29th January 2016

hardman&co

R.E.A. Holdings

2015 Trading Update – Behind The Fog

2015 has been a tough year with harsh climatic conditions and depressed commodity prices. We are forecasting a small and reduced profit for the year as a consequence and cash flow has been impacted negatively. The company has responded by introducing a net new $19.3m of funding being a mixture of equity and debt capital. But behind the fog of difficult business conditions, operating efficiencies can be seen to be rising and the electricity supply operations have begun to generate first year revenues. This is a significant development and we do not think that it has been adequately reflected in the valuation.

- **Strategy:** REA is developing and operating high quality palm oil production assets in East Kalimantan. By end 2016 the company should have planted some 40,800 ha of oil palm with 20,000 to 25,000 ha of further plantable area to complete, out of a total land bank of circa 111,000 ha. A mid-size plantation by Indonesian standards, REA represents an attractive consolidation target.
- **Share Price:** the ordinary shares and the 9% Cumulative Preference shares have been weak, reflecting depressed palm oil prices. The Prefs have been impacted by the re-pricing of corporate and EM debt, a change in UK tax treatment of dividends and concerns about cash flow, yet the 2015 Pref dividend has been paid and one director has acquired Pref shares recently.
- **Valuation:** Currently REA is trading at a discount of circa 21% to its peers. This looks anomalous on the basis of asset quality and operational efficiencies and taking into account a possible value of circa $30m for the electricity operations which began to generate revenues during 2015.
- **Risks:** Agricultural risk, commodity price risk and country risk are constants of palm oil production. A bias to the use of debt finance means that the net debt to equity ratio is currently estimated at 68.6%. REA has stated its intention to rebalance debt with permanent capital. Investors will be watching for progress on this front.
- **Investment summary:** REA is developing and operating high quality plantation assets to produce sustainable palm oil. Against a background of tightening land availability in Indonesia, REA reports that it is in discussion with various parties about a possible sale of a strategic stake in the business. We recommend that all valuations of the company should now reflect a separate valuation line for the electricity supply business, an operation almost unique to REA Kaltim.

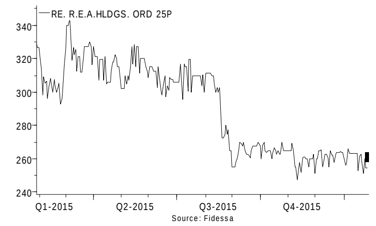
Financial summary and valuation

Year end Dec ($m)	2013	2014	2015E	2016E	2017E
Sales	111	126	91	109	137
EBITDA	39	43	22	32	50
Reported EBIT	27	32	11	20	36
Pretax Profit	25	24	3	7	23
EPS (cents)	16	40	-23	-17	13
Dividend per share(p)	7.25	7.75	0.00	0.00	4.00
Net (debt)/cash	-164.4	-179.2	-206.1	-195.4	-206.1
P/E (x)	25.3	9.9	-	-	30.5
Planted Hectares (ha)	33,830	34,614	36,814	40,814	42,814
EV/Planted Hectare ($/ha)*	12,327	12,048	11,328	10,217	9,740
FFB Production (Nucleus) (mt)	578,785	631,728	606,905	650,468	706,514

**EV/planted Hectare include market capitalisation of the 9% Cumulative Preference Shares*

Source: Hardman & Co Research

Food Processors



Source: Fidessa

Market data

EPIC/TKR	RE.
Price (p)	261.0
12m High (p)	343.5
12m Low (p)	247.5
Shares Ord (m)	36.7
Shares Prefs (m)	63.6
Mkt Cap Ord (£m)	95.8
Mkt Cap Pref (£m)	50.6
EV ($m)	417.0
Free Float* (%)	54%
Market	Main

**As defined by AIM Rule 26*

Description

R.E.A. is engaged in the operation and further development of palm oil plantations in East Kalimantan, Indonesia. The group also operates a stone quarry, and owns coal mining concessions that have been contracted out to other significant coal mine operators.

Company information

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Next event

Full Year Results	Apr-16

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Introduction

REA Holdings (REA) released a Trading Update 17th December which detailed a difficult agricultural year with the lowest rainfall recorded in 19 years and the lowest palm oil prices recorded since end 2008. With rainfall patterns out of sync in both 2014 and 2015 with the average for the past 19 years, the company saw production impacted in the year just ended and Hardman Agribusiness (HAB) believes crop output will be impacted in 2016 also in response to the very dry conditions experienced across the estates in the period July – October 2015.

However, 2015 was also a year marked by improving efficiencies as demonstrated by the oil extraction rates (OER) being achieved by the group's two older mills following a programme of refurbishment and management improvements. REA is now ranked within the top third of sector efficiencies by OER. Good progress was achieved with estate development, with 4,000 ha cleared for planting, of which some 2,200 ha were planted (784 ha in 2014). There was further progress too with the group's unique POME driven electricity generating business: 18 local villages are now connected for supply from three REA generators feeding off methane captured by plants at two of the company's mills. The methane capture plants utilise palm oil mill effluent (POME). The local utility is now installing prepay meters into local houses and as this process gathers pace amongst the 24 village communities currently scheduled to be connected to receive electricity generated by REA, HAB anticipates revenues growing to $1.25m in the short-term. For 2015 HAB is forecasting modest first time revenues as utilisation has been building up incrementally since the commencement of supply in April.

The difficult agricultural conditions and the depressed commodity price have led us to reduce our forecasts for both 2015 and 2016. The company has faced difficult decisions including suspending dividend payments on the ordinary shares for 2015 and determining to seek a strategic investor in REA Kaltim (REAK), the Indonesian holding company for REA's palm oil related businesses in Indonesia. The cash flow has been negatively impacted by lower than expected revenues and against this background the company has sought to contain costs and to bolster the balance sheet: new equity capital of some £9.6 million was raised in 2015. Funding activities for the 2015/16 period (as detailed in the Trading Update) resulted in the company increasing available funds by nearly $19.3m. As a component of this process the company also sought to lower the cost of debt capital and to secure new debt on longer maturities. However, gearing ratios look stretched: HAB estimates that net debt: equity will have ended 2015 at more than 68% and net debt: EBITDA will have spiked to more than 11.1x. The latter ratio has clearly dented investor confidence as reflected in the price of the REA 9% Cumulative Preference shares which are now yielding 11.2%. In this context it is noteworthy that whilst announcing suspension of dividend payments on the Ordinary shares, the company has continued to pay the dividend on the preference shares.

Looking ahead to 2016 REA has stated clearly that the rate of estate development will now depend on its ability to attract funding. Much rests on a successful transaction in respect of the proposed sale of a strategic stake in REAK. Similarly, the evolution of the commodity price during 2016 will also have an important bearing on cash flow. In these circumstances the company will prioritise conservative financial management, balance sheet strengthening and estate development – in that order. However readers should note that despite difficult trading and climatic conditions in 2015, the company planted some 2,200 ha of new plantations and with a further 2,200 ha of cleared land (ready for planting) carried over into 2016, the company feels confident that it can go out of the 2016 year with some 4,000 ha of additional planted area, taking the total planted area by end 2016 to circa 40,800 ha.

FY15 Trading Update

Operations

In the week ahead of the Christmas Break, REA published a Trading Update (17th December).

	11 Months to 30th November 2015	11 Months to 30th November 2014	Change (%)	11 Months to 30th November 2013
FFB Harvested (mt)	547,000	578,556	-5.5%	523,993
Harvestable Area (Ha - HAB estimate)	29,135	28,275	3.0%	26,915
Annualised Yield per Ha (mt)	20.5	22.3	-8.2%	21.2
3rd Party FFB (mt)	127,000	136,192	-6.7%	88,796
Total FFB Processed (mt)	665,000	705,613	-5.8%	612,224
CPO Produced (mt)	146,000	154,723	-5.6%	133,680
Oil Extraction Rate (%)	22.0%	21.9%		21.8%
Palm Kernels Produced (mt)	31,000	32,437	-4.4%	27,957
PK Extraction Rate (%)	4.7%	4.6%		4.6%
PK Oil Produced (mt)	11,000	11,826	-7.0%	10,249
PK Oil Extraction Rate (%)	34.8%	38.1%		36.6%
Rainfall Average Across Estates (mm)	1,967	2,233	-11.9%	3,030

Crop Production

Crop production was lower for the 11 months to end November 2015 than in the preceding year and on an annualised yield per hectare basis the outcome was a reduction on both 2014 and 2013. Lower rainfall both in 2014 and again in the period July to October 2015 was to blame and has been reflected in results across the region. Readers will note from the table above that the rainfall recorded on the plantations was down 11.9% on the first 11 months of 2014 and some 35% lower than for the same period in 2013. The data provided in the table below show that rainfall in each of the last 2 years has been below the average (3,462mm) and indeed the 2015 data are the lowest in the series.

	Rainfall (mm)
1997	2,475
1998	3,550
1999	4,012
2000	4,381
2001	3,447
2002	2,406
2003	3,550
2004	3,877
2005	4,739
2006	2,968
2007	4,413
2008	3,504
2009	3,122
2010	4,816
2011	3,413
2012	2,978
2013	3,386
2014	2,605
2015	2,141

Source: REAK

REA believes that both 2014 and 2015 were years in which El Nino weather patterns impacted on local rainfall. Although the current El Nino conditions look to be continuing in the Pacific area, REAK reports that it is now receiving regular levels of rainfall but it is too soon to say whether normal rainfall conditions have returned. The company notes that the 2014 and 2015 El Nino conditions resulted in extended drought periods for the REAK plantations and also in a period of excessive rainfall leading to localised flooding. This impacted crop levels in 2015 and may yet impact crop levels in 2016. We have reduced our forecast for 2016 production by some 50,000 mt of FFB to reflect the possible weather impact on 2016 crops, for an increase of only 7.2% over our 2015 full year forecast to give 650,468 mt. There is scope too for improvements in productivity across certain areas of the estates which were subject to greater disruption during the period of village disturbances. It is expected that as fertiliser regimes and general estate maintenance balance out the setbacks experienced by the palms in 2013/14, these areas will conform more closely to the company's targeted yield curve.

FFB Production

	2013	2014	2015e	2016e	2017e
FFB Prod' (own) (MT)	578,785	631,728	606,905	650,468	706,514
FFB (purchased) (MT)	99,348	149,002	135,000	130,000	130,000
Total FFB for processing (MT)	**678,133**	**780,730**	**741,905**	**780,468**	**836,514**
Own estate FFB yield/ha avg	*21.5*	*22.3*	*20.8*	*20.8*	*20.9*

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

Third party supply of FFB is also down for the first 11 months, by 6.7%. REAK reports that in 2015, deliveries from cooperatives increased by 5%, despite climatic and economic pressures, whereas 3rd party corporate tonnes purchased were only 42% of 2014 levels. This was not unexpected as two local plantation companies commissioned new mills during 2015 to process the fruit from their maturing plantations. While the demise of the corporate volumes was only to be expected, the volume of smallholder fruit purchased by REAK is expected to continue to grow steadily going forward.

