796
Actual cash distributions declared relating to the period	(9,202)	(27,690)	(36,806)	(28,332)
<b>Excess (deficiency) of cash provided by operating activities over cash distributions declared</b>	<b>\$ 8,684</b>	<b>\$ 9,273</b>	<b>\$ (1,059)</b>	<b>\$ (13,181)</b>
<b>Excess (deficiency) of earnings before non-controlling interest over cash distributions declared</b>	<b>\$ (1,736)</b>	<b>\$ (8,478)</b>	<b>\$ (12,812)</b>	<b>\$ (12,788)</b>
<b>Excess (deficiency) of distributable cash before non-recurring items over cash distributions declared</b>	<b>\$ 1,506</b>	<b>\$ 644</b>	<b>\$ 1,867</b>	<b>\$ 3,464</b>

(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 September 30, 2009, the Fund developed 26 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 September 30, 2009 the Fund acquired 133 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 third quarter and 2009 year-to-date results.

### Provision for Financing Charges

Financing fees represent charges incurred upon the renewal of the credit facility agreement. For GAAP, the fees relating to the Operating Facility and Term Loan Facility were netted against bank indebtedness and long-term debt respectively and the expense is recognized over the remaining credit facility term as a non-cash amortization charge under operating activities. The Fund views these charges as cash costs and has deducted them from distributable cash.

The following table provides an analysis of the total expenditures on financing charges:

(expressed in thousands of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Amortization of financing charges related to:				
Operating Line Facility	\$ 85	\$ -	\$ 85	\$ -
Term Loan Facility	23	-	23	-
Total provision for financing charges	\$ 108	\$ -	\$ 108	\$ -

### 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 September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Purchase of property and equipment	\$ 1,720	\$ 795	\$ 2,807	\$ 3,727
Growth expenditures including amounts relating to developed stores	(1,591)	(720)	(2,498)	(3,361)
Purchase of non-growth property and equipment	129	75	309	366
Provision for further non-growth property and equipment expenditures	-	-	-	(100)
Total provision for non-growth property and equipment	\$ 129	\$ 75	\$ 309	\$ 266

### 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 September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Pre-opening cost expenditures	\$ 111	\$ 100	\$ 228	\$ 874
Pre-opening cost expenditures for subsequently abandoned transactions	-	(1)	-	(48)
Total provision for pre-opening costs	\$ 111	\$ 99	\$ 228	\$ 826

### 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 September 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 nine months of 2009, non-recurring items reduced earnings before non-controlling interest by approximately \$0.2 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.

# **Liquor Stores Income Fund**

Interim Consolidated Financial Statements  
(unaudited)

**September 30, 2009**

(expressed in thousands of Canadian dollars)

# Liquor Stores Income Fund

Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

	September 30, 2009	December 31, 2008 (restated) (note 3)
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 9,078	\$ 3,530
Accounts receivable	1,957	1,928
Inventory (at cost)	100,910	114,072
Prepaid expenses and deposits	1,485	1,932
	113,430	121,462
<b>Deposits on future acquisitions</b> (note 5)	1,073	10
<b>Note receivable</b>	-	310
<b>Property and equipment</b>	44,658	46,743
<b>Intangible assets</b>	44,629	48,198
<b>Goodwill</b>	270,793	271,533
	\$ 474,583	\$ 488,256
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 7 (a))	\$ 26,427	\$ 31,172
Accounts payable and accrued liabilities	17,763	21,033
Distributions payable to unitholders (note 8)	2,493	2,478
Distributions payable to non-controlling interest (note 8)	546	557
Current portion of long-term debt (note 7 (b))	-	28,000
	47,229	83,240
<b>Long-term debt</b> (note 7 (b))	85,563	51,742
<b>Future income tax liability</b> (note 9)	10,852	10,616
<b>Non-controlling interest</b> (note 10)	45,697	48,013
	189,341	193,611
<b>Unitholders' Equity</b>		
Fund Units (note 11)	311,034	309,638
Equity component of convertible debentures	4,970	4,970
Contributed surplus (note 12)	756	1,156
Accumulated other comprehensive income (note 13)	(2,097)	1,404
Cumulative undistributed earnings (excess distributions)	(29,421)	(22,523)
	285,242	294,645
	\$ 474,583	\$ 488,256

