

**DIAMOND ESTATES WINES & SPIRITS INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED MARCH 31, 2019 AND 2018**



## *Independent auditor's report*

To the Shareholders of Diamond Estates Wines & Spirits Inc.

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### *Our opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Diamond Estates Wines & Spirits Inc. and its subsidiaries (together, the Company) as at March 31, 2019 and 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

#### **What we have audited**

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at March 31, 2019 and 2018;
- the consolidated statements of net (loss) income and statements of comprehensive (loss) income for the years then ended;
- the consolidated statements of changes in shareholders' equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

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### *Basis for opinion*

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

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

#### **Independence**

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

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### *Other information*

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

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*PricewaterhouseCoopers LLP*  
*PwC Centre, 354 Davis Road, Suite 600, Oakville, Ontario, Canada L6J 0C5*  
*T: +1 905 815 6300, F: +1 905 815 6499*

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



Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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### *Responsibilities of management and those charged with governance for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

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### *Auditor's responsibilities for the audit of the consolidated financial statements*

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from



error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Robert Sawyer.

**(Signed) "PricewaterhouseCoopers LLP"**

Chartered Professional Accountants, Licensed Public Accountants

Oakville, Ontario  
July 29, 2019

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**AS AT MARCH 31, 2019 AND 2018**

|  | 2019                 | 2018                 |
|--|----------------------|----------------------|
| <b>ASSETS</b>                                      |                      |                      |
| <b>Current:</b>                                    |                      |                      |
| Accounts receivable (Note 6)                       | \$ 2,906,154         | \$ 2,795,576         |
| Inventories (Note 7)                               | 19,462,687           | 17,037,104           |
| Prepaid expenses                                   | 232,592              | 539,834              |
|  | <b>22,601,433</b>    | <b>20,372,514</b>    |
| <b>Long term:</b>                                  |                      |                      |
| Property, plant and equipment (Note 9)             | 19,978,606           | 18,630,299           |
| Intangible assets (Notes 5 & 10)                   | 3,155,141            | 3,192,152            |
|  | <b>\$ 45,735,180</b> | <b>\$ 42,194,965</b> |
| <b>LIABILITIES</b>                                 |                      |                      |
| <b>Current:</b>                                    |                      |                      |
| Accounts payable and accrued liabilities (Note 11) | \$ 6,342,500         | \$ 6,070,159         |
| Note payable (Notes 5 & 12)                        | 550,000              | -                    |
| Unearned revenue and deposits received             | 60,810               | -                    |
| Current portion of term loans payable (Note 13)    | 452,187              | 454,287              |
| Current portion of finance leases (Note 14)        | 308,406              | 198,226              |
|  | <b>7,713,903</b>     | <b>6,722,672</b>     |
| <b>Long term:</b>                                  |                      |                      |
| Term loans payable (Note 13)                       | 21,536,947           | 18,895,188           |
| Finance leases (Note 14)                           | 844,076              | 322,505              |
|  | <b>30,094,926</b>    | <b>25,940,365</b>    |
| <b>SHAREHOLDERS' EQUITY</b>                        |                      |                      |
| Common shares (Notes 15, 16 & 17)                  | 19,157,313           | 16,657,513           |
| Contributed surplus                                | 747,081              | 589,982              |
| Accumulated deficit                                | (4,264,140)          | (992,895)            |
|  | <b>15,640,254</b>    | <b>16,254,600</b>    |
|  | <b>\$ 45,735,180</b> | <b>\$ 42,194,965</b> |
| <b>Subsequent event (Note 26)</b>                  |                      |                      |

*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 (LOSS) INCOME AND**  
**COMPREHENSIVE (LOSS) INCOME**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

|  | 2019                  | 2018                 |
|--|-----------------------|----------------------|
| <b>Revenue</b>   | <b>\$ 28,123,103</b>  | <b>\$ 34,270,921</b> |
| <b>Cost of sales</b>   |                       |                      |
| Change in inventories of finished goods and raw materials consumed                           | 14,978,177            | 17,801,714           |
| Freight in and other   | 914,339               | 1,285,798            |
| Depreciation of property, plant and equipment used in production<br>(Note 9)                 | 716,633               | 745,117              |
|  | <b>16,609,149</b>     | <b>19,832,629</b>    |
| <b>Gross profit</b>  | <b>11,513,954</b>     | <b>14,438,292</b>    |
| <b>Expenses</b>  |                       |                      |
| Employee compensation and benefits   | 6,887,937             | 6,433,759            |
| General and administrative   | 3,398,190             | 2,971,720            |
| Advertising and promotion  | 1,624,755             | 1,518,332            |
| Delivery and warehousing   | 739,350               | 812,502              |
| Interest on long-term debt   | 1,164,394             | 858,251              |
| Financing costs  | 93,706                | 142,377              |
| Restructuring charges  | -                     | 812,178              |
| Amortization of intangible assets (Note 10)  | 340,530               | 344,173              |
| Depreciation of property, plant and equipment used in selling and<br>administration (Note 9) | 352,393               | 331,172              |
| Share based compensation (Note 16(d))  | 549,399               | 186,651              |
|  | <b>15,150,654</b>     | <b>14,411,115</b>    |
| <b>(Loss) income before undernoted items and income taxes</b>                                | <b>(3,636,700)</b>    | <b>27,177</b>        |
| Other income (Note 5)  | 300,109               | -                    |
| <b>(Loss) income before income taxes</b>   | <b>(3,336,591)</b>    | <b>27,177</b>        |
| Income taxes (recovery) (Note 19)  | (65,346)              | -                    |
| <b>Net (loss) income and comprehensive (loss) income</b>                                     | <b>\$ (3,271,245)</b> | <b>\$ 27,177</b>     |
| <b>Basic (loss) income per share</b> (Note 15(a))  | <b>\$ (0.02)</b>      | <b>\$ 0.00</b>       |
| <b>Diluted (loss) income per share</b> (Note 15(a))  | <b>\$ (0.02)</b>      | <b>\$ 0.00</b>       |

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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**PERIOD FROM APRIL 1, 2017 TO MARCH 31, 2019**

|  | Note        | Common shares<br>Shares | Common shares<br>Amount | Contributed<br>surplus | Accumulated<br>deficit | Shareholders'<br>equity | Non-controlling<br>interest | Total         |
|--|-------------|-------------------------|-------------------------|------------------------|------------------------|-------------------------|-----------------------------|---------------|
| <b>As at April 1, 2017</b>                                     |             | 140,248,841             | \$ 16,635,745           | \$ 1,021,226           | \$ (1,001,177)         | \$ 16,655,794           | \$ 3,770,348                | \$ 20,426,142 |
| Exercise of options  | 16(a)       | 125,000                 | 21,768                  | (8,018)                | -                      | 13,750                  | -                           | 13,750        |
| Net income and comprehensive income                            |             | -                       | -                       | -                      | 8,282                  | 8,282                   | 18,895                      | 27,177        |
| Share based compensation                                       | 16(d)       | -                       | -                       | 186,651                | -                      | 186,651                 | -                           | 186,651       |
| Acquisition of non-controlling interest                        |             | -                       | -                       | (609,877)              | -                      | (609,877)               | (3,789,243)                 | (4,399,120)   |
| <b>As at March 31, 2018</b>                                    |             | 140,373,841             | 16,657,513              | 589,982                | (992,895)              | 16,254,600              | -                           | 16,254,600    |
| Net loss and comprehensive loss                                |             | -                       | -                       | -                      | (3,271,245)            | (3,271,245)             | -                           | (3,271,245)   |
| Exercise of options  | 16(a)       | 3,250,000               | 965,670                 | (358,170)              | -                      | 607,500                 | -                           | 607,500       |
| Settlement of DSUs   | 15(c)       | 200,405                 | 34,130                  | (34,130)               | -                      | -                       | -                           | -             |
| Share based compensation                                       |             | -                       | -                       | 549,399                | -                      | 549,399                 | -                           | 549,399       |
| Common shares issued on acquisition of Backyard Vineyards Inc. | 5 and 15(c) | 4,687,500               | 1,500,000               | -                      | -                      | 1,500,000               | -                           | 1,500,000     |
| <b>As at March 31, 2019</b>                                    |             | 148,511,746             | \$ 19,157,513           | \$ 747,081             | \$ (4,264,140)         | \$ 15,640,254           | \$ -                        | \$ 15,640,254 |

