



About the cover: Back to Back

This eye catching image was one of the images of a Merino wool jersey tank top displayed at the exciting Australian Merino photographic exhibition, *Back to Back*, presented by AWI in April 2006.

The *Back to Back* photographic exhibition featured images created by twenty-three of the world's most influential fashion photographers – 10 local and 13 international – featuring a super-sexy Merino wool jersey tank top designed by Australia's hottest new designer and AWI partner, Josh Goot. The AWI exhibition attracted a line up of some of the most influential guests from the Australian and international fashion industries.

Held at Sydney's Museum of Contemporary Art, the AWI exhibition coincided with Mercedes Australian Fashion Week, which last year generated \$240 million in fashion exports. Mercedes Australian Fashion Week is the major trade event for the Australian fashion industry, a week-long gathering for the who's who of designers, retailers, buyers and media, and the Australian Merino industry is a major player.



The fashion designer: Josh Goot

AWI partner Josh Goot designs clothes for a modern lifestyle. His collections are focused on the concept of 'tailored comfort'. His clothes are new and clean with a minimalist, 'future smart' appeal.

After three seasons, Goot's work made a significant impact locally and he was awarded the Tiffany & Co. young designer of the year for his debut collection and received much critical acclaim.

Since then he has showcased at New York Fashion Week and is now stocked in the world's top boutiques including Henri Bendel in New York, Browns Focus in London and Colette in Paris.

The photographer: Max Doyle

Highly regarded internationally for his commercial and editorial fashion photography, Doyle's work has appeared in I-D, The Face and Ray Gun. Doyle was selected for the 2005 Archibald Photography Portrait Prize.

Australian Wool Innovation Limited gratefully acknowledges the funds provided by the Australian Government to support the research, development, innovation and marketing detailed in this publication.

Australian Wool Innovation Limited
ABN 12 095 165 558

AWI does business directly with leading fashion designers, global textile manufacturers and retailers to get new Australian Merino wool products and innovations into the global marketplace.

AWI's mission is to drive research, development, innovation and marketing that will increase the long-term profitability of Australian woolgrowers.

Contents

01 Upfront

- 01 About AWI
- 02 AWI Board of Directors
- 04 Chairman's report
- 06 CEO's report

08 Report of program operations

- 08 Product Development
- 14 Product Marketing
- 20 Wool Production
- 28 Corporate Affairs

34 Good business

- 36 Managing our R&D strategically
- 39 Responding to Australian Government priorities
- 42 Corporate review
- 44 AWI staff

46 Financial statements

- 48 Directors' report
- 53 Financial report
- 77 Directors' declaration
- 78 Independent audit report to the members

80 Appendixes

- 82 Appendix A – 2005/06 report of progress against operational plan
- 96 Appendix B – Project list 2005/06
- 108 Appendix C – IP table

Who we are

Australian Wool Innovation Limited (AWI) invests funds in wool research, development and innovation (RDI) and marketing activities aimed at increasing the long-term profitability, productivity and sustainability of Australian woolgrowers.

Established in 2001, AWI is a not-for-profit company owned by 32,000 Australian farmers. The company invests in global RDI and marketing through the wool pipeline – from the fibre to fashion – in the areas of textile product development and marketing, wool production and industry affairs.

AWI does not own businesses – rather, we look to fund and commercialise global projects with science providers through to retailers. AWI aims to get the outcomes of the projects in which it invests rapidly and widely adopted or commercialised.

AWI investments are funded through an R&D levy paid by woolgrowers (currently two per cent of the sale price received for their shorn greasy wool) and a matching contribution from the Australian Government, capped at 0.5 per cent of the value of gross national value of wool production.

Woolgrowers vote every three years on the percentage of wool proceeds they would like to invest in wool R&D. There is currently a vote – WoolPoll 2006 – underway. The result of the vote will be announced at the AWI Annual General Meeting on 14 November 2006.

