

THE PAPERBARK CO

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Standing Committee on
Environment and Public Affairs
GPO Box A11
Perth WA 6837
Attention Mr Mark Warner

Dear Mark

The following is a submission to the current Enquiry into the Sandalwood Industry in Western Australia. The submission addresses the terms of reference of this enquiry. Should the Committee make a report to the Legislative Council I request a copy of the report be sent to me.

I am a Director, and part owner of The Paperbark Co., trading as Paperbark Essential Oils (PEO). PEO has owned a farm at Harvey since 1997, where we grow and distil a range of essential oil producing crops. PEO has also been actively involved since 2001 in the steam distillation (processing) of West Australian sandalwood to produce sandalwood oil. We were the first to steam distil this oil, at a time when the only other participant in this sector, Mt Romance (MRA), was using the solvent extraction process. We were actively encouraged in this development work by the FPC, and from 2001 to 2006 purchased sandalwood direct from the FPC under various agreements. In 2006 we entered into a 3 year supply contract (Private Treaty) with the FPC, and received sandalwood at a rate of 40tpa, averaged out over a 4 year period. Following this we again entered into a 1 year supply contract (Private Treaty) for a further 40t, which concluded in November 2011. We also purchase legal Private sandalwood when it is available. We have developed a world wide market for our sandalwood oil, and have I believe an excellent reputation in the industry.

PEO believe there are major problems in the Western Australian Sandalwood Industry, and specifically in the domestic value adding sector. The FPC has, through their lack of foresight and management skills, created this problem. They continue to add to this problem through ongoing poor decision making processes. In summary, PEO believe that they:

- signed off on a 21 year supply contract to MRA in 1995.
- are responsible for achieving a woeful rate of return on this contract, with nearly all of the best quality sandalwood from West Australian Crown Land being supplied to MRA at ridiculous prices
- had several opportunities to renegotiate this contract during ownership changes at Mt Romance, but did little.
- have now effectively put in place a Government sponsored monopoly by MRA in the Australian sandalwood oil industry, heavily subsidised by the West Australian public.
- are responsible for causing major disruption to the business of PEO, a successful domestic sandalwood oil producer which they, and the Minister for Agriculture, had previously supported for over a decade
- have instigated a policy of exporting the remainder of Crown Land sandalwood, with no regard for further possibilities of onshore value adding apart from those activities carried out by their Agent Wescorp.
- have convinced the responsible Minister that there should be no assessment at all of any other onshore value adding exercises.
- are selectively ignoring their published mission statement "...promoting local value adding for timber resources..."
- in conjunction with The Department of Environment and Conservation (DEC), seem incapable of controlling the trade in illegal sandalwood

PEO believe the circumstances contributing to the above include:

- In 1995 the FPC negotiated a supply contract with the fledgling domestic value adding company, MRA, to supply sandalwood through to 2016 at a CPI indexed fixed price, (with some detailed variations).
- When this contract was signed, the FPC must have been totally distracted by their corporate mission statement, which says that they should support and encourage domestic value adding and the benefits this brings to the community. There is no doubt that they should have supported MRA in its early years, but the terms of this contract were almost beyond belief.
- PEO believe the term of this fixed price contract with MRA was 15 years, with another 5 years of progressive ramp up to export parity pricing, 21 years in total. There have been some variations to this contract, made perhaps when MRA had ownership changes, eg 2006, but little if anything has been done to correct the situation.
- The contract terms are very complex, with various wood types attracting different purchase rates. The cynical amongst us would be inclined to think that it was the Buyer who drove these terms, with the Seller perhaps not even fully understanding the ramifications of the detail.
- The FPC has a mandate to sell Crown Land resources eg sandalwood, in order to maximise returns to the taxpayer and the State.
- The FPC also has a mandate to support and encourage domestic value adding, and the benefits this brings to the local community.
- The FPC has a poor overall record with regard to financial performance. There has been considerable pressure applied by various Governments to improve this performance.
- Perhaps partly as a result of this pressure, aggressive marketing by the FPC and its Agent, especially to the SE Asia region, has seen sandalwood demand in the Agarbati industry, and the value of export sandalwood, increase.
- This has left a large and increasing gap between the export value of sandalwood, and the domestic value as defined by supply to MRA.
- PEO entered the domestic sandalwood oil extraction industry in 2001, and pioneered the steam distillation extraction process. We recognised that at least part of the sandalwood oil market wanted a steam distilled product, as opposed to the solvent extraction process used at that time by MRA.
- We always intended to differentiate ourselves in the market with this product.
- Unfortunately MRA had also recognised this, and progressively changed their entire processing facilities to steam distillation after we commenced production.
- From 2001 to 2006, the FPC, and its Minister, continued to maintain an outward expression of support to companies wishing to value add on shore. PEO expended considerable time, effort and money to build up a successful business.
- Supply to PEO by the FPC was continued under contract from 2006 until November 2011. Supply pricing varied over this time, and whilst PEO never paid full export parity pricing, they did pay considerably more than MRA. How much more was never quite clear, but it could have been more than 3 times. PEO managed to make a success of this arrangement, despite this major obstacle. It has only been relatively recently, since MRA have been forced to recognize the 'true' cost of sandalwood as their contract heads towards full export parity pricing, that this obstacle for PEO has been removed.
- PEO received written written encouragement and support from the Minister for Agriculture in November 2006, who stated he was "*pleased to see (PEO's) on-going work in developing the local sandalwood oil industry*"
- PEO also clearly understood that that the availability of sandalwood was severely restricted as a result of the sustainable management processes put in place by the FPC, and that realistic options for expansion would not occur until after 2016 when MRA's contract would conclude, and the playing field levelled out.
- PEO was told in May 2011 that the FPC would cease all future supplies of sandalwood to them, under any circumstances, or at any price.
- The reason given was that there was insufficient sandalwood available to supply domestic oil distillation customers, apart from that which is already contracted to MRA.
- PEO believe this reason is totally without foundation.
- For the past decade, it is a fact that there has therefore been sufficient sandalwood harvested each year to supply MRA, PEO and the export market.
- During this time MRA also received varying quantities of additional wood over and above their contract amount. The exact quantities are not available to PEO, but they may be considerable.
- Other companies, including Austoils, are also seeking sandalwood supplies. Austoils recently invested heavily in facilities, but without any sandalwood supply arrangements with the FPC. They managed to establish

