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1st September 2019

Dear Fellow Black Sheep Brewery Shareholder.

Black Sheep Brewery PLC

Response to the 2019 audited Report & Accounts

Doubtless you will have read through our Black Sheep Brewery's ("Black Sheep" or "Company") latest Report and audited Accounts to 31st March 2019.

With curiously not one, but two chairman's statements (one printed as pages 1 and 2 in the Report, the other a fly-leaf) to digest, and much change announced, they make fascinating reading.

Another "Three Card Trick"

In last year's (to end March 2018) Report & Accounts, chairman Andy Slee ("Andy"), referred to the Management's "three card trick" of increasing revenues and margin, whilst reducing operating expenses, yet his real magician's sleight of hand was the totally illusory "return of the core business to profitability", by the simple and laughter inducing expedient of reducing directors' remuneration by £110,194, some eighty six times that year's reported profit!

And wait for it, this year they've done it again - employing the brilliantly original! wheeze of reducing directors' remuneration by a further £82,189 or 18.55%! And our magician claims they've recorded a second successive year of pre-tax profits! Pull the other leg Andy. Perhaps your secret plan is to ensure the long-term profitability of Black Sheep by making your co-directors pay to work there!

Where’s the Profitability?

Thirteen months ago, Andy stated “Our priority has been to return the core business to profitability”, and this year our magician begins his Chairman’s Statement with the words “as we recorded a second successive year of pre-tax profits after six previous years of losses”, then corrected in his fly-leaf letter to “a second year of trading profit”.

But sadly, by these heart-warming and technically true statements, Andy simply tries to take us all for fools, because (a) there was a reported after tax loss of £23,112 for the year to 31st March 2019 (see page 11), reflected in an equal reduction in group net equity (see page 12), of which more later, and (b) a little more careful reading at the foot of page 13 confirms that our brewery actually lost £105,563, against last year’s notional profit of £1,281.

This latest year’s loss was achieved in a year when true brewery revenues, after stripping out beer duty, actually increased by 5%, suggesting that profitless revenue growth was achieved at the expense of sacrificing margin.

The Balance Sheet

And an examination of the Black Sheep Balance Sheet shows that last year the Company’s (i.e. the Brewery’s) Debtors (moneys the Company are owed and need to collect) increased by an alarming 31.3%, and that’s in a year when revenues only increased by 5%, and overall, Group Creditors increased by 22.4% to £5.27 million, while Net Assets fell marginally to £5.63 million.

And that Net Asset figure includes Tangible Assets of £8.1 million, if you believe they’re genuinely worth that.

Beer Duty

Our magician than moves on to complain about UK Beer Duty, usefully(!) comparing it to the duty paid by Heineken on same-strength cider, rather than duty paid by other brewers on beer, and states that “Black Sheep have been front and centre of the campaign for duty reform”, while neglecting to point out that Black Sheep’s percentage payment of Beer Duty over the last six years has actually dropped by 11.7% from 42.18% to 37.25% (see page 39).

We can’t spend awards

In last year’s accounts, Andy lauded (a) “the Company’s increasing reputation for producing innovative beers of a high quality and consistency”, (b) the number of beer awards won including an industry award as “Beer Champion” and (c) the improved confidence amongst Black Sheep’s staff, whilst evidently forgetting that for us shareholders it’s dividend income and share price growth, not reputation, awards and staff confidence that we can savour and enjoy as reward for investing our hard earned capital.

The strange delay in completing the new In-house Packaging Plant

Then in his follow-up to last September 2018’s AGM, Andy wrote in October that to reduce “spiralling third party packaging costs that last year (i.e. 2018) topped £1.5m”, the Board were “delighted to announce the details of a £2.0m investment to bring packaging in house”, funded entirely by a debt facility from RBS, and that “this will save Black Sheep money as well as providing a potential income stream from third party packaging and will also allow us to be even nimbler with product development.”

While confusingly, in the latest year (i.e. 2019), without commencement, yet alone completion of the new packaging plant, Black Sheep’s “additional third-party packaging costs fell by circa 73% to £0.4 million, which makes one wonder how exactly our Management team do their sums!

