

DIAMOND ESTATES WINES & SPIRITS INC.

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED MARCH 31, 2017 AND 2016



June 22, 2017

Independent Auditor's Report

To the Shareholders of Diamond Estates Wines & Spirits Inc.

We have audited the accompanying consolidated financial statements of Diamond Estates Wine & Spirits Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at March 31, 2017 and March 31, 2016 and the consolidated statement of net income (loss) and comprehensive income (loss), statement of cash flows and consolidated statements of changes in shareholders' equity for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Diamond Estates Wines & Spirits Inc. and its subsidiaries as at March 31, 2017 and March 31, 2016 and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

DIAMOND ESTATES WINES & SPIRITS INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
AS AT MARCH 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
ASSETS		
Current:		
Accounts receivable (Note 5)	\$ 3,583,926	\$ 4,031,973
Inventories (Note 6)	16,587,546	16,891,492
Prepaid expenses	<u>321,313</u>	<u>151,735</u>
	20,492,785	21,075,200
Long term:		
Property, plant and equipment (Note 7)	15,974,405	14,127,405
Intangible assets (Note 8)	<u>3,509,447</u>	<u>3,831,904</u>
	<u>\$ 39,976,637</u>	<u>\$ 39,034,509</u>
LIABILITIES		
Current:		
Bank indebtedness (Note 9)	\$ 5,312,135	\$ 10,217,851
Accounts payable and accrued liabilities (Note 10)	5,225,846	6,239,376
Unearned revenue and deposits received	390,730	46,526
Loan payable - non-controlling interest (Note 12)	224,570	299,967
Current portion of term loans payable (Note 13)	741,547	10,386,559
Current portion of finance leases (Note 11)	<u>192,929</u>	<u>-</u>
	12,087,757	27,190,279
Long term:		
Term loans payable (Note 13)	6,969,961	-
Finance leases (Note 11)	<u>492,777</u>	<u>-</u>
	<u>19,550,495</u>	<u>27,190,279</u>
SHAREHOLDERS' EQUITY		
Common shares (Note 14)	16,635,745	8,522,378
Contributed surplus	1,021,226	937,413
Accumulated deficit	(1,001,177)	(1,711,121)
Non-controlling interest (Note 4)	<u>3,770,348</u>	<u>4,095,560</u>
	20,426,142	11,844,230
	<u>\$ 39,976,637</u>	<u>\$ 39,034,509</u>
Commitments and contingencies (Note 19)		
Subsequent event (Note 24)		

The accompanying notes form an integral part of these consolidated financial statements

Approved on behalf of the Board:

"David Beutel" Director

"Keith Harris" Director

DIAMOND ESTATES WINES & SPIRITS INC.
CONSOLIDATED STATEMENTS OF NET INCOME (LOSS)
AND COMPREHENSIVE INCOME (LOSS)
YEARS ENDED MARCH 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Revenue	\$ 34,288,679	\$ 29,194,116
Cost of sales		
Change in inventories of finished goods and raw materials consumed	19,005,928	16,505,025
Freight in and other	1,061,061	846,351
Depreciation of property, plant and equipment used in production (Note 7)	724,990	780,707
	<u>20,791,979</u>	<u>18,132,083</u>
Gross profit	<u>13,496,700</u>	<u>11,062,033</u>
Expenses		
Employee compensation and benefits	5,915,827	5,520,019
General and administrative	2,905,013	2,749,763
Advertising and promotion	1,339,538	914,347
Delivery and warehousing	1,199,676	1,007,167
Interest	977,813	1,198,094
Loss on foreign exchange	28,879	119,475
Amortization of intangible assets (Note 8)	345,766	333,175
Depreciation of property, plant and equipment used in selling and administration (Note 7)	162,141	106,041
Share based compensation (Note 15(b))	83,813	206,141
Loss on disposition of property, plant and equipment	3,502	652,973
	<u>12,961,968</u>	<u>12,807,195</u>
Net income (loss) and comprehensive income (loss)	<u>\$ 534,732</u>	<u>\$ (1,745,162)</u>
Net income (loss) and comprehensive income (loss) attributable to:		
Shareholders	\$ 709,944	\$ (1,706,819)
Non-controlling interest	(175,212)	(38,343)
	<u>\$ 534,732</u>	<u>\$ (1,745,162)</u>
Basic income (loss) per share (Note 14(c))	<u>\$ 0.01</u>	<u>\$ (0.02)</u>
Diluted income (loss) per share (Note 14(c))	<u>\$ 0.01</u>	<u>\$ (0.02)</u>

The accompanying notes form an integral part of these consolidated financial statements

DIAMOND ESTATES WINES & SPIRITS INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED MARCH 31, 2017 AND 2016

	Note	Common shares Shares	Common shares Amount	Contributed surplus	Accumulated deficit	Shareholders' equity	Non-controlling interest	Total
As at April 1, 2015		73,403,749	\$ 39,578,798	\$ 731,272	\$ (34,108,334)	\$ 6,201,736	\$ 4,091,403	\$ 10,293,139
Proceeds on issuance of common shares	14(a)(ii)	26,733,288	3,207,995	-	-	3,207,995	-	3,207,995
Share issuance costs	14(a)(ii)	-	(160,383)	-	-	(160,383)	-	(160,383)
Net loss and comprehensive loss		-	-	-	(1,706,819)	(1,706,819)	(38,343)	(1,745,162)
Share based compensation	15(b)	-	-	206,141	-	206,141	-	206,141
Reduction of stated capital and deficit	14(b)	-	(34,104,032)	-	34,104,032	-	-	-
Property, plant and equipment contributed by non-controlling interest	7	-	-	-	-	-	42,500	42,500
As at March 31, 2016		100,137,037	8,522,378	937,413	(1,711,121)	7,748,670	4,095,560	11,844,230
Proceeds on issuance of common shares	14(a)(i)	40,000,000	8,800,000	-	-	8,800,000	-	8,800,000
Share issuance costs	14(a)(i)	-	(708,994)	-	-	(708,994)	-	(708,994)
Exercise of options	15(a)	111,804	22,361	-	-	22,361	-	22,361
Net income and comprehensive income		-	-	-	709,944	709,944	(175,212)	534,732
Share based compensation	15(b)	-	-	83,813	-	83,813	-	83,813
Draw from KDC by non-controlling interest		-	-	-	-	-	(150,000)	(150,000)
As at March 31, 2017		140,248,841	\$ 16,635,745	\$ 1,021,226	\$ (1,001,177)	\$ 16,655,794	\$ 3,770,348	\$ 20,426,142

The accompanying notes form an integral part of these consolidated financial statements

DIAMOND ESTATES WINES & SPIRITS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED MARCH 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
Operating activities		
Net income (loss)	\$ 534,732	\$ (1,745,162)
Add (deduct) items not affecting cash		
Depreciation of property, plant and equipment	887,131	886,748
Amortization of intangible assets	345,766	333,175
Share based compensation	83,813	206,141
Loss on disposal of property, plant and equipment	3,502	652,973
Interest expense	977,813	1,198,094
Interest paid	<u>(991,913)</u>	<u>(1,183,994)</u>
	1,840,844	347,975
Change in non-cash working capital items		
Accounts receivable	448,047	(284,670)
Inventories	303,946	42,791
Prepaid expenses	(169,578)	57,888
Accounts payable and accrued liabilities	(999,430)	473,445
Unearned revenue and deposits received	<u>344,204</u>	<u>18,571</u>
	<u>1,768,033</u>	<u>656,000</u>
Investing activities		
Purchase of property, plant and equipment	(2,009,404)	(214,520)
Purchase of intangible assets	(23,309)	(25,404)
Proceeds from disposition of property, plant and equipment	<u>20,570</u>	<u>-</u>
	<u>(2,012,143)</u>	<u>(239,924)</u>
Financing activities		
Bank indebtedness	(4,905,716)	(859,059)
Repayment of loan payable - non-controlling interest	(75,397)	(1,075,580)
Repayment on term loans payable	(2,675,051)	(1,529,049)
Repayment of finance leases	(63,093)	-
Restricted cash	-	500,000
Net proceeds from issuance of common shares	8,091,006	3,047,612
Proceeds on exercise of options	22,361	-
Draw from KDC by non-controlling interest	(150,000)	-
Repayment of shareholder's loan payable	<u>-</u>	<u>(500,000)</u>
	<u>244,110</u>	<u>(416,076)</u>
Change in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	<u>\$ -</u>	<u>\$ -</u>
Non-cash transactions:		
Property, plant and equipment acquired under finance leases (Notes 7 & 11)	\$ 748,799	\$ -
Property, plant and equipment contributed by non-controlling interest (Note 7)	-	42,500
	<u>\$ 748,799</u>	<u>\$ 42,500</u>

The accompanying notes form an integral part of these consolidated financial statements

DIAMOND ESTATES WINES & SPIRITS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED MARCH 31, 2017 AND 2016

1. NATURE OF OPERATIONS

Diamond Estates Wines & Spirits Inc. ("Diamond" or the "Company") is a public company listed on the TSX-V whose shares trade under the symbol "DWS.V". Its principal business activities include the production, marketing and sale of wine, and through its agency division, Kirkwood Diamond Canada Partnership ("KDC"), distribution and marketing activities for various beverage alcohol brands that it represents in Canada. The address of the Company's registered office and principal place of business is 1067 Niagara Stone Road, Niagara-On-The-Lake, Ontario, L0S 1J0. The operations and principal place of business of KDC are located at 1155 North Service Road West, Oakville, Ontario, L6M 3E3.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation and statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). They were authorized for issuance by the Board of Directors on June 20, 2017.

