

# LIQUOR STORES N.A. LTD.

## CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three months ended March 31, 2017 and 2016

(Unaudited, expressed in thousands of Canadian dollars)



# Liquor Stores N.A. Ltd.

## Condensed Interim Consolidated Statements of Financial Position

(in thousands of Canadian dollars)

Note	March 31, 2017 \$	December 31, 2016 \$
<b>Assets</b>		
Current assets:		
Cash	2,982	7,020
Accounts receivable	2,725	3,184
Inventory	155,210	155,425
Prepaid expenses and deposits	11,471	10,380
	172,388	176,009
<b>Deferred tax assets</b>	17,638	16,819
<b>Purchase option</b>	1,073	1,537
<b>Property and equipment</b>	63,988	63,674
<b>Intangible assets</b>	46,609	46,690
<b>Goodwill</b>	158,198	158,318
	459,894	463,047
<b>Liabilities</b>		
Current liabilities:		
Accounts payable and accrued liabilities	52,476	67,857
Income taxes payable	3,625	399
Dividends payable	1,001	830
Derivative instrument	97	52
Current portion of long-term debt	370	323
	57,569	69,461
<b>Long-term debt</b>	157,103	135,838
<b>Deferred tax liabilities</b>	3,475	8,037
<b>Non-controlling interest put option</b>	14,275	14,316
	232,422	227,652
<b>Shareholders' Equity</b>		
Equity attributable to shareholders	223,496	230,889
Equity attributable to non-controlling interest	3,976	4,506
	227,472	235,395
	459,894	463,047

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

## Liquor Stores N.A. Ltd.

### Condensed Interim Consolidated Statements of Changes in Equity

(in thousands of Canadian dollars)

	Attributable to Shareholders of the Company					Total	Non-controlling interest	Total equity
	Share capital	Equity component of convertible debentures	Contributed surplus	Accumulated other comprehensive income	Deficit			
	\$	\$	\$	\$	\$	\$	\$	\$
<b>Opening balance – January 1, 2016</b>	249,303	3,328	175,761	24,460	(197,193)	255,659	77	255,736
Net earnings (loss) for the period	-	-	-	-	(1,743)	(1,743)	271	(1,472)
Foreign currency translation adjustment	-	-	-	(6,927)	-	(6,927)	(639)	(7,566)
Comprehensive loss for the period	-	-	-	(6,927)	(1,743)	(8,670)	(368)	(9,038)
Share-based payments	-	-	222	-	-	222	-	222
Settlement of equity-based payments	199	-	(199)	-	-	-	-	-
Dividends declared (note 6)	-	-	-	-	(5,778)	(5,778)	-	(5,778)
Dividend reinvestment plan issuance (note 6)	804	-	-	-	-	804	-	804
Recognition of non-controlling interest put liability	-	-	-	-	(14,474)	(14,474)	-	(14,474)
Acquisition of Birchfield Ventures LLC	-	-	-	-	-	-	4,854	4,854
Dividends declared by subsidiaries	-	-	-	-	-	-	(594)	(594)
Transactions with owners	1,003	-	23	-	(20,252)	(19,226)	4,260	(14,966)
<b>Balance – March 31, 2016</b>	250,306	3,328	175,784	17,533	(219,188)	227,763	3,969	231,732
<b>Opening balance – January 1, 2017</b>	251,180	6,334	176,881	20,744	(224,250)	230,889	4,506	235,395
Net earnings (loss) for the period	-	-	-	-	(4,910)	(4,910)	124	(4,786)
Foreign currency translation adjustment	-	-	-	(677)	-	(677)	(47)	(724)
Comprehensive earnings (loss) for the period	-	-	-	(677)	(4,910)	(5,587)	77	(5,510)
Share-based payments	-	-	469	-	-	469	-	469
Settlement of equity-based payments	455	-	(455)	-	-	-	-	-
Dividends declared (note 6)	-	-	-	-	(2,492)	(2,492)	-	(2,492)
Dividend reinvestment plan issuance (note 6)	217	-	-	-	-	217	-	217
Dividends declared by subsidiaries	-	-	-	-	-	-	(607)	(607)
Transactions with owners	672	-	14	-	(2,492)	(1,806)	(607)	(2,413)
<b>Balance – March 31, 2017</b>	251,852	6,334	176,895	20,067	(231,652)	223,496	3,976	227,472

