

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE AND SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
**(Unaudited - Prepared by Management)**

**(These unaudited interim condensed consolidated financial statements, prepared by management,  
have not been reviewed by the company's external auditors)**

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
**AS AT SEPTEMBER 30, 2016 AND MARCH 31, 2016**  
**(Unaudited - Prepared by Management)**

	<u>September 30</u> <u>2016</u>	<u>March 31</u> <u>2016</u>
<b>ASSETS</b>		
<b>Current:</b>		
Accounts receivable	\$ 6,087,832	\$ 4,031,973
Inventories	15,385,655	16,891,492
Biological assets	17,480	-
Prepaid expenses	191,728	151,735
	<u>21,682,695</u>	<u>21,075,200</u>
<b>Long term:</b>		
Property, plant and equipment	13,865,728	14,127,405
Intangible assets	3,676,990	3,831,904
	<u>\$ 39,225,413</u>	<u>\$ 39,034,509</u>
<b>LIABILITIES</b>		
<b>Current:</b>		
Bank indebtedness (Note 6)	\$ 9,711,878	\$ 10,217,851
Accounts payable and accrued liabilities	6,119,384	6,239,376
Deposits received	-	46,526
Loan payable - non-controlling interest	238,984	299,967
Current portion of term loans payable (Note 7)	1,135,337	10,386,559
Current portion of finance leases (Note 8)	17,253	-
	<u>17,222,836</u>	<u>27,190,279</u>
<b>Long term:</b>		
Term loans payable (Note 7)	8,700,987	-
Finance leases (Note 8)	46,170	-
	<u>25,969,993</u>	<u>27,190,279</u>
<b>SHAREHOLDERS' EQUITY</b>		
Common shares	8,522,378	8,522,378
Contributed surplus	1,001,177	937,413
Accumulated deficit	(352,361)	(1,711,121)
Non-controlling interest	4,084,226	4,095,560
	<u>13,255,420</u>	<u>11,844,230</u>
	<u>\$ 39,225,413</u>	<u>\$ 39,034,509</u>

**Going concern** (Note 1(b))

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

**Approved on behalf of the Board:**

"David Beutel" Director

"Keith Harris" Director

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF**  
**NET INCOME AND COMPREHENSIVE INCOME**  
**THREE AND SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
**(Unaudited - Prepared by Management)**

	Three month period ended September 30 2016	Six month period ended September 30 2016	Three month period ended September 30 2015 Restated (Note 3)	Six month period ended September 30 2015 Restated (Note 3)
<b>Revenue</b>	<b>\$ 10,264,535</b>	<b>\$ 19,413,655</b>	<b>\$ 7,987,895</b>	<b>\$ 15,214,911</b>
<b>Cost of sales</b>				
Change in inventories of finished goods and raw materials consumed	5,607,952	10,470,617	4,145,425	7,955,547
Freight in and other	244,359	524,349	194,763	329,907
Depreciation of property, plant and equipment used in production	180,264	359,195	170,008	370,916
	<u>6,032,575</u>	<u>11,354,161</u>	<u>4,510,196</u>	<u>8,656,370</u>
<b>Gross profit</b>	<b><u>4,231,960</u></b>	<b><u>8,059,494</u></b>	<b><u>3,477,699</u></b>	<b><u>6,558,541</u></b>
<b>Expenses</b>				
Employee compensation and benefits	1,676,875	3,163,025	1,412,377	2,886,501
General and administrative	688,102	1,425,302	706,886	1,426,325
Delivery and warehousing	334,504	606,317	349,368	565,178
Interest	277,143	564,008	294,133	607,137
Advertising and promotion	247,567	487,920	168,827	308,595
Loss on foreign exchange	57,281	28,861	24,110	29,912
Amortization of intangible assets	87,575	171,103	80,721	161,741
Depreciation of property, plant and equipment used in selling and administration	26,959	51,768	22,195	49,569
Share based compensation	54,730	63,764	37,341	82,603
	<u>3,450,736</u>	<u>6,562,068</u>	<u>3,095,958</u>	<u>6,117,561</u>
<b>Net income and comprehensive income</b>	<b><u>\$ 781,224</u></b>	<b><u>\$ 1,497,426</u></b>	<b><u>\$ 381,741</u></b>	<b><u>\$ 440,980</u></b>
<b>Net income and comprehensive income attributable to:</b>				
Shareholders	\$ 751,896	\$ 1,358,760	\$ 229,602	\$ 258,872
Non-controlling interest	29,328	138,666	152,139	182,108
	<u>\$ 781,224</u>	<u>\$ 1,497,426</u>	<u>\$ 381,741</u>	<u>\$ 440,980</u>
<b>Basic income per share (Note 9)</b>	<b><u>\$ 0.008</u></b>	<b><u>\$ 0.014</u></b>	<b><u>\$ 0.002</u></b>	<b><u>\$ 0.003</u></b>
<b>Diluted income per share (Note 9)</b>	<b><u>\$ 0.007</u></b>	<b><u>\$ 0.013</u></b>	<b><u>\$ 0.002</u></b>	<b><u>\$ 0.002</u></b>

