

DIAMOND ESTATES WINES & SPIRITS INC.

MANAGEMENT DISCUSSION AND ANALYSIS

THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2022 AND 2021

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The following management discussion and analysis ("MD&A") of Diamond Estates Wines & Spirits Inc. ("Diamond" or "the Company") provides a review of corporate developments, results of operations and financial position for the three and six months ended September 30, 2022 ("Q2 2023" and "YTD 2023" respectively) compared with the corresponding periods ended September 30, 2021 ("Q2 2022" and "YTD 2022" respectively). This discussion is prepared as of November 24, 2022 and should be read in conjunction with (i) the unaudited interim condensed consolidated financial statements and the accompanying notes for the three and six months ended September 30, 2022 and 2021, and (ii) both the audited consolidated financial statements and MD&A for the fiscal years ended March 31, 2022 and 2021. Additional information regarding Diamond is available on Diamond's SEDAR profile at www.sedar.com. The results reported in this MD&A have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are presented in Canadian dollars, which is the Company's functional currency.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements. Forward-looking statements can often be identified by the use of words such as "plans", "expects" or "does not expect", "is expected", "estimates", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or state that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved. Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements contained in this MD&A. Such forward-looking statements are based on a number of assumptions which may prove to be incorrect, including, but not limited to, the ability of the Company to obtain necessary financing, the economy generally, the Covid-19 pandemic, conditions in the target market of the Company, consumer interest in the services and products of the Company, competition and anticipated and unanticipated costs. Such statements could also be materially affected by environmental regulation, liquor regulation, taxation policies, competition, the lack of available and qualified personnel or management, stock market volatility and the ability to access sufficient capital from internal or external sources. Actual results, performance or achievement could differ materially from those expressed herein. While the Company anticipates that subsequent events and developments may cause its views to change, the Company specifically disclaims any obligation to update these forward-looking statements, except as required by applicable law. These forward-looking statements should not be relied upon as representing the Company's views as of any date subsequent to the date of this MD&A. Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results not to be as anticipated, estimated or intended. Readers should not place undue reliance on forward-looking statements. The factors identified above are not intended to represent a complete list of the factors that could affect the Company.

Detailed information on risks and uncertainties is provided in the "Uncertainties and Principal Risk Factors" section of the annual MD&A for the year ended March 31, 2022.

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COMPANY OVERVIEW

Diamond Estates Wines and Spirits Inc. is a producer of high-quality wines and ciders as well as a sales agent for over 120 beverage alcohol brands across Canada. The Company operates five wineries, four in Ontario and one in British Columbia, that produce predominantly VQA wines under such well-known brand names as 20 Bees, Creekside, EastDell, Lakeview Cellars, Mindful, Queenston Mile, Shiny Apple Cider, Fresh, Proud Pour, Red Tractor, Seasons, Serenity, Persona and Backyard Vineyards.

Through its commercial division, Trajectory Beverage Partners, the Company is the sales agent for many leading international brands in all regions of the country as well as being a distributor in the western provinces. These recognizable brands include Josh wines from California, Fat Bastard, Meffre, and Pierre Chavin wines from France, Brimincourt Champagne from France, Merlet and Larsen Cognacs from France, Kaiken wines from Argentina, Blue Nun and Erben wines from Germany, Felix Solis wines from Spain, Calabria Family Estate Wines from Australia, Saint Clair Family Estate Wines from New Zealand, Redemption Bourbon and Rye whiskies from the U.S., Gray Whale Gin from California, Storywood and Cofradia Tequilas from Mexico, Magnum Cream Liqueur from Scotland, Talamonti and Cielo wines from Italy, Catedral and Cabeza de Toiro wines from Portugal, Waterloo Beer & Radlers from Canada, Landshark Lager from the USA, Edinburgh Gin, Tamdhu, Glengoyne and Smokehead single-malt Scotch whiskies from Scotland, Islay Mist, Grand MacNish and Waterproof whiskies from Scotland, C. Mondavi & Family wines including C.K. Mondavi & Charles Krug from Napa, Wize Spirits and Hounds Vodka from Canada, Bols Vodka from Amsterdam, Koyle Family Wines from Chile and Pearse Lyons whiskies and gins from Ireland.

