TRANSCRIPT

Diamond Estates Wines & Spirits Inc.

Third Quarter 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 Third Quarter 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 — Director, Chief Executive Officer & President, Diamond Estates Wines & Spirits Inc.

Thank you, Joanna, and good morning, everyone. Welcome to Diamond Estates' financial results conference call for the third quarter and the nine months ended December 31, 2016.

As Joanna said, my name is Murray Souter, and I am the President and CEO of Diamond Estates Wines and Spirits. I'm joined by Alan Stratton, our Chief Financial Officer, today.

Beginning today, we plan to host conference calls every quarter in conjunction with our earnings releases. There are a lot of exciting developments going on right now in our company and within the Canadian wine industry, and we look forward to sharing them with you as time progresses.

I'll start this call by providing an overview of our results and other key developments in the quarter. Alan will discuss the financials in depth, and I'll conclude with some comments on our strategy and the broader wine market. After that, we'd 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 the forward-looking information in our news release this morning for more information.

Let me start by saying that this was a landmark quarter in our company's history. We delivered solid financial results, we raised $8.8 million to help execute our growth strategies and pay down debt, and we began to capitalize on the sale of wines in Ontario grocery stores, which got under way on October 28th last year.

My message to you this morning is that Diamond Estates is profitable and is well positioned for growth in an industry with very positive fundamentals.

Our earnings were in line with our expectations. So we reported revenue of $8.8 million in the third quarter, up 12.2 percent from the prior year, and that was primarily attributable to the strong growth in the winery division, where we experienced 35 percent increase in export sales and solid 8 percent growth in other channels.

We reported slightly positive net income for Q3, and for the first nine months of fiscal 2017 we had net earnings of $1.5 million. That represents a four-fold increase over the first nine months of fiscal 2016. Our brands performed well at home and abroad, and we are pleased to see that they are in a leading position in the Ontario grocery stores as well.

I’m going to discuss the grocery sales in a little more detail now because, frankly, I don’t think many investors realize what a market-changing event this is for us and for our industry. Our products are now available in 58 grocery stores, and that is just the start. There are currently 70 grocery stores licensed to sell wine. There are 12 that haven’t opened quite yet. And over the next six years, that number will jump to 300.

I’m pleased to say that we already have the largest number of brands on grocery store shelves of any company. And if you have been into any of the stores, you might have noticed that our shelf placement is very favourable.

As an Ontario VQA producer, we have an important built-in advantage. Half of the licenced grocery sales are carrying 100 percent VQA wines, while half of the stores, or 35 of the locations, are carrying 50 percent VQA wines. That gives the Ontario VQA producers 75 percent of the available shelf inventory.

In United States, grocery stores are the largest retail channel for wine. Over time, we see the Ontario market mirroring the US experience. Customers will get used to the idea of buying their food and wine pairings in one place, and we think it will become their preferred way of shopping. We will continue to ensure that we are well positioned in the Ontario grocery channel as sales expand.

The other important development in the quarter was our financing. Originally, we had planned to raise up to $5 million. We ultimately raised 8.8 million, as demand for the equity was significantly stronger than we expected. The transaction gave us the financial flexibility we need to pursue our organic growth strategy.

Our plan is to expand our wine production facility by approximately 50 percent, adding cooperage, storage, warehouse, and bottling space. This will create significant economies of scale, which should translate into stronger margins and better financial results.

I also want to note that we’re close to finishing construction of our retail store in Niagara-on-the-Lake, which will open in May. It’s going to be a very attractive, 2,500 square foot facility with a very large tasting area. Direct sales from this store will generate higher margins than any other distribution channel, and we’re confident that the facility will drive much higher volume sales at the winery than we currently have.

I’ll now ask Alan to review our financial results in greater detail. Alan?

