11th October 2016

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R.E.A. Holdings: Interims 2016

Within The Top 20 Largest Indonesian Producers

April 2012 the price of palm oil was trading at circa $1,200 mt, by 3Q 2015 it had fallen to $480 mt. A recovery within 2016 to circa $680 mt was offset for the Indonesian producers by a domestic levy of $50 mt to support the national biodiesel sector. To compound the pressures on producers, the El Nino weather pattern saw rainfall levels across the region down by more than 20% (June – June) with production declines at a similar level. REA has responded by squeezing costs, tightening efficiencies and accelerating planting rate. It is strongly positioned to benefit from any uptick in operating conditions.

- **Strategy**: REA Kaltim (REAK), the principal division of REA, is developing a bank of some 108,000 ha in East Kalimantan. At the current, accelerated rate of development, the proprietary plantations should be completed by 2020 at 60,000 ha (43,000 ha for end 2016). With some 6,600 ha of plasma plantations supplying its mills, REAK will end 2016 within the top 20 producers.
- **Renewable Energy:** With a high end profit margin (35%-50%), on supply of sustainable electricity from palm oil mill effluent, this distinct activity is on course for $0.8m of revenues in 2017 and has significant scope for growth. Although dependent on the palm oil operations for fuel, this almost unique activity within the sector, should enjoy an independent valuation.
- **Valuation:** Current EV per planted ha of $9,397, represents a discount of 11.2% to the Indonesian sector weighted average (ex Wilmar) of $10,585. This looks anomalous given REAK's efficiency levels, the plantation age profile, its significant land bank and a strategic investor positioned to acquire 49%.
- **Risks:** Agricultural risk (as shown by the El Nino weather pattern in 2015/16), commodity price risk, and country risk are constants of palm oil production. 1H gearing, at 72.5%, reflects both a capital structure more biased to debt than equity, the impact of tough operating conditions and a drive for growth.
- **Investment summary:** REA is developing and operating high quality plantation assets to produce sustainable palm oil. Against the background of tightening land availability in Indonesia and gathering consolidation within the sector, new partner DSN has acquired a 15% stake in REAK, with scope to attain 49% within 5 years (subject to agreement on price), yet the 2016 estimated EV/planted ha implies a valuation at only cost of development and trending lower into 2017.

Financial summary and valuation

Year end Dec ($m)	2013	2014	2015 (Restated)	2016E	2017E
Sales	111	126	91	88	124
EBITDA	39	43	15	19	41
Reported EBIT	27	32	-4	0	21
Pretax Profit	25	24	-9	-10	7
EPS (cents)	16	40	-53	-40	-10
Dividend per share (p)	7.25	7.75	0.00	0.00	4.00
Net (debt)/cash	-164.4	-179.2	196.7	206.0	209.9
P/E (x)	20.9	8.2	-	-	-
Planted Hectares (ha)	33,830	34,614	37,097	43,097	47,097
EV/Planted Hectare ($/ha)*	11,703	11,438	10,672	9,186	8,406
CPO Production (mt)	147,649	169,466	163,880	136,850	186,235

**EV/planted Hectare includes market value of the 9% Cumulative Preference Shares*

Source: Hardman & Co Research

Food Producers

Source: Thomson Reuters Eikon

Market data

EPIC/TKR	RE.
Price (p)	249.0
12m High (p)	325.0
12m Low (p)	210.0
Shares Ord (m)	36.8
Shares Prefs (m)	63.6
Mkt Cap Ord (£m)	91.7
Mkt Cap Pref (£m)	58.1
EV ($m)	395.9
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

Chairman	David Blackett
Managing Director	Mark Parry

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Key shareholders

Directors	29.4%
Prudential PLC	16.5%
Alcatel Bell Pension Fund	11.35%
Artemis UK	9.71%
First State Investment	4.02%

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REA Holdings: Substantive Progress Where It Matters

The first half of 2016 has been tough indeed for the palm oil producers of Asia, REA included. Production volumes are down by more than 20% across the region as a freakishly long dry period has depressed output, and commodity prices, while recovering more recently, opened the year at a low base. The published results for the half year 2016 include revenues down 15% and a loss of $5.2m (-$5.5m) at the pre-tax level. But behind these data are some solid achievements: plantation development has jumped, and should end the 2016 year at a record 6,000 ha of new planted area, pushing REA into the 'Top 20 List' of Indonesian producers. Milling efficiencies have tightened enough to elevate REA Kaltim (REAK) into a leading sector position. Cost control is again in evidence as CEO, Mark Parry raises efficiencies right across the business, leading to an 8 percentage point improvement in gross margin (pre depreciation).

Notwithstanding a rise in the net debt: equity ratio, (due partly to a change in accounting policies consequent on a revision to IAS 41), the Balance Sheet has seen further strengthening, with a repackaging of, and an increase in the company's principal Indonesian bank facilities. This in addition to an inflow of some $23.5m in temporary advances from PT Dharma Satya Nusantara TBK (DSN), REA's new partner, and investor in chief operating subsidiary REAK. Given better agricultural conditions and a stronger commodity price, REA is well positioned from a lower cost base, to see marginal returns strengthen markedly. Moreover, the electricity generation and sales activity, a profitable demonstration of best sustainable practice in palm oil production, is on course over the next couple of years to generate more than $1m of high margin revenues.

With the DSN agreement now being implemented, and noting that DSN can acquire up to 49% of REAK within the next 5 years (subject to agreement regarding amongst other things, the price at which further shares can be acquired), it looks anomalous that REA is trading some 11.2% below the Indonesian sector weighted average EV/planted ha metric (ex-Wilmar).

