

16 December 2005

Dear Shareholder,

This year has been a hectic and challenging year but also one of achievement for your company, Australian Wool Innovation.

The 200 or more producers who attended our recent showcase, forum and Annual General Meeting (AGM) in Adelaide heard first-hand about the partnerships we are building with retailers and manufacturers around the world, and the exciting progress we are making in many of our on-farm research areas such as mulesing, shearing and genetics.

It was particularly pleasing and encouraging to hear the enthusiasm and optimism in regard to Australian Merino wool from our guest speakers at the forum, David DaPonte from US retailer LL Bean and Willy Lin, vice-chairman of the Hong Kong Textiles Council.

Mr Lin is also Managing Director of Milo's International Knitwear which produces 2.5 million garments each year, so it was particularly exciting to hear his forecasts that with ongoing innovation and new fabrics, the prospects for Australian Merino wool garments are "immeasurable".

AGM election results

You, AWI shareholders, voted overwhelmingly to re-elect the incumbents to the Board of AWI - Kevin Bell, Peter Sykes and me.

The election result was a resounding endorsement of the strategy the Board has taken with your company - to build partnerships with international apparel decision makers and continue to invest in important on-farm areas.

The result also reinforced the important role of WoolProducers in these elections.

I look forward with a sense of optimism. Our demand building work will, I believe, deliver results over the next 24 months or so. These partnerships are putting more Australian Merino wool into the global apparel market.

Our on-farm research team is delivering some results in wool harvesting, mulesing, parasite control, wild dog control and genetics, and we can look forward to increasing opportunities to improve the performance of sheep and wool enterprises, particularly through the Sheep Genetics Australia and SheepGenomics programs.

AWI - AWS integration

AWI and Australian Wool Services, owners of The Woolmark Company, have now decided to appoint a corporate adviser to look at potential integration structures which protect the assets of the Australian wool industry, whilst making sure that any solution would be highly likely to meet agreement of both sets of shareholders

Our CEO, Dr Len Stephens, best summed up the future at the recent AGM when he said: "Our business, the AWI business, is now a combination of research, innovation and marketing. It is designed to add value to our customers' business and therefore boost your bottom line".



Yours sincerely,
Ian McLachlan AO
Chairman, Australian Wool Innovation Ltd

AWI Annual General Meeting, 9 November 2005
Chairman Ian McLachlan's address

Ladies and gentlemen, this year has been one of hectic activity and achievement, mixed with some annoying distractions.

Australian Wool Innovation was formed as a result of a decision by woolgrowers to enter into an arrangement with the Australian Government. It is a Company designed to pursue research, development and innovation for the whole wool industry, and in particular for its shareholders. It receives a levy from you, the shareholder, and some matching funds from the Government, for which we are grateful.

It is an excellent arrangement, as there is obviously no individual woolgrower business big enough to do its own meaningful research in this country or any other country, and no other organisation in the world with our vital interest in wool can do the necessary R&D or be a broker for innovation like AWI.

Our job is to produce an improved or new product. Our job is to produce an innovative idea, a new selling point, which stimulates those decision-makers in the trade to believe that they will make more profit from wool than from using competing fibres.

The price of wool is unsatisfactory and it is not improving. The main reason, but not the whole reason, is a weak American dollar vis-a-vis the Australian currency. All the wool, or nearly all the wool, which is going for sale is being sold, but of course at the finer end for far too little money. I will come back to that.

Test Marketing

The idea, though, that somehow promoting wool to the consumers of wool, by itself, in some overall generic sense, could be afforded by Australian woolgrowers alone went out of fashion some 15 years ago.

Nevertheless, in this next year or so, AWI is putting some of your money into a test marketing program which will find out if there is a profit to be made from this particular test marketing program.

Of course the question is: will there be an increase in demand which will send a price signal to the contributors of the money? AWI is of the view that part of this project should include some innovative products - presumably from us. Innovation is, of course, one of our essential jobs.

One of the most important aspects, however, of this whole project, which we authorised some contribution to in Hobart earlier in the year in IWTO, is that the International Wool Textile Organisation itself is to raise nearly half of the money for the project for this test.

It should not be forgotten that this is the first time that such a co-funding idea by those further down the chain has come to fruition in this way. I want to compliment Michael Lempriere, Juan Casanovas, the previous chairman of IWTO, whose co-funding conversations around the world helped this get going. So I want to compliment them for arranging the initial funding for this important breakthrough.

On-farm R&D

Your company is going well. Although in the past we have tried for a 50-50 split of our spending between on-farm and post-farm, there has been a predominance of on-farm spending in fact. This is because it is so difficult not to have program slippage in the post-farm research programs. When I mean slippage, I mean people not being able to deliver what they promise to deliver and therefore not being able to send the bills, and therefore we don't pay.