# Liquor Stores Income Fund

Consolidated Statements of Earnings and Comprehensive Income

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

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008 (restated) (note 3)	2009	2008 (restated) (note 3)
<b>Consolidated Statements of Earnings</b>				
Sales	\$ 138,915	\$ 123,913	\$ 385,520	\$ 339,902
Cost of sales	104,796	92,357	287,886	255,627
<b>Gross margin</b>	34,119	31,556	97,634	84,275
Operating and administrative expense	21,953	19,245	65,837	57,556
<b>Operating earnings before amortization, interest and other</b>	12,166	12,311	31,797	26,719
<b>Amortization</b>				
Property and equipment	1,542	1,434	4,628	3,808
Intangible assets	723	796	2,222	2,341
	2,265	2,230	6,850	6,149
	9,901	10,081	24,947	20,570
<b>Interest expense and other</b>				
Bank indebtedness	406	432	942	604
Long-term debt	307	45	740	474
Convertible debentures	1,332	1,297	3,920	3,791
Loss (gain) on foreign exchange	146	(609)	116	(784)
Gain on sale of investment (note 6)	(179)	-	(179)	-
	2,012	1,165	5,539	4,085
<b>Earnings before income tax and non-controlling interest</b>	7,889	8,916	19,408	16,485
Future income tax expense	423	587	196	3,580
<b>Earnings before non-controlling interest</b>	7,466	8,329	19,212	12,905
Non-controlling interest (note 10)	1,515	1,710	3,703	3,234
<b>Net earnings for the period</b>	\$ 5,951	\$ 6,619	\$ 15,509	\$ 9,671
<b>Earnings per Unit (note 14)</b>				
Basic	\$ 0.32	\$ 0.36	\$ 0.84	\$ 0.53
Diluted	\$ 0.32	\$ 0.36	\$ 0.84	\$ 0.53
<b>Consolidated Statements of Comprehensive Income</b>				
<b>Net earnings for the period</b>	\$ 5,951	\$ 6,619	\$ 15,509	\$ 9,671
<b>Other comprehensive loss</b>				
Net loss on translation of self-sustaining foreign operations (note 13)	(2,193)	-	(3,501)	-
<b>Comprehensive income for the period</b>	\$ 3,758	\$ 6,619	\$ 12,008	\$ 9,671

# Liquor Stores Income Fund

Consolidated Statements of Changes in Unitholders' Equity

(expressed in thousands of Canadian dollars)

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008 (restated) (note 3)	2009	2008 (restated) (note 3)
<b>Fund Units</b> (note 11)	\$ 311,034	\$ 309,549	\$ 311,034	\$ 309,549
<b>Equity component of convertible debentures</b>	4,970	4,970	4,970	4,970
<b>Contributed surplus</b> (note 12)	756	889	756	889
Accumulated other comprehensive income, beginning of period	96	-	1,404	-
Cumulative translation adjustments	(2,193)	-	(3,501)	-
<b>Accumulated other comprehensive income, end of period</b> (note 13)	(2,097)	-	(2,097)	-
Cumulative undistributed earnings (excess distributions), beginning of period	(27,893)	(23,308)	(21,670)	(11,307)
Change in accounting policy (note 3 (a))	-	-	-	95
Change in accounting policy (note 3 (b))	-	(156)	(853)	(450)
Cumulative undistributed earnings (excess distributions), as restated	(27,893)	(23,464)	(22,523)	(11,662)
Net earnings for the period	5,951	6,619	15,509	9,671
Distributions declared on Fund Units (note 8)	(7,479)	(7,431)	(22,407)	(22,285)
<b>Cumulative undistributed earnings (excess distributions), end of period</b>	(29,421)	(24,276)	(29,421)	(24,276)
<b>Unitholders' equity, end of period</b>	\$ 285,242	\$ 291,132	\$ 285,242	\$ 291,132