In this context it is interesting to note that REAK is working with SNV, an international development NGO, to improve the agricultural efficiency of the smallholders within its supply chain. The goal of optimising yields from smallholder farms is positive for both farmers and REAK. Additionally, the training provided is designed to make these smallholder producers RSPO compliant in due course so that an increasing proportion of the palm oil produced from the group's mills can be sold as RSPO certified.

Mill Efficiency

Oil extraction rate across the company's operations has strengthened to 22% (21.9%). It was noted in the statement that for the 5 months July – November 2015 the rate was higher again at 22.6%, as compared with 21.5% for the preceding six months. This has encouraged us to use 22.5% in our financial model for 2016. The company itself is feeling confident of an even stronger performance and it informs HAB that average OERs are currently running at closer to 24% across the three mills. This may mean that our forecasts are exceeded.

Mill Production

	2013	2014	2015e	2016e	2017e
OER	*21.8%*	*21.7%*	22.0%	22.5%	22.5%
Total CPO production (MT)	**147,649**	**169,466**	**163,219**	**175,605**	**188,216**
Palm Kernel Extracted (MT)	**30,741**	**35,764**	**30,418**	**31,999**	**34,297**
Total CPKO (MT)	**11,393**	**12,596**	**11,863**	**12,480**	**13,376**

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

The improvement in the reported data is welcome but expected noting that a major refurbishment programme across the group's two older mills is almost completed. Three of four boilers have been refurbished and the fourth boiler will be refurbished during 2016. Additionally, management of the mills has been tightened and in particular in respect to grading of 3rd Party fruit coming into the mills.

In the table below, REA is positioned within the top 3rd of operators for OER efficiency, but there is scope to tighten OER performance perhaps by another full percentage point.

Company Name	Oil Extraction Rate (%)
MP Evans	24.75%
Dharma Satya Nusantara Plantations	23.90%
Eagle High (BW Plantation)	23.50%
Sawit Sumbermas Sarana	23.30%
London Sumatra Indo	23.20%
Golden Agri	22.93%
First Resources	22.80%
United Plantations	22.77%
Palm CI (BRVM)	22.57%
Salim Ivomas Pratama	22.40%
IndoAgri	22.40%
KL Kepong	22.00%
R.E.A. Holdings *	22.00%
Astra Agro Lestari	21.94%
Sime Darby	21.86%
Sipef (Brussel)	21.81%
Genting Plantations	21.80%
Okomu Oil Palm PLC (Lagos)	21.80%
Kulim Malaysia	21.73%
Austindo Nusantara Jaya Plantation	21.70%
Sampoerna agro	21.70%
Global Palm	21.70%
Hap Seng Plantations	21.56%
Anglo-Eastern Plantations	21.30%
IOI Corporation	21.21%
Felda Global Ventures	21.01%
Carson Cumberbatch (Colombo)	20.97%
Sarawak Plantation	20.88%
IJM Plantations	20.80%
United Malacca	20.66%
TH Plantations	20.62%
Chin Teck Plantations	20.61%
Kwantas Corporation	20.50%
Sarawak Oil Palms	20.26%
Far East Holdings	19.11%
Univanich Oil Palm (Thailand)	18.59%
Presco Plc (Lagos)	17.02%

** 2015 Estimate*

Source: Published Company Data/Hardman Agribusiness

Electricity Supply

During 2013 the group obtained licences to generate and sell electricity to the state utility PLN for onward sale to the villages surrounding the group's estates. In April 2015 the group's two methane capture plants began to supply electricity. To date 18 villages out of 24 designated for connection to the local grid, are receiving electricity and PLN and the local utility are working to connect the remaining 6 villages.

The utility is also installing prepay meters in village homes and REA reports that "uptake is growing at a moderate pace". As more villages are connected to electricity supply and the number of prepay meters installed increases it is reasonable to assume that power off take will grow with positive implications for revenues. We are anticipating annual revenues of circa $1.25m once all villages are connected. Notwithstanding that initial revenues from this new business activity will be relatively modest, it seems reasonable to assume that the appetite for electricity amongst local populations will grow incrementally and thus the electricity generating activity remains a subsidiary business with the potential to make an important contribution to the future profitability and also to the value of the group. Noting that demand per household will likely increase as consumers purchase additional appliances etc, there is scope for revenues to grow materially over time. A projection of c.US$2m may be a reasonable and possibly conservative, estimate of future revenue. In addition, PLN has been considering linking the regional transmission network to the new local grid; in that event REAK could install further generating capacity and would be able to deliver electricity into the regional network 24 hours/day and 7 days/week, increasing revenue from electricity sales materially.

State-owned electricity utility PLN is aiming for sales growth of 6% in 2016, compared with growth of only 2.1% in 2015. PLN has pointed to slowing consumption by the industrial sector in 2015 for its weaker performance relative to previous years. Industrial-sector power consumption was 4.3% lower in 2015 compared to 2014. But better trends in consumption were recorded by the business sector, which grew by 6.5% in 2015, (11.7% growth in 2014). The electrification ratio was 88% for Indonesia as of the end of 2015, but in June 2015 the ratio for East Kalimantan was lower at 69%, with at least 7% of villages not connected to a power supply of any sort. The policy on the supply of electricity in rural, border and remote areas has been implemented through the development of renewable energy based on the local potential of each region. One focus has been on the construction of power plants which are fuelled with energy sources from palm oil mills. At the end of 2014 REA Kaltim was reported to be amongst four palm oil mills noted to have built palm oil mill effluent based electricity generating capacity.

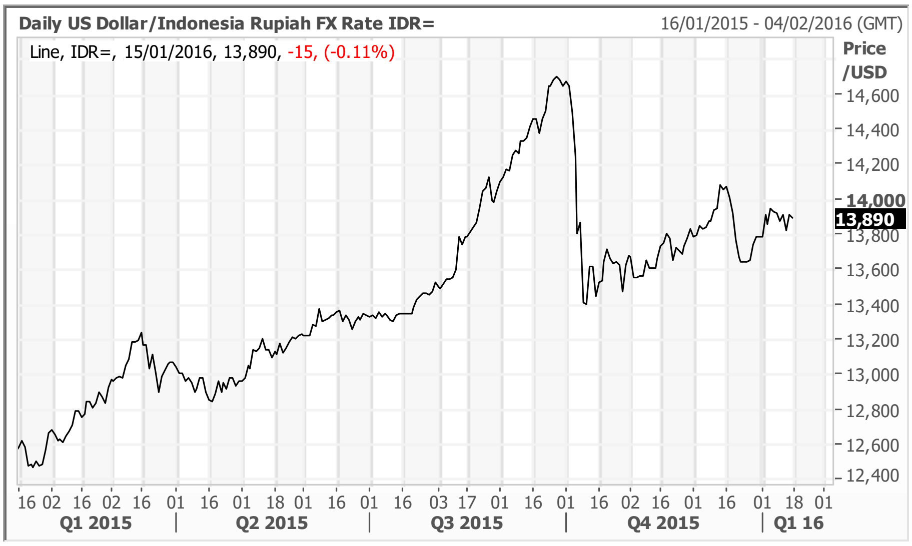
Those villages not currently connected to a supply grid either have no electricity or have less than 15 hours of supply per day from diesel generators. The marginal cost to generate a kWh of power from POME biogas is typically less than half of that from diesel and for this reason the opportunity has gained much attention from the governor of East Kalimantan, and the general manager of state-electricity company PLN Regional Office for East and North Kalimantan. The news service Republika reports that the authorities and PLN established the POME-biogas for Rural Electrification Partnership with the commitment to provide joint facilities for POME-biogas power plant developers. Apart from support for the transaction process to get a power purchase agreement with PLN, the partnership will provide power grid infrastructure required in the developing areas. An assessment by

Winrock International shows that with the current Feed In Tariff (FIT) rate for Kalimantan the project internal rate of return (IRR) is between 13 to 14%.

Not only does the electricity business endorse the company's reputation for the sustainability of its operations, it also adds to the value of the company – and this does not look to be adequately reflected in the current market valuation. REA's enterprise valuation per planted hectare is at a 21% discount to the sector notwithstanding upper tier efficiencies. With the electricity operations valued at circa $30m we believe that EV/ha would evolve at just over $12,000 for a discount of only 6%.

Revenue & Cash Flow

Against a background of reduced production and depressed commodity pricing, the company notes that its "own revenues have been adversely impacted...which will be reflected in the results reported for 2015". This can be expected to have a consequential and detrimental impact on cash flow. The company has continued to cut costs where possible and reported via the 17th December statement that the field workforce (which includes temporary workers) has been reduced by more than 10%. Its efforts to reduce costs will have been helped by the further depreciation of the Rupiah, down more than 8% this year. We are anticipating strong downward pressure on Administrative expenses ($16.4m in 2014) in the current year. The company also benefitted from some $2.2m release of its UK pension contribution provision in FY15. This implies administrative costs in the region of $14.9m for 2015.



Source: Reuters Eikon

Sustainability

We have noted in previous reports on REA, that the company has excellent sustainability credentials. REA's commitment to leadership in sustainability is a distinguishing feature of the group operations. The company is ranked 7th out of 50 palm oil producers for sustainable production by the London Zoological Society. http://www.sustainablepalmoil.org/companies/

Not only does it maintain a dedicated division (REA Kon) to manage its 21,000 ha conservation area, the company produces some 50% of the fertiliser used on the estates from composted palm oil mill and estate bio-waste, empty fruit bunches (EFB) and palm oil mill effluent (POME). While the commercial generation of electricity from mill effluent (used to generate methane) is a relatively uncommon practice within the sector, it demonstrates a pragmatic approach to environmental and social impact, reducing the production of an important greenhouse gas and bringing a highly valued benefit to remote rural communities while also boosting the bottom line.

REA is an innovator in environmental management for which it has been recognised by local authorities and international agencies. Techniques include the installation of water flow meters at all three mills, strict control of pesticides and herbicides, and now the company is seeking to provide traceability of all FFB processed to specific production plot, monitoring and mapping any encroachment into conservation areas for future restoration where possible and improvements in water use efficiency within the mills.

