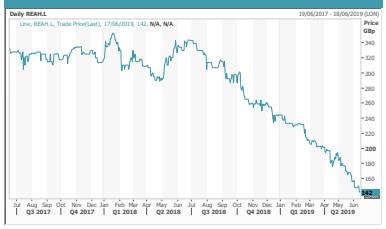
Food Producers



Source: Refinitiv

Market data

EPIC/TKR	**RE.**
Price (p)	**142.0**
12m High (p)	344.0
12m Low (p)	142.0
Shares Ord (m)	40.4
Shares Pref (m)	72.0
Mkt Cap Ord (£m)	57.3
Mkt Cap Pref (£m)	42.8
EV ($m)	331.6
Free Float	30.0%
Market	Main

Description

R.E.A. (REA) 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 that are being contracted out to third-party operators.

Company information

Managing Director	Carol Gysin
Chairman	David Blackett

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Key shareholders

Directors	28.55%
M&G Investment	15.0%
Alcatel Bell Pension Fund	10.3%
Artemis UK	8.8%
Aberforth Partners	7.3%

Diary

Jun'19	AGM
Sep'19	Interim results

Analyst

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R.E.A. HOLDINGS

Strong production continues; deferred 1H pref. dividend

REA's FY'18 results showed a marked recovery in the group's FFB production, up 50.8% YoY, to a record level of 800,050mt; CPO production increased by over 51%, to 217,721mt. However, revenue was up only 5.2%, to $105.5m ($100.2m); crop growth was strong but results were significantly dampened due to commodity prices, with the palm oil price hitting a 10-year low, at $440/mt, in November 2018. The CPO price suffered a 17% drop to an average $596/mt for 2018, and the PKO price plunged 27.2% for the year. With the PBJ transaction completed, REA is focusing on raising production efficiency and planting out the remaining land bank should funding become available.

- **FFB production:** Despite the slightly muted start to 2018, REA's FFB production has recovered to record levels since 2Q'18 – partly due to FFB production pattern recovery, and partly due to REA's much-improved harvesting process and fertiliser regime, started in 2H'16. REA expects FFB production of ca.900,000mt in FY'19; our expectation is slightly lower.

- **PBJ and financing position:** In August 2018, REA closed the sale of its PBJ estate to Malaysian operator KLK for $85m, or ca.$11,333/planted ha. The transaction transformed the group's operation into a more geographically concentrated development project, as well as releasing some balance sheet pressure.

- **Financing:** Management recognises the need to deleverage REA's indebtedness. Net debt, with the sale of PBJ, was $189.5m at end-FY'18, from $211.7m in FY'17. Net debt to equity was 72.5%, down from 76.5% in FY'17. A further reduction in cost of borrowings should help reduce some funding risk.

- **Valuation:** Palm plantation stocks have fallen out of favour with investors in recent years, due largely to weak commodity prices. The Asian Palm Oil Plantation Index fell 12.8% since Jan'18, while the Asian palm plantation sector saw an 18.8% valuation decrease, ending Jun'19 at $10,933/planted ha vs. $13,468/planted ha at end-Dec'17.

- **Investment summary:** For investors attracted by palm oil assets, now could be an opportunistic time to review this sector, with the sector valuation down ca.12.8% since the beginning of 2017. We expect REA to have ca.33,423 mature ha by end-2019, as well as stronger agricultural production across the estates, and the plantations to be fully planted by end-2025.

Financial summary and valuation

Year-end Dec ($m)	2016	2017	2018	2019E	2020E	2021E
Sales	79.3	100.2	105.5	133.4	158.1	167.4
EBITDA	16.8	20.7	12.8	29.4	58.7	66.6
Reported EBIT	-5.0	-2.2	-10.7	4.9	32.9	39.8
Adj. PBT	-18.4	-18.3	-20.3	-13.8	14.5	22.9
EPS (cents)	-48.2	-67.7	-54.4	-53.6	4.4	21.6
DPS (p)	0.0	0.0	0.0	0.0	0.0	0.0
Net (debt)/cash	-205.1	-211.7	-189.6	-227.4	-214.7	-194.9
P/E (x)	-	-	-	-	32.5	6.6
Planted hectare (ha)	42,846	44,094	36,500	36,700	36,700	36,700
Adj. EV/planted ha ($/ha)*	6,709	6,504	7,635	7,498	7,430	7,389
CPO production (mt)	127,697	143,916	217,721	246,847	254,021	269,003

**adjusted EV includes mkt. cap. of the 9% pref. share*
Source: Hardman & Co Research

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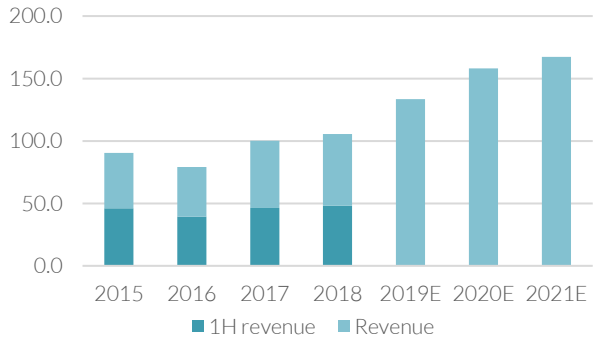
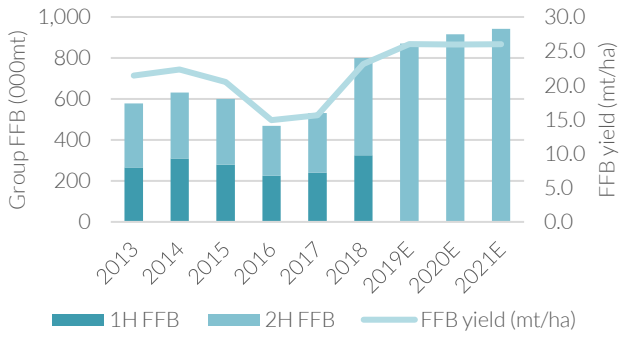
Revenue ($m)



