

LIQUOR STORES N.A. LTD.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three and six months ended June 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	June 30, 2015 \$	December 31, 2014 \$
Assets			
Current assets:			
Cash		4,057	3,003
Accounts receivable		2,210	2,099
Inventory		144,214	135,363
Prepaid expenses and deposits		10,959	9,153
		161,440	149,618
Deferred tax assets		5,032	3,918
Property and equipment		53,911	51,008
Intangible assets		39,667	36,714
Goodwill		286,301	284,607
		546,351	525,865
Liabilities			
Current liabilities:			
Accounts payable and accrued liabilities		41,311	48,629
Dividends payable to shareholders	7	2,459	2,452
Income tax payable		541	-
Derivative instrument		147	43
		44,458	51,124
Long-term debt	5	124,670	92,037
Deferred tax liabilities		17,096	17,946
		186,224	161,107
Shareholders' Equity			
Equity attributable to shareholders		360,067	364,652
Equity attributable to non-controlling interest		60	106
		360,127	364,758
		546,351	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					Total	Non-controlling interest	Total equity
	Share capital	Equity component of convertible debentures	Contributed surplus	Accumulated other comprehensive income	Deficit			
	\$	\$	\$	\$	\$	\$	\$	\$
Opening balance - January 1, 2014	188,824	3,328	174,695	342	(55,361)	311,828	94	311,922
Net earnings for the period	-	-	-	-	831	831	89	920
Foreign currency translation adjustment	-	-	-	435	-	435	-	435
Comprehensive income for the period	-	-	-	435	831	1,266	89	1,355
Share-based payments	-	-	42	-	-	42	-	42
Dividends declared	-	-	-	-	(12,512)	(12,512)	-	(12,512)
Dividend reinvestment plan issuance	1,185	-	-	-	-	1,185	-	1,185
Dividends declared by subsidiaries	-	-	-	-	-	-	(122)	(122)
Transactions with owners	1,185	-	42	-	(12,512)	(11,285)	(122)	(11,407)
Balance - June 30, 2014	190,009	3,328	174,737	777	(67,042)	301,809	61	301,870
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	-	-	-	-	2,168	2,168	79	2,247
Foreign currency translation adjustment	-	-	-	6,628	-	6,628	-	6,628
Comprehensive income for the period	-	-	-	6,628	2,168	8,796	79	8,875
Share-based payments	-	-	252	-	-	252	-	252
Adjustment to net proceeds on share issuance	(34)	-	-	-	-	(34)	-	(34)
Dividends declared (note 7)	-	-	-	-	(14,735)	(14,735)	-	(14,735)
Dividend reinvestment plan issuance (note 7)	1,136	-	-	-	-	1,136	-	1,136
Dividends declared by subsidiaries	-	-	-	-	-	-	(125)	(125)
Transactions with owners	1,102	-	252	-	(14,735)	(13,381)	(125)	(13,506)
Balance - June 30, 2015	247,928	3,328	175,179	14,281	(80,649)	360,067	60	360,127

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 Six Months Ended June 30, 2015 and 2014

(in thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30, 2015 \$	June 30, 2014 \$	June 30, 2015 \$	June 30, 2014 \$
Sales		190,606	178,168	338,032	315,543
Cost of sales		141,715	133,453	251,118	236,922
Gross margin		48,891	44,715	86,914	78,621
Operating and administrative expenses	11	36,277	35,459	72,819	68,369
		12,614	9,256	14,095	10,252
Amortization					
Property and equipment		2,866	2,257	5,115	4,317
Intangible assets		55	57	133	145
		9,693	6,942	8,847	5,790
Finance costs	6	1,894	2,401	4,154	4,569
Earnings before income taxes		7,799	4,541	4,693	1,221
Income tax expense	8	3,239	1,124	2,446	301
Net earnings		4,560	3,417	2,247	920
Other comprehensive income (loss)					
Items that may be reclassified subsequently to net earnings:					
Currency translation difference on foreign subsidiaries		(1,269)	(2,623)	6,628	435
Comprehensive income		3,291	794	8,875	1,355
Net earnings attributable to					
Owners of the parent		4,490	3,355	2,168	831
Non-controlling interest		70	62	79	89
		4,560	3,417	2,247	920
Comprehensive income attributable to					
Owners of the parent		3,221	732	8,796	1,266
Non-controlling interest		70	62	79	89
		3,291	794	8,875	1,355
Earnings per share					
Basic	10	0.16	0.14	0.08	0.04
Diluted	10	0.16	0.14	0.08	0.04