# Liquor Stores Income Fund

Consolidated Statements of Cash Flows

(expressed in thousands of Canadian dollars)

	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
		(restated)		(restated)
		(note 3)		(note 3)
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net earnings for the period	\$ 5,951	\$ 6,619	\$ 15,509	\$ 9,671
Items not affecting cash				
Amortization	2,265	2,230	6,850	6,149
Amortization of inventory fair value adjustment	-	-	155	-
Amortization of financing charges	108	-	108	-
Non-cash interest on convertible debentures	351	317	979	856
Future income tax expense	423	587	196	3,580
Unrealized gain on currency forward contract	-	(616)	-	(696)
Gain on sale of investment (note 6)	(179)	-	(179)	-
Non-controlling interest	1,515	1,710	3,703	3,234
Unit-based compensation (note 15)	220	255	555	677
Loss on sale of forfeited incentive plan units	-	-	30	-
	10,654	11,102	27,906	23,471
Net change in non-cash working capital items (note 17)	7,232	(1,035)	9,057	(7,989)
	17,886	10,067	36,963	15,482
<b>Financing activities</b>				
Increase (decrease) in bank indebtedness	481	3,397	(4,772)	13,298
Proceeds of long-term debt	-	-	4,818	7,185
Repayment of long-term debt	-	-	-	(15,000)
Distributions paid to unitholders (note 8)	(7,479)	(7,431)	(22,392)	(22,277)
Distributions paid to non-controlling interest (note 8)	(1,638)	(1,672)	(4,955)	(5,563)
Dividends paid to non-controlling interest by subsidiaries (note 10)	(84)	(79)	(338)	(321)
Net distributions and proceeds on long-term incentive plan units	(18)	-	(20)	(12)
	(8,738)	(5,785)	(27,659)	(22,690)
<b>Investing activities</b>				
Business acquisitions (note 4)	(953)	(2,363)	(1,087)	(4,478)
Proceeds from sale of investments (note 6)	966	-	966	-
Net deposits on future acquisitions	-	(1,064)	(1,155)	(3,064)
Note receivable (note 6)	234	(4)	234	(306)
Purchase of property and equipment	(1,720)	(795)	(2,807)	(3,727)
Proceeds on currency forward contract	-	-	-	95
	(1,473)	(4,226)	(3,849)	(11,480)
<b>Foreign exchange loss on cash held in foreign currency</b>	65	-	93	-
<b>Increase (decrease) in cash and cash equivalents</b>	7,740	56	5,548	(18,688)
<b>Cash and cash equivalents balance, beginning of period</b>	1,338	754	3,530	19,498
<b>Cash and cash equivalents balance, end of period</b>	\$ 9,078	\$ 810	\$ 9,078	\$ 810

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
September 30, 2009

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## 1 Nature of operations and organization

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

As at September 30, 2009, the Fund operated 225 retail liquor stores, of which 171 (2008 – 174) were in Alberta, 35 (2008 - 33) were in British Columbia and 19 (2008 – nil) were in Alaska. Of the stores operated, 197 (2008 – 183) were acquired by the Fund and 28 (2008 - 24) were developed by the Fund.

## 2 Significant accounting policies and basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”) for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited financial statements for the year ended December 31, 2008, except as noted below. However, these interim consolidated financial statements do not include all information and footnote disclosures required under Canadian GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with the audited financial statements and notes thereto, for the year ended December 31, 2008.

### Adoption of new accounting standards

Effective January 1, 2009, the Fund has adopted Canadian Institute of Chartered Accountants (“CICA”) Handbook section 3064 – Goodwill and intangible assets, which resulted in a retrospective change in the Fund’s accounting policy for pre-operating costs (see note 3). Concurrent with the adoption of this standard, EIC 27 – Revenues and Expenditures during the pre-operating period, has been withdrawn.