Plantation Development

The company reported good progress having been made during 2015 and noted that by the end of the year it expected to have cleared in excess of 4,300 ha across the PBJ and CDM estates, of which more than 2,200 ha will have been planted out. If funding were available, the company commented that it would be possible to clear another 4,000 ha in 2016 with planting proceeding steadily in the wake of the clearing programme.

Planted Hectares

		2013	2014	2015e	2016e	2017e
Hectare Planted (Ha)	Immature	6,915	6,339	7,679	9,539	8,984
	Mature	26,915	28,275	29,135	31,275	33,830
Total Planted (Ha)		**33,830**	**34,614**	**36,814**	**40,814**	**42,814**
% of Total Plantable		**56%**	**58%**	**61%**	**68%**	**71%**
Planted Within Year (ha)		2,555	784	2,200	4,000	2,000

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

The availability of funding will be a key driver of the forward development programme and much will depend on the proposal to sell an equity stake in REAK to a strategic investor. We are expecting the company to plant out 4,000 ha in 2016, but only 2,000 ha planted for 2017 depending on funding availability. Our financial model suggests that the company could utilise up to another $40m with a full development programme and it will be looking for a strategic stake transaction to significantly boost investment capital.

In respect of the stone quarrying operations, and realistically in the context of current cash flow expectations for the group, management continues to seek a "cornerstone" third party stone off take agreement to support the required investment in the road infrastructure needed to exploit the concession commercially. The December statement makes clear that in the current trading conditions and in the context of the group's capital structure it is the intention of the directors to undertake new development only in circumstances when "the major part of the development can be funded with equity or specific debt finance that is already in place".

Funding Activity

In response to the impact of reduced crop levels and the further downward pressure on the price of palm oil commodities on revenues and cash flow, REA has amongst other measures, including cost reductions, sought increased funding. As set out in the 2014 Report & Accounts the company has sought to repay shorter dated debt obligations by either raising new equity capital (including Preference Share Capital) and or debt financing with longer maturity dates.

2015 Funding Activity	Date	Amount (Units)	Currency	Price	Amount Raised	Coupon	Yield	Maturity
Issue of Preference Share Capital	01/07/2015	4,221,000	£	1.20	5,065,200	9.00%	7.5%	Perpetual
Sterling Notes	03/09/2015	26,552,000	£	1.00	26,552,000	8.75%	8.75%	2020
Sterling Notes (Acquired & Cancelled)	03/09/2015	-26,216,000	£	1.00	-26,216,000	9.75%	9.75%	2015/17
Sterling Notes	10/09/2015	300,000	£	1.00	300,000	8.75%	8.75%	2020
Sterling Notes	17/12/2015	5,000,000	£	0.97	4,850,000	8.75%	9.02%	2020
Issue of Ordinary Shares	15/10/2015	1,754,260	£	2.60	4,561,076			Perpetual
Addition To Working Capital Facility (annually revolving)	2015		$		5,000,000			
New Term Loan	2015		$		18,000,000			2022
Repayments re Cross Currency Interest Rate Swap	27/12/2015		$		-9,000,000			2015
Repayments re Indonesia Term Loans	2016		$		-18,000,000			2016
Net Available From Funding Activities			**$**		19,272,905			

Source: REA Statement 17th December 2015

As can be seen from the table above, which details the funding activities undertaken in 2015, the company replaced some £26.2m of 9.75% Sterling Notes due 2015/17 with some £31.7m of Sterling Notes with a coupon of 8.75% and maturing 2020. Fresh equity capital to the value of £9.63m was also issued, being £5.065m Preference Share Capital and £4,561m of Ordinary Share Capital.

The December statement notes that these measures "should meet the group's current cash requirements" but in the interest of improving the group's debt service coverage, it was proposed to raise additional equity capital by way of a placing of shares in REA Kaltim (REAK). While there is a longstanding commitment to listing REAK on the Jakarta Stock Exchange, in the current depressed market conditions, this action could not be expected to raise a material sum. In this context the company confirmed what it had already proposed – the sale of significant investment stake in REAK to a strategic investor. The December statement notes that the group "is currently in active discussions with several interested parties".

Forecasts

Readers will note from the table below that we have assumed the price of CPO trading no higher than $650/mt up to the end of 2017.

	2013	2014	2015e	2016e	2017e
CPO Price($/mt) Achieved	*648*	*665*	*495*	*550*	*650*

Our 2016 estimate would be positively impacted if the current $50/mt levy imposed on CPO by the Indonesian authorities in support of the biodiesel sector, is abandoned as is being rumoured. There is talk throughout the Indonesian sector that the largest Indonesian producers are lobbying the government to have this levy cancelled.

Coupled with climate effects on crop production we are projecting revenues of $91.4m for 2015 and $109m for 2016. And reduced marginal profitability for 2015 and 2016. With cost reductions and Rupiah depreciation the company can still produce a positive bottom line result – but it will be marginal in 2015 before strengthening, possibly sharply, in 2017. In these circumstances it is not surprising that the directors deemed it prudent that they "should not declare or recommend payment of any dividend on the ordinary shares in respect of 2015".

Profit & Loss					
Year Ended 31st Dec	**2013**	**2014**	**2015 e**	**2016 e**	**2017 e**
$m					
Revenue	**110.5**	**125.9**	**91.4**	**109.0**	**136.7**
Net (loss)/ gain arising from changes in inventory value	0.5	-1.7	-1.5	0.1	0.2
Cost of production	-69.9	-77.9	-70.1	-74.1	-86.3
Gross profit	**41.2**	**46.3**	**19.8**	**35.0**	**50.6**
Gross margin %	37.3%	36.8%	21.7%	32.1%	37.0%
Biological assets valuation	7.1	3.6	5.2	0.0	0.0
Other operating income	0.0	0.0	0.0	0.0	0.0
Distribution costs	-1.3	-1.3	-1.3	-1.4	-1.6
Administrative expenses	-19.0	-16.4	-12.7	-13.3	-12.9
Operating profit	**28.1**	**32.1**	**11.0**	**20.3**	**36.1**
EBITDA	38.8	42.7	22.3	32.3	49.6
Investment revenue	0.5	0.4	0.3	0.2	0.1
Finance costs	-3.3	-8.8	-8.6	-13.0	-13.7
Profit before tax	**25.2**	**23.7**	**2.7**	**7.4**	**22.6**
Tax	-12.5	-1.8	-2.1	-4.2	-6.8
Profit for the year	**12.7**	**22.0**	**0.6**	**3.2**	**15.8**
EPS (cents)	15.8	40.3	-22.3	-17.2	13.0
			0.0	0.0	4.0
Attributable to:					
Ordinary Shareholders	5.5	14.2			
Preference Shareholders	7.3	8.1	-8.3	-6.3	4.8
Non-controlling interests	-0.1	-0.3	8.9	9.2	9.2
Minorities	0.0	0.0	0.0	0.1	0.3
	12.7	**22.0**	0.0	0.3	1.6

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

Balance Sheet					
Year Ended 31st Dec	**2013**	**2014**	**2015 e**	**2016 e**	**2017 e**
$m					
NON-CURRENT ASSETS					
Goodwill	12.6	12.6	12.6	12.6	12.6
Biological Assets	288.2	310.2	327.6	342.9	358.5
Property, Plant & Equipment	147.0	151.2	151.7	150.0	148.3
Prepaid Operating Lease Rentals	30.5	33.9	33.4	33.0	33.5
Indonesia Stone and Coal Interests	30.4	31.3	31.6	32.1	32.6
Deferred Tax Assets	9.5	8.9	8.9	8.9	8.9
Non-Current Receivables	2.3	2.7	2.5	1.4	1.4
	520.4	550.8	568.4	580.9	595.9
CURRENT ASSETS					
Inventories	17.3	16.2	20.0	21.0	23.1
Trade & other receivables	28.6	25.5	23.8	27.3	31.3
Cash & equivalent	34.6	16.2	9.2	9.8	11.6
	80.5	57.9	53.0	58.1	66.0
TOTAL ASSETS	**600.9**	**608.7**	**621.4**	**639.0**	**661.9**
CURRENT LIABILITIES					
Trade and other payables	16.9	17.8	17.5	18.5	21.6
Current Tax Liabilities	2.9	2.6	2.9	5.0	7.6
Bank Loans	35.0	40.3	42.7	42.7	51.4
Sterling notes	0.0	14.7	-7.4	0.0	0.0
US dollar notes	6.0	0.0	3.3	3.3	3.3
Hedging instruments	0.0	9.6	0.0	0.0	0.0
Other Loans & Payables	0.9	1.2	1.0	1.4	1.4
	61.8	86.2	60.0	71.0	85.3
NON-CURRENT LIABILITIES					
Bank loans	62.3	60.6	79.3	79.3	95.5
Sterling notes	55.7	37.7	67.3	59.8	47.4
US dollar notes	33.5	33.5	30.1	30.1	30.1
Preference shares issued by a subsidiary	0.0	0.0	0.0	0.0	0.0
Hedging instruments	7.9	0.0	0.0	0.0	0.0
Deferred tax liabilities	73.4	77.2	77.5	79.7	82.2
Other loans & payables	6.9	6.8	6.8	6.8	6.8
	239.7	215.8	261.0	255.7	262.1
TOTAL LIABILITIES	**301.5**	**302.1**	**321.0**	**326.6**	**347.4**
TOTAL EQUITY	**299.4**	**306.6**	**300.4**	**312.3**	**314.5**

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

In the table below we detail our projections for the formation of the debt ratios through to 2020. The 2015 estimates indicate a net debt / EBITDA ratio nearly 6 points above the upper levels acceptable for an issuer of corporate bonds and this will help to explain the pressure on the price of the Cumulative Preference shares.

	2013	2014	2015 e	2016 e	2017 e	2018 e
Net Debt/Equity	54.9%	58.4%	68.6%	65.8%	68.8%	67.2%
Net Debt/EBITDA (before BA)	5.2	4.4	11.1	6.4	4.4	3.0
Net Debt/EBITDA	4.2	4.2	9.2	6.4	4.4	3.0

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

On the basis of our financial projections net debt/EBITDA should fall to 4.4x in 2017 and 3.0x in 2018. This would represent a capital structure with which investors would feel somewhat more comfortable, but it is dependent on the introduction of some $30m of new funding. We are assuming that dividends will only be paid at 52% of the 2014 level from 2017 as the company biases cash towards development.