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

Thank you, Murray. Revenue in the third quarter was $8.8 million, up 12.2 percent from 7.9 million in the same quarter last year. As Murray said, the increase was driven in part by the strong growth in export sales, but we had solid growth across all other sales channels as well. We had approximately $4.7 million of revenue in our Agency division and 4.1 million overall in our Winery division. Within the Winery division, export sales accounted for 34.6 percent, growing to $1.4 million, and revenue from the other winery sales channels rose 7.9 percent to $2.7 million.

Gross margin in Q3 was $3.4 million or 39 percent of revenue. By comparison, gross margin was 38.4 percent of revenue in Q3 of fiscal 2016. That improvement was driven by the Winery division that increased margins in the LCBO channel through a combination of price increases on specific brands implemented earlier in the year, a reduction in promotional activity such as price reductions, and the load into the new grocery channel.

This more than offset a decline in the margin at the Agency division, where we continue to see an increase in the sales mix in favour of products that we distribute, coupled with aggressive promotional activity to gain market share for those brands. This is part of a broader strategy to reinvigorate this business by working with suppliers to improve product sourcing costs, adjust pricing, and promotional activities to align with national brand strategies. These initiatives are expected to drive growth and improvements in profitability over the coming months.

Operating expenses in the quarter were $2.8 million compared to $2.4 million last year. While some of the increase supports our growth, primarily in brand building and employee retention, we also had an abnormal spike in legal fees and storage costs, the latter reflective of higher inventory balances in the Western region. We have a number of initiatives underway to reduce those inventory levels, while ensuring adequate supply to support growth in the Agency business.

Our standardized EBITDA in Q3 2017 was approximately $590,000 compared to 640,000 in Q3 2016. Net income was slightly positive compared to a slight loss last year.

Turning to the nine-month period ended December 31st. We had revenue of $28.2 million, an increase of 22.4 percent from 23.1 million in the first nine months of fiscal 2016. The biggest reason for the growth was the strong export sales, which nearly doubled to $5.8 million. The increase in export revenue was expected, as the Company fulfilled all of the orders that were previously announced on March 31st.

Overall revenue in the Winery division was $15 million year to date, compared to $10.9 million last year. Revenue in the Agency division was $13.2 million, compared to $12.2 million last year.

Our gross margin year to date was $11.9 million, up 19.2 percent from fiscal 2016. Gross margin as a percentage of revenue declined to 42 percent, compared to 43.1 percent in the same period last year. The decline is due to the factors in the Agency business that I mentioned previously, partly mitigated by improvements in the Winery division.

Our operating expenses as a percentage of revenue have improved to 30.3 percent in the first nine months of fiscal 2017, down from 32.9 percent last year. As a result, standardized EBITDA jumped 40.1 percent year over year to $3.3 million, up from 2.4 million last year.

Net income year to date was $1.5 million. That is an increase of 313 percent, compared to approximately $365,000 last year. In addition to higher revenue, net income was also boosted by lower interest and share-based compensation costs.

As Murray highlighted, we completed an $8.8 million equity offering in the quarter, positioning us with balance sheet metrics now more appropriate to our industry. Our working capital on December 31, 2016, improved significantly to $10.9 million as a result compared to an adjusted $3.2 million at the same period last year, when excluding the long-term portion of term debt then temporarily classified as current. Our balance sheet now reflects a debt-to-equity ratio of 0.59 to 1, compared to 1.76 to 1 at last fiscal year-end.

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

Murray Souter

Thanks, Alan. We're very optimistic about the future of Diamond Estates. Following our equity financing, we have a much stronger balance sheet and are well positioned to focus on our organic and inorganic growth opportunities. I spoke about the organic growth earlier. So I'd like to take a few moments now just to speak about the M&A on prospects.

As many of you know, the Ontario wine industry is highly fragmented, with the top five producers comprising just 45 percent of the market. The other 55 percent is spread amongst more than 150 small producers. We see many potential acquisition opportunities of smaller players that would allow us to leverage our infrastructure and enhance profitability. A lot of those small wineries would be too small to move the needle with our larger competitors, but could have a very meaningful impact for us. As you know, we have completed nine acquisitions over the past few years, so we do have some expertise and can successfully buy and integrate other businesses.