These consolidated financial statements are presented in Canadian dollars, unless otherwise stated.

(b) Basis of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries:

◆	Diamond Estates Wines & Spirits Ltd.	100%
◆	De Sousa Wines Toronto Inc.	100%
◆	Kirkwood Diamond Canada (partnership) <i>(See notes 4 and 24)</i>	50.01%

Diamond Estates Wines & Spirits Ltd. and Niagara Cellars (o/a Diamond Estates - The Winery) amalgamated on April 1, 2015 and carried on as Diamond Estates Wines & Spirits Ltd.

A subsidiary is an entity controlled by the Company. Control exists when the Company has power over an investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. The financial statements of a subsidiary are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries are changed when necessary to align them with the policies applied by the Company in these consolidated financial statements. All intercompany balances, income and expenses, and unrealized gains and losses resulting from intercompany transactions are eliminated in full.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(c) **Financial instruments**

The Company's financial assets consist entirely of accounts receivable. The Company's financial liabilities consist of bank indebtedness, accounts payable and accrued liabilities, deposits received, term loans payable, finance leases and loan payable - non-controlling interest.

(i) **Measurement of financial instruments**

Financial instruments are measured at fair value on initial recognition of the instrument and classified into one of the following categories:

- ◆ Fair value through profit or loss ("FVTPL")
- ◆ Loans and receivables
- ◆ Held-to-maturity investments
- ◆ Available-for-sale financial assets, or
- ◆ Other financial liabilities

Subsequent measurement of financial instruments is based on their initial classification. Financial instruments classified as FVTPL are measured at fair value and changes in fair value are recognized in profit and loss. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. The remaining categories of financial instruments are measured at amortized cost using the effective interest rate method.

Transaction costs related to financial assets and liabilities at FVTPL are recognized in profit and loss. When incurred, transaction costs are deducted against the fair value of the all other financial instruments on initial recognition.

Accounts receivable have been classified as loans and receivables. The remaining financial instruments have been classified as other financial liabilities.

The fair values of accounts receivable, bank indebtedness, accounts payable and accrued liabilities, unearned revenue and deposits received and loan payable - non-controlling interest approximate their fair values due to the short-term or demand nature of these balances. The fair values of the respective term loans and finance leases approximate their carrying values as the contracted lending rates approximate the rates currently available for similar borrowing arrangements.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(c) **Financial instruments, continued**

(ii) Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the investments have been negatively impacted. Evidence of impairment could include:

- ◆ Significant financial difficulty of the issuer or counterparty
- ◆ Default or delinquency in interest or principal payments, or
- ◆ It becoming probable that the borrower will enter bankruptcy or financial reorganization

The carrying amount of financial assets is reduced by any impairment loss directly for all financial assets with the exception of accounts receivable, where the carrying amount is reduced through the use of an allowance account. When an account receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

(iii) Hedge accounting

The Company has chosen not to apply hedge accounting to any of its derivative financial instruments. As a result of this policy choice, these derivative instruments are recorded initially and subsequently at fair value and the change in fair value is recorded directly in the consolidated statement of net income (loss) and comprehensive income (loss). There were no such derivative instruments outstanding at March 31, 2017 and 2016.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

(d) Inventory

Inventory that is purchased by the Company, including raw materials and wine, is valued at the lower of cost and net realizable value, with cost being determined on an average basis. Grapes produced from vineyards controlled by the Company that are part of inventory are measured at their fair value less costs to sell at the point of harvest. Inventory that is purchased by the Partnership is valued at the lower of cost and net realizable value, with cost being determined on a first-in, first-out basis.

Inventory of wine that is produced by the Company is valued at the lower of cost and net realizable value, with cost being determined on an average cost basis.

Inventories include all costs to purchase, convert and bring the inventories to their present location and condition. Such costs include purchase price net of discounts and rebates, applicable duties and taxes, transport and handling costs.

The Company tracks other inventory costs, such as direct labour, fixed and variable production overhead, including depreciation of production equipment, maintenance of production buildings and equipment and production management. These costs are allocated to inventory on a per litre basis.

(e) Property, plant and equipment

Depreciation is computed using the following annual rates and methods which reflect the estimated useful life of the assets as follows:

◆	Buildings	-	4 - 10%	declining balance
◆	Machinery and equipment	-	20%	declining balance
◆	Leasehold improvements	-	20%	declining balance
◆	Equipment	-	10 - 25%	declining balance
◆	Vehicles	-	30%	declining balance
◆	Computer equipment	-	30 - 45%	declining balance
◆	Vines	-	20 years	straight line

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(f) **Biological assets**

The Company measures biological assets, consisting of grapes grown on vineyards controlled by the Company, at cost, which approximates fair value as there has been minimal biological transformation since the initial cost incurrence. The initial costs incurred are comprised of direct expenditures required to enable the biological transformation of agricultural produce.

At the point of harvest, the fair value of biological assets is determined by reference to local market prices for grapes of a similar quality and the same varietal. At this point, agricultural produce is measured at fair value less cost to sell, which becomes the basis for the cost of inventories after harvest.

Gains or losses arising from a change in fair value less costs to sell are included in the consolidated statements of loss and comprehensive loss in the period in which they arise.

(g) **Intangible assets**

Intangible assets acquired separately are initially recorded at fair market value and subsequently at cost less accumulated amortization and impairment losses. Subsequent expenditures on development and maintenance of computer software are expensed as incurred.

Intangible assets with finite lives are amortized over their useful economic lives as follows:

♦	Computer software	-	1 - 5	years
♦	Distribution rights	-	11	years
♦	Trademarks	-	5	years

Gains and losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in profit and loss when the asset is derecognized.

Indefinite lived intangible assets are not subject to amortization and are assessed annually for impairment using the method described in the note 2(h). The pre-1993 winery licenses have an indefinite life because the expected usage, period of control and other factors do not limit their life.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

(h) Impairment testing of property, plant and equipment and intangible assets

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are largely independent cash flows (cash-generating units, or "CGUs").

All individual assets or CGUs are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, with the exception of indefinite lived intangibles which are tested for impairment annually in accordance with IAS 36.

An impairment loss is recognized for the amount by which the asset's or CGU's carrying amount exceeds its recoverable amount, which is the higher of fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows from each CGU and determines a suitable discount rate in order to calculate the present value of those cash flows. The data used for impairment testing procedures are directly linked to the Company's latest approved budget, adjusted as necessary to exclude the effects of future reorganizations and asset enhancements. Discount factors are determined individually for each cash-generating unit and reflect their respective risk profiles as assessed by management.

Impairment losses for CGUs reduce the carrying amount of the assets in that CGU. All assets are subsequently reassessed for indications that an impairment loss previously recognized may no longer exist. An impairment charge is reversed if the CGU's recoverable amount exceeds its carrying amount. Any reversal cannot result in the carrying amount exceeding the original value less the depreciation or amortization that would have been recognized.

Management has determined, using the above-noted valuation methods, that there is no impairment of intangible assets at March 31, 2017 and 2016.

(i) Finance leases

Assets held under finance leases are initially recognized at their fair value or, if lower, at amounts equal to the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly into profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the policy on borrowing costs. Contingent rents are recognized as expenses in the periods in which they are incurred. For sale and finance leaseback transactions, any gain or loss on the sale is deferred and amortized over the lease term. Finance leased assets are reported under the relevant asset categories, with recognition of a corresponding financial liability. They are depreciated on a declining balance basis of that relevant asset category.

(j) Unearned revenue and deposits received

Payments received from customers in advance of shipments are initially recorded in unearned revenue and deposits received. Revenue is recognized on actual shipment to the customer.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(k) **Income taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Tax on income is accrued using the tax rate that would be applicable to expected total annual earnings.

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that the taxable profits will be available against which those deductible temporary differences can be utilized.

Such deferred tax assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither taxable profit nor accounting profit.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and associates and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that the sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realized, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset tax assets against tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its tax assets and liabilities on a net basis.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(l) **Provisions and contingencies**

Provisions are recognized when a legal or constructive obligation exists as a result of past events and it is probable that an outflow of resources that can be reliably estimated will be required to settle the obligation. Where the effect is material, the provision is discounted using an appropriate current market-based pre-tax discount rate. The increase in the provision due to passage of time is recognized as interest expense.