Cash Flow					
Year Ended 31st Dec	**2013**	**2014**	**2015e**	**2016e**	**2017e**
$m					
NET CASH FROM OPERATING	**0.8**	**24.4**	**0.0**	**9.7**	**24.9**
Interest received	0.5	0.4	0.3	0.2	0.1
Proceeds from disposal of PP&E	0.1	0.0	2.3	0.0	0.0
Purchase of PP&E	-12.0	-14.9	-10.0	-8.5	-8.9
Expenditure on Biological Assets	-16.8	-18.5	-16.4	-20.1	-21.3
Expenditure on prepaid operating lease rentals	-4.3	-4.3	-1.5	-1.0	-1.0
Investment in Indonesian stone & coal	-0.9	-0.9	-0.3	-0.5	-0.5
CASH FROM INVESTING ACTIVITIES	**-33.5**	**-38.2**	**-25.7**	**-29.9**	**-31.5**
Preference dividends paid	-7.3	-8.1	-8.9	-9.2	-9.2
Ordinary dividends paid	-3.7	-4.3	-4.4	0.0	0.0
Repayment of borrowings	-5.0	-30.7	-5.0	-18.0	0.0
Proceeds of issue of ordinary shares	10.5	0.0	6.8	0.0	0.0
Purchase of treasury shares	0.0	-1.0	0.0	0.0	0.0
Proceeds of issue of preference shares	0.0	10.6	7.6	0.0	0.0
Redemption of US dollar notes	-9.7	-6.3	0.0	0.0	0.0
Redemption of Sterling notes	0.0	0.0	7.4	0.0	-12.4
Payment to close out hedging contracts	-1.9	0.0	-10.8	0.0	0.0
Net Sale and repurchase of US dollar notes	1.2	0.0	0.0	0.0	0.0
New bank borrowings drawn	57.6	35.4	26.0	18.0	30.0
Additional Funding	0.0	0.0	0.0	30.0	0.0
CASH FROM FINANCING	**41.8**	**-4.5**	**18.8**	**20.8**	**8.4**
NET INCREASE IN CASH	**9.0**	**-18.2**	**-6.9**	**0.6**	**1.8**
Cash B/F	26.4	34.6	16.2	9.2	9.8
Effect of exchange rate	-0.8	-0.1	-0.1	0.0	0.0
CASH BALANCE C/F	**34.6**	**16.2**	**9.2**	**9.8**	**11.6**

Source: REA Report & Accounts/17th December Statement/Hardman Agribusiness Estimates

Valuation

Enterprise Value/Planted Hectare: $10,112

The international listed sector valuation data detailed in the table below reveals REA trading at a discount of 21.3% to the peer group weighted average EV/planted hectare ($12,846). The Indonesian listed Indonesian operators traditionally have lower valuations than their Malaysian peers and this is evident in the data with REA grouped tightly with other Indonesian operators including Austindo, Astra Agro and MP Evans. Compared with this smaller group it is notable that REA mature hectares (31,275) are a smaller percentage of its total planted area (40,814 ha at end 2016) than for the other Indonesian operators grouped around it and a smaller percentage of its land bank (111,562 ha). These data point to REA's greater potential for growth, relative to its Indonesian peers, in the context of existing plantation assets.

Readers will note that we have sought to provide a valuation for the company's electricity supply business. This operation is almost unique to REA Kaltim and certainly it is not a typical component of the standard sector valuation metric of EV/ha. Now that this business is generating revenues, we believe that all valuations of REA must take into account the value of the electricity supply business additionally to the palm oil operations.

Company Name	Adjusted EV/ha ($/ha)	Mature ha as % of Planted Area	Planted Area as % Land Bank
DekelOil	53,883	0.0%	7.9%
Wilmar International	53,316	0.0%	na
Sawit Sumbermas Sarana	42,364	96.3%	43.8%
Univanich Oil Palm (Thailand)	23,606	94.0%	na
United Plantations	23,035	83.5%	na
IOI Corporation	22,823	84.0%	84.0%
Genting Plantations	16,274	72.9%	48.8%
TSH Resources	15,953	0.0%	76.0%
First Resources	15,187	68.9%	na
Golden Agri	15,130	92.7%	na
IJM Plantations	14,855	61.6%	na
Kwantas Corporation	14,556	88.2%	29.0%
KL Kepong	14,507	83.9%	74.3%
Presco Plc (Lagos)	13,683	74.7%	na
Okomu Oil Palm PLC (Lagos)	12,684	85.5%	na
Sime Darby	12,126	86.7%	na
United Malacca	10,803	71.4%	90.6%
Hap Seng Plantations	10,663	99.6%	89.7%
Austindo Nusantara Jaya Plantation	10,374	82.4%	45.8%
Astra Agro Lestari	10,302	82.3%	na
R.E.A. Holdings *	**10,112**	**76.6%**	**36.6%**
MP Evans	10,111	81.4%	83.8%
TH Plantations	10,106	63.6%	56.8%
DutaLand	10,085	100.0%	na
Far East Holdings	10,009	85.2%	na
Sarawak Oil Palms	8,944	94.7%	87.2%
Felda Global Ventures	8,852	0.0%	74.2%
Sipef (Brussel)	8,731	80.8%	na
Bakrie Sumatera Plantations	8,027	84.2%	na
BLD Plantation	7,701	91.0%	na
Eagle High (BW Plantation)	7,351	64.1%	32.4%
Dharma Satya Nusantara Plantations	7,049	76.6%	36.3%
Socfinasia (Luxembourg)	6,558	90.2%	na
London Sumatra Indo	6,130	83.2%	na
Indofood Agri Resources	5,814	75.3%	na
Carson Cumberbatch (Colombo)	5,711	76.0%	49.4%
Socfin (Luxembourg)	5,691	74.8%	na
Kulim Malaysia	5,655	85.7%	56.9%
Sampoerna agro	5,165	66.2%	na
Salim Ivomas Pratama	4,727	75.3%	na
Palm CI (BRVM)	4,588	87.8%	na
Anglo-Eastern Plantations	4,531	83.1%	50.5%
Socfinaf (Luxembourg)	4,305	67.1%	na
Chin Teck Plantations	3,586	61.8%	na
Sarawak Plantation	3,275	85.0%	75.4%
Equatorial Palm Oil ***	2,721	0.0%	na
Global Palm	1,421	95.4%	na
Feronia **	619	44.5%	na
Weighted average	12,846		

* 2015 Balance Sheet Estimates, 2016 Operational Estimates
** Feronia adjusted EV/ha adjusted for 23.5% of DRC gov holdings
*** Equatorial palm oil adjusted EV/ha adjusted for 50% of LBD holdings
Source: Company Reports, Reuters Eikon, Hardman Agribusiness

Enterprise Value: Net Asset Value (Price: Book) 1.3x

Excluding consideration of DekelOil (it is less of a plantation operator than a processor of 3rd Party fruit) the EV/NAV valuation range for the sector is wide, with the ratio extending from 8.4x (IOI) to 0.2x for some of the riskier African operators. Even excluding Sawit Sumbermas Sarana, a leading Indonesian operator in terms of efficiencies and valuation, the range still remains wide at 3.6x (DSN) to 0.6x (Golden Agri).

EV	Adjusted EV/ha ($/ha)	EV/NAV
DekelOil	53,883	22.3
IOI Corporation	22,823	8.4
Sawit Sumbermas Sarana	42,364	6.9
Dharma Satya Nusantara Plantations	7,049	3.6
TSH Resources	15,953	3.4
Astra Agro Lestari	10,302	3.1
KL Kepong	14,507	2.8
First Resources	15,187	2.8
Bakrie Sumatera Plantations	8,027	2.7
Carson Cumberbatch (Colombo)	5,711	2.4
IJM Plantations	14,855	2.2
TH Plantations	10,106	2.2
United Plantations	23,035	2.1
Felda Global Ventures	8,852	2.1
Genting Plantations	16,274	2.1
Eagle High (BW Plantation)	7,351	2.1
Sime Darby	12,126	2.0
Wilmar International	53,316	1.9
Sampoerna agro	5,165	1.9
Sarawak Oil Palms	8,944	1.8
Presco Plc (Lagos)	13,683	1.7
Socfin (Luxembourg)	5,691	1.7
Indofood Agri Resources	5,814	1.7
Univanich Oil Palm (Thailand)	23,606	1.5
Austindo Nusantara Jaya Plantation	10,374	1.4
Palm CI (BRVM)	4,588	1.3
R.E.A. Holdings *	**10,112**	**1.3**
Okomu Oil Palm PLC (Lagos)	12,684	1.3
London Sumatra Indo	6,130	1.2
Salim Ivomas Pratama	4,727	1.2
BLD Plantation	7,701	1.1
Socfinaf (Luxembourg)	4,305	1.1
MP Evans	10,111	1.1
Sipef (Brussel)	8,731	1.0
Kulim Malaysia	5,655	0.9
Kwantas Corporation	14,556	0.9
Hap Seng Plantations	10,663	0.8
Far East Holdings	10,009	0.8
Chin Teck Plantations	3,586	0.7
Anglo-Eastern Plantations	4,531	0.7
Sarawak Plantation	3,275	0.7
Golden Agri	15,130	0.6
United Malacca	10,803	0.6
DutaLand	10,085	0.5
Socfinasia (Luxembourg)	6,558	0.4
Feronia **	619	0.3
Equatorial Palm Oil ***	2,721	0.2
Global Palm	1,421	0.2
Weighted average	**12,846**	

Source: Company Reports, Reuters Eikon, Hardman Agribusiness

One group of the Indonesian operators forms around a relatively close range of 1.7x (Indofood Agri) to 1.0x (SIPEF) with REA pitched broadly in the middle of the group at 1.3x. Compared to the more robust ratios of Indonesian peers such as Agro Astra Lestari, 3.1x (controlled by Jardine Cycle & Carriage), or 3.6x DSN or Sampoerna at 1.9x, it can be seen that REA's valuation has scope to widen – especially noting the gearing ratios of many of the Indonesian cohort. Even Bakrie is trading at 2.7x whilst topping the gearing list below.

Company Name	Net Debt / Equity
Bakrie Sumatera Plantations	256%
Dharma Satya Nusantara Plantations	139%
Eagle High (BW Plantation)	121%
Wilmar International	100%
Sampoerna agro	77%
Sawit Sumbermas Sarana	71%
First Resources	70%
R.E.A. Holdings (estimated end 2015)	**68%**
Astra Agro Lestari	62%
Indofood Agri Resources	59%
Salim Ivomas Pratama	58%
Golden Agri	28%
Austindo Nusantara Jaya Plantation	17%
Sipef (Brussel)	6%
MP Evans	1%

Source: Company Reports, Reuters Eikon, Hardman Agribusiness

HAB believes that the EV/NAV ratio is significantly driven by business efficiencies. DSN trades on an EV/NAV ratio of 3.6x and tops the list of the Indonesian names below for FFB/ha and is close to the top also in respect of OER. Astra Agro trades on a multiple of 3.1x. Golden Agri's valuation is possibly depressed (in particular) by its whole value chain exposure to softening Chinese demand. United Plantations trades at 2.1x. REA's estate level efficiencies are now rising and this should be reflected in the EV/NAV ratio, with scope for the business to trade at over 2.0x NAV.

