

LIQUOR STORES N.A. LTD.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three and nine months ended September 30, 2015 and 2014

(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	September 30, 2015 \$	December 31, 2014 \$
Assets			
Current assets:			
Cash		2,790	3,003
Accounts receivable		4,469	2,099
Inventory		150,669	135,363
Prepaid expenses and deposits		11,797	9,153
		169,725	149,618
Deferred tax assets		5,330	3,918
Property and equipment		58,585	51,008
Intangible assets		40,830	36,714
Goodwill		287,930	284,607
		562,400	525,865
Liabilities			
Current liabilities:			
Accounts payable and accrued liabilities		49,936	48,629
Dividends payable to shareholders	7	2,464	2,452
Derivative instrument		122	43
		52,522	51,124
Long-term debt	5	127,017	92,037
Deferred tax liabilities		18,606	17,946
		198,145	161,107
Shareholders' Equity			
Equity attributable to shareholders		364,240	364,652
Equity attributable to non-controlling interest		15	106
		364,255	364,758
		562,400	525,865

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						Non-controlling interest	Total equity
	Share capital	Equity component of convertible debentures	Contributed surplus	Accumulated other comprehensive income	Deficit	Total		
	\$	\$	\$	\$	\$	\$	\$	\$
Opening balance – January 1, 2014	188,824	3,328	174,695	342	(55,361)	311,828	94	311,922
Net earnings for the period	-	-	-	-	6,103	6,103	134	6,237
Foreign currency translation adjustment	-	-	-	4,463	-	4,463	-	4,463
Comprehensive income for the period	-	-	-	4,463	6,103	10,566	134	10,700
Share-based payments	-	-	42	-	-	42	-	42
Dividends declared (note 7)	-	-	-	-	(18,790)	(18,790)	-	(18,790)
Dividend reinvestment plan issuance (note 7)	1,787	-	-	-	-	1,787	-	1,787
Dividends declared by subsidiaries	-	-	-	-	-	-	(182)	(182)
Transactions with owners	1,787	-	42	-	(18,790)	(16,961)	(182)	(17,143)
Balance – September 30, 2014	190,611	3,328	174,737	4,805	(68,048)	305,433	46	305,479
Opening balance – January 1, 2015	246,826	3,328	174,927	7,653	(68,082)	364,652	106	364,758
Net earnings for the period	-	-	-	-	6,310	6,310	106	6,416
Foreign currency translation adjustment	-	-	-	13,089	-	13,089	-	13,089
Comprehensive income for the period	-	-	-	13,089	6,310	19,399	106	19,505
Share-based payments	-	-	535	-	-	535	-	535
Adjustment to net proceeds on share issuance	(34)	-	-	-	-	(34)	-	(34)
Dividends declared (note 7)	-	-	-	-	(22,120)	(22,120)	-	(22,120)
Dividend reinvestment plan issuance (note 7)	1,808	-	-	-	-	1,808	-	1,808
Dividends declared by subsidiaries	-	-	-	-	-	-	(197)	(197)
Transactions with owners	1,774	-	535	-	(22,120)	(19,811)	(197)	(20,008)
Balance – September 30, 2015	248,600	3,328	175,462	20,742	(83,892)	364,240	15	364,255

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 and Comprehensive Income

Three and Nine Months Ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	Note	Three months ended		Nine months ended	
		September 30, 2015 \$	September 30, 2014 \$	September 30, 2015 \$	September 30, 2014 \$
Sales		194,186	181,921	532,218	497,464
Cost of sales		144,349	134,916	395,467	371,838
Gross margin		49,837	47,005	136,751	125,626
Operating and administrative expenses	11	38,940	34,469	111,759	102,838
Amortization		10,897	12,536	24,992	22,788
Property and equipment		2,813	3,176	7,928	7,492
Intangible assets		62	97	195	242
		8,022	9,263	16,869	15,054
Finance costs	6	2,324	2,345	6,478	6,913
Earnings before income taxes		5,698	6,918	10,391	8,141
Income tax expense	8	1,529	1,602	3,975	1,904
Net earnings		4,169	5,316	6,416	6,237
Other comprehensive income					
Items that may be reclassified subsequently to net earnings:					
Currency translation difference on foreign subsidiaries		6,461	4,028	13,089	4,463
Comprehensive income		10,630	9,344	19,505	10,700
Net earnings attributable to					
Owners of the parent		4,142	5,271	6,310	6,103
Non-controlling interest		27	45	106	134
		4,169	5,316	6,416	6,237
Comprehensive income attributable to					
Owners of the parent		10,603	9,299	19,399	10,566
Non-controlling interest		27	45	106	134
		10,630	9,344	19,505	10,700
Earnings per share					
Basic	10	0.15	0.23	0.23	0.26
Diluted	10	0.15	0.23	0.23	0.26

