FINAL TRANSCRIPT

Diamond Estates Wines & Spirits Inc.

Q4 2017 Financial Results Conference Call

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PRESENTATION

Operator

Good morning. My name is Joanna (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Diamond Estates Wines & Spirits Q4 2017 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-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, then the number 2. Thank you.

Mr. Souter, you may begin your conference.

Murray Souter — Chief Executive Officer and President, Diamond Estates Wines & Spirits Inc.

Thank you, Joanna, and good morning, everyone. Welcome to Diamond Estates' financial results conference call for the fourth quarter and the 12 months ended March 31, 2017.

As Joanna said, my name is Murray Souter, and I am the—Diamond Estates' President and Chief Executive Officer. I'm joined today by Alan Stratton, our Chief Financial Officer, who will speak a little later.

I'll start this call by providing an overview of the results for fiscal 2017 and some other key developments at the Company and Alan will then discuss the financials in depth, and I'll conclude with our comments on our strategy and broader wine and spirits market. After that, we will be pleased to answer any questions you may have.

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.

2017 was a transformational year for Diamond Estates. Our financial results improved significantly from the prior year, driven in part by much larger—much higher export sales.

Our export business has grown strongly over the past year and a half, particularly in China, where we have one of the best strategic positions of any Canadian producer.

We also benefitted from the start of wine sales in the Ontario grocery channel. This is the single most significant opportunity our industry has seen in decades.

We also completed an important $8.8 million equity financing that strengthened our balance sheet and enabled us to pursue some growth initiatives, including the capacity expansion at our winery.

Let me briefly touch on our financial results, which were the best in the history of the Company. We reported revenue of $34.3 million in the fiscal year, up 17.5 percent from the prior year. Our EBITDA rose nearly 85 percent to $2.8 million, up from 1.5 million in fiscal 2016. This reflects the operating leverage we were generating as our sales increased.

We reported positive net income for fiscal 2017 of roughly $0.5 million compared to a loss of 1.7 million last year. We're a profitable company, and we expect to be much more profitable in the future.

You'll note our fourth quarter results were slightly weaker than the prior three quarters in fiscal 2017, primarily reflecting the seasonal nature of our business. We are pleased that our Q4 gross margins and earnings improved over last year, due in part to stronger export sales and sales to VIA Rail, but this improvement was partially offset by a $300,000 provision to clear out excess inventory in the agency business, and that reflects the segment's underperformance.

Now I want to discuss the Ontario grocery channel. We're one of the three largest suppliers to Ontario grocery stores with roughly a 12 percent share of market, which is significantly above our overall market share. You can now find our products in all 69 stores that are open, and that number will grow significantly after the next tranche of licences gets released.

Every single grocer that currently sells wine in Ontario is carrying our Diamond products. As a reminder, grocery stores are obligated to show strong support for local VQA wine. Half of the locations are required to carry 100 percent VQA wine, and the other half are required to carry 50 percent VQA wines. As a leading VQA producer, we are ideally positioned to capitalize on this opportunity.

We said before that over time we expect grocery stores to become Ontario's preferred retail channel for wine, just as they are in the United States and other jurisdictions globally. The strong grocery sales we're seeing so far have only strengthened our belief in that case.

Moreover, given our strong representation in the grocery channel, this represents an outstanding opportunity for us to continue to grow our business.

In fact, a number of our brands are number one in their varietal categories, including our 20 Bees Cab Merlot, Chardonnay and Pinot Grigio, as well as our FRESH Moscato. Additionally, a number of our brands also ranked number two in their respective varietal categories.

Let me just now discuss the important internal events that have been going on in the Company. We recently broke ground on our capacity expansion at the Lakeview winery, which will increase our grape processing and storage capacity to support growing sales. This will give us improved economies of scale, leading to better operating leverage and profitability. The capital cost of this project is approximately $4.7 million.

On May 17th, we had another landmark moment at Lakeview winery with the grand opening of our new retail store. Many of you were there.

If you're ever in Niagara-on-the-Lake, I encourage you to come and see it. It's a very impressive facility. We have over 2,500 square feet of modern retail space with an attractive tasting area. We built this store because we felt it would drive significantly higher direct sales of our products at the winery, and so far we're pleased to see it is delivering as planned.

Finally, we made the decision to acquire 100 percent ownership of our agency business by buying out our joint venture partner. The cost of the acquisition was $4.4 million, and the transaction closed subsequent to our year-end on May 5th.

