

To: All Limited Partners  
Silkbush Mountain Vineyards

Re: Management Report

**Harvest Underway**

Anton and his crew started harvesting grapes on Feb. 20th (about three weeks later than usual) with our traditionally earliest ripening varieties, Sauvignon Blanc, Pinot Noir and Merlot. The harvest was completed on April 17<sup>th</sup>, with 812.4 tons, down 1% (8.7 tons) from 2016. Earlier in the season, however, his conservative anticipation for the 2017 harvest was for 957 tons, which shows the impact of the West Cape drought, especially minimal winter rain, on our vines. The lack of deep ground water cost us perhaps 144 tons!

We delivered to the following seven wineries:

|                | <u>TONNAGES</u> | <u>VARIETIES</u> | <u>PERCENTAGES</u>                             |
|----------------|-----------------|------------------|--|
| Wabooms        | 178.3           | 6                | 21.9%  |
| Rust & Vrede   | 210.9           | 6                | 26.0% (See note 1)                             |
| KWV            | 166.4           | 4                | 20.5%  |
| Bergsig        | 85.0            | 5                | 10.5% (chiefly for Silkbush wines; see note 1) |
| Flagstone      | 90.3            | 8                | 11.1%  |
| Overhex        | 60.4            | 1                | 7.4%   |
| Rickety Bridge | <u>15.9</u>     | 2                | <u>2.0%</u>                                    |
| <b>Totals</b>  | <b>812.4</b>    |                  | <b>100%</b>                                    |

**Note 1:** Approximately 22 tons of our deliveries to Bergsig will be made into bulk wine and sold to Rust en Vrede; accordingly, their affiliate, Guardian Peak, will ultimately receive about 28.7% of our total production.

We consider this good diversification of buyers and are pleased to see four wineries taking at least a few tons for many of the now 14 cultivars we produce. This gives us multiple winemaker reactions and more potential future

buyers should any one winery pull back on a given cultivar (variety). Cabernet and Shiraz are late to ripen cultivars and constitute close to 50% of our entire production. Accordingly, we don't normally know how well we have done until very close to the end. (In normal years, we have more than adequate water, but this is a far from normal years.)

The grape prices are rising, and we anticipate them to be even greater in 2019, when we presently expect a crop of about 1050 tons. Since 2014, we have replanted 18 hectares due to virus issues. We still have 10 hectares to go but are holding off doing so until we have positive cash flow from operations, which we anticipate by the 2019 harvest.

**Note 2:** We basically equalled the 2017 crop total, which I am happy with taken the conditions in consideration. Remember, we removed 5 ha last year which is not bearing, we have total 15 ha of unproductive/immature vines and five still not in full production, so that means our harvest was up from last year if you compare bearing hectares. The drought definitely had an effect and most significantly on the Merlot and Malbec. We are praying for a good winter so that the soil can get good moisture throughout the profile, something which did not happen last winter or the previous.

## 2017 Tax Returns

Your individual federal Schedule K-1s were emailed to you in February by the CPA firm in San Antonio that does the work. If you did not receive your K-1, please let us know and we will send you another copy.

## Drought Nightmare Continues in Cape

The drought is wreaking havoc on everyone including vineyards. To save the limited remaining water supplies for urban dwellers, most of the Cape's vineyards have been curtailed for water since last winter. The drop in Cape wine grape production will be severe according to these published reports:

"The drought follows a season of damage to crops from frost and hail, which together with 7% fewer hectares tilled for wine grapes over the past decade looks to make this year's harvest the smallest since 2005. Yields could fall between 16% and 20% from the estimated 1.4 million tons of grapes produced in 2017, based on projections.

Depending on the region, vines generally need between 250 and 600 millimeters (between 10 and 24 inches) of rain annually to survive. Though temperatures and precipitation vary by region, South Africa's Winelands have, on the whole, received about half as much rain in the run-up to the annual harvest, which began in early January.

Dams that supply irrigation water to the vineyards stood, on average, 26% full in mid-January compared with about 42% full a year ago. The deficit triggers quotas that have cut the amount of water available at some vineyards by as much as 80%."

The weather plaguing South Africa's wine industry also is taking a toll on the vineyards of Europe, where hail, frost and drought have slashed grape harvests across Italy, France and Spain, which together produce nearly two-thirds of the wine sold worldwide."

"Last year, global wine production fell by 8%. The International Organization of Vine & Wine calls [it the worst wine shortage in 50 years](#). SA is the seventh-biggest wine producer and ninth-largest wine exporter globally, exporting 440Ml a year, alongside the 400Ml sold at home. This makes it responsible for 4% of global production."