The Company's mission is to build lasting, mutually beneficial relationships with channel partners, growers, suppliers and employees. To meet this goal, the Company is undertaking significant investments in winemaking, brand marketing, sales programming, performance management and back-office infrastructure, including information systems which will support growth in an efficient, profitable manner. Based on its analysis of the market, the Company believes that the growth prospects for the domestic and import beverage alcohol markets in Canada are positive. The Company continues to be a participant in the export market and has been successfully expanding its focus beyond China. Canadian wines and particularly Icewine enjoy a premium product positioning with international consumers.

The Company is committed to achieving its sales objectives through its distribution network, which is focused on the provincial liquor boards, licensed restaurants and bars, grocery chains, Diamond's four retail locations, direct-to-consumer and export channels. This distribution network is supported by enhanced sales, marketing and promotional programs. To ensure the Company strives to maintain an adequate level of liquidity, including compliance with future debt covenants, the Company continues to maintain a strategic review process that engages in actions designed to reduce the cost structure, improve productivity and enhance future cash flow. The Company is continuing to focus on initiatives to reduce costs, enhance its production efficiencies and achieve cost synergies from its recent acquisitions and through a continual review of its operations and cost structure.

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RECENT EVENTS AND YTD 2023 HIGHLIGHTS

- Revenue for Q2 2023 of \$9.2 million, an increase of \$2.1 million from Q2 2022 revenue of \$7.1 million. The winery division experienced an increase of \$1.8 million; as a result of, a continuing resurgence in on-premise sales and expansion in distribution within the LCBO and Grocery channels throughout Q2 2023, while the export sales have rebounded from \$0.1 million in Q1 2023 to \$0.6 million in Q2 2023. The Agency experienced moderate growth increasing \$0.3 million to \$3.8 million in Q2 2023.
- Gross margin¹ for Q2 2023 was \$3.6 million, an increase of \$0.9 million from \$2.7 million in Q2 2022, while gross margin as a percentage of revenue was 38.7% for Q2 2023 compared to 38.1% in Q2 2022. However, when factoring in the adjustments to cost of goods sold for the fair value of EWG inventories sold, gross margin for Q2 2023 was \$3.8 million or 41.1% of revenue. The increase in gross margin was a result of increases in most channels driven by the acquisition of Equity Wine Group and price increases on most products.
- EBITDA¹ was negative \$0.4 million in Q2 2023, a decrease of \$0.1 million from negative \$0.3 million in Q2 2022, the decrease is mostly attributable to an increase in selling, general and administrative expenses from the EWG acquisition, brand redesigns on many of the core brands, increased spending requirements with the easing of Covid (promotions, events and travel) and the opening of our new Shiny retail store in July 2022.
- EBITDA for Q2 2023 was adjusted by \$0.2 million to account for the incremental fair value of EWG inventories sold since March, 2022, such that adjusted EBITDA was negative \$0.2 million in Q2 2023 compared to negative \$0.1 million in Q2 2022.
- For the rolling twelve-month period ended September 30, 2022, the Company was in breach of its fixed charged covenant ratio (see further discussion in "Liquidity and Capital Resources" section below).
- On October 24, 2022, the Company entered into an amendment to its Second Amended and Restated Credit Agreement (the "SARCA") with Bank of Montreal ("BMO") (see further discussion in "Subsequent Events" section below).
- On November 9, 2022, the Company closed a non-brokered private placement of 10.0 % unsecured convertible debentures of the Company for gross proceeds of \$4.9 million (see further discussion in "Subsequent Events" section below).
- The escrow receivable of \$1.1 million related to contingent consideration previously paid as part of the Shiny Apple asset acquisition was received in full on October 5, 2022.
- Diamond has begun to see export shipments as sales have seen a remarkable improvement from Q1 2023 to Q2 2023.
- On June 29, 2022, the Canadian government announced the Winery Sector Support Program which will provide grants to the wine producers for the next two budget years (F2022 and F2023). The Government has budgeted up to \$166M over the two-year period and will review further annual funding in the near future. This support equates to approximately \$0.81 per litre for wine produced from domestic fruit and has been welcomed by the industry as much needed support for this vital industry. The Company has applied for this support program and expects to receive a grant in the third quarter of fiscal 2023.

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- The Government of Canada has repealed the federal excise duty exemption of 100% Canadian wines effective June 30, 2022 and is subject to an excise tax of \$0.68 per litre. All wines packaged prior to June 30, 2022 can continue to be sold under the previous exemption. The Company estimated that the repeal of the exemption will not have a material impact on revenue for fiscal 2023 and is evaluating the impact on future periods.