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

**Liquor Stores N.A. Ltd.****Condensed Interim Consolidated Statements of Earnings (Loss) and Comprehensive Income (Loss)****Three Months Ended March 31, 2017 and 2016***(in thousands of Canadian dollars)*

	Note	March 31, 2017 \$	March 31, 2016 \$
<b>Sales</b>		162,419	172,034
Cost of sales		120,785	128,420
<b>Gross margin</b>		41,634	43,614
Selling and distribution expenses		35,848	34,900
Administrative expenses		5,032	6,628
<b>Operating profit before amortization</b>		754	2,086
<b>Amortization</b>			
Property and equipment		2,951	3,081
Intangible assets		99	130
<b>Operating loss</b>		(2,296)	(1,125)
Finance costs	3	3,167	2,521
Net loss (gain) on foreign exchange from financing activities		97	(1,963)
Fair value adjustments	4	586	355
<b>Loss before income taxes</b>		(6,146)	(2,038)
<b>Income tax recovery</b>	7	(1,360)	(566)
<b>Net loss</b>		(4,786)	(1,472)
<b>Other comprehensive income</b>			
Items that may be reclassified subsequently to net earnings:			
Currency translation difference on foreign subsidiaries		(916)	(8,997)
Net investment hedge		192	1,431
<b>Comprehensive loss</b>		<b>(5,510)</b>	<b>(9,038)</b>
<b>Net earnings (loss) attributable to</b>			
Owners of the parent		(4,910)	(1,743)
Non-controlling interest		124	271
		(4,786)	(1,472)
<b>Comprehensive income (loss) attributable to</b>			
Owners of the parent		(5,587)	(8,670)
Non-controlling interest		77	(368)
		(5,510)	(9,038)
<b>Loss per share</b>			
Basic	9	(0.18)	(0.06)
Diluted	9	(0.18)	(0.06)

*The accompanying notes are an integral part of these condensed interim consolidated financial statements.*

**Liquor Stores N.A. Ltd.****Condensed Interim Consolidated Statements of Cash Flow****Three Months Ended March 31, 2017 and 2016***(in thousands of Canadian dollars)*

	Note	March 31, 2017 \$	March 31, 2016 \$
<b>Cash provided by (used in)</b>			
<b>Operating activities:</b>			
Net earnings (loss) for the period		(4,786)	(1,472)
Adjustments to reconcile net loss to net cash flows from operating activities:			
Amortization of property and equipment		2,951	3,081
Amortization of intangible assets		99	130
Amortization of financing charges	3	71	104
Non-cash interest on convertible debentures	3	690	328
Unrealized foreign exchange (gain) loss		63	(2,208)
Fair value adjustments	4	586	355
Deferred income tax		(5,540)	(4,751)
Equity-settled share-based payments		469	222
Cash used in operating activities before changes in non-cash working capital		(5,397)	(4,211)
Net change in non-cash working capital items	11	(13,322)	(13,597)
		(18,719)	(17,808)
<b>Investing activities:</b>			
Purchase of property and equipment		(2,739)	(4,213)
Purchase of intangible assets		(238)	(501)
Acquisition, net of cash acquired		-	(20,912)
		(2,977)	(25,626)
<b>Financing activities:</b>			
Proceeds from long-term debt		20,407	51,390
Dividends paid	6	(2,275)	(6,617)
Dividends paid to non-controlling interest by subsidiaries		(436)	(339)
		17,696	44,434
<b>Foreign exchange gain (loss) on cash held in foreign currency</b>		(38)	(514)
<b>Increase (decrease) in cash</b>		(4,038)	486
<b>Cash - Beginning of quarter</b>		7,020	3,790
<b>Cash - End of quarter</b>		2,982	4,276

