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R.E.A. Holdings

An Elegant Solution

The announcement of an improving set of full year results for 2017 was complemented by the announcement that REA Kaltim (REAK) had entered into a conditional agreement for the sale of a 95% holding in the PBJ estate to KLK. Expected gross proceeds of $85m are anticipated to evolve at ca.$57m net of repayment of external borrowings and transaction costs. This represents an elegant solution to de-leveraging the balance sheet, focusing on a more contiguous plantation area, and freeing up capital for the remaining landbank. The transaction value compares favourably with market valuations of strongly performing Indonesian operators.

- **Strategy**: REA Kaltim, the principal division of REA, is developing a land bank of some 110,000 ha. At the current accelerated rate of development, the proprietary plantations should be completed by 2021 or 2022, at ca.50,000 ha.
- **Changing Fortunes:** The 2017 result evidences improving trends in estate productivity and operational efficiency. Nevertheless, further recovery is expected, and needed, over 2018, if 2019 is to prove the transition year we have projected.
- **Valuation:** The share price of the REA Ordinaries has responded well to news of the PBJ disposal and the valuation is now in line with sector peers at $12,501 per planted ha, excluding our valuation for the electricity operations and the carrying value for the coal and stone assets. The higher value accorded to MP Evans, recalls that it has been the focus of a take-over bid by KLK. In this context, readers will note that DSN has not excluded returning to acquire more of REAK.
- **Risks:** Agricultural risk, commodity price risk, and country risk are constants of palm oil production. The deleveraging of the balance sheet to give 2018 projected net debt to equity of 66.5% (76.5%) with the sale of the PBJ estate, will help to reduce funding risk, which is a standard threat to plantation projects.
- **Investment summary:** REA has scope, with its remaining plantable landbank of ca. 23,000 ha, to develop a planted estate of some 50,000 ha. We believe that the group's financial performance undergoes significant change from 2019 forwards. We are assuming some 34,000 ha of mature plantations for end 2019, coupled with stronger agricultural production across the estates, and a firmer CPO price. If these factors align as anticipated, then this will mark the point at which the business becomes self-sustaining.

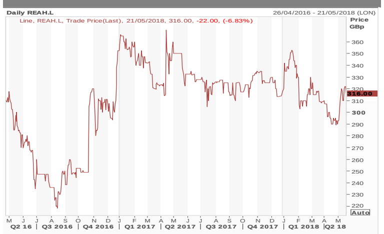
Financial summary and valuation

Year end Dec ($m)	2015 R	2016	2017	2018E	2019E
Sales	90.5	79.3	100.2	119.9	134.4
EBITDA	14.1	16.8	20.7	39.1	44.9
Reported EBIT	-6.6	-5.0	-2.2	15.9	21.5
Pre-tax Profit	-12.2	-9.3	-21.9	1.4	10.6
EPS (cents)	-59.0	-48.2	-67.0	-23.2	-4.2
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Net (debt)/cash	-196.7	-205.1	-211.7	-178.2	-189.8
P/E (x)	-	-	-	-	-
Planted Hectares (ha)	37,097	42,846	44,094	39,974	42,976
EV/Planted Hectare ($/ha) *	13,777	12,823	12,442	13,680	12,683
CPO Production (mt)	161,844	127,697	143,916	183,616	183,617

*R=restated, *EV/Planted Hectare includes mkt cap of the 9% Pref. Shares and 15% DSN Stake*

Source: Hardman & Co Agribusiness

Food Producers



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**RE.**
Price (p)	316
12m High (p)	365
12m Low (p)	282
Shares (m)	40.5
Shares Prefs (m)	72.0
Mkt Cap (£m)	128.0
Mkt Cap Pref (£m)	79.2
EV ($m)	511.1
Free Float	30.0%
Market	Main

Description

R.E.A. is engaged in the operation and further development of palm oil plantations in East Kalimantan, Indonesia. The Group also owns stone quarrying rights and concessions, and coal mining concessions which have been contracted out to 3rd Party operators.

Company information

Managing Director	Carol Gysin
Chairman	David Blackett

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Key shareholders

Directors	28.55%
M & G Investment Mang.	14.97%
Alcatel Bell Pension Fund	10.32%
Artemis UK	8.83%
Aberforth Partners	7.3%

Next event

June 2018	AGM
Sep 2018	Interim results

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An elegant solution

The details of an improving set of full year results for 2017 were complemented by the announcement that REA Kaltim (REAK) had entered into a conditional agreement for the sale of REAK's 95% holding in the PBJ estate to KLK. Expected gross proceeds of some $85m are anticipated to evolve at ca.$57m net of repayment of external borrowings (estimated $26m) and transaction costs. With net debt at 2017-year end of $211.7m ($205.09m), the net debt: equity ratio had expanded to 76.5% (66.3%). While net debt was lower than we had anticipated, due to the pay-back of some $11m in Sterling Notes during 2017, and a further raise of some $11m in Cumulative Preference capital in 2017, the squeeze on cashflow from cash interest payments of $24.9m ($20.7m) equalled 54.4% of cash generated from operations before taxation and interest payments. The debt burden was cramping the group's scope for developing its landbank and other assets; as stated in the Strategic report, Finance section of the 2017 Report & Accounts: "*Should the sale of PBJ…not be completed…,then the group would be left with a higher level of indebtedness than the directors believe is desirable…but on the reasonable assumption that the divestment…will be completed…the directors are confident that the group will have the cash resources that it needs for the foreseeable future*". Not only will the sale of PBJ reduce the group's debt burden, it will permit the group to consolidate its operations into a somewhat more contiguous area and it will obviate a capital allocation for a new mill for perhaps another 3 years, allowing this capital to be deployed instead to planting the group's remaining 10,000 ha of readily plantable landbank. All in all, an elegant solution in terms of strengthening the balance sheet, in focusing efforts on a more contiguous plantation area, and freeing up capital for development of the remaining landbank.

2017 full year results

Readers may recall that our report on the 2016 Full Year Results was titled: "All Change From 2019". We noted therein that while revenues could be expected to grow by more than 20% in 2017 (actual was 26.5%), "*on the basis of our projections, the group's financial performance undergoes significant change from 2019 onwards*". While total mature hectares will be lower than previously expected for 2019, consequent upon the PBJ sale, at 34,174, our projections still show the business becoming self-sustaining (as defined in "All Change": "*…generating sufficient cash to fully meet its obligations on interest payments, preference dividends, estate development and taxation*". The 2017 outcome evidences improving trends in estate productivity and operational efficiency, but further recovery is expected, and needed, over 2018, if indeed 2019 is to prove the transition year we have projected.