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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**PERIOD FROM APRIL 1, 2015 TO SEPTEMBER 30, 2016**  
**(Unaudited - Prepared by Management)**

	Common shares		Contributed surplus	Accumulated deficit	Shareholders' equity	Non-controlling interest	Total
	Shares	Amount					
<b>As at April 1, 2015 (Restated (Note 3))</b>	<b>73,403,749</b>	<b>\$ 39,578,798</b>	<b>\$ 731,272</b>	<b>\$ (34,108,334)</b>	<b>\$ 6,201,736</b>	<b>\$ 4,091,403</b>	<b>\$ 10,293,139</b>
Proceeds on issuance of common shares	26,733,288	3,207,995	-	-	3,207,995	-	3,207,995
Share issuance costs	-	(160,383)	-	-	(160,383)	-	(160,383)
Net income and comprehensive income	-	-	-	258,872	258,872	182,108	440,980
Share based compensation	-	-	82,603	-	82,603	-	82,603
Reduction of stated capital and deficit	-	(34,104,032)	-	34,104,032	-	-	-
<b>As at September 30, 2015 (Restated (Note 3))</b>	<b>100,137,037</b>	<b>8,522,378</b>	<b>813,875</b>	<b>254,570</b>	<b>9,590,823</b>	<b>4,273,511</b>	<b>13,864,334</b>
Net loss and comprehensive loss	-	-	-	(1,965,691)	(1,965,691)	(220,451)	(2,186,142)
Share based compensation	-	-	123,538	-	123,538	-	123,538
Property, plant and equipment contributed by non-controlling interest	-	-	-	-	-	42,500	42,500
<b>As at March 31, 2016</b>	<b>100,137,037</b>	<b>8,522,378</b>	<b>937,413</b>	<b>(1,711,121)</b>	<b>7,748,670</b>	<b>4,095,560</b>	<b>11,844,230</b>
Net income and comprehensive income	-	-	-	1,358,760	1,358,760	138,666	1,497,426
Share based compensation	-	-	63,764	-	63,764	-	63,764
Draw from KDC by non-controlling interest	-	-	-	-	-	(150,000)	(150,000)
<b>As at September 30, 2016</b>	<b>100,137,037</b>	<b>\$ 8,522,378</b>	<b>\$ 1,001,177</b>	<b>\$ (352,361)</b>	<b>\$ 9,171,194</b>	<b>\$ 4,084,226</b>	<b>\$ 13,255,420</b>

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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
(Unaudited - Prepared by Management)