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 and Nine Months Ended September 30, 2015 and 2014

(in thousands of Canadian dollars)

	Note	Three months ended		Nine months ended	
		September 30, 2015 \$	September 30, 2014 \$	September 30, 2015 \$	September 30, 2014 \$
Cash provided by (used in)					
Operating activities:					
Net earnings for the period		4,169	5,316	6,416	6,237
Adjustments to reconcile net income to net cash flows from operating activities:					
Amortization of property and equipment		2,813	3,176	7,928	7,492
Amortization of intangible assets		62	97	195	242
Amortization of financing charges	6	105	90	214	190
Non-cash interest on convertible debentures	6	328	304	941	868
Fair value adjustment on derivative instrument	6	(25)	(5)	79	(13)
Deferred income tax		1,510	1,602	(119)	(4,129)
Equity-settled share-based payments		283	-	535	42
Cash provided by operating activities before changes in non-cash working capital		9,245	10,580	16,189	10,929
Net change in non-cash working capital items	12	(2,148)	(178)	(15,496)	(9,734)
		7,097	10,402	693	1,195
Investing activities:					
Purchase of property and equipment	4	(3,505)	(3,832)	(17,835)	(7,742)
Purchase of intangible assets	4	(233)	(505)	(2,290)	(551)
		(3,738)	(4,337)	(20,125)	(8,293)
Financing activities:					
Net proceeds from (repayment of) bank indebtedness		-	(75)	-	933
Proceeds from sale and leaseback of assets	3	-	-	5,664	-
Net proceeds from (repayment of) long-term debt		2,045	(451)	34,386	23,223
Deferred financing fees paid on loans and borrowings		(132)	(123)	(561)	(373)
Dividends paid	7	(6,708)	(5,671)	(20,300)	(16,988)
Dividends paid to non-controlling interest by subsidiaries		(72)	(64)	(197)	(182)
		(4,867)	(6,384)	18,992	6,613
Foreign exchange gain on cash held in foreign currency		241	259	227	287
Decrease in cash		(1,267)	(60)	(213)	(198)
Cash - Beginning of period		4,057	4,391	3,003	4,529
Cash - End of period		2,790	4,331	2,790	4,331

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

September 30, 2015 and 2014

(in thousands of Canadian dollars)

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 300, 10508 – 82 Avenue, 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.A”.

The Company’s principal activity is the retailing of wines, beers and spirits. As at September 30, 2015 and 2014, the Company operated 247 (2014 - 246) retail liquor stores, of which 175 (2014 - 175) were in Alberta, 35 (2014 - 35) were in British Columbia, 22 (2014 - 23) were in Alaska and 15 (2014 - 13) were in Kentucky. Of the stores operated, 197 (2014 - 201) were acquired and 50 (2014 - 45) 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 November 5, 2015.

2 Basis of preparation and significant accounting policies

These condensed interim consolidated 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 condensed interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto, for the year ended December 31, 2014.

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, 2014.

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, 2014.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

3 Sale and leaseback of assets

On March 31, 2015, the Company completed a transaction with a third party whereby the Company sold and leased-back property and building in Fairbanks, Alaska for gross proceeds of \$5,957 less transaction costs of \$293. The Company has classified the lease as an operating lease, and given the transaction occurred at fair market value, the gain on sale of \$134 was recognized within amortization of property and equipment in the Statement of Earnings and Comprehensive Income for the nine months ended September 30, 2015.