¹ See definition of selected terms under the heading "Non-IFRS Financial Measures"

GOING CONCERN

The accompanying consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") (as issued by the International Accounting Standard Board ("IASB")) applicable to a going concern.

Net loss and comprehensive loss for YTD 2023 was \$3.0 million (YTD 2022 - \$1.4 million). Additionally, the Company reported negative cash flow from operations (before changes in non-cash working capital) of \$1.7 million in YTD 2023 (YTD 2022 - \$0.4 million). As at September 30, 2022, the Company had an accumulated deficit of \$16.5 million (September 30, 2021 - \$13.6 million). As at September 30, 2022, the Company had a working capital deficiency of \$2.8 million (2022 - \$0.7 million).

The operations and net loss for the rolling twelve-month period ended September 30, 2022 have resulted in the Company being in breach of its quarterly fixed charge covenant under the terms of its current credit agreement with Bank of Montreal ("BMO"), its primary lender. However, on October 24, 2022, the Company entered into an amendment for which the Company received a waiver on its fixed charge covenant to the end of the fiscal year. The significant working capital deficiency as at September 30, 2022 is from the covenant breach and amended Bank Agreement which reclassified the non-current debt in the amount of \$24.1 million as current. The Company has debt repayment requirements of \$1.7 million over the next twelve months, including the current portion of the non-revolving term loans and current portion of finance leases, as well as annual seasonal grape purchase commitments in the fall of 2023. These circumstances lend significant doubt as to the ability of the company to continue as a going concern and, accordingly, the appropriateness ultimately of the use of accounting principles applicable to the going concern assumption.

In response to the recurring operating losses and negative cash flows from operating activities, the Company is taking a number of actions to enhance its financial flexibility, to meet its obligations and to fund its ongoing business operations, as evidenced by the restructured credit agreement and debenture financing arranged after period end (*see further discussion in "Subsequent Events" section below*). To ensure the Company maintains an adequate level of liquidity, including compliance with debt covenants, the Company continues to maintain a strategic review process that engages in actions designed to reduce the cost structure, improve productivity and enhance future cash flow.

The Company's ability to meet the covenant measurements under the terms of its credit agreements with its lenders is still dependent upon continued improvement in profitable commercial operations and continued funding support from BMO, shareholders and new equity and debt placements. However, there can be no assurance that management will be successful in this regard. These consolidated financial statements do not include any adjustments to the carrying value of assets or liabilities, to the recoverable amounts or the reported expenses and consolidated balance sheet classifications that would be necessary if the going concern assumption were inappropriate, and these adjustments could be material.

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QUARTERLY PERFORMANCE (UNAUDITED)

The following table highlights certain key quarterly financial highlights. Commentary on the selected highlights is included under "Results of Operations" and "Liquidity and Capital Resources".

	Sep-2022 Q2 2023 \$	Jun-2022 Q1 2023 \$	Mar-2022 Q4 2022 \$	Dec-2021 Q3 2022 \$	Sep-2021 Q2 2022 \$	Jun-2021 Q1 2022 \$	Mar-2021 Q4 2021 \$	Dec-2020 Q3 2021 \$
<u>Balance sheet</u>								
Working capital surplus (deficiency)	(2,842,434)	(1,920,390)	(696,908)	23,401,723	(1,641,158)	20,410,991	20,401,475	20,351,192
Term debt, lease liabilities and debentures payable	27,879,579	29,747,827	28,707,858	28,683,046	27,121,527	26,943,179	26,897,902	25,606,250
Total equity	27,588,963	28,811,355	30,313,267	33,431,936	17,135,698	17,999,442	18,187,297	19,443,352
<u>Income statement</u>								
Revenue	9,216,140	7,480,778	7,074,715	8,394,161	7,144,174	7,372,807	5,365,358	6,964,106
Gross margin	3,570,345	3,012,205	2,046,886	3,195,982	2,719,618	3,085,178	1,732,970	2,909,327
EBITDA	(443,814)	(921,920)	(1,601,212)	(325,714)	(208,338)	407,304	(477,770)	211,415
Adjusted EBITDA	(223,815)	(701,920)	(1,141,572)	(21,865)	(267,986)	331,737	(812,515)	208,401
Net income (loss)	(1,366,434)	(1,613,872)	(3,101,092)	2,017,681	(1,035,479)	(354,092)	(1,411,045)	(482,832)
Basic and diluted income (loss) per share	(0.05)	(0.06)	(0.12)	0.08	(0.05)	(0.02)	(0.02)	(0.02)