	2016	2015 Restated (Note 3)
	<u>                    </u>	<u>                    </u>
<b>Operating activities</b>		
<b>Net income</b>	\$ 1,497,426	\$ 440,980
Add (deduct) items not affecting cash		
Depreciation of property, plant and equipment	410,963	420,485
Amortization of intangible assets	171,103	161,741
Share based compensation	63,764	82,603
Loss on disposal of property, plant and equipment	3,502	-
Interest expense	564,008	607,137
Interest paid	<u>(604,008)</u>	<u>(587,137)</u>
	2,106,758	1,125,809
 <b>Change in non-cash working capital items</b>		
Accounts receivable	(2,055,859)	(2,489,090)
Inventories	1,505,837	1,868,614
Biological assets	(17,480)	(20,349)
Prepaid expenses	(39,993)	69,801
Accounts payable and accrued liabilities	(79,992)	(992,593)
Deposits received	<u>(46,526)</u>	<u>(27,955)</u>
	1,372,745	(465,763)
 <b>Investing activities</b>		
Purchase of property, plant and equipment	(107,525)	(54,733)
Purchase of intangible assets	(16,189)	(15,351)
Proceeds from disposition of property, plant and equipment	<u>20,570</u>	<u>-</u>
	<u>(103,144)</u>	<u>(70,084)</u>
 <b>Financing activities</b>		
Bank indebtedness	(505,973)	(996,879)
Repayment of loan payable - non-controlling interest	(60,983)	(517,481)
Repayment on term loans payable	(550,235)	(997,405)
Repayment of obligations under capital leases	(2,410)	-
Net proceeds from issuance of common shares	-	3,047,612
Draw from KDC by non-controlling interest	<u>(150,000)</u>	<u>-</u>
	<u>(1,269,601)</u>	<u>535,847</u>
 <b>Change in cash</b>	-	-
Cash, beginning of period	-	-
<b>Cash, end of period</b>	<u>\$ -</u>	<u>\$ -</u>
<b>Non-cash transactions:</b>		
Property, plant and equipment acquired under finance leases (Note 8)	<u>\$ 65,833</u>	<u>\$ -</u>

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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE AND SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
**(Unaudited - Prepared by Management)**

1. **NATURE OF OPERATIONS AND GOING CONCERN**

(a) **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 operation and consolidation of wineries, wine, spirit, and beer distribution agencies, and sales and brand development. 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 Kirkwood Diamond Canada Partnership ("KDC") are located at 1155 North Service Road West, Oakville, Ontario, L6M 3E3.

(b) **Going concern**

The accompanying unaudited interim condensed 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. Accordingly, they do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business as they come due in the foreseeable future and at amounts different from those in the accompanying unaudited interim condensed consolidated financial statements.

While the Company has generated a profit in the six month period ended September 30, 2016 of \$1,497,426 (six month period ended September 30, 2015 - \$440,980), it has incurred repeated losses as net loss and comprehensive loss for the year ended March 31, 2016 was \$1,745,162 (year ended March 31, 2015 - \$1,710,255) and reported a working capital deficiency as at March 31, 2016 of \$6,115,079. The operations and net loss for the year ended March 31, 2016 resulted in the Company being in breach of one of its financial covenants under the terms of its current credit agreement with Meridian Credit Union ("MCU"), its primary lender (*see note 6(b)*). This covenant breach required the non-current portion of the MCU term loans of \$9,264,045 as at March 31, 2016 to be classified as a current liability under IFRS (*see note 7*). As of July 19, 2016, MCU had indicated in writing that it was prepared to waive the default, subject to no further defaults occurring and the expectation that the covenant in default would be met at the next stipulated reporting period, being June 30, 2016. The Company was in compliance with the terms of this financial covenant as at both June 30, 2016 and September 30, 2016, such that the non-current portion of the MCU term loans has been classified appropriately as long term. MCU has also lowered the debt service ratio for fiscal 2017 as detailed in (*see note 6(a)*). These circumstances still 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.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE AND SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
**(Unaudited - Prepared by Management)**

1. **NATURE OF OPERATIONS AND GOING CONCERN, CONTINUED**

The Company's ability to meet the covenant measurements under the terms of its credit agreements with its lender is still dependent upon continued improvements in profitable commercial operations. However, there is no assurance these circumstances will continue to be successful or sufficient. These unaudited interim condensed 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 unaudited interim condensed consolidated balance sheet classifications that would be necessary if the going concern assumption were inappropriate. Such adjustments could be material.