*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, 2019 AND 2018**

|   | 2019               | 2018             |
|---|--------------------|------------------|
| <b>Operating activities</b>   |                    |                  |
| Net (loss) income   | \$ (3,271,245)     | \$ 27,177        |
| Add (deduct) items not affecting cash                                   |                    |                  |
| Depreciation of property, plant and equipment                           | 1,069,026          | 1,076,289        |
| Amortization of intangible assets                                       | 340,530            | 344,173          |
| Share based compensation  | 549,399            | 186,651          |
| Gain on acquisition (Note 5)  | (300,109)          | -                |
| Amortization of deferred finance fees                                   | 93,706             | -                |
| Recovery of deferred income taxes                                       | (65,346)           | -                |
| Interest expense  | 1,164,394          | 858,251          |
| Interest paid   | <u>(1,085,223)</u> | <u>(858,251)</u> |
|   | (1,504,868)        | 1,634,290        |
| <b>Change in non-cash working capital items</b>                         |                    |                  |
| Accounts receivable   | (75,309)           | 788,350          |
| Inventories   | (1,040,798)        | (373,268)        |
| Prepaid expenses  | 343,992            | (218,521)        |
| Accounts payable and accrued liabilities                                | 61,033             | 844,313          |
| Unearned revenue and deposits received                                  | <u>60,810</u>      | <u>(390,730)</u> |
|   | (2,155,140)        | 2,284,434        |
| <b>Investing activities</b>   |                    |                  |
| Acquisition of non-controlling interest (Note 18)                       | -                  | (4,399,120)      |
| Acquisition of Backyard Vineyards Corp., net of cash acquired (Note 5)  | (609,386)          | -                |
| Purchase of property, plant and equipment                               | (951,790)          | (3,765,139)      |
| Purchase of intangible assets   | (14,519)           | (26,878)         |
| Proceeds from sale lease back of property, plant and equipment (Note 8) | <u>838,342</u>     | <u>-</u>         |
|   | (737,353)          | (8,191,137)      |
| <b>Financing activities</b>   |                    |                  |
| Bank indebtedness   | -                  | (5,312,135)      |
| Repayment of loan payable - non-controlling interest                    | -                  | (224,570)        |
| Proceeds on issuance of term loans payable                              | -                  | 10,000,000       |
| Proceeds on issuance of revolving term loan payable                     | -                  | 8,690,257        |
| Payment of financing costs on issuance of term loans payable            | -                  | (262,312)        |
| Repayment of finance leases   | (260,960)          | (208,309)        |
| Net drawings on revolving term loans and operating lines payable        | 3,045,953          | 1,046,530        |
| Repayment on non-revolving term loans payable                           | (500,000)          | (125,000)        |
| Repayment of MCU term loans payable                                     | -                  | (7,711,508)      |
| Proceeds on exercise of options (Note 16(a))                            | <u>607,500</u>     | <u>13,750</u>    |
|   | 2,892,493          | 5,906,703        |
| <b>Change in cash</b>   | -                  | -                |
| Cash, beginning of year   | <u>-</u>           | <u>-</u>         |
| <b>Cash, end of year</b>  | <u>\$ -</u>        | <u>\$ -</u>      |

**Non-cash transactions: (Note 24)**

*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, 2019 AND 2018**

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, operating as Trajectory Beverage Partners ("TBP"), 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 TBP are located at 100-435 North Service Road West, Oakville, Ontario, L6M 4X8.

2. **SIGNIFICANT ACCOUNTING POLICIES**

(a) **Basis of presentation and statement of compliance**

These consolidated financial statements have been prepared in compliance 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 July 29, 2019.

The currency of presentation for these consolidated financial statements is the Canadian dollar, which is also the functional currency of the Company.

(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% |
| ◆ | Backyard Vineyards Corp. ( <i>See note 5</i> )               | 100% |
| ◆ | Kirkwood Diamond Canada (partnership) ( <i>See note 18</i> ) | 100% |

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. Effective January 1, 2019, the operations of the agency business segment, previously operating in the Kirkwood Diamond Canada partnership, were transferred to TBP, a division of Diamond Estates Wines & Spirits Ltd.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

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 accounts payable and accrued liabilities, unearned revenue and deposits received, note payable, term loans payable and finance leases.

(i) **Measurement of financial instruments**

Effective April 1, 2018, the Company adopted IFRS 9: "Financial Instruments – Classification and Measurement of Financial Assets and Financial Liabilities" using the modified retrospective method. Under IFRS 9, financial assets and liabilities are initially recorded at fair value, including any directly attributable transaction costs, where permitted by the standard. For financial assets that are not subsequently held at fair value, the Company assesses whether there is evidence of impairment at each balance sheet date.

Financial instruments are classified into one of the following categories:

- ◆ Assets and liabilities at amortized cost
- ◆ Fair value through profit or loss ("FVTPL")
- ◆ Fair value through other comprehensive income ("FVOCI")

Subsequent measurement of financial instruments is based on their initial classification. Financial instruments classified as assets and liabilities at amortized cost

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.

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

Until March 31, 2018, the Company recorded and classified its financial instruments under IAS 39: "Financial Instruments - Recognition and Measurement", under which financial instruments were 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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(c) **Financial instruments, continued**

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

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

Accounts receivable were been classified as loans and receivables. The remaining financial instruments were been classified as other financial liabilities, consistent with their treatment under IFRS 9.

The fair values of accounts receivable, accounts payable and accrued liabilities, unearned revenue and deposits received and note payable approximated 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 approximated their carrying values as the contracted lending rates approximated the rates available for similar borrowing arrangements.

**(ii) Impairment of financial assets**

Financial assets are assessed for indicators of impairment at the end of each reporting period.

An expected credit loss model for financial assets is used under IFRS 9 in order to record allowances for loss. Under the model, expected credit losses are provided for on a forward-looking basis and are based on past history, current market conditions and estimates requiring management judgment. Applying the expected credit loss model on adoption of IFRS 9 did not have a significant impact on the Company's financial statements.

**(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 (loss) income and comprehensive (loss) income. There were no such derivative instruments outstanding at March 31, 2019 and 2018.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

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 TBP 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               | 40 years straight-line           |
| ◆ | Machinery and equipment | 5 to 40 years straight-line      |
| ◆ | Leasehold improvements  | Straight-line over term of lease |
| ◆ | Computer equipment      | 5 years straight-line            |
| ◆ | Vehicles                | 3 to 5 years straight-line       |
| ◆ | Vines                   | 20 years straight-line           |

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

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 income and comprehensive income 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 |
| ◆ | Customer lists      | - | 6     | years |
| ◆ | Distribution rights | - | 11    | years |
| ◆ | Trademarks          | - | 5     | years |
| ◆ | Website             | - | 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 note 2. The pre-1993 winery licenses and BYV brand name have an indefinite life because the expected usage, period of control and other factors do not limit their life.