## 3 Changes in accounting policies

- (a) Emerging Issues Committee Abstract #171 Future Income Tax Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow-Through

On August 28, 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 has retrospectively applied EIC-171 with restatement of prior periods as required by the standard’s transitional provisions.

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

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

## (b) Section 3064 – Goodwill and intangible assets

Pre-opening costs represent incremental direct costs incurred in acquiring and developing new retail liquor stores. Section 3064 – Goodwill and intangible assets states that pre-opening costs are to be expensed as incurred and no longer capitalized as an asset. Prior to the adoption of this standard, the Fund was deferring expenditures incurred during the pre-operating period and amortizing the costs over the 24 month period following the commencement of operations. Section 3064 requires the Fund to retrospectively restate prior periods.

The impact of retrospectively adopting Section 3064 is as follows:

	December 31, 2008 (restated)	December 31, 2008 (as originally presented)
(expressed in thousands of Canadian dollars)		
Balance sheet		
Pre-opening costs	\$ -	\$ 1,297
Non-controlling interest	48,013	48,279
Fund Units	309,638	309,730

The cumulative impact of the changes to December 31, 2008 is a decrease of \$852,533 to unitholders' equity.

The impact on reported earnings is as follows:

	Three months ended September 30, 2008	Nine months ended September 30, 2008
(expressed in thousands of Canadian dollars)		
Decrease in pre-opening cost amortization	\$ 578	\$ 1,056
Pre-opening costs expensed during the period	(99)	(826)
Increase in non-controlling interest	(88)	(42)
Increase in net earnings	391	188
Increase in basic and diluted earnings per unit	\$ 0.02	\$ 0.01

## 4 Business acquisition

During the three and nine month periods ended September 30, 2009, the Fund acquired one (2008 – 5) retail liquor store. The operating results of the acquisition are included in the results of the Fund from the acquisition date.

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

There were no adjustments to goodwill relating to prior period acquisitions for the three months ended September 30, 2009 (2008 - \$18,402). During the nine months ended September 30, 2009, there were adjustments to goodwill for \$134,858 (2008 - \$240,852) for prior year acquisitions relating to contingent payments and transaction costs. An additional \$42,994 (2008 – reduction to goodwill of \$106,000) related to prior year acquisitions was reclassified from working capital to goodwill as a result of finalizing third party valuations.

Of the goodwill acquired or adjusted during the three and nine month periods ended September 30, 2009, \$517,407 and \$695,259, respectively are expected to be deductible for tax purposes.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

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

(expressed in thousands of Canadian dollars)	<b>Three months ended September 30, 2009</b>	<b>Nine months ended September 30, 2009</b>
Purchase price:		
Cash paid during period	\$ 953	\$ 1,087
Net assets acquired:		
Working capital	259	215
Property and equipment	177	177
Goodwill	517	695
	\$ 953	\$ 1,087

## 5 Deposits on future acquisitions

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

Current period activity is as follows:

(expressed in thousands of Canadian dollars)	<b>Non-current Deposits</b>	<b>Current Deposits</b>
Balance – December 31, 2008	\$ 10	\$ 222
Deposits tendered	1,165	12
Holdback released and refunds received	(10)	(1)
Foreign currency translation	(92)	-
Balance – September 30, 2009	\$ 1,073	\$ 233

## 6 Sale of investment

During the three months ended September 30, 2009, the Fund sold its 80% interest in one store. The Fund received proceeds of \$965,983 for the sale. In connection with this transaction, the Fund also sold its note receivable for proceeds of \$234,000. The net gain on the sale was \$179,493.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

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## 7 Bank indebtedness and long-term debt

The Fund concluded an amended and restated credit agreement effective June 30, 2009, with significant terms as described below.

### a) Bank indebtedness

The Fund's credit facilities with a syndicate of Canadian banks comprise an extendible revolving \$95 million operating facility ("Operating Facility") and a \$48 million extendible revolving term loan facility ("Term Loan Facility"). The Fund also has a \$5 million USD operating facility with a US bank ("US operating facility").