We're very excited by the opportunity. The agency business, Kirkwood Diamond Canada, has low capital intensity and is capable of delivering strong free cash flow. It's a natural complement to our winery business and harnesses our experience in distribution.

As I indicated, the business is currently underperforming, and we are undertaking a number of initiatives to improve operations.

As background, Kirkwood Diamond currently sells more than 1.4 million cases of alcoholic beverages a year, and it's the fifth largest independent sales agency in Canada. Since we started the Kirkwood Diamond partnership in 2014, the business has grown every year on both a case and a dollar basis. It's an attractive business model, and when we add our new brands and revenue to our stable, the operating leverage can be very positive.

We're fortunate to have several large core brands that contribute a significant amount of the division's revenue. Those brands are owned by large clients who we expect to be with us for the years to come.

We think that there is a real opportunity to bring more value out of the business as a full owner. We're currently in the planning stages of a new vision for the agency division, which will leverage our regional experience as we develop our national strategy on our approach to grocery and on-premise accounts, two areas that are of great interest to our suppliers.

We're also going to invest in new systems and integrate the back-office functions to unlock additional cost synergies, and this should lead to improvements in distribution, sales, and brand management. We'll tell you more about our progress over the next several quarters.

I'll now invite Alan to review our fiscal 2017 financial results in greater detail.

Alan?

Alan Stratton — Chief Financial Officer, Diamond Estates Wines & Spirits Inc.

Thank you, Murray. As Murray reported, we had revenue last year of $34.3 million, up 17.5 percent from the prior year.

This was led by strong export sales in the winery division, which increased nearly 87 percent year over year to $6 million. However, revenue in other winery sales channels also rose a healthy 14.4 percent to $11.7 million. Put together, total revenue in the winery division was $17.7 million, an increase of 31.7 percent from 13.4 million in fiscal 2016.

In the agency business, revenue grew to $16.6 million, an increase of 5.3 percent compared to 15.8 million last year. This increase was driven primarily by growth in sales of prominent global brands that the agency division represents across Canada.

Gross margin in fiscal 2017 was $14.2 million or 41.5 percent of revenue. That compares to 11.8 million or 40.6 percent of revenue last year. The increase was driven by the winery division and was due to both higher export sales and lower promotional spending in the LCBO channel.

Gross margin declined very slightly in the agency division due to a decision to clear out excess inventory.

Total operating expenses were $11.4 million, up from 10.3 million last year. As Murray mentioned, we are starting to generate significant operating leverage at our winery as our sales increase. As a result, our operating expenses as a percentage of revenue fell to 33.2 percent in fiscal 2017 compared to 35.3 percent last year. That drove our record bottom-line performance.

EBITDA jumped 84.9 percent year over year to $2.8 million compared to 1.5 million in fiscal 2016. We also generated positive net income of approximately $0.5 million compared to a net loss of $1.7 million last year.

Now I'll discuss our fiscal fourth quarter results. As Murray noted earlier, the January to March quarter is a seasonally slow period, so our results are generally weaker than other quarters. Wine consumption is relatively low in this period compared to the rest of the year, and cold temperatures prevent us from shipping large quantities of product overseas.

That said, the results from our winery division were significantly stronger than last year due to the operating leverage we're getting at the Lakeview winery.

Overall revenue in Q4 was $6.1 million, essentially unchanged from Q4 2016. Revenue was slightly higher in the winery division and slightly lower in the agency division, but overall it was in line with expectations.

Gross margin increased to $2.3 million or 39 percent of revenue, up from 1.9 million or 31 percent of revenue last year. That was driven by higher export sales and sales to VIA Rail in the winery division.

Gross margin in the agency division was relatively flat year over year.

Operating expenses were $3.2 million, down from 3.8 million in Q4 2016. This decline was largely due to a write-off last year of approximately $650,000 related to design and development plans at the Lakeview winery. These plans were ultimately dropped in favour of our current multiphase expansion plan.

EBITDA was negative $0.5 million in the quarter compared to negative $0.8 million last year, and we reported a net loss of approximately $1 million, a significant improvement from the loss of 2.1 million in Q4 2016.

Turning to our balance sheet. Our working capital at March 31, 2017, was $8.4 million. That compares to adjusted working capital of $3.2 million on March 31, 2016, which excludes long-term debt that was then classified as current.