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.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

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, 2019 and 2018.

(h) **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 the basis of that relevant asset category.

(i) **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, 2019 AND 2018**

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(j) **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, 2019 AND 2018**

2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(k) **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.

(l) **Income per share**

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

Diluted income per share amounts are calculated by dividing the consolidated net income 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 per share amounts are not presented if their inclusion would be anti-dilutive.

(m) **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 surplus 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**  
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2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(n) **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.

(o) **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.

(p) **Revenue recognition**

The Company recognizes revenue from the sale of goods at a point in time when the performance obligation is fulfilled.

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 at the time the product is purchased.

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 the related performance obligation is complete, there is certainty about receipt of the consideration and all related costs have been incurred. Commission income is recognized when products are sold and related performance obligations are fulfilled.

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.

Revenue for custom processing, bulk wine storage and bottling is recognized over a period of time reflecting the Company's efforts to fulfil the related performance obligations.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(q) **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 43.7% (2018 - 44.2%) 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.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(q) **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, 2019 and March 31, 2018.

(r) **Business combinations**

Business combinations are accounted for using the acquisition method, whereby acquired assets and liabilities are recorded at fair value as of the date of acquisition with the excess of the purchase consideration over such fair value being recorded as goodwill.

If the fair value of the net assets acquired exceeds the purchase consideration, the difference is recognized immediately as a gain on acquisition in the consolidated statement of net income and comprehensive income.

Acquisition costs are expensed during the period in which they are incurred and are included in general and administrative expenses.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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2. **SIGNIFICANT ACCOUNTING POLICIES, CONTINUED**

(r) **Business combinations, continued**

The Company measures the identifiable assets acquired and liabilities assumed at their fair values on the date of acquisition. This requires estimates and judgments to be made, which are inherently subjective. As such, the amounts assigned to individual identifiable assets and liabilities, including the fair value of inventories, long-lived assets, the recognition and measurement of any unrecorded intangible assets and the determination of goodwill or the gain on acquisition are impacted. Due to the nature of these estimates, the purchase price allocation impacts the Company's reported assets and liabilities and future net earnings due to the impact on future cost of goods sold, amortization and impairment tests. In some circumstances, at the acquisition date, provisional values are used in accounting for a business combination, they may be adjusted retrospectively in subsequent periods pending confirmation or completion of the valuation of the acquired business. However, the measurement period will not exceed one year from the acquisition date.

3. **RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

- (a) IFRS 9: "Financial Instruments: Classification and Measurement of Financial Assets and Financial Liabilities" was issued by the IASB in July, 2014 and replaced 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 new standard was adopted effective April 1, 2018, using the modified retrospective approach, and resulted in the reclassification of the Company's financial assets previously classified as loans and receivables to financial assets at amortized cost. The adoption did not 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 supercedes IAS 18 "Revenue" and IAS 11 "Construction Contracts". The standard details a revised model for the recognition of revenue from contracts with customers. The standard is effective for first interim periods within annual periods beginning on or after January 1, 2018. The Company has adopted the accounting standard effective April 1, 2018, using a full retrospective approach and the adoption did not have a significant impact on the consolidated financial statements.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
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**4. 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:

- (a) 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 expects to adopt IFRS 16 using the modified retrospective transition method and currently expects to apply the following practical expedients: (i) grandfather the assessment of which transactions are leases; (ii) recognition exemption of short-term leases; and (iii) recognition exemption leases of low value items. The Company will recognize right-of-use assets and finance lease obligation liabilities for its leased premises on the consolidated statement of financial position upon adoption, effective April 1, 2019.

**5. ACQUISITION**

On June 28, 2018, the Company acquired 100% of the common shares of Backyard Vineyards Corp. ("BYV") for total consideration of \$2,800,000, of which \$750,000 was funded in cash, \$1,500,000 was funded by the issuance of 4,687,500 common shares and \$550,000 was funded by the assumption of a note payable (*see note 12*). The results of operations from June 29, 2018 onward have been included in these interim condensed consolidated financial statements and this acquisition has been accounted for as a business combination.

The following table summarizes the amounts paid or payable at the purchase date and the preliminary allocation of the purchase price to the identifiable assets acquired and liabilities assumed based on management's estimate of the fair values at the date of acquisition.

|                                   | <b>Backyard<br/>Vineyards<br/>Corp.</b> |
|-----------------------------------|---|
| <b>Assets acquired:</b>           |   |
| Cash                              | \$ 140,614                              |
| Accounts receivable               | 35,269                                  |
| Inventories                       | 1,325,959                               |
| Prepays and deposits              | <u>36,750</u>                           |
|                                   | <b>1,538,592</b>                        |
| Property, plant and equipment     | 1,470,000                               |
| Intangible assets - customer list | 70,000                                  |
| Intangible assets - brand name    | <u>219,000</u>                          |
|                                   | <b><u>3,297,592</u></b>                 |

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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5. **ACQUISITION, CONTINUED**

**Liabilities assumed:**

|  |                            |
|--|----------------------------|
| Accounts payable and accrued liabilities | 132,137                    |
| Deferred income taxes                    | 65,346                     |
|  | <b>197,483</b>             |
| <br>                                     |                            |
| <b>Net assets acquired</b>               | <b><u>\$ 3,100,109</u></b> |
| <br>                                     |                            |
| <b>Total purchase consideration</b>      | <b><u>\$ 2,800,000</u></b> |
| <br>                                     |                            |
| <b>Gain on acquisition</b>               | <b><u>\$ 300,109</u></b>   |

The gain on acquisition of BYV resulted from the recognition of tax losses which arose as a result of the write down of the tax basis in goodwill to its fair market value on the acquisition of control that can be used to offset future taxable income of BYV. This gain has been recorded as other income in the consolidated statement of net (loss) income and comprehensive (loss) income.

6. **ACCOUNTS RECEIVABLE**

|                     | 2019                       | 2018                       |
|---------------------|----------------------------|----------------------------|
| Trade receivables   | \$ 2,488,688               | \$ 2,739,352               |
| Accrued receivables | 417,466                    | 56,224                     |
|                     | <b><u>\$ 2,906,154</u></b> | <b><u>\$ 2,795,576</u></b> |

The Company has export insurance coverage from Export Development Canada on sales to a significant export customer to a maximum of \$675,000 at any one time.

7. **INVENTORIES**

|                                 | 2019                        | 2018                        |
|---------------------------------|-----------------------------|-----------------------------|
| Bulk wine                       | \$ 12,753,901               | \$ 10,424,250               |
| Bottled wine and spirits        | 6,208,841                   | 6,048,984                   |
| Bottling supplies and packaging | 499,945                     | 563,870                     |
|                                 | <b><u>\$ 19,462,687</u></b> | <b><u>\$ 17,037,104</u></b> |

The Company had a \$227,138 provision for inventory included in the consolidated statements of net (loss) income and comprehensive (loss) income for the year ended March 31, 2019 (2018 - \$56,132 recovery).