Interest on bank indebtedness related to the Operating Facility is payable at the lender's prime rate plus 1.50% or the banker's acceptance discount rate plus a stamping fee of 2.50%. Interest on amounts outstanding on the Term Loan Facility is payable at the lender's prime rate plus 1.50% or the banker's acceptance discount rate plus a stamping fee of 2.50%. Standby fees for the Operating Facility and Term Loan Facility are charged at an annual rate of 0.50% payable monthly on undrawn portions of the facilities. Interest on the US operating facility is payable at three month LIBOR + 2.00%. Financing fees relating to the Operating Facility have been capitalized and are being amortized over the term of the credit facility.

The bank indebtedness and long-term debt are collateralized by a general security agreement covering all present and after-acquired property of Liquor Stores LP and its affiliates and subsidiaries, a floating charge over all of Liquor Stores LP's and its direct and indirect subsidiaries present and after acquired real property, and an assignment of Liquor Stores LP's insurance. Further, Liquor Stores LP's direct and indirect subsidiaries have provided the syndicate with unlimited guarantees of the credit facilities. The assets of Liquor Stores LP and its subsidiaries represent substantially all of the Fund's assets.

As at September 30, 2009, \$27 million was advanced under the Operating Facility as banker's acceptances and \$33 million under the Term Loan Facility. No principal amounts are due on the Term Loan Facility until maturity at June 30, 2011. As at September 30, 2009, there were no amounts outstanding on the US operating facility.

At September 30, 2009, the Fund had issued \$3.7 million (2008 - \$3.7 million) in letters of guarantee for day-to-day inventory purchases in Canada and \$0.6 million (2008 - \$nil) for the United States.

The Fund's credit facility agreements contain both objectively determinable and subjective covenants which, if the Fund fails to comply, could accelerate repayment requirements.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

## b) Long-term debt

Long-term debt comprises the following:

(expressed in thousands of Canadian dollars)	Maturity Date	2009		September 30, 2009	December 31, 2008
		Effective Rate			
Term Loan Facility advance	June 30, 2011	4.03%		\$ 33,000	\$ 28,000
Unamortized financing charges <sup>(i)</sup>				(159)	-
				32,841	28,000
Convertible unsecured subordinated debentures:					
6.75% Debenture	December 31, 2012	10.13%		52,188	51,198
8.00% Debenture	December 31, 2011	4.85%		534	544
				85,563	79,742
Less: current portion of long-term debt				-	28,000
				\$ 85,563	\$ 51,742

(i) Financing fees related to the Term Loan Facility have been capitalized and are being amortized over the term of the facility.

## 8 Distributions

Distributions are determined in accordance with the Trust Indenture, and are based on earnings, before amortization and adjusted by capital expenditures. Distributions totalling \$0.405 (2008 - \$0.405) per Unit for each of Fund Units, Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units were declared by the Fund for the three month period ended September 30, 2009.

(expressed in thousands of Canadian dollars)		Fund Units		Liquor Stores Exchangeable LP Units		Liquor Stores Series 1 Exchangeable LP Units		Total	
Date distribution declared	Date distribution paid	Declared	Paid	Declared	Paid	Declared	Paid	Declared	Paid
Jan 15, 2009	Feb 13, 2009	\$ 2,483	\$ 2,483	\$ 442	\$ 442	\$ 114	\$ 114	\$ 3,039	\$ 3,039
Feb 13, 2009	Mar 13, 2009	2,483	2,483	442	442	114	114	3,039	3,039
Mar 13, 2009	Apr 15, 2009	2,484	2,484	441	441	114	114	3,039	3,039
Apr 15, 2009	May 15, 2009	2,492	2,492	433	433	114	114	3,039	3,039
May 15, 2009	Jun 15, 2009	2,493	2,493	432	432	114	114	3,039	3,039
Jun 15, 2009	Jul 15, 2009	2,493	2,493	432	432	114	114	3,039	3,039
Jul 15, 2009	Aug 14, 2009	2,493	2,493	432	432	114	114	3,039	3,039
Aug 14, 2009	Sep 15, 2009	2,493	2,493	432	432	114	114	3,039	3,039
Sep 15, 2009		2,493		432		114		3,039	
		\$ 22,407	\$ 19,914	\$ 3,918	\$ 3,486	\$ 1,026	\$ 912	\$ 27,351	\$ 24,312