Meanwhile, we are encouraged by the strong fundamentals underlying our industry. Wine sales in Ontario continue to grow at more than 30 percent between 2009 and 2015 as the millennial generation are drinking much more wine than their parents, the Boomers. We believe this trend will remain positive as the grocery channel rollout continues and allows consumers to pair food and wine in one simple step.

Our brands like FRESH and EastDell are well positioned in the sweet spot for millennial consumers, and we are seeing very strong sales in that channel. We also think the export market will remain strong for Canadian wine.

Canadian vintners, including Diamond Estates, are still in the early stages of capitalizing on exports to emerging markets such as China. We already have one of the strongest export businesses of any Ontario producer, and we're confident that that there will be more growth ahead.

That concludes my remarks. Alan and I would now be pleased to answer any questions you may have. Operator, you may open up 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 *, then the number 1 on your phone. One moment please for your first question.

Your first question comes from Corey Hammill from Paradigm Capital. Corey, please go ahead.

Corey Hammill — Paradigm Capital

Good morning, guys.

Murray Souter

Good Morning, Corey.

Corey Hammill

I have a list of things. I'm just going to do a couple. Then I'll fall back and see if anyone else wants to ask a few questions.

I'm going to jump all over the place. Can we start with grocery? So you're in 58 of the stores so far. You have a great number of listings. Can you talk about if there's any differences in what you're seeing, in terms of price point or brands that sell through the grocery store better or worse than through the LCBO? Just trying to understand the difference in the end customer that's shopping at one versus the other.

Murray Souter

Okay. We don't have any consumer metrics at this point, Corey, but I can tell you a couple things. First of all, pricing in the grocery channel has to be the same or higher than the LCBO. You're not allowed to discount it below LCBO sales pricing. That's the same for our retail outlets.

What we are seeing though is similar mirroring in terms of the sweet spot. I mentioned that in my remarks. 12.95 to 14.95 is where about two-thirds of the sales occur in the LCBO for VQA wine, and we're seeing similar sorts of things. We know from conversations in the industry that VQA wines are representing about 50 percent of the total sales of the grocery channel wine. So half is VQA and half is imports, which is very strong. Our market share in the LCBO is around 13. So we're seeing very strong fundamental growth in that channel.

Corey Hammill

I think that's important, because it shows that because these stores are favouring VQA wine, just the availability of it, you're more likely to pick it up off the shelf.

Murray Souter

Right. It's demonstrating that—I don't want to cast aspersions on anybody—but it's demonstrating that we are a very acceptable product to consumers; that it's not just an import market.

Corey Hammill

Now, I think it's the US challenging some of the British Columbia wine stores for their focus on selling British Columbian VQA wine, and I'm not all that familiar with the case other than reading it in the papers. In terms of Ontario and what the government's doing, do you think there's any risk of a challenge here because of how they're rolling out grocery and how they're favouring the local wineries?

Murray Souter

No. It is trade compliant. Both the Premier's Advisory Council, the AGCO, we belong to the Winery and Growers' Alliance of Ontario, the Wine Council of Ontario have all looked at it, both from a trade standpoint and from an operational standpoint. It's entirely trade compliant. So it supports the NAFTA agreements.

BC is unusual because what they did was they actually shut out everybody other than BC wines. We haven't done that in Ontario.

Corey Hammill

Okay. And then lastly, then I'll let someone else ask, the $8 million net that you raised. Can you just walk us through some of the time line on how you plan to deploy that capital in terms of growing your production capacity? Will it be in place in time for the upcoming season, for example?

Murray Souter

Absolutely. It has been my life recently. We are in the stage. We have the design completed. We have engineering completed. Applications have been made. The municipal applications have been made to move that through the bureaucracy at the local levels. We have C of A approval for Ministry of the Environment. We have preliminary architectural drawings.