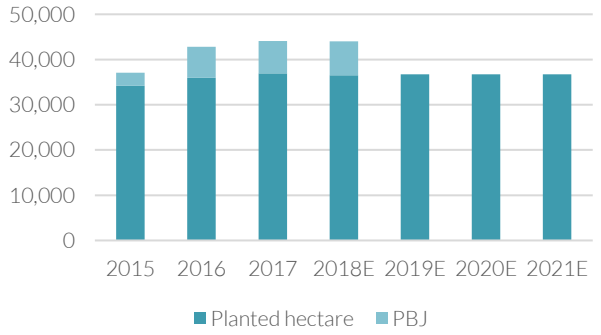
- FY'18 revenue was up by 5.2%, to $105.5m
- The average selling price achieved by the group was $472/mt for FY'18, 20.3% lower than in 1H'17

FFB production (000mt) and FFB yield (mt/ha)



- Significant recovery in FFB harvest, with record crop harvest at more than 800,000mt
- Result of a much-improved harvesting process and fertiliser regime
- Record FFB yield of 23.1mt/ha achieved in FY'18

Planted hectares (ha)



- Planted hectares of 36,500 ha in 2018, following the sale of PBJ
- Approximately 487 ha were planted in PBJ at the end of August 2018, aiming to maximise the sale proceeds
- Some 220 ha were planted in CDM
- REA's proprietary plantations should be completed by 2025, at ca.50,000 ha

CPO price (CIF Rott) ($/mt)

- Commodity prices on palm products have been on a downward trend since the beginning of 2017
- The average CPO price in 2018 was $596/mt, vs. $718/mt in 2017
- CPO CIF hit $440/mt in November 2018 – the lowest price seen in a decade
- From November 2018, the Indonesian government lifted the $50/mt levy on palm oil, when the price was below $570/mt

Source: Company data, MPOB, Hardman & Co Research

2018 full-year results

In REA's 2017 Annual Report, the chairman alluded to "...the beginnings of a much-needed recovery in group operations". The 2018 results demonstrated exactly that: a marked recovery in the production of the group's high-quality palm oil estates in East Kalimantan, after some difficult operating conditions created by the post-El Niño weather conditions in 2015/16. We now have a glimpse of the new management team's efforts in bringing the operations back on track.

Crops

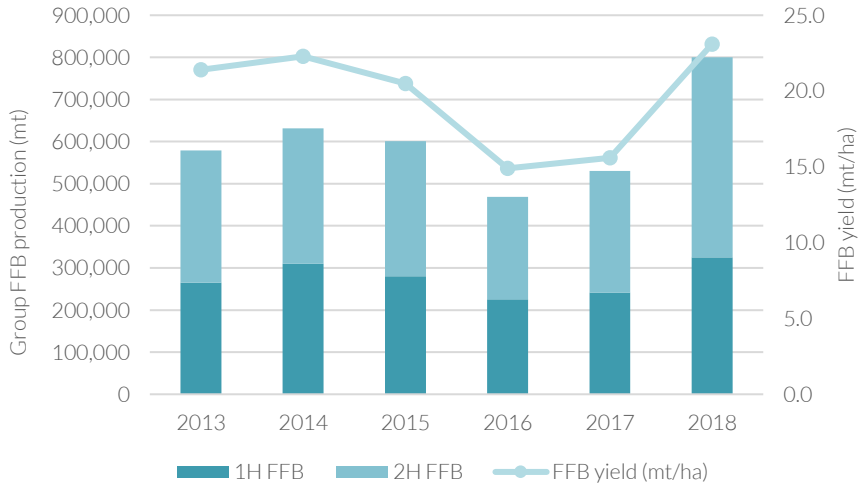
The group's FFB production reported a 50.8% increase from 2017, to a record level of 800,050mt in FY'18 (FY'17: 530,565mt), reflecting the results of the management team's remedial work in 2017/18.

Improved harvesting process and increased fertiliser regime are paying off

During 2016/17, acting on the advice of oil palm agronomists, fertiliser applications across the mature estates were significantly increased. For some years, REA 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 was a factor behind the low-end productivity per ha that had been seen for some years. The group also actively increased the number of harvesters available, and expanded its truck fleet to provide greater capacity for fruit evacuation.

Record level of group FFB production in FY'18

Group FFB production and yield



Source: REA Holdings, Hardman & Co Research

2019 crop outlook

Strong production trend continued into 2019

In its latest trading update released on 5 June 2019, REA confirmed that the strong production trend continued into the start of 2019 across the group's estates, with crop production at 275,000mt to the end of May'19, a 5.8% increase from May'18.

With only ca.130 ha expected to come into maturity in 2019, we have raised our FFB forecast by a further 8.8% for the year, to ca.870,096mt, which equates to 26.0mt of FFB/ha (although this is still lower than the group's internal budget for the year). Readers should bear in mind that the group now has fewer mature hectares forecast for 2019, following the sales of PBJ, and the forecast yield would be among the top operators. REA has stated that it will continue to 'feed' the mature plantations with similar dosages of fertiliser. We expect a further uplift, of 5.2%, in group FFB production, to 915,131mt, for 2020.

Production efficiency

Five-year FFB production					
FFB production	**2014**	**2015**	**2016**	**2017**	**2018**
FFB (group) (mt)	631,728	609,389	468,371	530,565	800,050
FFB (third-party) (mt)	149,002	138,657	98,052	114,005	191,228
Total FFB	**780,730**	**748,046**	**566,423**	**644,570**	**991,278**
FFB yield (mt/ha)	*22.3*	*20.5*	*14.9*	*15.6*	*23.1*
OER (oil extraction rate)	*21.9%*	*22.2%*	*22.8%*	*22.8%*	*22.5%*
CPO production (mt)	169,466	161,844	127,697	143,916	217,721
PKO (mt)	12,596	12,703	9,840	11,052	16,095

Source: REA Holdings, Hardman & Co Research

The two key ratios, when it comes to benchmarking against other plantation operators, are FFB mt/ha and OER (oil extraction rate). The most fundamental indicator of palm oil plantation efficiency is the FFB yield per ha. REA achieved a marked improvement on the FFB yield in FY'18, at 23.1mt/ha – the highest level in the past five years, showing an increase of 48.1% from FY'17. Although this was from a relatively lower base, it nonetheless demonstrated the management team's efforts in bringing the production level back up to the planting material's potential, following a difficult few years, when operational efficiencies were depressed by adverse weather conditions, and the impact of these on estate maintenance, etc.