Where we invest

Textile product development

AWI funds the development of innovative products made from Australian Merino wool, based on proposals developed collaboratively in business-to-business relationships with textile manufacturers and retail partners. AWI also works to develop new fundamental knowledge about the properties of wool fibre, and develop processes that may lead to new Merino fibre yarns and fabrics.

Textile product marketing

AWI provides a vital link between the research and development chain and the retail market by forming direct business relationships to commercialise wool innovations and build the demand for Australian Merino wool. AWI also plays a key role in working with industry and government to increase market access into Australian wool/textile importing countries, and providing shareholders and industry with the latest market information.

Wool production

AWI works with woolgrowers to help them compete profitably in the international markets for wool through the adoption of on-farm innovations. AWI aims to help woolgrowers reduce the cost of production on their farms through innovation in areas such as pastures and grazing, sheep health, genetic technologies to breed more productive sheep, and shearing.

Corporate affairs

Through the use of publications such as *Beyond the Bale*, the AWI website, events and forums, and the rural and metropolitan media, AWI seeks to inform woolgrowers, the government, and users of Australian Merino wool (such as textile manufacturers, fashion designers and retailers) about the value of the Australian Merino wool industry.

The company directors of Australian Wool Innovation Limited during 2005/06, their experience and their special responsibilities as at the end of the 2005/06 financial year are listed below.

All the directors were in office during the whole of the financial year.



I M McLachlan AO

Mr McLachlan is a woolgrower with pastoral interests in South Australia and New South Wales. He was the Chairman of the Australian Wool Industry Future Directions Task Force in 1999. He was a Federal Member of Parliament from 1990 to 1998 and was the Minister for Defence and a Cabinet Member of the Federal Coalition Government from 1996 to 1998. Previously he was the President of the National Farmers Federation from 1984 to 1988. He is currently the President of the South Australian Cricket Association, a Board Member of Cricket Australia and is a Director of Clean Seas Tuna Limited, a publicly listed company.

Special responsibilities as at 30 June 2006

Chairman of AWI
Remuneration & Appointments Committee member
Intellectual Property & Commercialisation Committee member
Integration Committee chairman



B P van Rooyen

Mr van Rooyen is currently Chairman of Visionglow Global Ltd and Australian Country Spinners Pty Ltd. He is a Director of the Australian Wool Testing Authority Ltd, New Zealand Wool Testing Authority Ltd, and Power Farming New Zealand Ltd. Mr van Rooyen is a former Director of Norwellan Textiles Ltd, Woolstock Australia Ltd and Bruck Textiles Pty Ltd. He is a past President of the Australian Wool Processors Council and a past member of the CSIRO Textiles, Clothing and Footwear Sector Advisory Committee.

Special responsibilities as at 30 June 2006

Deputy Chairman of AWI
Finance & Audit Committee chairman
Remuneration & Appointments Committee chairman
Integration Committee member
China Free Trade Committee chairman



C J Abell Dipl Mech Eng, BE (Hons), PhD

Dr Abell is a South Australian woolgrower and is currently a non-executive Director of Saab Systems Pty Ltd and Pacific Marine Batteries Pty Ltd. Dr Abell is a former Director of Vision Systems Ltd (1986 to 2001) and a former Chairman of LADS Corporation Ltd (1992 to 2001). He is also a former Director of Woolstock Australia Ltd (1999 to 2002).

Special responsibilities as at 30 June 2006

Finance & Audit Committee member
Intellectual Property & Commercialisation Committee member
Falkiner Memorial Field Station Committee chairman
Integration Committee member



K J Bell BVSc (Hons), PhD, AAAC (WA)

Dr Bell has been a self-employed consultant to sheep growers in south-western Australia since 1983. Prior to this, Dr Bell spent five years completing postgraduate research fieldwork and study involving sheep enterprises and has five years experience in international development projects. He was a sheep-cereal zone consultant representative on the zone farmer advisory committees of the former Australian Wool Research and Promotion Organisation (AWRAP). Dr Bell has recently been appointed Professor of Animal Production Systems at Murdoch University, overseeing the progression of a new degree program in Animal Science.