We have our estimates for stainless. We've chosen the supplier and—or we haven't chosen the supplier, but we know roughly what the requirements are, and we have all the bids in from the stainless suppliers. And we anticipate getting the building permits and breaking ground in late March, early April, as soon as those permits are available.

And the priority will be to put the cooperage in place. We need it. We've contracted for 400 additional acres of vines, so we have 1,600 additional tonnes coming in, which is about a 40 percent increase in our tonnage coming in. We need a place to put that juice, so that's the priority right now.

We will be completing the warehousing, bottling, and storage areas or processing areas will be fast following on that. May break ground in the summer; it might be closer to the fall when we break ground on them, but they're separated from the production end of the building. So they're on opposite ends of the facility.

Corey Hammill

So in terms of the storage facility that you're now using a third party for, should we assume that you'll be able to bring in-house those costs? Probably not, then fiscal '18, that'll be a fiscal '19 cost-saving initiative?

Murray Souter

That would be fair. I mean it's by the time you pour the flat floor and get all the racking in and everything else, it'll probably be close to the end of fiscal '18, so we probably will not see the benefit from that.

Corey Hammill

Okay. Thanks, guys. That's it for me.

Murray Souter

Okay.

Operator

Thank you. Your next question comes from Jim Belin from Aldebaran Asset Management. Jim, please go ahead.

Jim Belin — Aldebaran Asset Management

Thank you for taking my question. The first question is what do you see your maintenance capital expenditure requirements going forward after you complete the expansion?

Alan Stratton

Well, the facility is not very heavy on a maintenance capital equation because most of the cost was really in the stainless steel tanks, and once those are built, they don't—so we've got some pumps and whatnot, but generally speaking, we spend probably a couple hundred thousand dollars a year, and we don't see that really increasing any more than commensurate with the proportional increase in the size of the facility.

Jim Belin

Okay. Thank you. And I wonder whether you can just give me an idea. You mentioned possible acquisitions. To what extent would you put more emphasis on acquisitions versus pay-down of more debt?

Murray Souter

Well, I mean the acquisitions portion of it, the long-term aspects for this facility are that we basically will double its size over the next five years. There’s two ways to fill that facility up. One is through acquisition of additional brands, which we can deploy into our channels, whether they be grocery, retail, or export. The other is to do it organically. So from that standpoint, acquisitions or growth of throughput has a priority over pay-down of debt right now.

I think our debt is in pretty good shape. I’m looking across the table at Alan.

Alan Stratton

Yeah. I mean I think we’re in a bit of an imbalance right now. We’ve just raised $8 million, and the cash outflow for the capital portion hasn’t really started yet. But over time, one of the things we are working on is identifying sort of that optimal debt-to-equity ratio and keeping things in line with the debt-to-EBITDA as our EBITDA continues to grow, because we want to continue to keep sort of a target-weighted average cost of capital that’s in line for the industry.

Jim Belin

Okay. Thank you very much.

Murray Souter

You’re welcome.

Operator

Thank you. At this time, there are no further questions in queue. You may proceed. I’m sorry. We do actually have one question.

The question comes from Vay Jonynas from Alta Securities. Vay, please go ahead.

Vay Jonynas — Altus Securities

Good morning, and ...

Murray Souter

Good morning.

Vay Jonynas

Couple questions here. You mentioned that FRESH and EastDell were particularly well positioned for sales to millennials. Why?

Murray Souter

Okay. FRESH ...

Vay Jonynas

What is it about those two brands and millennials?

Murray Souter

Okay. So FRESH is a brand that’s specifically targeted to millennials. It’s the packaging. So let me back up just a bit on millennials. Millennials are very different from their Boomer parents in that they don’t carry the stigma of 25 years ago; our opinions of Ontario wines. Our Ontario wines back then were—Ontario wines were not very good. They were produced with local, native grapes, labrusca grapes, were not particularly viable from an industry standpoint. So we carry a lot of that baggage—the Boomer parents.