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RESULTS OF OPERATIONS

	<u>Q2 2023</u>	<u>YTD 2023</u>	<u>Q2 2022</u>	<u>YTD 2022</u>
Revenue	\$ 9,216,140	\$ 16,696,918	\$ 7,144,174	\$ 14,516,981
Cost of sales	<u>5,645,795</u>	<u>10,114,368</u>	<u>4,424,556</u>	<u>8,712,186</u>
Gross margin	3,570,345	6,582,550	2,719,618	5,804,795
<i>Gross margin (% of revenue)</i>	38.7%	39.4%	38.1%	40.0%
Selling, general and administration expenses	<u>4,014,159</u>	<u>7,974,941</u>	<u>2,969,659</u>	<u>5,677,580</u>
<i>SG&A expenses (% of revenue)</i>	43.6%	47.8%	41.6%	39.1%
EBITDA	(443,814)	(1,392,391)	(250,041)	127,215
Interest	340,801	634,990	281,445	545,198
Depreciation and amortization	<u>411,964</u>	<u>725,487</u>	<u>392,678</u>	<u>731,540</u>
Loss from operations	(1,196,579)	(2,752,868)	(924,164)	(1,149,523)
Gain on disposition of right-of-use assets	10,188	64,564	52,214	71,185
Restructuring charge	(36,000)	(36,000)	-	-
Share based compensation	(144,043)	(256,003)	(171,734)	(337,972)
Unrealized gain on derivative liability	<u>-</u>	<u>-</u>	<u>8,205</u>	<u>26,739</u>
Net loss and comprehensive loss	\$ (1,366,434)	\$ (2,980,307)	\$ (1,035,479)	\$ (1,389,571)

See definition of selected terms under the heading "Non-IFRS Financial Measures"

Revenue for Q2 2023 was \$9.2 million, an increase of \$2.1 million from \$7.1 million in Q2 2022. The winery division experienced an increase of \$1.8 million while the agency division increased by \$0.3 million. The Equity Wine Group acquisition contributed approximately \$1.2 million to the total increase in the winery division while the Shiny Apple Brand contributed \$0.2 million and the opening of our new Shiny retail outlet. The trending resurgence in on-premise and expanded distribution within the LCBO and Grocery channels continued throughout Q2 2023. While there was still softness experienced in the export market, in Q2 2023 compared to Q2 2022, exports have rebounded from \$0.1 million in Q1 2023 to \$0.6 million in Q2 2023. Agency revenue for Q2 2023 was \$3.8 million, an increase of \$0.3 million from \$3.5 million in Q2 2022, with growth moderated given ongoing global supply chain issues.

Gross margin for Q2 2023 was \$3.6 million, an increase of \$0.9 million from \$2.7 million in Q2 2022, while gross margin as a percentage of revenue was 38.7% for Q2 2023 compared to 38.1% in Q2 2022. However, when factoring the adjustments to cost of goods sold for the fair value of EWG inventories sold, gross margin for Q2 2023 was \$3.8 million and 41.1% of revenue. The winery experienced gross margins of 43.0% while the agency experienced gross margins of 32.6%. The gross margin of the winery business for Q2 2023 increased by \$0.9 million compared to Q2 2022. The gross margin of the agency business decreased by \$0.1 million to 32.6% due to higher product costs.

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Total SG&A expenses for Q2 2023 were \$4.0 million, an increase of \$1.0 million from \$3.0 million in Q2 2022. The change is mostly attributable to (i) an increase in employee compensation of \$0.4 million, resulting from the EWG acquisition and the opening of our new Shiny retail store in Q2 2022 which were closed in the prior year, (ii) an increase in advertising and promotion of \$0.5 million from marketing campaigns, and (iii) an increase in general and administrative expenses of \$0.1 million due to higher general expenses, professional fees and automobile expenses.

Interest expense for Q2 2023 of \$0.3 million was consistent compared to \$0.3 million in Q2 2022. Depreciation and amortization expense for Q2 2023 was \$0.4 million, consistent compared to \$0.4 million in Q2 2022.

Loss from operations for Q2 2023 was \$1.2 million compared to \$0.9 million in Q2 2022, a decrease in profitability of \$0.3 million. When factoring in the adjustments for the fair value of the EWG inventory sold, the loss from operations for Q2 2023 improves to a loss of \$1.0 million which is consistent with Q2 2022. The lower level of profitability compared to revenue is a direct result of an increase in selling, general and administration expenses quarter over quarter.