alternative wood supply arrangements, and for some time have placed considerable quantities of oil on the market.

- Presumably Austoils sought comment from the FPC regarding supply options, before they invested in processing facilities, and presumably the FPC would have advised them that there was not any spare sandalwood available to supply them.
- PEO believe that Austoils should have made appropriate business decisions with these facts in mind, and unless they had other sources of sandalwood in mind, they should not have made a decision to enter an industry which had a finite supply resource. There are many industries which the Government controls because of environmental considerations leading to limited supply eg fisheries.
- PEO's decade long continuity in the industry should not be terminated because of the demands of Austoils, or any other 'new' industry aspirant
- FPC must acknowledge that a successful business does not happen overnight, and a decade of involvement must count for more than just a desire to become involved.
- PEO understand that there has been no change to the annual quota of sandalwood harvested by the FPC, which we were originally lead to believe was approximately 2000tpa, but more recently have been advised is 1350tpa green wood, and 1350tpa dead wood.
- The FPC are supplying 550tpa of the best green wood from this harvest to MRA.
- PEO have been recently advised by The Minister for Agriculture that the 40tpa which has been withdrawn from supply to them has now been diverted to the export market.
- PEO have also been advised by The Minister that MRA had a Right of First Refusal clause added to their contract in 2008, for an additional 50t greenwood, and that this 50t has also been diverted to the export market.
- The Minister has stated to PEO that 1300t of greenwood is harvested annually, and that 70% of this wood is suitable for oil extraction. Of this 910t of greenwood, 550t is supplied to MRA under long term contract.
- The Minister has stated to PEO that ALL of this 910t which is in excess of the contractual supply to MRA, ie 360t, is required to be used to blend with dead wood to make a suitable specification of powder for the export market.
- The Minister would not explain to PEO why it had been necessary to increase the quantity of greenwood used in powder production, over what was available when both PEO and MRA were receiving additional greenwood and the quantity of greenwood available for powder production was less.
- The Minister stated he was not interested in having the FPC carry out a simple Cost Benefit Analysis of the returns to the State of export of High Specification powder using ALL surplus greenwood, vs returns to the State and community of export of a slightly lesser specification powder, but with the likes of PEO staying in business.
- PEO has requested information to confirm or otherwise whether ALL excess greenwood ie 360t, is used to make powder, or if in fact some of this greenwood is in fact exported as Pregrind or Logs. This information has not yet been made available, but PEO has information to suggest that considerable quantities of green logwood, and pregrind, is being exported, over and above powder exports.
- PEO has had to advise its clients that it no longer has certainty of supply for sandalwood, and that oil production by PEO is restricted by supplies of Private wood, as and when it is available.
- Now that a monopoly situation is in place, the FPC has one domestic customer. That customer, TFS/MRA, will be in a strong position to negotiate continuity of supply after their current contract expires in 2016.
- Illegal sandalwood harvesting appears to be relatively common place, with estimates of 800tpa and more. The FPC, and the Department for Environment and Conservation (DEC), are responsible for policing of such activities. The current situation is woeful, and quite frankly shameful, more befitting of a third world country than Australia. There is much discussion and disquiet in the industry about the effectiveness and indeed willingness of these organisation's abilities to police and prosecute illegal sandalwood harvesters, and more importantly, those who purchase wood from them.
- This situation will have a major impact on the long term viability of the West Australian Sandalwood industry.

PEO admit they are an aggrieved party in this industry. However we have been involved in the sandalwood oil industry for over a decade, we have established good markets and client relationships, and we have overcome sufficient of the many obstacles placed in our way to establish a very good and profitable family business. We have a very loyal customer base, both domestic and overseas, which in turn value adds to the sandalwood oil we sell them.

We would welcome the opportunity to further elaborate on our concerns for the Western Australian sandalwood industry, and the way it is managed. There is much to be said.

Yours sincerely

A handwritten signature in black ink, appearing to read "John Day". The signature is stylized with a large, looping initial "J" and a trailing flourish.

John Day
25 September 2012