

Chairman's message to shareholders



Dear Shareholders,

The first quarter of 2012 has passed quickly and since the last newsletter, the Company has progressed the Papyrus Egypt and the Yellow Pallet projects.

Papyrus Egypt (PPYEg)

The new factory building in Sohag, which is around 1200 sqm of factory on a 2000 sqm allotment and a substantial asset of PPYEg, is a concrete and masonry building that has been constructed at the cost of our partner, Egypt Banana Fibre Company (EBFC). Electricity and other essential infrastructure has now been connected. This is a significant milestone for Papyrus Egypt. We have now satisfied the Egyptian Government's development expectations when it granted PPYEg the land in Sohag.

EBFC has also lodged applications with the Egyptian Government's Social Development Fund (SDF) for 'soft loans' totalling 6 million Egyptian Pounds; the funds will be contributed as capital to PPYEg for purchasing essential banana veneering and fibre production machinery from the Papyrus Australia subsidiary Australian Advanced Manufacturing Centre (AAMC). We have been informed by the SDF processing officers that the loan applications have satisfied all preliminary requirements and now the applications are being assessed by the SDF Board.

The Nag-Hamady Fibre Company has satisfactorily completed its own scientific analysis and industrial testing of banana fibre for the purpose of making fibre board (MDF) and now, together with the Abu El Holl Company, a significant Egyptian panelboard manufacturer introduced by Nag-Hamady, we have jointly commissioned the Fraunhofer Institute in Germany to develop the formula to make certifiable industrial-use panelboard from banana fibre.

The Fraunhofer Institute is Europe's largest application-oriented research organisation and is regarded as a world-leading panelboard research Institute. We have made banana fibre panelboard in our own laboratory but this project will deliver an independent verification of the formula and costs of producing panelboard from banana fibre for certifiable industrial use worldwide – this is a valuable jointly-funded project which we expect to deliver results in June 2012.

Yellow Pallet

Yellow Pallet BV has been incorporated in Holland with Papyrus Australia holding 50% of the equity through a wholly-owned subsidiary, PPYEu Pty Ltd. Yellow Pallet has been funded jointly by Papyrus Australia and our Dutch partners to enable a pallet-making feasibility study to be undertaken.

The Yellow Pallet joint venture project has now progressed beyond the pre-feasibility phase which involved assessment of potential markets in Latin America and an independent assessment of the banana veneering and fibre production machines at our Walkamin Demonstration Factory in Far North Queensland. The assessment was performed by an engineer from Hollandia Systems BV in Holland to verify that the machines are capable of meeting the fibre production capacity necessary for commercial production of banana fibre pallets.

The final phase of the feasibility study to design and build a 'banana fibre pallet' production machine is ready to commence. The final funding requirements are being negotiated and we expect the feasibility study to be fully funded by soft loans amounting to Euro 2 million from Dutch venture capital entities PPM OOST and the Dutch Green Technology Fund. Ramy Azer will be Technical Director of the study and his contribution will be fully remunerated by Yellow Pallet to offset the cost to Papyrus Australia of his time.

Commercial support for the Yellow Pallet project has been demonstrated by two substantial Latin American banana production companies paying deposits toward the purchase of banana fibre pallet production machines. Each pallet production factory will require patented Papyrus technologies to supply the banana fibre feedstock.

Initial Yellow Pallet project research indicates that at least 10 Papyrus patented banana veneering and fibre production units will be required in the first 3 years of the project. Each pallet factory will operate one or two sets of Papyrus patented banana veneering and fibre production units to produce adequate banana fibre feedstock; that is a significant business opportunity for Papyrus Australia and AAMC.

The Philippines

Subsequent to our February 2012 visit to Davao city in the State of Mindanao, The Philippines, senior management of the Anflo Management and Investment Corporation, which operates a 6,500 hectare banana plantation near Davao under the trade name "TADECO", will be visiting Walkamin in late April 2012 to inspect the patented Papyrus machinery.