Half Year Results - 2016

Palm Oil Production

As we have noted in previous publications, there are some elements of a business that are within management's control and certain things which are not. In the case of the palm oil sector, weather and commodity pricing are not subject to the influence of management actions. These two key drivers of a palm oil business were negative for the whole of the Asian sector in the first half of 2016. For REA these factors meant that first half revenues declined by 15%, and ebitda by 18.2% year on year, impacted by reduced crops processed (-21%) as a result of the severe El Nino weather pattern, and lower average commodity prices (-5%) received during the first half.

The severity of the El Nino drought through second half of calendar 2015 and first half 2016, led to an unprecedented collapse in oil palm plantation output across much of Indonesia and Malaysia, with the former Borneo region (Kalimantan, Sarawak and Sabah) particularly impacted. Some describe the drought as not one but two (note the very low rainfall in second half of calendar 2015), certainly in the former Borneo region the dry weather has been a phenomenon up till end August.

Table 1:

Rainfall Average Across Estates (mm)	2016	2015	2014	2013	2012	2011
6 months to 30th June	1,574	1,505	1,295	2,087	1,791	2,011
% of total	na	70.3%	49.7%	61.7%	55.3%	58.9%
6 months to 31st December	na	636	1,311	1,298	1,450	1,403
12 Months to 31st December	na	2,141	2,606	3,385	3,241	3,414
12 Months to End June	2,210	2,816	2,593	3,537	3,194	
Change %	-21.5%	8.6%	-26.7%	10.7%		

Source: REA Holdings Interim and Full Year Reports

Rainfall for the 12 months June to June was down 21.5% on the preceding period, and it is dramatically lower than the rainfall received in 2012 and 2011.

The results of the major Indonesian operators have revealed declines in production output of up to 24%, and in the case of REA Kaltim, total FFB harvested in the first half, were down by some 21%, in line with the sample group average.

Table 2:

	FFB Production (mt)		% Change
	6 months up to June 15	6 months up to June 16	
Golden Agri	4,577,000	3,484,000	-24%
Salim Ivomas Pratama	1,511,900	1,270,000	-16%
Indofood Agri	2,077,000	1,661,000	-20%
First Resources	1,212,833	1,025,054	-15%
Wilmar International	2,115,750	1,685,572	-20%
Indonesian Group	11,494,483	9,125,626	-21%

Source: Company Reports

The severity of the decline for REA Kaltim is best observed by comparing with 2011, when with a smaller mature area (25,415 ha) compared with total mature hectares of 37,097 at the end of 2015, total FFB harvested on the company's plantations was higher by 33%. Look too, at the difference in rainfall between the years: down 21.7%.

Table 3:

6 Months To 30th June	2016	2015	2014	2013	2012	2011
FFB Harvested By Group (mt)	225,171	277,216	309,801	265,215	271,773	299,635
Third Party Supplied FFB (mt)	48,249	68,120	68,603	42,371	23,025	14,844
Total FFB (mt)	273,420	345,336	378,404	307,586	294,798	314,479
Change (%)	-20.8%	-8.7%	23.0%	4.3%	-6.3%	23.1%
Total FFB Processed (mt)	271,317	341,809	Na	na	294,798	314,479
CPO produced (mt)	64,618	73,536	81,048	65,948	68,451	71,334
Change (%)	-12.1%	-9.3%	22.9%	-3.7%	-4.0%	15.3%
Palm Kernels Extracted (mt)	12,967	15,629	Na	na	13,683	13,972
CPKO produced (mt)	4,863	5,318	6,398	5,002	5,386	5,330
CPO Extracted (%)	23.80%	21.50%	21.60%	21.50%	23.25%	22.68%
Palm Kernels Extracted (%)	4.80%	4.60%	Na	na	4.65%	4.44%
CPKO Extracted (%)	31.90%	33.50%	38.30%	36.10%	38.10%	39.31%

Source: REA Interim Reports

Combined with dramatically lower production, the sector had to contend also with depressed commodity pricing. REA achieved an average selling price for its palm oil of $516/mt, a decline of 4.8% on the previous year's soggy performance. Again for contrast, review the data for 2012 and 2011 at the peak of the cycle. If all the stars aligned for near perfect conditions in the 2011 year, with superb rainfall and peak pricing, the alignment in the first half of 2016 was cruelly reversed.

Table 4:

6 Months to 30th June	2016	2015	2014	2013	2012	2011
Achieved Average Selling Price Received For CPO ($mt) Port of Samarinda	516	542	711	625	1,095	1,196
Achieved Average Selling Price Received For CPKO ($mt) Port of Samarinda	985	862	1,034	583	830	916

Source: REA Interim Reports

Electricity Sales

REA is a leader in the field of generating renewable energy from palm oil mill waste and in the remote region of East Kalimantan in which it operates, there is scope for this business to make a progressively meaningful contribution to the bottom line.

Sales of electricity (a profitable demonstration of sustainable business practice) generated by burning methane produced from palm oil mill effluent (POME), totalled $0.28m in the first 6 months. Revenues achieved in 2015, (8 months only), totalled $233,000. Annualised, the result for the 8-month period would outturn at $350,000. The company noted in the 2015 annual report that sales in the first 3 months of 2016 were $133,000, implying a 9% increase in uptake in the second quarter of the year, which is consistent with management's advice that consumption per household can be expected to rise as households come to rely on the supply and adapt lifestyles based on the supply of electricity. Assuming a similar increase over the second half, the revenue outcome for 2016 could be expected in a range of $560,000-$580,000.