When a contingency substantiated by confirming events can be reliably measured and is likely to result in an economic outflow, a liability is recognized at the best estimate required to settle the obligation. A contingent liability is disclosed where the existence of an obligation will only be confirmed by future events, or where the amount of a present obligation cannot be measured reliably or it is not probable to result in an economic outflow. Contingent assets are only disclosed when the inflow of economic benefits is probable. When the economic benefit becomes virtually certain, the asset is no longer contingent and is recognized in the consolidated financial statements.

(m) **Income (loss) per share**

Basic income (loss) per share amounts are calculated by dividing consolidated net income (loss) for the reporting period attributable to common shareholders by the weighted average number of common shares outstanding during the period.

Diluted income (loss) per share amounts are calculated by dividing the consolidated net income (loss) attributable to common shareholders by the weighted average number of shares outstanding during the year plus the weighted average number of shares that would be issued on the conversion of all the dilutive potential ordinary shares into common shares. Diluted income (loss) per share amounts are not presented if their inclusion would be anti-dilutive.

(n) **Share based compensation**

The Company offers a share option plan for its directors, officers and employees. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured using the Black-Scholes option pricing model. Share based payments expense is recognized upon vesting over the tranche's vesting period by increasing contributed based on the number of awards expected to vest. Any consideration paid on exercise of share options is credited to share capital.

For equity settled transactions, the Company measures goods or services received at their fair value, unless that fair value cannot be estimated reliably, in which case the Company measures their value by reference to the fair value of the equity instruments granted.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

(o) Deferred share units (DSUs)

The Company grants DSUs to directors as part of their compensation. The DSUs vest immediately upon grant and are only settled in shares. The fair value of each DSU is measured at the date of the grant using the Black-Scholes option pricing model. The resulting compensation expense is charged to income as share based compensation with a corresponding increase to contributed surplus.

(p) Foreign currency translation

In preparing the consolidated financial statements of the Company, transactions in currencies other than the Company's functional currency are recorded at the rates of exchange prevailing at the dates of the transactions. These consolidated financial statements are presented in Canadian dollars, which is also the functional currency of the Company. At the end of each reporting period, monetary assets and liabilities are translated using the foreign exchange rate at that date. Non-monetary assets and liabilities are translated using the historical rate on the date of the transaction. All gains and losses on translation of these foreign currency transactions are included in profit or loss.

(q) Revenue recognition

The Company records a sale when it has transferred the risks and rewards of ownership of the goods to the buyer, namely: (i) the Company has no continuing managerial involvement over the goods, (ii) it is probable that the consideration will be received, and (iii) the amount of revenue and costs related to the transaction can be measured reliably.

For transactions with provincial liquor boards and licensee retail stores, the Company's terms are "FOB shipping point". Accordingly, sales are recorded when the product is shipped from the Company's distribution facility. Sales to consumers through retail stores and estate wineries are recorded when the product is purchased. Commission income is recognized when products are sold.

Revenue from brand management is presented net of the related costs as the Company is acting as an agent in these transactions. Revenue is recognized when there is certainty about receipt of the consideration and all related costs have been incurred.

The following are deducted from gross revenue to arrive at reported revenue: (i) excise taxes collected on behalf of the federal government, (ii) licensing fees and levies paid on wine sold through the Company's independent Ontario retail stores, (iii) incentive and discount programs and shelving payments provided to customers, (iv) product returns and (v) breakage.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

2. SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

(r) Uses of estimates and judgements

The preparation of these consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, include, but are not limited to, the following:

(i) Fair value of grapes at the point of harvest

Where possible, the fair value of grapes at the point of harvest is determined by reference to local market prices for grapes of a similar quality and the same varietal. For grapes for which local market prices are not readily available, the average price of similar grapes is used. The fair value of grapes is included in the cost of bulk wine inventory.

(ii) Property, plant and equipment

Property, plant and equipment represent a significant proportion of the asset base of the Company as they amount to 40.0% (2016 - 36.2%) of total assets. Therefore, estimates and assumptions made to determine their carrying value and related depreciation are critical to the Company's financial position and performance.

IFRS requires management to test for impairment of property, plant and equipment if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment testing is an area involving management judgement, requiring assessment as to whether the carrying value of assets can be supported by the net present value of future cash flows derived from such assets using cash flow projections which have been discounted at an appropriate rate.

The charge in respect of periodic depreciation is derived after determining an estimate of an asset's expected useful life and the expected residual value at the end of its life. The useful lives and residual values of the Company's assets are determined by management at the time the asset is acquired and reviewed annually for appropriateness. The lives are based on historical experience with similar assets as well as anticipation of future events which may impact their life.

DIAMOND ESTATES WINES & SPIRITS INC.
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2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(r) **Uses of estimates and judgements, continued**

(iii) **Gross versus net presentation**

When deciding the most appropriate basis for presenting revenue or costs of revenue, both the legal form and substance of the agreement between the Company and its business partners are reviewed to determine each party's respective role in the transaction. Where the Company's role in a transaction is that of principal, revenue is recognized on a gross basis. This requires revenue to comprise the gross value of the transaction billed to the customer, after trade discounts, with any related expenditure charged as an operating cost. Where the Company's role in a transaction is that of an agent, revenue is recognized on a net basis with revenue representing the margin earned.

(iv) **Useful life of intangible assets**

Significant judgement is involved in the determination of useful life for the computation of amortization of intangible assets. No assurance can be given that actual useful lives will not differ significantly from current assumptions.

(v) **Impairment of intangible assets**

Testing intangible assets for impairment involves estimating the recoverable amount of the CGUs to which intangible assets are allocated. This requires making assumptions about future cash flows, growth rates, market conditions and discount rates, which are inherently uncertain. Actual amounts may vary from these assumptions and cause significant adjustments. Management has concluded that a 10% change in any key assumption in the impairment test of intangible assets would not result in an impairment of intangible assets as at March 31, 2017 and March 31, 2016.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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3. **NEW AND REVISED IFRS STANDARDS AND INTERPRETATIONS NOT YET ADOPTED**

As at the date of authorization of these consolidated financial statements, the IASB has issued the following new or revised standards which are not yet effective:

- (a) **IFRS 9: "Financial Instruments: Classification and Measurement of Financial Assets and Financial Liabilities"** was issued by the IASB in July, 2014 and will replace IAS 39 "Financial Instruments: Recognition and Measurement". In addition, IFRS 7 "Financial Instruments: Disclosures" was amended to include additional disclosure requirements on transition to IFRS 9. The mandatory effective date of applying these standards is for annual periods beginning on or after January 1, 2018. The standard uses a single approach to determine whether a financial asset is measured at amortized cost or fair value. The approach is based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used. The standard requires that for financial liabilities measured at fair value, any changes in an entity's own credit risk are generally to be presented in other comprehensive income instead of net earnings. A new hedge accounting model is included in the standard, as well as increased disclosure requirements about risk management activities for entities that apply hedge accounting. The Company is currently evaluating the potential impact of this standard; however, it is not expected to have a significant impact on the consolidated financial statements.
- (b) **IFRS 15: "Revenue from Contracts with Customers"** was issued by the IASB in May, 2014 and will supersede IAS 18 "Revenue" and IAS 11 "Construction Contracts". The standard details a revised model for the recognition of revenue from contracts with customers. In April 2016, the IASB has amended IFRS 15 to clarify the guidance on identifying performance obligations, licences of intellectual property and principal versus agent. The amendments also provide additional practical expedients on transition. The standard is effective for first interim periods within annual periods beginning on or after January 1, 2018. The Company is currently in the process of evaluating the potential impact this new guidance will have on the Company's consolidated financial statements. The Company has not completed this evaluation and therefore, cannot conclude whether the guidance will have a significant impact on the consolidated financial statements at this time. However, based on preliminary work completed, the Company is considering the implications the new standard may have on its agency wine businesses, presentation of certain customer related trade spending, as well as the timing of recognition of certain promotional discounts, which are areas that could potentially be impacted by the adoption of the new guidance.
- (c) **IFRS 16 "Leases"** was issued by the IASB in January 2016 and will ultimately replace IAS 17, "Leases" and related interpretations. The new standard will be effective for fiscal years beginning on or after January 1, 2019, with early adoption permitted provided the Company has adopted IFRS 15, Revenue from Contracts with Customers. The new standard requires lessees to recognize a lease liability reflecting future lease payments and a "right-of-use asset" for virtually all leases contracts, and record it on the statement of financial position, except with respect to lease contracts that meet limited exception criteria. Given that the Company has significant contractual obligations in the form of operating leases under IAS 17, there will be a material increase to both assets and liabilities on adoption of IFRS 16, and material changes to the timing of recognition of expenses associated with the lease arrangements. The Company is analyzing the new standard to determine the impact of adopting this standard.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

3. **NEW AND REVISED IFRS STANDARDS AND INTERPRETATIONS NOT YET ADOPTED,**
CONTINUED

- (d) **IAS 7 "Statement of Cash Flow"** has been revised to incorporate amendments issued by the IASB in January 2016. The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. The adoption of these amendments is not expected to have a significant impact on the consolidated financial statements.
- (e) **IAS 12 "Income Taxes"** was amended by the IASB in January, 2016 to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments are effective for annual periods beginning on or after January 1, 2017. The adoption of these amendments is not expected to have a significant impact on the consolidated financial statements.