This year, however, we will be closer to a 50-50 split between on-farm and post-farm, and in the future we are looking forward to being able to spend up to two-thirds of your levy funding and the Government contribution on textiles and trade. We are certainly heading in that direction.

Nevertheless, some \$17 million will still be spent in the next few years on shearing, parasites, mulesing, feral dogs, foxes and genetics and genomics. The spending of these dollars is almost unarguable if you want on-farm productivity to increase, which it must.

I would particularly like to mention our investment in genetic technologies. I think the most important projects for the future of the Merino wool industry are the two major genetic projects we are funding in partnership with Meat & Livestock Australia, MLA.

MLA and AWI launched Sheep Genetics Australia, the world's biggest and best sheep genetic management service, here in Adelaide in the ram shed at the showgrounds last month. I personally think it was the most important thing to ever happen there, even though rams have been sold for \$400,000. As I reminded the meeting, one of them happened to be infertile. But, nevertheless, I think this is a much bigger exercise.

So there is now no excuse for the wool industry to lag behind the leaps in performance made by the lamb industry, the beef industry, the dairy industry, just to name but a few. We have the world's best tools and we have an unparalleled opportunity. We know if we measure it, we can improve it. Amongst the 100 million sheep in Australia lie the answers to the genetic challenges we now face and in the decades ahead.

The tools that will be made available to you all through the SheepGenomics program will provide us with the smart solutions for finding and replicating the genes which will keep the Australian Merino ahead.

Off-farm R&D

I move to the off-farm R&D. Let me now turn to the subject that you heard so much about this morning. The Board has made two major decisions in regard to building our demand for wool strategy over the past 12 months.

Firstly, we have asked Dr Len Stephens and his team to move away from long-term research that does not deliver a near and immediate market benefit. Secondly, as I mentioned earlier, we have shifted more of our budget into activities to build demand for Australian Merino wool.

You heard this morning from Graham Stewart and Pascal Senkoff how we are sharply focused on taking new innovations and technologies to the decision-makers in world apparel.

We are working with product developers, retailers, designers and manufacturers to get more Australian Merino wool into apparel products generally and globally.

Any influence that we can have in making wool more attractive to the apparel supply chain through advances in textile technology will create more demand. Our focus now is to keep building the national and international markets to do just that.

PETA

I turn now to other subjects. We have spent much of our time this year in Italy, Ireland, the UK and in the United States calming retailers who have been besieged by the animal rightists. The risk was - if we had not - that if sufficient of them had succumbed to the pressure put upon them, it could have started a general march away from wool.

I am delighted to say that with Les Targ at the helm, with early work from Len Stephens, who then handed over to Les Targ, and with great assistance from the Foreign Affairs Department and the Australian Government embassies in the countries I have just mentioned, that Robert Pietsch, representing WoolProducers of Australia, and I, representing AWI, have been able to sign two declarations on behalf of the wool industry taskforce, chaired by Peter Corish, which represents almost all of primary industry in this country, certainly the livestock industry.

We were able to sign those declarations which give the National Retail Federation in the US and the British Retail Consortium in the UK, comfort that they are being fully informed on all aspects of sheep welfare and mulesing in particular.

Under these two declarations as of now there is no role for PETA, and the live sheep trade in Australia will be run by Australians. These two retail organisations have applauded this approach and we continue to make sure that they are as informed as you and I are about what we are doing to solve the mulesing problem, with animal health and welfare at the forefront of our minds.

PETA legal case

I turn now to the legal case. Under the funding agreement with the Government, AWI has a responsibility for crisis management in the wool industry. I make no apology for, if you like, leading the industry into a court case against that organisation, PETA.

I take full responsibility for the court case, as does my Board. If you think we are wrong, well, no doubt you will fix that up this afternoon. But we are not wrong because, when the barbarian is at the gate striving to destroy your industry, you have to stand and fight; you do not walk outside to negotiate.

PETA and its allies have made many false claims over the impact that they are having on the demand for wool.

The Australian Sheep and Wool Industry Taskforce and our representative in New York have directly contacted all the major retailers of apparel product in the US. Not one of them has reported any change in the demand for wool products as a result of PETA's campaign. Not one of them has cancelled an order for wool products for this year's northern winter because of PETA's campaign, and PETA knows it.

I am very pleased that David DaPonte from LL Bean is here to show us just how one of the world's great apparel companies uses your wool. LL Bean, some of you remember, was one of the companies that PETA claimed as a scalp. Anyway, I'll let you judge because you heard him this morning.

One of the ironies of the mulesing issue is that it has helped us to develop many new relationships with global retailers, and we intend now to turn those relationships into opportunities to sell more wool.