Last year the nimble Andy stated that work was due to start early in 2019 and he expected the envisaged fast payback should become apparent by early 2020, but now no sign of that.

The Local Enterprise Partnership Grant

Since then, development of the planned new packaging project has, according to Andy, been slowed by the unscheduled acquisition and integration of York Brewery and “waiting for Local Enterprise Partnership grant money”. Since the new packaging plant is projected to save so much money, and the brewery or rather now “no-brewery” acquisition carried so much risk, perhaps a little more professional and intelligent due-diligence would have guided our hapless Management differently?

Andy says the “grant money is now in place”, but he does not reveal how much has been received, and my research suggests the cash amounts of grants available in North Yorkshire are tiny by comparison with the quoted “additional” packaging costs.

More notably, in the chairman’s statement contained in the latest printed Report & Accounts there is no mention of the previously promised funding from Royal Bank of Scotland (“RBS”), while in his additional fly-leaf chairman’s letter Andy states that “funding for this project has been secured with Royal Bank of Scotland plc”, and goes on to refer to a planned equity issue in the “near future”, and how challenging that has been.

To me the first omission of RBS strongly suggests the delay in implementing the new packaging plant is much more likely because they refused to advance any further funding without an additional counter-balancing equity injection.

In the second half last year (2018) when Andy announced Black Sheep's intention to extend its retail offer outside Masham, he explained that to finance such expansion, it might be necessary to fund such acquisitions with both debt and equity and that the Board would communicate with shareholders once a suitable investment had been targeted. His words were, "a review of the long-term funding and capital structure of the business was under way and would hopefully be completed in the early part of 2019".

The subsequent length of time it has taken Management to secure such additional equity funding, is hardly surprising given the parlous state of our Company's balance sheet with Net Current Liabilities having increased by 73.6% over the last year, and Black Sheep's weak growth and persistent lack of anything approaching meaningful profitability.

The "significant equity capital injection"

Andy reveals in his fly-leaf letter that the Board has asked Black Sheep's advisers, SPARK Advisory Partners ("SPARK"), to help raise new equity ("Placing") and debt. The odd necessity for Andy's second fly-leaf letter, suggests that SPARK made sudden progress on their fund-raising efforts after the 2019 Report & Accounts had gone to print.

In Andy's fly-leaf letter, he states that SPARK have been asked not to permit any investor ("New Investor") to "take overall control of the business", and warns us shareholders, that "introducing new strategic shareholders into the Company will involve some dilution to existing shareholdings".

What does that mean in practice?

Number of new shares to be issued

Well "overall control" would technically mean a New Investor acquiring more than fifty per cent (50%+) of the post equity capital injection number of shares in issue, but, as Black Sheep is a UK PLC and I believe subject to Takeover Panel rules, such an acquisition would, without a "white wash" from the Takeover Panel, trigger a mandatory offer by the New Investor to all shareholders at the Placing price, a risk the Board are unlikely to want to take.

I therefore think it more likely that SPARK will limit any New Investor to a maximum of 29.9% of the enlarged issued equity capital. Since there are currently 2,117,172 Ordinary £1 shares in issue, if Black Sheep were to issue just a further circa 905,000 new shares, a New Investor could acquire 29.9% of the enlarged Company's issued equity capital.

In practice however, because I assume a number of existing shareholders will also subscribe in a Placing, as Andy has promised we will be allowed to do (see second last paragraph of the fly-leaf), the Board may be able to issue rather more new shares to a New Investor, without breaching the 30% control threshold, perhaps between 975,000 and say 1.4 million new shares.

What price will the New Shares be issued at?

Then Andy's words "some dilution" suggest the Placing price will probably be at a discount to Black Sheep's current indicative share price of £1.50.

I have no idea what price level SPARK may be able to negotiate with a New Investor, but if the Placing price was done at just a small, say 10% discount to the notional market price, New Shares might be placed at say £1.35 each, which is less than the price of £1.40 at which the original second-round funding was undertaken twenty-six years ago in March 1993, and suggests the Placing might raise, before costs, between £1.3 million and £1.9 million.