Special responsibilities as at 30 June 2006

Falkiner Memorial Field Station Committee member



W B Merriman

Mr Merriman is Managing Director of the Merryville Stud. He oversees extensive commercial pastoral interests giving him broad farming and grazing experience. Mr Merriman has served on several industry boards, including National Woolgrower Forum, Major Woolgrowers Group and is past-president of both NSW and Australian Stud Merino Breeders associations.

Special responsibilities as at 30 June 2006

Remuneration & Appointments Committee member



H P Nivison BVSc

Mr Nivison is currently the Executive Chairman of Mirani Pty Ltd, a fine wool stud and commercial wool production business in northern NSW. Mr Nivison is also a Director of Australasian Rural Investments Pty Ltd, a company focused on sourcing and managing high quality rural businesses for non-traditional investors. Mr Nivison is a graduate of the Australian Rural Leadership Program and a registered veterinary surgeon.

Special responsibilities as at 30 June 2006

Finance & Audit Committee member

Intellectual Property & Commercialisation Committee chairman

Falkiner Memorial Field Station Committee member



P S Sykes

Mr Sykes is currently the Managing Director of Woolaby Australia Investments Pty Ltd, a business focusing on research, product development, marketing and retail within the wool industry. He is a consultant for Mariner Rural and Agricultural Solutions and a Director of Rylands (Humula) Pty Ltd. He is an AWI shareholder running 7,000 Merino sheep and 700 beef cattle in southern NSW. Mr Sykes has nine years experience in financial markets with Westpac Banking Corporation in money market trading, risk management and distribution.

Special responsibilities as at 30 June 2006

Intellectual Property & Commercialisation Committee member

Integration Committee member

Company secretaries

Leslie Mark Targ and Christopher Maitland Chapman Dip Law, MBA, FAICD, FCIS

chairman's report



Over the past year, AWI has made excellent progress with its on-farm research portfolio and taken a number of decisive steps to improve the marketing of Australian Merino into the global apparel trade.

AWI has a balanced research, development and marketing strategy that ensures gains through efficiency and productivity on the farm are supported by innovation and product marketing of Australian Merino wool. Our core business is to then take textile and garment innovations to our global business partners, who will in turn take Australian Merino wool to their global customers.

Who better to take textile and garment innovations to global manufacturers, retailers and designers, than AWI - the people who have developed them?

It has also been a year of intense scrutiny for AWI, with an independent review of our performance as part of our Statutory Funding Agreement with the Australian Government, and levy payers having their say on our future funding through WoolPoll 2006.

The review of performance conducted by economics consultancy ACIL Tasman found

that for the \$97 million we have invested on behalf of growers into on-farm research over the past three years, we have already delivered at least \$417 million in benefits.

The company's success in managing our on-farm research portfolio has come from concentrating on fewer, critically important projects that deliver direct cost savings or improved production potential to woolgrowers.

The Board's focus is to ensure our major on-farm research projects are delivering products woolgrowers can use.

Priority areas for on-farm research will continue to be sheep genetics, wool harvesting, pasture productivity and sustainable production systems.

Over the past year we have refined our off-farm marketing strategy and now have a more defined approach to influence demand for Australian Merino wool.

Over the past two years we have evolved from the traditional R&D model, where we would fund innovation in Merino textiles and offer the results to end-users, to a more targeted business partnership model.

Our strategy is now about direct business relationships.

We work with the leaders in each segment to develop innovations that give them a competitive advantage in their particular market.

We do business with companies that cause a ripple effect right through the supply chain when they launch a new product or adopt new technology.

We have also shifted our thinking about the scale of projects we will be involved in. That means saying no to some smaller potential partners.

Australia produces about 460 million kilograms of wool. To move the demand curve (sell more wool at better prices) we need to be creating now, new demand for several tens of millions of kilograms of clean wool.

A product development and marketing program that sells 100,000 garment pieces is a good start. But a project of this scale will move only an additional 30,000 kilograms of wool.

The Board has asked management to move its thinking from 100,000 piece projects to one million piece projects.