There were no new accounting pronouncements adopted during the year.

4. **KIRKWOOD DIAMOND CANADA AND NON-CONTROLLING INTEREST**

On October 1, 2014, the Company and The Kirkwood Group ("TKG") formed a new partnership named Kirkwood Diamond Canada ("KDC" or the "partnership") and began the process of integrating their respective agency businesses. The Company has a 50.01% interest in the partnership and a tie-breaking vote on the Executive Committee of the partnership, effectively giving it strategic and directional control over the operations of the partnership. Accordingly, the partnership's financial results are consolidated into the Company's financial statements.

Summarized financial data for KDC as at March 31, 2017 and March 31, 2016, and for the years then ended, before consolidation eliminations, are as follows:

	<u>2017</u>	<u>2016</u>
	\$	\$
Statement of financial position		
Accounts receivable	2,120,029	2,901,043
Inventories	3,864,080	4,296,593
Intangible assets	5,614,928	6,278,472
Bank indebtedness	(2,548,036)	(1,708,995)
Accounts payable	(1,730,489)	(3,553,401)
Loan payable - partner company	(224,570)	(299,967)
Statement of loss		
Revenues	17,116,770	16,304,680
Gross profit	7,197,054	7,270,976
Employee compensation and benefits	4,032,847	4,133,578
Net loss	(350,495)	(76,687)

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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4. **KIRKWOOD DIAMOND CANADA AND NON-CONTROLLING INTEREST, CONTINUED**

On May 5, 2017, the Company closed on the acquisition of the remaining 49.99% interest in KDC that was previously owned by its partner (*see note 24*).

5. **ACCOUNTS RECEIVABLE**

	2017	2016
Trade receivables	\$ 3,489,725	\$ 3,780,655
Accrued receivables	13,969	204,653
Government remittances recoverable	80,232	46,665
	<u>\$ 3,583,926</u>	<u>\$ 4,031,973</u>

On June 29, 2016, the Company obtained export insurance coverage from Export Development Canada on sales to a significant export customer to a maximum of \$675,000 at any one time.

6. **INVENTORIES**

	2017	2016
Bulk wine	\$ 8,334,917	\$ 8,892,403
Bottled wine and spirits	7,724,908	7,475,048
Bottling supplies and packaging	527,721	524,041
	<u>\$ 16,587,546</u>	<u>\$ 16,891,492</u>

Biological assets consist of grapes prior to harvest that are controlled by the Company. The Company owns land in Ontario to grow grapes in order to secure a supply of quality grapes for the making of wine. As at March 31, 2017, the Company held grape vines planted on 34 acres (2016 - 34 acres), 22 acres of which were held through the operating lease of the De Sousa Beamsville winery property. During the year ended March 31, 2017 and 2016, the Company harvested 155 tons of grapes (2016 - 114 tons) valued at \$169,684 (2016 - \$101,032).

The changes in the carrying amount of biological assets are as follows:

	2017	2016
Carrying value, beginning of year	\$ -	\$ -
Net increase in fair value less costs to sell due to biological transformation	169,684	101,032
Transferred to inventory on harvest	<u>(169,684)</u>	<u>(101,032)</u>
Carrying value, end of year	<u>\$ -</u>	<u>\$ -</u>

The Company is exposed to financial risk because of the long period of time between the cash outflow required to plant grape vines, cultivate vineyards, and harvest grapes and the cash inflow from selling wine and related products from the harvested grapes. Substantially all of the grapes from owned and leased vineyards are used in the Company's winemaking processes. Owned and leased vineyards, in combination with supply contracts with grape growers, are used to secure a supply of domestic grapes. These strategies reduce the financial risks associated with changes in the grape prices.

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MARCH 31, 2017 AND 2016

7. **PROPERTY, PLANT AND EQUIPMENT**

	<u>Land</u>	<u>Buildings</u>	<u>Machinery, equipment and vines</u>	<u>Leasehold improvements</u>	<u>Equipment</u>	<u>Vehicles</u>	<u>Computer equipment</u>	<u>Vehicles: capital lease</u>	<u>Total</u>
<u>Cost</u>									
As at April 1, 2015	\$ 1,126,642	\$ 12,572,743	\$ 8,993,244	\$ 80,400	\$ 168,545	\$ 96,341	\$ 323,115	\$ -	\$ 23,361,030
Additions	3,172	129,988	79,105	24,000	7,226	-	13,529	-	257,020
Disposals	-	(616,095)	(119,270)	(41,700)	(73,259)	(6,121)	-	-	(856,445)
As at March 31, 2016	1,129,814	12,086,636	8,953,079	62,700	102,512	90,220	336,644	-	22,761,605
Additions	5,020	1,226,768	750,756	-	-	-	26,860	748,799	2,758,203
Disposals	-	-	-	-	-	(60,430)	-	-	(60,430)
As at March 31, 2017	<u>\$ 1,134,834</u>	<u>\$ 13,313,404</u>	<u>\$ 9,703,835</u>	<u>\$ 62,700</u>	<u>\$ 102,512</u>	<u>\$ 29,790</u>	<u>\$ 363,504</u>	<u>\$ 748,799</u>	<u>\$ 25,459,378</u>
<u>Accumulated depreciation</u>									
As at April 1, 2015	\$ -	\$ 2,803,706	\$ 4,622,460	\$ 56,675	\$ 117,516	\$ 47,873	\$ 302,694	\$ -	\$ 7,950,924
Depreciation	-	370,609	471,475	8,745	6,426	14,541	14,952	-	886,748
Disposals	-	-	(115,481)	(34,140)	(47,958)	(5,893)	-	-	(203,472)
As at March 31, 2016	-	3,174,315	4,978,454	31,280	75,984	56,521	317,646	-	8,634,200
Depreciation	-	357,159	430,591	10,283	3,099	2,889	18,870	64,240	887,131
Disposals	-	-	-	-	-	(36,358)	-	-	(36,358)
As at March 31, 2017	<u>\$ -</u>	<u>\$ 3,531,474</u>	<u>\$ 5,409,045</u>	<u>\$ 41,563</u>	<u>\$ 79,083</u>	<u>\$ 23,052</u>	<u>\$ 336,516</u>	<u>\$ 64,240</u>	<u>\$ 9,484,973</u>
<u>Net book value</u>									
As at March 31, 2016	<u>\$ 1,129,814</u>	<u>\$ 8,912,321</u>	<u>\$ 3,974,625</u>	<u>\$ 31,420</u>	<u>\$ 26,528</u>	<u>\$ 33,699</u>	<u>\$ 18,998</u>	<u>\$ -</u>	<u>\$ 14,127,405</u>
As at March 31, 2017	<u>\$ 1,134,834</u>	<u>\$ 9,781,930</u>	<u>\$ 4,294,790</u>	<u>\$ 21,137</u>	<u>\$ 23,429</u>	<u>\$ 6,738</u>	<u>\$ 26,988</u>	<u>\$ 684,559</u>	<u>\$ 15,974,405</u>

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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7. **PROPERTY, PLANT AND EQUIPMENT, CONTINUED**

Current year additions to property, plant and equipment include construction costs related to the new retail store building of \$995,885, costs related to the winery facility expansion of \$203,921, deposits on tanks of \$629,436 and deposits on equipment for the new retail store of \$16,544 on which no depreciation has been taken as the assets were not yet in use at year end. Prior year additions include \$42,500 contributed by the non-controlling interest. Given the Company's plans for its expanded retail facility, previously capitalized design costs of \$616,095 related to prior winery expansion plans were written off in the prior year with their cancellation.