Company Name	FFB Yield (mt/ha)	Oil Extraction Rate (%)
MP Evans	na	24.8%
Sawit Sumbermas Sarana	na	23.3%
Dharma Satya Nusantara Plantations	26.2	23.9%
Sipef (Brussel)	22.4	21.8%
Golden Agri	22.1	22.9%
Astra Agro Lestari	22.0	21.9%
United Plantations	21.4	22.8%
R.E.A. Holdings *	**20.8**	**22.0%**
Wilmar International	20.6	na
Austindo Nusantara Jaya Plantation	20.3	21.7%
Sampoerna agro	19.7	21.7%
First Resources	18.7	22.8%
Anglo-Eastern Plantations	18.3	21.3%
Indofood Agri Resources	17.6	22.4%
Salim Ivomas Pratama	17.6	22.4%
London Sumatra Indo	17.5	23.2%
Eagle High (BW Plantation)	14.2	23.5%
Bakrie Sumatera Plantations	14.0	na

Source: Company Reports, Reuters Eikon, Hardman Agribusiness

In the context of seeking a strategic investor the group is well placed with a modern efficient plantation with perhaps another 25,000 hectares remaining to be planted. The depressed share price reflects the impact on the palm oil production sector of the commodity price which is trading more than 30% below its 10 year average, and possibly also concerns regarding balance sheet structure. For a strategic investor however the REA palm oil operations in Indonesia offer the opportunity to build a significant investment in a high quality young, modern plantation with efficiency levels within the top quartile of the sector. Moreover, with more than 40,000 ha planted in 2016 and perhaps another 20,000-25,000 ha available for planting, this business will provide an investor with rising cash flows and further scope for growth.

DCF Valuation

In the table below we present various valuation scenarios based on our 25 year financial model for the business. This excludes the developing revenues from the electricity supply operations and any revenues from the coal and quarrying assets. While stone and coal are assets for future exploitation, the electricity operations are now generating revenues and we have sought to express a value for these separately. The current share price (255p) implies a discount rate pitched around 12.75% and terminal growth in the order of 2%-2.5%. The discount rate has scope to ease on an improving outlook for the business (palm oil sector demand and prices) and improving country risk (when EM sector concerns begin to ease).

Share Price (p)

		Terminal Growth Rate						
		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%
Discount Rate	11.0%	444.3	449.2	454.6	460.5	467.1	474.5	482.8
	11.5%	384.8	388.8	393.2	398.0	403.3	409.2	415.8
	12.0%	330.6	333.9	337.4	341.3	345.6	350.4	355.6
	12.5%	281.0	283.7	286.6	289.8	293.3	297.1	301.4
	13.0%	235.4	237.7	240.1	242.7	245.5	248.7	252.1

Source: Hardman Agribusiness

The various scenarios presented above are calculated prior to a strategic stake sale and on the long term CPO price not exceeding $900/mt. The market value of the ordinary shares (at the time of writing) is £95m, also implying a discount rate a tad below 13%. In our opinion the market value does not reflect the existing and rising value of the electricity operations.

Market Capitalisation Ordinary Shares (£m)

		Terminal Growth Rate						
		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%
Discount Rate	11.0%	164	165	167	170	172	175	178
	11.5%	142	143	145	147	149	151	153
	12.0%	122	123	124	126	127	129	131
	12.5%	104	105	106	107	108	109	111
	13.0%	87	88	88	89	90	92	93

Source: Hardman Agribusiness

Electricity Operations

Our DCF model for the electricity operations is based on revenues and cash flow assumptions for ten years only. The model assumes that REAK will build from 3 MW of supply currently to 6 MW by end 2020. The terminal growth rate can reasonably be expected higher on this project than on the main palm oil production business, noting that only 69% of East Kalimantan was supplied with electricity at June 2015. Assuming a rate of 4% and a discount rate of 12.5% would give the operations a valuation of circa $30m.

Using Terminal Growth Rate

$m EV of Electricity Operations

	Terminal Growth Rate (%)									
Discount Rate		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
	9.0%	36.8	38.1	39.5	41.1	42.9	45.1	47.6	50.5	54.0
	9.5%	34.5	35.6	36.8	38.2	39.7	41.5	43.5	45.9	48.7
	10.0%	32.4	33.4	34.4	35.6	36.9	38.4	40.1	42.0	44.3
	10.5%	30.6	31.4	32.3	33.3	34.4	35.7	37.1	38.7	40.6
	11.0%	28.9	29.6	30.4	31.3	32.2	33.3	34.5	35.9	37.5
	11.5%	27.4	28.0	28.7	29.5	30.3	31.2	32.2	33.4	34.7
	12.0%	26.0	26.6	27.2	27.8	28.5	29.3	30.2	31.2	32.3
	12.5%	24.8	25.2	25.8	26.3	27.0	27.7	28.4	29.3	30.2
	13.0%	23.6	24.0	24.5	25.0	25.6	26.2	26.8	27.6	28.4

Source: Hardman Agribusiness

Sum Of The Parts

The table below suggests that REA is undervalued by some 22.6% (assuming a value of some $30m for the electricity operations). This assumption ignores the scope for an improving valuation as plantation efficiencies strengthen, if Indonesian country risk eases and if the palm oil price strengthens; REA is highly sensitive to movements in commodity price. Every $50/mt increase boosts the pretax level by circa $7m.

At End 2015	Units	Current Share Price	Market Capitalisation	Market Capitalisation	Exchange Rate
	(m)	(£)	(£m)	($m)	$:£
REA Cumulative Preference Shares	63.64	0.81	51.5	73.7	1.43
REA Ordinary Shares	36.71	2.55	93.6	133.9	1.43
Total Equity Market Capitalisation			**145.2**	**207.6**	
DCF Valuation Electricity Operations (HAB estimate January 2016)	na	na	na	30.2	1.43
Total Market Capitalisation + Electricity Operations				**237.8**	
Net of Preference Share Market Value				164.1	
Value of 20% shareholding				32.82	
Net Debt ($m)				206.5	
Total Enterprise Value				**444.27**	
EV/Planted ha (end 2015)				12,068	

Source: Hardman Agribusiness

REA 9% Cumulative Preference Shares

On 1st June, 2015 the REA Holdings 9% Cumulative Preference Shares (Prefs) touched a high of 131.50 pence. This was an all-time high and it was short lived, by 3rd September the shares had fallen to 94p. Investors who acquired Prefs in the issue of 4.221m at £1.20 on 1st July, will have sustained a 40.42% loss at the January 14th 2016 price of 71.50p. And yet...the Preference dividends continue to be paid. It is also notable that director, Mark Parry purchased 40,981 Prefs Thursday, January 21st. The stock was purchased at an average price of 73 pence per share, for a total transaction of £29,916.13.

The capital structure and interest coverage ratio (1.2x estimated for 2015 if including the dividend on the Prefs) are outside what is typically considered acceptable for an issuer of corporate bonds, but the company has developed a solid business with a proven long term track record of profitability and sound financial management. A ratio of 4x Debt: EBITDA is typically considered to be the acceptable level for an issuer of corporate bonds. Ratios higher than 4x – 5x may indicate that a company is at higher risk of defaulting on interest/dividend payments and repayment of principal. As readers will note from the table above the estimated debt/EBITDA ratio for REA in 2015 is seriously above the acceptable level and this may help to explain why the shares are now yielding 12.59% when they were yielding 6.8% at the start of June. But in addition there has been a re-pricing of high yield corporate bonds and in particular there has been a re-pricing of Emerging Market risk. The realisation that the US Federal Reserve was seeking to 'normalise' interest rate policy was certainly one driver behind a re-examination of risk pricing by investors in 2015, but so too was, and is, concern of a deeper problem within the global economy – mostly springing from China.

Energy related issues were amongst the first to see yields spike higher, however higher risk corporate issues have also seen credit terms tighten. The average BB-rated corporate bond was yielding circa 5%-6% in 2013/14 but today this is likely to be closer to 8%. The FT reported in November (23rd) last year that Standard & Poor's was projecting defaults climbing "...to 3.3% by September 2016, more than double the trailing rate two years previously, as commodity-linked companies begin to fail". With crude oil trading at or below $30bbl currently, there is growing concern that a deflationary tide emanating from China could unsettle global economic performance in 2016, and in particular put further pressure on the resource based Emerging Markets' economies and indeed on the prices of commodities themselves. The Chinese slowdown has created fears of a severe global contraction, with commodity-exporting developing economies bearing the brunt of the impact. Nowhere is this more clearly observed than in Brazil where yields have exceeded 15% with the country's political woes exacerbating the impact of the commodities down cycle.

Issuer	Ticker	Description	Pref Issue / Market Capitalisation	Issue Size (£m)	Pref Share Price (p)	Pref Coupon (p)	Pref Share Yield (%)	Net Debt/Equity	Net Debt : EBITDA(x)
BALFOUR BEATTY	BBYB	10.75P GROSS(NET PD)CUM CNV RED PRF 1P	7.34%	126.9	113.3	10.8	9.5%	20.8%	2.3
BP	BP.B	9% CUM 2ND PRF GBP1	0.01%	8.7	159.0	9.0	5.7%	17.0%	0.8
BP	BP.A	8% CUM 1ST PRF GBP1	0.01%	10.1	142.5	8.0	5.6%	17.0%	0.8
BRISTOL WATER	BWRA	8.75% CUM IRRD PRF GBP1	na	18.5	148.0	8.8	5.9%	72.8%	3.6
ECCLESIASTICAL INSURANCE OFFICE	ELLA	8.625% NON CUM IRRD PRF GBP1	na	135.2	132.3	8.6	6.5%	na	na
NORTHERN ELECTRIC	NTEA	8.061P(NET)CUM IRRD PRF 1P	na	164.7	145.0	8.1	5.6%	34.5%	1.6
PREMIER FARNELL	PFLB	89.2P CUM CNV RED PRF GBP(GBP CPN)	14.32%	53.6	16.3	89.2	548.9%	77.0%	2.4
R.E.A.HLDGS PLC **	RE.B	9% CUM PRF GBP1	52.81%	50.6	79.5	9.0	11.3%	68.3%	6.0

