

# Silkbush Mountain Vineyards Management Report

March 21, 2017

**To: All Limited Partners**

**Silkbush Mountain Vineyards**

**Re: 2017 Harvest and Management Report**

## Harvest Status

Anton reports the harvest is coming along exceedingly well. The quality of the grapes is high, the tonnages picked so far are at or just above expectations, and he thinks we may be complete by the end of March. If so, that would be at least two weeks earlier than average. As of March 15th, he has delivered 511.3 metric tons (over 50% of expectations) to a combined total of seven wineries. A breakdown of what has been picked is attached.

## Replanting Status

After putting in 5 hectares of new Cabernet Sauvignon, Grenache Noir, and Pinot Noir (partially already paid for) this year, our longer-term replanting program is for replanting at least 2.5 additional hectares annually. (Virtually all vineyards require some annual replanting.) Anton would prefer to do on average about 2 Ha more annually for next six years; however, exactly how fast this will be accomplished is not certain given the currently weak RSA wine and grape market.

## Wine for Silkbush Partners and for US Sale

By now almost all partners should have received their roughly pro rata distribution of *Silkbush* wines imported in late 2016. We brought in four pallets of 70 cases each, or a total of 280 cases. Two pallets of 2016 *Viognier*, one of 2014 *Altitude*, and one of 2014 *Shiraz*. Most of what was distributed was either *Viognier* or *Altitude*. Our importer of record, and now a limited partner, *Heritage Link Brands Inc./Selena Cuffe*, obtained a strong initial interest by *Whole Foods* in NY in the *Shiraz*, and, naturally, we had little of it available. Accordingly, we reserved virtually all the *Shiraz* for her sales efforts and a few bottles for tastings and reviews where we thought it would do the most good.

You may recall the 2016 *Viognier* received a Double Gold Medal last year at the prestigious 2016 *Michelangelo* wine competition, and another six months of age has increased the quality even further. Everyone we know who has tasted it is highly impressed and we hope it starts to sell in reasonable commercial quantities. The increasing US wine consumer interest in this wine category, especially in better restaurants, is very encouraging; nevertheless, a good many of us have observed that US *Viogniers* have widely varying taste profiles (not just “good” or “bad,” but very different tastes for the grape depending upon where it is grown and probably how talented the winemaker is). For example, as we remarked in our *Silkbush* blog posting of December 20, 2015, we have been favorably impressed by numerous *Viogniers* from Texas, but we did not mention we were disappointed by a number from Virginia.

We have the potential for making at least 3,500 cases of Viognier annually if we can find markets for that much. We also are making a *Shiraz Rose* which sold out quickly in South Africa, and we can make more of it in quantity at *Silkbush* as we grow a great deal of *Shiraz*. (While the price of *Rose* is usually lower, *Rose* is often available within six months of harvest as opposed to 2 years or more when making and aging serious *Shiraz*.) *Rose* sales are climbing everywhere in the world, including the US, as even men are appreciating dry *Rose* during warmer months; it is no longer just a sweet drink for women. Of course, we continue to produce stellar *Pinotage* as well but are not importing any more until somebody proves that the wine will sell in the US.

### Non US Wine Sales

We will likely sell at least 1,000-1250 9L (12 bottle) cases of *Silkbush* wine in South Africa and at least one neighboring country (Swaziland) during calendar 2017, up about 50% from 2016 sales. While that is encouraging, the potential profitability of domestic RSA wine sales has fallen with a recent RSA government excise tax increase of 8.8%. This is very discouraging for an industry that has had a difficult time for the past 10 years. While establishing our brand and gaining public recognition for top quality wine is important, it is clear that potential profitability for *Silkbush* is almost entirely dependent upon export sales, on which RSA taxes are not charged.

Despite a very close relationship with the owner of *Nam Wine Merchants* who also owns one of our key wineries, Guardian Peak, we still have yet to obtain retail listings in Namibia. Anton is trying to find an alternative, as while Namibia is a small country, it has a very substantial tourism business, especially from Germany. (It was a German colony until about 100 years ago.) Continuing, a German wine importer has tried samples of our wine and is prepaying for a half pallet, which will be shipped quite soon.

