

WILLAMETTE VALLEY VINEYARDS INC

Form DEF 14A

June 19, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of  
the Securities Exchange Act of 1934 (Amendment No.        )

Filed by the Registrant (X)  
Filed by a Party other than the Registrant ( )

Check the appropriate box:

- ( ) Preliminary Proxy Statement
- ( ) Confidential, for Use of the Commission Only (as permitted by Rule 14a-6 (e) (2))
- (X) Definitive Proxy Statement
- ( ) Definitive Additional Materials
- ( ) Soliciting Material Pursuant to 240.14a-12

WILLAMETTE VALLEY VINEYARDS, INC.  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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Notice of the Annual Meeting of Stockholders

To be held July 16, 2006

Dear Shareholders,

You are cordially invited to the 2006 Annual Meeting of Shareholders ("Annual Meeting") of Willamette Valley Vineyards, Inc., which will be held at our winery, 8800 Enchanted Way, S.E., Turner, Oregon 97392, on Sunday, July 16, 2006, beginning at 1:00 p.m., local time. The Annual Meeting will be held for the following purposes:

1. To consider and vote upon a proposal to elect seven members to our Board of Directors, each to hold office until the 2007 Annual Meeting or and until his or her successor is elected and qualified;
2. To consider and vote upon a proposal to ratify the decision of the Company's Audit Committee to appoint Moss Adams LLP as independent registered public accounting firm for the Company for the fiscal year ending December 31, 2006; and
3. To transact such other business as may properly come before the meeting or any postponements or adjournments of the meeting.

The foregoing items of business are more fully described in the Proxy Statement that accompanies this Notice.

Our Board of Directors has fixed May 18, 2006 as the record date for the determination of shareholders entitled to notice of and to vote at the Annual Meeting and any postponements or adjournments of the meeting, and only shareholders of record at the close of business on that date are entitled to this notice and to vote at the Annual Meeting. A list of shareholders entitled to vote at the Annual Meeting will be available at the meeting and at our offices for ten days prior to the meeting.

We hope that you will use this opportunity to take an active part in our affairs by voting on the business to come before the Annual Meeting, either by executing and returning the enclosed Proxy Ballot or by casting your vote in person at the meeting. Whether or not you plan to attend, please sign, date and return the enclosed proxy in the envelope provided. The prompt return of your proxy card will assist us in preparing for the Annual Meeting. If you receive more than one proxy card because you own shares registered in different names or addresses, each proxy card should be completed and returned.

BY ORDER OF THE BOARD OF DIRECTORS

Jim Bernau  
President and Chairperson of  
the Board of Directors

Turner, Oregon  
June 5, 2006

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## PROXY STATEMENT

for the

ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON JULY 16, 2006

## INTRODUCTION

### General

This proxy statement (the "Proxy Statement") and the accompanying proxy ballot are being furnished to the shareholders of Willamette Valley Vineyards, Inc., an Oregon corporation ("the Company"), as part of the solicitation of proxies by the Company's Board Directors from shareholders of record of outstanding shares of the Company's common stock, no par value (the "Common Stock"), for use in voting at the Company's Annual Meeting of Shareholders to be held on July 16th, 2006 at 1:00 PM at Willamette Valley Vineyards, 8800 Enchanted Way SE, Turner, Oregon 97392 and at any adjournments or postponements thereof, (the "Annual Meeting").

At the Annual Meeting, shareholders will be asked to consider and vote upon the following:

- (i) elect seven members of the Board of Directors,
- (ii) ratify the appointment by the Board of Directors of Moss Adams LLP as the independent registered public accounting firm of the Company for the year ending December 31, 2006, and
- (iii) transact such other business as may properly come before the meeting or any adjournments thereof.

This Proxy Statement, together with the enclosed proxy ballot, is first being mailed to the Company's shareholders on or about June 5, 2006.

Your vote is important. Accordingly, whether or not you plan to attend the Annual meeting, please sign and return the proxy ballot as soon as possible. Shares can be voted at the Annual meeting only if the holder is present in person or by proxy. If you receive more than one proxy card because your shares are registered in different names or at different addresses, please sign and return each such proxy so that all of your shares will be represented at the Annual Meeting.

### Solicitation, Voting and Revocability of Proxies

The Board of Directors has fixed the close of business on May 18, 2006 as the record date for the determination of the shareholders entitled to notice of and to vote at the Annual Meeting. Accordingly, only holders of record of Common Stock at the close of business on such date will be entitled to vote at the Annual Meeting, with each such share entitling its owner to one vote on all matters properly presented at the Annual Meeting. On the record date, there were 2,924 beneficial holders holding 4,058,182 of Common Stock. The presence, in person or by proxy, of a majority of the total number of outstanding shares of Common Stock entitled to vote at the Annual Meeting is necessary to constitute a quorum at the Annual Meeting.

Each enclosed proxy gives discretionary authority to the persons named therein with respect to any amendments or modifications of the Company proposals and any other matters that may be properly proposed at the Annual Meeting. The shares represented by all valid non-revoked proxies returned in time to be voted at the Annual Meeting will be voted in accordance with the instructions marked therein. EXECUTED BUT UNMARKED PROXIES WILL BE VOTED FOR THE ELECTION OF THE DIRECTORS NAMED IN THE PROXY AND FOR THE RATIFICATION OF THE COMPANY'S

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AUDITORS. As of the date hereof, the Company is not aware of any other matter to be presented for action at the Annual Meeting. However, if any other matter(s) properly comes before the Annual Meeting, the proxies solicited hereby will be exercised in accordance with the reasonable judgment of the proxy holders named therein. If the meeting is adjourned or postponed, your shares will be voted by the proxy holders on the new meeting date as well, unless you have revoked your proxy instructions before that date. Under Oregon law, shareholders are not entitled to dissenters rights with respect to any of the proposals set forth in this proxy statement.

The presence of a shareholder at the Annual Meeting will not automatically revoke such shareholder's proxy. A shareholder may, however, revoke a proxy at any time prior to its exercise by filing a written notice of revocation with, or by delivering a duly executed proxy bearing a later date to: Board Secretary, Willamette Valley Vineyards, Inc., 8800 Enchanted Way S.E., Turner, Oregon 97392, or by attending the Annual Meeting and voting in person. Attending the Annual Meeting in and of itself will not revoke previously given proxies. In order to be effective, all revocations and later-filed proxies not delivered in person at the Annual Meeting must be delivered to the Company at the address listed above not later than 5:00 p.m. local time, on Saturday, July 15th, 2006. A shareholder who attends the meeting need not revoke a previously executed proxy and vote in person unless the shareholder wishes to do so. All valid, un-revoked proxies will be voted at the Annual Meeting.

Proxies marked as abstaining will be treated as present for the purpose of determining whether there is a quorum for the Annual Meeting, but will not be counted as voting on any matter as to which abstinence is indicated. Broker "non votes" (i.e., the submission of a proxy by a broker or nominee specifically indicating the lack of discretionary authority to vote on the matter) will not be treated as present for purposes of determining whether there is a quorum for the Annual Meeting unless the broker is given discretion to vote on at least one matter on the agenda.

The Company will pay the cost of its proxy solicitation. In addition to the use of the mails, proxies may be solicited personally, by telephone or by email by directors, officers and employees of the Company, who will not be specially compensated for such activities. Your cooperation in promptly completing and returning the enclosed proxy to vote your shares of Common Stock will help to avoid additional expense.

If you are a shareholder of record and you plan to attend the annual meeting, please indicate this when you vote. If you are a beneficial owner of shares of Common Stock held by a bank, broker or other nominee, you will need proof of ownership to be admitted to the meeting. A recent brokerage statement or letter from the bank, broker, or other nominee are examples of proof of ownership. If you want to vote in person your shares of Company's common stock held in street name, you will have to obtain a proxy, executed in your favor, from the holder of record. You may be asked to provide proof of identification to gain entry to the Annual Meeting.

ELECTION OF DIRECTORS (PROPOSAL NO. 1) At the Annual Meeting, seven directors will be elected, each for a one-year term. Unless otherwise specified on the proxy, it is the intention of the persons named in the proxy to vote the shares represented by each properly executed proxy for the election as directors the persons named below as nominees. The Board of Directors believes that the nominees will stand for election and will serve if elected as directors. However, if any of the persons nominated by the Board of Directors fails to stand for election or is unable to accept election, the proxies will be voted for the election of such other person as a majority of the independent members of the present Board of Directors may recommend. There is no cumulative voting for election of directors. Directors are

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elected by a plurality of votes; therefore, the seven persons receiving the most votes, even if less than a majority of the votes cast, will be elected directors. Abstentions or failure to vote will have no effect on the election of directors, assuming the existence of a quorum.

The following table sets for the names of the Board of Directors nominees for election as a director, and each such person's age at May 31, 2006 and position with the Company.

| Name                   | Position(s) with the Company                        | Age |
|------------------------|---|-----|
| James W. Bernau ***    | Chairperson of the Board,<br>President and Director | 52  |
| James L. Ellis * ***   | Secretary and Director                              | 61  |
| Thomas M. Brian        | Director  | 57  |
| Delna L. Jones **      | Director  | 65  |
| Lisa M. Matich **      | Director  | 43  |
| Betty M. O'Brien*      | Director  | 63  |
| Stan G. Turel * ** *** | Director  | 58  |

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\*Member of the Compensation Committee

\*\*Member of the Audit Committee

\*\*\*Member of the Executive Committee

All directors hold office until the next annual meeting of Shareholders or until his or her successor has have been elected and qualified or his or her resignation, removal or disqualification. Executive officers are appointed by the Board of Directors and serve at the pleasure of the Board of Directors.

Set forth below is additional information as to each nominee.

James W. Bernau. Mr. Bernau has been President and Chairperson of the Board of Directors of the Company since its inception in May 1988. Willamette Valley Vineyards was originally established as a sole proprietorship by Oregon winegrower Jim Bernau in 1983, and he co-founded the Company in 1988 with Salem grape grower, Donald Voorhies. From 1981 to September 1989, Mr. Bernau was Director of the Oregon Chapter of the National Federation of Independent Businesses ("NFIB"), an association of 15,000 independent businesses in Oregon. Mr. Bernau has served as the President of the Oregon Winegrowers Association and the Treasurer of the association's Political Action Committee (PAC) and Chair of the Promotions Committee of the Oregon Wine Advisory Board, the State of Oregon's agency dedicated to the development of the industry. In March 2004, Mr. Bernau received the industry's Founder's Award for his service.

James L. Ellis. Mr. Ellis has served as a Director since July 1991 and Secretary since June 1997. Mr. Ellis has served as the Company's Director of Human Resources from January 1993, and Vice President /Corporate since 1998. From 1990 to 1992, Mr. Ellis was a partner in Kenneth L. Fisher, Ph.D. & Associates, a management-consulting firm. From 1980 to 1990, Mr. Ellis was Vice President and General Manager of R.A. Kevane & Associates, a Pacific Northwest personnel-consulting firm. From 1962 to 1979, Mr. Ellis was a member of and administrator for the Christian Brothers of California, owner of Mont La Salle Vineyards and producer of Christian Brothers wines and brandy.

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Thomas M. Brian. Mr. Brian was appointed to the Board of Directors in June of 2004. Mr. Brian has served as Chairman of the Washington County Board of Commissioners since 1999. Previously, he served for 10 years in the Oregon House of Representatives. While in the legislature, Mr. Brian was Chairman of the Revenue Committee and served on the Judicial and Ways and Means Committees. He also served 10 years as City Councilor and Mayor of Tigard, OR. Mr. Brian has successfully owned and operated a commercial/industrial real estate company for eighteen years.

Delna L. Jones. Ms. Jones has served as a Director since November 1994. Ms. Jones resigned from the Board in December of 2002 having moved to Southern California and was reappointed by the Board in March of 2004 having returned to Oregon. Currently Ms. Jones is President of Delna Jones and Associates, an independent consulting firm dealing with community relations. Ms. Jones was elected in 1998 and served as a County Commissioner for Washington County, Oregon from 1998 to 2000. Ms. Jones has served as project director for the CAPITAL Center, an education and business consortium from 1994 to 1998. From 1985 to 1990, Ms. Jones served as Director of Economic Development with US West Communications. Beginning in 1982, she was elected six times to the Oregon House as the State Representative for District 6. During her tenure, she served as the Assistant Majority Leader; she also chaired the Revenue and School Finance committee, and served on the Legislative Rules and Reorganization committee and the Business and Consumer Affairs committee.

Lisa M. Matich. Ms. Matich was appointed to the Board of Directors in April of 2004. She is the Director of Financial Analysis of PacifiCorp, a multi-state electric utility with over 1.5 million customers. Previously she was a Financial Consultant with SAIC 1996 to 2002, a Fortune 500 company and the nation's largest employee-owned research and engineering company. She was Chief Financial Officer of Egmont Electricity 1991-1996, a New Zealand electricity provider and public company. Ms. Matich also has a background in public accounting with both Price Waterhouse and Coopers & Lybrand. She is a CPA in the state of California and a member of the American Institute of Certified Public Accountants. Ms. Matich has a degree in Business Administration from the University of California, Berkeley.

Betty M. O'Brien. Ms. O'Brien has served as a Director since July 1991. Ms. O'Brien is a partner in Elton Vineyards, a commercial vineyard located in Eola Hills in Yamhill County, Oregon and established in 1983. Ms. O'Brien was the Executive Director of the Oregon Wine Board from 2001 to 2004. Ms. O'Brien was employed by Willamette University as its Director of News and Publications from 1988 to 2000. She is a member of the Oregon Winegrowers Association, having previously served as its President and Treasurer and as a director. Ms. O'Brien is a member of the Vineyard Management/Winemaking Program Advisory Committee at Chemeketa Community College (CCC). She heads a wine industry task force developing a new wine marketing program and curriculum leading to a two-year degree at CCC. She is teaching the first class in the program, Introduction to Wine Marketing.

Stan G. Turel. Mr. Turel has served as a Director since November of 1994. Mr. Turel is President of Turel Enterprises, a real estate management company managing his own properties in Oregon, Washington and Idaho. Prior to his current activities, Mr. Turel was the Principal and CEO of Columbia Turel, (formally Columbia Bookkeeping, Inc.) a position which he held from 1974 to 2001. Prior to the sale of the company to Fiducial, one of Europe's largest accounting firms, Columbia had 26,000 annual tax clients including 4,000 small business clients. Additionally Mr. Turel successfully operated as majority owner two cable TV companies during the 80's and 90's which were eventually sold to several public corporations. Mr. Turel is a pilot, was a former delegate to the White House Conference on Small Business and held positions on several state and local Government committees.

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The Board of Directors met six times during 2005, each Directors attended at least 75% of all meetings. A majority of the Company's directors are independent as that term is used under applicable SEC and Nasdaq rules and regulations.

Board of Directors Committees.

Nominating Committee

The Board of Directors acts as a Nominating Committee for selecting nominees for election as directors. Given its size and the Board believes it functions best as the Nominating Committee. In seeking nominees the Board looks for qualified candidates that will meet the oversight and financial expertise needs of the Company. The Board also looks for nominees who will meet the independent qualifications necessary to meet current standards. Nominations of candidates by shareholders of the Company to be considered by the Committee for membership on the Board of Directors may be submitted at any time, if such nominations are made pursuant to timely notice in writing to the Board Secretary. See "Shareholder Proposals and Nominations" below. The current nominees were selected by the independent members of the Board of Directors, which selection was ratified by the entire Board of Directors.

Compensation Committee

The Board of Directors has appointed a Compensation Committee, which reviews executive compensation and makes recommendations to the full Board regarding changes in compensation, and also administers the Company's 1992 Stock Incentive Plan. During the fiscal year ended December 31, 2005, the Compensation Committee held two meetings. The members of the Compensation Committee currently are Betty M. O'Brien, Chair, Stan Turel, both independent directors and James Ellis, the Company's Vice President and Director of Human Resources. A copy of the Committee's charter can be found on the Company's website, [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com)

Executive Committee

In 1997 the Board appointed an Executive Committee, members are: James Bernau, James Ellis, and Stan Turel. The Executive Committee held two meetings during 2005. All members were present.