2. **SIGNIFICANT ACCOUNTING POLICIES**

**Basis of presentation and statement of compliance**

These unaudited interim condensed consolidated financial statements have been prepared in accordance with IAS 34 "Interim Financial Reporting" as issued by the IASB, and accordingly do not include all the information required for full annual financial statements by IFRS. They have been prepared using the same accounting policies that were described in note 2 to the Company's annual consolidated financial statements for the year ended March 31, 2016 which were prepared in accordance with IFRS as issued by the IASB.

The note disclosures for these unaudited interim condensed consolidated financial statements only present material changes to the disclosures found in the Company's audited consolidated financial statements for the years ended March 31, 2016 and 2015

**Finance leases**

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

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

The unaudited interim condensed consolidated financial statements have not been reviewed by the Company's external auditors. They were authorized for issuance by the Board of Directors on November 10, 2016.

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

**DIAMOND ESTATES WINES & SPIRITS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**THREE AND SIX MONTH PERIODS ENDED SEPTEMBER 30, 2016 AND 2015**  
**(Unaudited - Prepared by Management)**

3. **RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS AND RESTATEMENT**

(a) **Early adoption of IAS 16: "Property, Plant, and Equipment" and IAS 41: "Agriculture"**

During May 2014 the IASB issued amendments to IAS 16 – Property, Plant, and Equipment and IAS 41 – Agriculture, which requires bearer plants to be classified as property, plant, and equipment and accounted for under IAS 16. The amended standards are effective for annual periods beginning on or after January 1, 2016.

The Company controls bearer plants consisting of grape vines and has elected to apply these amendments effective April 1, 2015, which is prior to the mandatory effective date. The earliest comparative period presented in the financial statements after adopting the amended standards began on April 1, 2014. The Company has elected to measure bearer plants using their fair value on that date as their deemed cost.

The following tables summarize the impact of adopting amended IAS 16 – Property, Plant, and Equipment and IAS 41 – Agriculture on the unaudited interim condensed consolidated statements of net income and comprehensive income and cash flows for the six month period ended September 30, 2015. The impact of adopting these standards on the consolidated statements of financial position has previously been reported upon in the audited consolidated financial statements for the year ended March 31, 2016.

Impact on consolidated statements of net income and comprehensive income	Three month period ended September 30, 2015 (as reported) \$	Impact of IAS 16 and IAS 41 changes \$	Three month period ended September 30, 2015 (as restated) \$	Six month period ended September 30, 2015 (as reported) \$	Impact of IAS 16 and IAS 41 changes \$	Six month period ended September 30, 2015 (as restated) \$
Depreciation of property, plant and equipment	191,127	1,076	192,203	418,333	2,152	420,485
Net income and comprehensive income	382,817	(1,076)	381,741	443,132	(2,152)	440,980
Net income per share: basic and diluted	0.00	0.00	0.00	0.00	0.00	0.00



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3. **RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS AND RESTATEMENT, CONTINUED**

(a) **Early adoption of IAS 16: "Property, Plant, and Equipment" and IAS 41: "Agriculture", continued**

<b>Impact on consolidated statements of cash flows <sup>(ii)</sup></b>	<b>Six month period ended September 30, 2015 (as reported) \$</b>	<b>Impact of IAS 16 and IAS 41 changes \$</b>	<b>Six month period ended September 30, 2015 (as restated) \$</b>
Net income for period	443,132	(2,152)	440,980
Depreciation of property, plant and equipment	418,333	2,152	420,485
Cash flow from operating activities	(465,763)	-	(465,763)

(i) Under the amended standards, grape vines are within the scope of property, plant, and equipment rather than biological assets. The Company elected to measure the grape vines at fair value at April 1, 2014 and to use this measurement basis as the deemed cost when applying IAS 16 after this date. In applying IAS 16, the Company amortizes grape vines on owned property over a 20 year period. Prior to adoption of the amended standards, the grape vines were measured at fair value less cost to sell at each reporting period and revaluation adjustments were recorded in change in inventories of finished goods and raw materials consumed in the consolidated statements of net income and comprehensive income.