In the table below, we see that REA's production efficiency compared well with other major Asian palm plantation operators. FFB yields reported from listed Indonesian operators ranged from 15.9mt/ha to 25mt/ha.

REA's FFB yield of 23.1mt/ha compared well with other palm operators in Asia

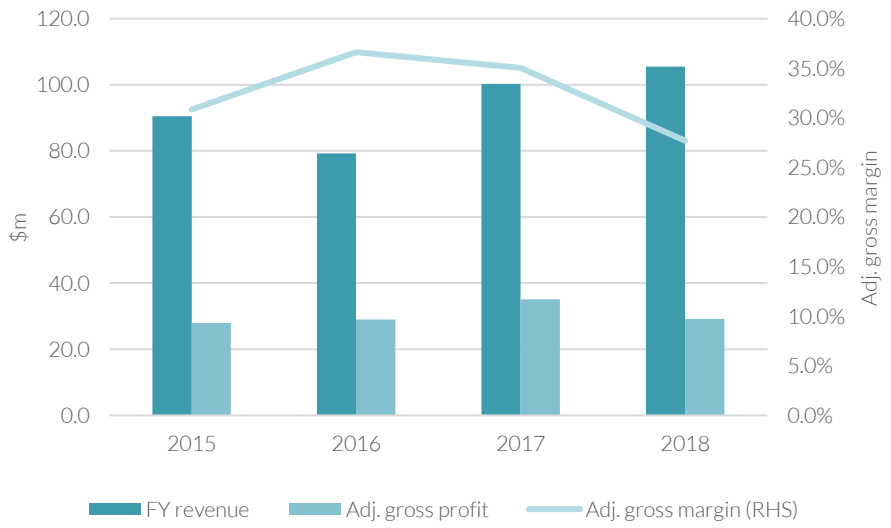
2018 Asian palm operators' production efficiencies			
Company	**Listed country**	**FFB yield (mt/ha)**	**OER**
United Plantations	Malaysia	26.2	21.8%
TSH Resources	Malaysia	25.4	N/A
DSN Group	Jakarta	25.0	23.6%
Sawit Sumbermas	Jakarta	24.4	22.8%
IOI Group	Malaysia	23.6	20.9%
REA Holdings	United Kingdom	23.1	22.5%
Golden Agri	Singapore	22.5	21.9%
ANJ	Jakarta	22.2	21.4%
KLK	Malaysia	21.6	21.8%
Wilmar International	Singapore	21.6	19.9%
Astra Agro	Jakarta	21.4	20.3%
Kwantas Corporation	Malaysia	21.2	20.9%
Sime Darby Plantation	Malaysia	20.5	21.0%
Hap Seng Plantations	Malaysia	20.5	20.6%
Anglo Eastern	United Kingdom	19.3	20.7%
MP Evans	United Kingdom	19.3	23.5%
TH Plantations	Malaysia	18.6	19.9%
Genting Plantations	Malaysia	18.2	21.3%
First Resources	Singapore	18.0	22.9%
IJM Plantations	Malaysia	17.5	21.0%
London Sumatra	Jakarta	17.4	23.0%
Felda Global	Malaysia	16.9	20.5%
Sarawak Oil Palms	Malaysia	16.4	20.5%
Indofood Agri	Singapore	15.9	22.0%
Salim Ivomas	Jakarta	15.9	22.0%
Sarawak Plantation	Malaysia	15.2	20.4%

Source: Hardman & Co Research

Profit & Loss account

- **Revenue:** REA's FY'18 revenue was significantly dampened by the weak CPO prices in the year, mirroring what was reported by other industry players across the globe. FY'18 revenue rose 5.2% to $105.5m (FY'17: $100.2m), despite a 50.8% increase in the group's FFB production.
- **Gross margin:** The gross margin was 5.9%, 7ppts lower than FY'17 (12.9%). On an adjusted basis, i.e. taking out depreciation and amortisation portion in the cost of production, which was implemented based on IAS41, the adjusted gross margin was 27.7% for FY'18 (FY'17: 35%).

Revenue, adjusted gross profit and adjusted gross margin



Source: REA Holdings, Hardman & Co Research

- **Admin expenses:** These appeared to be 14.5% higher than in FY'17 on the P&L; however, they were in fact kept at the same level when taking the capitalised portion into account as well. Following the sale of PBJ, the percentage of capitalisation is lower compared with FY'17, which is calculated based on the percentage of immature hectares.
- **EBIT and EBITDA:** With a depreciation charge of more than $22m, the operating loss for FY'18 was $10.7m. EBITDA was down 38.3% to $12.8m, giving the group an EBITDA margin of 12.1% (FY'17: 20.7%).
- **Profit on disposal:** In the FY'18 results, REA reported a $10.4m profit on disposal, which was significantly different from the $8m loss that was estimated in the February trading update. This was due to two technical adjustments involving the release of deferred tax liabilities and prior-year translation gains relating to PBJ.
- **Finance costs:** The finance cost was $5.4m on the P&L, a significant reduction from FY'17's $20.8m. The group benefited from a $14.8m positive swing in an exchange gain on bank loans and sterling notes, along with some $4.7m being capitalised into PP&E. The capitalised portion was significantly lower in FY'18, following the sale of PBJ (FY'17: $9.1m), which, similar to the capitalisation of admin expenses, is calculated based on the percentage of immature hectares.
- **Tax:** Tax charged to the FY'18 P&L was $12.7m, compared with $3.0m in FY'17, of which $10.6m was related to the calculation method of deferred tax that was associated with the PBJ transaction.

P&L			
Year-end Dec ($m)	2017	2018	change
Revenue	100.2	105.5	+5.2%
Gross profit	12.9	6.2	-51.9%
Adj. gross profit	35.1	29.2	-16.8%
EBITDA	20.7	12.8	-38.3%
Adj. PBT (before forex movement in finance costs)	-18.3	-20.3	-11.3%
Tax	-3.0	-12.7	+319.0%
Loss for the year	-24.9	-18.2	

Source: REA Holdings, Hardman & Co Research

Balance sheet

- Readers will note that the PP&E line reduced from 2018 onwards, as a result of the sale of PBJ.
- 2018 saw an outflow of $21.6m in working capital, including a $13.9m gain in an exchange rate translation. In particular, there was a $25m and $11.6m outflow of inventories and receivables, respectively. The $25m increase in receivables included an adjustment of $7.1m for receivables disposed related to the PBJ transaction. The cash outflow related to inventories was partly because of the much-increased production level in FY'18.