Audit Committee

The Audit Committee oversees our financial reporting process on behalf of the Board of Directors and reports to the Board of Directors the results of these activities, including the systems of internal controls that management and the Board of Directors have established, our audit and compliance process and financial reporting. The Audit Committee, among other duties, engages the independent public accountants retained as the registered public accounting firm, pre-approves all audit and non-audit services provided by the independent public accountants, reviews with the independent public accountants the plans and results of the audit engagement, considers the compatibility of any non-audit services provided by the independent public accountants with the independence of such auditors and reviews the independence of the independent public accountants. The members of the Audit Committee are Delna L. Jones, Lisa Matich, and Stan G. Turel. Ms. Matich is designated by the Board of Directors as the "audit committee financial expert" under SEC rules. The Audit Committee conducted four meetings in the year ended December 31, 2005 and all members attended the meetings. A copy of the Audit Committee charter can be found at our website, [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com)

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### DIRECTOR COMPENSATION

The members of the Company's Board of Directors do not receive cash compensation for their service on the Board, but are reimbursed for out-of-pocket and travel expenses incurred in attending Board meetings. Under the Company's Stock Incentive Plan adopted by the shareholders in 1992 and further amended by the shareholders in 1996, 1998, 1999 and 2001 beginning in 1997 an option to purchase 1,500 shares of Common Stock is granted to each Director for service on the Board during the year. This option was increased to 4,000 per year when the 50-share grant per Director's meeting was discontinued for the year 2000 and beyond. In December 2005, each Director was granted 14,000 options for service during 2005. In the foreseeable future, as a result of the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standard ("SFAS") No. 123R, Share-Based Payment, requiring all share-based payments to be recognized as expenses in the statement of operations based on their fair values and vesting periods, the Company does not intend to issue stock options to the Directors for their service.

### COMMUNICATION TO THE BOARD OF DIRECTORS

The Board of Directors welcomes and encourages shareholders to share their thoughts regarding the Company. Towards that end, the Board of Directors has adopted a policy whereby all communications should first be directed to the Company's Secretary. The Secretary will then distribute a copy of the communication to the Chairman of the Board, the Chairperson of the Audit Committee and the Company's outside counsel. Based on the input and decision of these persons, along with the entire Board of Directors if it is deemed necessary, the Company will respond to the communication. Shareholders should not communicate directly with any other individual officer or director unless requested to do so.

### CODE OF ETHICS

The Company adopted a code of ethics applicable to its Chief Executive Officer, Controller and other finance leaders, which is a "code of ethics" as defined by applicable rules of the Securities and Exchange Commission. Amendments to the code of ethics or any grant of a waiver from a provision of the code of ethics requiring disclosure under applicable SEC rules, if any, will be disclosed on our website at [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com). Any person may request a copy of the code of ethics, at no cost, by writing to us at the following address:

Willamette Valley Vineyards, Inc.  
8800 Enchanted Way SE  
Turner, OR 97392  
Attention: Corporate Secretary

### MANAGEMENT / EXECUTIVE OFFICERS

| Name            | Position  | Age |
|-----------------|---|-----|
| James W. Bernau | President, Director and Chairperson of the Board of Directors | 52  |
| James L. Ellis  | Vice President/Corporate and Board Secretary                  | 61  |
| Sean M. Cary    | Controller  | 33  |

Information concerning the principle occupation of Mr. Bernau and Mr. Ellis is set forth under "Election of Directors".



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### CHIEF EXECUTIVE COMPENSATION.

#### Summary of Cash and Certain Other Compensation

The following table provides certain summary information concerning compensation paid or accrued by the Company, to or on behalf of the Company's Chief Executive Officer, James W. Bernau (the "named executive officer") for the years ending December 31, 2004 and 2005.

| Name            | SUMMARY COMPENSATION TABLE |            |           |                               |                         |                               |                  |                         |
|-----------------|----------------------------|------------|-----------|-------------------------------|-------------------------|-------------------------------|------------------|-------------------------|
|                 | Annual Compensation        |            |           | Long Term Compensation        |                         |                               |                  |                         |
|                 | Year                       | Salary(\$) | Bonus(\$) | Other Annual Compensation(\$) | Restricted Stock Awards | Securities Underlying Payouts | LTIP Payouts(\$) | All Other Compensations |
| James W. Bernau |                            |            |           |                               | Award(s)<br>(\$)        | Options/<br>SARs (#)          |                  |                         |
| 2004            | 157,149                    | -          | 6,422     | -                             | 38,000                  | -                             | -                |                         |
| 2005            | 158,658                    | 37,500     | 6,985     | -                             | 147,000                 | -                             | -                |                         |

#### Bernau Employment Agreement

The Company and Mr. Bernau are parties to an employment agreement dated August 3, 1988 and amended in February 1997 and again amended in January of 1998. Under the amended agreement, Mr. Bernau is paid an annual salary of \$158,658 with annual increases tied to increases in the consumer price index. Pursuant to the terms of the employment agreement, the Company must use its best efforts to provide Mr. Bernau with housing on the Company's property. Mr. Bernau and his family live in the manufactured home free of rent and must continue to reside there for the duration of his employment in order to provide additional security and lock-up services for late evening events at the Winery and Vineyard. The employment agreement provides that Mr. Bernau's employment may be terminated only for cause, which is defined as non-performance of his duties or conviction of a crime.

#### Stock Options

In order to reward performance and retain high-quality employees, the Company often grants stock options to its employees. The Company does not ordinarily directly issue shares of stock to its employees. Options are typically issued at a per share exercise price equal to the closing price as reported by the Capital Market at the time the option is granted. The options vest to the employee over time. Three months following termination of the employee's employment with the Company, any and all unexercised options terminate.

#### Option Exercises and Holdings

The following table provides information, with respect to the named executive officer, concerning exercised options during the last fiscal year and unexercised options held as of December 31, 2005.

| Name            | Options exercised in the last fiscal year |                      |
|-----------------|---|----------------------|
|                 | Number<br>Of shares                       | Value<br>Realized(1) |
| James W. Bernau | 113,000                                   | \$271,926            |

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|                 | Number of Securities Underlying<br>Unexercised Options at FY-End |               |
|-----------------|--|---------------|
|                 | Exercisable  | Unexercisable |
| James W. Bernau | 75,000 (3.289)   |               |
|                 | 4,000 (4.136)  |               |
|                 | 64,000 (5.50)  |               |

|                 | Value of Unexercised<br>In-the-Money Options at FY-End(2) |               |
|-----------------|---|---------------|
|                 | Exercisable   | Unexercisable |
| James W. Bernau | 120,825   |               |
|                 | 3,056   |               |
|                 | -   |               |

(1) The value realized is based on the difference between the market price at the time of exercise of the options and the applicable exercise price.

(2) Options are "in the money" at the fiscal year-end if the fair market value of the underlying securities on such date exceeds the exercise price of the option. The amounts set forth represent the difference between the fair market value of the securities underlying the options on December 31, 2005 (\$4.90) per share based on the NASDAQ closing price for the Company's Common Stock on the NASDAQ Capital Market on that date), and the exercise price of the option, multiplied by the applicable number of options.

### CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

During 2004, the Company purchased grapes from Elton Vineyards for \$3,489. Betty M. O'Brien, a Director of the Company, is a principal owner of Elton Vineyards.

On November 26, 2002, Mr. Bernau was granted options to acquire 30,000 shares of the Company's common stock in exchange for his personal guarantee of \$1,000,000 of the Company's Line of Credit from GE Commercial Distribution Finance. The options were issued pursuant to the stock incentive plan and are accounted for as non-compensatory employee stock options. The options are exercisable anytime through November 26, 2007, at an exercise price of \$1.5070 per share. These options were exercised in 2005.

On June 1, 1992, the Company granted Mr. Bernau a warrant to purchase 15,000 shares of the Company's Common Stock as consideration for his personal guarantee of the Real Estate Loan and the Line of Credit from Farm Credit Services pursuant to which the Company borrowed \$1.2 million. The warrant is exercisable anytime through June 1, 2012, at an exercise price of \$3.42 per share. These options were exercised on 2/22/06.

On December 3, 1992, James W. Bernau borrowed \$100,000 from the Company. The loan was secured by Mr. Bernau's stock in the Company, and was payable, together with interest at a rate of 7.35% per annum, on March 14, 2009. Mr. Bernau repaid the entire balance of the loan in December 2004.

The Company believes that the transactions set forth above were made on terms no less favorable to the Company than could have been obtained from unaffiliated third parties. All future transactions between the Company and its officers, directors, and principal shareholders will be approved by a disinterested majority of the members appointed as a Affiliated Transactions

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Committee of the Company's Board of Directors, and will be on terms no less favorable to the Company than could be obtained from unaffiliated third parties.

### SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The following table sets forth certain information with respect to beneficial ownership of the Company's Common Stock as of December 31, 2005, by (i) each person who beneficially owns more than 5% of the Company's Common Stock (ii) each Director of the Company (iii) each of the Company's named executive officers, and (iv) all directors and executive officers as a group.

|  | Number of Shares Outstanding Stock/<br>Percent of Shares Beneficially Owned |
|--|---|
| James W. Bernau      President/CEO, Chair of the Board<br>2545 Cloverdale Road<br>Turner, OR 97392 | 965,299.5 (1)    20.6%  |
| James L. Ellis      Secretary, Director<br>7850 S.E. King Road<br>Milwaukie, OR 97222              | 111,800 (2)      2.4%   |
| Thomas M. Brian    Director<br>7630 SW Fir<br>Tigard, OR 97223                                     | 22,000 (3)      **  |
| Delna L. Jones      Director<br>14480 SW Chardonnay Ave<br>Tigard, OR 97224                        | 27,800 (4)      **  |
| Lisa M. Matich      Director<br>7250 Meadows Court<br>Wilsonville, OR 97070                        | 33,700 (5)      **  |
| Betty M. O'Brien   Director<br>22500 Ingram Lane NW<br>Salem, OR 97304                             | 38,150 (6)      **  |
| Stan G. Turel      Director<br>604 SE 121 Street<br>Vancouver, WA 98683                            | 46,692 (7)      1.0%  |
| Sean M. Cary      Controller<br>11334 Summit Loop SE<br>Turner, OR 97392                           | 30,000 (9)      **  |
| All Directors, executive<br>officers and persons owning<br>5% or more as a group (6 persons)       | 1,275,441.5 (8) 27.2%   |

\*\*                      Less than one percent.

(1) Includes 143,000 shares issuable upon exercise of options exercisable within 60 days of the date of this report.

(2) Includes 106,500 shares issuable upon the exercise of options exercisable within 60 days of the date of this report.

(3) Includes 22,000 shares issuable upon the exercise of options exercisable

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within 60 days of the date of this report.

(4) Includes 26,000 shares issuable upon the exercise of options exercisable within 60 days of the date of this report.

(5) Includes 26,000 shares issuable upon the exercise of options exercisable within 60 days of the date of this report.

(6) Includes 33,000 shares issuable upon the exercise of options exercisable within 60 days of the date of this report.

(7) Includes 26,000 shares issuable upon the exercise of options exercisable within 60 days of the date of this report.

(8) Includes 382,500 shares issuable upon exercise of options exercisable within 60 days of the date of this report.

(9) Includes 30,000 shares issuable upon the exercise of option exercisable with 60 days of the date of this report.

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### SECTION 16 REPORTS

Section 16(a) of the Exchange Act requires the Company's directors and officers, and persons who own more than ten percent (10%) of a registered class of the Company's equity securities, to file initial reports of ownership and report of changes in ownership with the Commission. Such persons also are required to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of the copies of such reports received by it with respect to fiscal year 2005, or written representations from certain reporting persons, the Company believes that all filing requirements applicable to its directors, officers and persons who own more than ten percent (10%) of a registered class of the Company's equity securities have been complied with for fiscal 2005.

### Compensation Committee Report

The Compensation Committee of the Board of Directors is tasked with administering the Company's 1992 Stock Incentive Plan as amended. The Committee and the Board believe that equity-based compensation ensures that the Company's employees, directors and distributors have a continuing stake in the long-term success of the Company. All options granted by the Company are typically granted with an exercise price equal to the market price of the Company's Common Stock on the date of grant and, accordingly, will only have value if the Company's stock price increases. All options have an individual vesting schedule and a term of ten years, except in the case of shareholders who hold a 10% or more of Company stock, in which case the term is 5 years and the grant price must be 10% over market on the day of grant. The Committee met two times and the entire Board acting as the Committee met once in 2005 and granted 496,500 options and 11,025 shares.  
Betty O'Brien, Chairperson, Stan Turel and Jim Ellis, (Management- non voting)  
-- Compensation Committee 2005

### Audit Committee Report

The general purpose of the Audit Committee is to assist the Board of Directors in the exercise of its fiduciary responsibility of providing oversight of the

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Company's financial statements and the financial reporting processes, internal accounting and financial controls, the annual independent audit of the Company's financial statements, and other aspects of the financial management of the Company. The Audit Committee is appointed by the Board of Directors. All committee members must be financially literate, or shall become financially literate within a reasonable period of time after appointment to the Committee.

**Audit Fees:** The aggregate fees billed by Moss Adams for the audit of the Company's annual financial statements and related services reasonably related to the performance of the audit for the fiscal year ended December 31, 2005 were \$104,461.

**Audit-Related Fees:** Moss Adams did not bill the Company for any assurance and related work in fiscal year 2005

**Tax Fees:** Moss Adams did bill the Company for tax compliance, tax advice and tax planning in fiscal year 2005. Moss Adams' fees in connection with federal and state tax returns, which were billed in 2005, were \$22,548, or 16% of the aggregate fees billed for professional services by Moss Adams in 2005.

**Other Fees:** Moss Adams did not bill the Company for any other products or services in fiscal year 2005.

**Pre-Approval Policies:** It is the policy of the Company not to enter into any agreement for Moss Adams to provide any non-audit services to the Company unless (a) the agreement is approved in advance by the Audit Committee or (b) (i) the aggregate amount of all such non-audit services constitutes no more than 5% of the total amount the Company pays to Moss Adams during the fiscal year in which such services are rendered, (ii) such services were not recognized by the Company as constituting non-audit services at the time of the engagement of the non-audit services and (iii) such services are promptly brought to the attention of the Audit Committee and prior to the completion of the audit were approved by the Audit Committee or by one or more members of the Audit Committee who are members of the Board of Directors to whom authority to grant such approvals has been delegated by the Audit Committee. The Audit Committee will not approve any agreement in advance for non-audit services unless (1) the procedures and policies are detailed in advance as to such services, (2) the Audit Committee is informed of such services prior to commencement and (3) such policies and procedures do not constitute delegation of the Audit Committee's responsibilities to management under the Securities Exchange Act of 1934 amended. To date, the Audit Committee has not established such policies and procedures because we do not intend to have our auditors provide any non-audit services in the foreseeable future. If our intentions change, the Audit Committee will adopt the appropriate pre-approval policies and procedures as outlined above.

**Specific Audit Committee Actions Related to Review of the Company's Audited Financial Statements:** In discharging its duties, the Audit Committee, among other actions, has (i) reviewed and discussed the audited financial statements to be included in the company's Annual Report on Form 10-K for the twelve months ended December 31, 2005 with management, (ii) discussed with the Company's independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standard, AU380) related to such financial statements, (iii) received the written disclosures and the letter from the Company's independent accountants required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees) and has discussed with the independent accountant the independent accountant's independence, and (iv) based on such reviews and discussions, the Audit Committee has recommended to the Board of Directors that the audited financial statements be included in the company's Annual Report on Form 10-K for the twelve months ended

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December 31, 2005.