**DIAMOND ESTATES WINES & SPIRITS INC.**  
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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, 2019, the Company held grape vines planted on 38 acres (2018 - 34 acres), 22 acres of which were held through the operating lease of the De Sousa Beamsville winery property and 4 of which were on held through the operating lease of the BYV winery property. During the year ended March 31, 2019, the Company harvested 152 tons of grapes (2018 - 155 tons) valued at \$172,900 (2018 - \$176,292).

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

|  | 2019      | 2018      |
|--|-----------|-----------|
| <b>Carrying value, beginning of year</b>                                       | \$ -      | \$ -      |
| Net increase in fair value less costs to sell due to biological transformation | 172,900   | 176,292   |
| Transferred to inventory on harvest  | (172,900) | (176,292) |
| <b>Carrying value, end of year</b>   | \$ -      | \$ -      |

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.

**8. WINERY EQUIPMENT SALE AND LEASEBACK**

On November 26, 2018, the Company completed the sale and leaseback of certain winery equipment to the Bank of Montreal ("BMO"). The details of the sale and leaseback, both done at fair value, are as follows:

- (a) The equipment was sold to BMO for cash proceeds of \$838,342 and resulted in the effective disposition of the winery equipment, previously classified as property, plant and equipment. The proceeds were equal to the net book value of the equipment sold and as such, no gain or loss on disposal was recognized.
- (b) The Company will lease the winery equipment from BMO for a period of seven years with the option to purchase the equipment at the end of the lease term for \$1. Blended principal and interest payments of \$11,777 are due monthly, with interest at 4.94%. Management has determined that the lease is a finance lease as the risks and rewards of ownership of the equipment transfer to the Company and the lease agreement contains a bargain purchase option. The present value of the minimum lease payments due over the seven year term total \$838,342.

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

|                                 | <u>Cost</u>  |               | Machinery,<br>equipment<br>and vines | Leasehold<br>improvements | Equipment  | Vehicles  | Computer<br>equipment | Machinery<br>and<br>equipment:<br>capital<br>lease | Vehicles:<br>capital<br>lease | Total         |
|---------------------------------|--------------|---------------|--------------------------------------|---------------------------|------------|-----------|-----------------------|--|-------------------------------|---------------|
|                                 | Land         | Buildings     |                                      |                           |            |           |                       |  |                               |               |
| As at April 1, 2017             | \$ 1,134,834 | \$ 13,313,404 | \$ 9,703,835                         | \$ 62,700                 | \$ 102,512 | \$ 29,790 | \$ 363,504            | \$ -   | \$ 748,799                    | \$ 25,459,378 |
| Additions                       | 598          | 2,920,226     | 789,000                              | -                         | -          | -         | 55,315                | -  | 43,334                        | 3,808,473     |
| As at March 31, 2018            | 1,135,432    | 16,233,630    | 10,492,835                           | 62,700                    | 102,512    | 29,790    | 418,819               | -  | 792,133                       | 29,267,851    |
| Additions                       | 3,795        | 23,307        | 817,008                              | -                         | -          | -         | 107,720               | 838,342  | 54,369                        | 1,844,541     |
| Disposals                       | -            | -             | (838,342)                            | -                         | -          | -         | -                     | -  | -                             | (838,342)     |
| Acquired on<br>purchase of BYV  | -            | -             | 1,461,946                            | -                         | -          | -         | 8,054                 | -  | -                             | 1,470,000     |
| As at March 31, 2019            | \$ 1,139,227 | \$ 16,256,937 | \$ 11,933,447                        | \$ 62,700                 | \$ 102,512 | \$ 29,790 | \$ 534,593            | \$ 838,342   | \$ 846,502                    | \$ 31,744,050 |
| <u>Accumulated depreciation</u> |              |               |                                      |                           |            |           |                       |  |                               |               |
| As at April 1, 2017             | \$ -         | \$ 3,531,474  | \$ 5,409,045                         | \$ 41,563                 | \$ 79,083  | \$ 23,052 | \$ 336,516            | \$ -   | \$ 64,240                     | \$ 9,484,973  |
| Depreciation                    | -            | 351,374       | 563,519                              | 1,828                     | 21,009     | 6,738     | 12,257                | -  | 195,854                       | 1,152,579     |
| As at March 31, 2018            | -            | 3,882,848     | 5,972,564                            | 43,391                    | 100,092    | 29,790    | 348,773               | -  | 260,094                       | 10,637,552    |
| Depreciation                    | -            | 381,265       | 493,223                              | 1,740                     | 870        | -         | 31,194                | 8,733  | 210,867                       | 1,127,892     |
| As at March 31, 2019            | \$ -         | \$ 4,264,113  | \$ 6,465,787                         | \$ 45,131                 | \$ 100,962 | \$ 29,790 | \$ 379,967            | \$ 8,733   | \$ 470,961                    | \$ 11,765,444 |
| <u>Net book value</u>           |              |               |                                      |                           |            |           |                       |  |                               |               |
| As at March 31, 2018            | \$ 1,135,432 | \$ 12,350,782 | \$ 4,520,271                         | \$ 19,309                 | \$ 2,420   | \$ -      | \$ 70,046             | \$ -   | \$ 532,039                    | \$ 18,630,299 |
| As at March 31, 2019            | \$ 1,139,227 | \$ 11,992,824 | \$ 5,467,660                         | \$ 17,569                 | \$ 1,550   | \$ -      | \$ 154,626            | \$ 829,609   | \$ 375,541                    | \$ 19,978,606 |

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**YEARS ENDED MARCH 31, 2019 AND 2018**

10. INTANGIBLE ASSETS

|                                 | Pre-1993<br>winery<br>licenses | Distribution<br>rights | Customer<br>Lists | Brand<br>Names | Trademarks | Computer<br>software | Website   | Total         |
|---------------------------------|--------------------------------|------------------------|-------------------|----------------|------------|----------------------|-----------|---------------|
| <b>Cost</b>                     |                                |                        |                   |                |            |                      |           |               |
| As at April 1, 2017             | \$ 750,000                     | \$ 8,819,763           | \$ -              | \$ -           | \$ 52,358  | \$ 185,655           | \$ -      | \$ 9,807,776  |
| Additions                       | -                              | -                      | -                 | -              | -          | 11,543               | 15,335    | 26,878        |
| As at March 31, 2018            | 750,000                        | 8,819,763              | -                 | -              | 52,358     | 197,198              | 15,335    | 9,834,654     |
| Additions                       | -                              | -                      | -                 | -              | -          | 14,519               | -         | 14,519        |
| Acquired on purchase of BYV     | -                              | -                      | 70,000            | 219,000        | -          | -                    | -         | 289,000       |
| As at March 31, 2019            | \$ 750,000                     | \$ 8,819,763           | \$ 70,000         | \$ 219,000     | \$ 52,358  | \$ 211,717           | \$ 15,335 | \$ 10,138,173 |
| <b>Accumulated amortization</b> |                                |                        |                   |                |            |                      |           |               |
| As at April 1, 2017             | \$ -                           | \$ 6,081,728           | \$ -              | \$ -           | \$ 48,000  | \$ 168,601           | \$ -      | \$ 6,298,329  |
| Amortization                    | -                              | 322,120                | -                 | -              | 871        | 18,626               | 2,556     | 344,173       |
| As at March 31, 2018            | -                              | 6,403,848              | -                 | -              | 48,871     | 187,227              | 2,556     | 6,642,502     |
| Amortization                    | -                              | 316,120                | 10,500            | -              | 872        | 9,971                | 3,067     | 340,530       |
| As at March 31, 2019            | \$ -                           | \$ 6,719,968           | \$ 10,500         | \$ -           | \$ 49,743  | \$ 197,198           | \$ 5,623  | \$ 6,983,032  |
| <b>Net book value</b>           |                                |                        |                   |                |            |                      |           |               |
| As at March 31, 2018            | \$ 750,000                     | \$ 2,415,915           | \$ -              | \$ -           | \$ 3,487   | \$ 9,971             | \$ 12,779 | \$ 3,192,152  |
| As at March 31, 2019            | \$ 750,000                     | \$ 2,099,795           | \$ 59,500         | \$ 219,000     | \$ 2,615   | \$ 14,519            | \$ 9,712  | \$ 3,155,141  |

Current year additions to computer software include \$14,519 in costs related to the Company's new ERP system which are not being amortized as the system was not yet in use as at March 31, 2019.