Our debt to equity ratio improved substantially to 0.68:1 compared with 1.76:1 at the last fiscal year-end. As you can see, the $8.8 million equity offering completed in December put us in a much stronger financial position. While we are currently under-levered, that will change in fiscal 2018 with the acquisition of the minority interest in our agency division, and the first phase of the expansion at the winery.

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

Murray Souter

Thank you, Alan. Fiscal 2017 was a very successful year for Diamond Estates, and we're even more excited about fiscal 2018 and beyond.

Our internal growth strategies are coming to fruition. We've recently opened, as I said earlier, our new retail store; we've broken ground on our winery expansion project; and have consolidated ownership in the agency business. These are three very important pillars that we expect will drive significant earnings growth in years ahead. We look forward to providing more updates on these exciting opportunities in future quarters.

At the same time, we're also keen to grow our winery business through acquisitions. The Ontario wine industry is highly fragmented. As many of you know, more than half of the market share is spread amongst roughly 150 small producers.

These companies are generally too small to attract the interest of the larger operators in our space, but some of them could be highly meaningful and profitable for Diamond Estates. We'll continue to watch the market closely for opportunities. With our improved balance sheet and history of successful acquisitions, we are capable of moving very quickly if the right opportunity arises.

Finally, I'd like to note that our industry fundamentals are extremely robust. Statistics Canada recently reported that in fiscal 2016, Canadians bought a record $7 billion of wine, up 4.1 percent from the previous fiscal year. Ontario sales were up 5.1 percent in the same period to $2.4 billion.

Every year we're seeing wine share of overall alcohol sales go up. Wine is becoming increasingly popular amongst the millennial cohort in Canada and around the world. They are now the largest wine-consuming cohort, meaning our industry has a major demographic advantage.

Additionally, the introduction of wine into Ontario grocery stores is making it more convenient than ever for consumers to get their hands on our products.

That concludes my remarks. Alan and I would now be pleased to answer any questions you may have.

Joanna, please open the floor for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, as a reminder should you have any questions at this time, please press *, followed by 1.

And your first question is from Bob Gibson from PI Financial. Bob, please go ahead.

Bob Gibson — PI Financial

Good morning. Thanks for taking my call.

Murray Souter

Thank you, Bob. How are you?

Bob Gibson

I'm good. You said that Q4 numbers were good because of increased export sales. I kind of did a back of the envelope, and it looked like Chinese sales were flat in the quarter.

Murray Souter

Sorry, sales were flat? Alan?

Bob Gibson

That's what it seemed to be; about 200,000.

Alan Stratton

That's correct, Bob. Yeah. No, the Q4, as we indicated, we can't ship much to China or overseas because of the winter and the temperature, so we seasonally see very low volume of export sales. And that's why if you look at the winery division our revenue was up slightly in the quarter, but export revenue didn't drive that.

Bob Gibson

Okay. And can you talk to the LCBO potential strike and how that might affecting your sales?

Murray Souter

Certainly. Well, first of all, we don't anticipate if there is a strike it will be very long. The last one we saw I believe it was four years ago, the consumer kind of cleaned out the LCBO in the days prior to it. They settled and then inventory went back into the system, so you got a spike for four days.

The LCBO, in the conversations we've had with them, they anticipate continuing to operate a limited number of their stores, and their DC will continue—their two large DCs will continue to operate with management.

We anticipate that it really will not affect our business as much as it will shipments from the LCBO to their stores. We sell in 30 to 60 days in advance, so that inventory is already in place and in the stores. And even if the strike is 10 days or 2 weeks, we wouldn't anticipate that it'll significantly diminish our shipments because those have already occurred, and it'll level out after that. So it probably will not affect our quarterly earnings.

Bob Gibson

Okay. The 650,000 write-off on the design costs, where should—where did you put that?

Alan Stratton

That was a loss on disposition of property, plant, and equipment in fiscal 2016.

Murray Souter

And it related to—

Bob Gibson

Oh the—

Murray Souter

Yeah.

Alan Stratton

Yeah.

Murray Souter

And it related designs from 2009.

Bob Gibson

Right. Okay. And can you give me a little more colour on the multiphase expansion? How is it looking? And what are the milestones?