Lisa Matich, 2005 Audit Committee Chair, Stan Turel, and Delna Jones

### ELECTION OF DIRECTORS (PROPOSAL NO. 1)

At the Annual Meeting seven directors will be elected, each for a one-year term. Unless otherwise specified on the proxy, it is the intention of the persons named in the proxy to vote the shares represented by each properly executed proxy for the election as directors the persons named below as nominees. The Board of Directors believes that the nominees will stand for election and will serve if elected as directors. However, if any of the persons nominated by the Board of Directors fails to stand for election or is unable to accept election, the proxies will be voted for the election of such other person as the majority of the independent members of the Board of Directors may recommend. There is no cumulative voting for election of directors. Directors are elected by a plurality of votes; therefore, the seven persons receiving the most votes, even if less than a majority of the votes cast, will be elected directors. Abstentions or failure to vote will have no effect on the election of directors, assuming the existence of a quorum. The Board of Directors unanimously recommends a vote FOR this proposal.

### RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS (PROPOSAL NO. 2)

The Audit Committee has appointed Moss Adams LLP ("Moss Adams") as independent auditors for the 2006 fiscal year. Moss Adams will audit the Company's consolidated financial statements for the 2006 fiscal year and perform other services. While shareholder ratification is not required by the Company's by-laws or otherwise, the Board of Directors is submitting the selection of Moss Adams to the shareholders for ratification as a good corporate governance practice. If the shareholders fail to ratify the selection, the Audit Committee may, but is not required to, reconsider whether to retain Moss Adams. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent public accountant or auditor at any time during the year if it determines that such a change would be in the best interest of the Company and its shareholders.

The proposal will be approved if, assuming the existence of a quorum, at least a majority of the shares of the Company's Common Stock cast on the proposal vote in favor of approval. Abstentions and broker non-votes are counted for purposes of determining whether a quorum exists at the Annual Meeting but will not be counted and will have no effect on the determination of the outcome of the proposal. The proxies will be voted for or against the proposal, or as an abstention, in accordance with the instructions specified on the proxy form. If no instructions are given, proxies will be voted for approval of the ratification of Moss Adams LLP.

A representative of Moss Adams LLP has been invited to attend the Annual Meeting at his own expense and will be given an opportunity to make a statement if he desires to do so and will be available to respond to appropriate questions.

The Board of Directors unanimously recommends a vote FOR this proposal. Assuming the existence of a quorum, the appointment of Moss Adams LLP will be ratified if approved by the holders of a majority of the shares present in person or by proxy.

Dismissal of Prior Auditor

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On December 8, 2004, the Company dismissed PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm. On that date, the Company's Audit Committee met to consider management's recommendation to dismiss PricewaterhouseCoopers LLP as the Company's Independent Registered Public Accounting Firm for the year ending December 31, 2004. At that meeting, the Audit Committee unanimously agreed to dismiss PricewaterhouseCoopers LLP as the Company's Independent Registered Public Accounting Firm. During the Audit Committee meeting, a representative of PricewaterhouseCoopers LLP left a telephone message with the Company's chief financial officer and Audit Committee chair, in which PricewaterhouseCoopers LLP resigned as the Company's Independent Registered Public Accounting Firm effective immediately. PricewaterhouseCoopers LLP later delivered, via facsimile, a letter confirming the cessation of the client-auditor relationship between the Company and PricewaterhouseCoopers LLP effective immediately.

Except as noted in the next sentence, the reports of PricewaterhouseCoopers LLP on the Company's financial statements for the years ended December 31, 2003 and 2002 contained neither an adverse opinion nor a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle. PricewaterhouseCoopers LLP's report on the Company's restated financial statements for the year ended December 31, 2003 included an explanatory paragraph with respect to substantial doubt about the Company's ability to continue as a going concern as a result of the Company's line of credit expiring on January 3, 2005.

During the Company's years ended December 31, 2003 and 2002 and through December 8, 2004, there were no disagreements with PricewaterhouseCoopers LLP, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which, if not resolved to PricewaterhouseCoopers LLP's satisfaction, would have caused it to make reference thereto in their reports on the Company's financial statements for such years.

In connection with such dismissal the Company identified that a) it had incorrectly applied the federal small winery tax credit during 2001, 2002 and 2003, b) it had capitalized and subsequently amortized certain label and package design costs that should have been expensed in the period incurred, c) it had improperly classified the amortization of deferred gain from a sales-leaseback in other income in 2001, 2002 and the first three quarters of 2003 rather than as an offset to lease expense included in selling, general and administrative expenses, and d) it had improperly classified an expense in other expense in the second quarter of 2003 rather than in cost of goods sold. The accounting errors arose because a) deficiencies in the design of the internal control structure and competencies within the accounting and financial reporting function and b) supervisory review procedures related to the preparation of the financial statements, including the process used to initially classify transactions, to ensure that amounts are appropriately classified in accordance with generally accepted accounting principles and classified consistently between reporting periods.

PricewaterhouseCoopers LLP had informed the Company that it believed the deficiency in the design of controls and oversight to ensure operating effectiveness of the controls in place to ensure consistent application of accounting principles generally accepted in the United States of America constituted a material weakness, as defined by the Public Company Accounting Oversight Board ("PCAOB") in PCAOB Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.

The Company has addressed and corrected these deficiencies.

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### SHAREHOLDER PROPOSALS AND NOMINATIONS OF DIRECTORS.

The independent members of the Board of Directors select and recommend to the Board of Directors for approval nominees for director and committee member positions. The Board then considers the recommendation of these directors and decides which nominees to present to the Company's shareholders for election to the Board of Directors.

Proposals by shareholders intended to be presented for action, including proposed nominees for election to the Board of Directors, at the 2007 annual meeting of shareholders must be received by the Company at its principal executive offices, 8800 S.E. Enchanted Way, Turner, Oregon 97392, not later than January 1, 2007. It is suggested that such proposals be submitted by Certified Mail-Return Receipt Requested. The SEC has amended Rule 14a-4(c) under the Exchange Act that governs the Company's use of discretionary proxy voting authority with respect to shareholder proposals that are not included in the Company's proxy solicitation materials pursuant to Rule 14a-8 of the Exchange Act. Therefore, in the event a shareholder does not notify the Company by at least April 20, 2007 (which is 45 days before the date the Company mails its proxy material for the prior year's annual meeting of shareholders (which date is expected to be on or about June 5, 2006 for the Company's 2006 Annual Meeting) of an intent to present such a proposal at the Company's 2007 Annual Meeting, the Company's management proxies will have the right to exercise their discretionary authority in connection with the matter submitted by the stockholder, without discussion of the matter in the proxy statement.

Shareholders who wish to submit a proposed nominee for election to the Board of Directors of the Company for consideration by the Nominating and Corporate Governance Committee should send written notice to the Chairman of the Board of Directors, Willamette Valley Vineyards, Inc., 8800 S.E. Enchanted Way, Turner, Oregon 97392 within the time periods set forth above. Such notification should set forth all information relating to the proposed nominee, as is required to be disclosed in solicitations of proxies for election of directors pursuant to Regulation 14A under the Exchange Act. This includes the proposed nominee's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; the name and address of such shareholder or beneficial owner on whose behalf the nomination is being made; and the number of shares of the Company owned beneficially and of record by such shareholder or beneficial owner. The Nominating and Corporate Governance Committee will consider shareholder nominees on the same terms as nominees selected by the Nominating and Corporate Governance Committee.

### OTHER MATTERS

As of the date of this Proxy Statement, the Board of Directors does not know of any other matters to be presented for action by the shareholders at the 2006 Annual Meeting. If, however, any other matters not now known are properly brought before the meeting, the persons named in the accompanying proxy will vote such proxy in accordance with the determination of a majority of the Board of Directors.

### COST OF SOLICITATION

The cost of soliciting proxies will be borne by the Company. In addition to use of the mails, proxies may be solicited personally or by telephone by directors, officers and employees of the Company, who will not be specially compensated for such activities.



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### ADDITIONAL INFORMATION

A copy of the Company's Annual Report to Shareholders for the fiscal year ended December 31, 2005 accompanies this Proxy Statement. The Company is required to file an Annual Report on Form 10-KSB with the Securities and Exchange Commission. Shareholders may obtain, free of charge, a copy of the Form 10-KSB by writing to James L Ellis, Secretary, Willamette Valley Vineyards, Inc., 8800 Enchanted Way S.E., Turner, Oregon 97392. Or they may access a copy through links provided on the Company's web site: [www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com). The information on the Company's website is not part of this Proxy Statement.

By Order of the Board of Directors  
James W. Bernau  
Chairperson of the Board  
June 5, 2006

Annual Report to Shareholders

### DESCRIPTION OF BUSINESS.

#### Introduction

Willamette Valley Vineyards, Inc. (the "Company") was formed in May 1988 to produce and sell premium, super premium and ultra premium varietal wines (i.e., wine which sells at retail prices of \$7 to \$14, \$14 to \$20 and over \$20 per 750 ml bottle, respectively). Willamette Valley Vineyards was originally established as a sole proprietorship by Oregon winegrower Jim Bernau in 1983. The Company is headquartered in Turner, Oregon, where the Company's Turner Vineyard and Winery are located on 75 acres of Company-owned land adjacent to Interstate 5, approximately two miles south of Salem, Oregon. The Company's wines are made from grapes grown at its vineyards (the "Vineyards") and from grapes purchased from other nearby vineyards. The grapes are crushed, fermented and made into wine at the Company's Turner winery (the "Winery") and the wines are sold principally under the Company's Willamette Valley Vineyards label. Willamette Valley Vineyards is the owner of Tualatin Estate Vineyards and Winery located on approximately 120 acres near Forrest Grove, Oregon, and leases an additional 105 acres of vineyard land at the Forest Grove location.

#### Products

Under its Willamette Valley Vineyards label, the Company produces and sells the following types of wine in 750 ml bottles: Pinot Noir, the brand's flagship and its largest selling varietal in 2005, \$15 to \$50 per bottle; Chardonnay, \$14 to \$25 per bottle; Pinot Gris, \$14 to \$18 per bottle; Riesling and Oregon Blossom (blush blend), \$10 per bottle (all bottle prices included herein are the suggested retail prices). The Company's mission for this brand is to become the premier producer of Pinot Noir from the Pacific Northwest.

The Company currently produces and sells small quantities of Oregon's Nog (a seasonal holiday product), \$10 per bottle, and Edelweiss, \$10 per bottle, under a "Made in Oregon Cellars" label.

Under its Tualatin Estate Vineyards label, the Company currently produces and sells the following types of wine in 750 ml bottles: Pinot Noir, the brand's flagship, \$28 per bottle; Chardonnay, \$17 per bottle; Semi-Sparkling Muscat, \$16 per bottle. The Company's mission for this brand is to be among the

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highest quality estate producers of Burgundy and Alsatian varieties in Oregon.

Under its Griffin Creek label, a joint effort between the Company and Quail Run Vineyards, the Company produces and sells the following types of wine in 750 ml bottles: Merlot, the brand's flagship, \$30 per bottle; Syrah, \$35 per bottle; Cabernet Sauvignon, \$35 per bottle; Cabernet Franc, \$30 per bottle; The Griffin (a Bordeaux blend), \$60 per bottle; Pinot Gris, \$18 per bottle; Viognier, \$25 per bottle; and Pinot Noir, \$25 per bottle. This brand's mission is to be the highest quality producer of Bordeaux and Rhone varieties in Oregon.

### Market Overview

**Wine Consumption Trends:** Wine consumption in the United States declined from 1987 to 1994 due to increased consumer health concerns and a growing awareness of alcohol abuse. That decline was led by sharp reductions in the low-cost non-varietal ("jug") wine and wine cooler segments of the market, which, prior to 1987, were two of the fastest growing market segments. Beginning in 1994, per capita wine consumption began to rise. The Company estimates that premium, super premium and ultra premium wine consumption will experience a moderate increase over the next few years. Consumers have restricted their drinking of alcoholic beverages and view premium, super premium and ultra premium wines as a beverage of moderation. The Company believes this change in consumer preference from low quality, inexpensive wines to premium, super premium and ultra premium wines reflects, in part, a growing emphasis on health and nutrition as a principal element of the contemporary lifestyle as well as an increased awareness of the risks associated with alcohol abuse.

### The Oregon Wine Industry.

Oregon is a relatively new wine-producing region in comparison to California and France. In 1966, there were only two commercial wineries licensed in Oregon. By contrast, in 2004, there were 247 commercial wineries licensed in Oregon and over 13,700 acres of wine grape vineyards, 11,100 acres of which are currently producing. Total production of Oregon wines in 2004 is estimated to be approximately 1,174,749 cases. Oregon's entire 2005 production would have an estimated retail value of approximately \$295.6 million, assuming a retail price of \$200 per case, and a FOB value of approximately one-half of the retail value, or \$147.8 million.

Because of climate, soil and other growing conditions, the Willamette Valley in western Oregon is ideally suited to growing superior quality Pinot noir, Chardonnay, Pinot gris and Riesling wine grapes. Some of Oregon's Pinot noir, Pinot gris and Chardonnay wines have developed outstanding reputations, winning numerous national and international awards

Oregon does have certain disadvantages, however. As a new wine-producing region, Oregon's wines are relatively little known to consumers worldwide and the total wine production of Oregon wineries is small relative to California and French competitors. Greater worldwide label recognition and larger production levels give Oregon's competitors certain financial, marketing, distribution and unit cost advantages.

Furthermore, Oregon's Willamette Valley has an unpredictable rainfall pattern in early autumn. If significantly above-average rains occur just prior to the autumn grape harvest, the quality of harvested grapes is often materially diminished, thereby affecting that year's wine quality.

Finally, phylloxera, an aphid-like insect that feeds on the roots of grapevines, has been found in several commercial vineyards in Oregon. Contrary to the California experience, most Oregon phylloxera infestations have expanded very slowly and done only minimal damage. Nevertheless,

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phylloxera does constitute a significant risk to Oregon vineyards. Prior to the discovery of phylloxera in Oregon, all vine plantings in the Company's Vineyard were with non-resistant rootstock. As of December 31, 2005, the Company has not detected any phylloxera at its Turner site. Beginning with the Company's plantings in May 1992, only phylloxera-resistant rootstock is used. In 1997, the Company purchased Tualatin Vineyards, which has phylloxera at its site. All plantings are on and all future planting will be on phylloxera resistant rootstock. The Company takes all necessary precautions to prevent the spread of phylloxera to its Turner site. Also phylloxera is active at the Belle Provenance Vineyard for which the Company has a 10-year lease. Any planting, training, and care of new plants at the Belle Provenance Vineyard will be the responsibility of the landowner under the terms of the lease, not at the expense of the Company.

As a result of these factors, subject to the risks and uncertainties identified above, the Company believes that long-term prospects for growth in the Oregon wine industry are excellent. The Company believes that over the next 20 years the Oregon wine industry will grow at a faster rate than the overall domestic wine industry, and that much of this growth will favor producers of premium, super premium and ultra premium wines such as the Company's.

### Company Strategy

The Company, one of the largest wineries in Oregon by volume, believes its success is dependent upon its ability to: (1) grow and purchase high quality vinifera wine grapes; (2) vinify the grapes into premium, super premium and ultra premium wine; (3) achieve significant brand recognition for its wines, first in Oregon and then nationally and internationally; and (4) effectively distribute and sell its products nationally. The Company's goal is to continue as one of Oregon's largest wineries, and establish a reputation for producing some of Oregon's finest, most sought-after wines.

Based upon several highly regarded surveys of the US wine industry, the Company believes that successful wineries exhibit the following four key attributes: (i) focus on production of high-quality premium, super premium and ultra premium varietal wines; (ii) achieve brand positioning that supports high bottle prices for its high quality wines; (iii) build brand recognition by emphasizing restaurant sales; and (iv) develop strong marketing advantages (such as a highly visible winery location, successful self-distribution, and life long customer service programs).

To successfully execute this strategy, the Company has assembled a team of accomplished winemaking professionals and has constructed and equipped a 22,934 square foot state-of-the-art Winery and a 12,500 square foot outdoor production area for the crushing, pressing and fermentation of wine grapes.

The Company's marketing and selling strategy is to sell its premium, super premium and ultra premium cork-finished-wine through a combination of (i) direct sales at the Winery, (ii) self-distribution to local and regional restaurants and retail outlets, and (iii) sales through independent distributors and wine brokers who market the Company's wine in specific targeted areas where self-distribution is not economically feasible.