8. **INTANGIBLE ASSETS**

	<u>Pre-1993 winery licenses</u>	<u>Distribution rights</u>	<u>Trademarks</u>	<u>Computer software</u>	<u>Total</u>
<u>Cost</u>					
As at April 1, 2015	\$ 750,000	\$ 8,819,763	\$ 52,358	\$ 136,942	\$ 9,759,063
Additions	-	-	-	25,404	25,404
As at March 31, 2016	750,000	8,819,763	52,358	162,346	9,784,467
Additions	-	-	-	23,309	23,309
As at March 31, 2017	<u>\$ 750,000</u>	<u>\$ 8,819,763</u>	<u>\$ 52,358</u>	<u>\$ 185,655</u>	<u>\$ 9,807,776</u>
<u>Accumulated amortization</u>					
As at April 1, 2015	\$ -	\$ 5,437,488	\$ 45,549	\$ 136,351	\$ 5,619,388
Amortization	-	322,120	1,362	9,693	333,175
As at March 31, 2016	-	5,759,608	46,911	146,044	5,952,563
Amortization	-	322,120	1,089	22,557	345,766
As at March 31, 2017	<u>\$ -</u>	<u>\$ 6,081,728</u>	<u>\$ 48,000</u>	<u>\$ 168,601</u>	<u>\$ 6,298,329</u>
<u>Net book value</u>					
As at March 31, 2016	<u>\$ 750,000</u>	<u>\$ 3,060,155</u>	<u>\$ 5,447</u>	<u>\$ 16,302</u>	<u>\$ 3,831,904</u>
As at March 31, 2017	<u>\$ 750,000</u>	<u>\$ 2,738,035</u>	<u>\$ 4,358</u>	<u>\$ 17,054</u>	<u>\$ 3,509,447</u>

- (a) The pre-1993 winery licenses issued to Lakeview Cellars Estate Winery Limited and De Sousa Wines Toronto Inc. grant the licensees considerably more flexibility than post-1993 licenses with respect to blending practices, location of operations and other wine-making matters. These licenses are transferable at the discretion of the Alcohol and Gaming Commission of Ontario ("AGCO").

DIAMOND ESTATES WINES & SPIRITS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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8. INTANGIBLE ASSETS, CONTINUED

The Company determined the recoverable amount of the pre-1993 winery licenses by estimating their value in use. Key assumptions used were:

	<u>2017</u>	<u>2016</u>
Pre-tax discount rate	14%	14%
Period of projected cash flows	5 years	5 years
Growth rate beyond period of projected cash flows	2%	2%

The Company uses past experience and current expectations about future performance in projecting cash flows, which are based on financial budgets for five years. For the period after five years, the Company projects cash flows using an assumed growth rate, which is based on expectations about long-term economic growth in Canada and any known industry specific factors that may influence long-term growth in the Canadian wine industry. The discount rate is estimated by referring to external sources of information about the cost of capital and the leverage of companies that operate in a similar industry to the Company and that are of similar size. The rate determined is then adjusted to a pre-tax basis. A 10% change in the assumptions used would not result in an impairment.

- (b) Distribution rights represent exclusive rights to act as an agent and/or distributor in certain provinces for various beverage alcohol products. These agency relationships are for either a fixed, renewable or unlimited term, subject to termination clauses in the agreements. Under these clauses, and under common law, the Company would be entitled to compensation, typically equal to one months' commission earnings for each year of representation, in the event that a contract is terminated. The distribution rights acquired as part of the KDC acquisition (*see note 4*) were valued at fiscal 2014 gross margin, normalized for variable selling costs and client relationships retained. The Company estimated that these distribution rights had an original useful life of 17 years, and that the acquisition cost would be amortized on a straight-line basis over their estimated remaining life as of October 1, 2014, the commencement date of the partnership, of 11 years.

DIAMOND ESTATES WINES & SPIRITS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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9. BANK INDEBTEDNESS

On September 19, 2016, the Company signed a new credit agreement with Meridian Credit Union ("MCU"), its primary lender, to replace the previous agreements dated March 31, 2016, January 12, 2015 and amended on March 25, 2015. In addition, on April 7, 2016, KDC entered into a credit agreement with Canadian Imperial Bank of Commerce ("CIBC") to provide a dedicated working capital facility for the Partnership (*see note 9(f)*).

	<u>2017</u>	<u>2016</u>
Meridian Credit Union:		
Operating Line (Note 9(b))	\$ 2,764,099	\$ 8,508,856
KDC Operating Line: (Note 9(e))	-	1,708,995
Canadian Imperial Bank of Commerce:		
KDC Operating Line (Note 9(f))	<u>2,548,036</u>	<u>-</u>
	<u>\$ 5,312,135</u>	<u>\$ 10,217,851</u>

(a) *Updated Meridian Credit Union agreement*

On September 19, 2016, the Company entered into an updated credit agreement with MCU reflecting the following significant changes from the prior agreement dated March 31, 2016:

- (i) a Letter of Credit sub-facility, included under the umbrella of the \$10,000,000 operating line, at a stand-by rate of 1.25% per annum for issued letters of credit. As at year end, a letter of credit in the amount of \$24,641 had been issued
- (ii) Margining limits were amended to include:
 - 90% of acceptable EDC insured balances under 90 days
 - increase in acceptable inventory to a maximum of \$9,000,000, increased from \$8,500,000
 - within the increased inventory cap, the limit on raw materials inventory increased to \$500,000 from \$300,000.
- (iii) Maintain a debt service ratio (to be measured annually) of 1.10|1.00 for fiscal 2017 only, still remaining at 1.25|1.00 for fiscal 2018 and thereafter.
- (iv) Maintain a debt service ratio (to be measured on a trailing four quarter basis, starting effective the end of Q3 in fiscal 2017) of 1.10|1.00 for fiscal 2017 only, still remaining at 1.25|1.00 for fiscal 2018 and thereafter.

The current credit agreement with MCU dated September 19, 2016 specifies the following overall terms:

(b) *Credit facilities*

- (i) Operating line of \$10,000,000, due on demand, bearing interest at prime plus 2.50%, interest payable monthly.
- (ii) Credit facilities also include the term loans payable to MCU (*see note 13*):

DIAMOND ESTATES WINES & SPIRITS INC.
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9. **BANK INDEBTEDNESS, CONTINUED**

(c) ***Security***

The above credit facilities are secured by general security agreements, a collateral mortgage for \$15,000,000 registered in the name of Diamond Estates Wines & Spirits Ltd. over its property and buildings, assignment of fire and liability insurance over both properties and buildings, and corporate guarantees and postponements of claim in favour of MCU by each of Diamond Estates Wines & Spirits Inc. and De Sousa Wines Toronto Inc., each of which is supported by respective general security agreements.

(d) ***Financial covenants***

The credit facilities are subject to the following financial covenants:

- (i) Achieve a minimum effective net worth of not less than \$7,500,000 commencing the fiscal year ended March 31, 2016, which is defined as: shareholders' equity plus loans from shareholders postponed to MCU less loans to shareholders and related parties and less 50% of pre-1993 winery licenses and 100% of other intangible assets;
- (ii) To maintain a debt to effective net worth of 3.25|1.00 to be measured as at March 31, 2017 (2016 - 3.50|1.00) (where total debt is defined as the sum of current liabilities plus long term liabilities, less any postponed amounts);
- (iii) Maintain a DSR of not less than 1.10|1.0 for the fiscal year ended March 31, 2017 (waived at March 31, 2016 (*see note 13*)) and 1.25|1.00, measured on an annual basis commencing with the fiscal year ended March 31, 2018 and annually thereafter; the DSR is defined as the ratio of consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") less 50% of KDC EBITDA to the sum of interest expense plus the current portion of long term debt and capital leases; and
- (iv) Maintain a trailing four quarter DSR (as defined above) of not less than 1.10|1.0 for the fiscal year ended March 31, 2017 and 1.25|1.00 commencing with the fiscal year ended March 31, 2018 and annually thereafter.

As at March 31, 2017 the Company was in compliance with the above noted covenants. The Company was not in compliance with the minimum effective net worth covenant as at March 31, 2016 (*see note 13*).

(e) ***Kirkwood Diamond Canada credit facility: Meridian Credit Union***

The MCU revolving operating line of credit is due on demand, interest only payments required monthly, calculated at prime plus 2.00%, total credit facility available is \$3,000,000, subject to certain margin limits in respect of accounts receivable and inventory similar to Diamond's facility.

On April 7, 2016, KDC entered into a new credit agreement with Canadian Imperial Bank of Commerce ("CIBC") (*see note 9(f)*). The transaction closed on June 2, 2016 when existing KDC obligations to MCU were repaid in full.

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9. **BANK INDEBTEDNESS, CONTINUED**

(f) ***Kirkwood Diamond Canada credit facility: Canadian Imperial Bank of Commerce***

The CIBC credit agreement includes the following major components: (i) various CAD and USD credit facilities to a maximum of CAD \$4,500,000, (ii) conventional margining on accounts receivable and 70% of eligible inventory value (to a maximum of \$2,250,000) (iii) bears interest at the CAD prime rate plus 1.25% and/or USD base rate plus 1.25%, and (iv) secured by (a) a first-priority security in all present and future property of KDC and (b) assignments and postponements of claim from the corporate partners. As at March 31, 2017, a letter of credit in the amount of \$50,000 was outstanding.

The financial covenants included are: (i) ratio of total liabilities less postponed debt to effective tangible net worth is not to exceed 3.00|1.00 at any time, tested quarterly, and (ii) fixed charge coverage ratio ("FCCR") of not less than 1.10|1.00 at any time, tested quarterly, calculated on a trailing twelve month basis. The FCCR is defined as the ratio of EBITDA (defined as earnings before interest, income taxes, depreciation and amortization) to the sum of debt service requirements, capital withdrawals, advances to affiliates and unfunded capital expenditures. As at March 31, 2017, KDC was in compliance with the above noted covenants.