The local grid formed by Perusahaan Listrik Negara (PLN), the Indonesian state utility, is currently serving 21 villages, but is to be extended to another 3, for a total of 24. REA reports that cabling is being installed in one village presently, but the speed of installations will depend on the utility's priorities and capacity. There is scope too for the utility to extend the grid to a wider range of villages with perhaps as many as 600 additional households. The first 24 villages and sub-villages represent some 11,400 family units, comprising circa 7,400 households. It is expected that with rising wealth, (REAK is spending more than $1m per month acquiring FFB from these villages), family units will split from joint households, to establish a larger number of single family residences. This pattern can be expected to increase demand for electricity.

In august 2016, PLN raised tariffs, by c.35% and converted the tariff to a USD rather than a Rupiah tariff. This will provide another boost to REAK's electricity revenues when its contract with PLN is renewed in April 2017, all in addition to any further natural consumption growth and or the connection to the grid of further communities. A revenue target for 2017 of $0.7m - $0.8m does not look unreasonable. With a high end profit margin on electricity supply (35%-50% depending on related maintenance costs), the business of supplying sustainable energy from POME has the potential to boost profits incrementally in the coming years and these cash flows should be valued distinctly from the palm oil operations.

Substantive Progress In Three Critical Aspects of the Business

1 - Rapid Progress Towards 60,000 ha Planted

Substantive progress has been made in respect of land bank development: 4,542 ha planted in the 8 months to end August, with the company targeting a further 1,500 ha to be planted by year end for a total of 6,000 ha planted in 2016. If achieved, and CEO Mark Parry is optimistic that it will be, this will mark the largest area planted in one year since the business was founded, exceeding the previous best of 4,829 ha planted in 1998. This is an important achievement for the company and its CEO: REA has been criticised for a patchy record (see below) in respect of achieved nucleus plantings prior to Parry's appointment to the CEO role in 2015.

Table 5:

Year to 31st Dec	2016 e	2015	2014	2013	2012	2011
Ha planted	6,000	2,251	784	2,555	2,140	860

Source: REA Full Year Reports

Planting rate matters: the company has a land bank of some 108,000 ha, of which 60,000 ha have been identified as suitable for planting. The creation of shareholder value in palm oil production businesses is driven initially by converting uncultivated land into productive plantations with the potential to produce 5-6 tonnes of CPOe pa. Even in the relatively depressed conditions of the sector today, planted oil palm plantations are achieving M&A values starting at $10,000 / ha.

If the company achieves the 6,000 ha planted target for 2016, the planted area will total 43,097 ha (37,097 ha). Assuming the company can progress and fund planting at the rate of 4,000 ha annually from 2017, the 60,000 ha target could be achieved by 2020.

It is also worth noting that REAK benefits from the production of FFB from 6,616 ha planted under plasma and PPMD schemes. Noting that the company is on course for some 43,000 ha planted by year end, the total production platform will be approaching 50,000 ha. This will push REAK into the Top 20 list of largest producers in Indonesia, whilst nudging SIPEF, (with a combined planted area of some 46,000 ha), out of the 20 spot, and positioning REAK somewhat behind Anglo Eastern Plantations (in 19th place), with circa 61,000 combined planted ha. DSN is currently 16th rated with a combined planted area of some 90,000 ha.

Table: 6

Indonesian Planted Area Ranking	Company	No. of Planted Hectares (Nucleus)	No. of Planted Hectares (Smallholders) (*Palm and Rubber)	Total	Smallholders as % of Nucleus Planted Area
1	**Golden Agri** *Public Listed - Singapore*	384,387	101,219	**485,606**	**26.3%**
2	**Salim Ivomas Pratama** *Public Listed - Indonesia*	246,359	90316*	**336,675**	**36.7%**
3	**Astra Agro** *Public Listed - Indonesia*	240,623	57,239	**297,862**	**23.8%**
4	**Sime Darby** *Public Listed - Malaysia*	204,412	43,000	**247,412**	**21.0%**
5	**First Resources** *Public Listed - Singapore*	178,338	29,237	**207,575**	**16.4%**
6	**Wilmar International** *Public Listed - Singapore*	166,800	31,666	**198,466**	**19.0%**
7	**Eagle High Plantations** *Public Listed - Singapore*	153,000	18,931	**171,931**	**12.4%**
8	**Asian Agri** *Private*	100,000	60,000	**160,000**	**60.0%**
9	**PT Perkebunan Nusantara IV** *State Owned*	137,350	21,200	**158,550**	**15.4%**
10	**Makin Group** *Private*	91,000	49,000	**140,000**	**53.8%**
11	**Musim Mas** *Private*	130,000	N/A	**130,000**	**N/A**
12	**Sampoerna Agro** *Public Listed - Indonesia*	80,000	50,000	**130,000**	**62.5%**
13	**London Sumatra Indo** *Public Listed - Indonesia*	94,019	35501*	**129,520**	**37.8%**
14	**KL Kepong** *Public Listed - Malaysia*	109,251	N/A	**109,251**	**N/A**
15	**Carson Cumberbatch (Colombo)** *Public Listed - Colombo*	80,000	19,340	**99,340**	**24.2%**
16	**Dharma Satya Nusantara (DSN)** *Public Listed - Indonesia*	69,000	21,000	**90,000**	**30.4%**
17	**Genting Plantations** *Public Listed - Malaysia*	67,702	8,363	**76,065**	**12.4%**
18	**Bakrie Sumatera Plantations** *Public Listed - Indonesia*	55,358	6,304	**61,662**	**11.4%**
19	**Anglo-Eastern Plantations** *Public Listed - London*	60,064	796*	**60,860**	**1.3%**
20	**Sipef Group** *Public Listed - Brussels*	44,762	1407	**46,169**	**3.1%**
	Total *All Entities*	**2,692,425**	**517,906**	**3,336,944**	**19.2%**

Source: Hardman Agribusiness/Company Report & Accounts

PPMD is a voluntary scheme, which was started in 2000 to assist members of local communities with access to land for the cultivation of oil palm. Under this scheme, REAK provides the co-operatives with oil palm seedlings, fertilisers and herbicides, as well as the technical assistance. Co-operatives repay the cost of the inputs provided, interest free, through deductions made when they sell their FFB to REAK's mills.