4 Acquisition of assets

On June 11, 2015, the Company acquired a retail liquor store in Alberta for cash consideration of \$2,142. The assets acquired do not meet the definition of a business and therefore the transaction was accounted for as an asset acquisition and not as a business combination. The purchase price has been allocated between the individual identifiable assets acquired based on their relative fair values at the acquisition date, as follows:

	\$
Inventory	862
Property and equipment	831
Intangible assets (lease at below market rates)	449
<u>Purchase price</u>	<u>2,142</u>

5 Long-term debt

On June 30, 2015, the Company and a syndicate of Canadian banks agreed to amend and restate the credit facility described in note 8(a) to the December 31, 2014 financial statements. The primary purpose of the amendment was to extend the maturity date of the credit facility to September 30, 2017.

As disclosed in the notes to the consolidated financial statements as at and for the year ended December 31, 2014, the Company has an existing interest rate swap that expires on December 14, 2015. On August 31, 2015, the Company entered into a forward-starting interest rate swap effective on December 14, 2015 and expiring December 14, 2019, to fix the effective interest rate on a notional \$60 million of principal debt with a rate equivalent to 1.23% plus the applicable credit spread determined with reference to the credit facility.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

6 Finance costs

Finance costs comprise the following:

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Interest expense				
Bank indebtedness	-	77	-	349
Long-term debt ⁽ⁱ⁾	719	919	1,951	2,632
Convertible debenture ⁽ⁱⁱ⁾	1,315	1,291	3,902	3,830
Fair value adjustment on interest rate swap	(25)	(5)	79	(13)
Net loss on foreign exchange from financing activities	315	63	546	115
	2,324	2,345	6,478	6,913

- i) Included in interest expense on long-term debt for the three and nine months ended September 30, 2015 was amortization of deferred financing costs of \$105 and \$214 (2014 - \$90 and \$190), respectively.
- ii) Interest expense on the convertible debentures for the three and nine months ended September 30, 2015, respectively, of \$1,315 and \$3,902 (2014 - \$1,291 and \$3,830) represents coupon interest of \$987 and \$2,961 (2014 - \$987 and \$2,962) and \$328 and \$941 (2014 - \$304 and \$868) pertaining to the impact of capitalized transaction costs and the accretion of the debt using the effective interest rate method.

7 Dividends

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Dividends declared	7,386	6,278	22,120	18,790
Dividends paid				
Dividends paid in cash	6,710	5,671	20,300	16,988
Dividends paid in shares	671	602	1,808	1,787

Dividends were declared on September 15, 2015 in the amount of \$0.09 per common share and will be paid on October 15, 2015 to the holders of common shares as at the close of the record date of September 30, 2015. Dividends are paid mid-month following the month of declaration.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

8 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. On June 29, 2015, the Alberta government enacted a two percent increase in the corporate income tax rate. The rate increase was effective July 1, 2015. As a result, the Company's deferred tax liability increased by \$1,301 as at June 30, 2015, offset by an reduction in deferred tax previously recognized in equity of \$47. The resulting estimated average annual effective tax rate for 2015 is 31% (the effective tax rate for the year ended December 31, 2014 was 24%).

9 Share capital

a) Authorized:

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

b) Issued and outstanding:

	#	\$
Balance – January 1, 2014	23,113,172	188,824
Shares issued under dividend reinvestment plan	154,059	1,787
Balance – September 30, 2014	23,267,231	190,611
Balance – January 1, 2015	27,240,760	246,826
Shares issued under dividend reinvestment plan	132,558	1,808
Adjustment to net proceeds on share issuance	-	(34)
Balance – September 30, 2015	27,373,318	248,600

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

10 Earnings per share

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Net earnings attributable to owners of the parent	4,142	5,271	6,310	6,103
	2015 #	2014 #	2015 #	2014 #
Weighted average number of common shares outstanding – Basic	27,346,024	23,241,958	27,302,204	23,188,955
Effect of dilutive securities				
Equity-settled share-based payment awards	20,017	-	30,370	-
Weighted average number of common shares outstanding – Diluted	27,366,041	23,241,958	27,332,574	23,188,955
	2015 \$	2014 \$	2015 \$	2014 \$
Basic earnings per share	0.15	0.23	0.23	0.26
Diluted earnings per share	0.15	0.23	0.23	0.26

Due to their anti-dilutive effect, the potential shares issuable in exchange for convertible debentures were not included in the diluted earnings per share calculation for the three and nine months ended September 30, 2015 and 2014.