*The accompanying notes are an integral part of these condensed interim consolidated financial statements.*

## **Liquor Stores N.A. Ltd.**

### **Notes to the Condensed Interim Consolidated Financial Statements**

**March 31, 2017 and 2016**

*(in thousands of Canadian dollars)*

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#### **1 Nature of the business**

Liquor Stores N.A. Ltd. (the “Company”) was incorporated under the Canada Business Corporations Act. The address of the Company’s registered office is 101, 17220 Stony Plain Road, Edmonton, Alberta. The Company’s common shares and convertible unsecured subordinated debentures trade on the Toronto Stock Exchange (the “TSX”) under the symbols “LIQ” and “LIQ.DB.B”.

The Company’s principal activity is the retailing of wines, beers and spirits. As at March 31, 2017, the Company operated 252 (2016 - 254) retail liquor stores, of which 178 (2016 - 180) were in Alberta, 34 (2016 - 35) were in British Columbia, 22 (2016 - 22) were in Alaska, 15 (2016 - 15) were in Kentucky, two (2016 - two) were in New Jersey and one (2016 - none) was in Connecticut. Of the stores operated, 194 (2016 - 198) were acquired and 58 (2016 - 56) were developed by the Company.

These condensed interim consolidated financial statements (the “financial statements”) were approved and authorized for issuance by the Board of Directors on May 8, 2017.

#### **2 Basis of preparation and significant accounting policies**

These financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, and do not include all of the information required for full annual financial statements. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, for the year ended December 31, 2016.

The preparation of condensed interim consolidated financial statements requires management to make judgements, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates. In preparing these interim financial statements, the significant judgements made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended December 31, 2016.

The Company’s operations are seasonal in nature. Accordingly, sales will vary by quarter based on consumer spending behaviour. The Company is able to adjust certain variable costs in response to seasonal revenue patterns; however, costs such as occupancy are fixed, causing the Company to report a higher level of earnings in the third and fourth quarters. This business seasonality results in quarterly performance that is not necessarily indicative of the year’s performance.

The accounting policies applied by the Company in these interim financial statements are the same as those applied by the Company and there have been no changes to critical accounting estimates or judgements made from those as described in its consolidated financial statements as at and for the year ended December 31, 2016.

## Liquor Stores N.A. Ltd.

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

(in thousands of Canadian dollars)

#### 3 Finance costs

Finance costs comprise the following:

	Three months ended March 31,	
	2017	2016
	\$	\$
Interest expense		
Long-term debt <sup>(i)</sup>	590	1,206
Convertible debentures <sup>(ii)</sup>	2,577	1,315
	3,167	2,521

- i) Included in interest expense on long-term debt was amortization of deferred financing costs of \$71 (2016 - \$104).
- ii) Interest expense on the convertible debentures of \$2,577 (2016 - \$1,315) represents coupon interest of \$1,887 (2016 - \$987) and \$690 (2016 - \$328) pertaining to the impact of capitalized transaction costs and the accretion of the debt using the effective interest rate method.

#### 4 Fair value adjustments

Fair value adjustments recognized in the period comprise the following:

	Fair Value Hierarchy	Three months ended March 31,	
		2017	2016
		\$	\$
Fair value adjustment to interest rate swap	Level 2	45	260
Fair value adjustment to non-controlling interest put option	Level 3	94	95
Fair value adjustment to purchase option	Level 2	447	-
		586	355

Financial instruments recognized on the balance sheet at fair value are classified in a hierarchy based on the significance of the estimates used in their measurement, as follows:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Inputs for the asset or liability that are not based on observable market data.

## Liquor Stores N.A. Ltd.

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

*(in thousands of Canadian dollars)*

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#### 4 Fair value adjustments (continued)

The fair value of the interest rate swap is calculated as the net present value of the future cash flows expected to arise on the variable and fixed rate tranches, determined using applicable yield curves at each measurement date. The fair value of the non-controlling interest put option and purchase options are calculated using the methods as described in the financial statements for the year-ended December 31, 2016.