(ii) Certain items within operating activities in the consolidated statements of cash flows have been reclassified as a result of adopting the IAS 16 and IAS 41 amendments as illustrated above. Other than presentation, there was no impact on the consolidated statements of cash flows as a result of the adoption of the amendments to IAS 16 and IAS 41.

(b) **Early adoption of IAS 1:**

The Company has chosen to early adopt the provisions of IAS 1 to assist users in better understanding the Company's financial performance, namely through the use of sub-totals (in the statement of net income and comprehensive income) to present cost of goods sold and gross profit calculations. The comparative numbers have been reclassified to conform to the presentation adopted in the current year with no impact to previously reported equity, net income and comprehensive income or cash flows.

(c) **Restatement of comparative balances**

The comparative financial statements and notes thereto for the six month period ended September 30, 2015 have been restated to reflect a correction in classification of certain costs relating to revenue recognition. The Company has reviewed its financial statement presentation of various costs, including customer incentive programs (such as Air Miles), discount programs and product returns, previously included in advertising and promotion and excise taxes included in change in inventories of finished goods and warehousing and receiving. Following this review, management has determined that these costs are better presented as deductions from revenue.

**DIAMOND ESTATES WINES & SPIRITS INC.**  
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3. **RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS AND RESTATEMENT, CONTINUED**

The impact of the restatement of the statements of net income and comprehensive income for the six month period ended September 30, 2015 is a reduction of \$725,484 in revenues and offsetting reductions of \$586,231 in advertising and promotion, \$84,717 in change in inventories of finished goods and raw materials consumed and \$54,536 in delivery and warehousing. There was no impact to previously reported equity, net income and comprehensive income or cash flows.

4. **NEW AND REVISED IFRS STANDARDS AND INTERPRETATIONS NOT YET ADOPTED**

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

- (a) **IFRS 9: "Financial Instruments: Classification and Measurement of Financial Assets and Financial Liabilities"** was issued by the IASB in July, 2014 and will replace IAS 39 "Financial Instruments: Recognition and Measurement". In addition, IFRS 7 "Financial Instruments: Disclosures" was amended to include additional disclosure requirements on transition to IFRS 9. The mandatory effective date of applying these standards is for annual periods beginning on or after January 1, 2018. The standard uses a single approach to determine whether a financial asset is measured at amortized cost or fair value. The approach is based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used. The standard requires that for financial liabilities measured at fair value, any changes in an entity's own credit risk are generally to be presented in other comprehensive income instead of net earnings. A new hedge accounting model is included in the standard, as well as increased disclosure requirements about risk management activities for entities that apply hedge accounting.
- (b) **IFRS 15: "Revenue from Contracts with Customers"** provides new requirements for recognizing revenue. The new standard's core principle is for a company to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. IFRS 15 also included a cohesive set of disclosure requirements that would result in an entity providing comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers. The new standard provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple element arrangements. The IASB has decided to propose to defer the effective date to January 1, 2018 from the previously expected effective date of January 1, 2017.
- (c) **IFRS 16 "Leases"** was issued in January 2016 and will ultimately replace IAS 17, "Leases". IFRS 16 specifies how an entity will recognize, measure, present and disclose leases. The standard provides a single lessees accounting model, requiring lessees to recognize assets and liability for all leases unless the lease term is 12 months or less or the underlying asset has a low value. The standard is effective for annual periods beginning on or after January 1, 2019 and must be applied retrospectively.

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

- (d) **IAS 7 "Statement of Cash Flow"** has been revised to incorporate amendments issued by the IASB in January 2016. The amendments require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted.