Three thoughts spring from that:

1. Any amount of new equity below £2 million is woefully inadequate to our Company's needs to re-balance its debt laden balance sheet and then to invest for growth;

2. What a disgrace it is on the part of the Theakston Family that this is the first time Black Sheep has ever sought to raise new equity, and at a time when its notional share price has fallen by 78.6% from its distant high; and

3. What a further disgrace it is that the current Board, having announced their possible intention to issue new equity more than a year ago, have allowed our Company's shares to change hands in limbo at the quarterly auctions organised by the Company's market-maker, Asset Match, effectively creating a false market in our Company's shares, because no one could possibly know at what price New Shares would/will be issued.

The York Brewery misadventure

Having purchased York Brewery in a rush last December, Andy suddenly announced on June 11th, post the latest year-end, that it would be closing that brewery just ten days later, due to an inability to agree new mutually acceptable rental terms with the landlord of the brewery site.

That sounds to me like poor due-diligence on our Management's behalf last December. A case of *purchase in haste, and repent at leisure at shareholders' expense*.

And despite having to close the York Brewery in early June and so far not having found a new site to operate from, in the carefully worded paragraph under "Events after the reporting date" on page 38, it states "the directors do not believe there is an impact upon the carrying value of the York Brewery purchase reflected in these accounts."

And in that same paragraph, while it also states the costs (including redundancies) "associated with the exit of the building were to date £41,000", there is no mention of the considerable additional costs that will certainly be incurred "if" and when York Brewery is reinstated in new, as yet to be identified premises.

In other words, not only our Board, but our auditors, RSM UK Audit LLP, too, have signed off on the proposition that a brewery that no longer has an operating brewery is worth exactly the same as it was before closure! Extraordinary. Doubtless, RSM will be able to fully justify that claim to their regulatory body, the Financial Reporting Council.

Conclusion

There are plenty of other conclusions to be drawn from a careful reading of these latest accounts, not least that while Andy has previously spoken of the next steps on the Management's (never ending) journey, there is no mention of future profitability, simply that the Board has evidently identified some "potential funders who share {the Board's} vision for the future of Black Sheep and are keen to support the Board to deliver {its} strategy". Why these brave souls would back the existing Management with their record of non-delivery, beats me.

As Andy writes, the Board are working very closely with a major high street lender to provide yet again more "debt funding for the purchase", so their strategy appears to be to irresponsibly continue to increase debt, for the installation of the new packaging plant, and expansion of Black Sheep's retail offer.

It is notable and sad, after twenty-seven years, that Andy's letters contain no visionary words about increasing our brewery's sales footprint, or crucially investing properly in branding, or Heavens help us achieve "real profitability".

While I congratulate Andy for not blaming Management's lack of progress on Brexit uncertainty like his predecessor once did, the latest Report & Accounts once again highlight the lengths our Board will go to so that Black Sheep can continue as a Theakston Family life-style benefit business at the expense of all of us shareholders.

The AGM on 19th September

I will be attending the 2019 AGM in Masham on Thursday 19th September and hope I will see many of you there.

As the contents of this letter make clear, NOW is surely the time for a change of management and direction at Black Sheep.

So, I strongly recommend you join with me in making your dissatisfaction plain to our hopeless Board, and in particular:

I strongly recommend that, like me and MathEngine PLC, you vote against Ordinary Resolutions 2, 4, 5 and 7, and against Special Resolutions 13 and 14.

Voting against Ordinary Resolutions 2, 4, 5 and 7 would enable us to be rid of RSM as auditors, the two Theakston boys and Paul Nolan, while voting against Special Resolutions 13 and 14 would (a) protect our rights not to be diluted in the promised Placing and (b) avoid Black Sheep's shares becoming even more illiquid than they already are.

Communication with Shareholders

I will be happy to discuss my conclusions and recommendations personally, with any and all of you, and will continue to do my best to respond individually to all messages/e-mails posted on my

www.buildingabetterblacksheep.com web-site, and at my

deeplyconcerned@buildingabetterblacksheep.com G-mail account.

I look forward to seeing you, sharing with you and together, hopefully working together to create real profitability and value for all the long-suffering stakeholders in Black Sheep.

Yours deeply concernedly and very sincerely,

David Nabarro

Director – MathEngine PLC, a Black Sheep shareholder