Net debt to equity reduced to 72.5%

- Net debt at the end of 2018 was $189.5m. Net debt to equity reduced from 76.5% to 72.5% at end-2018, following the paying back of borrowings held in PBJ.

Coal and stone interests

Interests in two coal mining concessions and two stone quarrying deposits

REA holds interests in respect of two coal mining concessions, as well as two stone quarrying deposits. Both the coal mining and stone concessions are held by Indonesian concession-holding companies. These companies are currently owned by REA's local partners, and therefore are not consolidated.

The concession-holding companies have been financed by loans provided by REA, on terms such that no dividends or other distributions or payments can be made by REA's local partners, without the prior agreement of REA.

The stone and coal interests are co-ordinated by an Indonesian subsidiary company: PT KCC Resources Indonesia (KCCRI). This company is 95%-owned by a UK subsidiary company of REA's, KCC Resources Ltd. The remaining 5% is owned by local partners in Indonesia.

In 2018, the group had given priority, in terms of capital allocations, to fund the reopening of its coal concession at Kota Bangun, as it believed it would provide a quicker return, with a lower-risk investment among these assets.

Coal interests

REA holds interests in respect of two coal mining concessions:

- Kota Bangun (Central East Kalimantan)
  - The land area within this concession extends to ca.4,400 ha.
  - The inferred coal resources have been assessed at ca.1.7m tonnes.
- Liburdinding (South-east Kalimantan)
  - The land area within this concession extends to ca.1,000 ha.

- The inferred coal resources have been assessed at ca.14.7m tonnes, but the quality of these resources suggests they are unlikely to be commercially utilised in the near term.

Slow-moving project, but progress has been made

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 secure a loading site on the Mahakam River for the coal recovered. The group reported that, in June 2018, it completed the purchase of the coal-loading facilities from the owners of an adjacent mine on the Mahakam River, together with a coal conveyor that crosses the group's concession, terminating at the loading point. Refurbishment of the loading point and conveyor began towards the end of 2018, and is expected to be completed in 2019.

Having secured the loading point to the Mahakam River and a licence to export coal from the Kota Bangun concession, in August, an existing stock pile of some 16,000 tonnes from previous mining operations was sold for ca.$1.5m. De-watering to provide access to Kota Bangun was completed during the year, to provide access to the mine for further drill testing. Options with various contractors to recommence the mining operation are currently under review.

In respect of the second concession at Liburdinding, REA has decided to put it on 'the back burner', as it prioritises the Kota Bangun concession, which the group believes will offer quicker returns, with lower risks.

Stone interests

Stone being delivered to the PBJ estate

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.

In respect of the group's andesite stone concession interest, the group is continuing to have discussions (with a view to a 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

For a long time, as the project has moved towards being fully planted, REA's management has been considering focusing the group's financial resources on the efficiency of development outcomes. PBJ was an outlying asset and will require further significant investment over the next two to three years. The transaction was completed on 31 August 2018. The sale of PBJ not only transformed the group's operations into a geographically concentrated set of plantations, but also released some financial pressure on the balance sheet.

PBJ estate land bank

	Ha
Planted area (as at 31 August 2018)	7,500
Of which: area planted during 2018	487
Area in development/cleared	4,927
Area for conservation/future development	4,386
Total area	**16,813**
Total area that has HGU title	11,603

Source: REA Holdings, Hardman & Co Research

The sale price basis of $85m implied an EV per planted ha (7,500 ha planted) of $11,333.

PBJ estate transaction details and valuation per ha

	$m
Final sale value of underlying assets	**85.0**
of which:	
Repayment of bank borrowing by PBJ	24.7
Net proceeds to REA Holdings	50.0
Ha planted by 31 August 2018	7,500
EV per planted ha ($/ha)	**11,333**

Source: REA Holdings, Hardman & Co Research

Implied EV/planted ha of $11,333

In the context of other recent transactions in oil palm plantations, the transaction prices vary widely across the sector. PBJ is a young plantation (average age is around 2.7 years), and is not expected to begin cropping for another two years.

Recent transaction benchmarks

Company	Acquired estate	Date	Transaction value ($m)	Land bank (ha)	Planted hectares	Valuation per hectare ($/ha)	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 areas
New Britain Palm Oil Limited	Markham Farming Company Limited	Aug'18	63.6	6,110	4,018	15,829	Plantation located close to PNG's largest port + two copra mills with capacity of 55,000 mt p.a.
Boustead Plantations Bhd	Pertama Land and Development	2018	RM750m	11,600		16,160	Planned RM250m (ca.$64m) for infrastructure, 60mt/hr mill (RM92m)
DSN Group	Bima Palma Group	Dec'18	ca.$143.8		17,000	8,461	-

Source: Hardman & Co Research, News articles

Assuming another $5,500 per ha investment required to bring PBJ to maturity, along with a 60mt/hr mill, this implies a price of $16,833 per mature ha. This compares very well with the current sector valuation. While the traded market in palm oil securities is suffering from a low commodity price cycle, the $11,333 per planted ha for an immature and incomplete plantation looks a very reasonable price (see below for a sample group of Indonesian operators).