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 Six Months Ended June 30, 2015 and 2014

(in thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30, 2015 \$	June 30, 2014 \$	June 30, 2015 \$	June 30, 2014 \$
Cash provided by (used in)					
Operating activities:					
Net earnings for the period		4,560	3,417	2,247	920
Adjustments to reconcile net income to net cash flows from operating activities:					
Amortization of property and equipment		2,866	2,257	5,115	4,317
Amortization of intangible assets		55	57	133	145
Amortization of financing charges	6	-	63	109	100
Non-cash interest on convertible debentures	6	318	293	613	564
Fair value adjustment on derivative instrument	6	(85)	(43)	104	(8)
Deferred income tax		2,771	1,124	(1,629)	(5,805)
Equity-settled share-based payments		254	-	252	42
Cash provided by operating activities before changes in non-cash working capital		10,739	7,168	6,944	275
Net change in non-cash working capital items	12	(5,074)	1,572	(13,348)	(9,512)
		5,665	8,740	(6,404)	(9,237)
Investing activities:					
Purchase of property and equipment	4	(7,457)	(2,235)	(14,330)	(3,909)
Purchase of intangible assets	4	(593)	(10)	(2,057)	(16)
		(8,050)	(2,245)	(16,387)	(3,925)
Financing activities:					
Net proceeds (repayment) of bank indebtedness		-	(3,366)	-	1,007
Proceeds from sale and leaseback of assets	3	-	-	5,664	-
Net proceeds from long-term debt		2,538	1,882	32,341	23,424
Deferred financing fees paid on loans and borrowings		(429)	-	(429)	-
Dividends paid	7	(6,798)	(5,658)	(13,592)	(11,318)
Proceeds received on exercise of stock-options		-	-	-	-
Dividends paid to non-controlling interest by subsidiaries		(8)	(32)	(125)	(122)
		(4,697)	(7,174)	23,859	12,991
Foreign exchange gain (loss) on cash held in foreign currency		(221)	(127)	(14)	33
Increase (decrease) in cash		(7,303)	(806)	1,054	(138)
Cash - Beginning of period		11,360	5,197	3,003	4,529
Cash - End of period		4,057	4,391	4,057	4,391

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

June 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 June 30, 2015 and 2014, the Company operated 247 (2014 - 245) retail liquor stores, of which 176 (2014 - 176) were in Alberta, 35 (2014 - 35) were in British Columbia, 23 (2014 - 22) were in Alaska and 13 (2014 - 12) were in Kentucky. Of the stores operated, 199 (2014 - 200) were acquired and 48 (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 August 14, 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

June 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 six months ended June 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
Purchase price	<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.

6 Finance costs

Finance costs comprise the following:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	\$	\$	\$	\$
Interest expense				
Bank indebtedness	-	39	-	66
Long-term debt ⁽ⁱ⁾	592	1,029	1,232	1,920
Convertible debenture ⁽ⁱⁱ⁾	1,305	1,280	2,587	2,539
Fair value adjustment on interest rate swap	(85)	(43)	104	(8)
Net loss on foreign exchange from financing activities	82	96	231	52
	<u>1,894</u>	<u>2,401</u>	<u>4,154</u>	<u>4,569</u>

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2015 and 2014

(in thousands of Canadian dollars)

6 Finance costs (continued)

- i) Included in interest expense on long-term debt for the three and six months ended June 30, 2015 was amortization of deferred financing costs of \$nil and \$109 (2014 - \$63 and \$100), respectively.
- ii) Interest expense on the convertible debentures for the three and six months ended June 30, 2015, respectively, of \$1,305 and \$2,587 (2014 - \$1,280 and \$2,539) represents coupon interest of \$987 and \$1,974 (2014 - \$987 and \$1,974) and \$318 and \$613 (2014 - \$293 and \$564) 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 June 30,		Six months ended June 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Dividends declared	7,373	6,263	14,735	12,512
Dividends paid	7,370	6,258	14,728	12,503
Dividends paid in shares	572	600	1,136	1,185

Dividends were declared on July 15, 2015 in the amount of \$0.09 per common share and will be paid on August 14, 2015 to the holders of common shares as at the close of the record date of July 31, 2015. Dividends are paid mid-month following the month of declaration.

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 is effective July 1, 2015. As a result, the Company's deferred tax liability increased by \$1,301, 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%).