** also includes scrip issue (3 for 50 Ord) of Cumulative Pref (9%) shares*

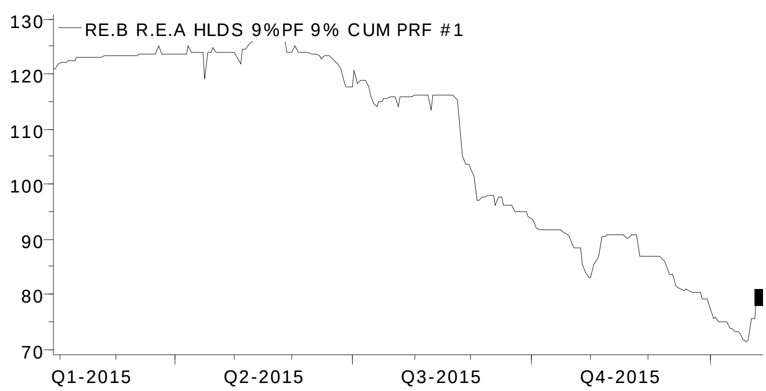
*** 2016 estimates*

Source: Company Reports, Fidessa, Hardman Agribusiness

Readers should also note the impact of the budget changes regarding the tax treatment of dividends to UK taxpayers that were announced in July 2015. Until April 2016 UK dividends are paid with a notional 10% tax credit, so for every £1,000 of dividend income received it is assumed that £111 in basic rate tax has already been paid (the total dividend is therefore £1,111). For investors who are not tax payers or are basic rate tax payers, there is no further tax liability on dividends received. This tax credit is being scrapped, so in future all dividend income will be treated as gross (i.e. untaxed) income. All taxpayers will have a tax-free dividend allowance of £5,000 a year but for amounts above this level, the rate of tax payable will depend upon the investor's other taxable income. If dividend income takes an individual from one band into the next, they will pay the higher dividend rate on that portion of income. The rates of taxation on dividend income above the £5,000 level have been increased to the following:

- 7.5% for basic-rate taxpayers;
- 32.5% for higher-rate taxpayers;
- 38.1% for additional-rate taxpayers.

As illustrated by the chart below, the REA 9% Cumulative Preference shares spiked down after the July announcement.



Source: Fidessa

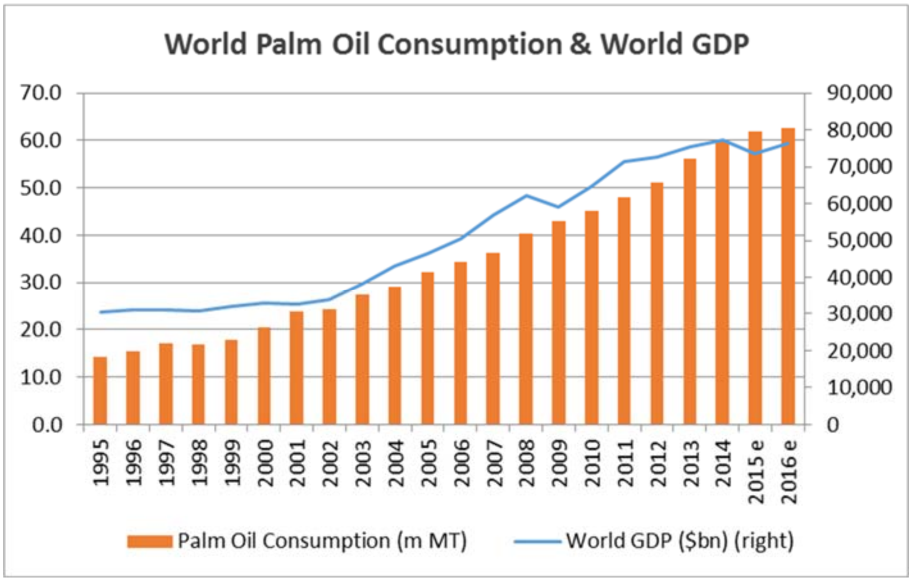
All these influences have combined with concerns about the capital structure of REA to bring downside pressure on the Prefs. In the last 12 months the yields on the London listed preference shares shown in the table above have moved very little for BP, Bristol Water and Ecclesiastical Insurance, but for REA they have widened by up to 5 percentage points; Balfour Beatty's yield has also expanded by 1.5 percentage points.

Palm Oil Commodity Pricing 2016

Palm oil sector analysts across the world seem to share a mixed outlook for the commodity price, but the mood is not entirely bearish. One school of thought anticipates some relief for the CPO price from the possible impact of El Nino weather patterns on production – and indeed a markedly dry period July to October 2015 across East Kalimantan, has implications for crops later in 2016. In December 2015, REA reported FFB production down (y-o-y) by 5.5% and this was likely due to the drier than normal conditions affecting its plantations in 2014. Malaysian sector December 2015 production fell by 15% month on month, and November production was also below trend. There is also a perfectly reasonable expectation that lower prices for CPO will inevitably lead to a slowing in growth of production as growers rein in spending on fertiliser and new planting, but there is deep concern too that a period of sustained low pricing for crude oil could derail the biofuel mandate targets for both Malaysia and Indonesia.

With the demand outlook key, data from the Malaysian Palm Oil Board w/c 11th January, 2016 showed a 1.1% decline relative to December exports as compared with a Reuters' poll forecast for a fall of 6.6%. Inventories also fell in December, by 9.5%. Falling production linked to weather conditions and falling inventories has led to forecasts from some analysts for the CPO price to push towards $700/mt during the 2016 year. These expectations of higher pricing are partly based on bullish sentiment around the developing biodiesl market in Indonesia. The government has indicated that it wants usage to reach 4.8m kilolitres in 2016 which would absorb more than 4.0 m mt of CPO, and this expansion in usage is to be partly subsidised by the current $50/mt levy (introduced in July 2015) that is causing so much upset amongst hard pressed producers.

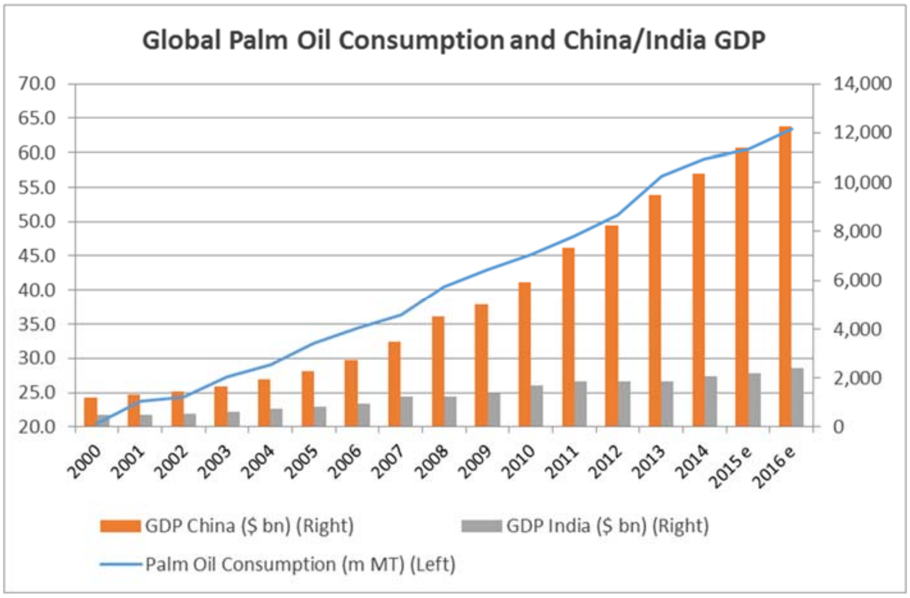
Globally, the natural link between the behaviour of the commodity price and the fundamentals for its supply and demand are specifically driven on the demand side of the equation by global GDP growth as the close correlation between the two is demonstrated in the chart below.



Source: Oil World, IMF

Source: World Bank

In this century the growth in consumption of palm oil has been closely linked to GDP expansion in the large developing economies of Asia. The table below details the close correlation with Chinese and Indian GDP expansion since 2000. Seen against this backdrop, the outlook for demand would be seriously impacted if the Chinese economy does indeed sustain a 'hard landing' in 2016.



Source: IMF, USDA

Growth expectations for China are muted. Annual growth of 6.8% is the target of the Chinese government, however there remains a degree of scepticism about whether this is actually being achieved. The Chinese Academy of Social Sciences (CASS), a respected government think tank, predicted in its "blue book" that the economy could expand at a slower pace: 6.6% to 6.8% in 2016 due to weak external demand and a cooling domestic investment. But some independent forecasters have suggested growth could be as low as 3%-2%. Fitch Ratings responded to these lower side forecasts 14 December 2015: "A sharp slowdown in China's GDP growth rate to 2.3% during 2016-2018 would disrupt global trade and hinder growth, with significant knock-on effects for emerging markets and global corporate". In turn, this would keep short-term interest rates and commodity prices lower for longer. Fitch noted that "This hypothetical Chinese slowdown scenario, framed with the help of Oxford Economics' Global Economic Model, would slow global GDP growth to 1.8% in 2017 from Oxford's August base case of 3.1%. As a result, any rise in U.S. and Eurozone short-term interest rates would be postponed, and oil prices would remain under pressure". In the event of a shock to the global economic system from a sharp downturn in the growth rate for China the consensus view seems to be that commodity prices would trade lower for longer.

The projections below suggest that palm oil stock utilisation in China will rise by 1.7% in the 2015/16 period.

China Palm Oil Projections	Oct/Sept 2014/15	Oct/Sept 2015/16	Change (%)
Imports (mt 000)	5,790	5,880	1.6%
Disappearance (mt 000)	5,889	5,990	1.7%
Source: Oil World			

World consumption of palm oil is projected to increase by 6.5%, significantly in excess of production growth which is projected at 3.8% in the table below.

World Palm Oil Projections	Oct/Sept 2014/15	Oct/Sept 2015/16	Change (%)
Imports (mt 000)	46,670	48,355	3.6%
Disappearance (mt 000)	60,562	64,518	6.5%
Production (mt 000)	61,685	64,041	3.8%
Source: Oil World			

The strong projections for world consumption will in part be due to anticipated growth in consumption in India (9.5%), the world's leading importer of the commodity.