2 - Operating Efficiencies/Cost Control

Oil Extraction Rates

Notable and substantive gains have been made in respect of oil extraction rates (now averaging 23.8%) across the company's three mills. The ongoing mill refurbishment programme, strengthening of mill management and practices, including security, and more rigorous grading of bought-in FFB, will have all contributed to this much improved performance.

Table: 7

6 Months To 30th June	2016 e	2015	2014	2013	2012	2011
CPO Extracted (%)	23.80%	21.50%	21.60%	21.50%	23.25%	22.68%
Palm Kernels Extracted (%)	4.80%	4.60%	na	na	4.65%	4.44%
CPKO Extracted (%)	31.90%	33.50%	38.30%	36.10%	38.10%	39.31%

Source: REA Interim Reports

Average OER across the business came in at 23.8% for the first half, in the very top end of sector standards. In the 2016 reporting season, MP Evans has reported a 26% extraction rate at one of its Indonesian mills. However, looking across the data for the leading producer names in Indonesia over the past five years, reveals that rates close to 24% are certainly top end. Interestingly, REAK's new shareholder and partner, DSN leads across the period.

Table: 8

Calendar Year (Oil Extraction Rate %)	2015	2014	2013	2012	2011
Eagle High Plantations	23.7	23.5	23.5	23.0	22.9
Dharma Satya Nusantara (DSN)	23.6	23.9	24.3	24.4	24.6
London Sumatra Indo	22.9	23.2	22.9	22.5	23.0
First Resources	22.7	22.8	23.1	23.3	23.6
Golden Agri	22.6	22.8	22.7	22.6	23.0
Indofood Agri	22.2	22.4	22.1	21.7	22.1
Sime Darby	21.7	21.9	21.8	21.8	21.4
Astra Agro	21.6	21.9	22.3	22.3	22.6
Sampoerna Agro	21.2	21.7	20.7	20.5	21.3
Anglo-Eastern Plantations	21.2	21.3	21.4	20.2	20.3

Source: Company Report & Accounts/Websites

Labour & Operational Efficiencies

And notwithstanding lower revenues, operating costs at estate level were lower on improved operating efficiencies thus helping to push the gross margin up by more than 8 percentage points (pre-depreciation charges; *see table below*).

Table 9:

6 Months to 30th June ($m)		2016		2015
Revenues		39.337		46.205
Change (%)		-14.9%		-30.5%
Sales of Goods	*38.1*		*44.3*	
Revenue from Services	*1.2*		*1.9*	
Net loss re changes in fair value of agricultural inventory		-0.66		-1.351
Cost of Sales		-32.538		-40.18
Depreciation of Mature Estates	*-4.079*		*-3.913*	
Depreciation / Amortisation of other Assets	*-4.928*		*-5.46*	
Total Depreciation		-9.007		-9.373
Purchase of External FFB	*-3.8*		*-7.6*	
Estate Operating Costs	*-19.7*		*-23.2*	
As % of Sale of Goods	*-51.7%*		*-52.4%*	
Other Costs		**-23.531**		**-30.807**
Gross Profit		6.139		4.674
Gross Margin (%)		15.61%		10.12%
Gross Profit pre Depreciation element		15.146		14.047
Pre-Depreciation Element Gross Margin (%)		**38.5%**		**30.4%**

Source: REA Interim Reports

Estate operating costs came in lower for the first half at $19.7m ($23.2m). Expressed as a % of Sales of Goods, this was also lower at 51.7% compared with 52.4% for the 2015 half year. In a better operating environment with higher production and better commodity prices, this cost element has scope to be pushed down maybe by as much as 25 percentage points, relative to Sales of Goods. We estimate that in 2012, estate operating costs were sub 30% of Sales of Goods in the first half of the year.

Wage increases in the regions where the bulk of the company's plantation staff are based have also been more restrained than in recent years. Year on year minimum wages increased by:

- 15% in Jakarta
- 0.2% in Samarinda
- 0.4% in Kutai Kartenegara (REAK/SYB)
- 7.5% in Kutai Timur (KMS, CDM)
- 12.7% in Kutai Barat (PBJ).

By far the largest portion of the workforce is based in Kutai Kartenegara and so the weighted average increase in the minimum wage was skewed towards 0.4% for daily and monthly paid employees. For salaried staff, the increase was 4% across the board, with the exception of promotions. This increase was materially lower than normal, driven by the difficult economic conditions being experienced in Kalimantan following the collapse of the coal industry and associated service industries. A number of international oil companies and associated service companies are reported to have withdrawn from the region, or materially scaled back operations in Kalimantan. REAK is hoping for a similar disciplined attitude to wage growth in 2017.