5-year production

	2013	2014	2015	2016	2017	Comment	2018E
FFB (own) (mt)	578,785	631,728	600,741	468,371	530,565	Remedial work in 2017 and 2018 should feed into a further improvement in 2018	650,904
FFB (purchased) (mt)	99,348	149,002	138,657	98,052	114,005		150,000
Total FFB for process (mt)	**680,146**	**780,730**	**739,398**	**566,423**	**644,570**		**800,904**
Own estate FFB mt/ha	*21.4*	*22.3*	*20.5*	*14.9*	*15.6*	REAK's estates are capable of 24+ mt / ha	*19.1*
Total FFB Processed (mt)	677,389	774,420	728,871	560,957	630,600		794,874
OER	*21.8%*	*21.7%*	*22.2%*	*22.8%*	22.8%	Harvesting and mill efficiencies can permit up to 25% OER; 3rd party supply tends to suppress upper level rates	23.0%
Total CPO production (mt)	**147,649**	**169,466**	**161,844**	**127,697**	**143,916**		**182,821**
Palm Kernel Extracted (mt)	**30,741**	**35,812**	**33,877**	**26,371**	**29,122**		**36,041**
Total CPKO (mt)	**11,393**	**12,610**	**12,557**	**9,840**	**11,052**		**12,975**

FFB – fresh fruit bunch
CPO – crude palm oil
CPKO – crude palm kernel oil
Source: Hardman & Co Agribusiness / Company Reports

A much-needed recovery

The two key ratios in the table above are FFB mt/ha and OER (oil extraction rates). The most fundamental indicator of palm oil plantation efficiency is FFB mt/ha. Top performing producers can exceed 24 mt/ha and as indicated in the table above REAK achieved 22.3 mt/ha in 2014. While the 2017-year result of 15.6 mt / ha marks an improvement (4.7%) on the disappointing result for 2016, when operational efficiencies were depressed (by adverse weather conditions, the impact of these on estate maintenance, and a shortage of harvesters), the historic record demonstrates that REAK has considerable scope for further improvement, if only to the productivity levels achieved in 2014. REAK operates in one of the most favourable locations for palm oil production in the world. The planting material across the estate have the genetic potential to produce up to 30 mt of FFB per hectare at peak production, so the outcomes for the past two years have been markedly sub-optimal. Management is focused on addressing the causes within its control: fertiliser regime, estate maintenance, and efficient harvesting, and the Chairman's statement for 2017 alludes to "…*the beginnings of a much-needed recovery in group operations*".

OER in the first quarter of 2017, continued to be impacted by the problems engendered by the adverse conditions in 2016, but by the middle of the year and into the second half, the group reports that rates were running at "*levels close to or above 23% for CPO…compared to 22%...in the first half*". The strengthening of this ratio has been made possible by improvements in mill efficiencies, upgrading of harvesting efficiencies (including repairs to roads after the weather impact of 2016), and improvements in the quality output of 3rd Party suppliers.

Crops

Going into the 2017, access to the plantations for recovery of crops, was impacted by the damage sustained to the estate roads, from the severe rains in late 2016. The group also found itself short of harvesters in 2016/2017, which further impacted crop recovery.

During 2017, acting on the advice of oil palm agronomists, fertiliser applications across the mature estates were significantly increased. For some years, REAK had been relying on estate produced composts of mill waste and estate waste for up to 50% of its fertiliser requirements. This policy was deemed to have been sub-optimal, and a factor behind the low-end productivity per hectare.

From an agronomic perspective, the 2017 year was marked by strong production mid-year, albeit 'more muted' in the final quarter of 2017, due to harvesting days reduced by heavy rain, and overhanging work to restore operational efficiencies in the plantations and to upgrade infrastructure including roads. An increase of 13.3% YoY, masked growth of 17.9% in the second half when the group produced 342,000mt of FFB (290,00 mt). Annualised, this level of production would equate to more than 20 mt/FFB/ha, which is easily within the capacity of the group plantations.

2018 Crop outlook

Reports suggest that the 2018 year got away to a muted start across East Kalimantan, but March and April were reported to have seen "a noticeable upturn". The group states that some 200,000 mt of FFB can be expected for the first four months of 2018 compared with 159,706 mt for the same period in 2017, a possible increase of 25%. The group has stated that it will continue to 'feed' the mature plantations with the same or similar higher dosages of fertiliser, in a continuation of the policy described above for 2017.

For 2018, we are projecting lower overall y-o-y growth (than that indicated for the first four months of 2018) of 22.7%, for projected estate production of some 650,904 mt FFB or 19.1 mt/ha.

OER

The issues referred to above, which impacted on crop recovery from the plantations, also impacted on achieved rates of oil extraction. Harvesting crops outside the period of optimal ripeness will reduce oil quantity and quality, but it may also mean for fewer ripe fruits harvested, if these begin to drop from the bunches and are not gathered from the ground. With any capacity constraints in the field, the recovery of fallen fruit is likely to have been negatively impacted, leading to lower OERs. By the middle of the 2017-year, the group reports that OERs had recovered to more than 23%. With further upgrades expected during 2018 to the milling facilities, the operational efficiency within the mills should continue to strengthen. We are projecting OER to improve slightly to 23% for 2018, then maintain at the same level from 2019 onwards.

2017 profit & loss account

The boost to revenues from increased FFB production and better achieved OERs, was anticipated, as also, was the strengthening in the gross margin, although the actual was stronger than our forecast. Both lines were helped by a stronger average received price for palm oil commodities: $592/mt CPO ($521), an improvement of 13.6%, and $1,134/mt ($1,111) for CPKO.

Gross margin

A gross margin of 12.9% leaves scope for significant further strengthening. Leading sector names in Indonesia are achieving gross margins in excess of 45%, while Kalimantan peers such as MP Evans and DSN are both achieving gross margins in excess of 30%.

Global palm companies 2017 gross margins

Company	Principal location of palm operations	2017 gross margin (%)
Okomu	Nigeria	75.8%
Presco	Nigeria	73.4%
Socfin	Africa & Asia	55.0%
Sawit Sumbermas	Indonesia	53.2%
First Resources	Indonesia	47.4%
PalmCI	Ivory Coast	46.7%
United Plantations	Indonesia & Malaysia	44.9%
IJM Plantations	Malaysia, Indonesia	39.2%
Sipef	Indonesia, PNG	37.9%
TSH Resources	Malaysia	35.5%
Genting Plantations	Malaysia, Indonesia	34.5%
DSN Group	Indonesia	33.4%
Provident Agro	Indonesia	33.3%
MP Evans	Indonesia	31.1%
ANJ	Indonesia	31.0%
Bakrie Sumatera	Indonesia	30.4%
Sime Darby Plantation	Malaysia, Indonesia	29.3%
London Sumatra	Indonesia	28.3%
Sampoerna Agro	Indonesia	26.6%
Anglo Eastern	Indonesia	25.4%
Eagle High Plantations	Indonesia	25.3%
DekelOil	Ivory Coast	24.8%
Sarawak Plantation	Malaysia	24.5%
Astra Agro	Indonesia	24.0%
Salim Ivomas	Indonesia	21.6%
TH Plantations	Malaysia	21.1%
Indofood Agri	Indonesia	20.2%
IOI Group	Malaysia, Indonesia	17.2%
Kwantas Corporation	Malaysia	15.9%
Golden Agri	Indonesia	14.6%
REA Holdings	Indonesia	12.9%
KLK	Malaysia, Indonesia, Africa	12.9%
Felda Global	Malaysia	11.5%
Wilmar International	Indonesia, Malaysia, Africa	7.9%
Univanich Palm Oil	Thailand	7.1%

Source: Eikon Thomson Reuters, Hardman & Co Agribusiness

Other costs

As detailed in the P&L table below, other costs increased by more than 25% in 2017, due to higher (+19.2%) estate operating costs (including maintenance costs) on the plantations: \$49.7m (\$41.7m), making good the impact of negative weather conditions in 2016 and a shortage of harvesters. This cost line was also impacted by the purchase of larger volumes of 3rd Party FFB in 2017, and at higher costs for a total expense of \$14.4m (\$9.1m), up 58.2%. This latter figure indicates, *at just one level*, what an important contribution, REA makes to the domestic economy of the region in which it operates.