Global palm sector valuation

Company	Listed country	Adjusted EV/planted ha ($/ha) as of 3 June	as of Dec'18	as of Dec'17
Wilmar International	Singapore	49,459	48,098	48,747
IOI Group	Malaysia	26,108	26,836	38,766
United Plantations	Malaysia	23,572	22,791	24,054
Sime Darby Plantation	Malaysia	15,414	15,686	19,578
Genting Plantations	Malaysia	14,774	14,294	13,592
MP Evans	United Kingdom	14,583	14,616	15,611
KLK	Malaysia	14,312	14,526	17,826
TSH Resources	Malaysia	13,374	13,867	19,707
Sawit Sumbermas	Jakarta	13,126	15,040	14,988
Golden Agri	Singapore	13,031	12,483	15,250
Bakrie Sumatera	Jakarta	12,371	12,390	9,726
First Resources	Singapore	12,276	12,226	13,830
Sipef	Euronext	8,743	9,336	13,030
REA Holdings	United Kingdom	8,337	10,119	10,590
Astra Agro	Jakarta	8,081	8,782	9,483
TH Plantations	Malaysia	8,081	7,905	10,324
Hap Seng Plantations	Malaysia	7,222	8,087	13,043
IJM Plantations	Malaysia	7,190	6,915	11,929
Kwantas Corporation	Malaysia	7,050	7,526	10,997
ANJ	Jakarta	6,863	7,891	7,261
Felda Global	Malaysia	6,542	5,840	7,472
DSN Group	Jakarta	6,451	6,682	7,386
Sampoerna Agro	Jakarta	6,330	6,425	6,476
Indofood Agri	Singapore	6,220	5,670	6,249
Sarawak Oil Palms	Malaysia	5,615	5,261	8,711
Salim Ivomas	Jakarta	4,381	4,914	5,368
London Sumatra	Jakarta	4,080	4,492	5,665
Anglo Eastern	United Kingdom	3,507	4,247	6,002
Sarawak Plantation	Malaysia	3,423	3,487	3,650
Weighted avg.		13,143	13,147	15,564
Weighted avg. (ex Wilmar)		10,933	11,021	13,468
Weighted avg.	Malaysia	13,304	13,303	17,004
Weighted avg.	Jakarta	6,839	7,442	7,907
Weighted avg. (ex Wilmar)	Singapore	10,793	10,353	12,247

Source: Hardman & Co Research

Jakarta-listed companies are trading at big discount on average to operators listed in Malaysia and Singapore.

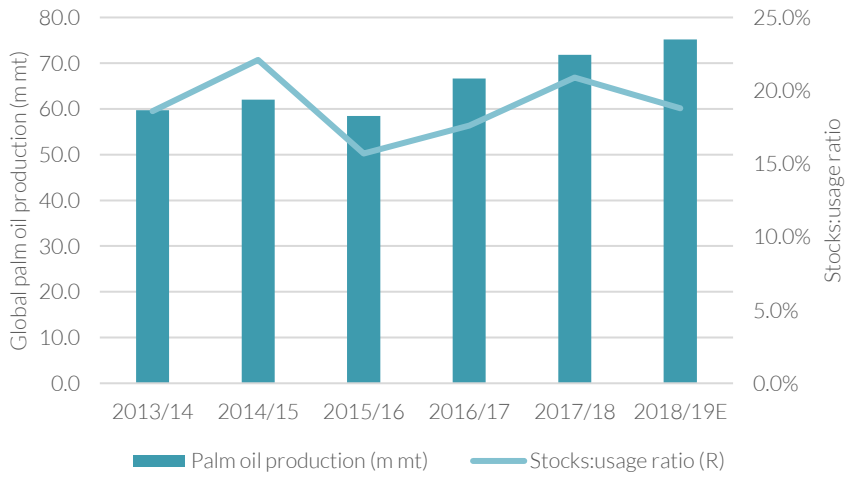
Palm oil market

2018 was a turbulent year for international trade. We have seen the push for a trade war with China, initiated by US president Donald Trump. This will inevitably hurt both sides of the trade. It has certainly hurt the American soy farmers, particularly by effectively banning imports of US soybeans by China. US soybean exports to China for the last four months of 2018 fell to virtually zero, at ca.0.38m mt, a 98% drop (20.5m mt) from 4Q'17. To the end of April 2019, accumulated 2018/19 US soybean exports to China were at only 5.9m mt, more than 20m mt lower than in the previous year. The soybean oil price reached its lowest point in December 2018, averaging $729/mt for the month. For US soybean, according to *Oil World*, stocks:usage is expected to rise to 24.5% for the 2018/19 season, from 10.2% in 2017/18. Globally, soybean stocks:usage is also expected to increase in 2018/19, to 31.6%, from 27.4%, following the failed trade negotiations at the beginning of May, which led to raised US tariffs on $200bn-worth of imports from China to 25% (from 10% previously).

As for palm oil, there was ample global production in 2018, particularly from the strong growth from Indonesia, which showed a 3.4m mt increase (or a 9.2% increase YoY). 2018 global production reached ca.71.8m mt, a 7.8% increase from 66.6m mt. Stocks:usage for 2018 was 20.9%, up from 17.8% in the 2016/17 season, and is then expected to fall back to 18.8% in 2019, due to a further increase in consumption, according to *Oil World*. Growth in domestic consumption from Indonesia is expected to increase by 26%, due to biodiesel production.

Stocks:usage for global palm oil, after rising in 2017/18, is expected to fall back in 2018/19

Global palm oil production and stocks:usage ratio



Source: Oil World

Commodity prices

Significant decline in palm oil price during 2018

There was a significant decline in the palm oil price during 2018, with the CPO price starting the year at $677.5/mt CIF, and hitting as low as $440/mt in November 2018 – the lowest level in the past 10-year period. In March 2018, the Indian government decided to increase the import tax on CPO and refined palm oil to 44% (from 30%) and 54% (from 40%), respectively, as a measure to support local farmers. Combined with a weak Indian Rupee, palm oil imports were down 0.68m mt (or 7.3%) YoY in the world's largest palm oil importing country. However, at the beginning of January 2019, the Indian government decided to cut the import tax slightly, to 40% and 50%, respectively, and to 45% for Malaysian imports.

Although we have seen a small rebound in the palm oil price in recent months, with 1Q averaging $538/mt CIF, for some newer established plantations, this price level could possibly be just breaking even at the farm gate level.

Indonesian government reduced levy in hope to help palm oil prices

On 26 November 2018, the Indonesian government announced that it would temporarily remove the $50/mt export levy on palm oil and levies of palm-derived products when the price of palm oil falls below $570/mt, in the hope of reducing the impact of the recent plunge in commodity prices. The charge will kick in at $10-25/mt once prices are in a range of $570-$619/mt, and then rise to $20-50/mt when prices are above $619/mt.

