



AUSTRALIAN ALPACA FLEECE LIMITED

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DIRECTORS' REVIEW OF THE JUNE 2007 YEAR

Dear fellow shareholders,

I have pleasure in reporting to you on the operations of AAFL for the year ending 30 June 2007.

The scale of your business has increased significantly, with revenue growing from \$1,098,000 to \$2,777,000, an increase of 153%. Whilst that is indicative of further acceptance of Australian alpacas producing an increasingly higher quality exotic and beautiful fibre, it places huge strains on all the resources of the company, our people, our control systems and our finances. When we consider that when the company acquired the business of the Co-op in March 2004 it had an annual turnover of around \$300,000, we have come a long way in just three years.

Your board has adopted a growth strategy for the following reasons:

- We believe it is important to have a market for **all** parts of the alpaca fleece. To be a credible supplier, we must have significant and regular supplies of fleece in all lines.
- Most processors want white or light fawn fleece. This allows them to supply garments in a range of colours. If manufacturers cannot supply a range of colours, they become less able to compete with other suppliers of exotic fibre such as cashmere and silk. Some growers who have coloured animals with beautiful fleeces are concerned that we do not seem as interested in coloured fleece. As a public company, we must primarily be ruled by economic considerations. However AAFL has found markets for all fleece colours produced, and continues to search.
- Our business is cyclical at both ends. Shearing is done primarily in Spring and Summer, and we produce garments for Autumn and Winter. So we need to collect, class and clean to get our product to processors for manufacturing and delivery of goods to stores in time for the first Autumn chills. Consequently we need fleece as soon as it is shorn so it may be classed and the cycle completed within a year.
- Why are we interested in export? For two reasons: first the Australian market can absorb only so much alpaca product, and secondly, the northern hemisphere, with opposing seasons, helps to even out the cyclical pattern mentioned in the last paragraph.

- Being a good employer is not just about obeying the industrial and OH&S legislation. It is also about creating a business environment which allows people to grow and improve and extend their management skills. A static business cannot offer that personal growth. Our staff are motivated, flexible and keen to progress. Our success depends on them as well as a regular supply of fleece.

The result for the year was a loss of \$48,000. Although disappointing, we would like shareholders to focus on the steady improvement since AAFL started. A summary of the three years since we started is as follows:

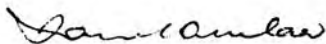
FY	\$000 Revenue	\$000 Loss	Percent of sales	Tonnes of raw fleece
2005	624	395	63.30%	44,794
2006	1098	102	9.39%	42,274
2007	2777	48	1.72%	67,200

We do not expect, nor do we want, the 2008 year to show the same business growth as 2007. We took on three new staff, all at different times during the year, and they need to integrate and not be under the same pressure as last year. Your board expects a total revenue in the vicinity of \$3.5m. And even more exciting news, we expect to be in profit.

At the time of the last share issue, in March 2006, we laid before shareholders a plan that changed the way the company did business. We embarked on value adding our fleece. Since then more change has been thrust upon us. Australian fibre processing capacity is diminishing, both in scouring and finishing. We do not want to be locked into a position of being held to ransom by having too few suppliers, or being exposed to significant loss by having too few customers.

Plans are under way for a share issue to shareholders later this year. Every shareholder will have the right to acquire new shares in proportion to their present shareholding. Hopefully, at that time we will be able to offer the smaller of our now 920 shareholders the option of topping up their holdings with additional shares to give them a more meaningful investment. Shareholders who wish to buy or sell shares in AAFL continue to have available the sale facility courtesy of Geoff Gregory.

On behalf of the board,



Ian Winlaw
Chairman



Michael Talbot
Managing Director