<https://law.stanford.edu/2018/02/06/running-out-of-water-cape-town-the-u-s-and-drought/>

<https://www.reuters.com/article/us-saundersonmeyer-drought-commentary/commentary-in-drought-hit-south-africa-the-politics-of-water-idUSKBN1FP226>

## Jefferson Trip to Cape

For the first time in roughly 20 years I did not go to the Cape at harvest. This change of plans is partly due to the big wine show, Capewine2018, now a triannual event, being held in mid September; I have never missed this event and, all told, I will spend some three weeks in the Cape. Secondly, given the expectation of Cape Town and environs running out of water in late April/mid-May, I chose not be in the area at that time. Civic disturbances could be very serious with millions prospectively out of water.

During this September trip (which will be my 39<sup>th</sup> since 1994), I will try to get some sense of vineyard valuations, from other vineyard owners. We have also engaged Kanaan Properties to provide us an estimate of market value for Silkbush. The owner, Wimpie Basson, has been a leading vineyard broker for over the 21 years I have known him. Nevertheless, he has not been able to sell a vineyard in over a year. The Silkbush intrinsic value should be rising because the quality and quantity of our production, increasing prices and our established reputation of a top quality producer. However, due to the drought the majority of vineyards likely will drop in value and numerous ones will undoubtedly be offered for sale. Likely bottom line: our equity above outstanding debt will be nominal at most, and potentially nonexistent.

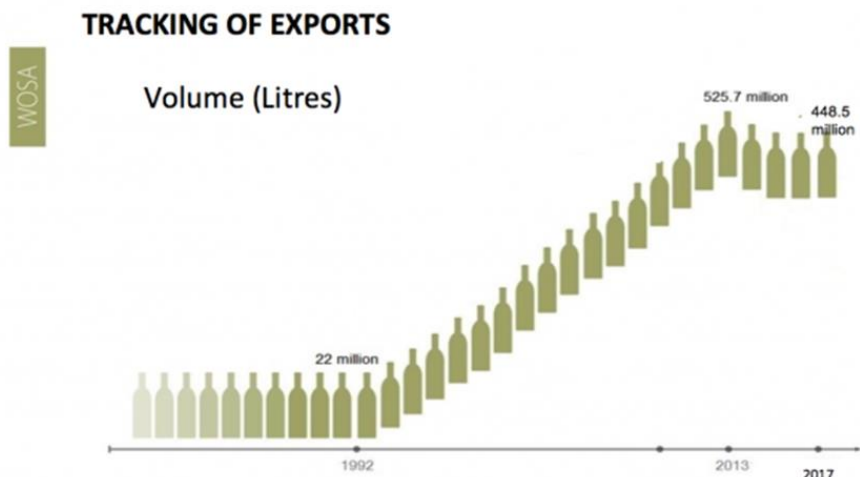
Definitely, we are not alone. According to Wines of South Africa (WOSA) CEO Siobhan Thompson, [only about one in seven of South Africa's 3,160 producers \(growers\) were making a profit and almost half were losing money](#). For 2018, when final results are tabulated, certainly far more than 50% will lose money. Few buyers want to venture into such markets.

## RSA wine sales falter in China, the world's leading wine market

China is likely to displace Britain as the world's second-largest wine consumer, in terms of value, by 2021, according to research from Vinexpo. The growth rate of the Chinese wine market is estimated to exceed 30 per cent over the next five years, starting from 2017 onward, and attain a size of US\$23 billion (S\$30.42 billion) in 2021, second only to the US. Wine priced between US\$5 and US\$20 per bottle remains the dominant choice of Chinese consumers. The premium sector, which means wine priced at US\$10 to US\$20 per bottle, saw year-on-year growth of 11.4 per cent in China during 2017; the origin of the wine was the most decisive factor for Chinese consumers when picking a bottle, and France remains the most popular country of origin for them.

Unfortunately, South African wine exports have dropped to 448.5 million litres in 2017 from a peak of nearly 526m in 2013. Source: WOSA