Continuing the PETA campaign against them has cost some millions of dollars, and it may cost more. It has not (cost) the 15 or 20, as some misinformed people have suggested. But if PETA has success in other countries, then we are ready for them, and I would expect that you would expect us to be so.

Finances

I turn now to finances.

There have been some inaccurate assertions quoted in the press recently about the financial position of your company, and I would like to just briefly address our current position.

Over the last few years, AWI has consistently underspent against its plans, either because we tempered our spending in some areas where for a number of reasons we were not convinced that the direction and the strategy was correct or because we simply could not find sufficient projects which we saw as justifying investment of your funds.

We also exercised some caution several years ago when both the size of the clip fell with the drought and when prices fell along with them.

The current level of reserves in the company, cash in the bank today, is \$101 million - it was two days ago. That is not a result of a deliberate strategy, but it reflects to some extent our under-spend in previous years.

Like you, the Board has wanted to do more, and we now have the new executive skills in place and new strategies, particularly in the areas of trade and textiles.

Dr Len Stephens will tell you more about some of these exciting initiatives that are now under way to increase demand as a result of the company moving dramatically further into the area of working with textile manufacturers, designers and apparel retailers.

That said, I want to assure you that the Company is being prudent in looking at how we spend our money.

Every month the Board of AWI keeps an eye on our current cash position, the amount due to be spent over the next five years under contracts, and income levels. Also, a large number of our contracts deliberately have go/no go points in them which allow us to terminate them early, and therefore we finish up not paying the full value of those contracts if they have been unsatisfactorily performed.

If the project fails to show the sort of results that we would expect, that is what happens. So we know that the probability is that we will not spend all the funds we have contractually committed as a result.

In 2003 your Board introduced a policy of reserves to smooth out the effect of these price fluctuations on our income as part of a new range of corporate governance measures.

That said, if prices go down, obviously we will slow our contracting efforts down as well.

Contrary to some of the nonsense that has been put about, and in the unhappy circumstance that WoolPoll recommended no levy to commence - because there is a WoolPoll next year - but let's say in a very unhappy circumstance the WoolPoll recommended no levy to commence on July 1 2007, in other words, this one were to cease on June 30 2006, AWI would still be able to pay all its bills without breaking a contract.

AWI - AWS integration

Let me now turn to the AWI/AWS integration, or some form of integration as we have described it at AWI.

We have worked very hard over the last six or seven months to see if there is a way to remedy the mistake that the Australian industry and the Government made when they formed two different organisations several years ago, the two organisations Australian Wool Services and Australian Wool Innovation.

After detailed discussions with the AWS Board, AWI has found it difficult to agree to a full merger and I understand that the Australian Wool Services Board would like to make some changes to the way that they are currently operating.

I understand their Chairman, Mr Flugge, will outline to the AWS meeting tomorrow the general direction that it wishes to take for the time being. It may well be that AWI might take up some significant investment in future projects that the AWS Board will be running, but that will be AWI's choice.

I must say to you that I am personally disappointed that we have not got further in these discussions, but I have agreed with the Chairman of that company that such discussions are not closed.

Meanwhile, we at AWI will be free to pursue our own R&D and our own marketing initiatives you heard all about this morning outlined to you at this meeting earlier.

AWI future

I look forward, ladies and gentlemen, to the next two years with a sense of optimism. Our on-farm research team is delivering some results and we can look forward to more commercialised innovations in the field of wool harvesting and mulesing and so on.

Our demand building side for Merino wool will, I believe, deliver results over the next 24 months or so. These partnerships with the decision-makers in the leading businesses in China, in Europe and in the US are putting more Australian Merino wool into the global apparel market.

Interestingly, the PETA issue has introduced us to hundreds of retailers. Our job will now be to transfer that interest into technological help where we can help them produce new product with an edge.

We are asking those retailers, "What can our R&D do to help you? What can we do to help you make more money?"

In 2006 at WoolPoll you will have the opportunity to have your say on what level the wool R&D levy should be set. The broad strategy I have spoken about today, and the activities that you have heard about this morning, and the detailed financial statements Len Stephens is about to present to you are based on the continuation of the current two per cent levy.

I believe a two per cent levy, with a contribution from the Australian Government, delivers enough base funding for us to do the job.

It's been a challenging year, but your company has risen to the challenges, and it is in good shape to deliver more innovation, both on-farm and in the textile industry, forward in 2006 and beyond.

Finally, I would like to thank Len Stephens, his Executive Team and all his staff - they have worked extraordinarily hard this year in a very challenging year - as well as your team of Directors for the work that they have done. Thank you very much indeed.

Ian McLachlan AO
AWI Chairman
9 November, 2005