

Diamond Estates Wines & Spirits Ltd.

Fiscal 2020 Second Quarter Financial Results

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CORPORATE PARTICIPANTS

Murray Souter

Diamond Estates Wines & Spirits Ltd. — President & Chief Executive Officer

Paul Dowdall

Diamond Estates Wines & Spirits Ltd. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Nick Corcoran

Acumen Capital — Analyst

Operator

Good morning, my name is Nicole, and I will be your conference coordinator today. At this time, I would like to welcome everyone to the Diamond Estates Wines & Spirits Fiscal 2020 second quarter financial results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question & answer session and I will provide instructions for asking questions.

Mr. Souter you may begin your conference...

Murray Souter, President & Chief Executive Officer

Thank you, Operator, and good morning everyone. Welcome to Diamond Estates' fiscal 2020 second quarter conference call. I am Murray Souter, Diamond Estates' president and chief executive officer. I'm joined this morning by Paul Dowdall, our chief financial officer. I'll begin by providing an overview of the quarter and other important developments at the Company. Paul will then discuss our second quarter financials in detail, and I'll conclude with some comments on our strategy and outlook. After that, we will be pleased to answer your questions.

Before we begin, I need to remind listeners that certain statements about future events made on this conference call are forward-looking in nature and are based on certain assumptions and analyses made by the Company. Please refer to the cautionary statement on forward-looking information in our news release this morning for more information.

Our financial performance in the second quarter continued to be impacted by lower export sales. As previously mentioned, this issue relates to our key Chinese distributor, who encountered delays in opening new stores and thus had excess inventory. As I noted on the last conference call, these stores are now open and we expect export sales to begin to recover over the latter half of the fiscal year.

Despite the disappointing export sales, we had a lot of positive results in the second quarter. I want to highlight the fact that every other sales channel in the winery division, apart from export, had solid growth. Of course, we are most excited about the Ontario grocery channel, where our year-over-year sales growth was greater than 20%. We have the number one market share in grocery among VQA wines, and our brands have five of the top 10 market positions and 4 of the top 5 which is quite an accomplishment. 20bees specifically holds each of the top three positions so we are a clear market leader in this channel.

On September 11th, the government released licenses for an additional 87 grocery stores, authorizing them to sell wine. Wine is already available in many of these locations, with more to come in the months ahead. We were pleased to see that these approvals happened on schedule and are excited about the growth of this sales channel as more licenses get handed out in the future.

Turning to British Columbia, we are expanding our national accounts thanks to our Backyard Vineyards winery, which continues to perform well. Backyard brought us some significant new business in the high-margin licensee channel during the second quarter, including supply agreements with restaurants in the Original Joe's Franchise Group such as Original Joe's and State & Main. These are primarily located in Western Canada.

In our agency division, Trajectory Beverage Partners, we are generating sales growth from several of our key partner brands. The agency also brought in some major new partners in the quarter, including: Pierre Chavin Wines, the largest French supplier of organic, low alcohol and no alcohol wines; and Lucien Albrecht, the biggest seller of Alsace wines to the United States. As we reported last year, we changed our strategy in the agency division to focus on a smaller number of high-quality brands, and the results have been positive so far.

In terms of corporate developments, the most important event of the quarter was obviously our strategic partnership with Lassonde Industries, which I discussed on our last conference call in July. Lassonde acquired a 19.9% stake in Diamond Estates for approximately \$7 million, while also entering a commercial brokerage agreement with us. Lassonde is backing us in large part because they share our view that grocery will eventually become the preferred sales channel for Ontario wine drinkers. With Lassonde's support, we expect to grow our Ontario grocery business and are utilizing their sales force to expand our presence in grocery stores in most region across Canada.

Subsequent to the second quarter, we completed an additional private placement in which we raised an additional \$2.3 million. This provided us with further liquidity to pursue our growth objectives.

Overall, we believe our competitive position is strong. Our business is performing well, and we look forward to resuming solid growth as our export business rebounds and as we continue to leverage our partnership with Lassonde Industries.

I'll now invite Paul to review our second quarter financial results in more detail. Paul ...

Paul Dowdall, Chief Financial Officer

Thanks Murray.

Starting with revenue in the second quarter totaled \$7.2 million, a decline of 11.7%, or \$1 million, from \$8.2 million in Q2 last year. The decline was attributable to the temporary decline in export sales that Murray noted earlier. Export sales declined significantly to \$0.2 million, compared to \$1.7 million in Q2 2019. This impact was partially offset by growth in every other winery sales channel. Within the agency division, the revenue decline of \$0.2 million consists of Q2 2019 sales attributed to lost suppliers in that fiscal

being partially offset by \$0.4 million in Q2 2020 sales growth from existing agency partner brands this is in spite of challenges around the flood of low-cost imports.

Gross margin in Q2 2020 was \$3.8 million, or 52.3% of revenue, compared to \$3.7 million, or 45.7% of revenue, in Q2 last year. The significant increase in gross margin percentage was driven by our continued development of the higher-margin retail and licensee channels, positive impact from our premiumization strategy, and increased contribution from contract sales.

Total SG&A expenses were \$3.6 million for the second quarter, compared to \$3.4 million in Q2 last year. The increase was primarily attributable to non-recurring professional fees pertaining to our lending agreement with Bank of Montreal.

EBITDA was \$0.2 million in Q2 2020, compared to \$0.3 million in Q2 2019. The decline was mainly due to the professional fees I just mentioned. After stripping out non-recurring items, we had Adjusted EBITDA of \$0.3 million, compared to \$0.5 million in Q2 last year.

Net loss was \$0.5 million, compared to a net loss of \$0.4 million in Q2 2019.

