Fragrant Atlas Coming Out Of Its Shell

BY JAMES DUNN - 13/05/2015 | VIEW MORE ARTICLES BY JAMES DUNN

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The Australian sharemarket does not have much in the way of luxury goods companies, with the exception of accessories manufacturer and retailer Oroton (ORL). But a tiny Perth-based company is doing its best to rectify that, with ambitious plans to build an Australian-owned jewellery and perfumes house.

Atlas Pearls and Perfumes Limited (ATP) has two business divisions, a fully integrated pearling business, and the 50%-owned Essential Oils of Tasmania (EOT), a distillation and solvent extraction business. Atlas operates pearl farms spread across the Indonesian archipelago, including Bali, Flores, and West Papua, from which it grows, matures and harvests white and silver South Sea pearls, which are graded, distributed as loose pearls or made into jewellery, and sold to jewellery wholesalers or through the company's own retail outlets, in Perth and Bali.

EOT produces a wide range of pure essential oils and fine plant extracts for the food, flavour and fragrance markets across the world. Atlas has combined the two businesses in developing the world's first perfume from pearls: instead of only using the pearl – which comprises only 1% of the oyster – Atlas has developed a process to extract peptides from the harvested oyster, and use them to make perfumes and ingestible products for the health and wellness industries.

Last year, EOT won a $1.1 million grant from AusIndustry's Commercialisation Australia program to commercialise this intellectual property. The grant allowed EOT to build the first commercial-scale super-critical liquid CO2 extraction device in Australia. This device can separate essential oils, fragrances and bio-active compounds without the use of chemical solvents, which gives extracts that can be certified organic. This will be a critical attribute in EOT's plans to penetrate the perfume, "nutriceuticals" and "cosmeceuticals" markets.

EOT has more than 300 hectares of crops that it owns or is grown under contract on 20 farms. These crops include lavender, boronia, Tasmanian native mountain pepper, parsley, fennel, truffle, blackcurrant and peppermint. In 2014 EOT launched five fragrances under the Wild Islands brand, its first consumer products, each specifically highlighting one of the company's "signature" ingredients: mountain pepper, boronia, fire tree, lavender and pearl, the latter under the brand Ayu. The fragrances were designed in France by world-renowned perfumer Michel Roudnitska. The pearl-based Ayu range also includes soaps and moisturisers that claim to penetrate the skin with anti-ageing pearl proteins.

In April, Atlas sold a 50% stake in EOT to Hobart-based Westwood Properties, for $1.4 million. As part of the deal Westwood will build and lease back to EOT a state-of-the-art bio-actives extraction and perfume-making plant, in Hobart. Atlas plans to use this plant to break into the European perfume market. While EOT only generates about 10% of Atlas' revenue at present, the company expects this contribution to rise significantly as the new plant opens up access to high-margin revenue streams from the global luxury-goods supply chain.

Four years ago, Atlas was struggling to sell its pearls to just three Australian-based customers. Now the company sells 80% of its pearls to about 50 of the world's top jewellery wholesalers. The jewellery expansion, under the company's retail brand Perl'eco, was driven by former Atlas executive chairman and chief executive officer, and now consultant to the company, Stephen Birkbeck, who built on his extensive connections in the French perfume business, which he had developed while running sandalwood company Mount Romance in the 1990s and 2000s.

As with many luxury products, the pearls market was hit hard by the GFC, and took a while to recover. Atlas – which is one of only three major industry players producing high-quality white South Sea pearls – recorded its best pearl auction result since the GFC in June 2014, on the way to lifting revenue by 56% in FY14, to $16.3 million, on the back of high pearl prices and the first full-year contribution from EOT (which Atlas bought in 2013). That helped the company return to profitability, notching up a $1.8 million net profit, a $2.7 million turnaround on the $945,000 net loss for FY13.

However, the December 2014 half-year result was not so promising, with revenue from continuing operations down 35% to $6 million, and the bottom-line result coming in at a loss of $7 million, compared to a $200,000 profit at December 2013. The company attributed the step backward in profitability to the smaller pearls that were harvested and sold during the period; provisions raised against older jewellery inventory and the accounting effect of $8.3 million in "fair value" movements.

Difficulties in the pearling operation persist. In March, Atlas was forced into an emergency capital raising, after discovering the pearls it will harvest at its five South Sea farms will be 15% smaller in FY15 than in FY14, as a result of poor decisions on seeding younger oysters using smaller nuclei size (the company says corrective action began on this problem in 2012). The company offered shareholders a one-for-five non-renounceable pro rata entitlement offer at 4.5 cents a share, to raise up to $3.1 million. But shareholders stumped up only $723,300, and the underwriters – a group of shareholders, entities and persons related to the family of current Atlas director Tim Martin – had to pick up almost 77% of the offered shares.

Atlas now expects the drop in pearl sizes to reverse in FY16 as a result of the natural flushing of the oysters concerned, which were replaced with stronger animals, and an increase in the number and quality of seeded oysters to be harvested in FY16.

The expected decline in pearl production notwithstanding, the company reported strong results from its March auction, held in Kobe, Japan. Total sales were just over $1.326 million, at an average of 6.6% over reserve prices. There were 16 successful bidders (from more than 30 buyers that attended), with one "particularly aggressive" buyer accounting for almost one-third of the total auction result.

Atlas said the results achieved at Kobe were "slightly over" its target, and confirmed stable prices as well as solid demand for its pearls. The company added that it was "pleasing to notice" that bidding was strong across most shapes and qualities of pearls on offer. Atlas' next auction will be held in June.

ATP shares have slid from 13.5 cents in August 2014, after the FY14 result, to 4.8 cents at present, which values the company at a minuscule $15 million. The shares are difficult to buy, and patience would be required to build a stake. But Atlas is certainly an interesting story: buyers are backing the company's ability to continue to capture increasing demand, and resulting better pearl prices, coming out of China and the re-emerging North American market; and to expand greatly the value-adding of its pearl products; and the ability of the perfume division to generate high-margin revenue from the global perfume and wellness industries. The company has a strong balance sheet, with almost five times more equity than debt, and is positioned well to grab hold of significant opportunities.

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