10-year palm oil price (CIF Rott, $/mt)

Source: MPOB, Hardman & Co Research

Looking to 2019, *Oil World* is expecting the world consumption of palm oil to increase significantly, by 6.7m mt in the October/September 2018/19 season, to 75.2m mt. A significant portion of this increase is expected come from sizeable growth the Indonesian energy sector.

On 23 August 2018, the Indonesian government issued a regulation expanding the use of biodiesel to the non-Public Sector Obligation (non-PSO) for transport use. According to USDA, biodiesel use in the non-PSO sector will boost the use of palm oil feedstock to 2.5m mt in 2019, a 189% increase from the 2018 estimate. This may help to provide some upward pressure on the CPO price for 2019. So far, we have seen an average $100/mt price recovery from the lowest point in November 2018.

Palm oil price (CIF Rott, $/mt)

Small price recovery since the low point in November 2018

Source: MPOB, Hardman & Co Research

Forecasts

Land bank

REA has a land bank of more than 82,000 ha in East Kalimantan, Indonesia, following the sale of PBJ, of which 36,500 ha were planted at the end of December 2018. With such a land bank, REA's management team is targeting to develop (plant out) a total of 50,000 ha by the end of 2025, subject to funding availability and commodity prices.

REA land bank

	REAK	CDM	KMS	PU	SYB	KKS1	PBJ2	Total
Fully titled land (ha)	30,106	9,784	7,321	9,097	8,217	-		64,525
Land held subject to titling (ha)		5,454	1,964			5,150	5,269	17,837
REA land bank (ha)								82,362
Of which planted (ha)								36,500
Planted area at end of 2017*								44,094
PBJ (planted ha as of 31 Aug 2018)								-7,500
New planted area during 2018 (incl. PBJ)*								656
Transferred to co-operatives								-750
Estimated planted area at end-2018								36,500
Target planted area by 2025								50,000

** includes area from the sold PBJ estate*
Source: REA Holdings

Production

A record level of group FFB was reported in the FY'18 results, with a total of 800,050mt of FFB, an increase of 50.8% from FY'17 (530,565mt). The management team's efforts to ensure that an adequate level of harvesting resources is in place and that improvements are being made in various areas of infrastructure are paying off. The FFB/ha yield, as a result, is approximately 23.1mt/ha for the year – the highest FFB yield level we have seen since 2012.

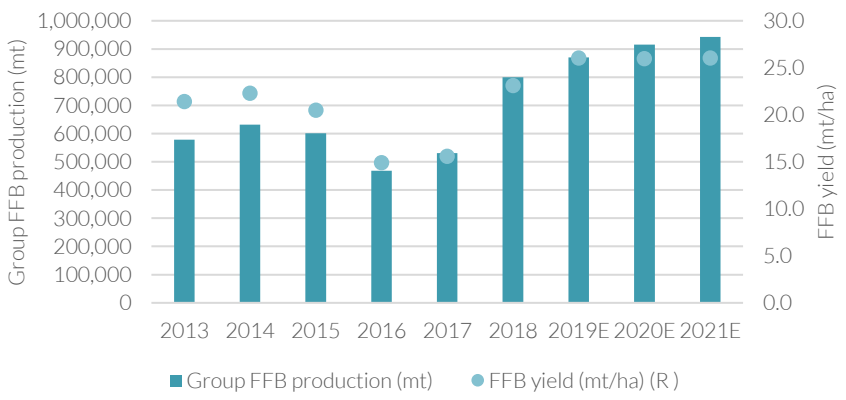
REA's management team is confident that the group will be able to achieve an even better FFB harvest for 2019, and the bunch censor has been working extremely well in informing the management team in 'real-time'. Management continues to see a rise in yield from the increased fertiliser regime, which started in 2H'16. We are estimating an uplift of 8.8% in group FFB production, to 870,096mt, in 2019, giving an FFB yield of 26.0mt/ha. However, REA management is aiming for an even better production level: in the 2018 annual report, the company stated that it was targeting ca.900,000mt of FFB for 2019, implying an FFB/ha of ca.26.9mt/ha.

REA is targeting 900,000mt of FFB for FY'19, implying an FFB yield of 26.9mt/ha

Third-party FFB for FY'18 was at a record level of 191,228mt, an increase of 67.7% from the previous year, due to the maturing plasma plantations' increasing output and the strong recovery in productivity from the El Niño weather pattern in 2015/16. Our forecasts include a small increase of 5.2% of third-party FFB, to approximately 201,000mt for FY'19.

Planting programme for the coming years has been put on hold given current commodity prices and the group's funding availability.

Nucleus FFB production and yield



Source: REA Holdings, Hardman & Co Research

FFB production and CPO production

	2015	2016	2017	2018	2019E	2020E	2021E
Planted ha							
Mature	29,367	31,521	34,076	33,292	33,423	35,225	36,225
Immature	7,730	11,325	10,018	3,208	3,277	1,475	475
Total planted ha	**37,097**	**42,846**	**44,094**	**36,500**	**36,700**	**36,700**	**36,700**
Planting in the year	2,251	5,758	1,248	275	0	0	0
FFB production							
FFB (group) (mt)	609,389	468,371	530,565	800,050	870,096	915,131	942,594
FFB (third-party) (mt)	139,276	98,052	114,005	191,228	201,228	211,228	221,228
Total FFB	**748,665**	**566,423**	**644,570**	**991,278**	**1,071,324**	**1,126,359**	**1,163,822**
FFB yield (mt/ha)	*20.8*	*14.9*	*15.6*	*23.1*	*26.0*	*26.0*	*26.0*
OER	22.3%	22.8%	22.8%	22.5%	23.0%	23.0%	23.0%
CPO production (mt)	**163,880**	**127,697**	**143,916**	**217,721**	**246,847**	**254,021**	**269,003**

Source: REA Holdings, Hardman & Co Research

Profit & Loss

We project an average price for CPO of $540/mt CIF for the year, with the group's received price at $480/mt. The Rotterdam CIF price of $536/mt average for the first four months of 2019 compares with an average price of $669/mt for the same period of 2018. We are expecting the CPO price to recover further in 2020 and 2021, to $650/mt CIF. A marginal increase in received commodity prices and a further improvement in production imply 26.4% growth in revenue for FY'19, to ca.$133.4m, with a gross margin of 17.2%.