Turning now to our balance sheet ...

Working capital was \$14.3 million as at September 30, 2019, compared to \$14.9 million as at March 31, 2019, which was our fiscal 2019 year-end. The decline is primarily due to reduced inventory levels and the settlement of a note payable for \$550,000.

Our debt-to-equity ratio as at September 30, 2019 was 0.93:1, down from 1.51:1 as at March 31st. The change was due to a reduction of debt following our private placement with Lassonde Industries in July 2019, partially offset by an increase in lease liabilities that resulted from the adoption of IFRS 16 at the start of fiscal 2020.

I would now like to provide a little more detail on the recent private placement offering that Murray noted earlier. On October 30th, we closed the sale of 12.2 million common shares of Diamond Estates at a price of 19 cents per share for total gross proceeds of approximately \$2.3 million. The private placement consisted of a brokered offering of approximately 6.5 million shares, and a non-brokered offering of approximately 5.7 million shares.

Additionally, on October 30th, we announced that an option holder exercised options for 2 million common shares at an exercise price of 12 cents per share. These options were due to expire on November 10th. A retiring director also had 360,015 vested deferred share units converted into common shares of Diamond Estates on a one-for-one basis.

I will now turn it back over to Murray for some closing comments.

Murray ...

Murray Souter, President & Chief Executive Officer

Thanks Paul.

We are currently nearing the end of our annual grape harvest. As you might have guessed, our harvest in Ontario was impacted by cool weather in the spring and fall. This affected our later ripening varieties, but we managed to bring in the vast majority of our committed and contracted tonnage. This should not impact our growth plans due to our available supply from prior vintages. In British Columbia, meanwhile, we had a good harvest with some minor impact from cold weather and were able to process in excess of our planned tonnage. Overall, our harvest in both regions was a success and provided what we need to fully utilize our capacity in Niagara-on-the-Lake.

While our Niagara winery is performing well, we recently decided to close operations at our Toronto winery. This is a non-core asset for us and was not achieving the returns we require. We are actively seeking a more profitable location in which we can utilize the license associated with this winery.

Meanwhile, we are continuing to advance our Lakeview winery project in British Columbia's Okanagan Valley and are in the final stages of our planning. We anticipate breaking ground in the near future. This is an exciting project, and we are well positioned to advance it after strengthening our liquidity through the two recent financings.

Finally, it is important to note that our Ice-wines recently won two Double Golds, as well as a Silver and a Bronze, at the China Wine & Spirit Awards. This is no ordinary wine competition. It is easily one of the most influential one in the world, as the judges purchase an estimated 90 million bottles a year between them. Thousands of wines from around the world were blind-tasted and scored by the judges. This recognition is a major benefit to us as we look to grow our export business in China, where icewine is highly valued.

That concludes our prepared remarks this morning. Paul and I would now be pleased to answer any questions you may have. Operator, please open the line for questions...

QUESTION AND ANSWER SESSION

Operator

The first question will come from the line of Nick Corcoran with Acumen Capital.

Nick Corcoran, Acumen Capital

Good morning.

Murray Souter, President & Chief Executive Officer

Good morning, Nick.

Nick Corcoran, Acumen Capital

The first question is just on the gross margin. You had a really strong gross margin as a percentage of revenue at 52.3%. How sustainable do you see that going forward or were there any one-time items that might have helped the quarter?

Paul Dowdall, Chief Financial Officer

In terms of one-time items, there weren't any this quarter that stood out in a material fashion. We look at the margin this quarter being representative. We will see fluctuations as different sales channels have different contributions in different months, but by and large we feel that the current quarter's gross margin is largely representative of what we should see going forward with, as mentioned, some minor variations around channel mix.

Nick Corcoran, Acumen Capital

Great. And then in the past there's been some talk on the expansion of wine and beer in grocery and convenience stores in Ontario. Do you have any update on what the current outlook is on that?

Murray Souter, President & Chief Executive Officer

Yeah, I can answer that Nick. I'm intimately involved in it. It is moving forward. The government has been somewhat quiet. They were very vocal up until kind of late summer. It's been very quiet. We know that there have been a number of negotiations ongoing with the beer companies. But we continue to meet, as an industry, with the government. In fact, we have meetings in the very near future and anticipate that they will continue to move that forward.

The political agenda with the government is that they want to modernize retail and make convenience for the consumer a primary benefit and we anticipate that they will continue to execute against that. So, we expect more news in the very near future.

Nick Corcoran, Acumen Capital

Great. And the last question is on the Lassonde partnership. Can you maybe give an update on how that's progressing and what we might look to see in the future on that?

Murray Souter, President & Chief Executive Officer

Yeah, it's progressing extremely well. We have two like-minded partners who see the world very much the same. We've been in numerous meetings. They are actually representing our brands at the brokerage level now within grocery and we're seeing considerable activity, which is very good. They have a large sales force, which we anticipate. We're also exploring other opportunities in terms of packaging and product development as well as other relationships, I won't go into the details, but other relationships that would benefit both parties going forward in terms of operational efficiency and capability.

Nick Corcoran, Acumen Capital

Great. That's all for me. Thank you.

Murray Souter, President & Chief Executive Officer

You're welcome. Thanks, Nick.

Operator

Again, to ask an audio question, please press star one.

We currently show no further audio questions.

Murray Souter, President & Chief Executive Officer

Okay. Thank you very much. I guess that concludes the call for this morning. Thank you for your interest in Diamond Estates and we look forward to speaking with you again after Q3 reporting in the winter. Have a great day.

Operator

This does conclude today's conference call. We thank you for your participation and ask that you please disconnect your line.