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10. **INTANGIBLE ASSETS, CONTINUED**

- (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").

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

|   | <u>2019</u> | <u>2018</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 18) 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.

11. **ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

|                                | <u>2019</u>         | <u>2018</u>         |
|--------------------------------|---------------------|---------------------|
| Trade accounts payable         | \$ 4,903,840        | \$ 4,028,977        |
| Accrued liabilities            | 1,332,662           | 2,041,182           |
| Government remittances payable | 105,998             | -                   |
|                                | <u>\$ 6,342,500</u> | <u>\$ 6,070,159</u> |

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12. **NOTE PAYABLE**

The note payable is due to Azura Management (Kelowna) Corp. ("AMKC"), bears interest at 5% and is due June 28, 2019.

Subsequent to March 31, 2019, the Company agreed to an extension of the term of the note payable with AMKC revising the due date to July 31, 2019.

13. **TERM LOANS PAYABLE**

As at March 31, 2019, the balances outstanding on the Company's term loans were as follows:

|                               | March 31<br>2019     | March 31<br>2018     |
|-------------------------------|----------------------|----------------------|
| BMO term loans:               |                      |                      |
| Revolving operating term loan | \$ 12,686,672        | \$ 9,595,677         |
| Non-revolving term loan       | 9,375,000            | 9,875,000            |
|                               | <u>22,061,672</u>    | 19,470,677           |
| Financing costs               | <u>(72,538)</u>      | <u>(121,202)</u>     |
|                               | 21,989,134           | 19,349,475           |
| Current portion               | <u>(452,187)</u>     | <u>(454,287)</u>     |
|                               | <u>\$ 21,536,947</u> | <u>\$ 18,895,188</u> |

The BMO credit agreement executed on September 29, 2017 is guaranteed by a general security agreement covering the assets of the Company and its subsidiaries and is subject to the following facilities and terms:

The revolving operating term loan is for working capital and general corporate requirements and is subject to the following terms:

- (a) Revolving credit facility of up to \$13,000,000, subject to specified borrowing base margin limitations
- (b) Monthly interest only payments at CAD prime rate +1.00%
- (c) Due on September 26, 2020
- (d) Standby fee of 0.50% on available unused revolving term credit to be paid on the last day of each quarter

The non-revolving term loan is for the purpose of refinancing the previous term debt and funding scheduled fiscal 2019 capital expenditures. The loan is subject to the following terms:

- (a) Initial principal of \$10,000,000, amortized over a period of 20 years
- (b) Monthly interest only payments at CAD prime rate +1.25%
- (c) Quarterly principal payments of \$125,000

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13. **TERM LOANS PAYABLE, CONTINUED**

The BMO credit agreement includes the following sub-facilities:

- (a) Letter of credit sub-facility included under the umbrella of the \$13,000,000 revolving term loan, up to a maximum of \$1,000,000 at a rate of CAD prime +2.50% having a term of up to 1 year. As at March 31, 2019 there was a letter of credit in the amount of \$24,641 was outstanding with BMO (March 31, 2018 - \$24,641).
- (b) Bankers' acceptance ("BA") sub-facility included under the umbrella of the revolving and non-revolving term loans, with a minimum draw of \$1,000,000, terms of 28 to 182 days, fees charged at rates 2.50% to 2.75% per annum on the face amount of the BA plus interest at the BA rate. As March 31, 2019 a BA was in place on the non-revolving term loan to fix the effective interest rate at 4.54% (BA rate of 2.04%) for the period from March 1, 2019 to April 1, 2019. As at March 31, 2018 a BA was in place on the non-revolving term loan to fix the effective interest rate at 4.08% (BA rate of 1.58%) for the period from March 1, 2018 to April 2, 2018.
- (c) Treasury risk management facility of up to \$1,500,000 to facilitate hedging of interest rate risk and foreign exchange risk at market rates as determined by the lender. As at March 31, 2019 and March 31, 2018 there were no amounts outstanding on this facility.

The Company also has available a delayed draw term loan of \$2,500,000 to finance future capital expenditures at a rate of CAD prime +1.25%, repayable in quarterly principal instalments commencing at the end of the fiscal quarter in which the initial draw takes place. A standby fee in the amount of 0.55% to be payable quarterly is due on the undrawn portion of this loan. There was no balance drawn on this facility as at March 31, 2019 and March 31, 2018.

A master lease finance line facility of \$2,500,000 is available to the Company to finance equipment under the BMO Equipment Leasing Group and shall reduce monthly in accordance with agreed upon terms based on market rates at the time of each advance. As at March 31, 2019 there was a balance of \$792,860 drawn on this facility (March 31, 2018 - \$Nil) (*see notes 8 and 14*).

The BMO credit agreement is subject to the following major financial covenants:

- (a) Minimum fixed charge coverage ratio of 1.25 | 1
- (b) Maximum ratio of total liabilities to tangible net worth of 2.00 | 1
- (c) Annual capital expenditures are not to exceed \$5,000,000 in fiscal 2018 and \$1,500,000 in subsequent years without prior bank approval

Prior to March 31, 2019, the Company had attained a waiver from BMO pertaining to the minimum fixed charge coverage ratio and the minimum total liabilities to effective net worth ratio as these ratios were not in compliance with the above noted covenants at March 31, 2019. The waiver applies to the reporting period ended March 31, 2019 and for all times up to June 30, 2019. On June 27, 2019, the Company received a waiver from BMO pertaining to the minimum fixed charge coverage ratio and the maximum total liabilities to effective net worth ratio as these ratios were not expected to be in compliance with the above noted covenants at June 30, 2019 (*see note 26*). As such, the outstanding balances have been presented as a non-current liability. Without this waiver, BMO would have been entitled to request immediate payment on the outstanding balances of the term loans payable.

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13. **TERM LOANS PAYABLE, CONTINUED**

On July 29 2019, the terms of certain financial covenants with BMO were amended. The fixed charge coverage ratio was amended to include the net proceeds of the Lassonde brokered private placement (*see note 26*) as equivalent to earnings before interest, depreciation and amortization for the period ending October 2020.

14. **FINANCE LEASES**

On August 2, 2016, the Company executed a Master Lease Agreement (“MLA”) with Element Fleet Management Inc. for the acquisition, management and disposal of automobiles to support sales and marketing functions. 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 are currently at 4.55%.