Management asserts that savings have been achieved by way of improved labour productivity, tightening up on practices, and working methods. Seen in the context of much improved milling efficiencies, these additional gains suggest a pattern of tighter management across the operations. Following the material headcount reduction exercise across the mature plantation operations in 2015, REAK nevertheless expects to achieve further efficiency gains, largely driven by the use of new systems and IT solutions, including at its Indonesian head-office locations. The REAK Plantation Management System (RKPMS), will permit the centralised management and analysis of all human resources and operational data. REAK believes that the greater scrutiny of operations provided by RKPMS will enable easier identification of opportunities for further efficiency gains. Notwithstanding this continuing focus on operational efficiencies, total headcount will steadily increase in line with estate developments at PBJ and CDM, and further new developments such as at Prasetia Utama.

Distribution Costs

Distribution costs were slightly elevated y-o-y in nominal and % terms, a reflection on commodity pricing, notwithstanding lower volumes.

Table 10:

6 Months to 30th June ($m)	2016	2015	2014	2013
Distribution Costs	-0.508	-0.494	-0.674	-0.674
As % of Sales of Goods	-1.3%	-1.1%	-1.0%	-1.5%

Source: REA Interim Reports

Administrative Expenses

Administrative expenses have been creeping up as a % of Sale of Goods, reflecting all of lower prices, now also lower volumes, and wage inflation in Kalimantan. Wage rates have been rising inexorably in Indonesia (until 2016), offset in the last few years, by Rupiah depreciation versus the US$. The Rupiah: US$ depreciation over the past 4 years has now averaged some 38%. This has helped offset wage inflation in reported $ results. Tighter management of labour and operating efficiencies are to be welcomed in this context, given that at some point it can be expected that the Rupiah will begin to rebalance against the US$. The forecasting agency Trading Economics expects the Rupiah to strengthen a little over the next twelve months to trade at circa 13,091 – for a gain of circa 3%.

Head Office expenses have been rising steadily as a proportion of total Admin Expenses (pre capitalisation and UK Pension adjustments), up from 24.9% in 1H 2013 to 40.1% in1H 2016. This trend reflects the establishment of a senior executive team in Singapore as the business' senior executive is progressively moved to Asia. Total salary costs have risen as a consequence, but readers should note that these costs are also thought to include one-off recruitment and legal costs. It can be expected that some additional costs will have been generated in 1H 2016 in relation to the DSN transaction.

The investment in senior management comes as Richard Robinow and John Oakley have transitioned to retirement, with both Mark Parry and a recently recruited CFO and Regional Corporate Secretary, operating out of Singapore, in addition to David Blackett (based in London) assuming the role of Chairman. Over time the company proposes to gradually, but materially, reduce the London resource in line with the refocusing of central management to Asia. However, for as long as the company retains a London office, the additional cost associated with maintaining two central management locations will remain within Administrative Expenses. It is to be noted however, that with the further development of the land bank, this central overhead will be spread over an increasingly larger cost base: accordingly, administrative expenses should reduce as a % of total costs.

Table 11:

6 Months to 30th June ($m)	2016	2015	2014	2013
Administrative Expenses				
Indonesian Operations	-5.309	-5.683	-7.476	-7.643
Change %	*-6.6%*	*-24.0%*	*-2.2%*	*28.2%*
Change % Rupiah/US$ rate	-4.30%	-9.56%	-21.05%	-5.34%
Indonesian Operations as % Sales of Goods	-13.93%	-12.83%	-11.45%	-16.54%
Average Rate Rupiah: $ rate	13,479	12,923	11,795	9,744
Head Office (London & Singapore)	-3.53	-2.696	-3.106	-2.639
HO Expenses as % of Total Admin Pre Capitalisation & Pre UK Pension Scheme	40.1%	31.4%	29.1%	24.9%
UK Pension Scheme	0	2.179	0.261	-0.189
Net Forex Changes	0.033	-0.217	-0.106	-0.009
Profit/Loss Fixed Asset Disposal (Financial Asset 2013)	0	0	0	-0.291
Admin Expenses Pre Capitalisation	**-8.806**	**-6.417**	**-10.427**	**-10.771**
Capitalisation	1.65	2.00	2.24	2.74
Admin Expenses in P&L	**-7.161**	**-4.415**	**-8.187**	**-8.029**

Source: REA Interim Reports

Depreciation

The 2016 1H financial results incorporate significant changes in accounting policies. After much urging, especially from the financial sector, the International Accountancy Standards Board determined in 2014 to amend IAS 41 as it related to tree crops. The amendment, which was available for implementation post 01/01/2016, means that biological assets are no longer to be carried at fair value, but are instead to be accounted for as property, plant and equipment (PP&E).

Across the plantation sector, firms have elected either to write off the fair value on the 2015 period balance sheet, or to depreciate this fair value on the accounts over the remaining commercial life of the assets. REA has adopted this second approach. It is therefore likely to mean that the group will in future report profits that are lower than they would have been under the previous IAS 41. Whereas previously income statements would reflect movements in the fair value of biological assets (which could have been expected to be positive for a developing plantation business), now REA's statements will instead include a depreciation charge. While this will have no impact on the cash flow, it will introduce a certain charge to the P&L. Specifically in 2015 the net gain to fair value of biological assets was $13.1m, but on restatement for the amendment to IAS 41, the P&L must instead absorb a depreciation charge of $7.8m for a reversal of $20.9m to pretax profits. This change in accounting policy has therefore had a material impact on the 1H 2016 statement.

Table 12:

6 Months to 30th June 2015	Pre-IAS 41 Amendment	Restated
Revenue	46.205	46.205
Gross Profit	8.587	4.674
Net Gain Change FV Biological Assets	2.907	0
Distribution & Admin Costs	-4.909	-4.909
Operating (Loss)/Profit	6.585	-0.235
Net Financing Costs	-5.228	-5.228
Pretax (Loss)/Profit	1.357	-5.463

Source: REA Half Year Reports

To see adjustments for Gross Profit, please refer to Table: 9 above.

