

LIQUOR STORES N.A. LTD.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

Three and six months ended June 30, 2014 and 2013

(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, 2014 \$	December 31, 2013 \$
Assets			
Current assets:			
Cash		4,391	4,529
Accounts receivable		1,866	1,342
Inventory		135,297	131,716
Prepaid expenses and deposits		8,272	7,525
		149,826	145,112
Deferred tax assets		2,019	2,732
Property and equipment		47,259	46,782
Intangible assets		35,191	35,282
Goodwill		282,833	282,768
		517,128	512,676
Liabilities			
Current liabilities:			
Bank indebtedness	3	932	-
Accounts payable and accrued liabilities		38,065	40,746
Dividends payable to shareholders	5	2,087	2,080
Income tax payable		2,343	3,577
Derivative instrument	12	87	95
		43,514	46,498
Long-term debt	3	157,907	133,819
Deferred tax liabilities		13,837	20,437
		215,258	200,754
Shareholders' Equity			
Equity attributable to shareholders		301,809	311,828
Equity attributable to non-controlling interest		61	94
		301,870	311,922
		517,128	512,676

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 \$ (note 7)	Equity component of convertible debentures \$	Contributed surplus \$	Accumulated other comprehen- sive income \$	Deficit \$			
Opening balance – January 1, 2013	185,696	3,328	174,900	(4,505)	(41,761)	317,658	92	317,750
Net earnings for the period	-	-	-	-	6,686	6,686	92	6,778
Foreign currency translation adjustment	-	-	-	3,918	-	3,918	-	3,918
Comprehensive income for the period	-	-	-	3,918	6,686	10,604	92	10,696
Share-based payments	-	-	61	-	-	61	-	61
Exercise of share options	990	-	(94)	-	-	896	-	896
Dividends declared	-	-	-	-	(12,411)	(12,411)	-	(12,411)
Dividend reinvestment plan issuance	1,029	-	-	-	-	1,029	-	1,029
Dividends declared by subsidiaries	-	-	-	-	-	-	(121)	(121)
Transactions with owners	2,019	-	(33)	-	(12,411)	(10,425)	(121)	(10,546)
Balance – June 30, 2013	187,715	3,328	174,867	(587)	(47,486)	317,837	63	317,900
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 (note 5)	-	-	-	-	(12,512)	(12,512)	-	(12,512)
Dividend reinvestment plan issuance (note 5)	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

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, 2014 and 2013

(in thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30, 2014 \$	June 30, 2013 \$	June 30, 2014 \$	June 30, 2013 \$
Sales		178,168	167,669	315,543	303,971
Cost of sales		133,453	126,094	236,922	227,478
Gross margin		44,715	41,575	78,621	76,493
Operating and administrative expenses	10	35,459	29,863	68,369	58,289
Amortization		9,256	11,712	10,252	18,204
Property and equipment		2,257	2,582	4,317	4,613
Intangible assets		57	89	145	178
		6,942	9,041	5,790	13,413
Finance costs	4	2,401	1,808	4,569	4,202
Earnings before income taxes		4,541	7,233	1,221	9,211
Income tax expense	6	1,124	1,912	301	2,433
Net earnings		3,417	5,321	920	6,778
Other comprehensive income (loss)					
Items that may be reclassified subsequently to net earnings:					
Currency translation difference on foreign subsidiaries		(2,623)	2,573	435	3,918
Comprehensive income		794	7,894	1,355	10,696
Net earnings attributable to					
Owners of the parent		3,355	5,260	831	6,686
Non-controlling interest		62	61	89	92
		3,417	5,321	920	6,778
Comprehensive income attributable to					
Owners of the parent		732	7,833	1,266	10,604
Non-controlling interest		62	61	89	92
		794	7,894	1,355	10,696
Earnings per share					
Basic	8	0.14	0.23	0.04	0.29
Diluted	8	0.14	0.23	0.04	0.29

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, 2014 and 2013

(in thousands of Canadian dollars)