EBITDA margin

In respect of EBITDA marginal returns, REA will be aiming to bring its efficiencies in line with sector leading names such as First Resources and Sawit Sumbermas, both at ca. 45%. Near neighbours in East Kalimantan such as MP Evans and DSN are also achieving marginal returns of approximately 30%-39%. Readers will note in the expanded P&L table below, that the EBITDA margin has steadily improved from

14.1% in 2015, to 16.8% in 2016 and 20% in 2017. We are projecting a level of 27.2% adjusted EBITDA margin in 2018 and 33.4% in 2019.

Global palm companies 2017 EBITDA margins

Company	Principal Location of Palm Operations	2017 EBITDA Margin (%)
Sipef	Indonesia, PNG	64.2%
Okomu	Nigeria	61.2%
Presco	Nigeria	46.4%
First Resources	Indonesia	45.2%
Sawit Sumbermas	Indonesia	44.9%
Hap Seng Plantations	Malaysia	38.7%
MP Evans	Indonesia	38.6%
United Plantations	Indonesia & Malaysia	37.9%
Genting Plantations	Malaysia, Indonesia	37.6%
Eagle High Plantations	Indonesia	32.7%
IJM Plantations	Malaysia, Indonesia	32.1%
TH Plantations	Malaysia	30.3%
DSN Group	Indonesia	29.9%
London Sumatra	Indonesia	29.2%
Sarawak Plantation	Malaysia	28.4%
Anglo Eastern	Indonesia	28.3%
Socfin	Africa & Asia	27.9%
Provident Agro	Indonesia	26.5%
Astra Agro	Indonesia	24.5%
Sime Darby Plantation	Malaysia, Indonesia	22.7%
Sampoerna Agro	Indonesia	22.7%
PalmCI	Ivory Coast	22.3%
TSH Resources	Malaysia	20.4%
REA Holdings	Indonesia	20.0%
Indofood Agri	Indonesia	19.5%
Salim Ivomas	Indonesia	19.1%
ANJ	Indonesia	16.9%
Bakrie Sumatera	Indonesia	15.6%
DekelOil	Ivory Coast	15.4%
IOI Group	Malaysia, Indonesia	14.1%
Sarawak Oil Palms	Malaysia	11.3%
KLK	Malaysia, Indonesia	10.2%
Kwantas Corporation	Malaysia	8.4%
Golden Agri	Indonesia	7.7%
Felda Global	Malaysia	7.0%
Univanich Palm Oil	Thailand	4.6%
Wilmar International	Indonesia, Malaysia, Africa	4.2%

Source: Eikon Thomson Reuters, Hardman & Co Agribusiness

Distribution costs

Up by more than 25%, distribution costs were in broadly line with forecast, aligned to the larger volume of FFB produced during the year. Interestingly, the logistics expertise of the group, and the facilities established for getting its palm oil products to market, are strategic marketing assets. The group operates a fleet of barges to transport CPO and CPKO from its mills to either its storage tanks in the transhipment terminal it owns in Samarinda, or to buyers' port, be it Balikpapan (East Kalimantan) or Kota Baru (South Kalimantan). Management argues that its flexibility in getting production to market, is an important factor in achieving optimal pricing and avoiding delays in selling through product.

Administrative expenses

Administrative expenses were higher than our previous forecasts. At $13.7m ($12.0m) this reflected a number of one-off costs incurred in the year, and in particular the move of the Indonesian admin functions to Balikpapan (from Samarinda and Jakarta), in addition to various costs associated with the termination of employment of the former CEO, Mark Parry. We had expected greater cost savings to offset some of these items.

Finance costs

The greatest negative impact on the P&L came in the form of a $15.3m negative swing in the adjusted value of the Sterling Notes, for movements in the £:$ exchange rate. In 2016 the adjustment produced a $10.5m credit to the P&L, while in 2017, the effect was a $4.8m charge.

Attributable profits/losses

For holders of ordinary equity in the listed company and at the REAK level (DSN), the 2017 result was in contrast (as previously) with the outcomes for holders of the preference shares. The impact on ordinary shareholders, at the attributable level, was strongly impacted by the increase in finance costs, this is mainly due to adjustments to the valuation of the Sterling Notes as a consequence of exchange rate movements. Not surprisingly, under these circumstances, the preferred shares have outperformed the ordinaries.

2017 P&L analysis

Year Ended 31st Dec ($m)	2015 (Restated)	2016	Reported For 2017	Change Y-o-Y (%)	Comment	Hardman & Co Research, 26 September 2017: "Bouncing Back" Forecast	Comment	2018 E
Revenue	90.5	79.3	100.2	26.4%	Reflects a return to more normal operational patterns and efficiencies	103.2	Reported broadly in line with Forecast	119.9
Net (loss)/ gain arising from changes in inventory value	-1.1	0.632	-1.1		Quality and pricing impacted by harvesting issues in 2017	-1.8	Forecast assumed lower reference prices for CPO ($585/mt) and PKO ($1100/MT)	1.1
Cost of production								
Depreciation	-21.7	-21	-22.2	5.8%		-23.8	Many variables; Company also announced a change of accounting policy regarding amortisation of land titles	-23.2
Other costs	-61.4	-50.9	-64.1	25.9%	Elevated expenses on plantations and higher costs and volumes of 3rd Party FFB	-66.5	Broadly in line	-72.2
Gross profit	6.2	8.1	12.9	59.2%	Revenue driven	11.1	Reported is better than Forecast due to lower than expected depreciation	25.6
Gross margin %	*6.9%*	*10.2%*	*12.9%*		*Improving but with further scope to widen*	*10.8%*	*A lower than anticipated depreciation charge, improved GP*	*21.4%*
Distribution costs	-1.1	-1.1	-1.4	25.3%	Larger volumes shipped	-1.3	In line	-1.5
Administrative expenses	-11.7	-12	-13.7	14.0%	Increase was driven by certain one-off costs associated with cessation of Mark Parry's employment. Plus Balikpapan relocation costs.	-12.3	We had factored in certain cost savings items to offset, which have not materialised.	-14.7
Gain on disposal								6.5