China will continue to be a major part of our business to business strategy because China and the rest of Asia is the new manufacturing hub for global textiles, and we need to make sure Chinese companies make premium Australian Merino apparel.

European firms are central in supporting this direction through their leadership in fashion, design and technology.

So while China is important, we are renewing our efforts in the six major markets for consumer apparel: USA, Japan, Germany, Italy, UK and India.

Through direct business relationships with the right brands, we can successfully communicate to consumers, via quality finished garments, the unique values of the world's most beautiful and versatile natural fibre.

Our retail business partners are now asking us to co-brand with them; they want consumers to understand the peerless natural qualities of Australian Merino wool and that the garment contains unique fabric technology from AWI.

In July 2006, AWI and Australian Wool Services (AWS) signed a Memorandum of Understanding, outlining the process of integration for the two companies.

The merging of the two companies, in my view, will resolve a flaw in the way product marketing and on-farm R&D institutions had been established in the wool industry.

While AWS and The Woolmark Company will bring new people, networks and experience into the team marketing Australian Merino wool, I am convinced the direct business relationship model will continue to be the right strategy to build demand for Australian Merino.

AWI and the Australian Wool and Sheep industry Taskforce's strategy of standing firm against animal rights extremists PETA has

proved to be the right call. The live sheep trade is still operating and we anticipate having an alternative to surgical mulesing commercially available before the end of 2007.

We are not aware of any global retailer of significance who is not using Australian Merino wool because of PETA's campaign.

While the wool market has staged a slow recovery, prices are still disappointing. In this price environment, it is critically important AWI continues to deliver on-farm technology to reduce costs and increase production, while at the same time, investing to build demand for Australian Merino wool.

With so many passionate and committed people within the wool industry, and the right business plan, we can create the opportunities to see this great Australian industry stride ahead.



Ian McLachlan AO

Chairman

Australian Wool Innovation Limited
21 September 2006



The profitability of the wool industry is on everyone's mind and drives every decision made by AWI.

While most growers are looking for better returns, a study conducted for AWI by three agricultural consulting firms showed that over the past five years the top performing Merino flocks were just as profitable as prime lamb flocks or beef cattle. This same study showed that dual purpose sheep enterprises (based on Merino ewes) were the most profitable livestock enterprise in many parts of Australia over that same period, and that in these dual purpose sheep enterprises, wool still accounted for up to 60 percent of income.

Your research and development levies invested in the on-farm research portfolio address some of the key factors that influence the profitability of wool growing and

have delivered real benefits to shareholders over the past 12 months.

Some examples include:

- The launch of Sheep Genetics Australia (in partnership with Meat and Livestock Australia).
- Land Water and Wool (LWW) has been a major investment by AWI and Land and Water Australia, involving thousands of wool producers around Australia. The program has provided practical guidelines on grazing management, biodiversity, native vegetation and water quality. In addition techniques to remediate over one million hectares of saline affected land were developed.
- Over 1,753 individual shearers and 575 wool handlers have been trained, a total of over 2,328 for 2005/06, and 4,500 copies of new, interactive shearer and wool handler training resources have been distributed.
- AWI's online wool-pricing tool Woolcheque was given a new look and feel in May this year, making it even easier for woolgrowers to independently price their wool clip. Since its launch, visits to the site have increased by 40 per cent; with over 21,000 visitors to Woolcheque from July 2005 to June 2006.

In the coming year the enormous effort that has been put into the development of alternatives to mulesing will begin to pay off. At the time of writing, the new breech clips and injectables have been evaluated on more than 4,000 sheep on 15 farms.

Twenty six companies have expressed interested in commercialising these products.

The Peak Hill Industries' *ShearEzy* upright posture shearing platform has been through several modifications on the first prototype and will now be available for delivery in late 2006. Good progress is also being made with two other new shearing platforms, with shearing rates approaching traditional methods and further developments to increase shearing rates and reduce costs underway.