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
September 30, 2009

## 9 Future income taxes

Prior to June 12, 2007, the Fund provided for current and future income taxes only for its incorporated subsidiaries. On June 22, 2007, Bill C-52, including provisions related to the taxation of income trusts commencing January 1, 2011 (or sooner in certain circumstances), received Royal Assent. As a consequence, Canadian income trusts are required to provide for future income taxes arising from those temporary tax differences expected to reverse after January 1, 2011. The substantively enacted tax rates for 2011 and 2012 are 26.5% and 25.0% respectively.

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

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

(expressed in thousands of Canadian dollars)	September 30, 2009	December 31, 2008
Future income tax liabilities:		
Intangible assets	\$ 5,828	\$ 6,312
Property and equipment	2,594	2,566
Goodwill	3,690	2,627
	12,112	11,505
Future income tax assets:		
Issue and financing costs	541	549
Deferred lease inducements	231	198
Long term incentive plans	66	79
Non-capital losses	422	63
	1,260	889
	\$ 10,852	\$ 10,616

The above includes a net future income tax liability recorded by a wholly-owned US subsidiary of \$14,945 (2008 – \$84,528).

Future income taxes of \$2,370,237 attributable to the Fund's exchangeable interests are not recorded. During the three months ended September 30, 2009, 5,788 (2008 – nil) units were exchanged resulting in an increase to future taxes of \$3,311 (2008 - \$nil). During the nine month period ended September 30, 2009, 77,853 (2008 – 37,456) units were exchanged which increased future income taxes by \$42,150 (2008 – \$23,863).

The Fund has recognized future income taxes related to non-capital losses of \$1,610,673 (2008 - \$690,663) available in subsidiaries to offset income of future years. Realization of the non-capital losses is considered to be more likely than not. If not utilized, \$17,748 will expire in 2027, \$582,266 will expire in 2028 and \$1,010,659 will expire in 2029.

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

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

## 10 Non-controlling interest

	Liquor Stores Exchangeable LP Units	Series 1 Exchangeable LP Units	Total
Balance – December 31, 2008	# 3,275,914	# 845,409	# 4,121,323
Exchanged for Fund Units	(77,853)	-	(77,853)
<b>Balance – September 30, 2009</b>	<b># 3,198,061</b>	<b># 845,409</b>	<b># 4,043,470</b>

	(restated – note 3)
(expressed in thousands of Canadian dollars)	
Balance – December 31, 2008	\$ 47,755
Earnings	3,446
Exchanged for Fund Units	(712)
Exchangeable LP Unit conversion	(42)
Distributions declared (note 8)	(4,944)
<b>Balance – September 30, 2009</b>	<b>\$ 45,503</b>

### Subsidiaries

Balance – December 31, 2008	\$ 258
Earnings	257
Sale of investment	17
Dividends	(338)
<b>Balance – September 30, 2009</b>	<b>\$ 194</b>
<b>Total</b>	<b>\$ 45,697</b>

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

The Exchangeable LP Units and Series 1 Exchangeable LP Units issued by Liquor Stores LP have economic and voting rights equivalent to the Fund Units (note 11), except in connection with the exchangeability terms as described below. They are exchangeable, directly or indirectly, on a one-for-one basis for Fund Units at the option of the holder, under the terms of the Exchange Agreement. The Exchangeable LP Units are not required to be exchanged for Fund Units before transferring to third parties. Exchangeable LP Units and Series 1 Exchangeable Units have been treated as non-controlling interest.