2017 P&L analysis (continued)

Year Ended 31st Dec ($m)	2015 (Restated)	2016	Reported For 2017	Change Y-o-Y (%)	Comment	Hardman & Co Research, 26 September 2017: "Bouncing Back" Forecast	Comment	2018 E
Operating profit/(loss)	-6.6	-5.0	-2.2		The impact of changes to IAS 41 is clearly evident in this line. Effective 1 January 2016, Bearer Plants, formerly classified as Biological Assets in the Balance Sheet, are now divided into PP&E Structure and PP&E Planting, and are treated as an investment cost, (and are subject to depreciation), instead of being accorded a fair value. Whereas formerly, the application of IAS 41 resulted in a positive impact on the P&L, the new treatment has resulted in a significantly enlarged depreciation charge to the reported P&L, and this will mark the pattern of reporting for some years to come. Across the plantation sector, companies have responded in different ways, with many palm oil producers simply writing off the built-up value in Biological Assets in one significant adjustment; REA has decided to do this incrementally.	-2.5	Our estimated depreciation charges were higher than reported	15.9
EBITDA	14.1	16.8	20.7	19.4%	Revenue Driven	21.4	We factored in lower Admin Expenses	39.1
Investment revenue	0.3	1.7	1.1		A one-off interest payment of $1.1m relating to a previous tax refund, boosted this line	0.4	We had not allowed for the interest payment	0.2

2017 P&L analysis (continued)								
Year Ended 31st Dec ($m)	2015 (Restated)	2016	Reported For 2017	Change Y-o-Y (%)	Comment	Hardman & Co Research, 26 September 2017: "Bouncing Back" Forecast	Comment	2018 E
Finance costs	-6	-6	-20.8	246.2%	Mainly due to exchange rate impact on Sterling borrowings	-22.3		-14.8
Profit before tax	-12.2	-9.3	-21.9			-24.4		1.4
Tax	-0.7	-2	-3.0		Two principal factors have adversely affected this charge in 2017. First, regulations in Indonesia limit interest deductions for tax purposes in circumstances where the equity in an entity is small by comparison with interest bearing borrowings. Following the anticipated sale later in the year of the group's holding in PBJ, reorganisation of Indonesian subsidiary capital structures should mitigate the negative impact of these regulations in future. Secondly, the tax losses in Indonesia, which can only be carried forward for a maximum of five years, have been reviewed and partly written down to reflect revised anticipated utilisation.	-2	We were unaware of the tax regulation	-2.5
Profit for the year	-12.9	-11.3	-24.9			-26.4		-1.1
EPS (cents)	-59	-48.2	-67.0			-72.9		-23.2

2017 P&L analysis (continued)								
Year Ended 31st Dec ($m)	**2015 (Restated)**	**2016**	**Reported For 2017**	**Change Y-o-Y (%)**	**Comment**	**Hardman & Co Research, 26 September 2017: "Bouncing Back" Forecast**	**Comment**	**2018 E**
Attributable to:								
Ordinary Shareholders	-20.9	-17.8	-27.4			-29.5		-9.4
Preference Shareholders	8.5	7.4	7.8			7.3		8.7
Non-controlling interests	-0.5	-0.9	-5.3			-4.1		-0.5
	-12.9	**-11.3**	**-24.9**			**-26.4**		**-1.1**

Source: Hardman Agribusiness

Electricity generation/sustainability

Methane from the group's two methane capture plants (commissioned in 2012 on the REAK/Perdana and SYB mills/estates), drives four generators, each with the capacity to generate 1 megawatt of electricity. These generators provide electricity for the group's operations, allowing it to achieve material savings (we estimate $3m p.a.) in the consumption of diesel (for generation of electricity).

An additional three megawatts of generating capacity have been installed to supply electricity to 26 local villages and communities surround the group's plantations. This electricity is supplied via the national state electricity company PLN, and the local distribution partner Perusda. Against our projection of $600,000 in revenues for 2017, the group reported $627,000 ($563,000). Demand continues to increase, and revenues are expected to grow progressively over the next few years. The group believes that in time, PLN may call for more electricity with the potential for the group to run eight megawatts of generating capacity. Our financial model envisions revenues of circa $1m p.a. by 2019. Payment for electricity supplied by PLN is at fixed rates, as established by Indonesian regulations. The group currently receives circa $0.07 per kilowatt hour of electricity supplied.

There is potential for natural growth in respect of electricity supply as a result of incremental consumption by connected households, as further households install meters and as new villages become connected. Should PLN connect the regional distribution/transmission network to the national grid, then REAK could install further capacity (including at the most recently commissioned Satria mill) with the potential to deliver electricity 24 hours per day throughout the year. In this event, subject to payment rates, revenues could become material within a group context. For valuation purposes, we have assumed that by 2020/21, REAK will be supplying six megawatts of electricity to PLN, with a likely expansion at Satria mill.

Coal & stone assets

It is significant that in the current year, the group is giving priority, in terms of capital allocations, to the reopening of its coal concession at Kota Bangun, as it believes, provides a quicker return, with a lower risk investment amongst these assets. The group has had to make, and continues to make, hard choices around the deployment of capital. Whatever the potential of these assets, there has not been sufficient capital, nor sufficient confidence in the returns achievable on investment in these assets, to divert capital from the more predictable palm oil production assets.

Coal

This has been a slow-moving project. An expectation that the activities would resume at the Kota Bangun concession in 2017, was frustrated by the need to securing a load site on the Mahakam River, for the coal recovered. The group reports that in April 2018, it concluded arrangements with the owners of an adjacent mine to acquire an established loading point on the Mahakam River, together with a coal conveyor that crosses the group's concession, terminating at the loading point. An application has now been filed for a new licence to export coal from the Kota Bangun concession and once received, de-watering can begin, and mining can recommence. At the same time, the group is finalising arrangements to sell existing coal stocks of some 16,000 tonnes with a possible value of $1.0m to $1.5m.

In respect of the group's second concession at Liburdinding, the group remains open to selling the concession (the coal from which has a relatively high sulphur content) or entering into a royalty-based agreement, with a contractor to operate the concession, as it has done for Kota Bangun.

Stone

Quarrying of the limestone reserves on the concession adjacent to the PBJ estate began in May 2017, and stone is being delivered to the PBJ estate, where it is being crushed (by the contractor operating the concession) for use in hardening estate roads. Under the conditional agreement for the sale of PBJ to KLK, it has been provided that the group subsidiary supplying this stone to PBJ, will be given a right of first refusal on all future contracts for the supply of stone to PBJ. In 2017, 22,000 mt of crushed stone were sold to PBJ for road building.

In respect of the group's andesite stone concession, the group continues to have discussions (with a view to joint venture) with third parties who may have an interest in operating the quarry, marketing the stone, and providing the capital necessary for development of the concession.

PBJ sale

The sale of an outlying asset, which will remain a focus for further significant investment for the next 2-3 years, will not only leave the group with a geographically concentrated set of plantations, it will release more than $40m of previously scheduled PBJ capex (over 2-3 years), for development of the remaining properties, and it will relieve the significant pressure on the end 2017 balance sheet with a gearing ratio in excess of 76%. Under all the circumstance it is hard to argue with the logic of this transaction.