LIQUIDITY AND CAPITAL RESOURCES

	September 30,	
	2022	March 31, 2022
ASSETS		
Accounts receivable	\$ 5,102,023	\$ 5,204,837
Inventory	27,208,914	28,913,977
Prepaid expenses	<u>569,660</u>	<u>383,727</u>
Biological assets	<u>354,272</u>	-
Total current assets	<u>33,234,869</u>	34,502,541
Property, plant and equipment	25,459,397	25,893,088
Right of use assets	2,703,856	2,878,226
Intangible assets	<u>4,704,671</u>	<u>4,891,344</u>
Total assets	<u>\$ 66,102,793</u>	<u>\$ 68,165,199</u>
LIABILITIES		
Accounts payable and accrued liabilities	\$ 10,289,751	\$ 8,799,574
Current portion of term loans payable and lease liabilities	<u>25,787,552</u>	<u>26,399,875</u>
Total current liabilities	<u>36,077,303</u>	35,199,449
Lease liabilities, net of current portion	2,092,027	2,307,983
Deferred income taxes	<u>344,500</u>	<u>344,500</u>
Total liabilities	<u>38,513,830</u>	37,851,932
SHAREHOLDERS' EQUITY		
	<u>27,588,963</u>	<u>30,313,267</u>
	<u>\$ 66,102,793</u>	<u>\$ 68,165,199</u>

Liquidity risk is the risk that the Company may encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stress conditions, without incurring unacceptable losses or damage to the Company's reputation. To ensure the Company maintains an adequate level of liquidity, including compliance with debt covenants, the Company maintains a strategic review process that engages in actions designed to reduce the cost structure, improve productivity and enhance future cash flow (see further discussion in "Going Concern" section above);

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The working capital deficiency as at September 30, 2022 increased by \$2.1 million to \$2.8 million from \$0.7 million as at March 31, 2022. The operations and net loss for the rolling twelve-month period ended September 30, 2022 have resulted in the Company being in breach of its quarterly fixed charge covenant under the terms of its current credit agreement with BMO. However, on October 24, 2022 the Company entered into an amendment for which the Company received a waiver on its fixed charge covenant to the end of the fiscal year. The significant working capital deficiency as at September 30, 2022 is from the covenant breach and amended Bank Agreement, which reclassified the non-current debt in the amount of \$24.1 million (March 31, 2022 - \$23.0 million) as current. On a pro-forma basis, assuming the long-term debt can be classified as such, working capital as at September 30, 2022 would have been \$21.3 million (March 31, 2022 - \$22.3 million)

Accounts receivable of \$5.1 million as at September 30, 2022 decreased by \$0.1 million from \$5.2 million as at March 31, 2022. The decrease is a result of a moderate decline in accrued receivables. Within account receivables resides a \$1.1 million escrow receivable, related to the contingent consideration previously paid into escrow as part of the Shiny Apple acquisition, which was recoverable as at September 30, 2022 and was received in full on October 5, 2022.

The inventory balance was \$27.2 million as at September 30, 2022, a decrease of \$1.7 million from \$28.9 million as at March 31, 2022. The bulk wine decreased by approximately \$2.1 million as a result of bottlings that occurred throughout the six-month period. With the forecasted increase in demand for the Company's winery brands coinciding with market expansion and retail modernization, the Company continues to hold higher inventories of bulk and finished goods in anticipation of increasing demand.

Property, plant and equipment of \$25.5 million as at September 30, 2022 decreased by \$0.4 million from \$25.9 million as at March 31, 2022. The decrease was mostly attributable to depreciation taken for the six month period.

Right-of-use assets of \$2.7 million as at September 30, 2022 decreased from \$2.9 million as at March 31, 2022, largely due to depreciation of \$0.1 million taken for the six month period.

Intangible assets of \$4.7 million as at September 30, 2022 decreased by \$0.2 million from \$4.9 million as at March 31, 2022 due to depreciation taken for the six month period.

Accounts payable and accrued liabilities of \$10.3 million as at September 30, 2022 increased by \$1.5 million from \$8.8 million as at March 31, 2022. The increase in trade accounts payable of \$1.7 million from \$6.7 million to \$8.4 million was largely due to expenditures related to bottling bulk wines and purchasing supplier inventory for the fall the selling season.