#### 5 Hedge of a net investment in foreign operation

The Company is applying hedge accounting to foreign currency differences arising between the \$USD functional currency of Birchfield and the \$CAD functional currency of the Company. The Company has therefore designated a portion of the principal amount outstanding of the \$USD borrowings made by the Company as a net investment hedge of the net assets of Birchfield. The Company's investments in other subsidiaries are not hedged.

No ineffectiveness was recognized in the current period from the net investment hedge.

#### 6 Dividends

	Three months ended March 31,	
	2017	2016
	\$	\$
Dividends declared	2,492	5,778
Dividends paid		
Dividends paid in cash	2,275	6,617
Dividends paid in shares	217	804

Dividends were declared on April 13, 2017 in the amount of \$0.03 per common share and will be paid on May 15, 2017 to the holders of common shares as at the close of the record date of April 28, 2017. Dividends are paid mid-month following the month of declaration.

#### 7 Income tax

Income tax is recognized based on management's estimate of the weighted average annual effective tax rate expected for the full financial year. The estimated average annual effective tax rate for 2017 is 22.1%.



## Liquor Stores N.A. Ltd.

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

(in thousands of Canadian dollars)

#### 8 Share capital

a) Authorized:

An unlimited number of voting common shares are authorized to be issued.

b) Issued and outstanding:

	#	\$
Balance – January 1, 2016	27,449,891	249,303
Shares issued under dividend reinvestment plan	110,029	804
Shares issued on settlement of equity based compensation awards	14,056	199
<b>Balance – March 31, 2016</b>	<b>27,573,976</b>	<b>250,306</b>
Balance – January 1, 2017	27,664,070	251,180
Shares issued under dividend reinvestment plan	22,159	217
Shares issued on settlement of equity based compensation awards	45,611	455
<b>Balance – March 31, 2017</b>	<b>27,731,840</b>	<b>251,852</b>

#### 9 Loss per share

	Three months ended March 31,	
	2017	2016
	\$	\$
Loss attributable to owners of the parent	(4,910)	(1,743)
	<b>2017</b>	<b>2016</b>
	<b>#</b>	<b>#</b>
Weighted average number of common shares outstanding – Basic	27,676,433	27,464,008
Effect of dilutive securities		
Equity-settled share-based payment awards	-	20,654
Weighted average number of common shares outstanding - Diluted	27,676,433	27,484,662
	<b>2017</b>	<b>2016</b>
	<b>\$</b>	<b>\$</b>
Basic loss per share	(0.18)	(0.06)
Diluted loss per share	(0.18)	(0.06)

For the period ended March 31, 2016, potential shares issuable in exchange for all equity-settled share based payment awards have been excluded in the diluted earnings per share calculation as their effect would have been anti-dilutive. The potential shares issuable in exchange for convertible debentures were not included in the diluted earnings per share calculation for the three months ended March 31, 2017 and 2016 due to their anti-dilutive effect.

## Liquor Stores N.A. Ltd.

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

(in thousands of Canadian dollars)

#### 10 Related party transactions

The following transactions were carried out with related parties:

	Three months ended March 31,	
	2017	2016
	\$	\$
Professional fees <sup>(i)</sup>		
Recognized in administrative expenses	-	10
	-	10

<sup>(i)</sup> A Director of the Company was a partner in a law firm to which the Company incurred professional fees for legal services in the prior year. The Director is no longer a partner in this law firm.

#### 11 Supplementary disclosure of cash flow information

Changes in non-cash working capital items comprise the following:

	Three months ended March 31,	
	2017	2016
	\$	\$
Accounts receivable	472	5,270
Inventory	(355)	(6,979)
Prepaid expenses and deposits	(1,107)	667
Accounts payable and accrued liabilities	(15,558)	(13,478)
Income tax payable	3,226	923
	(13,322)	(13,597)

Interest and income taxes paid are included in cash provided by operating activities in the Statements of Cash Flows.