11 Related party transactions

- a) The following transactions were carried out with related parties:

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Professional fees ⁽ⁱ⁾				
Recognized in operating and administrative expenses	24	19	77	61
Included in the initial carrying value of long-term debt	-	-	50	-
Rent expense ⁽ⁱⁱ⁾	-	-	-	194
	24	19	127	255

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

11 Related party transactions (continued)

- (i) A Director of the Company is a partner in a law firm to which the Company incurred professional fees for legal services.
- (ii) Rent in 2014 includes amounts paid to entities controlled by a former Director of the Company up until May 15, 2014 when the Director retired from the Company's Board and ceased to be a related party.

There was \$3 included in accounts payable and accrued liabilities (December 31, 2014 – \$19) relating to these transactions.

- b) Included in operating and administrative expenses for the nine months ended September 30, 2015 are payments of \$675 related to the departure of the Company's former Executive Vice President, Business Development, General Counsel and Corporate Secretary. Included in operating and administrative expenses for the nine months ended September 30, 2014 are payments of \$617 related to the departure of the Company's former Chief Financial Officer. These expenses have been included in the Canadian operating segment (note 13).

12 Supplementary disclosure of cash flow information

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

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Accounts receivable	(2,229)	(434)	(2,325)	(962)
Inventory	(3,458)	1,602	(8,914)	(1,808)
Prepaid expenses and deposits	(649)	587	(2,391)	(167)
Accounts payable and accrued liabilities	4,729	(350)	(1,866)	(4,018)
Income tax payable	(541)	(1,583)	-	(2,779)
	(2,148)	(178)	(15,496)	(9,734)

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

	Three months ended September 30,		Nine months ended September 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Interest paid	614	933	3,695	4,867
Income taxes paid	1,607	1,604	4,981	9,019

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

(in thousands of Canadian dollars)

13 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. Both 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 margin, which is defined as earnings before amortization, finance costs and income tax expense, as included in the internal management reports that are reviewed regularly by the Company's Chief Executive Officer (the Company's chief operating decision maker) and follow the organization, management and reporting structure of the Company. Operating margin is one of the primary benchmarks used by management to evaluate the performance of its operating segments. A reconciliation of operating margin to earnings before income taxes, an earnings measure used in the Company's Condensed Interim Consolidated Statement of Earnings and Comprehensive Income, has been included in the table below.

Operating margin is not an earnings measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, operating margin may not be comparable to similar measures presented by other issuers. Investors are cautioned that operating margin 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

September 30, 2015 and 2014

*(in thousands of Canadian dollars)***13 Operating segments (continued)**

	Three months ended September 30, 2015		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	138,315	55,871	194,186
Operating margin	9,753	1,144	10,897
Property and equipment amortization			2,813
Intangible asset amortization			62
Finance costs			2,324
Earnings before income taxes			5,698
Other information			
Expenditures for additions to:			
Property and equipment	4,925	1,423	6,348
Intangible assets	101	132	233
Total assets at September 30, 2015	441,034	121,366	562,400
	Three months ended September 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	137,917	44,004	181,921
Operating margin	10,844	1,692	12,536
Property and equipment amortization			3,176
Intangible asset amortization			97
Finance costs			2,345
Earnings before income taxes			6,918
Other information			
Expenditures for additions to:			
Property and equipment	2,729	739	3,468
Intangibles	-	508	508
Total assets at December 31, 2014	424,571	101,294	525,865

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 30, 2015 and 2014

*(in thousands of Canadian dollars)***13 Operating segments (continued)**

	Nine months ended September 30, 2015		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	382,323	149,895	532,218
Operating margin	23,127	1,865	24,992
Property and equipment amortization			7,928
Intangible asset amortization			195
Finance costs			6,478
Earnings before income taxes			10,391
Other information			
Expenditures for additions to:			
Property and equipment	10,978	7,729	18,707
Intangible assets	2,158	132	2,290
Total assets at September 30, 2015	441,034	121,366	562,400

	Nine months ended September 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	371,997	125,467	497,464
Operating margin	19,007	3,781	22,788
Property and equipment amortization			7,492
Intangible asset amortization			242
Finance costs			6,913
Earnings before income taxes			8,141
Other information			
Expenditures for additions to:			
Property and equipment	6,978	1,234	8,212
Intangibles	-	513	513
Total assets at December 31, 2014	424,571	101,294	525,865