Murray Souter

It's looking rather muddy right now today, but it's—yeah. The plan is as we go through the next four, we—Bob, as you know, we look at everything from a harvest standpoint, which is slightly different than from a fiscal standpoint, so I'll speak in harvest years. So for harvest 2017, we need looking at our forward projections with both export, our forecast for grocery and the LCBO, as well as on-premise, we look to be needing to add in significant capacity, both for this harvest 2017 and

2018, to the tune of about 1.6 million litres of capacity. We have about 4.5 million litres currently in the system, and generally you operate capacity in this industry at about 80 to 83 percent of your design capacity. So we need to add in the 1.6 to support sales in calendar 2018 and calendar 2019.

And then the next phase will happen the year after that where we'll be adding in somewhere between 1 million and 2 million litres, and it may be over two years through that. So over the next four harvests we'll be adding in an average—if you were to average it out—somewhere between 800,000 litres and 1 million litres each year. And the reason we're stepping that, of course, is that there's a number of factors. Mother Nature can cause all sorts of angst, you can have record harvests and you can have diminished harvests, and we want to be prudent with our capital expenditures as we go forward so that we're—always got a little bit of dry powder in the bank.

Bob Gibson

Great. Thanks. And then lastly, has Kirkwood made any brand wins from customers?

Murray Souter

From the standpoint of suppliers?

Bob Gibson

Yes.

Murray Souter

We made a number over the past fiscal year; expanded Charles Wells; added in Anciano. There's a number of major brands that we've added. Right now, we're doing a lot of work around filling in where we are the representatives in different markets, but not maybe in Ontario or BC, for example.

That tends to be the nature of the industry. It tends to be very fragmented. And we've got with our national platform, we solve a lot of issues for suppliers from the standpoint of being able to represent them in all markets, including Quebec. And we're doing a lot of work with our suppliers to fill in those gaps. It's low-hanging fruit. We are pitching some very major pieces of business, and hopefully they'll be coming our way in the future as well.

Bob Gibson

Great. Thanks so much.

Murray Souter

You're welcome.

Operator

Thank you. Your next question is from Corey Hammill from Paradigm. Corey, please go ahead.

Corey Hammill — Paradigm Capital

Good morning, guys.

Murray Souter

Good morning, Corey.

Corey Hammill

A few things; I'm going to jump around. One on the strike—

Murray Souter

Yeah.

Corey Hammill

—at the grocery store, so the way I understand it is that there is inventory sitting at the distribution centre, and those distribution centres to feed the grocery stores should continue to operate in the very near term anyway if there's a strike. That's what you believe as well?

Murray Souter

Correct.

Corey Hammill

All right. And how much inventory in terms of days or weeks do you think you guys have sitting at those distribution centres?

Murray Souter

We would have a significant amount. We actually monitor that inventory. And while I'm speaking here and stretching time out, I'm going to actually look up the result.

Corey Hammill

I do that too; I just repeat the question.

Murray Souter

Yeah. You just keep talking amongst yourselves. Just bear with me for a moment.

Corey Hammill

Sure.

Murray Souter

But the LCBO has actually been expanding quite significantly their base of inventory. And if I can find Gillian's (phon) note here to me; I'm typing frantically into my laptop. Here we are. Bingo. So our inventory is up right now about 20—sorry, no, more than that. It's up about 35 percent within the LCBO DCs currently.

Corey Hammill

Okay.

Murray Souter

So they've pulled forward obviously and put in some safety stock. That will feed on a—that'll probably feed them for about five weeks, five, six weeks.

Corey Hammill

Got it. Just I mean no way consumers are going to go six weeks with the LCBO being closed.

Murray Souter

No. They'll be—there'll be—

Corey Hammill

They want a recipe to privatize and open up the grocery stores for everything, it'll be to close for six weeks in the summertime.

Murray Souter

Yeah. Yeah. I think Premier Wynne's popularity would probably be a little lower after that.

Corey Hammill

I mean we're single digits. It's hard to go much lower. Other interesting thing you mentioned, the 12 percent grocery store market share I thought was a great stat. Just for (unintelligible), what do you think your overall market share is in Ontario?

Murray Souter

It's about 5.6. So we're almost double. Yeah.

Corey Hammill

Got it. Perfect. Again, I am going to jump all over. The new wineries, I think we're at like week five now of it being open. So I know it's early days. Things—I've been down the last bunch of weekends, so things have been really busy in Niagara in June. Do you have any early metrics on how the store is performing versus sort of June of last year, given the doubling of size and just the nicer overall experience?