Around 60% of South Africa's wine production is shipped in bulk,

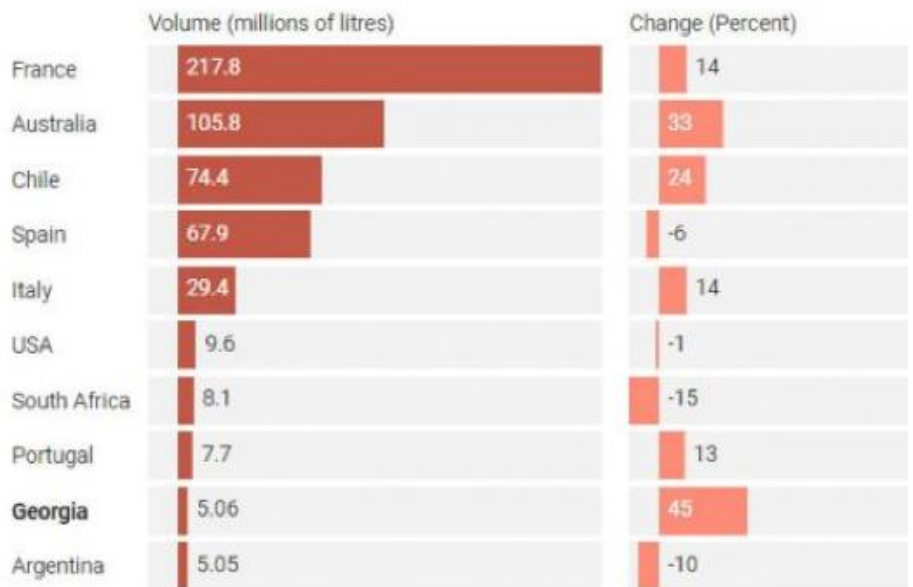


leaving 40% sold in bottle (a ratio that the industry wants to reverse by 2025). It is very important to ship in branded bottles into foreign markets, for several reasons. First, bulk wine prices are seldom greater than production costs so they do not represent a profit opportunity for many. Secondly, bulk wine is usually blended with other wines so a national reputation for quality wine is not created, making it that much more difficult for branded products from a wine region to penetrate the consumer's mind.

The drop last year in sales to China is especially disturbing, as China represents the future of international wine sales growth. And most of South Africa's wine sales in China have been as bulk wine.

McKinsey & Co has projected China's upper middle class and affluent population will grow from 43.5 million in 2012 to 225 million in 2025: and account for 44% of world wide luxury sales demand. "Chinese consumers are attracted to foreign brands as they aspire to Western life and strongly associate quality with imported products," said Willa Yang, Wine Australia's Head of Market in China.

### Source of China's wine imports in 2017



\*Chart on right shows percentage change versus 2016  
 Chart: Decanter • Source: Chinese customs office

### Silkbush wines continue to earn excellent reviews!

Posted Feb. 12, 2018 by Reverse Wine Snob: <http://ReverseWineSnob.com>

#### Silkbush Mountain Vineyards Altitude – Cheeky!

A wine with altitude AND attitude. As we just discussed in our Ask The Expert post a few days ago, there's a good reason you often see the altitude of vineyards called out on wine labels. Today we put that to the test with a wine that not only calls it out but is actually named Altitude.

The 2014 Silkbush Mountain Vineyards Altitude begins with quite a nice aroma of dark, tart fruit, lots of spice, lots of licorice and mint. It's a very enticing combination of aromas. Taking a sip reveals tons of excellent, spicy, rich, tart fruit that is more red than black. You'll also find good balance and structure with hints of vanilla, licorice, cola and more. Each of the five varietals in this blend contribute nicely to the overall. It ends with more spice and more rich fruit on the savory, long finish that gets even better with some time in the glass. This is definitely not your typical boring, manufactured red blend. I'm a big fan of this one.

## 2014 Silkbush Mountain Vineyards Altitude

**TASTE: 9    COST: 5    OVERALL RATING: 7.8    Highly Recommended**

From the bottle: 35% Malbec, 25% Petit Verdot, 15% Shiraz, 15% Pinotage and 10% Merlot from vineyards on the slopes of Waaihoek Mountains in Bredekloof, South Africa. The wine has 3.1 g/L of residual sugar. 14% Alcohol

Surrounded by 2000-meter high mountain peaks, the grapes for this wine are grown between 400 and 700-meter elevations. Nurtured on hilly slopes, shale soils and pure mountain water, these grapes are grown beneath rugged mountain cliffs in the midst of wild fynbos and proteas.

The Silkbush Mountain Vineyards Altitude will be hard to find as it is a new wine to the U.S. market but should be available for \$15-\$20. Ready to buy? Check your local retailers. **Imported by Heritage Link Brands.**

## 2016 Silkbush Viognier receives 90 point rating



## THE **tastingpanel** MAGAZINE

### BLUE REVIEWS

In each issue, Editor-in-Chief Anthony Dias Blue selects a wide range of the best wines and spirits from among the more than 500 he samples over the course of a month. The reviews are subjective editorial evaluations, made without regard to advertising, and products are scored on a 100-point scale:

85-89: VERY GOOD

90-94: OUTSTANDING

95-100: CLASSIC

Once products are selected for publication, producers and importers will be offered the option of having their review accompanied by an image (bottle photo or label art) for a nominal fee. There is no obligation to add an image, nor does the decision affect the review or score in any way.

The "twisty" icon indicates wines sealed with a screwcap closure.

For additional Blue Reviews, go to [www.blueifestyle.com](http://www.blueifestyle.com).

Prices are for 750 ml bottles unless otherwise noted.