	Note	Three months ended		Six months ended	
		June 30, 2014 \$	June 30, 2013 \$	June 30, 2014 \$	June 30, 2013 \$
Cash provided by (used in)					
Operating activities:					
Net earnings for the period		3,417	5,321	920	6,778
Adjustments to reconcile net income to net cash flows from operating activities:					
Amortization of property and equipment		2,257	2,582	4,317	4,613
Amortization of intangible assets		57	89	145	178
Amortization of financing charges	4	63	82	100	165
Non-cash interest on convertible debentures	4	293	270	564	520
Fair value adjustment on derivative instrument	4	(43)	(455)	(8)	(310)
Deferred income tax		1,124	2,054	(5,805)	(3,390)
Share-based payments		-	15	42	68
Cash provided by operating activities before changes in non-cash working capital		7,168	9,958	275	8,622
Net change in non-cash working capital items	11	1,572	8,594	(9,512)	1,641
		8,740	18,552	(9,237)	10,263
Investing activities:					
Purchase of property and equipment		(2,235)	(2,136)	(3,909)	(3,507)
Purchase of intangible assets		(10)	(143)	(16)	(214)
		(2,245)	(2,279)	(3,925)	(3,721)
Financing activities:					
Proceeds (repayment) of bank indebtedness		(3,366)	1,644	1,007	(2,248)
Proceeds (repayment) from long-term debt		1,882	(12,259)	23,424	5,003
Dividends paid	5	(5,658)	(5,681)	(11,318)	(11,371)
Proceeds received on exercise of stock-options		-	810	-	896
Dividends paid to non-controlling interest by subsidiaries		(32)	(37)	(122)	(121)
		(7,174)	(15,523)	12,991	(7,841)
Foreign exchange gain (loss) on cash held in foreign currency		(127)	314	33	392
Increase (decrease) in cash		(806)	1,064	(138)	(907)
Cash – Beginning of period		5,197	3,159	4,529	5,130
Cash - End of period		4,391	4,223	4,391	4,223

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, 2014 and 2013

(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, 2014, the Company operated 245 (December 31, 2013 - 246) retail liquor stores, of which 176 (2013 - 176) were in Alberta, 35 (2013 - 36) were in British Columbia, 22 (2013 - 22) were in Alaska and 12 (2013 - 12) were in Kentucky. Of the stores operated, 200 (2013 - 202) were acquired and 45 (2013 - 44) 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, 2014.

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, 2013.

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 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 financial statements as at and for the year ended December 31, 2013.

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 in its consolidated financial statements as at and for the year ended December 31, 2013 except as described below.

Change in Accounting Policy

The Company has adopted IFRIC 21, Levies which provides guidance on when to recognize an obligation to pay a levy other than income tax. The standard was effective January 1, 2014 and adoption of IFRIC 21 did not result in any current or retrospective adjustment.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

3 Bank indebtedness and long-term debt

On March 31, 2014, the Company and a syndicate of Canadian banks agreed to amend and restate the credit facility described in note 9(b) to the December 31, 2013 financial statements. Significant changes to the credit facility include an increase in the extendible revolving operating facility from \$150,000 to \$175,000 and an extension of the maturity date to May 31, 2016.

4 Finance costs

Finance costs comprise the following:

	Three months ended June 30,		Six months ended June 30,	
	2013 \$	2013 \$	2013 \$	2013 \$
Interest expense				
Bank indebtedness	39	50	66	158
Long-term debt ⁽ⁱ⁾	1,029	933	1,920	1,848
Convertible debenture ⁽ⁱⁱ⁾	1,280	1,257	2,539	2,494
Fair value adjustment on interest rate swap	(43)	(455)	(8)	(310)
Net loss on foreign exchange from financing activities	96	23	52	12
	2,401	1,808	4,569	4,202

- i) Included in interest expense on long-term debt for the three and six months ended June 30, 2014 was amortization of deferred financing costs of \$63 and \$100 (2013 - \$82 and \$165), respectively.
- ii) Interest expense on the convertible debentures for the three and six months ended June 30, 2014, respectively, of \$1,280 and \$2,539 (2013 - \$1,257 and \$2,494) represents coupon interest of \$987 and \$1,974 (2013 - \$987 and \$1,974) and \$293 and \$564 (2013 - \$270 and \$520) pertaining to the impact of capitalized transaction costs and the accretion of the debt using the effective interest rate method.

5 Dividends

Dividends are determined in accordance with the Board of Directors periodic review of Company performance. During the three months ended June 30, 2014, the Company declared monthly dividends of \$0.09 per share or \$6,263 (2013 - \$0.09 per share or \$6,215). Dividends of \$6,258 (2013 - \$6,208) were paid during the period, of which \$600 (2013 - \$527) was paid in shares pursuant to the Company's dividend reinvestment plan.

During the six months ended June 30, 2014, the Company declared monthly dividends of \$0.09 per share or \$12,512 (2013 - \$0.09 per share or \$12,411). Dividends of \$12,503 (2013 - \$12,400) were paid during the period, of which \$1,185 (2013 - \$1,029) was paid in shares pursuant to the Company's dividend reinvestment plan.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

Dividends of \$2,087 were payable as at June 30, 2014 (2013 - \$2,080). Dividends are paid mid-month following the month of declaration.

Dividends were declared on July 15, 2014 in the amount of \$0.09 per common share and will be paid on August 15, 2014 to the holders of common shares as at the close of the record date of July 31, 2014.

6 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 2014 is 25% (the effective tax rate for the year ended December 31, 2013 was 22.5%).