Murray Souter

Yeah. We're above … significantly above year-ago sales. I won't give you a number because it's still early and I don't want to get pegged with it, but there's two very interesting and they're pretty common sense results from this. One is we're selling significantly higher-priced, higher-margin product. The old store was a double-wide trailer and it did a very good job selling $1 million worth of wine out of a double-wide trailer, but the new facility is selling a much higher proportion of 20 and $30 bottles of wine than the old facility did.

And secondly, we're seeing much more drive-in traffic—drive-by traffic. So we do a great job on tours, bus tours and arrangements that we have with a lot of the tour companies, which is probably about half of the people in Niagara come down via tours. But what we're seeing now is a significant increase in two- and three-person vehicles arriving and stopping in and shopping and buying; not just coming in and having a tasting and leaving. They actually are buying, so both of those metrics bode very, very well for longer term.

Corey Hammill

And yet it's stocked I noticed with a lot more ancillary products, which should be good as well.

Murray Souter

Yeah. Absolutely.

Corey Hammill

You got to be pretty good on $12 jam.

Murray Souter

Yeah. You got it.

Corey Hammill

CapEx budget for 2018, I just want to make sure that we're on the same page. So you did the Kirkwood buyout, but what is the total budget we should be allocating for CapEx this year?

Murray Souter

Alan?

Alan Stratton

We're looking currently we'll probably be spending about another $2.5 million in fiscal 2018 on the winery expansion.

Corey Hammill

Okay. So 2.5 million over and above the Kirkwood buyout, and that's actually a little lighter than I had, so that's good.

Alan Stratton

Well, some of our expansion will get … will drift into the next fiscal—

Corey Hammill

Sure.

Alan Stratton

—year as well.

Corey Hammill

Yeah. That's fine. Export. So export business was super-strong in fiscal '17. Is there anything you can sort of comment on about fiscal '18? I mean you gave some parameters I think last year about how fast it was going to grow. What should we think about the growth this year? Was there some anomaly last year? Should we expect—

Murray Souter

I don't want to make—yeah. I don't want to make it a forward-looking statement, but you're always a year out on statistics, as we just finished fiscal—or Stats Canada gave us our fiscal 2016. The Chinese equivalent for that, their market growth, is their growth was over 15 percent through that period for total wine, and I think it was 19 percent for red wine. So very, very strong—continued strong growth in that market.

We are obviously a well-positioned participant in that, and we are seeing—we are continue to seeing our partners over there grow their purchase orders with us. So we're pleased with where we are.

Corey Hammill

Okay.

Murray Souter

We need more wine.

Corey Hammill

Yeah. Fair. And the expansion will help. And then lastly on acquisitions, you made some good comments about acquisitions in this space. When you look at acquisitions, are you looking to add volume? Are you looking to add—to fill a hole in the portfolio? Are you looking to add more physical locations? What should we think of when you're looking at a potential acquisition?

Murray Souter

So we would start at the top with brand, which would be volume-related, and then brands that are positioned to fill any portfolio gaps also are good. But generally speaking, we're looking for brands because they have a strong relationship with their consumer; they have established distribution. We have the ability to produce. We have the ability to manage that sales function, the channel, the take-to-market strategy. So we're looking for brands in the perfect world.

Corey Hammill

Okay.

Murray Souter

Most wineries are tied to obviously to an asset base of a winery and land, so it's trying to find those that fit that is probably the biggest challenge.

Corey Hammill

And should we assume you'd like to do something like with EastDell where you're willing to buy it, but then you would like to sell off the land and the building and really just bring the brand in-house?

Murray Souter

Yeah. We would look at those as well, yeah.

Corey Hammill

Okay. That is—I have a page of notes, but that's it for me. Thank you.

Murray Souter

You're welcome, Corey.

Operator

Thank you. Your next question comes from Vay Jonynas from Wellington. Vay, please go ahead.

Vay Jonynas — Wellington-Altus

Good morning.

Murray Souter

Good morning.

Vay Jonynas

First of all, you mentioned that 69 of the 70 licensees in grocery stores are already in operation, and that's the first tranche of the—

Murray Souter

Yeah. First tranche.

Vay Jonynas

—licences awarded. How big will the second tranche be? And when do you expect that to be awarded?