PBJ estate land bank

	As at 31 Dec 2017
Planted Area (ha)	7,062
Area in Development/Cleared (ha)	5,365
Areas for Conservation / Future Development (ha)	4,386
Total Area (ha)	**16,813**
of which has HGU title (ha)	11,603

Source: REA, Hardman & Co Agribusiness

The conditional purchase and sale agreement price of $85m implies an EV per planted hectare (7,482 hectares planted) at completion of $11,361.

PBJ estate transaction details as announced on 25th April 2018

	$m
Conditional Agreed Price ($m)	**85.0**
Expected Utilisation	
Repayment of bank borrowing by PBJ ($m)	*26.0*
Transaction costs ($m)	*2.0*
Net proceeds to REA Holdings ($m)	*57.0*
Total Utilisation ($m)	***85.0***
Expected Utilisation of Net Proceeds to REA Holdings	
Amount owing by PBJ to REA ($m)	*33.8*
Proceeds to REA Holdings for 95% shareholding in PBJ ($m)	*23.2*
	57.0
EV per planted hectare ($/ha)	**11,361**
Valuation is based on planted hectares at time of completion	7,482

Source: REA, Hardman & Co Agribusiness

In the context of another recent and closely comparable transaction (MP Evans/Bumi Mas Agro), the price achieved is closely aligned. Like the MP Evans acquisition detailed below, PBJ is a young plantation (2.7 years from planting average age), not expected to begin cropping for another 3 years.

MP Evans acquisition of BMA

Company	Acquired estate	Date	Transaction Value ($m)	Land Bank (ha)	Planted Hectare	Valuation per hectare ($/ha)	Avg age of plantation	Further investment required
MP Evans	Bumi Mas Agro	Dec-17	89.2	8,240	7,800	11,436	Young plantation ca. 4 years	Needs mill + infrastructure + improvement in some planted area

Source: MP Evans, Hardman & Co Agribusiness

The transaction value also compares well, indeed very well, with listed market valuations for superior quality assets (see below for sample group of strongly performing Indonesian operators). Assuming another $5,500 per hectare would have been required (approximately) for completion to maturity of the PBJ estate including 60 t/h mill, completed infrastructure and maturity of the planted area, the implied mature price per ha would be $16,861. This is in excess of current sector values. While the traded market in palm oil securities, discounts valuations for the low cycle price of CPO, $11,316 per planted hectare for an immature, and incomplete plantation, looks a very reasonable price.

Sector valuation

Company	Stock Exchange	Adjusted EV/ha ($/ha)	Planted Hectares (ha)	Market Cap ($m)	FFB Yield (mt/ha)	Oil Extraction Rate (%)	FFB Produced (mt)	Gross Margin (%)	EBITDA Margin (%)
Astra Agro	Jakarta	9,057.3	224,617	1,770.8	19.2	20.6%	3,941,618	24.0%	24.5%
DSN Group	Jakarta	7,198.8	69,369	325.2	22.8	0.0%	1,382,000	33.4%	29.9%
Sawit Sumbermas	Jakarta	13,095.0	82,520	897.0	0.0	24.2%	1,231,847	53.2%	44.9%
First Resources	Singapore	12,758.5	179,521	2,022.7	17.5	22.2%	2,682,944	47.4%	45.2%
Golden Agri	Singapore	14,736.2	399,995	3,346.4	20.5	0.0%	7,498,000	14.6%	7.7%
Anglo Eastern	London	5,905.0	66,256	412.0	17.9	20.5%	929,600	25.4%	28.3%
MP Evans	London	14,577.4	33,850	545.9	19.9	23.3%	434,500	31.1%	38.6%
REA Holdings	London	8,457.6	44,007	162.9	15.6	22.8%	530,565	12.9%	20.0%
Weighted Average / Totals		**11,868**	**1,100,135**	**13,056**	**16.9**				

Source: REA, Hardman & Co Agribusiness

Forward view forecasts 2018 – 2020

Production

FFB and CPO Production

	2015	2016	2017	2018E	2019E	2020E
Planted hectare						
Mature	29,571	31,521	34,076	34,043	34,174	35,376
Immature	7,518	11,325	10,018	5,933	8,802	10,600
	37,089	42,846	44,094	39,976	42,976	45,976
Planting in the year	2,236	5,757	1,248	3,000	3,000	3,600
FFB (own) (mt)	600,741	468,371	530,565	650,904	723,878	760,140
FFB (3rd party) (mt)	138,657	98,052	114,005	150,000	160,000	170,000
	739,398	566,423	644,570	800,904	883,878	930,140
FFB yield (mt/ha)	*20.5*	*14.9*	*15.6*	*19.1*	*21.2*	*21.5*
OER (%)	22.2%	22.8%	22.8%	23.0%	23.0%	23.0%
CPO production (mt)	161,844	127,697	143,916	182,821	200,079	212,545

Source: REA, Hardman Agribusiness

- We are anticipating an uplift of nearly 23% in nucleus FFB production in 2018 due to steadily improving infrastructure on the plantations and the necessary harvesting resources in place, and (of course) assuming continuation of normal weather patterns. REAK is targeting a better result still, noting that the palms are evidencing strong productivity so far in this first half year. We will review our forecasts after the end of the first half.
- Our forecasts also include an increase of more than 31% in 3rd party FFB, due to the maturing plasma plantations increasing output, and the steady improvement in palm productivity in the wake of the EL Nino weather pattern of 2015/16.
- After achieving a modest increase in FFB/Ha in 2017, we are looking for a stronger performance to more than 19.0mt/ha in 2018, (for an increase of 22.4%).

P&L

- Readers should note that our forecast for received CPO price is lower in 2018 at $570/mt than in 2017, when the company achieved $592/mt.
  - The Rotterdam CIF price of $669/mt average for the first four months of 2018, compares to an average price $758/mt for the first 4 months of 2017; for the 2017 year the Rotterdam CIF price averaged $718/mt. The weaker price in 2018 can be attributed to a mix of factors including higher crops, strong soya production in the Americas and reduced demand from India due to raised import levies.
- We project an average received price of $700/mt CIF for years 2019 and 2020
- Our P&L forecasts also include an expected $6.5m gain (at pre-tax level) on disposal from the sale of PBJ.
- As a consequence of debt repayment, associated with the PBJ disposal, and additionally boosted by the redemption of £8m sterling notes in 2017, we

anticipate ongoing reductions in financing costs. In 2018 we are projecting costs (as stated in the P&L) to fall to some $14.8m compared with $20.8m in 2017. Actual cash cost of financing is however still expected at $21.1m in 2018, (before any exchange rate impact), which compares with $26.2m (cash outflow) in 2017.

- We are expecting finance costs to reduce further in 2019 and 2020, if and only if, the company manages to switch its Rupiah denominated borrowings to dollar denominated borrowings, which should attract a significantly lower interest rate, which we would expect at around 6% compared with 11% for Rupiah debt.
- We are projecting a 1p dividend on the Ordinary shares in 2020.

