

Chairman's message to shareholders



I am writing this message on my return from Europe and Egypt where, together with Ramy Azer the Managing Director, we were assisting our partners to develop and promote the banana fibre product market in Europe, and to establish Papyrus Egypt which will supply the banana fibre products to Europe.

Customer demand for banana fibre products

What we have experienced for some time is the challenge of meeting customer demand for banana fibre products outside of Australia. The demand for alternate fibre and fibre products in Australia is not the same as elsewhere in the world because of our abundant supply of, and comfortable reliance on, natural fibre derived from forest timber, and our country's conservative and entrenched industrial preferences and processes in the craft paper, cardboard, packaging, panelboard, and veneer utilisation industries such as cabinet making, furniture manufacturing and building fit-out and decorative industries.

Our Australian geographical location, the cost of labour, energy and transport, and the cost of undertaking an industrial processing activity in a remote agricultural region of Australia have directed the company to other banana growing regions.

Having successfully proven the banana veneering and fibre producing technologies, and the operation of a demonstration banana veneer and fibre production factory in a banana plantation at Walkamin, we are ready to take the next step and assist with the establishment of the world's first commercial banana fibre production operation in a country where there is a demand for a new source of natural fibre and there is an abundant supply of useable banana agricultural waste to produce product for local consumption and export to Europe.

In Europe there is the demand for environmentally sustainable fibre products and there is a real hunger in Egypt for an alternate source of natural fibre to make those environmentally sustainable products.

Natural fibre

Natural fibre is derived from various sources ranging from forest trees to a multiple variety of agricultural crops to field grass. The ideal source of agricultural fibre for an industrial application such as craft paper, cardboard and panelboard is fibre derived from waste agricultural products not otherwise useable for food by animals or humans.

Bagasse is the waste fibre resulting after the extraction of sugar juice from harvested sugar cane. Bagasse is the only natural agricultural fibre available in Egypt for MDF and other panelboard production. Bagasse is a fibre in great demand, and it is relatively expensive in Egypt because it is also in demand there as a bio-fuel. Likewise banana fibre is derived from agricultural waste presently not otherwise useable for any purpose until it is converted by the patented Papyrus' technologies and processes.

Europe

Europe features prominently in all of our strategic business planning for a variety of substantive reasons previously announced, not the least of which are:

- the proximity of Europe to Egypt which is the closest banana growing country and a long term trading partner to Europe;
- Egypt is a developing country and carbon emission reduction projects are eligible for the United Nations sponsored Clean Development Mechanism (CDM) carbon certificates which are presently tradeable in Europe and are in demand;
- the demonstrable consumer demand for "green" products in Europe;
- the initiative of timber veneer distributors in Italy and Monaco in seeking out our banana veneer product as a substitute for timber veneer to be used in the decorative panelboard and furniture industries;
- the initiative of wood based panelboard manufacturers in Belgium in seeking out our banana fibre product to be used as a substitute for wood based fibre in panelboard production;
- the creative energy in Europe, and Holland in particular, demonstrated by architects, designers and craftsmen in the building and decorative furniture industries seeking "green" product solutions;
- the commitment of many European governments and public enterprises to assist developing countries to establish more indigenous self supporting and exporting enterprises – especially those like banana fibre production which are environmentally sustainable; and
- the availability of venture capital for new and innovative industrial enterprises which address the environmentally sustainable objectives of many European governments and companies as well as the community at large.

Egypt – the strategic direction for sourcing banana fibre

At the outset I emphasise that our choice of Egypt as the location of the world's first commercial banana fibre production factory was a considered strategic decision of the Board, having regard to many factors not the least of which are:

- the identified demand in Egypt for a new indigenous renewable and sustainable source of fibre – Egypt does not have any forests and imports at great cost most of the fibre required for its considerable domestic consumption;
- the comparatively cheaper and readily available energy, labour and infrastructure costs in Upper Egypt;
- the availability of abundant quantities of waste banana tree trunk material in Upper Egypt which is currently a nuisance waste by-product of banana fruit production; and

- the encouragement of the Egyptian government, the Executive Governor of the Sohag Governate in Upper Egypt (a Governate is the equivalent of a State in the Australian context), and leading business organisations such as the National Bank of Egypt and the Upper Egypt Investment Company, and regional communities, to establish a new, and for Upper Egypt, a significant economic enterprise which benefits the community and the environment.

I am mindful that a democratic movement has caused unrest recently in Egypt, but I can say that having been there for a few weeks to witness and to discuss the situation with many locals from the Cairo and Sohag communities, there is an almost universal desire by the community to get on with the democratic changes and to support business and the economy in the meantime.

Cairo has a population of around 30m people, and, yes there are demonstrations seeking change, but by and large they do not disrupt the daily life of the very large urban community. Life in the Upper Egypt region, which is a rural community, and is where we are focused for the Papyrus Egypt project, is more settled and peaceful.

Governate of Sohag

We have chosen the Governate of Sohag (population 8-9m and over 500km south from Cairo in the Nile Valley of Upper Egypt) as the place where Papyrus Egypt (PPYEg) will establish the first banana fibre production facility. The Executive Governor of the Sohag Governate met with us to assure us we were very welcome in Egypt and that the regional government agencies would do all they could to assist Papyrus to establish the Papyrus Egypt project.