10. **ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

	<u>2017</u>	<u>2016</u>
Trade accounts payable	\$ 4,115,963	\$ 5,357,908
Accrued liabilities	1,109,883	881,468
	<u>\$ 5,225,846</u>	<u>\$ 6,239,376</u>

DIAMOND ESTATES WINES & SPIRITS INC.
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11. **FINANCE LEASES**

In August 2016, the Company executed a Master Lease Agreement (“MLA”) with an equipment finance and leasing company to acquire automotive equipment. The leases are primarily for a 48 month period, expiring at various times up to March 2021 and provide for the transfer of the risks and rewards of ownership of the automotive equipment to the Company. Accordingly, each lease has been classified as a finance lease and a corresponding asset and lease obligation has been recognized in the financial statements. The effective interest rates implicit in each lease range from 3.31% to 3.41%.

The following is a schedule of future minimum annual lease payments for vehicles under finance leases together with the balance of the obligations as at March 31, 2017.

	Minimum lease payments	Present value of minimum lease payments
Not later than one year	\$ 213,437	\$ 192,929
Later than one year and up to lease expiry	<u>516,511</u>	<u>492,777</u>
	729,948	685,706
Less: interest	<u>(44,242)</u>	<u>-</u>
Total obligations under finance leases	685,706	685,706
Less: current portion	<u>(192,929)</u>	<u>(192,929)</u>
	<u>\$ 492,777</u>	<u>\$ 492,777</u>

Estimated principal repayments are as follows:

Year ending March 31, 2018	\$ 192,929
Year ending March 31, 2019	187,909
Year ending March 31, 2020	182,921
Year ending March 31, 2021	<u>121,947</u>
	<u>\$ 685,706</u>

Vehicles acquired under finance leases during the year ended March 31, 2017 totalled \$748,799 (2016 - \$Nil). Interest expense on the finance leases for the year ended March 31, 2017 was \$6,716 (2016 - \$Nil).

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12. LOAN PAYABLE - NON-CONTROLLING INTEREST

Amounts due to The Kirkwood Group arise from the purchase of inventory as more fully described in note 4 and funding of operations during the merger and integration of the two agency businesses. The loan, payable to The Kirkwood Group Ltd., a company related to a corporate partner of KDC by common control, is unsecured, interest-bearing at 5% per annum and repayable on demand. Interest expense provided for on this loan during the year ended March 31, 2017 totalled \$14,108 (2016 - \$14,100).

	<u>2017</u>	<u>2016</u>
Loan payable - non-controlling interest	<u>\$ 224,570</u>	<u>\$ 299,967</u>

On May 5, 2017, coincident with the Company's purchase of the remaining 49.99% interest in KDC that was previously owned by its partner (*see note 24*), this loan payable was repaid in full.

13. TERM LOANS PAYABLE

As more fully described in note 9(a), the Company has various term loans with MCU under its new credit agreement dated September 19, 2016, the terms and conditions of which with respect to the term loans are virtually unchanged from the previous credit agreement dated March 31, 2016. As at March 31, 2017, the amounts outstanding were as follows:

	<u>2017</u>	<u>2016</u>
Meridian Credit Union term loans:		
Non-revolving loan #1	\$ 6,612,003	\$ 8,563,784
Non-revolving loan #2	1,099,505	1,370,684
Non-revolving loan #3	-	452,091
	<u>7,711,508</u>	<u>10,386,559</u>
Current portion	(741,547)	(1,122,514)
Remaining portion classified as current due to covenant breach (Note 9(d))	-	(9,264,045)
	<u>\$ 6,969,961</u>	<u>\$ -</u>

Term loans payable were paid down on December 20, 2016 out of the proceeds of the private placement described in note 14(a)(i) as follows:

- (a) 10% of the original principal of non-revolving loan #1 in the amount of \$1,300,000
- (b) 10% of the original principal of non-revolving loan #2 in the amount of \$150,000
- (c) the entire then-remaining principal of non-revolving loan #3 in the amount of \$222,290

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13. **TERM LOANS PAYABLE, CONTINUED**

The major terms of non-revolving loan #1 are now as follows:

- (a) Remaining term of 1 years, 9 months, due by December 31, 2018
- (b) Amortized over a period of 12 years
- (c) Bears interest at fixed rate of 5.40%
- (d) Repayable in blended monthly payments of principal and interest of \$94,319

The major terms of non-revolving loan #2 are now as follows:

- (a) Remaining term of 1 years, 10 months, due by February 5, 2019
- (b) Amortized over a period of 10 years
- (c) Bears interest at a fixed rate of 4.99%
- (d) Repayable in blended monthly payments of principal and interest of \$15,905

The equal monthly blended payments of principal and interest under non-revolving loans #2 and #3 have been changed to a combined total of \$44,966 (\$15,905 and \$29,061 respectively) from a combined total of \$64,773 (\$16,338 and \$48,435 respectively), a total monthly decrease of \$19,807.

As at March 31, 2016, the Company was not in compliance with the MCU covenant relating to minimum effective net worth. This covenant breach required the non-current portion of the MCU term loans of \$9,264,045 as at March 31, 2016 to be classified as a current liability under IFRS at that date. As of July 19, 2016, MCU had indicated in writing that it was prepared to waive the default, subject to no further defaults occurring and the expectation that the covenant in default would be met at the next stipulated reporting period, being March 31, 2017. The Company was in compliance with the terms of this financial covenant as at March 31, 2017, such that the non-current portion of the MCU term loans has been classified appropriately as long term.

Estimated principal repayments are as follows:

Year ending March 31, 2018	\$ 741,547
Year ending March 31, 2019	<u>6,969,961</u>
	<u>\$ 7,711,508</u>

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14. **SHARE CAPITAL AND OTHER EQUITY INSTRUMENTS**

Authorized

Unlimited Common shares, no par value

Continuity schedules for each component of the Company's share capital and other equity instruments are disclosed in the consolidated statements of changes in shareholders' equity for the years ended March 31, 2017 and 2016. Details of major changes in each component during that period are as follows:

(a) **Private placements**

- (i) On December 20, 2016, the Company completed a brokered private placement of 40,000,000 common shares at an issuance price of \$0.22 per common share for gross proceeds of \$8,800,000, less issuance costs of \$708,994, for net proceeds of \$8,091,006. The proceeds are to be used to expand the principal wine production facility, add cooperage (barrel storage), warehouse and bottling space, KDC acquisition (*see note 24*) and for general corporate purposes including reduction of debt (*see note 13*).
- (ii) On April 15, 2015, the Company completed a brokered private placement of 26,733,288 common shares at an issuance price of \$0.12 per common share for gross proceeds of \$3,207,995, less issuance costs of \$160,383, for net proceeds of \$3,047,612. As a result of exceeding \$3,000,000 from this equity raise, the Company was required to pay \$456,069 against non-revolving loan #3 from Meridian Credit Union. The remaining proceeds were used for working capital, the construction of a new retail outlet at the Company's Diamond Estates Winery, sales and marketing initiatives and general corporate purposes.

(b) **Reduction in stated capital**

At the Company's Annual General Meeting on September 22, 2015, shareholders approved a reduction in stated capital. Effective that date, stated capital was reduced by \$34,104,032 pursuant to the provisions of the Ontario Business Corporations Act. The reduction in stated capital decreased the accumulated deficit of the Company. No cash distribution was made in connection with the reduction in stated capital.

(c) **Income (loss) per share**

Basic income (loss) per share is computed using the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the year ended March 31, 2017 was 111,215,026 (2016 - 98,018,826).

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14. **SHARE CAPITAL AND OTHER EQUITY INSTRUMENTS, CONTINUED**

For the year ended March 31, 2016, diluted income (loss) per share and the weighted average number of common shares exclude all potentially dilutive equity instruments since their effect is antidilutive. For the purpose of calculating diluted earnings per share for the year ended March 31, 2017, the Company assumed the exercise of dilutive options. The assumed proceeds from these instruments was regarded as having been received from the issue of ordinary shares at the average market price of ordinary shares during the year. The difference between the number of ordinary shares issued and the number of ordinary shares that would have been issued at the average market price of ordinary shares during the period was be treated as an issue of ordinary shares for no consideration.

As at March 31, 2017, the following potentially dilutive equity instruments were all outstanding: (1) 6,150,000 options (2016 - 6,682,400), and (2) 1,124,882 deferred share units (2016 - 819,133). The fully diluted number of common shares outstanding for the year ended March 31, 2017 was 147,523,723 (2016 - 107,638,570).

15. **STOCK OPTIONS**

The Company has adopted a stock option plan under which it may grant options to acquire shares of the Company to directors, officers and consultants of the Company. The maximum number of common shares issuable pursuant to the plan is equal to 10% of the issued and outstanding common shares at the close of business on the date of any grant, with an additional restriction of 5% to any one individual in a twelve month period.