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

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
September 30, 2009

## 11 Unitholders' equity

Units outstanding and capital contributions are as follows:

(expressed in thousands of Canadian dollars)	Number of units	Net capital contributions
Balance – December 31, 2008 (restated – note 3)	# 18,356,996	\$ 309,638
Issued for Exchangeable Units	77,853	712
Vested Units (note 15 (a))	31,256	674
Forfeited units	3,124	68
Cash distributions on vested Units	-	(58)
<b>Balance – September 30, 2009</b>	<b># 18,469,229</b>	<b>\$ 311,034</b>

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

Consideration for units issued on exchange of Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units during the three and nine month periods ended September 30, 2009 was recorded at the carrying amount of the Liquor Stores Exchangeable LP Units and Series 1 Exchangeable LP Units.

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

## 12 Contributed Surplus

The table below summarizes the changes in contributed surplus:

(expressed in thousands of Canadian dollars)	Amount
Balance – December 31, 2008	\$ 1,156
Vested Units (note 15 (a))	(674)
Unit-based compensation expense (note 15 (a))	274
<b>Balance – September 30, 2009</b>	<b>\$ 756</b>

The Fund manages two unit-based incentive plans under which certain senior management receives a portion of their compensation (note 15 (a)). Awarded Units vest evenly over a period of three years. As the Units vest, they are transferred to the plan participant and recorded against contributed surplus.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

## 13 Accumulated Other Comprehensive Income

The following table outlines the components of accumulated other comprehensive income as at September 30, 2009:

(expressed in thousands of Canadian dollars)	<b>Amount</b>
Balance – December 31, 2008	\$ 1,404
Foreign currency translation adjustment <sup>(i)</sup>	(3,501)
Balance – September 30, 2009	\$ (2,097)

(i) Net of income tax expense of \$nil.

## 14 Earnings per Unit

(expressed in thousands of Canadian dollars, except per unit amounts)	<b>Three months ended September 30, 2009</b>		<b>Nine months ended September 30, 2008</b>	
	<b>(restated – note 3)</b>		<b>(restated – note 3)</b>	
Net earnings (numerator utilized in basic and diluted Earnings per Unit)	\$ 5,951	\$ 6,619	\$ 15,509	\$ 9,671
Units outstanding, beginning of period	# 18,463,440	# 18,347,730	# 18,356,996	# 18,294,278
Weighted average of Units issued less treasury Units acquired	3,649	-	80,526	45,864
Denominator utilized in basic earnings per unit	# 18,467,089	# 18,347,730	# 18,437,522	# 18,340,142
Potential units under unit-based compensation plans (note 15 (a))	4,844	1,294	15,115	14,838
Denominator utilized in diluted earnings per unit	# 18,471,933	# 18,349,024	# 18,452,637	# 18,354,980
Earnings per Unit – Basic	\$ 0.32	\$ 0.36	\$ 0.84	\$ 0.53
Earnings per Unit – Diluted	\$ 0.32	\$ 0.36	\$ 0.84	\$ 0.53

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

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements  
September 30, 2009

## 15 Unit-based compensation plans

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

The following table summarizes the status of the Plans:

	LTIP		2007 Plan		Total	
Unvested Units - December 31, 2008	#	50,109	#	28,541	#	78,650
Vested Units transferred to participants		(16,985)		(14,271)		(31,256)
Forfeited units		(2,086)		(1,038)		(3,124)
Unvested Units - September 30, 2009	#	31,038	#	13,232	#	44,270

In January 2009, 2,086 forfeited LTIP Units and 1,038 forfeited 2007 Plan Units were sold on the market resulting in a reduction to compensation expense of \$30,714. For the remaining units granted, the compensation expense will be recognized over the vesting period of three years or sooner under certain circumstances.

Compensation expense for the LTIP for the three months ended September 30, 2009 was \$74,906 (2008 - \$195,927) and \$226,550 (2008 - \$458,713) for the nine month period ended September 30, 2009. Compensation expense of \$25,800 (2008 - \$71,178) was recorded for the 2007 Plan for the period ended September 30, 2009 and \$78,140 (2008 - \$213,534) for the nine month period ended September 30, 2009.