The BMO credit facilities are governed under the terms of the SARCA and include the BCAP term loan, an existing non-revolving term loan, a revolving operating line, the total of which was \$25.3 million as at September 30, 2022, a decrease of \$0.7 million from \$26.0 million as at March 31, 2022. The decrease resulted from repayments on the non-revolving term loans of \$0.6 million.

On November 30, 2021, the Company entered into a Second Amended and Restated Credit Agreement ("SARCA") with Bank of Montreal ("BMO"). The SARCA folds in the previous BMO facility of EWG with the Company's existing BMO credit facility. EWG was acquired by the Company in October, 2021, and a condition of the transaction was for the Company to consolidate all its facilities with BMO. The notable terms of the SARCA are as follows:

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Credit limits: The revolving term loan of \$14.4 million with an accordion feature to fund future growth and non-revolving term loan of \$10.8 million.

Maturity dates: The revolving and non-revolving facilities have a two-year term expiring as at January 2, 2024, including the Business Credit Availability Program ("BCAP") facility.

Interest rates: The interest rate on each of the facilities is as follows:

- prime plus 1.40% under the revolving term facility;
- prime plus 1.65% under the non-revolving term facility; and
- prime plus 1.65% under the BCAP Facility.

Repayment: The non-revolving term loan is repayable in 80 quarterly principal payments of 1.25% of the drawn amount, or \$134,413. The BCAP loan is repayable in 48 monthly principal payments of \$57,292.

Subsequent to the reporting date (*as further described in the "Subsequent Events" section below*), the Company restructured its finances by virtue of:

- On October 24, 2022, the Company entered into an amendment to its SARCA
- On November 9, 2022, the Company closed a non-brokered private placement of 10.0 % unsecured convertible debentures of the Company for gross proceeds of \$4.9 million

The Company's debt to equity ratio increased to 1.02:1 as at September 30, 2022 from 0.96:1 as at March 31, 2022, where debt is defined as total liabilities less accounts payable and accrued liabilities, and equity is defined as shareholders' equity. This increase is due to the loss incurred for the six month period in 2023.

The Company has common shares and other equity instruments outstanding at each reporting date as follows:

	September 30, 2022	March 31, 2022	Change in reporting period
Common shares	27,875,978	27,875,978	-
Stock options	1,985,000	1,785,000	200,000
Deferred share units	391,177	335,073	56,104
Warrants	5,555,905	5,630,905	(75,000)
Total equity instruments	<u>35,808,060</u>	<u>35,626,956</u>	<u>181,104</u>

The Company did not issue any common shares during the six month period in 2023.

On August 28, 2022, the Board of Directors authorized the issuance of 200,000 stock options to a key member of management. The options each have an exercise price of \$0.90 and a term of 5 years, vesting as to 25% per year on each anniversary date over the next 4 years.

During YTD 2023, the Company issued the following deferred share units ("DSUs") in settlement of deferred directors' compensation: (i) May 22, 2022: 25,852 DSUs valued at \$28,438, and (ii) August 28, 2022: 30,252 DSUs valued at \$28,438.

On July 1, 2022, 75,000 warrants previously issued to BMO as consideration for entering into an amended banking agreement expired unexercised.

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NON-IFRS FINANCIAL MEASURES

Management uses net loss and comprehensive loss as presented in the unaudited interim condensed consolidated statements of net loss and comprehensive loss as well as "gross margin", "EBITDA" and "Adjusted EBITDA" as a measure to assess performance of the Company. The Company defines "gross margin" as gross profit excluding depreciation. EBITDA and "Adjusted EBITDA" are other financial measures and are reconciled to net loss and comprehensive loss below under "Results of Operations".

EBITDA and Adjusted EBITDA are supplemental financial measures to further assist readers in assessing the Company's ability to generate income from operations before considering the Company's financing decisions, depreciation of property, plant and equipment and amortization of intangible assets. EBITDA comprises gross margin less operating costs before financial expenses, depreciation and amortization, non-cash expenses such as share-based compensation, one-time and other unusual items, and income tax. Adjusted EBITDA comprises EBITDA before non-recurring expenses including cost of sales adjustments related to inventory acquired in business combinations, EWG transaction costs expensed, government funding under CEWS and CERS programs, and other non-recurring adjustments included in the calculation of EBITDA. Gross margin is defined as gross profit excluding depreciation on property, plant and equipment used in production. Operating expenses exclude interest, depreciation on property, plant and equipment used in selling and administration, and amortization of intangible assets.

