

SILKBUSH MOUNTAIN VINEYARDS

MANAGEMENT REPORT



December 29, 2016

To: *All Limited Partners*
Silkbush Mountain Vineyards

As the year ends, we have some interesting and relatively good news to report, so we'll get right into it:

1. Anton anticipates our 2017 harvest, which will probably commence in February and complete in early/mid-April, should be about 970 tons. Since we have close to 20% of our acreage out of production, in various stages of replanting and growing back to full production, 970 tons will be quite decent. When we are back at full throttle, we should be averaging over 1,200 tons per year of top quality fruit.

In 2017, we are removing two blocks of virus impacted Cabernet Sauvignon, in total 5 ha. It will be replaced with a new clone Cabernet (2.5 ha) and Sauvignon blanc (2.5 ha) with which we are doing very well in the bottle, but do not have enough of as most is sold to *Guardian Peak* winery for their restaurant.

In 2016, we replanted 5 ha of Shiraz to Pinot Noir, Grenache Noir, and Shiraz. We have quite a lot of excited interest from various wineries for the former two cultivars while the latter remains in demand and we do not have enough.

2. At present, we anticipate crushing about 10% of our tonnage (95-100 tons) for the *Silkbush* brand at nearby *Bergsig Estate*, a large, top flight winery in its own right. (They have done a brilliant job making wine for us the last two years.) Such tonnage would produce about 63,000 liters of bulk wine, or enough for 7,000 9-liter cases. Our Rose wine is becoming a big hit, and it and our white, Viognier, can be bottled and sold in the same year we harvest the grapes; our reds, including Shiraz, Cabernet, Mouvedre, Pinotage, and now Durif (Petit Sirah), will likely require two years of aging before release.
3. Using the historical "rule of thumb" of 7,000 cases of 12 bottles per 100 tons, in future years, 1,200 tons should yield 84,000 cases of wine, albeit produced presently among several wineries to whom we sell grapes. Measured against that large total productive capacity, the 1,000+ cases we have sold in South Africa this past year looks rather meager. However, we are truly getting our brand established, accepted, and awarded; we may grow sales at a 50% rate or more in 2017. This all is an

accomplishment, especially considering the shoestring we are operating on. Building a meaningful brand is a capital-intensive undertaking, and we remain quite undercapitalized.

In the past year, largely due to Anton's efforts, we have:

- Established a representative and distributor in Mpumalanga (a NE province of South Africa where most of the game camps are); our wines are a hit there, sales are going well.
- We more than doubled sales in Kwa Zulu Natal (KZN) province which has a large population and a major vacation industry.
- We changed distributors in Johannesburg (Gauteng province) and are making better headway in the most over supplied market in RSA.
- We established a representative and distributor on the Garden Route (East Cape province) and got several listings in various restaurants and outlets.
- We have established representation in Swaziland.
- We continue pursuing Namibia and are expanding our footprint in the Western Cape.
- We won several gold and double gold awards at well reputed wine competitions and our new look label and packaging is getting numerous compliments.
- We grew with local sales turnover of R150 000 in '15 to just shy of R1m in '16.

4. Nevertheless, we are only just starting to get the brand positioned in the US, too. Selena Cuffe and her *Heritage Link Brands* importing company, our marketing partner and principal importer, has recently obtained shelf space at the sole *Whole Foods Markets* store allowed to sell wine in Manhattan. Featured as a new product, initial sales of Shiraz and Viognier are encouraging; WFM is also considering featuring our brand on a regional basis starting in March as we have volunteered to discount our price a bit to contribute to their Foundation. We also have some four other agents/distributors considering carrying our wine in several other states in the mid Continent and South. We hope the brand starts selling by the container load, rather than the pallet, by the end of 2017.
5. We are also very proud of another accomplishment by our management team: the creation of a *Silkbush Educational Foundation* and the imminent exporting of 22 near new PC laptops donated by the IT department of a Minnesota teachers' union (that chooses to remain anonymous). The donation has been facilitated by a close friend of the Jefferson family; Dave will pay the shipping costs, and some Rotarians in Cape Town are processing the forms required by the RSA Customs people. Eleven of the laptops will be given to *Leap Technology Schools* in CT, and the 11 others to a middle school in the Breerivier area chosen by Anton. There is no question that most children of ag workers who are not exposed to technology early are going to always be in low skill, entry level jobs. We can't help them all but this is a significant start and we hope to influence other wineries and growers to do similar things.
6. Importantly, attached is the roster of partners scheduled to make capital contributions to *Silkbush Mountain Vineyards* by January 31st. Please send your checks to *Burdell Properties* as early as possible. The harvest will be about to begin, and we must order replacement vines and hire heavy equipment to complete the replanting, which happens within months after the last grapes are picked.
7. I will make my annual pilgrimage to *Silkbush* starting the second week of April and stay to the end of the month. In addition to meeting with Anton and reviewing the vineyard status, I will make distributor

calls in the Jo'berg/Gauteng area. In South Africa, just as in the US, the people that sell your wine are most responsive to attention from producer visits. Anton has been very effective in these efforts yet we can stretch Anton only so far. Fortunately, I have been doing such visits for almost 20 years for *White Oak Winery* and the past three years for *Silkbush Mountain Vineyards*.