The millennials don’t carry that. They see the industry as it is today, which is strong, vibrant, tremendous investments in capital, in crop sciences, in food technology, processing technology. And we’ve moved ourselves significantly along the continuum from what we were to the production of good quality wine.

So millennials are a natural market, and they’re people who are now evolving their tastes and moving out of the sweet wines or sweet profile of teenagers and young adults, to a more sophisticated palate. And we have positioned FRESH to capitalize on that shift. Both from their attitudes and awareness and opinions, they tend to be very locally focused. They’re the ones that are driving the craft beer phenomenon and also from a taste profile.

The packaging on FRESH is all locally produced by artists. The graphics are produced by local artists. They’re linked through social media back to both the artist and to the winery, to events. We use social media to promote it. And the wines themselves, the taste profile, is consistent with what the millennials are looking for from a taste profile standpoint. So that brand is perfectly suited.

Also EastDell, which has just gone through a complete revamp of its label and its packaging to make it much younger, to appeal to a much younger audience, it tended to be—hadn’t had a label change in almost 15 years, which is unusual in the North American industry, and is now positioned, both from a price point and from a packaging standpoint, to a younger 30s and 40s consumer.

Because it’s our largest brand, it also has a lot of appeal into the suburban markets where the millennials are now moving to. They’re moving out of the city and into the urban markets as the family formations are taking place. So that is benefitting us as well.

Vay Jonynas

Okay. Now secondly, with respect to your export sales to China. At one point in time I had noted that you had mentioned that your Chinese distributor had three standing stores of its own.

Murray Souter

Correct.

Vay Jonynas

But it was only several dozen. It wasn’t a particularly high number for China. Could you update that number and basically explain why that number is so low?

Murray Souter

Yeah. They ...

Vay Jonynas

For a company in China.

Murray Souter

Yeah. They sell through two channels. They have their own stores, but they also sell through other retail stores.

Vay Jonynas

Mm-hmm.

Murray Souter

Their stores were largely branded Diamond Estates, and they've continued to open stores. I don't have a more recent count, but it's 35 or somewhere in that range. I can certainly get that number if it's important. But they sell through several hundred other retail stores. So they have their own stores, and then they sell through other stores as well. So they are ...

Vay Jonynas

And their own stores only carry Diamond Estates wines?

Murray Souter

That's correct. They only carry their products, yep. They import other stuff into China, which are in their stores, but they only carry Diamond Estates wine.

Vay Jonynas

Mm-hmm. Okay. And they also sell through other retail channels, you're saying?

Murray Souter

Correct.

Vay Jonynas

Mm-hmm. But there would be tremendous expansion opportunities from to 35 stores in China, you would think.

Murray Souter

There are. They are growing significantly. I'll put it that way. You've seen kind of the first wave of that in our fiscal results this year. We anticipate that, that trend will continue strongly into the future.

Vay Jonynas

Now also in your wholesale business, about two years ago you were refocusing to a sales model based on just earning commissions as opposed to buying the product and reselling at a higher markup. And my understanding at the time is you were doing so to conserve capital, although right now, you've raised quite a bit of capital. Will you be making any changes in the distribution arrangement because you have more capital now?

Murray Souter

Probably not. That business is driven more by what the customers want than driven by what we want. You're selling to both local, provincial authorities. You're selling to restaurants and bars. And in Western Canada, because of they're much further along in terms of deregulation of the alcohol sales than we are in Ontario or Eastern Canada, you see a very different market out there.

It is easier to advance sales in BC/Alberta quickly than it is to advance sales in Ontario. The time lag from kind of pulling on the lever in Ontario to getting results is about eight months. Out west, it's about three or four months. But they're different markets, and we're seeing good solid growth in our commissions across the country.

Our preference would be to sell on a commission basis in the Agency business, but in Western Canada you have to operate under a buy-sell, because of the nature of the business. And it's the market that's really dictating where we end up now.