On November 26, 2018, the Company executed an MLA with BMO for the lease-back of winery equipment that was sold to the bank (*see note 8*). The lease is for an 84 month period, expiring October, 2025. The lease contains a bargain purchase option to acquire the equipment at the end of the lease term for \$1 and provides for the transfer of the risks and rewards of ownership of the winery equipment to the Company. Accordingly, this 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 rate implicit in the lease agreement is 4.94%

The following is a schedule of future minimum annual lease payments for assets under finance leases together with the balance of the obligations as at March 31, 2019.

|  | <b>Minimum<br/>lease<br/>payments</b> | <b>Present value<br/>of minimum<br/>lease payments</b> |
|--|---------------------------------------|--|
| Not later than one year                        | \$ 355,128                            | \$ 308,406   |
| Later than one year and up to lease expiry     | <u>948,600</u>                        | <u>844,076</u>   |
|  | <b>1,303,728</b>                      | 1,152,482  |
| Less: interest                                 | <u>(151,246)</u>                      | <u>-</u>   |
| Total obligations under finance leases         | <b>1,152,482</b>                      | 1,152,482  |
| Less: current portion                          | <u>(308,406)</u>                      | <u>(308,406)</u>                                       |
|  | <b><u>\$ 844,076</u></b>              | <b><u>\$ 844,076</u></b>                               |
| Estimated principal repayments are as follows: |                                       |  |
| Year ending March 31, 2020                     |                                       | \$ 308,406   |
| Year ending March 31, 2021                     |                                       | 247,858  |
| Year ending March 31, 2022                     |                                       | 125,996  |
| Year ending March 31, 2023                     |                                       | 128,132  |
| Year ending March 31, 2024                     |                                       | 127,280  |
| Subsequent                                     |                                       | <u>214,810</u>   |
|  |                                       | <b><u>\$ 1,152,482</u></b>                             |

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14. **FINANCE LEASES, CONTINUED**

Vehicles acquired under finance leases during the year ended March 31, 2019 totalled \$54,369 (2018 - \$43,334). Winery equipment acquired under finance leases during the year ended March 31, 2019 totalled \$838,342 (2018 - \$Nil).

Interest expense on the finance leases for the year ended March 31, 2019 was \$32,444 (2018 - \$22,653).

15. **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 period from April 1, 2017 to March 31, 2019. Details of major changes in each component during that period are as follows:

(a) **(Loss) income per share**

Basic (loss) income 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, 2019 was 145,802,051 (2018 - 140,282,745).

As at March 31, 2019, the following potentially dilutive equity instruments were outstanding: (1) 11,850,000 options (2018 - 7,175,000), and (2) 1,622,000 deferred share units (2018 - 1,563,238). The fully diluted number of common shares outstanding for the year ended March 31, 2019 was 161,983,746 (2018 - 149,112,079).

(b) **Issuance of common shares**

On June 28, 2018, the Company issued 4,687,500 common shares valued at \$0.32 per share in settlement of \$1,500,000 of the purchase consideration paid to acquire Backyard Vineyards Corp. (*see note 5*).

(c) **Settlement of Deferred Share Units**

On April 3, 2018, on the retirement of a member of the Board of Directors, 200,405 DSUs were settled in common shares of the Company.

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16. **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, 2019 and 2018 was as follows:

|  | <u>2019</u>       |  | <u>2018</u>      |  |
|--|-------------------|--|------------------|--|
|  | <u>Options</u>    | <u>Weighted<br/>-average<br/>exercise<br/>price (\$)</u> | <u>Options</u>   | <u>Weighted-<br/>average<br/>exercise<br/>price (\$)</u> |
| Outstanding, beginning of year                     | 7,175,000         | 0.19   | 6,150,000        | 0.17   |
| Options exercised (see note 16(a))                 | (3,250,000)       | 0.19   | (125,000)        | 0.11   |
| Expiry of options (see note 16(b))                 | (175,000)         | -  | (100,000)        | -  |
| Granted to BOD and key management (see note 16(c)) | 7,100,000         | 0.28   | 1,250,000        | 0.28   |
| Granted to CFO (see note 16(c))                    | <u>1,000,000</u>  | <u>0.20</u>  | -                | -  |
| Outstanding, end of year                           | <u>11,850,000</u> | <u>0.25</u>  | <u>7,175,000</u> | <u>0.19</u>  |

As at March 31, 2019, the issued and outstanding options to acquire common shares of the Company are as follows:

| <u>Grant date</u> | <u>Number of options</u> |                    | <u>Exercise<br/>price (\$)</u> | <u>Remaining<br/>life</u> | <u>Expiry date</u> |
|-------------------|--------------------------|--------------------|--------------------------------|---------------------------|--------------------|
|                   | <u>Granted</u>           | <u>Exercisable</u> |                                |                           |                    |
| June 5, 2014      | 500,000                  | 500,000            | 0.25                           | 0.18                      | June 5, 2019       |
| November 10, 2014 | 1,400,000                | 1,400,000          | 0.12                           | 0.62                      | November 9, 2019   |
| November 10, 2014 | 600,000                  | 600,000            | 0.12                           | 0.62                      | November 9, 2019   |
| January 15, 2018  | 750,000                  | 187,500            | 0.29                           | 3.79                      | January 14, 2023   |
| February 27, 2018 | 500,000                  | 125,000            | 0.27                           | 3.91                      | February 26, 2023  |
| October 1, 2018   | 7,100,000                | -                  | 0.28                           | 4.50                      | September 30, 2023 |
| January 23, 2019  | <u>1,000,000</u>         | <u>-</u>           | 0.20                           | 4.82                      | January 22, 2024   |
|                   | <u>11,850,000</u>        | <u>2,812,500</u>   | 0.16                           | 3.62                      |                    |

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16. **STOCK OPTIONS, CONTINUED**

(a) **Exercise of options**

- (i) On April 10, 2018, 150,000 of the stock options originally granted on November 24, 2014 were exercised at the purchase price of \$0.11 for total proceeds of \$16,500.
- (ii) On September 21, 2018, 500,000 of the stock options originally granted on September 24, 2013 were exercised at the purchase price of \$0.25 and 2,000,000 of the stock options originally granted on September 24, 2013 were exercised at the purchase price of \$0.20 per share for total proceeds of \$525,000.
- (iii) On November 1, 2018, 350,000 of the stock options originally granted on November 24, 2014 were exercised at the purchase price of \$0.11 per share for total proceeds of \$38,500.
- (iv) On November 24, 2018, 250,000 of the stock options originally granted on November 24, 2014 were exercised at the purchase price of \$0.11 per share for total proceeds of \$27,500.

(b) **Expiry of options**

During the year ended March 31, 2019, a total of 175,000 options, initially granted on November 24, 2014 expired unexercised on the departure of two executives of the Company.

(c) **Issuance of options**

- (i) On October 1, 2018, the Company issued stock options to its directors and key members of the management team. A total of 7,100,000 stock options were issued with an exercise price of \$0.28 per share with a term of five years, vesting evenly on each anniversary date over 4 years. The fair value of these options was calculated with the Black-Scholes option pricing model, using the assumptions of: (1) risk free interest rate of 2.02%, (2) expected volatility of 90.51%, (3) expected life of 5 years, and (4) dividend yield of 0.0%, the fair value attributed to each option was \$0.20.
- (ii) On January 23, 2019, the Company issued a total of 1,000,000 stock options to a key member of management with an exercise price of \$0.20 per share. The fair value of these options was calculated with the Black-Scholes option pricing model, using the assumptions of: (1) risk free interest rate of 1.93%, (2) expected volatility of 88.05%, (3) expected life of 5 years, and (4) dividend yield of 0.0%, the fair value attributed to each option was \$0.20.

