



ACN 009 220 053

## **SHAREHOLDER UPDATE No. 40 – November 2009**

Dear Shareholder,

### **INTRODUCTION**

As a producer of South Sea pearls, Atlas continues to concentrate on the operational side of the business seeking significant improvements in the quality of production through a dedicated focus on process control, research and development, and technical and operational systems development. This focus has helped Atlas maintain its reputation as the best South Sea pearl producer in Indonesia.

As the Company grew over the last decade, it was engaged in a successful partnership with Pearlautore International for the distribution and sales of our loose pearls. This commercial arrangement proved to be mutually beneficial for both Atlas and Pearlautore, but when the pearl industry was impacted by the global financial crisis (GFC), this arrangement proved to be not as flexible as required. Therefore the Company will not renew this arrangement when the agreement expires at the end of the year.

### **PEARL MARKET**

The GFC has impacted the pearling industry and this impact is still being felt as we close out 2009. However, a more pertinent question for the pearling industry is: "Was the industry in trouble before this and how will it recover from its current position?" A recent report from an eminent pearl industry participant has highlighted the problem of over-supply in the pearl market. The early success of the limited number of participants in the industry led others to emulate the results of the industry leaders. Improvements in farming techniques resulted in commensurate increases in production levels over the last 10 years. In 1998, the production of South Sea pearls was around 650 kan (2.4 tonnes). It is estimated that 2009 will see around 3,350 kan (12.5 tonnes) of white South Sea pearls produced with the highest volume of goods from Indonesia but the highest value from the Australian production.

Part of this increase in supply was driven by a higher demand for pearls but supply quickly overtook demand in this process. This growth in production reduced the scarcity of these pearls with this excess in supply exceeding demand resulting in lower prices. The GFC has exacerbated this problem but is most likely not the single cause of the position that the industry finds itself in now.

However, there is a light at the end of this tunnel for Atlas. The Company is in a unique position where it has a lower cost base than the Australian South Sea pearl producers with pearl quality not dissimilar from the Australian producers, although our average pearl size is somewhat smaller. Likewise our quality is significantly better than the majority of Indonesian and Philippine South Sea pearl producers. Our focus on high quality production of white South Sea pearls and operational efficiencies has ensured that the Atlas pearling business will remain viable into the future. As a result of the GFC we have renewed our efforts to improve efficiencies in all areas of company operations while at the same time keeping our oyster seeding and pearl production in line with our 2009 business plan and long-term goals.

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Anecdotal evidence indicates that most pearl producers have reduced their seeding output in 2009, some by as much as 50%. This was necessary for these producers to cut costs. It also encouraged producers to focus more on quality to improve profits in the future; however, business survival has been the main driver in this decision-making process and any results from quality improvement will not be seen for at least one more year. As a result there is likely to be further reductions and consolidation within the pearling industry with smaller producers unable to remain viable unless they specialise in niche markets.

With a decrease in supply over the next few years and an inevitable increase in demand as the global economy recovers, there will be an improvement in the prospects for the industry. There is already evidence of increasing demand from wholesalers as they position themselves for this recovery. Given that pearl jewellery represents less than 5% on average of most jewellery production, there is opportunity to improve demand through an increase in market share in the jewellery sector.

In anticipation of the end of our current pearl distribution agreement, Atlas has commenced its market development with valuable contacts made within the industry. As we look towards 2010 and beyond I feel we have gained considerable market intelligence which will further strengthen the Company and provide it with more opportunities for future growth. The Company expects to have a good supply of pearls available for sale in early 2010 from and efforts have been put into further developing our pearl preparation and distribution capacity.

Retail outlets in Bali have performed poorly in the second half of 2009. Although tourist numbers have seen improvement, there is less discretionary spending taking place. Efforts are continuing in relation to the Company's wholesale jewellery venture, but to date there has not been a significant take-up of the products offered. As with retail, this is assessed to be a result of the GFC with improvement anticipated once the market returns.

## **OPERATIONAL MATTERS**

Atlas had a good start to the hatchery season with a number of successful spawnings at the Company's new hatchery facility in North Bali. Brood stock for this breeding was selected from the cohorts identified through the genetics research program. Grading of the first batches of spat commenced in early November with excellent numbers of baby oysters moved onto the farm sites in Bali.

The seeding program of virgin oysters is now undertaken fully in N. Bali. Strict supervision and auditing of technician procedures is expected to result in a higher standard of pearl quality. The technicians that remain at the West Papua project will carry out reseedling of harvested oysters. It is expected that Atlas will finish 2009 with just over 370,000 oyster seedlings.

## **CORPORATE**

Although the Company has remained profitable for 2009 we have focused on maintaining sufficient cash flow ahead of profit margin in this difficult period. With pearl prices 40-50% below what they were last year and sales similarly down by 60%, the Company's total revenue will be in excess of \$6M and it expects to report an operation profit in excess of \$500,000 before tax, foreign currency movements and Agriculture Asset valuation adjustments for the full year to 31 December 2009.

The Company continues to maintain a strong balance sheet with sufficient cash reserves to meet the foreseeable future requirements. After a recent review the Company's banker continues to remain supportive of its ongoing lending position.

The Company has not declared a dividend in 2009 and is not expecting to make any cash distributions to shareholders for the balance of this year. The Board does not feel that it is prudent to pay any dividends while we continue to protect our cash position in this uncertain market.

As previously advised, the Indonesian Tax Authorities made an assessment in relation to the Indonesian subsidiary's 2007 tax payment and are seeking an additional \$1.9M in assessed taxes and penalties in Indonesia. The Company has filed an objection against this assessment on the grounds that the basis of this tax claim is contrary to prior assessments made by the Indonesian tax authorities. Atlas is also seeking relief under the double tax arrangements between Australia and Indonesia through the ATO. The Company expects that this will ultimately be resolved and it will have a neutral affect on the groups' cash and tax position.

I remain confident that Atlas will continue to operate profitably and that there will be a return to a strong cash flow position in the future. The timing of this will depend partly on the recovery of the global economy. Atlas will be further developing its distribution networks and marketing capacity in 2010 in the area of loose pearls and jewellery. As a result of aggressive cuts in operational costs and gains in efficiencies and anticipated early 2010 sales, Atlas should have sufficient cash reserves to weather this global financial crisis. The next 12-18 months will be challenging but exciting as we endeavour to protect shareholder value.

Sincerely

A handwritten signature in cursive script, appearing to read "Richard Wright".

**Richard Wright**  
**Managing Director**