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

Awards accruing to DSU Plan participants for the three and nine months ended September 30, 2009 totalled \$119,490 (2008 – reduce compensation expense by \$12,118) and \$281,111 (2008 - \$4,413), respectively, which was recorded as compensation expense in the period. As at September 30, 2009 participants have accumulated an entitlement to the equivalent cash value of 37,063 Units under the DSU Plan (December 31, 2008 – 26,938).

## 16 Related party transactions

A director of a subsidiary of the Fund is a partner in a law firm to which the Fund incurred professional fees during the three and nine month periods ended September 30, 2009 of \$60,708 (2008 - \$92,177) and \$191,923 (2008 - \$274,298), respectively. Further, the Fund paid fees and expenses to a company controlled by the Executive Chairman of the Fund in the amount of \$2,427 (2008 - \$38,461) for consulting services during the nine months ended September 30, 2009. Rent paid to companies controlled by a director of the GP amounted to \$140,633 (2008 - \$99,613) and \$447,222 (2008 - \$329,404) respectively for the three and nine months ended September 30, 2009. These operating and administrative expenses are incurred in the normal course of business at terms similar with unrelated parties and are measured at the exchange amount. There was \$20,863 included in accounts payable and accrued liabilities (December 31, 2008 - \$15,000) relating to these transactions.

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

## 17 Supplemental disclosure of cash flow information

Changes in non-cash working capital items:

(expressed in thousands of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Accounts receivable	\$ (888)	\$ 1,203	\$ (89)	\$ 1,170
Inventory	5,124	(1,134)	11,412	(6,195)
Prepaid expenses and deposits	153	(333)	431	(553)
Accounts payable and accrued liabilities	2,843	(771)	(2,697)	(2,411)
	\$ 7,232	\$ (1,035)	\$ 9,057	\$ (7,989)

(expressed in thousands of Canadian dollars)	Three months ended September 30,		Nine months ended September 30,	
	2009	2008	2009	2008
Interest paid	\$ 641	\$ 475	\$ 3,577	\$ 3,166
Income taxes paid	4	4	43	234

## 18 Segmented information

The Fund identifies operating segments based on business activities and management responsibility. The Fund operates within a single operating segment, being the operation of retail liquor stores in Canada and the United States.

(expressed in thousands of Canadian dollars)	Three months ended September 30, 2009			Nine months ended September 30, 2009		
	Canada	US	Total	Canada	US	Total
Total sales <sup>(i)</sup>	\$ 119,289	\$ 19,626	\$ 138,915	\$ 327,308	\$ 58,212	\$ 385,520
Goodwill	260,651	10,142	270,793	260,651	10,142	270,793
Property and equipment	41,231	3,427	44,658	41,231	3,427	44,658

(i) Sales are allocated to countries based on location of store.

## 19 Economic dependence

Under Alberta provincial legislation the Fund is required to purchase liquor and related products sold in Alberta from the Alberta Gaming and Liquor Commission. As the Fund's income in Alberta is derived entirely from the sale of liquor and related products, its ability to continue viable operations is largely dependent upon maintaining its relationship with this main supplier.

The Fund is dependent on Connect Logistics Services Inc. and Brewers Distributor Ltd. in Alberta and the Liquor Distribution Branch in British Columbia for the majority of its products. Any significant disruption in the operations of these organizations resulting in interruption in supply would have a material adverse effect on liquor store operations including the operations of the Fund.

## 20 Seasonal nature of the business

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

# Liquor Stores Income Fund

Notes to Consolidated Financial Statements

September 30, 2009

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## 21 Subsequent event

On October 22, 2009, the Fund completed the acquisition of eight retail liquor stores located in Kentucky, USA. The stores are located in the cities of Lexington and Louisville. The aggregate purchase price (including inventory) was approximately \$28.6 million and was financed with existing credit facilities. Management is in the process of allocating the purchase price to the net assets acquired, and this allocation will be reflected in the Fund's fourth quarter results.