The Company believes the location of its Winery next to Interstate 5, Oregon's major north-south freeway, significantly increases direct sales to consumers and facilitates self-distribution of the Company's products. The Company believes this location provides high visibility for the Winery to passing motorists, thus enhancing recognition of the Company's products in retail outlets and restaurants. The Company's Hospitality Center has further increased the Company's direct sales and enhanced public recognition of its wines.

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### Vineyard

The Company now controls 280 acres of vineyard land. At full production, these vineyards should enable the Company to grow approximately 50% of the grapes needed to meet the Winery's ultimate production capacity of 298,000 gallons (124,000 cases).

### The Property.

The Company's estate vineyard at the Turner site currently has 48 acres planted and producing, with 24 acres of Pinot Noir and 24 acres of Pinot Gris and Chardonnay. The oldest grapevines were planted in 1985, with additional grapevines planted in 1992, 1993, and 1999. Vineyards generally remain productive for 30 to 100 years, depending on weather conditions, disease and other factors. We estimate these vines will continue to produce for another 35 years under conditions known today.

The Vineyard uses an elaborate trellis design known as the Geneva Double Curtain. The Company has incurred the additional expense of constructing this trellis because it doubles the number of canes upon which grape clusters grow and spreads these canes for additional solar exposure and air circulation. Research and practical applications of this trellis design indicate that it should increase production and improve grape quality over traditional designs.

Beginning in 1997, the Company embarked on a major effort to improve the quality of its flagship varietal by planting new Pinot Noir clones that originated directly from the cool climate growing region of Burgundy rather than the previous source, Napa, California, where winemakers believe the variety adopted to the warmer climate over the many years it was grown there.

These new French clones are called "Dijon clones" after the University of Dijon in Burgundy, which assisted in their selection and shipment to a US government authorized quarantine site, and then seven years later to Oregon winegrowers. The most desirable of these new Pinot Noir clones are numbered 113, 114, 115, 667 and 777. In addition to certain flavor advantages, these clones ripen up to two weeks earlier, allowing growers to pick before heavy autumn rains. Heavy rains can dilute concentrated fruit flavors and promote bunch rot and spoilage. These new Pinot Noir clones were planted at the Tualatin Estate on disease resistant rootstock and the 667 and 777 clones have been grafted onto 7 acres of self rooted, non-disease resistant vines at the Company's Estate Vineyard near Turner.

New clones of Chardonnay preceded Pinot Noir into Oregon also arranged by the University of Dijon, and were planted at the Company's Estate Vineyard on disease resistant rootstock.

The purchase of Tualatin Vineyards, Inc. in April 1997 (including the subsequent sale-leaseback of a portion of the property in December 1999) added 83 acres of additional producing vineyards and approximately 60 acres of bare land for future plantings. In 1997, the Company planted 19 acres at the Tualatin site and planted another 41 acres in 1998, the majority being Pinot Noir.

Also in 1997, the Company entered into a 10-year lease with O'Connor Vineyards, now known as Belle Provenance, (53 acres) located near Salem to manage and obtain the supply of grapes from Belle Provenance Vineyards. In 2005, the Company informed Belle Provenance Vineyards that the Company will terminate the current lease at the end of the initial 10-year term.

In 1999, the Company purchased 33 acres of vineyard land adjoining Tualatin Estate for future plantings and used lot line adjustments to create three

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separate land parcels at Tualatin Estate.

Grape Supply.

In 2005, the Company's 48 acres of producing estate vineyard yielded approximately 129 tons of grapes for the Winery's fifteenth crush. Tualatin Vineyards produced 539 tons of grapes in 2005. Belle Provenance Vineyards produced 177 tons of grapes in 2005. In 2005, the Company purchased an additional 277 tons of grapes from other growers. The Winery's 2005 total wine production was 171,889 gallons (72,297 cases) from its 2004 and 2005 crushes. The Company expects to produce 175,000 gallons in 2006 (73,600 cases) from its 2005 crush. The Vineyard cannot and will not provide the sole supply of grapes for the Winery's near-term production requirements. The Company has also entered into grape purchase contracts with certain directors or their respective affiliates of the Company.

In 2005, the Company entered into a long-term grape purchase agreement with one of its Willamette Valley wine grape growers whereby the grower agreed to plant 40 acres of Pinot Gris and 50 acres of Riesling and the Winery agreed to purchase the yield at fixed contract prices through 2015. The wine grape grower must meet strict quality standards for the wine grapes to be accepted by the Winery at time of harvest and delivery. This new long-term grape purchase agreement will increase the Company's supply of high quality wine grapes and provide a long-term grape supply, at fixed prices.

The Company fulfills its remaining grape needs by purchasing grapes from other nearby vineyards at competitive prices. The Company believes high quality grapes will be available for purchase in sufficient quantity to meet the Company's requirements. The grapes grown on the Company's vineyards establish a foundation of quality, through the Company's farming practices, upon which the quality of the Company's wines is built. In addition, wine produced from grapes grown in the Company's own vineyards may be labeled as "Estate Bottled" wines. These wines traditionally sell at a premium over non-estate bottled wines.

Viticultural Conditions.

Oregon's Willamette Valley is recognized as a premier location for growing certain varieties of high quality wine grapes, particularly Pinot Noir, Chardonnay, Riesling and Pinot Gris. The Company believes that the Vineyard's growing conditions, including its soil, elevation, slope, rainfall, evening marine breezes and solar orientation are among the most ideal conditions in the United States for growing certain varieties of high-quality wine grapes. The Vineyard's grape growing conditions compare favorably to those found in some of the famous Viticultural regions of France. Western Oregon's latitude (42o-46o North) and relationship to the eastern edge of a major ocean is very similar to certain centuries-old wine grape growing regions of France. These conditions are unduplicated anywhere else in the world except in the great wine grape regions of Northern Europe.

The Vineyard's soil type is Jory/Nekia, a dark, reddish-brown, silky clay loam over basalt bedrock, noted for being well drained, acidic, of adequate depth, retentive of appropriate levels of moisture and particularly suited to growing high quality wine grapes.

The Vineyard's elevation ranges from 533 feet to 700 feet above sea level with slopes from 2 percent to 30 percent (predominately 12-20 percent). The Vineyard's slope is oriented to the south, southwest and west. Average annual precipitation at the Vineyard is 41.3 inches; average annual air temperature is 52 to 54 degrees Fahrenheit, and the length of each year's frost-free season averages from 190 to 210 days. These conditions compare favorably with conditions found throughout the Willamette Valley viticultural region and

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other domestic and foreign viticultural regions, which produce high quality wine grapes.

In the Willamette Valley, permanent vineyard irrigation generally is not required. The average annual rainfall provides sufficient moisture to avoid the need to irrigate the Vineyard. However, if the need should arise, the Company's property contains one water well which can sustain sufficient volume to meet the needs of the Winery and to provide auxiliary water to the Vineyard for new plantings and unusual drought conditions.

### Winery

Wine Production Facility. The Company's Winery and production facilities are capable of producing up to 104,000 cases (247,000 gallons) of wine per year, depending on the type of wine produced. In 2005, the Winery produced 171,889 gallons (72,297 cases) from its 2003 and 2004 crushes. The Winery is 12,784 square feet in size and contains areas for processing, fermenting, aging and bottling wine, as well as an underground wine cellar, a tasting room, a retail sales room and administrative offices. There is a 12,500 square foot outside production area for crushing, pressing and fermenting wine grapes, and a 4,000 square foot insulated storage facility with a capacity of 30,000 cases of wine. The Company also has a 20,000 square foot storage building to store its inventory of bottled product. The production area is equipped with a settling tank and sprinkler system for disposing of wastewater from the production process in compliance with environmental regulations.

With the purchase of Tualatin Vineyards, Inc., the Company added 20,000 square feet of additional production capacity. Although the Tualatin facility was constructed over twenty years ago, it adds 20,000 cases of wine production capacity to the Company, which the Company felt at the time of purchase was needed. To date, production and sales volumes have not expanded enough to necessitate the utilization of the Tualatin facilities. The Company decided to move current production to its Turner site to meet short-term production requirements. The capacity at Tualatin is available to the Company to meet any anticipated future production needs.

Hospitality Facility. The Company has a large tasting and hospitality facility of 19,470 square feet (the "Hospitality Center"). The first floor of the Hospitality Center includes retail sales space and a "great room" designed to accommodate approximately 400 persons for gatherings, meetings, weddings and large wine tastings. An observation tower and decking around the Hospitality Center enable visitors to enjoy the view of the Willamette Valley and the Company's Vineyard. The Hospitality Center is joined with the present Winery by an underground cellar tunnel. The facility includes a basement cellar of 10,150 square feet (including the 2,460 square foot underground cellar tunnel) to expand storage of the Company's wine in a proper environment. The cellar provides the Winery with ample space for storing up to 1,600 barrels of wine for aging.

Just outside the Hospitality Center, the Company has a landscaped park setting consisting of one acre of terraced lawn for outdoor events and five wooded acres for picnics and social gatherings. The area between the Winery and the Hospitality Center forms a 20,000 square foot quadrangle. As designed, a removable fabric top that can cover the quadrangle, making it an all-weather outdoor facility to promote sale of the Company's wines through outdoor festivals and social events. The Company utilizes this space to host numerous events, most notably the annual fundraiser for the Marion-Polk Food Share, "Chefs' Nite Out."

The Company believes the Hospitality Center and the park and quadrangle has made the Winery an attractive recreational and social destination for tourists and local residents, thereby enhancing the Company's ability to sell its wines.

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### Mortgages on Properties.

Mortgages on Properties. The Company's winery facilities are subject to two mortgages with a principal balance of \$2,269,865 at December 31, 2005. The mortgages are payable in monthly aggregate installments, including principal and interest, of approximately \$454,000 annually through 2012. After 2012, the Company's monthly aggregate mortgage payments including interest will be approximately \$92,000 annually until the year 2014. The mortgage on the Turner site had a principal balance of \$1,723,320 on December 31, 2005. The mortgage on the Tualatin Valley property, issued in April 1997 to fund the acquisition of the property and development of its vineyard, had a principal balance of \$546,545 on December 31, 2005.

### Wine Production.

Wine Production. The Company operates on the principle that winemaking is a natural but highly technical process requiring the attention and dedication of the winemaking staff. The Company's Winery is equipped with current technical innovations and uses modern laboratory equipment and computers to monitor the progress of each wine through all stages of the winemaking process.

The Company's recent annual grape harvest and wine production is as follows:

| Crush Year | Tons of<br>Grapes<br>Crushed | Production<br>Year | Cases<br>Produced |
|------------|------------------------------|--------------------|-------------------|
| 2001       | 1859                         | 2001               | 85,554            |
| 2002       | 1091                         | 2002               | 110,063           |
| 2003       | 917                          | 2003               | 92,208            |
| 2004       | 994                          | 2004               | 73,212            |
| 2005       | 1132                         | 2005               | 72,297            |

### Sales and Distribution

Marketing Strategy. The Company markets and sells its wines through a combination of direct sales at the Winery, sales directly and indirectly through its shareholders, self-distribution to local restaurants and retail outlets in Oregon, directly through mailing lists, and through distributors and wine brokers selling in specific targeted areas outside of the state of Oregon. As the Company has increased production volumes and achieved greater brand recognition, sales to other domestic markets have increased, both in terms of absolute dollars and as a percentage of total Company sales.

Direct Sales. The Company's Winery is located adjacent to the state's major north-south freeway (Interstate 5), approximately 2 miles south of the state's third largest metropolitan area (Salem), and 50 miles in either direction from the state's first and second largest metropolitan areas (Portland and Eugene, respectively). The Company believes the Winery's unique location along Interstate 5 has resulted in a greater amount of wines sold at the Winery as compared to the Oregon industry standard. Direct sales from the Winery are an important distribution channel and an effective means of product promotion. To increase brand awareness, the Company offers educational Winery tours and product presentations by trained personnel.

The Company holds four major festivals and events at the Winery each year. In addition, open houses are held at the Winery during major holiday weekends such as Memorial Day, Independence Day, Labor Day and Thanksgiving, where barrel tastings and cellar tours are given. Numerous private parties, wedding receptions and political and other events are also held at the Winery.

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Direct sales are profitable because the Company is able to sell its wine directly to consumers at retail prices rather than to distributors or retailers at wholesale prices. Sales made directly to consumers at retail prices result in an increased profit margin equal to the difference between retail prices and distributor or wholesale prices, as the case may be. For 2005, direct sales contributed approximately 17% of the Company's revenue.

**Self-Distribution.** The Company has established a self-distribution system, called Bacchus Fine Wines, to sell its wines to restaurant and retail accounts located in Oregon. Eighteen sales representatives, who take wine orders and make some deliveries primarily on a commission-only basis, currently carry out the self-distribution program. Company-provided trucks and delivery drivers support several of these sales representatives. The Company believes this program of self-representation and delivery has allowed its wines to gain a strong presence in the Oregon market with over 1,200 restaurant and retail accounts established as of December 31, 2005.

The Company has expended significant resources to establish its self-distribution system. The system initially focused on distribution in the Willamette Valley, but has expanded to the Oregon coast and southern Oregon. For 2005, approximately 53% of the Company's net revenues were attributable to self-distribution.

**Distributors and Wine Brokers.** The Company uses both independent distributors and wine brokers primarily to market the Company's wines in specific targeted areas where self-distribution is not feasible. Only those distributors and wine brokers who have demonstrated knowledge of and a proven ability to market premium, super premium, and ultra premium wines are utilized. Outside of Oregon, the Company's products are distributed in 37 states and the District of Columbia.

On March 8, 2006 the Company terminated an incentive distribution agreement with a national wine distributor group (the "distributor") with fourteen affiliated distributors. Under the agreement, the Company had agreed to pay the distributor incentive compensation if certain sales goals were met over a five year period. The Company terminated the agreement because the distributors did not reach these goals in every year since the agreement's inception. Following the termination, the Company has continued to do business with the distributors on terms and conditions generally available to all of the Company's distributors.

**Tourists.** Oregon wineries are experiencing an increase in on-site visits by consumers. In California, visiting wineries is a very popular leisure time activity. Wineries in Washington are also experiencing strong interest from tourists. Chateau Ste. Michelle, located near Woodinville, Washington, for example attracts approximately 200,000 visitors per year.

The Company believes its convenient location, adjacent to Interstate 5, enables the Winery to attract a significant number of visitors. The Winery is located less than one mile from The Enchanted Forest, which operates from March 15 to September 30 each year and attracts approximately 130,000 paying visitors per year. Adjacent to the Enchanted Forest is the Thrillville Amusement Park and the Forest Glen Recreational Vehicle Park, which contains approximately 110 overnight recreational vehicle sites. Many of the visitors to the Enchanted Forest and RV Park visit the Winery.

### Competition

The wine industry is highly competitive. In a broad sense, wines may be considered to compete with all alcoholic and nonalcoholic beverages. Within the wine industry, the Company believes that its principal competitors include



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wineries in Oregon, California and Washington, which, like the Company, produce premium, super premium, and ultra premium wines. Wine production in the United States is dominated by large California wineries that have significantly greater financial, production, distribution and marketing resources than the Company. Currently, no Oregon winery dominates the Oregon wine market. Several Oregon wineries, however, are older and better established and have greater label recognition than the Company.

The Company believes that the principal competitive factors in the premium, super premium, and ultra premium segment of the wine industry are product quality, price, label recognition, and product supply. The Company believes it competes favorably with respect to each of these factors. The Company has received "Excellent" to "Recommended" reviews in tastings of its wines and believes its prices are competitive with other Oregon wineries. Larger scale production is necessary to satisfy retailers' and restaurants' demand and the Company believes that its current level of production is adequate to meet that demand for the foreseeable future. Furthermore, the Company believes that its ultimate forecasted production level of 298,000 gallons (124,000 cases) per year will give it significant competitive advantages over most Oregon wineries in areas such as marketing, distribution arrangements, grape purchasing, and access to financing. The current production level of most Oregon wineries is generally much smaller than the projected production level of the Company's Winery. With respect to label recognition, the Company believes that its unique structure as a consumer-owned company will give it a significant advantage in gaining market share in Oregon as well as penetrating other wine markets.