EBITDA does not represent the actual cash provided by the operating activities nor is it a recognized measure of financial performance under IFRS. Readers are cautioned that this measure should not be considered as a replacement for those as per the consolidated financial statements prepared under IFRS. The Company's definitions of this non-IFRS financial measure may differ from those used by other companies.

The Company calculates gross margin as follows:

	<u>Q2 2023</u>	<u>YTD 2023</u>	<u>Q2 2022</u>	<u>YTD 2022</u>
	\$	\$	\$	\$
Revenue	9,216,140	16,696,918	7,144,174	14,516,981
Cost of sales				
Change in inventories of finished goods and raw materials consumed	5,645,795	10,114,368	4,424,556	8,712,186
Depreciation	161,684	204,716	208,789	321,008
Gross profit	3,408,661	6,377,834	2,510,829	5,483,787
Exclude depreciation	161,684	204,716	208,789	321,008
Gross margin	3,570,345	6,582,550	2,719,618	5,804,795
<i>Gross margin (% of revenue)</i>	<u>38.7%</u>	<u>39.4%</u>	<u>38.1%</u>	<u>40.0%</u>

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The Company calculates EBITDA and Adjusted EBITDA as follows:

	<u>Q2 2023</u>	<u>YTD 2023</u>	<u>Q2 2022</u>	<u>YTD 2022</u>
	\$	\$	\$	\$
Net loss for period	(1,366,435)	(2,980,307)	(1,035,479)	(1,389,571)
Interest	340,801	634,990	281,445	545,198
Depreciation and amortization	411,964	725,487	392,678	731,540
Share-based compensation	144,043	256,003	171,734	337,972
Restructuring charge	36,000	36,000	-	-
Gain on disposition of right-of-use assets	(10,188)	(64,564)	(52,214)	(71,185)
Unrealized gain on derivative liability	-	-	(8,205)	(26,739)
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EBITDA	(443,815)	(1,392,391)	(250,041)	127,215
Cost of goods sold adjustments for fair value of EWG inventories sold	220,000	440,000	-	-
Government funding under CEWS and CERS programs	-	-	59,648	135,215
Inventory adjustment	-	-	-	147,894
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Adjusted EBITDA	(223,815)	(952,391)	(190,393)	410,324

SUBSEQUENT EVENTS

Credit agreement

On October 24, 2022, the Company entered into an amendment to its Second Amended and Restated Credit Agreement (the "SARCA") with Bank of Montreal ("BMO") (see note 8). The major components of the amendment are as follows:

The interest rate on each of the facilities is now as follows:

- ◆ prime plus 2.40% under the revolving term facility;
- ◆ prime plus 2.65% under the non-revolving term facility;
- ◆ prime plus 2.65% under the BCAP facility;
- ◆ alternate base rate Canada plus 2.40% in the case of each base rate Canada loan under the revolving term facility; and
- ◆ alternate base rate Canada plus 2.65% in the case of each base rate Canada loan under the non-revolving term facility.

The Amendment is subject to compliance with the following additional covenants:

- ◆ the leverage ratio shall not be less than or equal to 2.00 to 1 for every calendar month and fiscal quarter
- ◆ the Company will not permit its forecasted or actual liquidity (as defined under the SARCA) to be less than \$Nil

All other terms of the SARCA, as amended, remain in full force and effect.

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Debenture financing

On November 9, 2022, the Company closed a non-brokered private placement of 10.0% unsecured convertible debentures of the Company for gross proceeds of \$4.9 million. The Company intends to use the net proceeds of the placement for general working capital and investment purposes.

The debentures bear interest from the date of issue at 10.0% per annum, calculated monthly, in arrears. The interest accrues on the principal outstanding under the debentures until such principal is repaid or converted. The debentures mature one year from their date of issuance unless the holder requests to accelerate the maturity date in the event the Company completes an equity financing within the next 12 months.

STRATEGIC OUTLOOK AND DIRECTION

Diamond is committed to building enduring, high quality beverage alcohol brands that enhance life enjoyment in a socially responsible manner. The Company believes in the development of leading brands that recognize consumers' interests in wine, beer, cider and ready-to-drink beverages and spirits, while addressing their desire to explore many of the Company's exciting offerings. The Company has also added a low alcohol brand Mindful, to its domestic portfolio in addition to low alcohol and no-alcohol beer and wine suppliers to its import portfolio, reflecting consumer interest and demand in those categories. Vertically integrated, Diamond combines modern and efficient production facilities for its Niagara and B.C. wines with a national marketing agency for its broad portfolio of leading international wines and spirits. The Company is well positioned to add to its throughput of wine production and leverage its national sales force to drive growth from existing brands and support new brands secured by the agency without material change to its cost structure.