India Palm Oil Projections	Oct/Sept 2014/15	Oct/Sept 2015/16	Change (%)
Imports (mt 000)	9,160	9,500	3.7%
Disappearance (mt 000)	8,880	9,720	9.5%
Source: Oil World			

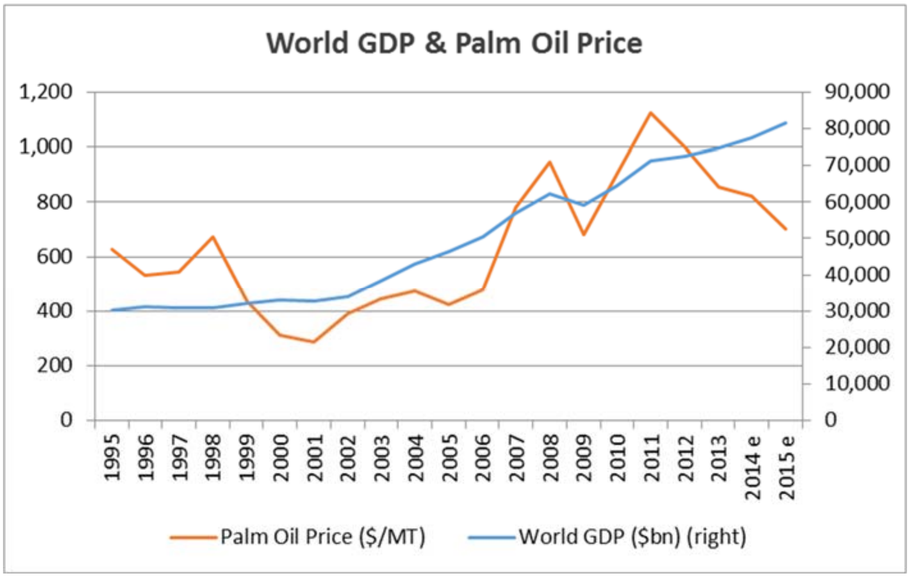
The economic outlook for India is amongst the best for the emerging market group.

World Real GDP Growth (%)	2014e	2015f	2016f	2017f
World	2.6	2.8	3.3	3.2
High Income Countries	1.8	2	2.4	2.2
Developing Countries	4.6	4.4	5.2	5.4
China	7.4	7.1	7.0	6.9
India	**7.3**	**7.5**	**7.9**	**8.0**
World Trade Volume (%)	3.6	4.4	4.9	4.9

Source: World Bank Global Economic Prospects June 2015

During 2016 the price performance of palm oil will potentially be influenced by:

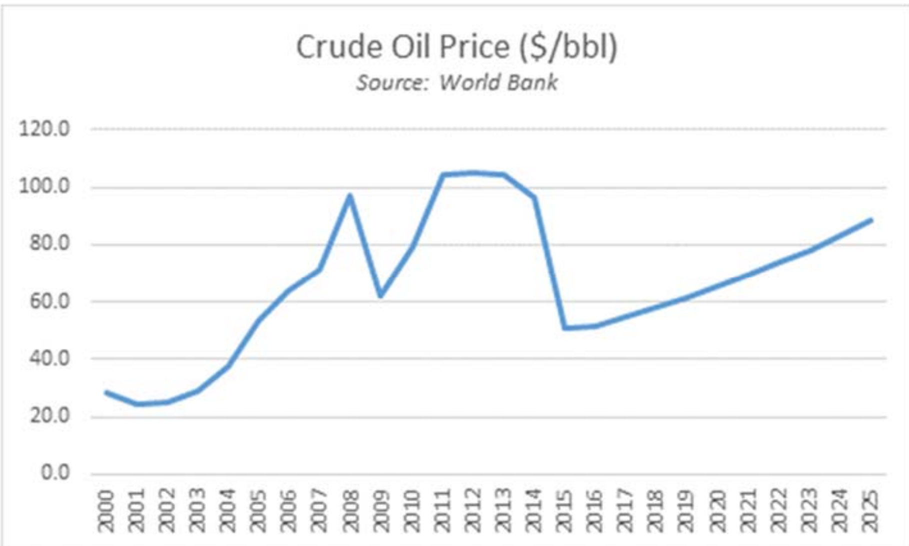
- the impact on production from the El Nino weather pattern
- the economic outcomes in China and India
- world GDP growth (see chart below).



Source: IMF, World Bank

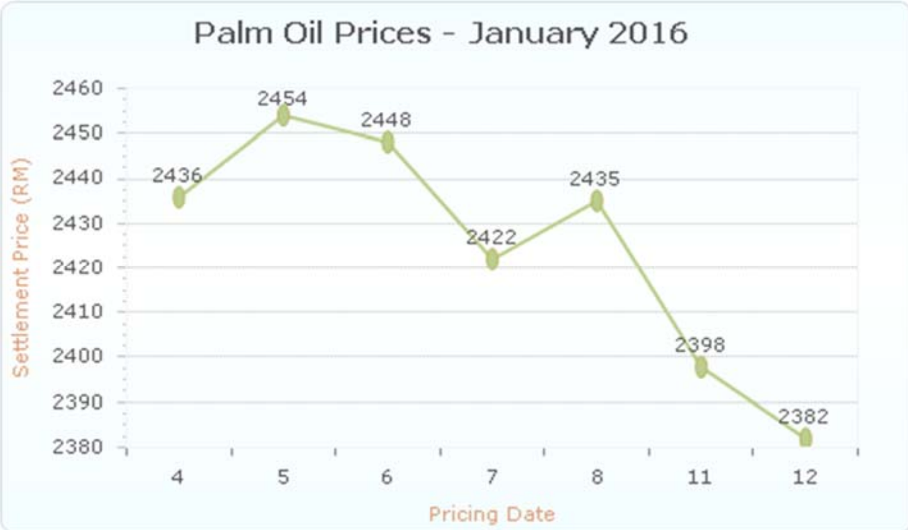
CPO Price Correlated With Crude Oil

The 2016 year has opened with oil & gas analysts competing for lowest call on the price of crude oil. Variously Goldmans and Morgan Stanley have been reported to have issued forecasts down to $20 bbl, RBS $16 bbl and Standard Chartered down to $10 bbl. View against a backdrop of increasing supply, analysts fear a hard landing for the Chinese economy would create deflationary gales across the global economy driving oil lower. In its December monthly report, the IEA said world oil-demand growth will slow to 1.2 million barrels a day in 2016 after surging to 1.8 million barrels a day in 2015, as support from sharply falling oil prices begins to fade; if the global economy is thrown off course by an outward wave of Chinese deflation, demand could be lower still. Continued strong OPEC production and the possibility of extra Iranian oil hitting the market in 2016 is expected to grow global inventories by 300 million barrels.



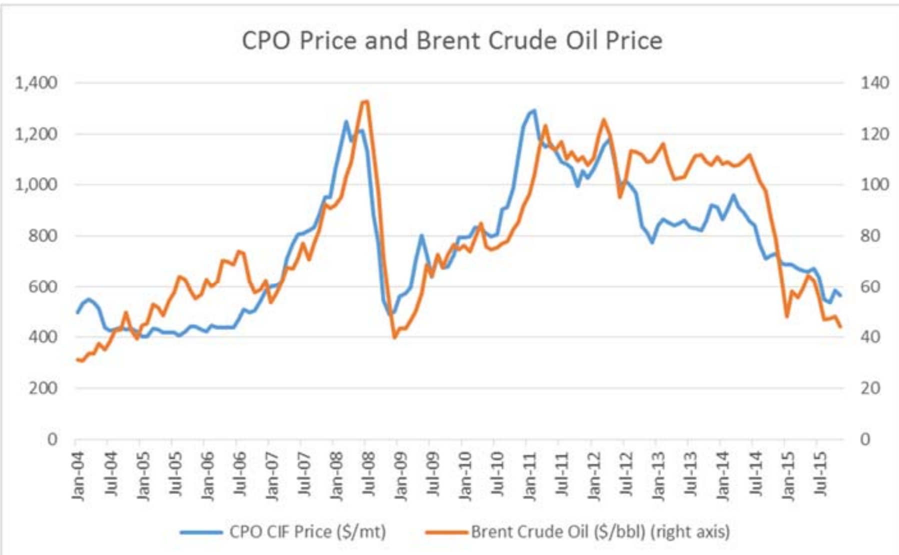
Source: World Bank

Prices along the oil-futures curve are shown below $60 bbl until 2018 in the chart above from the World Bank, and indeed the consensus amongst sector watchers is that a recovery is still far off. For palm oil, the 'mood music' from the crude oil sector is not helpful.



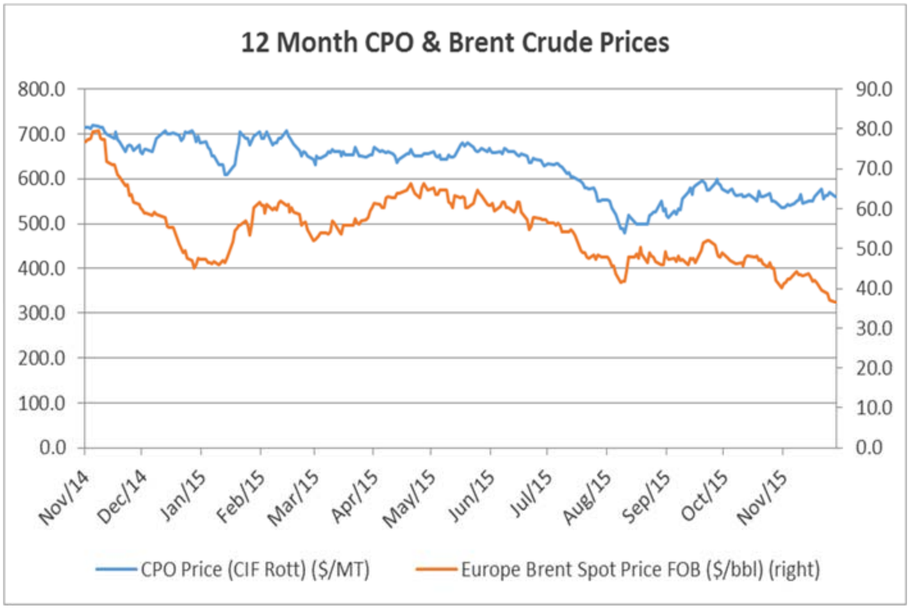
Source: Malaysian Palm Oil Board

The growing importance of biodiesel over the past 10 years, especially as mandated in palm oil producing countries (Indonesia, Malaysia and Colombia in particular), has provided support for the palm oil price as a source of marginal and influential demand. Oil World reported that in the year to 30th September 2014, biofuel production absorbed some 15% of global vegetable oil production. Variously between 5% and 13% of the annual palm oil crop is used for the production of biodiesel, leading to an argument that the 'biodiesel tail' wags the price of the 'dietary oil dog' – that the significant marginal demand for the commodity provided by the biodiesel manufacturing sector disproportionately influences the pricing of the commodity. Under this school of thought, downward pressure on the price of crude oil has the potential to also bear down on the price of CPO.