### Governmental Regulation of the Wine Industry

The production and sale of wine is subject to extensive regulation by the U.S. Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau and the Oregon Liquor Control Commission. The Company is licensed by and meets the bonding requirements of each of these governmental agencies. Sale of the Company's wine is subject to federal alcohol tax, payable at the time wine is removed from the bonded area of the Winery for shipment to customers or for sale in its tasting room. The current federal alcohol tax rate is \$1.07 per gallon; however, wineries that produce not more than 150,000 gallons during the calendar year are allowed a graduated tax credit of up to \$0.90 per gallon on the first 100,000 gallons of wine (other than sparkling wines) removed from the bonded area during that year. The Company also pays the state of Oregon an excise tax of \$0.67 per gallon on all wine sold in Oregon. In addition, all states in which the Company's wines are sold impose varying excise taxes on the sale of alcoholic beverages. As an agricultural processor, the Company is also regulated by the Oregon Department of Agriculture and, as a producer of wastewater, by the Oregon Department of Environmental Quality. The Company has secured all necessary permits to operate its business.

Prompted by growing government budget shortfalls and public reaction against alcohol abuse, Congress and many state legislatures are considering various proposals to impose additional excise taxes on the production and sale of alcoholic beverages, including table wines. Some of the excise tax rates being considered are substantial. The ultimate effects of such legislation, if passed, cannot be assessed accurately since the proposals are still in the discussion stage. Any increase in the taxes imposed on table wines can be expected to have a potentially adverse impact on overall sales of such products. However, the impact may not be proportionate to that experienced by producers of other alcoholic beverages and may not be the same in every state.

### Employees

As of December 31, 2005 the Company had 80 full-time employees and 6 part-time

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employees. In addition, the Company hires additional employees for seasonal work as required. The Company's employees are not represented by any collective bargaining unit. The Company believes it maintains positive relations with its employees.

### Additional Information

The Company files quarterly and annual reports with the Securities and Exchange Commission. The public may read and copy any material that the Company files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington D.C. 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. As the Company is an electronic filer, filings may be obtained via the SEC website at ([www.sec.gov](http://www.sec.gov)). Also visit the Company's website ([www.WillametteValleyVineyards.com](http://www.WillametteValleyVineyards.com)) for links to stock position and pricing.

### DESCRIPTION OF PROPERTY.

See "DESCRIPTION OF BUSINESS -- Winery" and "-- Vineyard".

The Company carries Property and Liability insurance coverage in amounts deemed adequate by Management.

### LEGAL PROCEEDINGS.

There are no material legal proceedings pending to which the Company is a party or to which any of its property is subject, and the Company's management does not know of any such action being contemplated.

### SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no matters submitted to a vote of security holders during the Company's Fourth Quarter ended December 31, 2005.

### MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's Common Stock is traded on the Capital Market (formerly known as the NASDAQ Small Cap Market) under the symbol "WVVI." As of December 31, 2005, there were 3,029 stockholders of record of the Common Stock.

The table below sets forth for the quarters indicated the high and low bids for the Company's Common Stock as reported on the Capital Market. The Company's Common Stock began trading publicly on September 13, 1994.

#### Quarter Ended

|      | 3/31/05 | 6/30/05 | 9/30/05 | 12/31/05 |
|------|---------|---------|---------|----------|
| High | \$3.45  | \$4.53  | \$5.46  | \$8.92   |
| Low  | \$2.74  | \$3.11  | \$3.49  | \$4.44   |

#### Quarter Ended

|      | 3/31/04 | 6/30/04 | 9/30/04 | 12/31/04 |
|------|---------|---------|---------|----------|
| High | \$2.52  | \$2.54  | \$2.50  | \$3.98   |
| Low  | \$2.00  | \$2.07  | \$1.87  | \$2.06   |

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The Company has not paid any dividends on the Common Stock, and the Company does not anticipate paying any dividends in the foreseeable future. The Company intends to use its earnings to grow the distribution of its brands, improve quality and reduce debt.

### Equity Plan Information

|  | Number of<br>Securities<br>Number of<br>Securities to be<br>issued upon<br>exercise of<br>outstanding<br>options, warrants<br>and rights | Weighted-average<br>exercise price of<br>outstanding<br>options, warrants<br>and rights | remaining available<br>for future issuance<br>under equity<br>compensation<br>plans (excluding<br>securities reflected<br>in common (a)) |
|--|--|---|--|
| Plan Category  | (a)  | (b)   | (c)  |
| Equity compensation plans approved by security holders     | 609,500  | \$3.57  | 107,801  |
| Equity compensation plans not approved by security holders | -  | \$-   | -  |
| Total  | 609,500  | \$3.57  | 107,801  |

### MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION.

#### Forward Looking Statement

This Management's Discussion and Analysis of Financial Condition and Results of Operation and other sections of this Form 10KSB contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", and variations of such words and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements include, for example, statements regarding general market trends, predictions regarding growth and other future trends in the Oregon wine industry, expected availability of adequate grape supplies, expected positive impact of the Company's Hospitality Center on direct sales effort, expected increases in future sales. These forward-looking statements involve risks and uncertainties that are based on current expectations, estimates and projections about the Company's business, and beliefs and assumptions made by management. Actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to: availability of financing for growth, availability of adequate supply of high quality grapes, successful performance of internal operations, impact of competition, changes in wine broker or distributor relations or performance, impact of possible adverse weather conditions, impact of reduction in grape quality or supply due to disease, impact of governmental regulatory decisions, and other risks detailed below as well as those discussed elsewhere in this Form 10KSB and from time to time in the Company's Securities and Exchange Commission filing and reports. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic economic conditions.

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### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses Willamette Valley Vineyards' consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles. As such, management is required to make certain estimates, judgments and assumptions that are believed to be reasonable based upon the information available. On an on-going basis, management evaluates its estimates and judgments, including those related to product returns, bad debts, inventories, investments, income taxes, financing operations, and contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's principal sources of revenue are derived from sales and distribution of wine. Revenue is recognized from wine sales at the time of shipment and passage of title. Our payment arrangements with customers provide primarily 30 day terms and, to a limited extent, 45 or 60 day terms. Shipping and handling costs are included in general and administrative expenses.

The Company values inventories at the lower of actual cost to produce the inventory or market value. We regularly review inventory quantities on hand and adjust our production requirements for the next twelve months based on estimated forecasts of product demand. A significant decrease in demand could result in an increase in the amount of excess inventory quantities on hand. In the future, if our inventory cost is determined to be greater than the net realizable value of the inventory upon sale, we would be required to recognize such excess costs in our cost of goods sold at the time of such determination. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand could have a significant impact on the ultimate selling price and, therefore, the carrying value of our inventory and our reported operating results.

We capitalize internal vineyard development costs prior to the vineyard land becoming fully productive. These costs consist primarily of the costs of the vines and expenditures related to labor and materials to prepare the land and construct vine trellises. Amortization of such costs as annual crop costs is done on a straight-line basis for the estimated economic useful life of the vineyard, which is estimated to be 30 years. The Company regularly evaluates the recoverability of capitalized costs. Amortization of vineyard development costs are included in capitalized crop costs that, in turn are included in inventory costs and ultimately become a component of cost of goods sold.

The Company pays depletion allowances to the Company's distributors based on their sales to their customers. The Company sets these allowances on a monthly basis and the Company's distributors bill them back on a monthly basis. All depletion expenses associated with a given month are expensed in that month as a reduction of revenues. The Company also pays a sample allowance to some of the Company's distributors in the form of a 1.5% discount applied to invoices for product sold to the Company's distributors. The expenses for samples are expensed at the time of sale in the selling, general and administrative expense. The Company's distributors use the allowance to sample product to prospective customers.

Amounts paid by customers to the Company for shipping and handling expenses are included in the net revenue. Expenses incurred for shipping and handling

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charges are included in selling, general and administrative expense. The Company's gross margins may not be comparable to other companies in the same industry as other companies may include shipping and handling expenses as a cost of goods sold.

### OVERVIEW

#### RESULTS OF OPERATIONS

The winery's flagship varietal, Pinot Noir, led sales with an increase of 98%, from 24,550 cases in 2004, to 49,677 cases of the total 110,000 cases of Willamette Valley Vineyards produced wines sold in 2005. Sales revenue increased 46% and net income increased 149% for the year ended December 31, 2005, as compared to the prior year period. Sales revenue increased primarily due to strong sales of the core product offerings to our out-of-state distributors and through the Oregon Wholesale Department, called Bacchus Fine Wines, to Oregon restaurant and retail outlets.

Out-of-state distributor sales revenue increased 78% for the year ended December 31, 2005 as compared to the prior year period. A 59% increase in the distributor's depletions (sales from the distributors to their customers) was the driving force behind the increase in out-of-state sales revenues. The continued demand of certain products has prompted the Company to make careful, upward adjustments in prices as new vintages are released, and place those products on allocation with its distributors in order to address inventory constraints.

Sales revenue through the Company's wholesale sales force and through direct sales from the winery to retail licensees in the state of Oregon increased 38% for the year ended December 31, 2005 as compared to the prior year period, primarily due to the growth of distributed wine brands. Revenue from sales of Company produced products through Bacchus Fine Wines increased 22% for the year ended December 31, 2005 as compared to the prior year period, also contributing to the revenue growth.

The Company used \$3,052,330 of cash generated from net earnings and the reduction in wine inventories resulting from record sales to reduce the amount owed under the bank credit line, the distributor obligation and other financing in 2005. As a result, interest costs have dropped significantly compared to comparable prior year periods. The Company plans to continue to use cash generated from operations to maintain short term financing balances at zero into the future, to the extent possible.

The Company has instituted a 401(k) Profit Sharing Plan for 2006 as an incentive to long-term employee retention and development with a portion of the interest savings as a result of the reduction of debt. The Company will make a safe harbor contribution of 100% of what employees contribute up to 4% of their annual pay.

Increased sales of Company produced products have reduced inventory levels and the Company is reviewing sales projections in order to plan appropriate future inventory production levels. In the past year, the Company planted an additional 25 acres of vines at its Forest Grove site, bringing the planted acreage controlled by the Company to over 250 acres, and contracted on a long term basis for 90 new acres of wine grapes. The Company expects the shortage of inventory of certain products is likely to constrain the Company's operating performance during 2006.

In 1997, the Company entered into a 10-year lease with O'Connor Vineyards, now known as Belle Provenance, (53 acres) located near Salem to manage and obtain the supply of grapes from Belle Provenance Vineyards. In 2005, the Company

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informed Belle Provenance Vineyards that the Company will terminate the current lease at the end of the initial 10-year term, after the 2006 harvest.

### Wine Quality

The quality of the Company's wines continues to attract national attention. Winery Founder and President Jim Bernau attributes much of the record sales to a national interest in the variety Pinot Noir resulting from the movie "Sideways". The winery staff conducted a national essay contest promoted through its distributors, retailers and website where contestants submitted short essays entitled "Why I Love Oregon Pinot Noir" to win their own "Sideways" trip to Oregon Wine Country. The "\$40 a Day" Food Network show featuring chef Rachael Ray's visit to the winery aired a number of times in 2005, increasing wine consumer awareness of Willamette Valley Vineyards wines as did the nationally broadcast cellar visit of Public Broadcasting's "Caprial and John's Kitchen". Results in the fourth quarter of 2005 were influenced by our Willamette Valley Vineyards Pinot Noir being included in Wine.com's national holiday promotion as well as East Coast wine retailer Stew Leonard's holiday catalog. Also in the fourth quarter of 2005, Consumer Reports magazine listed our Pinot Gris as a "Best Buy" in its holiday catalog and The San Francisco Chronicle named this wine among its Top 100 for the year.

### Sales

Finished wine revenues increased 30% in the year ended December 31, 2005 as compared to the previous year. Unit sales (6 and 12 bottle cases) increased 30% from the previous year. Case sales from the Winery increased to 110,000 cases in the year ended December 31, 2005 from 84,449 cases in 2004 for product produced by the Company. The Company continued to experience increased unit sales for products other than its own through Bacchus Fine Wines, from 13,782 cases in 2004 to 27,217 cases in 2005. The Company's distributors experienced a collective increase of 59% in sales of Company products to their retail customers in 2005.

### Wine Inventory

Inventories of wines produced by the Company continued to decrease in 2005 from their peak in 2002. The Company has held wine production below sales rates for the past several years to bring inventories into balance. The Company believes the fixed costs per unit of production will reduce when production volumes increase. Total finished wine inventory decreased to 134,123 cases in 2005 from 137,399 the previous year due to the sale of the Company's products, and offset by the continued purchasing of other wines for resale by Bacchus Fine Wines. There are many factors that will affect the Company's successful marketing of these wines, including whether the wines maintain their quality through the time they are sold and consumed, whether consumers will continue to enjoy these varieties and to be willing to pay higher prices for these wines, whether increased supply of these types of wines from the Company and other sources will put downward pressure on prices, as well as other factors, many of which management cannot control. In addition, factors that affect the Company's ability to operate profitably and implement the sales and marketing strategy may affect the successful marketing of these wines. Management believes if these factors are successfully addressed, the Company can profitably market these wines.

### Seasonal and Quarterly Results

The Company has historically experienced and expects to continue experiencing seasonal fluctuations in its revenues and net income. In the past, the Company has reported a net loss during its first quarter and expects the first quarter to be the weakest of the year, including the first quarter of 2006. Sales volumes increase progressively beginning in the second quarter through

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the fourth quarter because of consumer buying habits.

The following table sets forth certain information regarding the Company's revenues, excluding excise taxes, from Winery operations for each of the last eight fiscal quarters:

|                                | Fiscal 2005 Quarter Ended |         |         | Fiscal 2004 Quarter Ended |         |         |         |         |
|--------------------------------|---------------------------|---------|---------|---------------------------|---------|---------|---------|---------|
|                                | (in thousands)            |         |         | (in thousands)            |         |         |         |         |
|                                | 3/31                      | 6/30    | 9/30    | 12/31                     | 3/31    | 6/30    | 9/30    | 12/31   |
| Tasting room and retail sales  | \$ 334                    | \$ 460  | \$ 514  | \$ 535                    | \$ 328  | \$ 331  | \$ 458  | \$ 482  |
| On-site and off-site festivals | 46                        | 2       | 18      | 8                         | 50      | 12      | 16      | 10      |
| In-state sales                 | 1,237                     | 1,789   | 1,751   | 2,298                     | 902     | 1,171   | 1,283   | 1,783   |
| Bulk/Grape sales               | 90                        | 12      | 9       | 10                        | 9       | 7       | 10      | 21      |
| Out-of-state sales             | 722                       | 1,311   | 1,458   | 1,446                     | 597     | 650     | 635     | 896     |
| Total winery revenues          | \$2,429                   | \$3,574 | \$3,750 | \$4,297                   | \$1,886 | \$2,171 | \$2,402 | \$3,192 |

### Period-to-Period Comparisons

Revenue. The following table sets forth, for the periods indicated, select revenue data from Company operations:

Year Ended December 31  
(in thousands)

|                                 | 2005     | 2004     |
|---------------------------------|----------|----------|
| Tasting room and retail sales   | \$ 1,843 | \$ 1,599 |
| On-site and off-site festivals  | 74       | 88       |
| In-state sales                  | 7,075    | 5,139    |
| Bulk /Grape Sales               | 121      | 47       |
| Out-of-state sales              | 4,937    | 2,778    |
| Revenues from winery operations | \$14,050 | \$ 9,651 |
| Less Excise Taxes               | 382      | 264      |
| Net Revenue                     | \$13,668 | \$ 9,387 |

### 2005 Compared to 2004

Tasting room and retail sales for the year ended December 31, 2005 increased \$243,403, or 15%, as compared to the corresponding prior year period. Tasting room sales increased during the year ended December 31, 2005, due primarily to increased customer traffic flows at the Company's winery tasting room, a 13% increase in purchases in the tasting room and a 36% increase in key customer phone sales. The focus on customers for life through telephone, mail order and retail sales will continue with the goal of expanding the customer base and continuing the trend of increasing revenue generation by the retail department. The Company experienced a decrease in revenue during 2005 in on-site and off-site festivals revenue of 16%, or \$13,763 as compared to the same period in 2004. This decrease is due primarily to the continuing focus away from on-site and off-site events, and towards telephone, mail order and retail sales.