Tadeco is a very substantial banana grower with a vertically integrated business growing, packing and exporting banana fruit to Japan, China, Russia and the Middle East. Tadeco makes its own banana fruit packing boxes from imported kraft paper. We believe that the banana veneer and fibre is a viable substitute for kraft paper in the manufacture of banana fruit packing boxes.

Veneering and Fibre Production Machines

Previously I have reported that the base assemblies for 2 veneering machines are complete and waiting for the fitment of blade assemblies and the controlling system. We will not commission the completion of these two machines until we have received payment due from our Egyptian partner.

Commercialisation Strategy

Papyrus Australia's commercialisation strategy is to license its banana tree trunk processing technology to manufacturing partners worldwide in locations where banana is grown. Intellectual property will be developed in both the primary processing of banana trunks to generate fibre and veneer, and also in value-adding processes that convert the fibre into end-user products such as kraft paper and building materials.

Revenue will be generated from technology licencing fees, and machinery sales and support services.

Papyrus Australia may also take equity positions in early-adopter ventures, as it has done with Papyrus Egypt and Yellow Pallet BV, to help build confidence and stimulate investment by partners. It is anticipated that these ventures will generate a profitable return to the Company in the longer term as well as revenue from machinery sales in the short term.

Conclusion

Slowly but surely these signature projects are coming together and I will again communicate with you shortly on their progress. The board is confident that the company is going in the right direction toward achieving our ultimate goal of being a technology licensing company.

Ted Byrt
Chairman



Frequently Asked Questions

Q. Why has Papyrus Australia shifted its focus from paper production technology to building materials?

A. Technology for converting banana tree trunk fibre into paper products was the focus prior to and following the stock exchange float in 2005. This involved extracting fibre from the outer layer of a banana tree trunk and using this as a substitute for forest wood fibre in a conventional paper-making process.

While the technical feasibility of this approach was proven, the cost of breaking into the entrenched wood fibre paper-making industry proved beyond the resources of the Company; it remains a potential future application of banana tree trunk fibre.

Faced with this barrier, successful trials were performed to produce panelboard of various densities from outer trunk fibre; the CSIRO assisted in confirming the utility of the material for this purpose. Financial modelling of an operation producing fibre for panelboard production demonstrated the viability of this approach. Market research in Europe in 2009/2010 also confirmed that banana fibre panelboard was seen as an attractive alternative to panelboard made from forest wood.

This combination of positive market research, successful scientific testing and positive financial modelling led us to focus on developing processes for making building materials from banana tree trunk fibre.

Q. Why has Egypt been selected for the first overseas factory?

A. Demonstrated market demand in Europe for building products made from fibre sources other than forest timber led us to seek a banana growing country proximate to the potential European market.

Transporting banana fibre from Australia to Europe made no financial sense and resulted in a significant transport 'carbon footprint' that counter-acted the 'green' credentials of the Papyrus process.

Other banana-producing countries proximate to Europe, such as India, Sri Lanka and several African nations, were considered but found to have significant infrastructure and logistical disadvantages. Egypt has relatively sound infrastructure and logistic support.

Egypt also had another critically important advantage. Lacking a domestic timber resource, it was already producing panelboard from costly imported wood fibre and an alternative local fibre source (ie sugar cane/bagasse) and selling these products in Egypt and also to the Middle East and Europe. Banana trunk fibre was considered a better "non seasonal" and more abundant raw material than bagasse. We believe that banana fibre will also be proven to be a better material than imported wood fibre.

We were in 2010 already selling inner trunk veneer to an Egyptian company that applied it as a decorative layer on floorboard and panelboard products. Based on these business relationship, manufacturing and market access factors, in mid 2010 we started to work with partners on the establishment of a production factory in Egypt to supply banana trunk fibre for building panel products for the European market.

There is no doubt that Egypt is a challenging business environment, particularly since the revolution on 25 January 2011, but we remain confident that it was the right choice.