Murray Souter

Okay. So we don't know the size or the timing of it. There's always indications in the marketplace. So it has been very successful. It has been the—everything we understand from talking to the grocery operators and from talking to other wineries and the competitors who have the more traditional winery retail stores that used to be the kiosks within the grocery stores is that the sales velocity within grocery stores is 2 to 3 times faster than the sales velocity within LCBOs for a specific product. So it's very successful. So everybody likes it. Consumers love it. We hear constantly from consumers in our tracking that they think it's a great idea.

But the government controls the timing of that. Given that they're in negotiations with the LCBO currently, and this change of wine and beer in grocery is the first significant change in the Liquor Control Act since 1929, this is a big step. And unfortunately, the union that controls the stores, or that is involved in the stores, thinks we should go back to 1929. But the reality is that this is a very positive experience for the consumer. And I would anticipate that once the government has completed their negotiations with the LCBO staff that they would start to look at their next timing and number.

They've committed to opening 300 stores. They've couched the language a bit in terms of testing, but they've committed to opening 300 stores, which would be very beneficial.

Vay Jonynas

Okay. Now I understand that with respect to Vincor and the Wine Rack stores and Andrew Peller and their Wine Shops that if the Wine Shops and the Wine Racks are not open to other winery sales, they cannot be in supermarkets.

Murray Souter

That's correct.

Vay Jonynas

Or—but you have your own dedicated wine stores, well, one in Niagara and one on Kingston Road.

Murray Souter

Correct.

Vay Jonynas

Is it within a certain geographic distance that this general rule applies? Or how is this rule applied? Because of course, you're in the supermarkets despite having a dedicated chain of two or three stores.

Murray Souter

Yeah. So the licences that Peller, Colio—Constellation by the way is now called Arterra, A-R-T-E-R-R-A.

Vay Jonynas

Okay.

Murray Souter

And those three, the licence that they have are called a pre-’89 retail licence. They’re a winery retail store, so they’re an off-premise facility. We don’t have any of those licences. The licences that we have are what’s called a pre-’93 licence, which is a winery licence. So our facilities all produce. They’re located at a winery. So even that winery in Kingston and Scarborough—as I jokingly say, we have the largest winery in Scarborough—it actually is a winery where we produce 25 percent of the—sorry, of those sales, 25 percent of the product is produced on that site, or 25 percent—

Vay Jonynas

Oh.

Murray Souter

—the process is produced. So whether it’s fermentation or bottling or whatever it happens to be, you have to do 25 percent of your inventory has to be produced on-site. So in the basement of that store is actually a processing facility.

The Colios, Pellers, and Arterras of the world are not allowed to participate until they open a minimum number—and I don’t know what the number is; I know it’s north of 50 stores—and those stores have to—of the VQA sales, 50 percent of the VQA sales have to be competitive products. And in order to do that—sorry, if they are successful in doing that, then they are given access to the other grocery channel stores, and only after that.

Vay Jonynas

Okay. Now with respect to your new store in Niagara-on-the-Lake, it was my understanding when you announced that you were going to build this new sales facility that the problem was twofold right now. First of all, a double-sales trailer was simply tacky. And secondly, that you didn't have enough capacity in the double trailer to handle the bus tours. Now your recent announcement with respect to the completion of the facility, though, mentioned in fact that you still didn't have enough capacity to handle bus tours, and you would be building another facility that would serve both as a staging area and a banquet hall.

Now can you explain that to me? And who would be operating the banquet hall? Do you have any expertise in the banquet hall business?

Murray Souter

Yeah—

Vay Jonynas

Could you explain that?

Murray Souter

Yeah. Vay?

Vay Jonynas

Yeah?

Murray Souter

I'm not sure what you're referring to. So the current facility that we built is—retail space is about 2,500 square feet and that's out of our former facility, which was under 1,000 square feet of retail space. So we more than doubled—2.5 times increased it. And it is, like everything else, you'd love to build it as big as you can, and you may be reflecting on some comments I made at the opening about the fact that this is the first of many phases.

We will be adding to that facility so that we can capitalize—as I said earlier, 50 percent of the traffic in the Niagara Region is bus tours and 50 percent is drive-by, people doing their own personal tours—and we want to be able to serve both audiences well. A second building would allow us to actually do that, and it would be a building adjacent to the one that we have right now.