Finance Costs

Readers will note from the table below that interest charged on bank loans and overdrafts increased to $5.12m ($3.69m), driven by an increase in bank loans of nearly $20m: $122.3m ($103). Sterling weakness relative to the $ meant that annual dividends on the Preference shares fell to $7.5 million (2015: $8.46m) and the redemption liability on the Sterling notes to $10.8 million.

Table: 13

	1H 2016 $m	1H 2015 $m	1H 2014 $m	FY2015 $m	FY2014 $m
Interest on bank loans and overdraft	5.12	3.69	3.94	8.13	4.87
Interest on US dollar notes	1.36	1.28	1.68	2.72	3.44
Interest on sterling notes	2.78	2.51	2.79	5.04	5.41
Change in value of sterling notes arising from exchange fluctuations	-5.64	0.47	1.85	-4.95	-3.35
Movements relating to derivative financial instruments	0.00	-0.73	-2.08	1.69	2.40
Change in value of loans arising from exchange fluctuations	3.57	-1.12	0.53	-2.69	-0.35
Other finance charges	0.57	0.89	0.54	0.90	-0.40
	7.76	6.97	9.25	10.83	12.02
Amount included as additions to biological assets	-2.87	-1.72	-1.68	-4.87	-3.25
	4.90	5.26	7.57	5.96	8.77
Of which: arising from exchange rate fluctuations	-2.07	-1.39	0.30	-5.96	-1.30
Actual cash interest expenses	9.83	8.36	8.95	16.79	13.32

Source: REA Reports

3 – Strengthening of The Balance Sheet

Substantive progress has also been achieved in strengthening the balance sheet, notwithstanding the y-o-y increase in the net debt: equity ratio to 72.5% (65.1%). While net debt has increased by some $10m, net assets/shareholders' funds have been negatively impacted as a consequence of the changes in accounting treatment of the biological assets as a result of the amendment to IAS41. (Using the restated shareholders' funds of $294.8 for 1H 2015).

At the half year, net debt stood at $212m ($192.0m). Importantly the company agreed a repackaging of the principal Indonesian bank facilities: the previous package of US$ and Rupiah borrowings $88.6m, has been replaced with new borrowings all in Rupiah, totalling $95.3m. This repackaging included a reduced revolving credit facility of $26.0m ($35.5m). The balance of the facilities is repayable over a period of 5 years. This has resulted in a reduction of amounts repayable 2016 and 2017 of $4.7m and $19.8m respectively. Further funding will be required however to support the accelerated planting programme and to refinance some $45m of $ and Sterling notes falling due during 2017. The group reports that it "is well advanced in discussions of several financing alternatives…".

Reviewing the table below, which compares the balance sheet between the 2015 and 2016 half years, readers will note that the Sterling Notes hedge was closed last year, which resulted in a $10m cash outflow in FY15 results. Readers will also note that REA has been able to reduce the coupon on the 2020 portion of Sterling notes, now 8.75%. As detailed in the table below, some $33.7m of 7.5% $ Notes are due for redemption by 2017. As these $ and £ Note programmes have fallen due, the company has been adept at rolling over some or all of its obligations. We are assuming in our model that it will roll-over at least $20m of the 2017 programme, with the residue being met by new bank facilities.

It should also be noted that the investment agreement with PT Dharma Satya Nusantara Tbk (DSN) provides a new source of debt and equity capital for the development of the business. The short term 3rd party loan detailed in the table below is an advance from DSN under that agreement.

Table 14:

	1H16 $m	1H15 $m
7.5 per cent dollar notes 2017	33.7	33.6
9.5 per cent guaranteed sterling notes 2015/17	9.5	53.1
8.75 per cent guaranteed sterling notes 2020 (“2020 sterling notes”) (£31.9 million nominal)	41.0	-
Hedge of the principal amount of £22 million nominal of the sterling notes	-	8.3
Indonesian term bank loans	86.8	72.0
Drawings under working capital lines	35.5	31.0
Third party short term loan	10.0	-
Total Debt	216.5	198.0
Cash and cash equivalents	-4.5	-6.0
Net Debt	212.0	192.0
Total Shareholders' Funds	292.3	294.8
Net Debt/Equity Ratio	72.5%	65.1%

Source: REA Half Year Reports

In May 2016, an initial conditional agreement was signed between REA and PT Dharma Satya Nusantara Tbk (DSN), for the purchase of a 15% stake in REA’s principal operating subsidiary, REA Kaltim (REAK). The consideration for equity of REAK will amount to $15m in cash with (up to) a further $0.85m payable (by year end 2017) depending upon the recovery of certain over payments of taxation. REAK is financed by a combination of equity and shareholder loans and DSN will be putting up additional shareholder loans proportionately to its equity interest. These will comprise $ and Sterling loans to REAK of $10.0m and £3.9m respectively, on terms mirroring the terms of existing shareholder loans. It is expected that DSN will provide further shareholder loans to subsidiaries of REAK of $17m during 2017 to reflect existing shareholder loans to those subsidiaries. To date the company has received temporary advances from DSN amounting to some $23m. This marks what is expected to be a long term relationship between the two companies: DSN may increase its holdings in REAK to 49% over a period of 5 years on the basis that each increase will be subject to agreement on price and consents from other stakeholders including REA shareholders.