Source: World Bank, EIA

While the chart above demonstrates a relatively tight correlation between the price activity of the two commodities up to mid 2012, the relationship has since weakened, as made clearer by the chart below, and especially in the period since October 2014. After the collapse in the price of Brent and WTI, palm oil is no longer competitive with crude oil for the manufacture of transportation fuel.



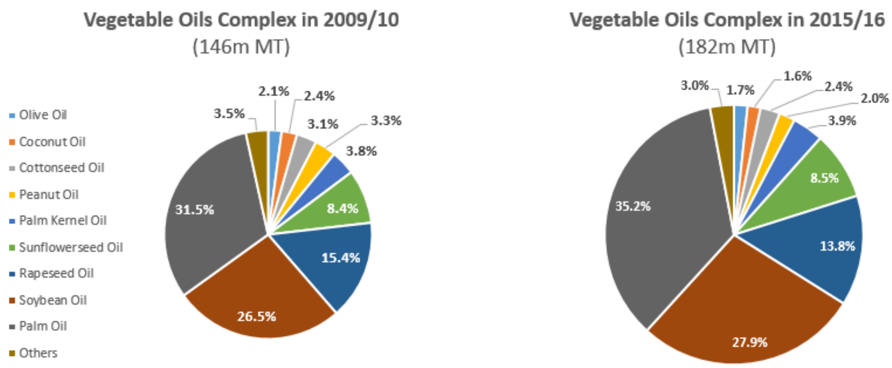
Source: World Bank, EIA

Currently Brent crude is trading at circa $32 per barrel which translates to some $239/mt (7.454 barrels per mt). This makes CPO uncompetitive for the production of automotive fuel.

Price Pressure From Within Vegetable Oil Complex

HAB's sources in Asia note that with abundant supplies of both palm oil and soybean oil, the palm oil price is struggling to gain traction. In its 16th January 2016 World Agricultural Supply and Demand Estimates, the USDA projected global soybean production at 319.0 million tons, down 1.1 million on smaller crops in the United States and South Africa. Larger soybean production in China is partly offsetting. Increased soybean exports for Argentina and increased soybean and rapeseed exports for Canada more than offset lower U.S. soybean exports. Global oilseed crush is projected higher mainly on increased soybean crush for Argentina, China, and Vietnam and increased rapeseed crush for Canada and China. The weight of soybean oil on the market does not look to be easing anytime soon.

The global production of vegetable oil is another important driver of CPO pricing. Soybean oil exerts the greatest influence (amongst the Complex constituents) on the traded price of palm oil as it is the second largest of the oils in the complex after palm oil and a direct competitor.

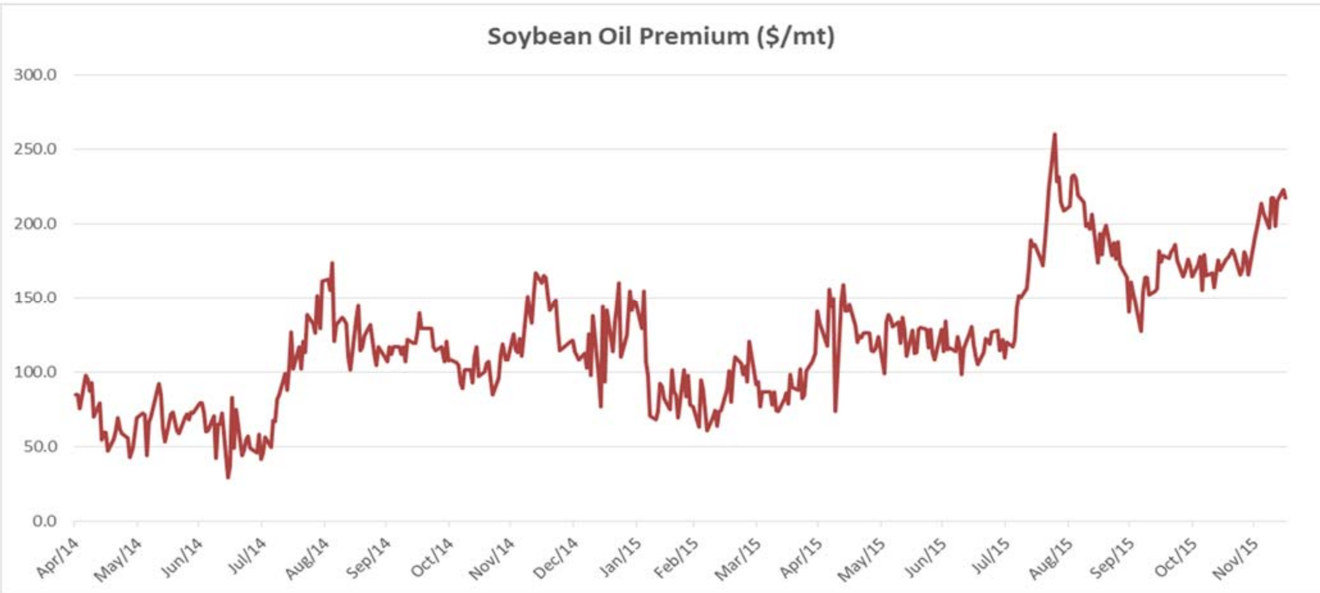


Source: USDA, Oil World

The depreciation of the Brazilian real during 2015 is expected to lead to an increased cultivation area for soya notwithstanding lower international prices during the year as Brazilian supplied soya products are becoming cheaper for international buyers relative to other sources. This trend for rising production of soya has the potential to provide increasing competition for palm oil. Global soybean stocks are expected to be marginally higher. Oil World is forecasting that imports of soy oil will rise by 9.8% and that growth in utilisation of soy oil stocks will slightly exceed production growth.

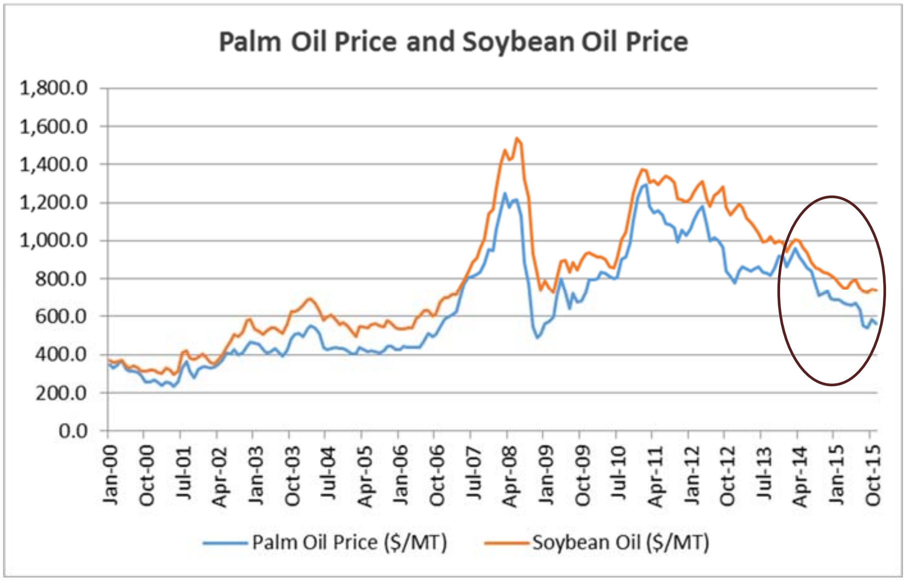
World Soy Oil Projections (Oil World data)	Oct/Sept 2014/15	Oct/Sept 2015/16	Change (%)
Imports (mt 000)	11,150	12,240	9.8%
Disappearance (mt 000)	47,060	50,070	6.4%
Production (mt 000)	47,797	50,738	6.2%

This outlook may result in a widening in the soy/palm oil premium.



Source: MBPO, Hardman Agribusiness

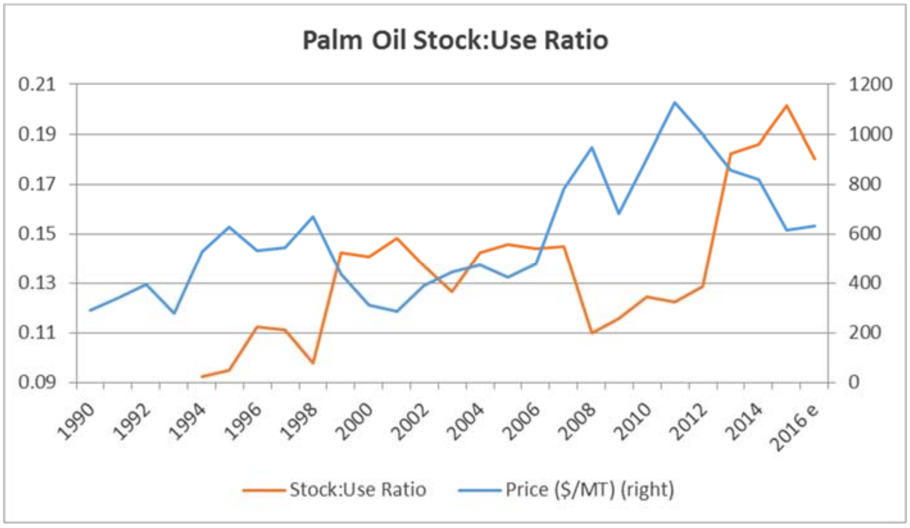
Soy oil trades at a premium to palm oil as it is perceived to be a superior product. CPO is harder to store and turns cloudy in cooler temperatures, limiting its use in the northern winter. Alternatively, palm oil does not need to be hydrogenated for processed food production, unlike soy oil, and for this reason it has enjoyed recent demand growth in North America. The chart below illustrates the close correlation in the traded price of the two commodities over the period 2000-2015.



Source: World Bank

Stock: Use Ratio

The CPO price is also sensitive to the volumes of the commodity that are being kept in stock. The stock to use ratio depicted below has trended between 9% in 1994 to a high of nearly 15% in 2001. As demonstrated by the steep fall in the ratio to 11% in 2008, it triggers price rises as it falls and leads to price weakness at it rises as shown in the chart below for the period 2012-2014.



Source: USDA, World Bank

Changes in the stock: use ratio can be driven by production volatility, by spikes and troughs in consumption that are likely to be economically linked, and by excess production and competition from other oils in the complex, but in particular by soybean oil as discussed above.

Commodity Price Assumptions in HAB's Financial Model For REA

HAB's 2016 financial model for REA is based on an average received price of $550/mt CPO and $876/m CPKO. For 2017 we are using $650/mt CPO and $889/mt CPKO. As readers will note from the chart below, our CPO assumptions are (2016) 27% and (2017) 14% below the 10 year average price of $757/mt.

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