Profit & Loss

Year Ended 31st Dec $m	2015 (Restated)	2016	2017	2018E	2019E	2020E
Average CPO price (CIF $/mt)	*614*	*704*	*718*	*685*	*700*	*700*
CPO price achieved ($/mt)	*485*	*521*	*592*	*570*	*585*	*585*
Revenue	**90.5**	**79.3**	**100.2**	**119.9**	**134.4**	**142.4**
Net (loss)/ gain arising from changes in inventory value	-1.1	0.6	-1.1	1.1	0.6	0.4
Cost of production						
Depreciation	-21.7	-21.0	-22.2	-23.2	-23.4	-24.5
Other costs	-61.4	-50.9	-64.1	-72.2	-74.4	-75.7
Gross profit	**6.2**	**8.1**	**12.9**	**25.6**	**37.1**	**42.5**
Gross margin %	6.9%	10.2%	12.9%	21.4%	27.6%	29.9%
Direct cash cost per CPOe($/mt)	*-352*	*-370*	*-411*	*-362*	*-340*	*-326*
Biological assets valuation	0.0	0.0	0.0	0.0	0.0	0.0
Other operating income	0.0	0.0	0.0	0.0	0.0	0.0
Distribution costs	-1.1	-1.1	-1.4	-1.5	-1.7	-1.8
Administrative expenses	-11.7	-12.0	-13.7	-14.7	-14.0	-14.0
Profit on disposal	0.0	0.0	0.0	6.5	0.0	0.0
Operating profit	**-6.6**	**-5.0**	**-2.2**	**15.9**	**21.5**	**26.8**
EBITDA	14.1	16.8	20.7	39.1	44.9	51.3
Investment revenue	0.3	1.7	1.1	0.2	0.1	0.2
Finance costs	-6.0	-6.0	-20.8	-14.8	-11.0	-11.3
Profit before tax	**-12.2**	**-9.3**	**-21.9**	**1.4**	**10.6**	**15.6**
Tax	-0.7	-2.0	-3.0	-2.5	-2.5	-3.9
Profit for the year	**-12.9**	**-11.3**	**-24.9**	**-1.1**	**8.1**	**11.7**
EPS (c)	-59.0	-48.2	-67.0	-23.2	-4.2	3.1
Dividend (p)	0.0	0.0	0.0	0.0	0.0	1.0
Attributable to:						
Ordinary Shareholders	-20.9	-17.8	-27.4	-9.4	-1.7	1.3
Preference Shareholders	8.5	7.4	7.8	8.7	8.7	8.7
Non-controlling interests	-0.5	-0.9	-5.3	-0.5	1.1	1.7
	-12.9	**-11.3**	**-24.9**	**-1.1**	**8.1**	**11.7**

Source: REA, Hardman Agribusiness

Balance Sheet

- Readers will note that the PP&E line reduces in 2018 onwards, this is as a result of the proposed PBJ sale
- 2017 saw an $23.9m cash inflow in working capital largely due to a rise in creditors (+$20m), but also bolstered by reductions in inventory and debtors. We are expecting a reversal of $18.4m in 2018 working capital, largely focused on creditors ($15m).
- Net debt: equity reduces from 76.5% end 2017 to an estimated 66.5% end 2018 with the benefit of the PBJ transaction, before edging up to 73.6% by 2020 as the company presses on with the development of its landbank, for a projected short 46,000 ha planted.

Balance sheet

Year Ended 31st Dec ($m)	2015 (Restated)	2016	2017	2018E	2019E	2020E
NON-CURRENT ASSETS						
Goodwill	12.6	12.6	12.6	12.6	12.6	12.6
Intangible Assets	0.0	4.2	3.5	2.9	1.9	1.0
Property, Plant & Equipment	468.9	471.9	482.3	419.9	423.6	425.9
Prepaid Operating Lease Rentals	34.3	34.2	35.2	33.5	34.5	35.5
Indonesia Stone and Coal Interests	35.3	37.2	37.9	39.4	40.9	41.4
Deferred Tax Assets	15.7	12.8	9.9	9.9	9.9	9.9
Non-Current Receivables	1.4	3.1	5.0	4.0	4.0	4.0
	568.1	576.0	586.3	522.1	527.4	530.2
CURRENT ASSETS						
Inventories	11.2	15.8	11.5	13.8	14.5	15.1
Biological Assets	2.1	2.0	1.9	1.9	1.9	1.9
Investments	2.2	9.9	2.7	2.7	2.7	2.7
Trade & other receivables	29.1	42.6	39.3	40.0	35.4	31.0
Cash & equivalent	15.8	24.6	5.5	7.5	6.7	9.7
	60.3	94.8	61.0	65.9	61.1	60.4
TOTAL ASSETS	**628.4**	**670.9**	**647.3**	**588.1**	**588.5**	**590.6**
CURRENT LIABILITIES						
Trade and other payables	27.0	43.4	62.2	46.8	42.5	39.1
Current Tax Liabilities	3.4	0.3	0.0	-1.5	-2.0	-0.6
Bank Loans	50.9	28.6	28.1	20.8	25.0	27.0
Sterling notes	0.0	10.1	0.0	0.0	0.0	0.0
US dollar notes	0.0	20.0	0.0	0.0	0.0	0.0
Other Loans & Payables	0.1	0.5	10.5	10.5	11.5	5.0
	81.4	103.0	100.8	76.6	77.0	70.5
NON-CURRENT LIABILITIES						
Bank loans	72.0	97.8	97.0	83.2	100.2	108.2
Sterling notes	55.9	37.0	41.4	41.4	41.4	41.4
US dollar notes	33.6	23.6	23.6	23.6	23.6	23.6
Deferred tax liabilities	86.1	80.8	79.6	78.1	77.6	79.0
Other loans & payables	5.6	19.0	28.1	16.9	3.0	5.7
	253.2	258.3	269.7	243.3	245.8	257.9
TOTAL LIABILITIES	**334.6**	**361.3**	**370.6**	**319.9**	**322.8**	**328.4**
TOTAL EQUITY	**293.8**	**309.6**	**276.7**	**268.2**	**265.7**	**262.2**

Source: Company, Hardman Agribusiness

Net indebtedness	2015 R	2016	2017	2018E	2019E	2020E
Total Debt	212.4	229.7	220.0	188.4	199.2	205.4
Cash	15.8	24.6	8.3	10.2	9.4	12.4
Net Debt	196.7	205.1	211.7	178.2	189.8	193.0
Net Debt/Equity	66.9%	66.3%	76.5%	66.5%	71.4%	73.6%

Source: REA Hardman & Co Agribusiness

Cashflow

- The 2018 cashflow will be strongly influenced by the PBJ transaction which is expected to result in some $83m net proceeds, and repayment of c.a. $26m in PBJ associated borrowings.
- The outstanding feature of our projections for 2020 related to the roll-over of some $41m (dependent on exchange rates) of Sterling Notes.