Outlook 2016/2017

While weather and pricing are out of management’s control, investors will note that the critical drivers of success are now manifestly in place: expanded planted area “progressing rapidly towards the target of 60,000 ha”, upper end milling efficiencies, and a squeezed cost base. With weather patterns returning to a more normal profile, the business is positioned for a better year in 2017. The 2016 Interim Statement even notes: “Provided that crops continue to recover as expected and prices…are maintained around current levels, the directors expect that payment of ordinary dividends can be resumed in respect of 2017”.

Revised Hardman Forecasts

Looking out to 2018, we have been cautious on development, taking total planted area to 50,597 ha by end 2018. The company will likely seek to improve on these suggested targets. However, we have carried through the improved OER in our forecasts over the period, extending it to 24% in 2018. With an improving weather pattern, and the palms now set on recovery, we have built in a solid rise in FFB/CPO production for 2017, which does not seem contentious. The price achieved is harder to predict.

Our revenue forecasts are based on an average CPO price received of $570 / mt 2016 and $610/mt for 2017. The 2017 forecast, embraces a wide spread of expectations from $530/mt at the nadir of annual demand to $770/mt at the peak. The leading forecasters are mostly bearish calling the price down into the $550/mt area: the clues for the year's outcome will lie in the progress of the Chinese and Indian economies, the price of crude oil, and the volume of soybean oil produced. $610/mt will hopefully prove to be a conservative assumption. Much will depend on all the drivers mentioned above and even perhaps on the outcome of the US Presidential election. This we must keep under review.

Table 15:

		2013	2014	2015	2016e	2017e
Hectare Planted (Ha)	Immature	6,960	6,339	7,730	11,590	13,035
	Mature	27,102	28,275	29,367	31,507	34,062
Total Planted (Ha)		**34,062**	**34,614**	**37,097**	**43,097**	**47,097**
% of Total Plantable		**57%**	**58%**	**62%**	**72%**	**78%**
Planting rate		2,555	784	2,251	6,000	4,000

Source: REA Reports, Hardman Agribusiness Forecasts

Table 16:

	2012	2013	2014	2015	2016e	2017e
FFB Prod' (own) (MT)	597,722	578,785	631,728	609,389	475,000	662,501
FFB (purchased) (MT)	64,014	99,348	149,002	139,276	100,000	120,000
Total FFB for process (MT)	661,736	678,133	780,730	748,665	575,000	782,501
Own estate FFB yield/ha avg	22.4	21.4	22.3	20.5	15.1	19.4
OER%	22.9%	21.8%	21.9%	22.2%	23.8%	23.8%
Total CPO production (MT)	151,516	147,649	169,466	163,880	136,850	186,235
CPO yield per hectare (MT/ha)			0.0	0.0	0.0	0.0
Actual PK Extraction Rate	4.64%	4.53%	4.6%	4.6%		
Palm Kernel Extracted (MT)	30,734	30,741	35,764	34,354	25,875	35,213
PKOER%	37.6%	37.1%	38.1%	35.0%		
Total CPKO (MT)	11,549	11,393	12,596	12,703	9,315	12,677
CPO Price ($/mt)	800	648	665	485	570	610

Source: REA Reports, Hardman Agribusiness Forecasts

The 2016 forecasts fully reflect the tough conditions for the sector: low volumes and low average price received. The outlook to 2017 turns on these elements reversing into a more favourable trend. While it would be beyond any experience to have another such extreme weather pattern depress output, the pricing picture is less predictable. On the assumption that events unfold broadly as assumed, then the cost tightening and strengthened efficiencies instituted at REAK, should produce much improved marginal returns. Readers will note that we have pegged Admin expenses around the $14m level after several years of increases.

Table 17: Profit & Loss

Profit & Loss		
Year Ended 31st Dec	**2016 e**	**2017 e**
$m		
Revenue	**87.6**	**124.1**
Net (loss)/ gain arising from changes in inventory value	-1.3	0.0
Cost of production	-71.2	-87.6
Gross profit	**15.0**	**36.5**
Gross margin %	17.2%	29.4%
Biological assets valuation	0.0	0.0
Other operating income	0.0	0.0
Distribution costs	-1.1	-1.5
Administrative expenses	-14.0	-14.1
Operating profit	**0.0**	**20.9**
EBITDA	18.8	41.3
Investment revenue	0.2	0.2
Finance costs	-10.0	-14.0
Profit before tax	**-9.8**	**7.1**
Tax	0.9	-2.1
Profit for the year	**-8.9**	**5.0**
EPS (cents)	-42.5	-9.7
Dividend (GBp)	0.0	4.0
Attributable to:		
Ordinary Shareholders	-15.7	-3.6
Preference Shareholders	8.6	8.0
Non-controlling interests	-0.2	0.1
Minorities	-1.6	0.4
	-8.9	**5.0**

Source: Hardman Agribusiness Forecasts

Of which depreciation:

Table: 18

Year Ended 31st Dec	**2016 e**	**2017 e**
$m		
Depreciation (as part of CoGS)	-17.815	-19.415

Source: Hardman Agribusiness Forecasts

The profile of the Balance Sheet will continue to be shaped by the amendment to IAS 41, with depreciation of the book value of the biological assets (over their remaining commercial life), negatively impacting net asset value (whereas formerly there were regular increases in the value of those assets in line with new plantings and (any) annual upticks in the commodity price). This evolution of asset value, also has the effect of weakening the net debt: equity ratio which we expect to see widen to 74.9% by end 2017. Although this ratio would reduce if the company elected to revalue its plantations which it may well do given the expected substantial additions of value through extension planting.