We're not planning on putting food service in there, although when we do build it—and right now it's just at the preliminary design stage—when we do build it, we will have a commercial kitchen in there, but not to serve—operate as a restaurant. It would be to allow it in off-hours to be used for weddings and things like that, and have the ability to serve food. It also allows us to put the bus tours—and we get numerous. If you're ever down at our store, we get half a dozen bus tours; in fact more than that on a—every Saturday and Sunday each. And that separate facility will allow us to bring in those large audiences and serve them while still serving the drive-by traffic effectively.

Vay Jonynas

Okay. Is there any timing on this additional building?

Murray Souter

It all depends on how successful we are.

Vay Jonynas

Okay. Now I also hear from my informed sources a rumour that you plan to dig a lake. Not just a pond, but a massive lake at the new sales facility. So I'm wondering at the cost of building a lake, the timing of it, and how a lake helps you sell wine?

Murray Souter

Well, we are Lakeview. It's actually part of the design of the facility, and I mean building a lake it would be about 2 times the size of a backyard swimming pool, but it would only be about 18 inches deep. So we won't be sailing my sailboat on it, but it's really a reflecting pond more than anything else.

And it just allows—it's part of the landscape architecture of the facility. And if you—next time you're down I'd be happy to show you the preliminary design of it, and show you what we're trying to do. But it's not a massive lake by any stretch.

Vay Jonynas

Okay. So the lake was an exaggeration on the—

Murray Souter

Yeah—

Vay Jonynas

—part of your enthusiastic sales staff.

Murray Souter

Yeah. Somebody's feeding you bad news there.

Alan Stratton

Mother Nature's doing a good job, though, of trying to create a lake for us.

Murray Souter

Yeah. Right now while we're trying to pour concrete.

Vay Jonynas

Okay.

Murray Souter

Anything else?

Vay Jonynas

Oh, you mentioned that your distribution business, the Kirkwood, keeps growing. And it's grown every year over the last five years or whatever. But you also said—and you're—it's the fifth largest distributor in Canada now overall?

Murray Souter

Independent. Yes.

Vay Jonynas

Independent distributor.

Murray Souter

Yes.

Vay Jonynas

But you also mentioned that it's underperforming. How and in what way is it underperforming?

Murray Souter

We think we can get—first of all, there's capacity within that system to be able to add more volume to it. So the distributorships tend to be fixed costs, so it's predominantly people. I mean you don't have big manufacturing plants, things like that. It's fixed operating costs, which are the biggest expense. So the cost to manage a $1 million brand is the same cost as a $250,000 brand.

Vay Jonynas

Mm-hmm.

Murray Souter

So the more $1 million brands you've got, the more profitable you're going to be. So that's what we mean by underperforming.

There's also the opportunity with 100 percent ownership to be able to use all of the back-office systems between the two halves of the organization, the distribution system, all the back-office support, finance, payroll, everything else, which again running parallel structures within the two organizations is costly. It's not efficient. So that's what we mean by underperforming.

Vay Jonynas

Okay. Oh, is the VIA sale a onetime thing?

Murray Souter

It's a contract. It's a rotating contract that VIA Business class—we have VIA coach or regular service. We're the—we just won that again, that RFP for another, I think it's two years. And the Business class they serve with their meals—if you've ever gone VIA One, VIA Business class, they serve a wine and obviously spirits and beer to the customers during the journey, and it's a rotating contract.

So we just completed—and actually we benefitted. Normally it's a six-month rotating contract; every two years you're a part of it. We just completed, and because of the timing we actually got a couple of extra months out of it, which was very beneficial for us. It was the end of their RFP period, so they extended the pouring of our wines, our McMichael and our FRESH Red Perspectives—or Satin Red—

Vay Jonynas

Mm-hmm.

Murray Souter

—sorry, through that time period.

Vay Jonynas

Okay.

Murray Souter

Any other questions? Operator, let's move to—Vay, are you there?

Operator

Vay, do you have any further questions for the presenters?

At this time, I do not see any other questions in the queue.

Murray Souter

Great. All right. Well, thank you, everyone. And that concludes our call this morning. I really thank you for your interest in Diamond Estates. And as always, Alan and I are available to speak at any time. We look forward to speaking with you again after Q1 in August at some point.

Thanks very much.

Operator

Ladies and gentlemen, this concludes today's conference call. We thank you for participating, and we ask that you please disconnect your lines.

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