Cashflow

Year Ended 31st Dec ($m)	2015 (Restated)	2016	2017	2018E	2019E	2020E
OPERATING PROFIT	**-6.6**	**-5.0**	**-2.2**	**15.9**	**21.5**	**26.8**
NET CASH FROM OPERATING	**20.1**	**2.6**	**19.7**	**-12.0**	**25.3**	**32.7**
Interest received	0.3	1.7	0.0	0.2	0.1	0.2
Net proceeds from disposal of PP&E	2.5	0.1	-	83.0	-	-
Purchase of PP&E	-32.3	-31.1	-32.0	-26.2	-25.7	-25.3
Expenditure on Biological Assets	-	-	-	-	-	-
Expenditure on prepaid operating lease rentals	-1.3	-0.4	-0.9	-1.0	-1.0	-1.0
Investment in Indonesian stone & coal	-4.0	-1.9	-0.7	-1.5	-1.5	-0.5
CASH FROM INVESTING ACTIVITIES	**-34.8**	**-31.6**	**-33.5**	**54.6**	**-28.1**	**-26.7**
Preference dividends paid	-8.5	-7.4	-7.8	-8.7	-8.7	-8.7
Ordinary dividends paid	-4.2	-	-	-	-	-
Repayment of borrowings	-9.6	-11.0	-6.8	-31.1	-13.8	-
Repayment of borrowings from related party	-	-	-7.4	-10.5	-10.5	-3.8
Proceeds of issue of ordinary shares	6.8	13.0	-	-	-	-
Proceeds of issue of preference shares	7.8	-	10.9	-	-	-
Redemption of US dollar notes	-	-	-20.2	-	-	-
Issuance of Sterling notes, by exchange	39.9	-	-	-	-	-
Redemption of Sterling notes	-39.9	-	-11.2	-	-	-41.4
Proceeds of issue of sterling notes (net of cost)	4.1	1.9	-	-	-	41.0
Purchase of sterling notes	-2.2	-	-	-	-	-
Proceeds of sales of investment	-	-	7.1	-	-	-
Payment on termination of hedging contract	-10.2	-	-	-	-	-
Net Sale and repurchase of US dollar notes	-	-0.1	-	-	-	-
New bank borrowings drawn	30.3	14.9	6.4	10.0	35.0	10.0
Proceeds of sale of shareholding in subsidiary	-	14.0	-	-	-	-
Loans from non-controlling shareholder	-	12.4	24.0	-	-	-
CASH FROM FINANCING	**14.5**	**37.8**	**-4.9**	**-40.3**	**2.0**	**-3.0**
NET INCREASE IN CASH	**-0.3**	**8.9**	**-18.8**	**2.2**	**-0.8**	**3.0**
Cash b/f	16.2	15.8	24.6	5.5	7.5	6.7
Effect of exchange rate	-0.2	0.0	-0.2	-	-	-
CASH BALANCE C/F	**15.8**	**24.6**	**5.7**	**7.8**	**6.7**	**9.7**

Source: REA, Hardman Agribusiness

Valuation

The share price of the REA Ordinaries has responded well to news of the PBJ disposal and the valuation is now in line with sector peers at $12,501 per planted ha, excluding our valuation for the electricity operations and the carrying value for the coal and stone assets. The higher value accorded to MP Evans, recalls that the company has been the focus of a take-over bid by KLK. In this context, readers will note that DSN has not excluded returning to acquire more of REAK.

International palm oil sector EV/Hectare value

Market	EV/planted hectare ($/ha)
Market weighted average	15,062
Market weighted average (ex Wilmar)	12,360
Malaysia market weighted average	16,739
Indonesia market weighted average	7,211
Singapore market weighted average (ex Wilmar)	11,280

Selected company EV/planted hectare valuation

Anglo-Eastern	5,762
DSN Group	7,072
First Resources	12,204
MP Evans	14,687
REA adjusted EV/planted hectare (excl. DSN shares of 15%)	**12,442**
Sawit Sumbermas	11,524
Sipef	12,331

Source: Hardman & Co Agribusiness

Sum of The Parts Valuation

	$m
Hectares planted at 31st Dec 2017 (ha)	44,094
Average per planted hectare EV (Jakarta and Singapore listed ex Wilmar) ($/ha)	9,245
Oil palm operation valuation ($m)	407.6
Electricity generation ($m)	6.9
Coal and stone asset value (as reported in balance sheet) ($m)	37.9
Sum of the parts valuation	**452.5**
Market capitalisation of ordinary share	174.1
Market capitalisation of preference share	107.7
Non-controlling interest at 31st Dec 2017	17.6
Net debt at 31st Dec 2017	211.7
EV	**511.1**

Source: Hardman & Co Agribusiness

Electricity

Our previous DCF valuation for the electricity generating activity was prepared in January 2016. At that time, we were assuming that three additional 1MW (Megawatt) generators would be added in 2018, 2019, and 2020 respectively. In our new DCF calculation (as shown below), we have assumed only two further generators being commissioned, both in 2019/2020 and coming on-stream in 2020/2021. We are assuming a 50% gross margin, with little in the way of additional costs.

DCF Calculation

Estimated EV of electricity generation

	$m	Terminal Growth Rate (%)								
		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
Discount Rate (%)	9.0%	8.2	8.5	8.9	9.3	9.8	10.4	11.1	11.8	12.8
	9.5%	7.6	7.9	8.3	8.6	9.0	9.5	10.1	10.7	11.5
	10.0%	7.1	7.4	7.7	8.0	8.3	8.7	9.2	9.7	10.4
	10.5%	6.7	6.9	7.2	7.4	7.7	8.1	8.5	8.9	9.4
	11.0%	6.3	6.5	6.7	6.9	7.2	7.5	7.8	8.2	8.6
	11.5%	5.9	6.1	6.3	6.5	6.7	7.0	7.3	7.6	7.9
	12.0%	5.6	5.7	5.9	6.1	6.3	6.5	6.7	7.0	7.3
	12.5%	5.2	5.4	5.5	5.7	5.9	6.1	6.3	6.5	6.8
	13.0%	5.0	5.1	5.2	5.4	5.5	5.7	5.9	6.1	6.3

Source: REA, Hardman & Co Agribusiness

Coal & Stone

Balance Sheet Holding Value

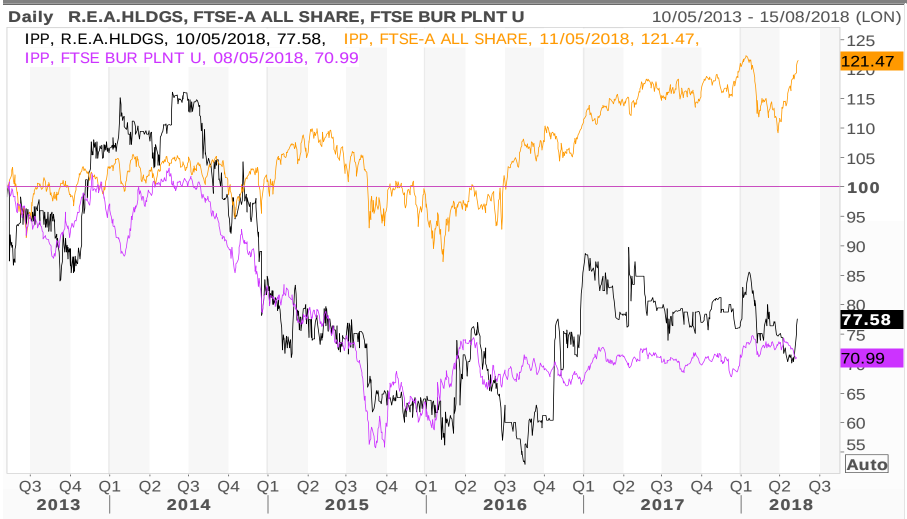
Carrying value for coal and stone in the 2017 Balance sheet is shown as $37.9m.