The Company has not early adopted any of these standards, but management is currently assessing the impact of their application in the unaudited interim condensed consolidated financial statements and intends to adopt these standards at their effective dates.

5. **SEASONALITY**

Revenue is subject to seasonal variation in demand from its customers for beverage alcohol products. For example, export sales are clustered in the spring and fall when climate conditions are optimal for intermodal transportation. The fourth quarter is traditionally the lowest for revenue in all major sales channels due to softness in demand during the winter months.

6. **BANK INDEBTEDNESS**

On September 19, 2016, the Company signed a new credit agreement with Meridian Credit Union ("MCU"), its primary lender, to replace the previous agreements dated March 31, 2016, January 12, 2015 and amended on March 25, 2015. In addition, on January 23, 2015, KDC entered into a credit agreement with MCU to provide a dedicated working capital facility for the Partnership (*see note 6(c)*).

(a) ***Updated Meridian Credit Union agreement***

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

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

All other major components, including operating line limit, term loan amounts, interest rates, due date dates and security remained unchanged.

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6. **BANK INDEBTEDNESS, CONTINUED**

(b) ***Covenant measurement: breach and subsequent compliance***

As at March 31, 2016, the Company was not in compliance with the covenant relating to minimum effective net worth. This covenant breach required the non-current portion of the MCU term loans of \$9,264,045 as at March 31, 2016 to be classified as a current liability under IFRS (see notes 1(b) and 7). As of July 19, 2016, MCU had indicated in writing that it was prepared to waive the default, subject to no further defaults occurring and the expectation that the covenant in default would be met at the next stipulated reporting period, being June 30, 2016. The Company was in compliance with the terms of this financial covenant as at both June 30, 2016 and September 30, 2016.

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

On April 7, 2016, KDC entered into a new credit agreement with Canadian Imperial Bank of Commerce ("CIBC") (see note 6(d)). The transaction closed on June 2, 2016 when existing obligations to MCU were repaid in full.

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

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

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

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7. **TERM LOANS PAYABLE**

As more fully described in note 6(a), the Company has various term loans with MCU under its new credit agreement dated September 19, 2016, the terms and conditions of which with respect to the term loans are virtually unchanged from the previous credit agreement dated March 31, 2016. As at September 30, 2016, the amounts outstanding were as follows:

	<b>September 30 2016</b>	<b>March 31 2016</b>
Meridian Credit Union term loans:		
Non-revolving loan #1	\$ 8,225,927	\$ 8,563,784
Non-revolving loan #2	1,309,093	1,370,684
Non-revolving loan #3	301,304	452,091
	9,836,324	10,386,559
Less: current portion	(1,135,337)	(1,122,514)
Remaining portion classified as current due to covenant breach (Note 6(b))	-	(9,264,045)
	<b>\$ 8,700,987</b>	<b>\$ -</b>

8. **FINANCE LEASES**

In August 2016, the Company executed a Master Lease Agreement (“MLA”) with an equipment finance and leasing company to acquire automotive equipment. As at September 30, 2016, the Company has acquired two vehicles and expects to acquire up to five additional vehicles by the end of the fiscal year. The leases are for a 48 month period, expiring in July 2020 and provides for the transfer of ownership of the automotive equipment at the end of the lease term at a pre-determined price. Accordingly, these lease is classified as a finance lease and a corresponding asset and lease obligation was recognized in the financial statements. The effective interest rates implicit in each lease range from 3.31% to 3.33%.

The following is a schedule of future minimum annual lease payments for vehicles under finance leases together with the balance of the obligation as at September 30, 2016.

	<b>Minimum lease payments</b>	<b>Present value of minimum lease payments</b>
Not later than one year	\$ 19,098	\$ 17,253
Later than one year and up to lease expiry	48,172	46,170
	67,270	63,423
Less: interest	(3,847)	-
Total obligations under finance leases	63,423	63,423
Less: current portion	(17,253)	(17,253)
	<b>\$ 46,170</b>	<b>\$ 46,170</b>

Vehicles acquired under finance leases during the three month period ended September 30, 2016 totalled \$65,833 (three month period ended September 30, 2015 - \$NIL). Interest expense on the finance leases for the three and six month periods ended September 30, 2016 was \$308 and \$308 respectively (three and six month periods ended September 30, 2015 - \$NIL and \$NIL respectively).