7 Share capital

a) Authorized:

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

b) Issued and outstanding:

	#	\$
Balance – January 1, 2013	22,924,591	185,696
Exercised stock options	57,750	896
Transfer from contributed surplus for share options exercised	-	94
Shares issued under dividend reinvestment plan	57,752	1,029
Balance – June 30, 2013	23,040,093	187,715
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

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

8 Earnings per share

	Three months ended June 30,		Six months ended June 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Net earnings attributable to owners of the parent	3,355	5,260	831	6,686
	2014 #	2013 #	2014 #	2013 #
Weighted average number of common shares outstanding – Basic	23,187,867	23,008,043	23,162,014	22,973,535
Effect of dilutive securities				
Equity-settled share-based payment awards	-	30,057	-	35,424
Weighted average number of common shares outstanding - Diluted	23,187,867	23,038,100	23,162,014	23,008,959
	2014 \$	2013 \$	2014 \$	2013 \$
Basic earnings per share	0.14	0.23	0.04	0.29
Diluted earnings per share	0.14	0.23	0.04	0.29

Due to their anti-dilutive effect, the equity-settled share options and 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, 2014.

9 Share-based payments

During the six months ended June 30, 2014, the Company granted 64,020 restricted share units with a value of \$776. Compensation expense of \$102 and \$108 related to these awards was recognized for the three and six months ended June 30, 2014, respectively. No performance share units were awarded during the period.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

10 Related party transactions

The following transactions were carried out with related parties:

- a) Operating and administrative expenses

	Three months ended June 30,		Six months ended June 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Professional fees ⁽ⁱ⁾	25	37	42	75
Rent expense ⁽ⁱⁱ⁾	78	115	194	232
	103	152	236	307

⁽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 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.

These operating and administrative expenses are incurred in the normal course of business at terms similar to those applicable to unrelated parties.

There was \$8 included in accounts payable and accrued liabilities (December 31, 2013 – \$12) relating to these transactions.

- b) 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. This expense has been included in the Canadian operating segment (note 13).

11 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,	
	2014 \$	2013 \$	2014 \$	2013 \$
Accounts receivable	(577)	(202)	(528)	1,444
Inventory	647	5,737	(3,409)	3,632
Prepaid expenses and deposits	(624)	1,898	(755)	3,629
Accounts payable and accrued liabilities	3,710	1,875	(3,624)	(9,412)
Income tax payable	(1,584)	(714)	(1,196)	2,348
	1,572	8,594	(9,512)	1,641

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

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,	
	2014 \$	2013 \$	2014 \$	2013 \$
Interest paid	2,954	2,937	3,872	4,865
Income taxes paid	1,620	528	7,415	3,432

12 Fair value of financial instruments

a) Financial instruments measured at fair value

Financial instruments recognized at fair value include deferred share and restricted awards, which are level 1 measurements and the interest rate swap, which is a level 2 measurement. There have been no transfers of instruments between levels in the hierarchy.

The fair values of interest rate swaps are calculated as the net present value of the future cash flows expected to arise on the variable and fixed legs, determined using applicable yield curves at each measurement date.

Fair value hierarchy

Financial instruments recognized on the statement of financial position 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.

b) Financial instruments measured at other than fair value

Financial assets that are measured at other than fair value on the consolidated statements of financial position include cash and accounts receivable. The carrying value less impairment provision of trade receivables approximates fair value due to the short-term nature of the instruments.

Financial liabilities that are valued at other than fair value are comprised of bank indebtedness, accounts payable and accrued liabilities, dividends payable to shareholders, and long-term debt.

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

(in thousands of Canadian dollars)

The carrying value of trade payables and dividends payable approximates their fair value due to the short-term nature of the instruments. The carrying value of bank indebtedness and long-term debt approximates the fair value, as the interest rate affecting these instruments is at a variable market rate. Debentures with a face value of \$67,500 have a fair value of \$69,856 (December 31, 2013 – \$69,525), determined based on market trading values at the balance sheet date.

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, 2014 and 2013

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

	Three months ended June 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales	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
Intangible assets	-	-	-
Total assets at June 30, 2014	426,527	90,601	517,128

	Three months ended June 30, 2013		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales	128,808	38,861	167,669
Operating margin	9,761	1,951	11,712
Property and equipment amortization			2,582
Intangible asset amortization			89
Finance costs			1,808
Earnings before income taxes			7,233
Other information			
Expenditures for additions to:			
Property and equipment	1,813	2,638	4,451
Intangibles	6	141	147
Total assets at December 31, 2013	422,118	90,558	512,676

Liquor Stores N.A. Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

June 30, 2014 and 2013

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

	Six months ended June 30, 2014		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales	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
Intangible assets	-	5	5
Total assets at June 30, 2014	426,527	90,601	517,128
	Six months ended June 30, 2013		
	Canadian Operations \$	US Operations \$	Consolidated \$
Sales	232,833	71,138	303,971
Operating margin	15,099	3,105	18,204
Property and equipment amortization			4,613
Intangible asset amortization			178
Finance costs			4,202
Earnings before income taxes			9,211
Other information			
Expenditures for additions to:			
Property and equipment	2,765	2,992	5,757
Intangibles	72	146	218
Total assets at December 31, 2013	422,118	90,558	512,676