PPYEg has been granted land of 2,000msq in the Kawthar industrial estate in Sohag city to build the factory. The land grant is being processed by the relevant Egyptian government agency and will be finalised in the next few weeks. This region of Upper Egypt grows abundant numbers of banana and the productivity is about 4 times what we experience in Australia thus giving a far higher density of banana plantations and useable waste banana tree trunk after fruit harvest.

Papyrus Egypt

Our partners in PPYEg are a diverse group of business owners in strategically related industries:

- a founding partner and the other shareholder in PPYEg, the Egyptian Banana Fibre Company (EBFC), is an existing customer of Papyrus Australia purchasing banana veneer from our Walkamin factory and using that veneer to make banana veneered decorative door skins, floor boards and decorative panels presently being sold by EBFC into the Egyptian market;
- in addition banana veneered decorative panels are being sold by EBFC to customers in Europe through an architectural panel design company in Holland, Steward Design Panels. Papyrus Australia has exhibited these products on our web site for some time and has now received the latest product range of engineered decorative acoustic ceiling panels which are in demand in Europe through Steward Design Panels. Photos of these ceiling panels have recently been added to the web site at www.papyrusaustralia.com.au
- another partner in PPYEg is a Sohag based company which presently imports forest fibre to Egypt to make cardboard boxes for local demand. The largest such manufacturer in the Sohag region, this partner realises the inherent value of indigenous banana fibre as a potential substitute for imported costly forest fibre in the cardboard box manufacturing business; and
- another participant in the project is the NAG-HAMADY Fiber Board Company based in the Sohag Governate. NAG-HAMADY is Egypt's largest producer of bagasse fibre MDF panelboard sold in Egypt and the Middle East region, and is looking for additional sources of agricultural fibre for its growing business to export to Europe. NAG-HAMADY believe that banana fibre will be the additional natural fibre they are seeking for their existing business of panelboard manufacture.

The Papyrus Egypt project is not the end game – far from it – it is just a small beginning to achieve our goal to become an innovative Australian based technology development and licensing company. This project will itself demonstrate to other interested parties in Egypt and other banana growing regions the real opportunity to utilise banana tree waste to create many valuable banana fibre products for local markets and export.

“Tree free” MDF panelboard

Of great importance to this project in Egypt is the fact that in addition to the use of banana veneer, the substrate of the new decorative floorboards and panels being marketed by EBFC through Steward Design Panels in Holland, is derived totally from bagasse fibre manufactured by NAG-HAMADY.

The banana veneered floorboards and the decorative banana veneered panels made by EBFC and available in Egypt and Europe, are the first totally “green” natural fibre panels available in Egypt and Europe – absolutely tree free. This is a significant marketing edge for the Papyrus branded products.

Scientific tests and industrial trials for banana fibre panelboard

Papyrus Australia now has an exclusive agreement with NAG-HAMADY to scientifically test and industrially trial and produce banana fibre MDF and other panelboard, starting with a mix of bagasse and banana fibres, proceeding to 100% banana fibre to be sold by PPYEg in Egypt, the Middle East region and exported to Europe.

Subject to the successful outcome of these scientific tests and industrial trials by NAG-HAMADY to utilise banana fibre in the production of MDF panelboard, which will be undertaken in the coming months (and which Papyrus Australia has already proven in our own laboratory trials) and to help secure the procurement of all available banana fibre from Papyrus Egypt, NAG-HAMADY has committed to an “off-take” agreement with Papyrus Egypt to purchase the annual production of banana fibre from the first banana fibre factory established by Papyrus Egypt.

It is anticipated in the “off-take” agreement that the initial annual production by Papyrus Egypt of banana fibre will exceed 5,000 tonnes on a dry basis and that NAG-HAMADY will be seeking to procure that quantity of dry banana fibre from Papyrus Egypt at a price per tonne to be agreed between NAG-HAMADY and Papyrus Egypt having regard to relevant factors, and in particular the then price of bagasse fibre per tonne calculated on an equivalent dry basis.

Papyrus Australia has also been appointed an exclusive distributor in Europe for NAG-HAMADY to sell all of their fibre panelboard produced for export and not otherwise purchased by PPYEg.

Yellow Pallet project

I have already mentioned sale of the Egypt manufactured banana fibre products in Europe through Steward Design Panels in Holland.

In addition we are in discussions with a group of successful Dutch business people and organisations to produce the world's first banana fibre pallet, to be known in the market as “yellow pallet”, and to be used initially in Central and South America in the logistics industry to transport banana fruit for export mainly to Europe and North America.

Presently, South America is the largest continent in banana fruit production with a significant export industry for several countries. Banana fruit is packed in cardboard boxes made from imported wood based fibre, and is transported on timber pallets made from imported and costly forest timber. Recent trials by the timber industry to produce an alternate wood fibre pallet for the banana export industry in Central and South America has not been successful because of the inability of wood fibre pallets to resist moisture uptake and their inherent brittleness because of the small size of wood fibres – qualities not suffered by banana fibre.