We are expecting a small reduction in finance costs in FY'19, to ca.$19.4m, before taking exchange rate value fluctuations into account (FY'18: $20.8m). The group's borrowing costs should reduce further, if, and only if, the group manages to switch its Rupiah-denominated borrowings to dollar-denominated borrowings, which should attract a significantly lower interest rate.

Management is also in the process of cost reduction and improving cost efficiencies. Following the sale of PBJ and the now more concentrated estate, REA can reduce some estate operation costs and from a gradual reduction of temporary workers that were employed for remedial upkeep work. REA has also initiated closure of the regional office in Singapore recently, and this is expected to complete before the end of 2019. The full effect of cost reduction should come through in FY'20. As a result, we should see a much-improved gross margin from 2020. REA is aiming to become

operating cashflow positive with the implementation of various cost reduction measures.

Profit & Loss

Year-end Dec ($m)	2016	2017	2018	2019E	2020E	2021E
Average CPO price (CIF $/mt)	704	718	596	540	650	650
Achieved CPO price ($/mt)	521	592	472	460	555	555
Revenue	**79.3**	**100.2**	**105.5**	**133.4**	**158.1**	**167.4**
Growth rate	-12.4%	26.5%	5.2%	26.4%	18.6%	5.9%
Net (loss)/gain arising from changes in inventory value	0.6	-1.1	0.3	-0.1	0.0	0.0
Depreciation and amortisation	-21.0	-22.2	-23.0	-24.5	-25.8	-26.8
Other costs	-50.9	-64.1	-76.6	-85.8	-83.6	-84.5
Gross profit	**8.1**	**12.9**	**6.2**	**23.0**	**48.7**	**56.1**
Gross margin	10.2%	12.9%	5.9%	17.2%	30.8%	33.5%
Other operating income	0.0	0.0	0.0	0.0	0.0	0.0
Distribution costs	-1.1	-1.4	-1.3	-2.1	-2.2	-2.3
Administrative expenses	-12.0	-13.7	-15.7	-15.9	-13.6	-14.0
Operating profit	**-5.0**	**-2.2**	**-10.7**	**4.9**	**32.9**	**39.8**
EBITDA	**16.8**	**20.7**	**12.8**	**29.4**	**58.7**	**66.6**
Profit on disposal	0.0	0.0	10.4	0.0	0.0	0.0
Investment revenue	1.7	1.1	0.3	0.7	0.5	0.7
Finance costs	-6.0	-20.8	-5.4	-19.5	-18.9	-17.5
PBT	**-9.3**	**-21.9**	**-5.5**	**-13.8**	**14.5**	**22.9**
Adj. PBT (excl. exchange rate fluctuations from finance costs)	-18.4	-18.3	-20.3	-13.8	14.5	22.9
Tax	-2.0	-3.0	-12.7	-2.5	-2.6	-2.7
Loss for the year	**-11.3**	**-24.9**	**-18.2**	**-16.3**	**11.9**	**20.2**
EPS (c)	-48.2	-67.7	-54.4	-53.6	4.4	21.6
DPS (p)	0.0	0.0	0.0	0.0	0.0	0.0
Attributable to:						
Ordinary shareholders	-17.8	-27.4	-22.0	-21.6	1.8	8.7
Preference shareholders	7.4	7.8	8.4	8.4	8.4	8.4
Non-controlling interests	-0.9	-5.3	-4.5	-3.1	1.7	3.1

Source: REA Holdings, Hardman & Co Research

Finance costs

Year-end Dec ($m)	2016	2017	2018	2019E	2020E	2021E
Bank loans	-12.6	-15.7	-15.5	-15.6	-14.8	-13.6
Sterling notes	-5.2	-5.2	-4.1	-3.9	-3.9	-4.0
US dollar notes	-2.9	-2.7	-1.9	-1.8	-1.8	-1.8
Loans from related parties	-0.3	-1.9	-2.5	-2.0	-2.0	-1.4
Other financial costs	-0.3	-0.8	-1.0	-1.0	-1.0	-1.0
Exchange rate benefit (loss)	9.1	-3.6	14.8	0.0	0.0	0.0
	-12.1	**-29.8**	**-10.2**	**-24.4**	**-23.6**	**-21.9**
% of interest to be capitalised	22.0%	23.5%	15.9%	20.0%	20.0%	20.0%
Capitalised interest costs	-6.1	-9.1	-4.8	-4.9	-4.7	-4.4
Interest costs in the P&L	**-6.0**	**-20.8**	**-5.4**	**-19.5**	**-18.9**	**-17.5**

Source: REA Holdings, Hardman & Co Research

Balance sheet

Net debt to equity reduced from 76.5% at end-2017 to 72.5% at end-2018, following the paying back of borrowings held in PBJ. With further borrowings planned for the expansion of the mill in Satria, we expect REA to end 2019 with net debt to equity of 96.4%.