(d) **Share based compensation**

Total share based compensation recognized for the year ended March 31, 2019 of \$549,399 (2018 - \$186,651) based on accrual of previously granted options expected to vest in the reporting period and the issuance of DSUs as described in note 17.

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**17. 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 1.3% 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. The DSUs issued under this plan to non-executive directors are to be settled in common shares of the Company when the director retires from all positions with the Company.

On August 29, 2017, the Company issued an aggregate of 438,356 DSUs to non-executive directors under the DSU Plan in settlement of \$128,000 of deferred directors' compensation.

On August 31, 2018, the Company issued an aggregate of 259,167 DSUs to non-executive directors under the DSU Plan in settlement of \$77,750 of deferred directors' compensation.

To date, a total of 1,822,405 DSUs have been issued, of which 1,622,000 remain outstanding, after the settlement of 200,405 DSUs into common shares of the company on retirement of a member of the Board of Directors on April 3, 2018.

**18. KIRKWOOD DIAMOND CANADA PARTNERSHIP AND NON-CONTROLLING INTEREST**

On May 5, 2017, the Company closed on the previously announced acquisition of the 49.99% interest in Kirkwood Diamond Canada (KDC), its agency business, that was owned by its partner. As such, the Company now owns 100% of KDC and has rebranded it under the operating name Trajectory Beverage Partners.

The purchase price of \$4,399,120 was allocated by eliminating the non-controlling interest balance of \$3,789,243, with the remaining \$609,887 being recorded as a reduction to contributed surplus as detailed in the Consolidated Statement of Changes in Shareholders' Equity.

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19. **INCOME TAXES**

(a) **Income rate reconciliation**

The reconciliation of the combined Canadian federal and provincial statutory income tax rates on the net income for the years ended March 31, 2019 and 2018 is as follows:

|   | <u>2019</u>           | <u>2018</u>      |
|---|-----------------------|------------------|
| <b>Net income before recovery of income taxes</b> | <b>\$ (3,336,591)</b> | <b>\$ 27,177</b> |
| Expected income tax recovery                      | <u>26.50%</u>         | <u>26.50%</u>    |
| Expected income tax recovery                      | <b>\$ (884,197)</b>   | <b>\$ 7,202</b>  |
| Decrease (increase) resulting from:               |                       |                  |
| Non-deductible expenses                           | 175,251               | 60,451           |
| Non-taxable income                                | (79,529)              | -                |
| Change in tax benefits not recognized             | 724,501               | (67,653)         |
| Tax rate differential                             | <u>(1,372)</u>        | <u>-</u>         |
| <b>Recovery of income taxes</b>                   | <b>\$ (65,346)</b>    | <b>\$ -</b>      |

The recovery of income taxes of \$65,346 for the year ended March 31, 2019 (2018 - \$Nil) relates entirely to the release of the deferred tax liability relating to the acquisition of BYV.

(b) **Deferred tax**

The following table summarizes the components of deferred tax:

|                                     | <u>2019</u>     | <u>2018</u>  |
|-------------------------------------|-----------------|--------------|
| <b>Deferred tax asset</b>           |                 |              |
| Non-capital losses carried forward  | \$ 2,238,807    | \$ 1,999,988 |
| Deferred financing costs            | -               | 15,145       |
| Reserves                            | 16,149          | 63,852       |
| <b>Deferred tax liabilities</b>     |                 |              |
| Property, plant and equipment       | (1,882,156)     | (1,758,407)  |
| Intangible assets                   | (273,035)       | (320,578)    |
| Inventory                           | (65,779)        | -            |
| Deferred financing costs            | <u>(33,986)</u> | <u>-</u>     |
| <b>Net deferred tax liabilities</b> | <b>\$ -</b>     | <b>\$ -</b>  |

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19. **INCOME TAXES, CONTINUED**

(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>2019</u>       | <u>2018</u> |
|------------------------------------|-------------------|-------------|
|                                    | \$                | \$          |
| Non-capital losses carried forward | <b>16,475,281</b> | 13,266,430  |
| Capital losses carried forward     | <b>397,388</b>    | 397,388     |
| Share issuance costs               | <b>500,039</b>    | 577,719     |
| Reserves                           | <b>216,405</b>    | 396,491     |
| Intangible assets                  | <b>1,809,197</b>  | 1,638,906   |

The non-capital loss carry forwards expire as noted in the table below. The net capital loss carry forwards may be carried forward indefinitely, but can only be used to reduce capital gains. Share issue and financing costs will be fully amortized in 2023. 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.

|      |                      |
|------|----------------------|
| 2028 | \$ 1,546,369         |
| 2029 | 637,792              |
| 2030 | 8,635,937            |
| 2031 | 3,750,634            |
| 2032 | 2,007,278            |
| 2033 | 475,778              |
| 2034 | 1,665,014            |
| 2035 | 1,387,850            |
| 2036 | 331,652              |
| 2037 | 217,839              |
| 2038 | 1,609,314            |
| 2039 | 2,631,140            |
|      | <u>\$ 24,896,597</u> |

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

During the years ended March 31, 2019 and 2018, 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:

|   | 2019         | 2018       |
|---|--------------|------------|
| Salary  | \$ 1,151,480 | \$ 976,575 |
| Director fees   | 80,250       | 78,500     |
| Share based compensation under stock option plan ( <i>see note 16 (d)</i> ) and DSU Plan ( <i>see note 17</i> ) | 549,399      | 186,651    |
| Interest on loan payable - non-controlling interest   | -            | 4,212      |
| Winery lease payments   | 100,000      | 100,000    |
| Vineyard maintenance  | -            | 105,391    |
| Grape purchases   | 110,089      | 115,282    |

Accounts payable and accrued liabilities as at March 31, 2019 includes \$481,184 (March 31, 2018 - \$379,627) with respect to balances owing to related parties for the transactions disclosed above.

21. **COMMITMENTS AND CONTINGENCIES**

- (a) Under various lease agreements with varying terms, the Company leases its offices Oakville, Ontario, its retail store in Toronto, Ontario and its BYV winery property in Langley, British Columbia. Future remaining minimum lease payments as at March 31, 2019 are as follows:

|                  |              |
|------------------|--------------|
| 2020             | \$ 402,213   |
| 2021             | 375,712      |
| 2022             | 385,258      |
| 2023             | 393,505      |
| 2024             | 398,051      |
| Subsequent years | 1,549,569    |
|                  | \$ 3,504,308 |

- (b) There were no additional significant contractual commitments outstanding at March 31, 2019. Contractual commitments to purchase property, plant and equipment were \$583,688 as at March 31, 2018 related to the expansion of the winery production facility.
- (c) From time to time, the Company is involved in potential litigation matters arising out of the ordinary course and conduct of its business. The Company does not expect the outcome to have a material impact on the consolidated financial statements.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
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22. **SEGMENTED INFORMATION**