Yellow Pallet is also the name chosen for the proposed joint venture entity. The promoters of the JV are presently undertaking a feasibility study in Holland and Central and South America to utilise banana fibre in the production of banana fibre pallets. Papyrus Australia will be an equity partner in the Yellow Pallet project and JV. The draft business case envisages that Yellow Pallet will develop and own intellectual property and other proprietary property such as proprietary adhesives and specialist machinery necessary to manufacture the banana fibre pallets.

Yellow Pallet will sell banana fibre producing factories which will comprise the patented Papyrus banana veneering and fibre producing machines to be manufactured by the Papyrus Australia wholly owned subsidiary The Australian Advanced Manufacturing Centre Pty Ltd (AAMC), together with the Yellow Pallet proprietary adhesives and specialist machines needed to manufacture banana fibre pallets.

Participants in the Yellow Pallet JV and project are:

- a diverse group of Dutch business people headed by our previous European market research and development team of Rob de Jong and Hein van Opstal;
- a reputable and internationally leading Dutch agricultural research and teaching organisation The Wageningen University & Research Centre;
- The Wageningen University is totally focussed on all aspects of the agricultural economy from a worldwide perspective. Dr Gert Kema heads the Plant Research Centre - one of the commercial divisions of the University.
- Dr Gert Kema is a world recognised expert on banana fruit production, banana plant genetics and banana plant disease. He is working closely with all banana growing and exporting country governments in Central and South America addressing banana plantation disease control and productivity improvement. Other participants in his project work are large banana industry growers and exporters such as Dole and Chiquita, as well as community growing cooperatives throughout the region. Together with our other Dutch partners he identified the opportunity to meet the need of banana growers and exporters to develop a banana fibre pallet to replace costly timber and unsuitable wood fibre pallets;
- a reputable and internationally leading fibre research entity The Food & Bio-based Research Institute which is also a research and business unit of the Wageningen University. This Institute is a unique Institute expert in the scientific properties and industrial applications of all types of agricultural fibre, except banana, which they now want to scientifically analyse and trial for industrial applications such as banana fibre pallets; and
- a Dutch government funded venture capital entity PPM OOST.

Yellow Pallet project leadership

Leading the Yellow Pallet JV project team are Ramy Azer who is technical director and Hein van Opstal who is project manager. This outcome focussed project has access to a team of professional advisors from disciplines ranging across logistics, mechanical engineering, machinery production and marketing, who have been engaged to assist the Yellow Pallet team and the scientists at the Wageningen University.

Dr Gert Kema is the Yellow Pallet Ambassador presently advocating the use of this natural readily available and sustainable alternative to timber and wood fibre pallets in Central and South America as part of his project work in that continent.

“Add-on” technologies

As I said earlier, our first step internationally is the Papyrus Egypt project to produce and sell banana fibre products into the European market, to be followed by the Yellow Pallet project which is now underway.

In this regard it should be noted that the technology and the pallet making machines to be developed by Yellow Pallet are “add-on” technologies to the primary patented Papyrus’ technologies we own in the BVU (banana veneering unit) and the FPU (fibre production unit) both of which are essential pre-requisites to any use of the banana tree trunk for a commercial application of banana fibre in panelboard, or like applications utilising banana fibre.

Likewise we expect “add-on” technology and machinery to be developed with NAG-HAMADY following their MDF trials utilising banana fibre and we will continue to refine and improve our own BVU and FPU technologies and machines as we learn from field experiences. The future of Papyrus Australia is as a technology development and licensing company as evidenced by the projects with Yellow Pallet and NAG-HAMADY.

BVU and FPU machines

Finally, the Banana Veneering Unit (BVU) and Fibre Production Unit (FPU) to be installed in the Papyrus Egypt project are under construction by the Papyrus Australia wholly owned subsidiary AAMC, and an initial non-refundable part deposit of AUD100,000 for the purchase of those machines has been received from our partner in Egypt, the Egyptian Banana Fibre Company.

The balance of the deposit, namely AUD400,000 is expected to be received by 30 November 2011 following further capital investment in EBFC by new investors whom we met in Egypt over the past weeks.

The balance of the AUD2m payable for the BVU and FPU machines will be received by Papyrus Australia in three tranches of AUD500k each, first, on completion of the machines and before their despatch by ship to Egypt, second, on the issue of an installation and commissioning notice by Papyrus Australia, and finally, 60 days after the successful installation and commissioning of these machines in the Papyrus Egypt factory.

Conclusion

The Papyrus journey has been and will continue to be an organic journey with measurable commercial outcomes underpinned by patience, persistence and strategic partners. There is no magic wand or silver bullet available to achieve our goals, only hard work, which we are undertaking with a passion within our limited financial ability.

I look forward to reporting progress to you, our patient supporting shareholders, on all of the current projects at our AGM, which will be held on 23 November 2011 at the Papyrus Australia boardroom at Thebarton. Please come to the AGM to question the directors about our status, hear the latest news first hand, and to inspect the new products developed for the European market.

Ted Byrt.

Chairman.