Share price performance

REA ordinary versus FTSE Bursa Malaysia Asian palm oil plantation index

Against the five-year price chart shown below, the REA share price has tracked relatively closely with the Malaysia Asian Palm Oil Plantation Index, but it has notably weakened during 2018.

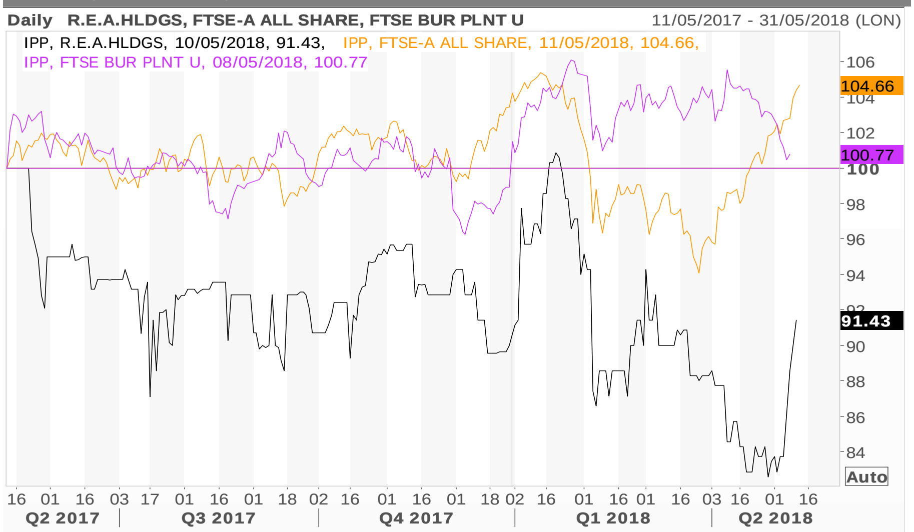
REA 5-year share performance



Source: Eikon Thomson Reuters, Hardman & Co Agribusiness

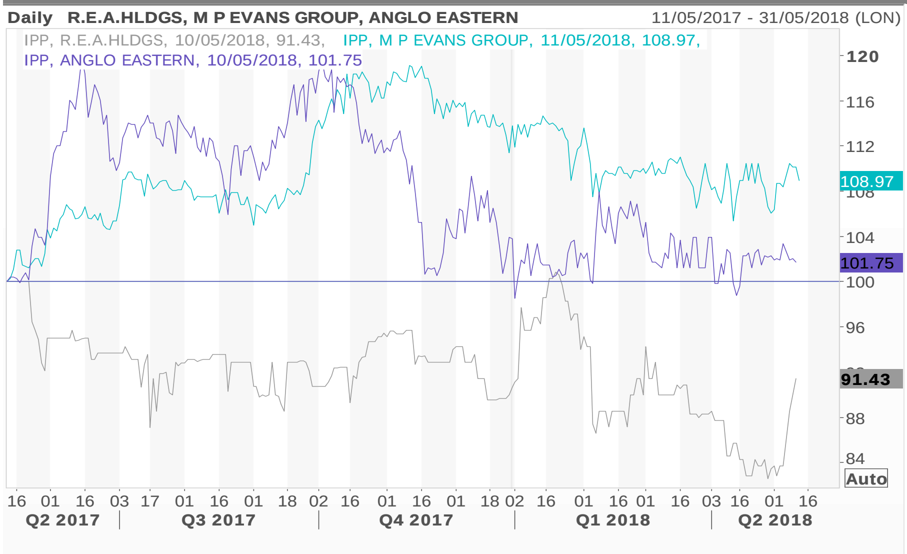
The 2018 share price performance against both the FTSE All Share and the Asian Palm Oil Index, has been notably weak, possibly reflecting concerns about the Balance Sheet. The PBJ transaction should go some way to addressing such concerns.

REA 1-year share performance



Source: Eikon Thomson Reuters, Hardman & Co Research

REA 1-year share performance

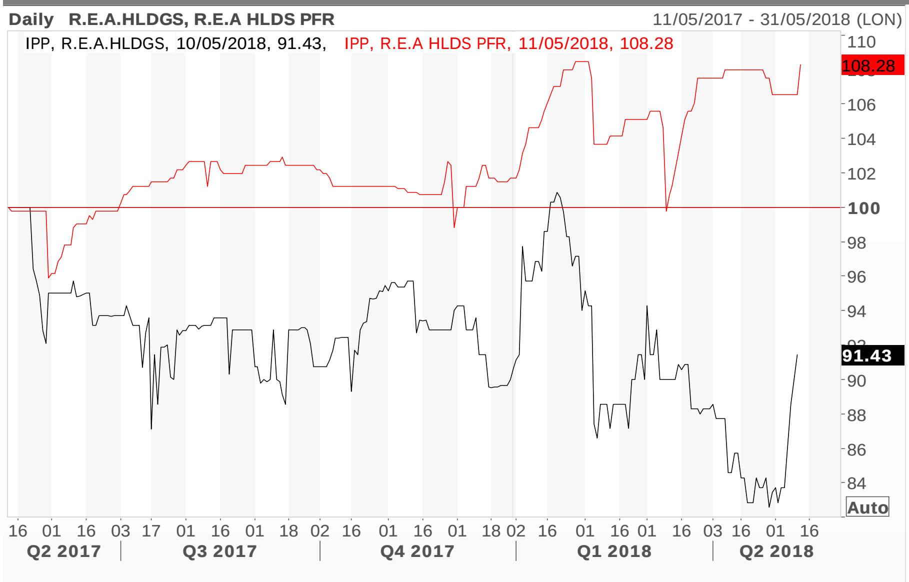


Source: Eikon Thomson Reuters, Hardman & Co Agribusiness

REA cumulative preference capital versus REA ordinary

Not surprisingly, the Pref shares have strongly outperformed the Ordinaries, likely weighed down by concerns about the Balance Sheet. It may also be the case that investors are now happy to benefit from the excellent yield on the Prefs (8.3% gross at £1.08), while speculating that in the event that REA is finally bid for, the Prefs too may be bid for at a premium.

REA ordinary share and preference share 1-year price performance



Source: Eikon Thomson Reuters, Hardman & Co Agribusiness

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