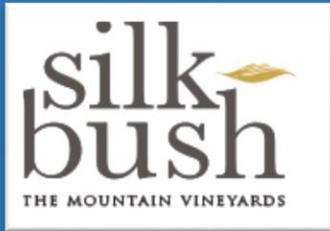


SILKBUSH MOUNTAIN VINEYARDS



MANAGEMENT REPORT

October 12, 2016

OVERVIEW

Much has transpired since we reported last on July 15th. Insofar as our winery business development, the big news is Silkbush winning some significant awards. We will import three of our new wines in the US by (likely) mid-November, and we will make sure that all partners receive at least one case of Silkbush wine. Four pallets of *Viognier*, *Altitude*, and *Shiraz* are now bottled and labeled, awaiting a prospective co-loading container in Cape Town; the freight forwarders have to assemble six other pallets of wine (for a full container) from other RSA wineries, all headed to NY/NJ to complete the shipment. In order to do this, as usual, we had to go through the COLA process (Certificate of Label Approval) with TTB, a US government agency, but this time our importer/partner of record is *Heritage Link Brands*, owned and managed by Selena Cuffe, Brooklyn, NY. As you know, Selena will be our principal US wine marketing agent but her company also handles several other brands in the US, and she is developing a new brand for HLB, called *Kindred*, which will be sourced from multiple international sources. So her resources are being stretched, especially since her marketing VP, Ms. Ama Perodin, left to take a high paying job in a different industry. Lastly, the most recent revisions to the Silkbush website are almost complete, but 99% can be enjoyed now (www.silkbush.com). On the Internet, we are proud to look like a first class “wine farm.”

On the farming front, Anton and his crew finished replanting 5.5 Ha (13.6 acres) of grapes and he reports the young plants are growing exceptionally well already. He made another trip to Namibia this year where we believe *Nam Wine Merchants* will soon be handling our Silkbush brand. The company is owned by Jean Englebrecth, also the owner of *Guardian Peak* winery in Stellenbosch, where we are one of only two suppliers of grapes, and reportedly will soon be over 50% of their grape input. Catherine and I, on our so-called vacation auto trip to Swaziland and Mpumalanga, obtained two new distributors, one of which will also carry our wine in Mozambique, a country immediately adjacent to Swaziland, on South Africa’s eastern border.

The amount of time and energy this all requires is really hard to appreciate, especially in advance by management and also by those not directly involved, including family members and our other partners. Fortunately, I now have the able assistance three days a week of Ms. Lisa O’Connor. Lisa has been assisting our family with numerous tasks on an hourly basis the last two years, and learning a lot about Silkbush activities in the process. She is very quick, energetic, experienced, responsible and damn smart, as I have come to expect from University of California graduates. (I am surrounded by Cal grads, as both partners John Rauck and Don Groth are also Berkeley products. Big Game will be a lot of fun this year, we should think; Cal finally has a good football team that actually looks like it will win more games than it loses.)

WINE MARKETING

As below exhibits, you will find the Gold Medal accomplishments of Silkbush wines as determined by *Vitis Vinifera* (Exhibit 1) and the *Michelangelo Wine Competition* (Exhibit 2). It is one thing to think your children are all beautiful but when others draw the same conclusions, family pride has objective grounds for its bragging. Nevertheless, wine judging is inherently subjective: case in point, our 2014 Shiraz. It was submitted to *Vitis Vinifera*, along with five others, and it did NOT receive a Gold Medal. However, when Selena tasted all the new wines with the NY wine buyer for Whole Foods Market, a potential major account, the buyer went crazy over the quality of the Shiraz, ranking it their first choice. (Frankly, if they start buying in quantity, we'll take that every day over Gold Medals, but favorable reviews are always exceedingly helpful in obtaining motivated distributors and retailers.)

As you will see from our attached email to a TX distributor who presently carries two of Selena's wines, the "narratives" (the back stories) are also quite important. In return, they have requested samples of our three wines and appear eager to consider them for the Texas market. We also have a prospective broker in the Midwest who has been very keen to get us into perhaps four states as soon as he receives samples from us.