	Three months ended March 31,	
	2017	2016
	\$	\$
Interest paid	519	1,102
Income taxes paid	954	265

## **Liquor Stores N.A. Ltd.**

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

*(in thousands of Canadian dollars)*

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## **12 Operating segments**

The Company has two reportable segments: Canadian Operations and US Operations. Segmentation is based on differences in the regulatory environments of Canada and the US and reflects the basis on which management measures performance and makes decisions regarding the allocation of resources. The Canada and US segments operate retail liquor stores in their respective jurisdictions.

Financial information regarding the results of each reportable segment is included below. Performance is measured based on operating profit before amortization, and is included in the internal management reports that are reviewed regularly by the Company's President and Chief Executive Officer (the Company's chief operating decision maker, or "CODM") and follow the organization, management and reporting structure of the Company. Operating profit before amortization is one of the primary benchmarks used by management to evaluate the performance of its operating segments. A reconciliation of operating profit before amortization to earnings before income taxes, an earnings measure used in the Company's consolidated Statement of Earnings and Comprehensive Income, has been included in the table below.

Operating profit before amortization is not an earnings measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, operating profit before amortization may not be comparable to similar measures presented by other issuers. Users are cautioned that operating profit before amortization should not be construed as an alternative to earnings before income tax as determined in accordance with IFRS, as an indicator of performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

**Liquor Stores N.A. Ltd.**

## Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

*(in thousands of Canadian dollars)***12 Operating segments (continued)**

	<b>Three months ended March 31, 2017</b>			
	<b>Canadian Operations \$</b>	<b>US Operations \$</b>	<b>Corporate and Other Reconciling Items \$</b>	<b>Consolidated \$</b>
Sales to external customers	105,538	56,881	-	162,419
Operating profit before amortization	5,504	282	(5,032)	754
Property and equipment amortization				2,951
Intangible asset amortization				99
Finance costs				3,167
Net loss on foreign exchange from financing activities				97
Fair value adjustments				586
Earnings before income taxes				(6,146)
<b>Other information</b>				
Expenditures for additions to				
Property and equipment <sup>(i)</sup>	3,114	512	-	3,626
Intangible assets <sup>(i)</sup>	238	-	-	238
Total assets at March 31, 2017 <sup>(i)</sup>	316,841	143,053	-	459,894
<b>Three months ended March 31, 2016</b>				
	<b>Canadian Operations \$</b>	<b>US Operations \$</b>	<b>Corporate and Other Reconciling Items \$</b>	<b>Consolidated \$</b>
Sales to external customers	110,428	61,606	-	172,034
Operating profit before amortization	6,276	2,438	(6,628)	2,086
Property and equipment amortization				3,081
Intangible asset amortization				130
Finance costs				2,521
Net gain on foreign exchange from financing activities				(1,963)
Fair value adjustments				355
Earnings before income taxes				(2,038)
<b>Other information</b>				
Expenditures for additions to				
Property and equipment <sup>(i)</sup>	654	455	-	1,109
Intangible assets <sup>(i)</sup>	56	1	-	57
Total assets at December 31, 2016 <sup>(i)</sup>	316,520	146,527	-	463,047

<sup>(i)</sup> Total corporate assets are not regularly reported to the CODM but rather, a split between US and Canadian assets is provided. The disclosure above reflects what is regularly provided to the CODM.

## **Liquor Stores N.A. Ltd.**

### Notes to the Condensed Interim Consolidated Financial Statements

March 31, 2017 and 2016

*(in thousands of Canadian dollars)*

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#### **13 Subsequent Event**

On May 3, 2017, the Company redeemed all of its outstanding 5.85% convertible unsecured subordinated debentures (the “5.85% Debentures”). The 5.85% Debentures were redeemed prior to their maturity date of April 30, 2018 in accordance with the terms of the trust indenture governing the 5.85% Debentures. The aggregate principal amount of the 5.85% Debentures redeemed was \$67.5 million, reflecting a redemption price equal to \$1,000 for each \$1,000 principal amount of 5.85% Debentures held. Proceeds for the redemption were obtained from the Company’s syndicated credit facility.