Over the past three years, the Covid-19 pandemic has had a material impact on the global economy. In the spring of 2023, the pandemic impact has eased significantly and consumers have returned to more normal shopping and consumption behaviour. We anticipate the impact of Covid to continue to ease, but also expect that some volatility will continue both domestically and around the world. We also expect to see continued supply chain challenges, pressure on staffing and recent record setting inflation – further fueled by the conflict in Ukraine.

We are seeing a return to more normal sales channel development with the return of the On-Premise (restaurant and bars) business to near pre Covid levels, the partial return of business to our winery retail stores and significantly improved export sales as countries around the world re-open to import wines and consumers get back to entertaining and dining out. Interest in and appreciation of Canadian Icewine and table wines remains high. Our company continues to successfully expand distribution into several new jurisdictions including Finland, USA, Thailand, Singapore, Vietnam and Taiwan.

Consumers discovered on-line shopping for wine and beer during the pandemic and we see this as a very positive development for our business. This channel is more profitable given tax treatment of direct sales and it allows a more controlled retail interaction with our customers. This provides an additional way to build enduring brand relationships and to turn a first interaction at one of our wineries into an ongoing dialogue and purchasing behaviour. It also provides us greater ability to manage our inventories as we control what we promote.

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The retail modernization of the sale of beverage alcohol in Ontario continues to be a high priority for the provincial government. To date, the government has issued 450 beer licenses and 226 wine licenses to Ontario grocers and has reiterated its commitment to allowing the sale of beer and wine in grocery, big-box and convenience stores during their current mandate, which began in June, 2022. There is an active debate within the beverage alcohol industry and government on how best to influence this modernization program to the benefit of all stakeholders.

RECENTLY ADOPTED AND ISSUED ACCOUNTING PRONOUNCEMENTS

IAS 16 "Property, Plant and Equipment"

This standard has been amended to prohibit an entity from deducting from the cost of an item of property, plant and equipment any proceeds received from selling items produced while the entity is preparing the asset for its intended use, clarify that an entity is "testing whether the asset is functioning properly" when it assesses the technical and physical performance of the asset and require certain related disclosures. The amendments are effective for annual periods beginning on or after January 1, 2022. The adoption of the amendment did not have a significant impact on the unaudited interim condensed consolidated financial statements.

IAS 37 "Provisions"

This standard has been amended to clarify that, before a separate provision for an onerous contract is established, an entity recognizes an impairment loss that has occurred on assets used in fulfilling the contract, rather than on assets dedicated to that contract and to clarify the meaning of costs to fulfil a contract. The amendments are effective for annual periods beginning on or after January 1, 2022. The adoption of these amendments did not have a significant impact on the unaudited interim condensed consolidated statements.

IFRS 9 "Financial Instruments"

This standard has been amended to address which fees should be included in the 10% test for derecognition of financial liabilities. This amendment is effective for annual periods beginning on or after January 1, 2022. The adoption of the amendment did not have a significant impact on the unaudited interim condensed consolidated statements.

IAS 1, "Presentation of Financial Statements"

This standard has been amended to clarify the classification of liabilities as current or non-current depending on the rights that exist at the end of the reporting period. Classification is unaffected by the expectations of the entity or events after the reporting date. The amendment also clarifies the meaning of settlement of a liability. This amendment is effective for annual periods beginning on or after January 1, 2023. The standard has also been amended to specify that covenants to be complied with after the reporting date do not affect the classification of debt as current or non-current at the reporting date. Instead, the amendments require a company to disclose information about these covenants in the notes to the financial statements. The amendments are effective for annual reporting periods beginning on or after January 1, 2024, with early adoption permitted.

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IAS 12 "Income Taxes"

This standard has been amended to require companies to recognize deferred tax on transactions that, on initial recognition, give rise to equal amounts of taxable and deductible temporary differences. The amendments are effective for annual reporting periods beginning on or after January 1, 2023. The Company has not yet assessed the impact of this amendments on the unaudited interim condensed consolidated financial statements.