**Business segments**

The Company operates in two business segments, namely (i) sales of manufactured wines and (ii) distribution and sales of products represented in Canada under agency agreements with third parties. The following table presents selected financial information associated with each of these segments for the year months ended March 31, 2019 and 2018:

|   | <u>March 31, 2019</u> |                   |                   |
|---|-----------------------|-------------------|-------------------|
|   | Agency                | Manufactured      | Consolidated      |
|   | \$                    | wines             | \$                |
| Gross revenue   | 13,629,912            | 14,982,026        | 28,611,938        |
| Inter-segment revenue   | <u>(488,835)</u>      | <u>-</u>          | <u>(488,835)</u>  |
| Net revenue   | <u>13,141,077</u>     | <u>14,982,026</u> | <u>28,123,103</u> |
| Gross profit  | 5,819,900             | 5,694,054         | 11,513,954        |
| Interest on long-term debt  | 106,321               | 1,058,073         | 1,164,394         |
| Depreciation and amortization   | 473,979               | 935,577           | 1,409,556         |
| Additions of property, plant and equipment and intangible assets        | 282,867               | 1,576,153         | 1,859,020         |
| Fair value of property, plant and equipment acquired on purchase of BYV | -                     | 1,470,000         | 1,470,000         |

Statement of financial position balances as at  
March 31, 2019

|                   |           |            |            |
|-------------------|-----------|------------|------------|
| Intangible assets | 1,055,060 | 2,100,081  | 3,155,141  |
| Total assets      | 6,927,879 | 38,807,301 | 45,735,180 |
| Total liabilities | 3,541,346 | 26,553,580 | 30,094,926 |

March 31, 2018

|  | Agency            | Manufactured      | Consolidated      |
|--|-------------------|-------------------|-------------------|
|  | \$                | wines             | \$                |
| Gross revenue  | 17,365,179        | 17,333,002        | 34,698,181        |
| Inter-segment revenue  | <u>(427,260)</u>  | <u>-</u>          | <u>(427,260)</u>  |
| Net revenue  | <u>16,937,919</u> | <u>17,333,002</u> | <u>34,270,921</u> |
| Gross profit   | 7,034,119         | 7,404,173         | 14,438,292        |
| Interest on bank indebtedness                                    | 98,871            | 759,380           | 858,251           |
| Depreciation and amortization                                    | 448,467           | 971,995           | 1,420,462         |
| Additions of property, plant and equipment and intangible assets | 109,767           | 3,725,584         | 3,835,351         |

Statement of financial position balances as at  
March 31, 2018

|                   |           |            |            |
|-------------------|-----------|------------|------------|
| Intangible assets | 2,420,115 | 772,037    | 3,192,152  |
| Total assets      | 7,538,034 | 34,656,931 | 42,194,965 |
| Total liabilities | 2,794,625 | 23,145,740 | 25,940,365 |

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

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22. **SEGMENTED INFORMATION, CONTINUED**

**Geographic information**

|                 | 2019          | 2018          |
|-----------------|---------------|---------------|
| <b>Revenue</b>  |               |               |
| Canada          | \$ 23,068,640 | \$ 26,483,659 |
| China and other | 5,054,463     | 7,787,262     |
|                 | \$ 28,123,103 | \$ 34,270,921 |

23. **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.

**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    | 2019            |            | 2018            |            |
|--|-----------------------|----------------|-----------------|------------|-----------------|------------|
|  |                       |                | Carrying amount | Fair value | Carrying amount | Fair value |
|  |                       |                | \$              | \$         | \$              | \$         |
| Accounts receivable                      | Financial assets      | Amortized cost | 2,906,154       | 2,906,154  | 2,795,576       | 2,795,576  |
| Accounts payable and accrued liabilities | Financial liabilities | Amortized cost | 6,342,500       | 6,342,500  | 6,070,159       | 6,070,159  |
| Unearned revenue and deposits received   | Financial liabilities | Amortized cost | 60,810          | 60,810     | -               | -          |
| Note payable                             | Financial liabilities | Amortized cost | 550,000         | 550,000    | -               | -          |
| Term notes payable                       | Financial liabilities | Amortized cost | 21,989,134      | 21,989,134 | 19,349,475      | 19,349,475 |
| Finance leases                           | Financial liabilities | Amortized cost | 1,152,482       | 1,152,482  | 515,434         | 515,434    |

**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, credit facilities and finance leases (Notes 13 & 14). Assuming that other variables remain constant, a 1% change in the prime lending rate as at March 31, 2019 would impact interest expense and net income by \$234,000 (2018 - \$199,000).

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

**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 credit risk on the Company's trade receivables through established credit monitoring policies, including analysis of 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 based on the expected credit losses in order to reflect risks related to bad debts.

Aged amounts receivable and related provision are as follows:

|                     | <u>2019</u>         | <u>2018</u>         |
|---------------------|---------------------|---------------------|
| Current             | \$ 1,684,139        | \$ 1,650,904        |
| 30 days past due    | 549,178             | 486,966             |
| 60 days past due    | 182,803             | 226,523             |
| 90 days past due    | 260,497             | 153,694             |
| 120 days past due   | 381,554             | 451,046             |
| Amount provided for | <u>(152,017)</u>    | <u>(173,557)</u>    |
|                     | <u>\$ 2,906,154</u> | <u>\$ 2,795,576</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 6, the Company has a credit insurance policy 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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23. **FINANCIAL INSTRUMENTS AND RISK FACTORS, CONTINUED**

**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"), 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:

|                            | 2019    | 2018    |
|----------------------------|---------|---------|
| <b>Accounts receivable</b> |         |         |
| US dollars (USD)           | 11,053  | 21,899  |
| Euros (EUR)                | 9,245   | 27,829  |
| Australian dollars (AUD)   | 1,738   | 532     |
| British pounds (GBP)       | 1,495   | 10,206  |
| <b>Accounts payable</b>    |         |         |
| US dollars (USD)           | 171,764 | 190,576 |
| Euros (EUR)                | 97,367  | 5,486   |
| Australian dollars (AUD)   | 17,766  | -       |

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, 2019 would affect net income and comprehensive income by approximately \$27,000 (2018 - \$20,000).

**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 and term loans payable (see note 13).

Total current liabilities as at March 31, 2019 of \$7,713,903 (2018 - \$6,722,672), which includes accounts payable and accrued liabilities, unearned revenue and deposits received, note payable, 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.

As at March 31, 2019, the Company had a working capital surplus of \$14,887,530 (2018 - \$13,649,842).

**DIAMOND ESTATES WINES & SPIRITS INC.**  
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23. **FINANCIAL INSTRUMENTS AND RISK FACTORS, CONTINUED**

**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, 2019, sales to four customers, including the Liquor Control Board of Ontario ("LCBO") comprised 55.7% (2018 - 60.6%) of total revenue. As at March 31, 2019, these four customers represented 25.6% of accounts receivable (2018 - 29.3%).

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

24. **NON-CASH TRANSACTIONS**

|  | 2019       | 2018      |
|--|------------|-----------|
| Property, plant and equipment acquired under<br>finance leases (Note 14) | \$ 892,711 | \$ 43,334 |
| Issuance of note payable in exchange for shares (Note 5)                 | 550,000    | -         |
| Issuance of common shares in exchange for shares (Note 5)                | 1,500,000  | -         |

25. **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 term loans (*see note 13*) and there has been no change in the overall capital risk management strategy during the year.

26. **SUBSEQUENT EVENT**

On July 29, 2019, the Company completed a brokered private placement with Lassonde Industries Inc. ("Lassonde") to issue 36.9 million common shares at \$0.19 per share for gross proceeds of \$7.011 million. The issuance of the common shares has led to Lassonde taking a 19.9% ownership in the Company and Lassonde will have the right to designate two of the seven members of the Board of Directors.