Sales in the state of Oregon, through the Company's independent sales force and through direct sales from the winery increased \$1,936,110, or 38%, in the year ended December 31, 2005, as compared to the corresponding prior year period. Sales through the Company's independent sales force alone for the year

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ended December 31, 2005 increased \$1,605,925, or 38%, as compared to the prior year period. The Company's direct instate sales to its largest customer increased \$311,931, or 42%, in the year ended December 31, 2005, as compared to the prior year period. These increases are largely the result of the broader product lines presented and increased product placements through the development of Bacchus Fine Wines.

Out-of-state sales in the year ended December 31, 2005 increased \$2,158,981, or 78%, as compared to the prior year period. The increased sales are primarily a result of promotional allowances offered to distributors by the Company that are resulting in increased depletions by the Company's distributors. Depletions of wine through the Company's distributors to their customers increased in the year ended December 31, 2005 by 58%, to 47,783 cases, from 30,227 cases in the prior year period. The Pinot Noir variety led sales in 2005.

The Company pays alcohol excise taxes to both the Oregon Liquor Control Commission and to the U.S. Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau. These taxes are based on product sales volumes. The Company is liable for the taxes upon the removal of product from the Company's warehouse on a per gallon basis. The Company also pays taxes on the grape harvest on a per ton basis to the Oregon Liquor Control Commission for the Oregon Wine Board. The Company's excise taxes for the year ended December 31, 2005 increased 45% as compared to the prior year period. This was due primarily to the increased sales in the year ended December 31, 2005 as compared to the prior year period, thereby increasing overall sales volumes and taxes calculated based on volume. Sales data in the discussion above is quoted before the exclusion of excise taxes.

As a percentage of net revenue, gross profit decreased to 47% in the year ended December 31, 2005, from 49% in the prior year period. While the Company is continuing its focus on improved distribution of higher margin products as well as continuing to reduce grape and production costs, we anticipate that our increased representation of brands other than our own through our Oregon sales force will further erode the gross margins due to the lower margins associated with selling those brands. While the gross margin may erode due to such representation, the Company does not anticipate that net income will follow that trend.

Amortization of vineyard development costs is included in capitalized crop costs that, in turn, are included in inventory costs and ultimately become a component of cost of goods sold. For the years ending December 31, 2005 and 2004, approximately \$79,000 and \$77,000, respectively, were amortized into inventory costs.

Selling, general and administrative expenses for the year ended December 31, 2005 increased 23% compared to the prior year period. This increase is due primarily to higher fixed Oregon wholesale sales and delivery costs and increased shipping and fuel costs. As a percentage of net revenue from winery operations, however, selling, general and administrative expenses decreased to 32% for the year ended December 31, 2005, as compared to 38% for the prior year period, primarily as a result of increased revenues.

|                                | Year Ended December 31 |        |
|--------------------------------|------------------------|--------|
|                                | 2005                   | 2004   |
| Miscellaneous rebates          | \$ -                   | \$ 44  |
| Gain on Tualatin<br>land sale  | -                      | 76,003 |
| Farm Credit interest<br>rebate | 17,336                 | 14,504 |



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|  |    |        |    |        |
|--|----|--------|----|--------|
| Insurance settlement for<br>Vehicle loss | \$ | -      | \$ | 7,296  |
|  |    | <hr/>  |    | <hr/>  |
| Other income<br>(expense)                | \$ | 17,336 | \$ | 97,847 |

Interest expense decreased 23% or \$71,105 in the year ended December 31, 2005 as compared to the prior year period. Interest costs were lower primarily due to less debt outstanding during the period.

The provision for income taxes and the Company's effective tax rate were \$628,261 and 35% of pre-tax income in the year ended December 31, 2005 with \$345,476 or 43% of pre-tax income recorded for the prior year period.

As a result of the above factors, net income increased to \$1,156,939 in the year ended December 31, 2005 from \$463,682 for the prior year period. Earnings per share were \$0.26 and \$0.10, in the years ended December 31, 2005 and 2004, respectively.

### Liquidity and Capital Resources

At December 31, 2005, the Company had a working capital balance of \$6.8 million and a current ratio of 4.00:1. At December 31, 2004, the Company had a working capital balance of \$6.4 million and a current ratio of 2.87:1. The Company had a cash balance of \$415,591 at December 31, 2005 compared to a cash balance of \$851,492 at December 31, 2004. The decrease in cash was primarily due to the reduction in the Company's line of credit and distributor obligation.

Total cash provided by operating activities in the year ended December 31, 2005 was \$2,570,841, compared to \$644,569 for the prior year period, primarily as a result of an increase in net income, which was substantially attributable to the conversion of inventory to cash through sales in the year ended December 31, 2005 compared to the prior year period.

Total cash used in investing activities in the year ended December 31, 2005 was \$371,073, compared to \$244,590 in the prior year period. Cash used in investing activities consisted of property and equipment additions and vineyard development costs.

Total cash used in financing activities in the year ended December 31, 2005 was \$2,635,669, compared to \$251,348 in the prior year period. Cash used in financing activities primarily consisted of payments on the long term debt, the line of credit, and the distributor obligation.

At December 31, 2005, the line of credit balance was \$0, on a maximum borrowing amount of \$2,000,000. The Company has a loan agreement with Umpqua Bank that contains, among other things, certain restrictive financial covenants with respect to total equity, debt-to-equity and debt coverage, that must be maintained by the Company on a quarterly basis. As of December 31, 2005, the Company was in compliance with all of the financial covenants.

As of December 31, 2005, the Company had a total long-term debt balance of \$2,269,865 owed to Farm Credit Services. The debt with Farm Credit Services was used to finance the Hospitality Center, invest in winery equipment to increase the Company's winemaking capacity, complete the storage facility, and purchase Tualatin Vineyards. In August of 2005, the Company signed a new business loan agreement with Umpqua Bank to borrow \$1,500,000 to pay-off the distributor obligation. As of December 31, 2005, the Company had repaid the entire principle balance of the Umpqua agreement, leaving no outstanding

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balance included in the long-term debt balance.

The Company believes that cash flow from operations and funds available under its existing credit facilities will be sufficient to meet the Company's foreseeable short and long term needs.

The Company's contractual obligations as of December 31, 2005 including long-term debt, grape payables and commitments for future payments under non-cancelable lease arrangements are summarized below:

|  | Payments Due by Period |                     |                     |                     |                     |
|--|------------------------|---------------------|---------------------|---------------------|---------------------|
|  | Total                  | Less than<br>1 year | 1-3 years           | 4-5 years           | After 5<br>years    |
| Long-term debt and<br>capital lease<br>obligations | \$ 2,269,865           | \$ 283,334          | \$ 637,724          | \$ 745,752          | \$ 603,055          |
| Grape Payables                                     | 471,873                | 275,772             | 128,034             | 68,067              | -                   |
| Operating Leases                                   | 2,745,404              | 218,992             | 336,569             | 367,785             | 1,822,058           |
| <b>Total Contractual<br/>Obligations</b>           | <b>\$ 5,487,142</b>    | <b>\$ 778,098</b>   | <b>\$ 1,102,327</b> | <b>\$ 1,181,604</b> | <b>\$ 2,425,113</b> |

### Risk Factors

The following disclosures should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations. These disclosures are intended to discuss certain material risks of the Company's business as they appear to Management at this time. However, this list is not exhaustive. Other risks may, and likely will, arise from time to time.

#### Agricultural Risks Could Adversely Affect Our Business

Winemaking and grape growing are subject to a variety of agricultural risks. Various diseases, pests, fungi, viruses, drought, frost and certain other weather conditions can affect the quantity of grapes available to the Company, decreasing the supply of the Company's products and negatively impacting profitability. In particular, certain of the Company's vines are not resistant to phylloxera; accordingly, those vines are particularly at risk to the effects from an infestation of phylloxera.

#### We May Not Be Able to Grow or Acquire Enough Quality Fruit for Our Wines

The adequacy of our grape supply is influenced by consumer demand for wine in relation to industry-wide production levels. While we believe that we can secure sufficient supplies of grapes from a combination of our own production and from grape supply contracts with independent growers, we cannot be certain that grape supply shortages will not occur. A shortage in the supply of wine grapes could result in an increase in the price of some or all grape varieties and a corresponding increase in our wine production costs.

#### Loss of Key Employees Could Harm Our Reputation and Business

Our success depends to some degree upon the continued service of a number of key employees. The loss of the services of one or more of our key employees, including the President, Winemaker, Controller and the Bacchus General Manager, could harm our business and our reputation and negatively impact our

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profitability.

### Adverse Public Opinion Regarding Our Bacchus Portfolio May Harm Our Business

The Company has invested heavily in products for resale through our Bacchus Fine Wines department. The Company believes that having these products for sale will make it easier to sell additional Company product to the same buyers. If this strategy proves to be unsuccessful, the Company will have substantial inventory of non-Company products to sell at prices that may not cover our costs of such inventory and may result in our selling less Company product than anticipated. Either or both effects could adversely affect our profitability and shareholder value.

### The Company's Ability to Operate Requires Utilization of the Line of Credit

The Company's cash flow from operations historically has not been sufficient to provide all funds necessary for the Company's Operations. The Company has entered into a line of credit agreement to provide such funds and entered into a term loan arrangement, the proceeds of which were used to acquire the Tualatin operations and to construct the Hospitality Center. There is no assurance that the Company will be able to comply with all conditions under its credit facilities in the future or that the amount available under the line of credit facility will be adequate for the Company's future needs. Failure to comply with all conditions of the credit facilities or to have sufficient funds for operations could adversely affect the Company's results of operations and shareholder value.

Costs of being a publicly-held company may put us at a competitive disadvantage

As a public company, we incur substantial costs that are not incurred by our competitors that are privately-held. These compliance costs may result in our wines being more expensive than those produced by our competitors and/or may reduce our profitability compared to such competitors.

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Willamette Valley Vineyards, Inc.

We have audited the accompanying balance sheet of Willamette Valley Vineyards, Inc., as of December 31, 2005, and the related statements of operations, shareholders' equity, and cash flows for the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe

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our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Willamette Valley Vineyards, Inc., as of December 31, 2005, and the results of its operations and cash flows for the two years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Santa Rosa, California  
March 29, 2006

Willamette Valley Vineyards, Inc.  
Balance Sheet

|  | December 31,<br>2005 |
|--|----------------------|
| <b>ASSETS</b>  |                      |
| Current assets:  |                      |
| Cash and cash equivalents  | \$ 415,591           |
| Accounts receivable, net (Note 2)  | 1,568,255            |
| Inventories (Note 3)   | 6,950,993            |
| Prepaid expenses and other current assets  | 22,561               |
| Deferred income taxes (Note 9)   | 91,000               |
|  | -----                |
| Total current assets   | 9,048,400            |
| Vineyard development costs, net  | 1,526,073            |
| Property and equipment, net (Note 4)   | 4,037,160            |
| Debt issuance costs  | 35,410               |
| Other assets   | 80,071               |
|  | -----                |
|  | \$ 14,727,114        |
|  | -----                |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                      |
| Current liabilities:   |                      |
| Line of credit (Note 5)  | \$ -                 |
| Current portion of long-term debt (Note 6)   | 283,334              |
| Accounts payable   | 811,141              |
| Accrued expenses   | 348,169              |
| Income taxes payable   | 344,987              |
| Grape payables   | 471,873              |
|  | -----                |
| Total current liabilities  | 2,259,504            |
| Long-term debt (Note 6)  | 1,986,531            |
| Distributor obligation (Note 12)   | -                    |
| Deferred rent liability  | 164,771              |
| Deferred gain (Note 11)  | 442,214              |
| Deferred income taxes (Note 9)   | 148,000              |
|  | -----                |
| Total liabilities  | 5,001,020            |
|  | -----                |
| Commitments and contingencies (Note 11)  |                      |
| Shareholders' equity (Notes 7 and 8):  |                      |
| Common stock, no par value - 10,000,000<br>shares authorized, 4,660,202 issued and<br>outstanding at December 31, 2005 | 7,613,222            |
| Retained earnings  | 2,112,872            |

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|                            |                             |
|----------------------------|-----------------------------|
| Total shareholders' equity | -----<br>9,726,094<br>----- |
|                            | \$ 14,727,114<br>-----      |

The accompanying notes are an integral part of the financial statements.

Willamette Valley Vineyards, Inc.

Statements of Operations

For the Years Ended December 31, 2005 and 2004

|   | 2005         | 2004         |
|---|--------------|--------------|
| Net revenues                                    | \$13,667,869 | \$ 9,387,141 |
| Cost of goods sold                              | 7,282,112    | 4,806,326    |
|   | -----        | -----        |
| Gross margin                                    | 6,385,757    | 4,580,815    |
| Selling, general and<br>administrative expenses | 4,385,354    | 3,569,296    |
|   | -----        | -----        |
| Income from operations                          | 2,000,403    | 1,011,519    |
| Other income (expenses):                        |              |              |
| Interest income                                 | 1,197        | 4,633        |
| Interest expense                                | (233,736)    | (304,841)    |
| Other income                                    | 17,336       | 97,847       |
|   | -----        | -----        |
|   | (215,203)    | (202,361)    |
|   | -----        | -----        |
| Income before income taxes                      | 1,785,200    | 809,158      |
| Income tax provision (Note 9)                   | 628,261      | 345,476      |
|   | -----        | -----        |
| Net income                                      | \$ 1,156,939 | \$ 463,682   |
|   | -----        | -----        |
| Basic net income<br>per common share            | \$ 0.26      | \$ 0.10      |
|   | -----        | -----        |
| Diluted net income<br>per common share          | \$ 0.25      | \$ 0.10      |
|   | -----        | -----        |

The accompanying notes are an integral part of the financial statements.

Willamette Valley Vineyards, Inc.

Statements of Shareholders' Equity

For the Years Ended December 31, 2005 and 2004

|                                 | Common stock<br>Shares | Dollars   | Retained<br>earnings | Total     |
|---------------------------------|------------------------|-----------|----------------------|-----------|
|                                 | -----                  | -----     | -----                | -----     |
| Balances at December 31, 2003   | 4,479,478              | 7,167,589 | 492,251              | 7,659,840 |
| Stock issuance for compensation | 5,300                  | 12,190    | -                    | 12,190    |

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|   |           |              |             |              |
|---|-----------|--------------|-------------|--------------|
| Common stock issued and options exercised | 1,500     | 2,550        | -           | 2,550        |
| Net income                                | -         | -            | 463,682     | 463,682      |
| Balances at December 31, 2004             | 4,486,278 | \$ 7,182,329 | \$ 955,933  | \$ 8,138,262 |
| Stock issuance for compensation           | 2,725     | 9,610        | -           | 9,610        |
| Common stock issued and options exercised | 171,199   | 421,283      | -           | 421,283      |
| Net income                                | -         | -            | 1,156,939   | 1,156,939    |
| Balances at December 31, 2005             | 4,660,202 | \$ 7,613,222 | \$2,112,872 | \$ 9,726,094 |

The accompanying notes are an integral part of the financial statements.

Willamette Valley Vineyards, Inc.