I plan to meet with the Director of WOSA (Wines of South Africa) and see where they are in getting a *Free Trade Agreement* with China (PRC), much as Australia, Chile, and New Zealand have. In very large part, this tax decrease has led to a meteoric rise in Aussie wine exports to the PRC; in the last 12 months, their sales have increased 50% to \$500 million/yr. And to put that into context, Australian wine sales to the PRC were \$27 million only 10 years ago. Australia is now the 2nd largest imported wine source to China, standing only behind France. And at an average price of \$5.90/bottle (imported), OZ is receiving 23.4% of all foreign wine sales. This is about the pricing level we and most other South African producers would like to be achieving in China, to say nothing about the large volumes.

Many factors are involved in such success, but the excise tax of 14% levied on all other wine regions who do not have Free Trade Agreements is a major differentiator. The Chinese tariff on Aussie wine in January 2017 will be only 5.6%; in 2018 it goes to 2.8% and 2019 to zero! To understand how this impacts wine price, 14% of the average Aussie imported bottle price of \$5.90 would be \$.83 excise tax. Multiplied by a conservative 3 times to derive impact on estimated retail prices, the additional cost to the Chinese consumer for anybody else's wine is about \$2.50. This is a major advantage to the wines from Free Trade regions, and South Africa needs to be a member of that grouping.

8. Although some may disagree, we believe the vineyard sales in Napa and Sonoma that we are making is quite encouraging for the long-term valuation of *Silkbush Mountain Vineyards*. Napa Valley and the Russian River Valley have become "wine brands" themselves along with their 1,000+ wineries by producing top quality wine. This was not accomplished overnight, but it has been validated by consistent wine reviews, praise within the wine trade, and, ultimately, in wine sales at profitable and increasing prices. The national and international acceptance of Napa/Sonoma wines at higher levels is now pushing our CA vineyard values upward at very substantial rates. We have one Napa vineyard in escrow at a price close to 50% higher than previous appraisals; a second vineyard in Sonoma will be going from a Letter of Intent to contract within days, at a price also some 50% greater than a comparable vineyard (less than a mile away) appraised for two years ago. NorCal vineyard prices are soaring. Whether this just reflects the peak of a frothy market, or whether new market values are being established, will not be known for another year or two.

At the same time, the better wines from the Cape are now receiving equivalent reviews and acclaim, somewhat improved selling prices, and finally grape prices are also starting to rise modestly. But if South African wine can gain traction in some more markets, we should see bidding for our quality grapes; then resulting price increases are seldom linear. Certainly, international wine competition is intense but if international inflation starts to kick in the next few years, our South African vineyard should also benefit. Stay tuned.

9. While *Homestead Capital* (a \$576 million institutional ag investment fund sponsor, purchasing our NorCal vineyards) does not presently have authorization for overseas investments, they anticipate their next fund will be able to invest outside the US. Several other similar US pension funds have been investing offshore with farms and vineyards for several years. Whether *Homestead* will become a Joint Venture partner with *Silkbush* in another year or two remains to be seen. If their experience with our

vineyards and us is successful, we should have the first shot with them. We also have a new institutional investment company in Gauteng familiar with us, and reportedly giving *Silkbush Mountain Vineyards* some serious consideration in the second half of 2017. We will see where this all leads.

Dave Jefferson

Co-Founder/Director
Silkbush Mountain Vineyards

Silkbush 2017 Capital Contributions

<u>Limited Partner</u>	<u>\$ 2017 Capital</u>	<u>Percentage Contribution</u>
Babbit, Edward	\$ 38,500.00	19.2500%
Baker, Robert	25,000.00	12.5000%
Ballent, Theodore	8,333.00	4.1665%
Hayes, William	8,333.00	4.1665%
Jefferson, David	37,717.00	18.8585%
Kamm, Thomas	4,167.00	2.0835%
Kawase-Taj, Patricia	17,100.00	8.5500%
Stewart, Jon	12,500.00	6.2500%
Shekou, Joe & Heidi	4,167.00	2.0835%
Smith, Norman	15,000.00	7.5000%
Stevens, Sally	12,500.00	6.2500%
Stuckey, Richard	8,333.00	4.1665%
Wade, R.L.	<u>8,350.00</u>	<u>4.1750%</u>
Total	\$ 200,000	100%

The 2017 capital contribution is needed by January 31, 2017. We are replanting certain vineyard blocks during the South African winter (starting by June) and we need to make vine deposits and prepay on equipment contracts in advance of actual planting.