Table 19: Balance Sheet

Year Ended 31st Dec	2016 e	2017 e
$m		
NON-CURRENT ASSETS		
Goodwill	12.6	12.6
Biological Assets	328.7	342.4
Property, Plant & Equipment	155.6	156.9
Prepaid Operating Lease Rentals	34.5	34.7
Indonesia Stone and Coal Interests	35.8	36.3
Deferred Tax Assets	15.8	15.8
Non-Current Receivables	1.5	1.5
	584.5	600.2
CURRENT ASSETS		
Inventories	12.8	11.9
Investments	2.0	1.5
Trade & other receivables	29.0	28.8
Cash & equivalent	12.2	8.8
	56.0	51.1
TOTAL ASSETS	**640.5**	**651.3**
CURRENT LIABILITIES		
Trade and other payables	27.8	26.9
Current Tax Liabilities	-4.2	-1.1
Bank Loans	45.4	53.9
Sterling notes	0.0	0.0
US dollar notes	0.0	0.0
Other Loans & Payables	0.1	0.2
	69.1	79.8
NON-CURRENT LIABILITIES		
Bank loans	84.3	100.1
Sterling notes	55.9	44.8
US dollar notes	33.6	20.0
Hedging instruments	0.0	0.0
Deferred tax liabilities	84.6	87.7
Other loans & payables	20.8	38.6
	279.1	291.1
TOTAL LIABILITIES	**348.3**	**371.0**
TOTAL EQUITY	**292.2**	**280.3**

Source: Hardman Agribusiness Forecasts

Table: 20

	2016 e	2017 e
Total Debt	219,130	218,781
Cash	12,201	8,839
Net Debt	206,929	209,942
	2016e	**2017e**
Net Debt/Equity (incl Preference Capital)	70.8%	74.9%

Source: Hardman Agribusiness Forecasts

Readers will note that we have allowed for the roll-over of some $20m of the 2017 $ Notes in 2017 and increased bank facilities of $25m. Also notable: $17.8m of loan finance coming into the balance sheet from DSN. We have not included any further purchases of REAK equity by DSN in the period, but this cannot be excluded.

Table 21: Cash Flow

Year Ended 31st Dec	**2016 e**	**2017 e**
$m		
NET CASH FROM OPERATING	**-1.0**	23.8
Interest received	0.2	0.2
Proceeds from disposal of PP&E	0.0	0.0
Purchase of PP&E	-9.4	-11.6
Expenditure on Biological Assets	-20.3	-24.7
Expenditure on prepaid operating lease rentals	-1.0	-1.0
Change in minority interest	0.0	0.0
Investment in Indonesian stone & coal	-0.5	-0.5
CASH FROM INVESTING ACTIVITIES	**-30.9**	**-37.5**
Preference dividends paid	-8.6	-8.0
Ordinary dividends paid	0.0	0.0
Repayment of borrowings	0.0	-0.7
Redemption of US dollar notes	0.0	-13.6
Redemption of Sterling notes	0.0	-11.0
New bank borrowings	6.7	25.0
Strategic Partner (equity)	15.0	0.0
Loan from related parties	15.2	17.8
CASH FROM FINANCING	**28.3**	**9.4**
NET INCREASE IN CASH	**-3.6**	-4.3
Cash b/f	15.8	13.2
Effect of exchange rate	0.0	0.0
CASH BALANCE C/F	**12.2**	**8.8**

Source: Hardman Agribusiness Forecasts

Valuation Relative to International Sector EV per Planted Hectare

REA, currently trading at $9,397 Enterprise Value per planted ha, is positioned at a discount of 11.2% to the Indonesian sector weighted average (ex Wilmar) of $10,585. The valuation looks anomalous given achieved efficiency levels, the age profile of the plantations, the expansion potential of the land bank and a strategic investor positioned to acquire 49% of REAK.

Table 22:

Company Name	Adjusted EV/ha ($/ha)
Wilmar International	54,338
Sawit Sumbermas Sarana	39,620
United Plantations	26,945
IOI Corporation	23,458
Univanich Palm Oil (Thailand)	21,521
Genting Plantations	19,830
Golden Agri	16,752
TSH Resources	16,316
First Resources	16,083
IJM Plantations	16,026
KL Kepong	15,975
United Malacca	14,289
Kwantas Corporation	13,950
Austindo Nusantara Jaya Plantation	13,765
Sime Darby	12,745
Hap Seng Plantations	12,331
Felda Global Ventures	11,875
Astra Agro Lestari	10,708
TH Plantations	10,425
Provident Agro	10,267
Far East Holdings	10,259
DutaLand	9,774
Sipef (Brussel)	9,469
R.E.A. Holdings *	9,397
Presco Plc (Lagos)	9,253
Okomu Oil Palm PLC (Lagos)	8,743
Sarawak Oil Palms	8,455
Eagle High (BW Plantation)	8,027
Bakrie Sumatera Plantations	8,026
London Sumatra Indo	7,652
MP Evans	7,575
Socfinasia (Luxembourg)	7,536
BLD Plantation	7,453
Dharma Satya Nusantara Plantations	7,328
Carson Cumberbatch (Colombo)	7,221
Sampoerna agro	6,229
Indofood Agri Resources	6,117
Salim Ivomas Pratama	6,031
Palm CI (BRVM)	5,456
Anglo-Eastern Plantations	4,311
Sarawak Plantation	3,777
Chin Teck Plantations	3,748
Socfin (Luxembourg)	3,494
Socfinaf (Luxembourg)	3,301
Global Palm	2,205
Equatorial Palm Oil ***	2,063
Feronia **	1,964
Weighted average EV/ha ($/ha)	13,951
Indonesian EV/ha ($/ha)	15,105
Indonesian EV/ha (ex Wilmar) ($/ha)	10,585

* Estimates 2016
** 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: Hardman Agribusiness

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