Statements of Cash Flows

For the Years Ended December 31, 2005 and 2004

|   | 2005        | 2004       |
|---|-------------|------------|
| Cash flows from operating activities:   |             |            |
| Net income  | \$1,156,939 | \$ 463,682 |
| Reconciliation of net income to net cash (used for) provided by operating activities: |             |            |
| Depreciation and amortization   | 556,487     | 636,889    |
| Gain on disposal of fixed assets  | -           | (81,401)   |
| Loss on disposal of vines   | -           | 31,063     |
| Deferred income taxes   | (46,574)    | (17,388)   |
| Bad debt expense  | 16,066      | -          |
| Stock issued for compensation   | 9,610       | 12,190     |
| Changes in assets and liabilities:  |             |            |
| Accounts receivable   | (675,811)   | (111,674)  |
| Inventories   | 1,448,344   | (511,545)  |
| Prepaid expenses and other current assets   | 30,498      | (6,494)    |
| Note receivable   | 5,000       | 61,134     |
| Other assets  | 2,244       | (28,803)   |
| Accounts payable  | 300,338     | (241,416)  |
| Accrued expenses  | (178,691)   | 55,419     |
| Income taxes receivable/payable   | 66,017      | 362,881    |
| Grape payables  | (120,517)   | (77,324)   |
| Deferred rent liability   | 32,986      | 22,790     |
| Deferred gain   | (32,095)    | 74,566     |
| Net cash provided by operating activities   | 2,570,841   | 644,569    |
| Cash flows from investing activities:   |             |            |
| Additions to property and equipment   | (248,030)   | (292,510)  |
| Vineyard development expenditures   | (123,043)   | (102,532)  |
| Proceeds on sale of fixed assets  | -           | 693,632    |
| Net cash provided by (used for) investing activities                                  | (371,073)   | 244,590    |
| Cash flows from financing activities:   |             |            |
| Debt issuance costs   | (4,622)     | (2,178)    |

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|  |             |            |
|--|-------------|------------|
| Net increase (decrease) in line of credit balance    | (1,232,251) | 101,735    |
| Proceeds from and stock options exercised            | 421,283     | 2,550      |
| Repayments of distributor obligation                 | (1,500,000) | -          |
| Issuance of long-term debt                           | 1,500,000   | 28,923     |
| Repayments of long-term debt                         | (1,820,079) | (382,378)  |
|  | -----       | -----      |
| Net cash used for financing activities               | (2,635,669) | (251,348)  |
|  | -----       | -----      |
| Net (decrease) increase in cash and cash equivalents | (435,901)   | 637,811    |
| Cash and cash equivalents:                           |             |            |
| Beginning of year                                    | 851,492     | 213,681    |
|  | -----       | -----      |
| End of year  | \$ 415,591  | \$ 851,492 |
|  | -----       | -----      |

The accompanying notes are an integral part of the financial statements.

Willamette Valley Vineyards, Inc.

Notes to Financial Statements

### 1. Summary of Operations, Basis of Presentation and Significant Accounting Policies

#### Organization and Operations

Willamette Valley Vineyards, Inc. (the "Company") owns and operates vineyards and a winery located in the state of Oregon, and produces and distributes premium, super premium, and ultra premium wines, primarily Pinot Noir, Pinot Gris, Chardonnay, and Riesling. In 2005 and 2004 no one customer represented more than 10% of revenues. Sales in Oregon through the Company's independent sales force and through direct sales from the winery represented approximately 50% and 53% respectively, of revenues for 2005 and 2004. Out-of-state sales represented approximately 35% and 29% respectively, of revenues for 2005 and 2004. Foreign sales represent less than 1% of total sales. The Company also sells its wine through the tasting room at its winery.

#### Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances at the time. Actual results could differ from those estimates under different assumptions or conditions.

#### Segment Reporting

The Company has a single operating segment consisting of the retail, instate self-distribution and out of state sales departments. These departments have similar economic characteristics, offer the same products to customers, utilize the same production facilities and processes and have similar customer types and distribution methods.

#### Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate

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that value:

Cash and Cash Equivalents, Accounts Receivables, Prepaid Expenses and Other Current Assets, Accounts Payable, Accrued Expenses and Other Current Liabilities

The carrying amounts of these items are a reasonable estimate of their fair values.

### Concentration of risk

Cash and cash equivalents are maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit and therefore bear minimal credit risk.

Financial instruments that potentially subject the Company to credit risk are accounts receivable. The Company performs ongoing credit evaluations of its customers and does not require collateral. A reserve is maintained for potential credit losses. The allowance for doubtful accounts is based on an assessment of the collectibility of customer accounts. The Company regularly reviews the allowance by considering factors such as historical experience, credit quality, the age of the accounts receivable balances, and current economic conditions that may affect a customer's ability to pay.

### Line of Credit

Borrowings under the line of credit arrangement have variable interest rates that reflect currently available terms and conditions for similar debt. The carrying amount of this debt is a reasonable estimate of its fair value.

### Long-Term Debt

The fair value of the Company's long-term debt, including the current portion thereof, is estimated based on the present value method using AA rates provided by Farm Credit Services for the Northwest Farm Credit Services debt and estimated current rates for similar borrowing arrangements for all other long term debt. The carrying value and estimated fair value of long term debt, including current portion is as follows:

|                 | Carrying<br>Value | Fair<br>Value |
|-----------------|-------------------|---------------|
| Northwest Farm  |                   |               |
| Credit Services | \$ 2,269,865      | \$ 2,301,546  |

### Other Comprehensive Income

The nature of the Company's business and related transactions do not give rise to other comprehensive income.

### Cash and Cash Equivalents

Cash and cash equivalents include highly liquid short-term investments with an original maturity of less than 90 days.

### Inventories

After a portion of the vineyard becomes commercially productive, the annual crop and production costs relating to such portion are recognized as work-in-process inventories. Such costs are accumulated with related direct and indirect harvest, wine processing and production costs, and are transferred to finished goods inventories when the wine is produced, bottled, and ready for sale. The cost of finished goods is recognized as cost of sales when the wine product is sold. Inventories are stated at the lower of first-in, first-out ("FIFO") cost or market by variety. In accordance with general practices in the wine industry, wine inventories are generally included in current assets



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in the accompanying balance sheet, although a portion of such inventories may be aged for more than one year (Note 3).

### Vineyard Development Costs

Vineyard development costs consist primarily of the costs of the vines and expenditures related to labor and materials to prepare the land and construct vine trellises. The costs are capitalized until the vineyard becomes commercially productive, at which time annual amortization is recognized using the straight-line method over the estimated economic useful life of the vineyard, which is estimated to be 30 years. Accumulated amortization of vineyard development costs aggregated \$566,591 and \$487,273 at December 31, 2005 and 2004, respectively.

Amortization of vineyard development costs are included in capitalized crop costs that in turn are included in inventory costs and ultimately become a component of cost of goods sold. For the years ending December 31, 2005 and 2004 approximately \$79,000 and \$77,000 respectively, were amortized into inventory costs.

### Property and Equipment

Property and equipment are stated at cost or the historical cost basis of the contributing shareholders, as applicable, and are depreciated on the straight-line basis over their estimated useful lives as follows:

|                   |           |
|-------------------|-----------|
| Land improvements | 15 years  |
| Winery building   | 30 years  |
| Equipment         | 5-7 years |

Expenditures for repairs and maintenance are charged to operating expense as incurred. Expenditures for additions and betterments are capitalized. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is included in operations. The Company reviews the carrying value of investments for impairment whenever events or changes in circumstances indicate the carrying amounts may not be recoverable.

### Debt Issuance Costs

Debt issuance costs are amortized on the straight-line basis, which approximates the effective interest method, over the life of the debt. For the years ended December 31, 2005 and 2004, amortization of debt issuance costs was approximately \$12,000 and \$22,000 respectively.

### Income Taxes

The Company accounts for income taxes using the asset and liability approach whereby deferred income taxes are calculated for the expected future tax consequences of temporary differences between the book basis and tax basis of the Company's assets and liabilities.

### Deferred Rent Liability

The Company leases land under a sale-leaseback agreement. The long-term operating lease has minimum lease payments that escalate every year. For accounting purposes, rent expense is recognized on the straight-line basis by dividing the total minimum rents due during the lease by the number of months in the lease. In the early years of a lease with escalation clauses, this treatment results in rental expense recognition in excess of rents paid, and the creation of a long-term deferred rent liability. As the lease matures, the deferred rent liability will decrease and the rental expense recognized will be less than the rents actually paid. For the period ended December 31, 2005 and 2004, rent costs recognized in excess of amounts paid totaled \$32,985 and \$22,790, respectively.

### Revenue Recognition

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The Company recognizes revenue when the product is shipped and title passes to the customer. The Company's standard terms are 'FOB' shipping point, with no customer acceptance provisions. The cost of price promotions and rebates are treated as reductions of revenues. No products are sold on consignment. Credit sales are recorded as trade accounts receivable and no collateral is required. Revenue from items sold through the Company's retail locations is recognized at the time of sale. The Company has established an allowance for doubtful accounts based upon factors pertaining to the credit risk of specific customers, historical trends, and other information. Delinquent accounts are written-off when it is determined that the amounts are uncollectible.

### Cost of Goods Sold

Costs of goods sold include costs associated with grape growing, external grape costs, packaging materials, winemaking and production costs, vineyard and production administrative support and overhead costs, purchasing and receiving costs and warehousing costs.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of non-manufacturing administrative and overhead costs, advertising and other marketing promotions. Advertising costs are expensed as incurred or the first time the advertising takes place. For the years ended December 31, 2005 and 2004, advertising costs incurred were approximately \$23,000 and \$19,500 respectively.

The Company provides an allowance to distributors for providing sample of products to potential customers. For the years ended December 31, 2005 and 2004, these costs, which are included in selling, general and administrative expenses, totaled approximately \$64,000 and \$43,000 respectively.

### Shipping and Handling Costs

Amounts paid by customers to the Company for shipping and handling costs are included in the net revenue. Costs incurred for shipping and handling charges are included in selling, general and administrative expense. For the years ended December 31, 2005 and 2004, such costs totaled approximately \$416,000 and \$269,000 respectively. The Company's gross margins may not be comparable to other companies in the same industry as other companies may include shipping and handling costs as a cost of goods sold.

### Excise Taxes

The Company pays alcohol excise taxes based on product sales to both the Oregon Liquor Control Commission and to the U.S. Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau. The Company is liable for the taxes upon the removal of product from the Company's warehouse on a per gallon basis. The federal tax rate is affected by a small winery tax credit provision which declines based upon the number of gallons of wine production in a year rather than the quantity sold. The Company also pays taxes on the grape harvest on a per ton basis to the Oregon Liquor Control Commission for the Oregon Wine Advisory. For the years ended December 31, 2005 and 2004, excise taxes incurred were approximately \$382,000 and \$264,000 respectively.

### Stock Based Compensation

The Company accounts for the employee and director stock options in accordance with provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees. Pro forma disclosures as required under Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock Based Compensation, and as amended by SFAS No. 148, Accounting for Stock Based Compensation - Transition and Disclosure, are presented below (Note 8).

Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards consistent with the

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provisions of SFAS No. 123, the Company's net earnings would have been reduced to the pro forma amounts indicated as follows for the year ended December 31 (Note 8 for certain assumptions with respect to this computation):

|  | 2005         | 2004       |
|--|--------------|------------|
| Net income, as reported  | \$ 1,156,939 | \$ 463,682 |
| Add: Stock-based compensation expense included in reported net income, net of tax                                |              | 7,314      |
| Deduct: Total stock-based employee compensation expense under fair value based method for all awards, net of tax | (675,854)    | (45,771)   |
|  | \$ 481,085   | \$ 425,225 |
| Earnings per share:  |              |            |
| Basic - as reported  | \$ 0.26      | \$ 0.10    |
| Basic - pro forma  | 0.11         | 0.09       |
| Diluted - as reported  | 0.25         | 0.10       |
| Diluted - pro forma  | 0.10         | 0.09       |

On December 16, 2005, the FASB finalized FAS 123R "Share-Based Payment," which will be effective for the first interim or annual reporting periods beginning after December 15, 2005. The new standard will require the Company to record compensation expense for stock options using a fair value method. On March 29, 2005, the SEC issued SAB 107, which provides the Staff's views regarding interactions between FAS 123R and certain SEC rules and regulations and provides interpretations of the valuation of share-based payments for public companies.

The Company is currently evaluating FAS 123R and SAB 107 to determine the fair value method to measure compensation expense, the appropriate assumptions to include in the fair value model, the transition method to use upon adoption and the period in which to adopt the provisions of FAS 123R. The impact of the adoption of FAS 123R cannot be reasonably estimated at this time due to the factors discussed above as well as the unknown level of share-based payments granted in future years. The effect of expensing stock options on the Company's results of operations using the Black-Scholes model is presented in the table above.

On December 12, 2005 the Board of Directors of Willamette Valley Vineyards, Inc. approved the accelerated vesting (the "Acceleration") of unvested stock options to purchase 130,750 shares of common stock previously granted to employees and officers under the Company's 1992 Stock Incentive Plan and 2002 Stock Option Plan with exercise prices of \$1.46-\$4.98 per share. The Acceleration was effective December 23, 2005, and the exercise prices of all the options vested were not changed. The Acceleration resulted in an increase in stock-based compensation expense net of tax of approximately \$114,897 in 2005 and a reduction in future stock-based compensation expense and administrative costs associated with complying with SFAS No. 123R.

### Basic and Diluted Net Income per Share

Basic earnings per share are computed based on the weighted-average number of common shares outstanding each year. Diluted earnings per share are computed using the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the year. Potentially dilutive shares from stock options and other common stock equivalents are

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excluded from the computation when their effect is antidilutive.

Options to purchase 609,500 shares of common stock were outstanding at December 31, 2005 and diluted weighted-average shares outstanding at December 31, 2005 include the effect of 116,150 stock options. Options to purchase 284,200 shares of common stock were outstanding at December 31, 2004 and diluted weighted-average shares outstanding at December 31, 2004 include the effect of 59,823 stock options. In addition, the warrant outstanding since 1992 was included in the computation of diluted earnings per share in 2005, but not included in 2004 because the exercise price of \$3.42 was greater than the average market price of the common shares during 2004.

|         | 2005        |  |                          | 2004       |  |                          |
|---------|-------------|--|--------------------------|------------|--|--------------------------|
|         | Income      | Weighted<br>average<br>shares<br>outstanding | Earnings<br>per<br>share | Income     | Weighted<br>average<br>shares<br>outstanding | Earnings<br>per<br>share |
| Basic   | \$1,156,939 | 4,518,827                                    | 0.26                     | \$ 463,682 | 4,485,136                                    | 0.10                     |
| Options | -           | 116,150                                      | -                        | -          | 59,823                                       | -                        |
| Warrant | -           | 15,000                                       | -                        | -          | -  | -                        |
|         | -----       | -----  | -----                    | -----      | -----  | -----                    |
| Diluted | \$1,156,939 | 4,649,977                                    | \$0.26                   | \$ 463,682 | 4,544,959                                    | \$0.10                   |
|         | =====       | =====  | =====                    | =====      | =====  | =====                    |

### Statement of cash flows

#### Supplemental disclosure of cash flow information:

|   | 2005       | 2004       |
|---|------------|------------|
| Interest paid   | \$ 234,000 | \$ 305,000 |
| Supplemental schedule of noncash<br>investing and financing activities: |            |            |
| Capital leases  | -          | 17,327     |
| Issuance of common stock (Note 7)                                       | 9,610      | 12,190     |

### Liquidity

The Company's ability to fund operations requires utilization of amounts available pursuant to a line of credit agreement as further discussed in Note 5. There was \$0 outstanding on the line of credit with Umpqua Bank as of December 31, 2005. Management believes existing cash and cash flow from operations, combined with the amounts available under the line of credit facility will be sufficient to satisfy all debt service obligations and fund the Company's operating needs and capital expenditures for the foreseeable future.

### 2. Accounts Receivable

Oregon law prohibits the sale of wine in Oregon on credit; therefore, the Company's accounts receivable balances are the result of sales to out-of-state and foreign distributors. At December 31, 2005 the Company's accounts receivable balance is net of an allowance for doubtful accounts of \$57,951.