Anthony Dias  
**BLUE REVIEWS**

Presented by **BLUE** LIFESTYLE

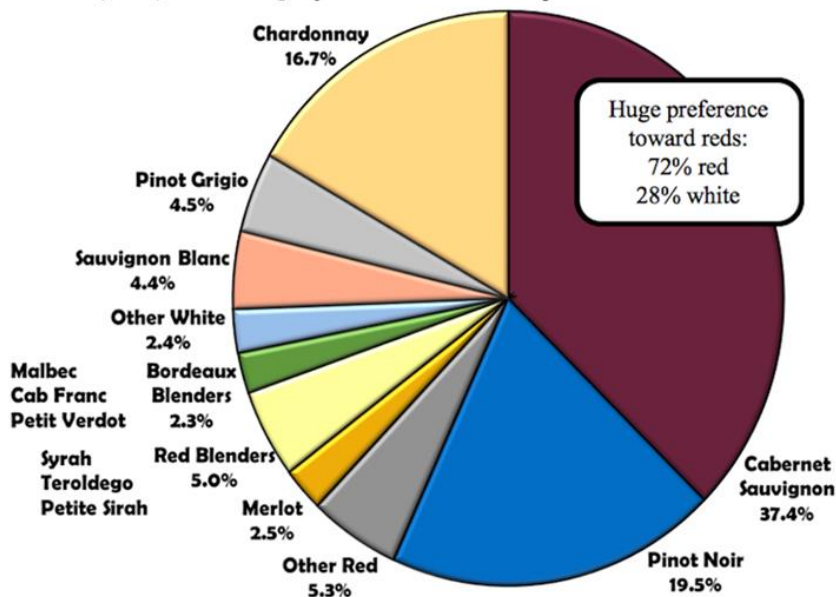
**90** Silkbush Mountain Vineyards  
2016 Viognier, Bredekloof,  
South Africa (\$20) Sumptuous with ripe  
tropical fruit and clean style; silky and juicy  
with balance and good length. 🌀

HERITAGE LINK BRANDS

Anton reports our brand continues to sell in increasing quantities in South Africa, especially in some top end game camps. Our 2017 bottle sales are up 56% over 2016. Legacy Hotels ([www.legacyhotels.co.za](http://www.legacyhotels.co.za)), a luxury chain, owns, among other properties, the Kuzuko Lodge in a private concession to the north of the Addo Elephant National Park, the third largest national park in South Africa. The Food and Beverage Manager loves our wines and is moving to a position where he may be able to replace a number of other wineries offerings with ours. This is the slow but steady way a brand builds a following.



**19,000,000 Winegrape Vines Were Sold by CA Nurseries in 2017**



Source: Allied Grape Growers presentation at 2018 Unified Symposium

**Bank Financing Status**

We financed all our operating costs this season (about \$210,000) with a Ned Bank loan that must be paid off in May. I will replace the 10% interest local bank loan with my own funds advanced to our affiliated Wine Fund at an interest rate of 6%. While Anton believes the vineyard will be able to operate with its own capital henceforward, including service of a local term loan of \$150,000, the Wine Fund debt of Silkbush Holdings continues to compound and is not being reduced. This is not a sustainable situation for Silkbush, and we need to come up with a plan within this year. One alternative, sale of the vineyard, may be unlikely. If that cannot be arranged, much of the Wine Fund debt must be converted into equity to avoid foreclosure. This would be highly dilutive to current equity. (This is the principal reason for obtaining a current appraisal of value.)

Incidentally, the Rand has been strengthening for the last few years. Two years ago, the Rand was about R15.5/US\$1, and as recently as two months ago it was over R14/\$1. Recently it has been approximately R12/\$1. While that appreciation is a greater vote of confidence in the country's currency, and that Jacob Zuma's recent successor as President is the highly regarded Deputy-President Cyril Ramaphosa, the more expensive Rand will make our payoff of the local operating loan more expensive in US Dollars.

With 56% of the 2017 grape harvest in CA already red grapes, 2017 plantings suggest the future will be trending even higher for reds. Because Silkbush is planted 93% to noble reds, we are certainly poised to supply the future US wine market. Now, if US wine drinkers will only start considering South African wine more seriously!

**Conclusion**

You have heard it all before: great vineyard, great grapes, great wines, great management, and great future (if we live that long). However, after 18 years of operations, break even in the Cape next year is the best we can do. And we still have too much debt at the Holding Company level.

We plan to bring a preliminary plan to the Silkbush Advisory Committee in June and refine the plan after I return from South Africa in early October; based upon what the Committee decides, we will report to the Partnership in the Fourth Quarter of the year. We are also investigating what may be an advantageous treatment of Silkbush partner tax capital accounts in 2018.

*Regards,*

**Dave Jefferson**

Director, Silkbush Mountain Vineyards