Lisa and I have adapted our medal awards discussion for a new Silkbush blog posting. We don't blog frequently but rather when we presumably have something meaningful to discuss. Selena has submitted sample bottles of all our wines to the major wine journals, such as *Wine Spectator* and *Wine Enthusiast*, for reviews in the months to come. Doing well in those magazines would be very helpful.

Lastly, we need to trademark any special names we use for our proprietary blends, like *Altitude*. That name was accepted by the *RSA Wine & Spirits Board* but our attorneys are nervous about its use in the US and elsewhere, since numerous other wineries use *Altitude* in their labels. Accordingly, we will change the "export label version" next year to "Silkbush *Altitude*" or something of that nature. We also need to trademark Silkbush in China- such is the nature of trying to establish and sell wine in the world today. Lots of time consuming details ...

VINEYARD OPERATIONS

Our replanting of virus impacted vines is about 50% complete. During their late winter, Anton reported replanting 5.5 Ha to: 2.2ha of Pinot Noir, 1.8 ha of Grenache noir, and 1.5 ha of Shiraz. Note that Pinot Noir and Grenache are new cultivars to our operations. The Pinot Noir will likely be sold to a winery making sparkling wine ("Champagne" or *Methode Cape Classic*, MCC, as it is properly called in the Cape); about 25% of the Cape wineries are now making MCC wines. The Grenache will permit us to make various Rhone blends with our existing Shiraz and Viognier plantings.

In regard to local marketing, Anton continues: "we are represented in Gauteng, the Lowveld, Natal, and Swaziland- I am setting up the Garden Route (a major tourism drive) where we are already listed at three restaurants, and then City Cellars in Cape Town which has just started an online shop too. Namibia remains an 80% chance of retail listings but we keep working in it. I foresee the need for a PA / admin help in the next year or so if growth remains steady as it is."

As we have remarked earlier, we now have some five different distributors carrying Silkbush in Southern Africa which is very positive. While we don't anticipate very high case sales volumes in the next two years or so, domestic distribution is quite important in building both brand visibility and image for export sales, where we really need to succeed.

Furthermore, to build sales volume, wineries normally have one or two key employees "work the markets" with the distributors' sales people. At present, we only have one such person, Anton Roos, and he has to spend the bulk of his time on the vineyard and assuring the wine is handled properly at Bergsig, including blending, aging, label design, packaging, and shipping logistics. Anton is doing a yeoman effort for us but he only has so many days per year for all

these non-farming activities. I anticipate being back in RSA from April 10th to April 29th, with about 50% of my time there spent on pushing our brand, but that is still a drop in the bucket to what is really needed.

And in the “years are flying by department,” Anton and Franci’s eldest son, Johann will start at the *University of Stellenbosch* in January 2017. He was just an infant when I met the Roos family in 1998! His two younger brothers, Francois and Antonie, are not too far behind either. Fortunately for all, the brothers all get along together quite well, are great students, Internet hip, of course, and should be happy and successful in the years to come. Their parents are naturally very proud of them, as am I as well.

While cell phones are almost as pervasive in the RSA as they are in the USA, personal computers (PCs) are not, especially among the children of most farm workers. We are strongly of the opinion that failure to become highly computer literate during the formative years will severely limit all students once they graduate. Recently, through a family member in Minnesota, I met the head of the EDP department of a large teachers’ union. They are upgrading their PCs with new Microsoft Surface laptops, and will soon have as many as two dozen older PC laptops available to be given away. Anton and I are working on establishing a Silkbush education foundation for the children of vineyard workers, and we may be able to ship all these “barely obsolete” PCs to RSA for two local secondary schools. If we have as many as one PC for every two or three students, we think it would make a real difference in their modern education. We will keep you informed as this project rolls ahead. (One of the first steps is making sure we can ship the computers in protected boxes and that we will not have problems with customs.)