Stock option activity for the years ended March 31, 2017 and 2016 was as follows:

	<u>2017</u>		<u>2016</u>	
	<u>Options</u>	<u>Weighted -average exercise price (\$)</u>	<u>Options</u>	<u>Weighted- average exercise price (\$)</u>
Outstanding, beginning of year	6,682,400	0.17	6,682,400	0.17
Options exercised (<i>see note 15(a)</i>)	(111,804)	0.20	-	-
Expiry of options (<i>see note 15(a)</i>)	(420,596)	-	-	-
Outstanding, end of year	<u>6,150,000</u>	<u>0.17</u>	<u>6,682,400</u>	<u>0.17</u>

(a) WKN options

In connection with the reverse takeover of Whiteknight Acquisitions II Ltd ("WKN") on September 24, 2013, the Company assumed 532,400 options granted to former officers and directors of WKN at an exercise price of \$0.20. The options vested immediately and retained their original expiry date of March 7, 2017. On February 28, 2017, 111,804 of these options were exercised for gross proceeds of \$22,361, and the remainder of 420,596 expired unexercised.

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15. **STOCK OPTIONS, CONTINUED**

(b) Share based compensation

Total share based compensation recognized for the year ended March 31, 2017 was \$83,813 (2016 - \$206,141) based on accrual of previously granted options expected to vest in the reporting period and the issuance of DSUs as described in note 16.

As at March 31, 2017, the issued and outstanding options to acquire common shares of the Company are as follows:

Grant date	Number of options		Exercise price (\$)	Remaining life	Expiry date
	Granted	Exercisable			
September 24, 2013	2,000,000	2,000,000	0.20	1.49	September 23, 2018
September 24, 2013	600,000	600,000	0.25	1.49	September 23, 2018
June 5, 2014	500,000	250,000	0.25	2.18	June 5, 2019
November 10, 2014	1,400,000	840,000	0.12	2.62	November 9, 2019
November 10, 2014	600,000	360,000	0.12	2.62	November 9, 2019
November 24, 2014	1,050,000	525,000	0.11	2.62	November 23, 2019
	<u>6,150,000</u>	<u>4,575,000</u>	0.17	2.11	

16. **DEFERRED SHARE UNITS ("DSUs")**

On June 21, 2016, the Board of Directors approved an increase in the maximum number of common shares reserved for issuance under the Company's DSU plan (the "DSU Plan") from 1,000,000 to 2,000,000, which is approximately 1.4% of the then issued and outstanding common shares. The DSU Plan provides that the maximum number of DSUs issuable to insiders (as that term is defined by the Exchange) pursuant to the DSU Plan, together with any common shares issuable pursuant to any other security-based compensation arrangement of the Company, will not exceed 10% of the total number of outstanding common shares.

On July 27, 2016, the Company issued an aggregate of 305,749 DSUs to non-executive directors under the DSU Plan in settlement of \$41,063 of deferred directors' compensation. To date, a total of 1,124,882 DSUs have been issued. The DSUs are to be settled in common shares of the Company when the director retires from all positions with the Company.

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17. **INCOME TAXES**

(a) **Income rate reconciliation**

The reconciliation of the combined Canadian federal and provincial statutory income tax rates on the net income (loss) for the years ended March 31 is as follows:

	<u>2017</u>	<u>2016</u>
Net income (loss) before recovery of income taxes	\$ 534,732	\$ (1,745,162)
Expected income tax recovery	<u>26.50%</u>	<u>26.50%</u>
Expected income tax recovery	\$ 141,700	\$ (462,470)
Decrease (increase) resulting from:		
Non-controlling interest and other	189,700	(124,840)
Non-deductible expenses	34,860	66,250
Change in tax benefits not recognized	<u>(366,260)</u>	<u>521,060</u>
Recovery of income taxes	\$ -	\$ -

(b) **Deferred tax**

The following table summarizes the components of deferred tax:

	<u>2017</u>	<u>2016</u>
Deferred tax asset		
Non-capital losses carried forward	\$ 1,732,048	\$ 1,967,123
Deferred tax liabilities		
Property, plant and equipment	(1,730,588)	(1,901,313)
Intangible assets	<u>(1,460)</u>	<u>(65,810)</u>
Net deferred tax liabilities	\$ -	\$ -

(c) **Unrecognized deferred tax assets**

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities. Deferred tax assets have not been recognized in respect of the following deductible temporary differences:

	<u>2017</u>	<u>2016</u>
	\$	\$
Non-capital losses carried forward	16,572,169	17,567,696
Capital losses carried forward	397,388	794,780
Share issuance costs	1,034,420	853,830
Other	-	37,960

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17. **INCOME TAXES, CONTINUED**

The non-capital loss carry forwards expire as noted in the table below. The net capital loss carry forward may be carried forward indefinitely, but can only be used to reduce capital gains. Share issue and financing costs will be fully amortized in 2019. The remaining deductible temporary differences may be carried forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future taxable profit will be available against which the group can utilize the benefits therefrom.

2025	\$	255,873
2026		838,075
2027		325,416
2028		2,372,947
2029		632,792
2030		8,635,937
2031		3,750,634
2032		2,053,189
2033		660,697
2034		1,713,379
2035		1,387,850
2036		331,652
2037		149,719
	\$	23,108,160

18. **KEY MANAGEMENT COMPENSATION, RELATED PARTY TRANSACTIONS AND BALANCES**

During the years ended March 31, 2017 and 2016, the Company had the following related party transactions, including (i) compensation of key management personnel and directors, and (ii) transactions with entities related to or controlled by directors, as follows:

	<u>2017</u>	<u>2016</u>
Salary	\$ 749,200	\$ 723,200
Director fees	85,625	85,231
Share based compensation under stock option plan (<i>see note 15(b)(a)</i>) and DSU Plan (<i>see note 16</i>)	83,813	206,141
Interest on loan payable - non-controlling interest (<i>see note 12</i>)	14,108	14,100
Interest on shareholder loan	-	40,000
Winery lease payments	100,000	115,731
Vineyard maintenance	114,471	44,053
Grape purchases	118,178	115,406
Purchase of property, plant and equipment (<i>see note 7</i>)	-	42,500

Accounts payable and accrued liabilities as at March 31, 2017 includes \$266,245 (March 31, 2016 - \$305,531) with respect to balances owing to related parties for the transactions disclosed above.

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19. **COMMITMENTS AND CONTINGENCIES**

- (a) Under various lease agreements with varying terms, the Company leases certain vehicles and pieces of equipment. The leases do not satisfy the conditions of finance leases and therefore have been treated as operating leases. Lease payments are recognized as an expense when paid. Total operating lease expense recognized in the current year was \$12,506 (2016 - \$5,511). Future remaining minimum lease payments as at March 31, 2017 are \$5,707 for fiscal 2018.
- (b) Under various lease agreements with varying terms, the Company leases its offices in Halifax and Oakville, Ontario and its retail store in Toronto. Future remaining minimum lease payments as at March 31, 2017 are as follows:

2018	\$ 282,347
2019	197,044
2020	94,295
2021	<u>8,357</u>
	<u>\$ 582,043</u>

- (c) Contractual commitments to purchase property, plant and equipment were \$3,968,684 as at March 31, 2017 (2016 - \$Nil) related to the expansion of the winery production facility. These costs will be spread out over the next two fiscal years.
- (d) From time to time, the Company is involved in potential litigation matters arising out of the ordinary course and conduct of its business.

On June 24, 2014, the Company was served with a statement of claim by a former management employee for wrongful termination. The Company filed a statement of defense and with the advice of counsel, filed a motion for summary judgement. The motion was denied by a Judge, who advised the parties to seek mediation. Mediation was not successful and the case is proceeding towards trial. A provision for loss has been recorded based on the opinion of the Company's counsel should it lose at trial. The Company does not expect the outcome to have a material impact on the consolidated financial statements.

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20. **SEGMENTED INFORMATION**

Business segments

The Company operates in two business segments, namely (i) sales of manufactured wines and (ii) agency sales. The following table presents selected financial information associated with each of these segments for the years ended March 31, 2017 and 2016:

	<u>Year ended March 31, 2017</u>		
	Agency	Manufactured	Consolidated
	\$	wines	\$
Gross revenue	17,116,770	17,702,621	34,819,391
Inter-segment revenue	(530,712)	-	(530,712)
Net revenue	<u>16,586,058</u>	<u>17,702,621</u>	<u>34,288,679</u>
Gross profit	6,666,342	6,830,358	13,496,700
Interest on bank indebtedness	138,611	839,202	977,813
Depreciation and amortization	374,773	858,124	1,232,897
Additions of property, plant and equipment and intangible assets	479,265	2,302,247	2,781,512
Intangible assets	2,743,435	766,012	3,509,447
Total assets	9,451,497	30,525,140	39,976,637
Total liabilities	4,942,006	14,608,489	19,550,495

	<u>Year ended March 31, 2016</u>		
	Agency	Manufactured	Consolidated
	\$	wines	\$
Gross revenue	16,304,680	13,442,953	29,747,633
Inter-segment revenue	(553,517)	-	(553,517)
Net revenue	<u>15,751,163</u>	<u>13,442,953</u>	<u>29,194,116</u>
Gross profit	6,717,459	4,344,574	11,062,033
Interest on bank indebtedness	173,773	1,024,321	1,198,094
Depreciation and amortization	331,586	888,337	1,219,923
Additions of property, plant and equipment and intangible assets	53,970	228,454	282,424
Intangible assets	3,074,602	757,302	3,831,904
Total assets	10,390,824	28,643,685	39,034,509
Total liabilities	5,570,368	21,619,911	27,190,279

Transactions between segments are measured at the exchange amount, which approximates fair value. All of the Company's assets are located in Canada.