Changes in the allowance for doubtful accounts are as follows:

| Balance at<br>Beginning<br>Of period | Charged to<br>costs and<br>expenses | Charged to<br>other<br>accounts | Write-offs<br>net of<br>recoveries | Balance at<br>end of<br>period |
|--------------------------------------|-------------------------------------|---------------------------------|------------------------------------|--------------------------------|
| _____                                | _____                               | _____                           | _____                              | _____                          |

Fiscal year ended December 31, 2004:

Allowance for

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|                   |           |       |       |       |           |
|-------------------|-----------|-------|-------|-------|-----------|
| Doubtful accounts | \$ 41,885 | \$ -  | \$ -  | \$ -  | \$ 41,885 |
|                   | =====     | ===== | ===== | ===== | =====     |

Fiscal year ended December 31, 2005:

Allowance for

|                   |           |           |       |       |           |
|-------------------|-----------|-----------|-------|-------|-----------|
| Doubtful accounts | \$ 41,885 | \$ 16,066 | \$ -  | \$ -  | \$ 57,951 |
|                   | =====     | =====     | ===== | ===== | =====     |

3. Inventories

Inventories consist of:

|   |              |
|---|--------------|
| Winemaking and packaging materials  | \$ 223,389   |
| Work-in-process (costs relating to unprocessed<br>and/or unbottled wine products) | 1,790,472    |
| Finished goods (bottled wine<br>and related products)                             | 4,937,132    |
|   | -----        |
| Current inventories   | \$ 6,950,993 |
|   | -----        |

4. Property and Equipment

|  |              |
|--|--------------|
| Land and improvements                  | \$ 769,644   |
| Winery building and hospitality center | 4,707,802    |
| Equipment                              | 3,975,652    |
|  | -----        |
|  | 9,453,098    |
| Less accumulated depreciation          | (5,415,938)  |
|  | -----        |
|  | \$ 4,037,160 |
|  | -----        |

5. Line of Credit Facility

In December of 2005 the Company entered into a revolving line of credit agreement with Umpqua Bank that allows borrowings of up to \$2,000,000 against eligible accounts receivables and inventories as defined in the agreement. The revolving line bears interest at prime and is payable monthly. The interest rate was 7.25% at December 31, 2005. At December 31, 2005 there were borrowings of \$0 on the revolving line of credit.

The weighted-average interest rate on the aforementioned borrowings for the fiscal years ended December 31, are as follows:

|      |       |
|------|-------|
| 2005 | 5.75% |
| 2004 | 5.55% |

The line of credit agreement includes various covenants, which among other things, requires the Company to maintain minimum amounts of tangible net worth, debt-to-equity, and debt service coverage as defined, and limits the level of acquisitions of property and equipment. As of December 31, 2005, the Company was in compliance with these covenants.

Umpqua Bank Capital borrowings are collateralized by the bulk and case goods inventory and the proceeds from the sales thereof.

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### 6. Long-Term Debt

Long-term debt consists of:

|                                     |                     |
|-------------------------------------|---------------------|
|                                     | 2005                |
| Northwest Farm Credit Services Loan | \$ 2,269,865        |
|                                     | -----               |
|                                     | 2,269,865           |
| Less current portion                | (283,334)           |
|                                     | -----               |
|                                     | <u>\$ 1,986,531</u> |

The Company has an agreement with Northwest Farm Credit Services containing two separate notes bearing interest at a rate of 7.85%, which are collateralized by real estate and equipment. These notes require monthly payments ranging from \$7,687 to \$30,102 until the notes are fully repaid in 2014. The loan agreement contains covenants, which require the Company to maintain certain financial ratios and balances. At December 31, 2005, the Company was in compliance with these covenants. In the event of future noncompliance with the Company's debt covenants, Northwest Farm Credit Services ("FCS") would have the right to declare the Company in default, and at FCS' option without notice or demand, the unpaid principal balance of the loan, plus all accrued unpaid interest thereon and all other amounts due shall immediately become due and payable.

Future minimum principal payments of long-term debt mature as follows:

Year ending  
December 31,

|            |                     |
|------------|---------------------|
| 2006       | \$ 283,334          |
| 2007       | 306,393             |
| 2008       | 331,331             |
| 2009       | 358,394             |
| 2010       | 387,358             |
| Thereafter | 603,055             |
|            | -----               |
|            | <u>\$ 2,269,865</u> |

### 7. Shareholders' Equity

The Company is authorized to issue 10,000,000 shares of its common stock. Each share of common stock is entitled to one vote. At its discretion, the Board of Directors may declare dividends on shares of common stock, although the Board does not anticipate paying dividends in the foreseeable future.

On June 1, 1992, the Company granted its president a warrant to purchase 15,000 shares of common stock as consideration for his personal guarantee of the real estate loans and the line of credit with Northwest Farm Credit Services (Notes 6 and 8). The warrant is exercisable through June 1, 2012 at an exercise price of \$3.42 per share. As of December 31, 2005, no warrants had been exercised.

In each of the years ended December 31, 2005 and 2004, the Company granted 2,725 and 5,300 shares of stock valued at \$9,610 and \$12,190, respectively, as compensation to employees. The cost of these grants was capitalized as inventory or included in selling, general and administrative expenses in the

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statement of operations. The effects of these noncash transactions have been excluded from the cash flow statements in each period.

### 8. Stock Incentive Plan

900,000 Shares of common stock have been reserved for issuance to employees and directors of the Company under a stock incentive plan. Administration of the plan, including determination of the number, term, and type of options to be granted, lies with the Board of Directors or a duly authorized committee of the Board of Directors. Options are generally granted based on employee performance with vesting periods ranging from date of grant to seven years. The maximum term before expiration for all grants is ten years. As of December 31, 2005, there are approximately 107,801 shares available for future issuance under this plan.

At December 31, 2005 and 2004, the following transactions related to stock options occurred:

|                                  | 2005      |  | 2004     |  |
|----------------------------------|-----------|--|----------|--|
|                                  | Shares    | Weighted<br>average<br>exercise<br>price | Shares   | Weighted<br>average<br>exercise<br>price |
| Outstanding at beginning of year | 284,200   | \$ 1.90                                  | 288,600  | \$ 1.69                                  |
| Granted                          | 496,500   | 4.15                                     | 84,000   | 2.31                                     |
| Exercised                        | (171,199) | 2.46                                     | (1,500)  | 1.70                                     |
| Forfeited                        | (1)       | 3.00                                     | (86,900) | 1.77                                     |
|                                  | -----     |  | -----    |  |
| Outstanding at end of year       | 609,500   | \$ 3.57                                  | 284,200  | \$ 1.90                                  |

Weighted-average options outstanding and exercisable at December 31, 2005 are as follows:

| Exercise price | Options outstanding                     |   | Weighted average exercise price | Options exercisable                     |                                 |
|----------------|---|---|---------------------------------|---|---------------------------------|
|                | Number outstanding at December 31, 2005 | Weighted average remaining contractual life |                                 | Number exercisable at December 31, 2005 | Weighted average exercise price |
| \$ 1.46        | 8,000                                   | 7.09  | \$ 1.46                         | 8,000                                   | \$ 1.46                         |
| 1.50           | 9,300                                   | 2.03  | 1.50                            | 9,300                                   | 1.50                            |
| 1.56           | 42,000                                  | 4.58  | 1.56                            | 42,000                                  | 1.56                            |
| 1.69           | 6,500                                   | 4.66  | 1.69                            | 6,500                                   | 1.69                            |
| 1.75           | 38,000                                  | 2.17  | 1.75                            | 38,000                                  | 1.75                            |
| 1.81           | 3,000                                   | 3.24  | 1.81                            | 3,000                                   | 1.81                            |
| 2.30           | 60,000                                  | 8.58  | 2.30                            | 26,400                                  | 2.30                            |
| 2.31           | 20,000                                  | 8.40  | 2.31                            | 20,000                                  | 2.31                            |
| 2.75           | 1,000                                   | 0.48  | 2.75                            | 1,000                                   | 2.75                            |
| 2.99           | 24,000                                  | 9.12  | 2.99                            | 24,000                                  | 2.99                            |
| 3.00           | 200                                     | 0.06  | 3.00                            | 200                                     | 3.00                            |
| 3.29           | 79,000                                  | 4.12  | 3.29                            | 79,000                                  | 3.29                            |
| 3.76           | 111,500                                 | 9.58  | 3.76                            | 100,200                                 | 3.76                            |
| 4.14           | 4,000                                   | 4.58  | 4.14                            | 4,000                                   | 4.14                            |
| 4.98           | 25,000                                  | 9.76  | 4.98                            | 6,500                                   | 4.98                            |
| 5.00           | 114,000                                 | 9.99  | 5.00                            | 114,000                                 | 5.00                            |
| 5.50           | 64,000                                  | 4.99  | 5.50                            | 64,000                                  | 5.50                            |

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|                |         |       |         |         |         |
|----------------|---------|-------|---------|---------|---------|
| -----          | -----   | ----- | -----   | -----   | -----   |
| \$ 1.46-\$5.50 | 609,500 | 7.01  | \$ 3.57 | 546,100 | \$ 3.60 |

The Company adopted SFAS No. 123 in 1996 and has elected to account for its stock-based compensation under Accounting Principles Board Opinion 25. As required by SFAS No. 123, the Company has computed for pro forma disclosure purposes (Note 1) the value of options granted during each of the two years ended December 31 using the Black-Scholes option-pricing model with the following weighted-average assumptions used for the grants in 2005 and 2004:

|                         |          |          |
|-------------------------|----------|----------|
|                         | 2005     | 2004     |
| Risk-free interest rate | 4.26 %   | 4.83 %   |
| Expected lives          | 10 years | 10 years |
| Expected volatility     | 45 %     | 50 %     |

Adjustments are made for options forfeited prior to vesting. For the years ended December 31, 2005 and 2004, the total value of the options granted was computed to be approximately \$1,356,068 and \$129,615, respectively, which would be amortized on the straight-line basis over the vesting period of the options.

For the years ended December 31, 2005 and 2004, the weighted average fair value of options granted was computed to be \$2.73 and \$1.54, respectively.

9. Income Taxes

The provision for income taxes consists of:

|                                 |           |           |
|---------------------------------|-----------|-----------|
|                                 | 2005      | 2004      |
| Current tax expense:            |           |           |
| Federal                         | \$591,247 | \$299,963 |
| State                           | 83,588    | 68,472    |
|                                 | -----     | -----     |
|                                 | 674,835   | 368,435   |
|                                 | -----     | -----     |
| Deferred tax expense (benefit): |           |           |
| Federal                         | (43,041)  | (20,349)  |
| State                           | (3,533)   | (2,610)   |
|                                 | -----     | -----     |
|                                 | (46,574)  | (22,959)  |
|                                 | -----     | -----     |
| Total                           | \$628,261 | \$345,476 |
|                                 | -----     | -----     |

The effective income tax rate differs from the federal statutory rate as follows:

|                                     |                         |        |
|-------------------------------------|-------------------------|--------|
|                                     | Year ended December 31, |        |
|                                     | 2005                    | 2004   |
| Federal statutory rate              | 34.0 %                  | 34.0 % |
| State taxes, net of federal benefit | 2.6                     | 4.4    |
| Permanent differences               | (0.5)                   | 3.9    |
| Other, primarily prior year taxes   | (0.9)                   | 0.6    |
|                                     | -----                   | -----  |
|                                     | 35.2 %                  | 42.9 % |
|                                     | -----                   | -----  |

Permanent differences consist primarily of nondeductible meals and entertainment and life insurance premiums.

Deferred tax assets and (liabilities) at December 31 consist of:



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|                                       | 2005        |
|---------------------------------------|-------------|
| Accounts receivable                   | \$ 22,000   |
| Inventories                           | 68,000      |
| Other                                 | 1,000       |
|                                       | -----       |
| Net current deferred tax asset        | 91,000      |
|                                       | -----       |
| Depreciation                          | (372,000)   |
| Deferred gain on sale-leaseback       | 170,000     |
| Deferred liabilities                  | 54,000      |
|                                       | -----       |
| Net noncurrent deferred tax liability | (148,000)   |
|                                       | -----       |
| Net deferred tax liability            | \$ (57,000) |
|                                       | -----       |

10. Related Parties

During 2004, the Company purchased grapes from certain director/shareholders for an aggregate price of \$3,489. At December 31, 2004 grape payables included no amounts owed to these shareholders.

The Company provides living accommodations in a manufactured home on the Company's premises for the president and his family as additional compensation for security and lock-up services the president provides. During the years ended December 31, 2005 and 2004, the Company recorded \$6,985 and \$6,422, respectively, in expenses related to the housing provided for its president.

11. Commitments and Contingencies

Litigation

From time to time, in the normal course of business, the Company is a party to legal proceedings. Management believes that these matters will not have a material adverse effect on the Company's financial position, results of operations or cash flows, but due to the nature of the litigation, the ultimate outcome cannot presently be determined.

Operating Leases

The Company entered into a lease agreement for approximately 45 acres of vineyards and related equipment in 1997. In December 1999, under a sale-leaseback agreement, the Company sold a portion of the Tualatin Vineyards property with a net book value of approximately \$1,000,000 for approximately \$1,500,000 cash and entered into a 20-year operating lease agreement. The gain of approximately \$500,000 is being amortized over the 20-year term of the lease. In December 2005, under a new sale-leaseback agreement, the Company sold another portion of the Tualatin Vineyards property with a net book value of approximately \$551,000 for approximately \$727,000 cash and entered into a 14-year operating lease agreement. Approximately \$99,000 of the total gain of \$176,000 realized from this sale/leaseback transaction has been deferred and will be amortized over the life of the lease agreement.

The amortization of the deferred gain totals approximately \$25,000 per year for the 1999 sale-leaseback agreement and \$7,000 for the 2005 sale-leaseback agreement, and is recorded as an offset to the related lease expense in selling, general and administrative expenses.

As of December 31, 2005, future minimum lease payments are as follows:

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|              |              |
|--------------|--------------|
| Year ending  |              |
| December 31, |              |
| 2005         | \$ 218,992   |
| 2006         | 158,083      |
| 2007         | 178,486      |
| 2008         | 182,061      |
| 2009         | 185,724      |
| Thereafter   | 1,822,058    |
|              | -----        |
| Total        | \$ 2,745,404 |
|              | =====        |

The Company is also committed to lease payments for various office equipment. Total rental expense for all operating leases excluding the vineyards, amounted to \$15,638 and \$11,915 in 2005 and 2004, respectively. In addition, payments for the leased vineyards have been included in inventory or vineyard developments costs and aggregate approximately \$215,436 for the year ended December 31, 2005.

### Susceptibility of Vineyards to Disease

The Tualatin Vineyard and the leased vineyards are known to be infested with phylloxera, an aphid-like insect, which can destroy vines. The Company has not detected any phylloxera at its Turner Vineyard.

It is not possible to estimate any range of loss that may be incurred due to the phylloxera infestation of our vineyards. The phylloxera at Tualatin Estate Vineyard is believed to have been introduced on the roots of the vines first planted on the property in the southern most section Gewurztraminer in 1971 that the Company partially removed in 2004. The remaining vines, and all others infested, remain productive at low crop levels.

### 12. Distributor Obligation

On March 8, 2006 the Company terminated an incentive distribution agreement with a national wine distributor group (the "distributor") with fourteen affiliated distributors. Under the agreement, the Company had agreed to pay the distributor incentive compensation if certain sales goals were met over a five year period. The Company terminated the agreement because the distributors did not reach these goals in every year since the agreement's inception. Following the termination, the Company has continued to do business with the distributors on terms and conditions generally available to all of the Company's distributors.

### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

### ITEM 8A. CONTROLS AND PROCEDURES.

a) We carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer, Chief Financial Officer and other management personnel, of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934 as of December 31, 2005. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures as of December 31, 2005 were effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the

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Securities and Exchange Commission's rules and forms.

The Company does not expect that its disclosure controls and procedures will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The Company considered these limitations during the development of its disclosure controls and procedures, and will continually reevaluate them to ensure they provide reasonable assurance that such controls and procedures are effective.

b) There were no changes in the Company's internal control procedures over financial reporting that occurred during the period ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting, except as noted above.