China potential: Per *The Drinks Business* (2nd March, 2017 by Natalie Wang):

*New figures from Vinexpo predict that wine sales in China will grow by 39.8% in the next three years, leading the country to become the world's second largest wine market after the US. Speaking to press on 1 March in London, Vinexpo CEO Guillaume Deglise said that by 2020, China's wine sales will surpass France and the UK, and grow to a total value of US\$21.7 billion, trailing only behind the US' US\$38.6 billion. Despite its overall size, China's per capita wine consumption only ranks 36th in the world with 1.34 litres, compared to France's 47.19 litres. In 2020, per capita consumption is expected to grow to 1.53 litres. In addition, China is forecast to become the world's biggest non-sparking wine market by 2020, Deglise said. More than 94.5 million cases of non-sparking wines are expected to be exported to China by that time, an increase of 79.3%.*

Every wine producing region in the world is highly aware of this potential, and attempting to penetrate the PRC market profitably is a substantial challenge. From any standpoint, it is going to take an investment in people, time, and energy to establish a solid foothold in China. Fortunately, other RSA wineries, perhaps in a disorganized fashion, have been clawing out a decent market share. Imported wines have roughly a 30% market share in China, and are expected to grow to about 40% within 5 years.

*Silkbush* has applied for trademark registration in China and we hope to have initial samples in Hong Kong within the next three months. The key matter, as you would imagine, is having a responsible and enthusiastic importer involved. My trip a year ago established a beachhead but we have not as yet established who we should try to work with. Mainland China importers for RSA wines still need to deal with the 14% tariff that applies to most imported wines but there are no taxes or tariffs for Hong Kong.

It appears the Manila importer who took down a pallet about 18 months ago is just about ready to make a two pallet order that will be paid for in advance. However, the bureaucratic paperwork has been mind numbing, and until we have the bank transfer received, nothing is guaranteed.

## USA Wine and Vineyard Sales

As we have mentioned before, the wine and vineyard market continues very strong in the US. We closed our Napa Valley sale for *Chiles Valley Vineyard* on February 14<sup>th</sup> for a price of about \$115,000/acre, after attaining good operating profits the last few years, and we have a small *Pinot Noir* vineyard in Sonoma County in escrow with the same institutional buyer, with a sale date of June 30<sup>th</sup>. The *Pinot Noir* vineyard will sell for about \$147,000/acre, or roughly 50% higher than appraised value of highly comparable vineyards less than a mile away. Some believe that the present prices reflect a bubble in valuations, but at least as many think the NYSE at 21,000 for the DJIA is also a bubble!

Our buyer for these two CA vineyards is *Homestead Capital*, a new institutional investment firm dedicated to agriculture based in San Francisco. We met with its management team in December and found them to be very good people. They have about \$700 million in their first two investment funds; they are giving thought to including a portion of their third fund in opportunities outside the US. Accordingly, they might be a possible partner for *Silkbush* in a couple of years.

## Other Short Topics

- The Rand continues to strengthen (or the Dollar fallen) to about R13 to Dollar, from about R15.5 about a year ago. The Rand may have been unduly weak last year, although the overall financial picture for South Africa has not appreciably strengthened. The head of state, Jacob Zuma, continues to say idiotic things, much as certain other Presidents in other countries, which gives foreign investors little confidence but fortunately JZ will be out of office in little more than one year. However, endemic inflation will still plague the country, little matter who replaces Zuma.
- The 20+ donated computer computers (for two South African schools) still have not been shipped from Minnesota, but my darling niece Carla has taken over the effort. We should see the machines boxed, the permits issued in the Cape for tax-free treatment, and the shipment on the water sometime in April.
- Johann Roos started at *Potchefstroom University* in January 2017. His brother, Francois, is but one year behind, and quite determined to study viticulture at *Stellenbosch University*. Fortunately for their parents, the kids have been good students, are and will be recipients of Uncle Dave's significant and continuing contributions to the *Silkbush Education Foundation*.

## 2016 Federal Tax Return

Preparation of the federal tax return is underway by the CPA firm we have used for several years in San Antonio, TX. We anticipate the return being finalized within the next ten days and the Schedule K-1s being distributed individually by our CPA, Art Machado. Lisa O'Connor, in my absence, will also have copies if anyone misplaces theirs.

Regards,

Dave Jefferson, Cofounding Director

Silkbush Mountain Vineyards