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9. **INCOME PER SHARE**

Basic income per share is computed using the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the three and six month periods ended September 30, 2016 were 100,137,037 and 100,137,037 respectively (three and six month periods ended March 31, 2016 - 100,137,037 and 95,900,614 respectively).

As at September 30, 2016, the following potentially dilutive equity instruments were all outstanding: (1) Nil warrants (2015 - 288,220), (2) 6,682,400 options (2015 - 6,682,400), and (3) 1,124,882 deferred share units (2015 - Nil). The fully diluted number of common shares outstanding for the six month periods ended September 30, 2016 and 2015 were 107,944,319 and 107,107,657 respectively.

10. **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 DSU Plan from 1,000,000 to 2,000,000, which is approximately 2.0% of the current issued and outstanding. The DSU Plan provides that the maximum number of DSUs issuable to insiders (as that term is defined by the Exchange) pursuant to the DSU Plan, together with any common shares issuable pursuant to any other security-based compensation arrangement of the Company, will not exceed 10% of the total number of outstanding common shares.

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

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11. **SEGMENTED INFORMATION**

**Business segments**

The Company operates in two business segments, namely (i) sales of manufactured wines and (ii) agency sales. The following table presents selected financial information associated with each of these segments for the six month periods ended September 30, 2016 and 2015:

	<u>Six month period ended September 30,</u> <u>2016</u>		
	Agency	Manufactured wines	Consolidated
	\$	\$	\$
Gross revenue	8,818,058	10,925,468	19,743,526
Inter-segment revenue	<u>(329,871)</u>	<u>-</u>	<u>(329,871)</u>
Net revenue	<u>8,488,187</u>	<u>10,925,468</u>	<u>19,413,655</u>
Gross profit	3,651,320	4,408,174	8,059,494
Interest on bank indebtedness	70,693	493,315	564,008
Depreciation and amortization	190,078	391,988	582,066
Additions of property, plant and equipment and intangible assets	6,955	116,759	123,714
Intangible assets	2,906,295	770,695	3,676,990
Total assets	11,660,505	27,564,908	39,225,413
Total liabilities	6,703,113	19,266,880	25,969,993

	<u>Six month period ended September 30,</u> <u>2015</u>		
	Agency	Manufactured wines	Consolidated
	\$	\$	\$
Gross revenue	8,177,698	7,326,570	15,504,268
Inter-segment revenue	<u>(289,357)</u>	<u>-</u>	<u>(289,357)</u>
Net revenue	<u>7,888,341</u>	<u>7,326,570</u>	<u>15,214,911</u>
Gross profit	3,800,390	2,758,151	6,558,541
Interest on bank indebtedness	90,560	516,577	607,137
Depreciation and amortization	185,567	396,499	582,066
Additions of property, plant and equipment and intangible assets	-	70,084	70,084

**Statement of financial position balances as at  
March 31, 2016**

Intangible assets	3,069,155	762,749	3,831,904
Total assets	10,390,824	28,643,685	39,034,509
Total liabilities	5,570,368	21,619,911	27,190,279

Transactions between segments are measured at the exchange amount, which approximates fair value.

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11. **SEGMENTED INFORMATION, CONTINUED**

**Geographic information**

	<u>2016</u>	<u>2015</u>
<b><i>Revenue</i></b>		
Canada	\$ 14,983,390	\$ 13,252,070
China and other	<u>4,430,265</u>	<u>1,962,841</u>
	<u>\$ 19,413,655</u>	<u>\$ 15,214,911</u>

All of the Company's assets are located in Canada.

12. **COMPARATIVE FIGURES**

Certain of the comparative figures have been reclassified, where applicable, to conform to the presentation adopted in the current quarter.