As an investment for the future of the industry, the \$30 million Sheep Genomics project (in partnership with MLA) is progressing well and will complete its first stage in 2008. This project aims to identify DNA markers for sheep production traits including parasite resistance, better wool quality and improved lambing performance. Sheep Genomics is a complex, international project involving nearly 100 scientists and 179 separate research contracts. We expect the first DNA markers for sheep production traits to be delivered over the next two years.

Australian Merino textile product development and innovation marketing

Our off-farm investments have changed significantly throughout the year as a result of greatly improved understanding of apparel retailers' needs. We have summarised these needs in a revised offering called "Knowledge-Innovation-Market Support (KIM)".

The Knowledge retailers look for includes information on sourcing, selling, designing and quality of garments made from Australian Merino wool. Innovation is needed in design, functionality and

manufacturing efficiency. Market Support includes point of sale materials, swing tags, consumer research, product launches and the optional use of an AWI brand.

Our KIM service is delivered through direct business relationships and during the year we have steadily increased the number of these relationships in place all over the world. Work delivered over the past year will be showcased as products in the coming year. For example this years AWI "Innovation Collection" is currently being shown to our partners and retailers all over the world. The collection has three themes: Merino Care, Merino Soft and Merino Visual.

Due to the length of the wool supply chain and the workings of the global fashion calendar, most of the products resulting from these relationships will not appear on the shelves until 2007/08. However, there have been some early successes this year with launches in China of the washable suit by Heilan, the Merino Active fleece by Haitian and the Red Island range by Purely Merino in Australia.

During the year AWI participated in a number of other industry initiatives that will produce benefits in future years, including the establishment of the Australian Wool Textile Training Centre, participation in the Australia-China Free Trade talks and the IWTO/AWI/Woolmark Test Marketing Project.

Corporate affairs

It is important for us to keep the industry and shareholders informed of the company's activities and the past year has been a busy one in this regard. The corporate affairs team has put together some remarkable events, including:

- Five industry forums attended by more than 800 woolgrowers.
- Principal sponsorship of The World Merino Conference in Perth, with more than 1,000 people attending the Innovation Day.
- Twenty young stud Merino breeders from across the country attended an Australian Association of Stud Merino Breeders leadership course.
- The AWI-Nino Cerruti Fashion Design Competition in partnership with Hong Kong Polytechnic University gave fashion students the chance to discover first-hand the remarkable qualities of Australian Merino wool.
- The creative 'Back to Back' photographic exhibition showing work by 23 of the world's most influential fashion photographers featuring an Australian Merino wool garment was attended by 250 fashion retailers, international buyers and media during the Mercedes Australian Fashion week in May.

Finances and staff

Reflecting reduced wool sales, the total revenue for the year was \$57,035,000, compared to \$64,999,000 last year. This was comprised of \$38,359,000 levies, \$11,048,000 government contributions, \$5,437,000 investment income and \$2,191,000 other income.

Total expenditure for the year was \$82,678,000, of which research, development and marketing

expenditure was \$70,421,000. This total is composed of \$29,303,000 for Wool Production, \$21,749,000 for Product Development, \$11,841,000 for Product Marketing, and \$7,528,000 for Corporate Affairs (including information and education activities).

Consistent with our strategic plan, we have invested more into new off-farm demand building programs than on-farm production projects over the past 12 months. The balance between off-farm and on-farm for the past 12 months was 55% off-farm and 45% on-farm.

We finished the year with funds under investment and cash in hand of \$77,114,000 and forward liabilities committed and planned for research contracts of \$54,022,000. The past year has been the culmination of a three year journey, to transform AWI from a predominantly on-farm R&D company with an interest in textile technology to a robust, international organisation that can simultaneously manage a large Wool Production R&D program in Australia and Product Development and Product Marketing programs in Australia and throughout Asia, Europe and the US.

The on-farm R&D portfolio will continue to deliver in 2006-2007 and we now have the right marketing strategy and the right people in place to meet our goals to build the demand for Australian Merino wool.



Dr Len Stephens

Chief Executive Officer

Australian Wool Innovation Limited
21 September 2006