Vay Jonynas

Okay. And in your revenues, in the Agency business revenues, if you just earn a commission, then only the commission shows up in the revenues, I understand. But if you're actually owning the product and then reselling the product, it would be the total selling price of the product that shows up in your revenues. Correct?

Murray Souter

That's correct. That's correct. Yeah. There's buy-sell in Western Canada and it's commission everywhere else.

Vay Jonynas

Mm-hmm.

Murray Souter

Anything else I can help you with?

Vay Jonynas

No. I'm fine.

Murray Souter

Great.

Operator

Thank you. Your next question is a follow-up from Jim Belin from Aldebaran Asset Management. Please go ahead, Jim.

Jim Belin

Yes. I was wondering, in your international brands, are you finding it increasingly difficult to get shelf space? It seems like there's a proliferation of liquors that are being produced around the world.

Murray Souter

Are you talking about when we import?

Jim Belin

Right. Mm-hmm.

Murray Souter

Okay. Yeah. I mean any retail outlet has—you always have pressures for shelf space. And the retailers are very good. I mean you probably don't know this. I used to be the CEO of Blacks Photography, and retailers are very good at trading suppliers off against each other for shelf space. And it is incredibly difficult to get listings.

The LCBO has a gatekeeping process. I'll use them as the example, but all of the provincial authorities are the same. They have a gatekeeping process where they basically ask suppliers to bid for—price and bid against certain segments, whether it be a single-malt Scotch from Scotland or Irish whiskey or a certain price point of a Bordeaux or a French wine. They have their bid sheets or their request for submissions is what they call them. They can run 1,300 or 1,400 different categories.

So it is difficult to get shelf space, and it takes a certain level of expertise to be able to migrate through that and suppliers who are willing to invest in the near term, if it's a new entry, and certainly in the long term if it's an established brand.

Jim Belin

Mm-hmm. I'm just wondering—that you have—it sounds like a very compelling growth story on the wine side. And I'm wondering whether to this extent, if there's a constant battle going on for shelf space on the spirit side, whether it makes sense to put even more focus on the wine and divest the spirits side?

Murray Souter

We never comment on anything forward looking, but I mean we're constantly evaluating the business and particularly in terms of where we're making investments. The Agency business has been important to us, largely because of the channel management, that very important focus, getting products listed and sold either at the LCBO, now at grocery, with licensees and facilities outside of the traditional channels. So it's very important that you have a strong presence in the marketplace, because it doesn't matter how good a product you make. If you can't get it to the market, it'll never sell.

Jim Belin

Sure.

Murray Souter

And I wouldn't want to—I mean we are, as I said, we're constantly evaluating what our business is looking like over the long ter. We're in the midst of a strategic plan right now, as we do every year, constantly looking at what's going on in the marketplace, so. It's a challenge.

Jim Belin

Thank you very much.

Murray Souter

You're welcome. Thanks, Jim.

Operator

Thank you. Your next question comes from Mathieu Bernier from Walter Financial. Mathieu, please go ahead.

Mathieu Bernier — Walter Financial

Good morning, guys. I guess my question relates to understanding the seasonality in the winery business. Let's start maybe with export sales. Are those done at this point for the year?

Murray Souter

Yeah. So Mathieu, the big seasonal push for the Chinese consumer just passed. That was the Chinese New Year.

Mathieu Bernier

Okay.

Murray Souter

And the lead-up to that is—it's kind of our—well, it's their New Years, our Christmas, our holiday season, very similar to them. So there's a big push to have product on the shelf in depth, and then they go into the normal lull that we go into.

We're complicated a little bit in that they take in—because we ship from Ontario in containers and the port of exit is Vancouver, we don't ship to export markets. Our suppliers want us to ship out of Vancouver, so we don't move goods across from kind of the middle of December through till about the middle of March, because of the temperatures.

Mathieu Bernier

Okay.

Murray Souter

Yeah. Temperature controlled containers are not good; one end is hot, the other end's cold. Wine does not like to be hot. So we, generally speaking, try and get most of the inventory into the markets, which is why you won't see much in fourth quarter.