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2015 and 2014

(in thousands of Canadian dollars)

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	101,534	1,185
Balance – June 30, 2014	23,214,706	190,009
Balance – January 1, 2015	27,240,760	246,826
Shares issued under dividend reinvestment plan	78,641	1,136
Adjustment to net proceeds on share issuance	-	(34)
Balance – June 30, 2015	27,319,401	247,928

10 Earnings per share

	Three months ended		Six months ended	
	June 30,		June 30,	
	2015	2014	2015	2014
	\$	\$	\$	\$
Net earnings attributable to owners of the parent	4,490	3,355	2,168	831
	2015	2014	2015	2014
	#	#	#	#
Weighted average number of common shares outstanding – Basic	27,299,433	23,187,867	27,280,078	23,162,014
Effect of dilutive securities				
Equity-settled share-based payment awards	20,956	-	21,222	-
Weighted average number of common shares outstanding – Diluted	27,320,389	23,187,867	27,301,300	23,162,014
	2015	2014	2015	2014
	\$	\$	\$	\$
Basic earnings per share	0.16	0.14	0.08	0.04
Diluted earnings per share	0.16	0.14	0.08	0.04

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 six months ended June 30, 2015 and 2014.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2015 and 2014

(in thousands of Canadian dollars)

11 Related party transactions

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

	Three months ended June 30,		Six months ended June 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Professional fees ⁽ⁱ⁾				
Recognized in operating and administrative expenses	25	25	53	42
Included in the initial carrying value of long-term debt	85	-	85	-
Rent expense ⁽ⁱⁱ⁾	-	78	-	194
	110	103	138	236

(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. The commitment remaining under this lease agreement at June 30, 2015 is \$857 for the term ending on March 31, 2017.

There was \$100 included in accounts payable and accrued liabilities (December 31, 2014 - \$19) relating to these transactions.

- b) Included in operating and administrative expenses for the six months ended June 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 three and six months ended June 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).

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2015 and 2014

*(in thousands of Canadian dollars)***12 Supplementary disclosure of cash flow information**

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

	Three months ended June 30,		Six months ended June 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Accounts receivable	(823)	(577)	(96)	(528)
Inventory	(1,660)	647	(5,456)	(3,409)
Prepaid expenses and deposits	(2,313)	(624)	(1,742)	(755)
Accounts payable and accrued liabilities	812	3,710	(6,595)	(3,624)
Income tax payable	(1,090)	(1,584)	541	(1,196)
	(5,074)	1,572	(13,348)	(9,512)

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

	Three months ended June 30,		Six months ended June 30,	
	2015 \$	2014 \$	2015 \$	2014 \$
Interest paid	2,550	2,954	3,081	3,872
Income taxes paid	1,557	1,620	3,374	7,415

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 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

June 30, 2015 and 2014

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

	Three months ended June 30, 2015		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	139,218	51,388	190,606
Operating margin	11,645	969	12,614
Property and equipment amortization			2,866
Intangible asset amortization			55
Finance costs			1,894
Earnings before income taxes			7,799
Other information			
Expenditures for additions to:			
Property and equipment	2,171	4,428	6,599
Intangible assets	593	-	593
Total assets at June 30, 2015	433,200	113,151	546,351
	Three months ended June 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	133,658	44,510	178,168
Operating margin	7,153	2,103	9,256
Property and equipment amortization			2,257
Intangible asset amortization			57
Finance costs			2,401
Earnings before income taxes			4,541
Other information			
Expenditures for additions to:			
Property and equipment	2,034	356	2,390
Intangibles	-	-	-
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

June 30, 2015 and 2014

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

	Six months ended June 30, 2015		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	244,008	94,024	338,032
Operating margin	13,374	721	14,095
Property and equipment amortization			5,115
Intangible asset amortization			133
Finance costs			4,154
Earnings before income taxes			4,693
Other information			
Expenditures for additions to:			
Property and equipment	6,053	6,306	12,359
Intangible assets	2,057	-	2,057
Total assets at June 30, 2015	433,200	113,151	546,351
	Six months ended June 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales to external customers	234,080	81,463	315,543
Operating margin	8,163	2,089	10,252
Property and equipment amortization			4,317
Intangible asset amortization			145
Finance costs			4,569
Earnings before income taxes			1,221
Other information			
Expenditures for additions to:			
Property and equipment	4,249	495	4,744
Intangibles	-	5	5
Total assets at December 31, 2014	424,571	101,294	525,865