Geographic information

	<u>2017</u>	<u>2016</u>
Revenue		
Canada	\$ 28,278,039	\$ 25,974,958
China and other	<u>6,010,640</u>	<u>3,219,158</u>
	<u>\$ 34,288,679</u>	<u>\$ 29,194,116</u>

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21. **FINANCIAL INSTRUMENTS AND RISK FACTORS**

Risk management

The Company is exposed to interest rate risk, credit risk, foreign currency risk, liquidity risk and concentration risk associated with its financial assets and liabilities. Management has the overall responsibility for the establishment and approval of the Company's risk management policies. The Company's objectives are to manage the risks and risk exposure through a combination of sound business practices and the involvement of management in the daily operations.

(a) **Classification of financial instruments**

The classification and measurement of the financial assets and liabilities, as well as their carrying amounts and fair values are as follows:

Assets/liabilities	Category	Measurement	2017		2016	
			Carrying amount	Fair value	Carrying amount	Fair value
			\$	\$	\$	\$
Accounts receivable	Loans and receivables	Amortized cost	3,583,926	3,583,926	4,031,973	4,031,973
Bank indebtedness	Other liabilities	Amortized cost	5,312,135	5,312,135	10,217,851	10,217,851
Accounts payable and accrued liabilities	Other liabilities	Amortized cost	5,225,846	5,225,846	6,239,376	6,239,376
Unearned revenue and deposits received	Other liabilities	Amortized cost	390,730	390,730	46,526	46,526
Loan payable - non-controlling interest	Other liabilities	Amortized cost	224,570	224,570	299,967	299,967
Term notes payable	Other liabilities	Amortized cost	7,711,508	7,711,508	10,386,559	10,386,559
Finance leases	Other liabilities	Amortized cost	685,706	685,706	-	-

(b) **Interest rate risk**

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in interest rates. In seeking to minimize the risks from interest rate fluctuations, the Company manages exposure through its normal operating and financing activities. The Company is exposed to interest rate risk primarily through its floating interest rate bank indebtedness and credit facilities (*see note 9*). Assuming that other variables remain constant, a 1% change in the prime lending rate as at March 31, 2017 would impact interest expense and net income (loss) by \$53,000 (2016 - \$102,000).

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21. **FINANCIAL INSTRUMENTS AND RISK FACTORS, CONTINUED**

(c) **Credit risk**

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the Company by failing to discharge its obligations. The Company is exposed to credit risk on its accounts receivable. Its exposure is generally limited to the carrying amount on the consolidated statements of financial position. The Company minimizes credit risk on cash by depositing with only reputable financial institutions.

Management reviews all balances greater than 90 days old, historical payment trends, customer history and events to assess if there should be any allowance for accounts receivable for balances that are impaired. Provisions are recognized, if necessary, in order to reflect risks related to bad debts.

Aged amounts for which a provision has not been recognized are as follows:

	<u>2017</u>	<u>2016</u>
Current	\$ 2,209,670	\$ 2,441,166
30 days past due	845,789	713,787
60 days past due	129,420	247,791
90 days past due	134,656	169,517
120 days past due	349,973	479,690
Amount provided for	<u>(85,582)</u>	<u>(19,978)</u>
	<u>\$ 3,583,926</u>	<u>\$ 4,031,973</u>

The Company reviews a new customer's credit history before extending credit and conducts regular reviews of its existing customers' credit performance. Customers with no credit evaluation are required to pay cash with no credit terms. As detailed in note 5, the Company has now obtained credit insurance from Export Development Canada on sales to a significant export customer to a maximum of \$675,000 at any one time. Based on the historical information and the credit quality of accounts receivable, management has assessed credit risk as low. It is reasonably possible that the actual amount of loss, if any, incurred on trade receivables will differ from management's estimate.

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21. **FINANCIAL INSTRUMENTS AND RISK FACTORS, CONTINUED**

(d) **Foreign currency risk**

Foreign currency risk is the risk that changes in foreign currency rates will adversely affect the Company. The Company conducts transactions with parties worldwide, and as a result, there are balances denominated in United States dollars ("USD"), New Zealand dollars ("NZD"), Australian dollars ("AUD"), Euros ("EUR") and British pounds ("GBP"). A significant change in currency exchange rate between the Canadian dollar relative to these currencies could have an effect on the operating results. The Company has not hedged its exposure to currency fluctuations.

The following summarizes the Company's exposure to currency risk through balances denominated in the following respective foreign currencies:

	<u>2017</u>	<u>2016</u>
Accounts receivable		
New Zealand dollars (NZD)	7,148	-
US dollars (USD)	36,006	33,204
Euros (EUR)	83,316	48,555
Australian dollars (AUD)	1,028	4,591
British pounds (GBP)	17,470	13,334
Accounts payable		
US dollars (USD)	216,257	382,974
Euros (EUR)	89,819	727,646
British pounds (GBP)	-	1,750

Based on the above exposure and assuming that all other variables remain constant, a +/- 10% change in the value of the Canadian dollar relative to these currencies as at March 31, 2017 would affect net income (loss) and comprehensive income (loss) by approximately \$21,000 (2016 - \$105,000).

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21. **FINANCIAL INSTRUMENTS AND RISK FACTORS, CONTINUED**

(e) **Liquidity risk**

Liquidity risk is the risk arising from the Company not being able to meet its obligations as they come due. The Company manages its liquidity needs by carefully monitoring scheduled debt servicing payments for its financial liabilities as well as forecasting cash inflows and outflows due in day-to-day business. The data used for analyzing these cash flows is consistent with that used in the contractual maturity presented in bank indebtedness (*see note 9*).

Total current liabilities as at March 31, 2017 of \$12,087,757 (2016 - \$27,190,279), which includes bank indebtedness, accounts payable and accrued liabilities, unearned revenue and deposits received, loan payable - non-controlling interest, current portion of term loans payable and finance leases, are considered current and are due within 12 months of the end of the reporting period. Total current liabilities as at March 31, 2016 includes the non-current portion of the MCU term loans of \$9,264,045 classified as a current liability as the Company was not in compliance with the covenant relating to minimum effective net worth at that date (*see notes 1(b), 9(e) and 13*).

As at March 31, 2017, the Company had a working capital surplus of \$8,405,028 (2016 - deficiency of \$6,115,079). The completion of two private placements since April, 2015 for net proceeds of \$11,138,618 (*see note 14(a)*) has significantly improved the Company's liquidity.

(f) **Concentration risk**

Concentration risk is the risk arising from a dependence on one customer or supplier for a significant portion of sales or purchases. The risk of a significant customer having financial difficulties would have a negative impact on the Company. During the year ended March 31, 2017, sales to four customers, including the Liquor Control Board of Ontario ("LCBO") comprised 52.5% (2016 - 53.1%) of total revenue. As at March 31, 2017, these four customers represented 22.0% of accounts receivable (2016 - 21.9%).

Management has many other sales to distributors and customers and, other than disclosed above, is not dependent on the sales to any one single customer.

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22. CAPITAL DISCLOSURES

The Company's objectives when managing capital are to provide a return for owners and ensure sufficient resources are available to meet day-to-day operations. Capital is considered to consist entirely of total equity and bank indebtedness. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company or in the light of changes in economic conditions and the risk characteristics of the underlying assets. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

The Company is subject to externally imposed capital requirements related to its bank indebtedness and term loans (*Notes 9 and 13*) and there has been no change in the overall capital risk management strategy during the year.

23. COMPARATIVE FIGURES

Certain of the comparative figures have been reclassified, where applicable, to conform to the presentation adopted in the current period, including \$106,868 reclassified from interest to general and administrative.

24. SUBSEQUENT EVENT

On May 5, 2017, the Company announced that it had closed the previously announced \$4,399,120 acquisition of the remaining 49.99% interest in KDC, its agency business (*see note 4*), that was previously owned by its partner, such that the Company now owns 100%. Due to the limited amount of time since the acquisition date, the Company is currently assessing the impact of the transaction on the financial statements.