Mathieu Bernier

Okay. And if I can ask a similar seasonality question on the Canadian sales for the winery. You mentioned 8 percent growth year over year, but if I look at your second quarter where you sold 3.7; this quarter 2.7. I guess I would have expected with the entry into the grocery store and Christmas and all that that maybe sequentially you could you be at least flat. Any insight on that?

Murray Souter

Sorry. The 2.7—we're just trying to find the numbers you just quoted. The 3.7...

Mathieu Bernier

Sorry. 2.7 would be the Canadian winery sales.

Murray Souter

Segment sales.

Alan Stratton

Yeah.

Murray Souter

Okay.

Mathieu Bernier

Yeah. For this quarter. And 3.7 would be the second quarter equivalent.

Murray Souter

Yeah. So second quarter we did—there's a couple things going on there. You start the lead-in for what is fiscal third quarter, consumer fourth quarter starts before September 30th. So you do see some lead-in to that. We also see most of the inventories are in the channel; are generally loaded in by the time, kind of the end of October, maybe second week of November.

Mathieu Bernier

Okay.

Murray Souter

So and the LCBO being the largest producer and consumer of about 80 percent of our shipments, they suck up a big chunk of that. And so it's really spread over September and October, a little bit into November. So depending on the timing of the shipments, you can see it early or later.

It was somewhat earlier this year because of the grocery load-in. So October 28th, the grocery stores went live. They placed their orders with the LCBO, who's the wholesaler of choice, towards the first week of October. In fact, I think some of them were in September. So that inventory was shipped in in September. So it was in the other quarter. So you would've seen a better balance between the quarters if you'd looked at it on a weekly basis.

Mathieu Bernier

Okay.

Alan Stratton

Also Q2, July, August, September, is our strongest season for the retail stores at the wineries.

Mathieu Bernier

Yeah. Yeah.

Alan Stratton

So again, the seasonality will reflect the higher retail store revenues in that quarter as well, which is embedded in that number that you quoted.

Mathieu Bernier

Okay. Perfect. And maybe just a last one if I may? You mentioned increasing the processing capacity by 40 percent. I guess there's a difference between the processing and then the selling, because you have to mature some of the wines. Can we get to a 40 percent increase in sales capacity in what, three years from now? Or two years from now? If I think about it on a volumetric basis?

Murray Souter

Yeah. We've been doing, I think as you know, we're doing about 225,000 cases currently, and it's no secret that we could be above that with additional capacity, which is why we're growing the business. Today we could be above that.

So with the additional capacity, you bring in white wines; they sit in tank for a year. Red wines more than a year; probably closer to two years. So the wines that we bring in, the additional tonnage we'll be bringing in this fall, so the fall of 2017, will be available for fiscal 2019.

Mathieu Bernier

Yeah.

Murray Souter

The product that we took in this past year, which we literally filled the facility this past year. Actually we were probably over capacity, but we've filled the facility, and it will drive sales over the next 12 months. So it's entirely within the realm of possibility, without making it a forward-looking statement, to say that we'll be there.

Mathieu Bernier

Sure. Yeah. Okay.

Alan Stratton

From a plant standpoint, we'll be at the point where, once this expansion is done, we have the capacity, but teeing up the supply. ..

Murray Souter

Yup.

Alan Stratton

And then the sales to align with that—

Murray Souter

Yeah.

Alan Stratton

—will take a little longer.

Mathieu Bernier

Okay. Thank you very much, guys.

Murray Souter

You're welcome, Mathieu. Thank you.

Operator

Thank you. There are no further questions at this time. You may proceed.

Murray Souter

Great. Well, thank you, everyone. It's been really a pleasure today. This concludes the meeting, or the conference call. And I thank you very much for your interest in Diamond Estates. And we look forward to speaking with you again very soon, and have a great long weekend for those of you who are enjoying it.

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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