CURRENCY MOVEMENTS (& THEIR IMPLICATIONS)

In July the Rand was 15 to the Dollar; more recently the Rand has strengthened about 10%, and is in the R13.5 -R13.9 range, prospectively making RSA wines a little more expensive in the US market than earlier, but not meaningfully so. For a growing wine business, the major cost to be absorbed is usually not the bottling expenses but rather the investment in bulk wine inventory, which may be required for years, and the expenses of building an unknown brand in a foreign market. “Brand building” usually means “feet on the street,” agents who present the new wines, tasting discounts, extended payment terms, higher commissions, perhaps cooperative advertising expenses for distributors and the list goes on. While our operating costs in RSA are much lower than here in the States, we obtain no benefit from a cheaper Rand when it comes brand building in the US or Asia.

NAPA AND SONOMA VINEYARD ACTIVITIES

We note that after having our Chiles Valley in Napa on the market for several years, we have a full price, all cash offer in escrow with an institutional buyer. If they remove contingencies on November 1st, we will close on Jan. 31, 2017 for \$12,430,000, or about \$120,000/planted acre. There have also been two other recent sales of large Napa vineyards, above \$200,000 and \$300,000/acre, respectively. The Napa vineyard market is incandescent, and Sonoma as well, although at prices normally 50% of the top Napa prices. A number of North Coast wineries have changed hands the past two years, the demand for premium grapes has never been higher, and the prices of vineyards appear to be tracking even faster.

We wish we could report the same results in South Africa, but it is a far different story there, much to our frustration. Despite the fact all the international wine journalists have concluded and published that that most South African wines are superb, and there is growing interest in RSA wines, actual sales have lagged. We have been baffled for years that

there has been no closing of the gap between South African grape and vineyard prices and those of the premium areas of California. Rationally this can't continue forever, but it has for some 20 years.

This is not to contend we have not seen big swings in Napa/Sonoma prices. Napa Cabernet, the Gold standard for grapes, dropped in 2009-2010 about 80% or more, and you could not find buyers for vineyards in that period, at prices above raw land value. However, grape and vineyard prices for Napa have since soared, exceeding prior highs, and Sonoma has been tagging along for the ride.

Most US consumer salary increases have lagged for years while US wine prices are escalating. Imported wines are presently 31% of total US wine consumption and increasing, so hopefully our day is coming.

2017 CAPITAL CALL

Our final capital call per our current partnership agreement is next year, and we have decided to move it 60 days earlier than this year, to January 31, 2017. We have attached a schedule of pro rata shares in the capital call, (*Exhibit 3*). In 2017 we expect to replant about 5 Ha (including Cabernet Sauvignon and Sauvignon Blanc), therefore we need to start preparing the ground as soon as the 2017 harvest is complete. We also must make deposits on grafted vines in their fall; vines are delivered from nurseries in the winter and planting starts in August, if not late July. It is cold and nasty weather then, but getting the vines in the ground pays off with a long growing season and stronger vines.

All in all, much of the 2017 expenditures are "front end loaded." We appreciate your assistance in contributing the capital as early as possible.

Very truly yours ~

Dave Jefferson

See three following exhibits and one attachment

**silk
bush**
THE MOUNTAIN VINEYARDS



We are proud to announce our latest achievements at the Vitis Vinifera Awards.

Focusing on quality – the results speak for themselves.



www.silkbush.com

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THE MOUNTAIN VINEYARDS



Grand d'or (Double Gold)

Michelangelo Awards 2016

Our latest accolades from the biggest wine competition in SA – 1829 total entries.



Gold

focusing on quality – the results speak for themselves.

Exhibit 3

Silkbush 2017 Capital Contributions

Limited Partner	2017 Capital Contribution	Percentage
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%
Kuhry, 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.	8,350.00	4.1750%
Total	<u>\$ 200,000.00</u>	<u>100.0000%</u>

The 2016 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 certain deposits and prepay on equipment contracts in advance of actual planting.