Balance sheet						
@ 31 Dec ($m)	2016	2017	2018	2019E	2020E	2021E
Non-current assets						
Goodwill	12.6	12.6	12.6	12.6	12.6	12.6
Intangible assets	4.2	3.5	2.6	1.7	0.9	0.0
Property, plant and equipment	471.9	482.3	407.2	412.0	402.9	391.5
Land titles	34.2	35.2	35.9	36.2	36.5	36.8
Stone and coal interests	37.2	37.9	46.0	49.5	52.0	53.5
Deferred tax assets	12.8	9.9	10.1	10.1	10.1	10.1
Non-current receivables	3.1	5.0	7.5	8.0	8.0	8.0
Total non-current assets	**576.0**	**586.3**	**521.9**	**530.1**	**522.9**	**512.5**
Current assets						
Inventories	15.8	11.5	22.6	23.5	22.9	23.2
Biological assets	2.0	1.9	2.6	2.6	2.6	2.6
Investments	9.9	2.7	0.0	0.0	0.0	0.0
Trade and other receivables	42.6	39.3	50.7	48.2	48.5	51.4
Cash and cash equivalents	24.6	5.5	26.3	16.8	22.9	32.2
Total current assets	**94.8**	**61.0**	**102.2**	**91.2**	**96.9**	**109.3**
Total assets	**670.9**	**647.3**	**624.1**	**621.3**	**619.8**	**621.8**
Current liabilities						
Trade and other payables	-43.4	-62.2	-59.8	-57.6	-55.0	-55.6
Current tax liabilities	-0.3	0.0	0.0	0.0	0.0	0.0
Bank loans	-28.6	-28.1	-14.0	0.0	0.0	0.0
Sterling notes	-10.1	0.0	0.0	-38.2	0.0	0.0
US dollar notes	-20.0	0.0	0.0	0.0	0.0	-23.7
Other loans and payables	-0.5	-10.5	-0.7	-4.2	-10.5	-4.2
Total current liabilities	**-103.0**	**-100.8**	**-74.5**	**-100.0**	**-65.5**	**-83.4**
Non-current liabilities						
Bank loans	-97.8	-97.0	-117.0	-151.0	-151.0	-151.0
Sterling notes	-37.0	-41.4	-38.2	0.0	-40.0	-40.0
US dollar notes	-23.6	-23.6	-23.7	-23.7	-23.7	0.0
Deferred tax liabilities	-80.8	-79.6	-79.2	-80.0	-80.0	-80.0
Other loans and payables	-19.0	-28.1	-30.1	-30.9	-20.5	-16.3
Total non-current liabilities	**-258.3**	**-269.7**	**-288.3**	**-285.6**	**-315.1**	**-287.3**
Total liabilities	**-361.3**	**-370.6**	**-362.8**	**-385.7**	**-380.6**	**-370.7**
Equity	**309.5**	**276.7**	**261.3**	**235.7**	**239.2**	**251.1**

Source: REA Holdings, Hardman & Co Research

Net debt to equity ratio is expected to reduce with increased cash position

Net indebtedness						
	2016	2017	2018	2019E	2020E	2021E
Net debt ($m)	205.1	211.7	189.5	227.1	214.4	194.6
Net debt/equity	66.3%	76.5%	72.5%	96.4%	89.6%	77.5%

Source: REA Holdings, Hardman & Co Research

Cashflow

Capex on PP&E for FY'20 and FY'21 is significantly reduced with the pending planting programme. If the improvement of production and cost efficiency as well as the reduction in finance costs are successfully achieved, REA is set to end FY'20 and FY'21 with a cash pile that management can decide whether to utilise for its planting programme or to pay down its borrowings.

1H'19 preference shares dividend to be deferred

In the June 2019 trading update, REA announced the group's decision to defer its half-year payment of dividend on the group's preference shares due on 30 June 2019, in order to conserve cash in case of any further negative impact from current commodity prices. Without more information, we are assuming only the half-year dividend will be deferred.

Cashflow

Year-end Dec ($m)	2016	2017	2018	2019E	2020E	2021E
Operating profit/(loss)	**-5.0**	**-2.2**	**-10.7**	**4.9**	**32.9**	**39.8**
Of which:						
Change in working capital	9.2	23.9	-21.6	-0.6	-2.4	-2.5
Tax paid	-2.3	-6.6	-1.8	-3.0	-2.5	-2.6
Interest paid	-20.7	-24.9	-25.0	-24.4	-23.6	-21.9
Net cash from operating activities	**2.6**	**19.7**	**-26.9**	**1.5**	**30.3**	**39.6**
Investing activities						
Interest received	1.7	0.0	0.1	0.7	0.5	0.6
Net proceeds from disposal of PP&E	0.1	0.0	0.0	0.0	0.0	0.0
Net proceeds from disposal of assets	0.0	0.0	2.8	0.0	0.0	0.0
Purchase of PP&E	-31.1	-32.0	-23.8	-22.9	-10.3	-9.6
Purchase of intangible assets	0.0	-0.1	0.0	0.0	0.0	0.0
Expenditure on land titles	-0.4	-0.9	-1.0	-1.0	-1.0	-1.0
Investment in stone and coal interests	-1.9	-0.7	-5.6	-3.5	-2.5	-1.5
Net cash used in investing activities	**-31.6**	**-33.7**	**-27.5**	**-26.7**	**-13.4**	**-11.5**
Financing activities						
Preference dividends paid	-7.4	-7.8	-8.4	-4.2	-12.6	-8.4
Ordinary dividends paid	0.0	0.0	0.0	0.0	0.0	0.0
Repayment of borrowings	-11.0	-6.8	-105.8	0.0	0.0	0.0
Repayment of borrowings from related parties	0.0	-7.4	-19.9	0.0	0.0	-10.5
Net proceeds of issue of ordinary shares	13.0	0.0	0.0	0.0	0.0	0.0
Net proceeds of issue of preference shares	0.0	10.9	0.0	0.0	0.0	0.0
Net proceeds of issue of dollar notes	-0.1	0.0	0.0	0.0	0.0	0.0
Redemption of dollar notes	0.0	-20.2	0.0	0.0	0.0	0.0
Redemption of sterling notes	0.0	-11.2	0.0	0.0	-38.2	0.0
Net proceeds of issue/sales of sterling notes	1.9	0.0	0.0	0.0	40.0	0.0
Purchase of sterling notes	0.0	0.0	-1.3	0.0	0.0	0.0
Proceeds of sale of investments	0.0	7.1	2.7	0.0	0.0	0.0
Proceeds of sale of shareholding in subsidiary	14.0	0.0	0.0	0.0	0.0	0.0
New borrowings from non-controlling shareholders and related parties	12.4	24.0	13.4	0.0	0.0	0.0
New bank borrowings drawn	14.9	6.4	119.8	20.0	0.0	0.0
Repayment of balances from divested subsidiary	0.0	0.0	50.0	0.0	0.0	0.0
Settlement of bank loan by purchaser of subsidiary	0.0	0.0	24.7	0.0	0.0	0.0
Net cash used in financing activities	**37.8**	**-4.9**	**75.5**	**15.8**	**-6.6**	**-18.9**
Net increase in cash	**8.9**	**-18.9**	**21.1**	**-9.4**	**6.1**	**9.3**
Cash b/f	15.8	24.6	5.5	26.3	16.8	22.9
Effect of exchange rate	0.0	-0.2	-0.3	0.0	0.0	0.0
Cash balance c/f	**24.6**	**5.5**	**26.3**	**16.8**	**22.9**	**32.2**

Source: REA Holdings, Hardman & Co Research

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