7th December 2016

R.E.A. Holdings

At a 19% discount to Indonesian sector peers

Food Producers

Source: Eikon Thomson Reuters

Market data

EPIC/TKR	RE.
Price (p)	302.0
12m High (p)	340.0
12m Low (p)	232.0
Shares Ord (m)	36.8
Shares Prefs (m)	63.6
Mkt Cap Ord (£m)	111.13
Mkt Cap Prefs (£m)	57.24
EV ($m)	392.2
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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R.E.A. Holdings plc ("REA") announced the completion of the acquisition by PT Dharma Satya Nusantara Tbk ("DSN") of a 15% shareholding in PT REA Kaltim Plantations ("REAK"), on Friday, 2nd December. The agreements between the group and DSN, received regulatory approval and were completed on 2 December 2016. As a result, subsidiaries of DSN have acquired, by a combination of subscription for new shares and acquisition of existing shares, a 15% equity interest in REAK. 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).

- **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 in Indonesia.
- **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:** With the DSN agreement now completed, it looks anomalous that REA is trading some 19% below the Jakarta sector weighted average EV/planted ha metric of $11,096.
- **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 dash 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 on a par with the $9,000 / ha cost of development.

Financial summary and valuation

Year end Dec ($m)	2013	2014	2015 (Restated)	2016E	2017E
Sales	111	126	91	88	124
EBITDA	39	43	15	19	41
Reported EBIT	27	32	-4	0	21
Pre-tax Profit	25	24	-9	-10	7
EPS (cents)	16	40	-53	-40	-10
Dividend per share (p)	7.25	7.75	0.00	0.00	4.00
Net (debt)/cash	-164.4	-179.2	-196.7	-206.0	-209.9
P/E (x)	28.6	11.2	-	-	-
Planted Hectares (ha)	33,830	34,614	37,097	43,097	47,097
EV/Planted Hectare ($/ha) *	13,281	12,980	10,719	9,019	8,327
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

Table of Contents

DSN Acquisition of 15% holding in REA Kaltim completed

$15m Cash, Plus Debt Capital

The overall consideration payable for the interest acquired amounts to the equivalent of $15 million in cash, with up to a further $850,000 payable depending upon the recovery by REAK of certain overpaid tax amounts prior to 1 January 2018. Concurrently with this acquisition, a subsidiary of DSN has also provided dollar and sterling loans to REAK of, respectively, $10 million and £3.9 million on terms mirroring the terms of existing dollar and sterling loans from the company to REAK. Discussions are continuing between the group and DSN regarding further proposed loans by subsidiaries of DSN to subsidiaries of REAK.

Temporary advances previously made by subsidiaries of DSN to REAK pending completion of the agreements between DSN and the group have been repaid now, with repayment effected by set off against the amounts that became payable by subsidiaries of DSN to REAK by way of subscription of shares and provision of loans pursuant to such agreements.

Sector Valuations

The combination of a firmer commodity price ($770/mt CIF Rotterdam) and the KLK bid for MP Evans Group Plc, has seen Asian sector valuations rise from 2016 lows. The revised offer for MP Evans by KLK of £7.40 per share, (15th November) suggests a valuation per planted hectare (net of estimated $73m of cash on the balance sheet and a valuation of some $51m for the Malaysian property interests) of circa $11,650.

This contrasts with the valuation for REAK's plantations, implied by the May 2016 agreement between REA and DSN, for the purchase of a 15% stake in REAK: the implied enterprise value per planted hectare was estimated by Hardman Agribusiness (based on 39,600 ha planted at time of agreement) at some $9,750/ha. Our sense for M&A activity within the Indonesian sector suggested that, prior to the KLK bid for MP Evans, transactions were being negotiated, typically, in the range of $10,000-$12,000 per planted ha. With most of this activity, privately conducted, the public nature of the KLK / MP Evans bid, has provided a new set of references for M&A negotiations. At the £7.40 per share KLK offer for MP Evans, 15th November, the implied valuation of MP Evans' planted hectares, adjusted for estimated net cash on the balance sheet, and the value of the company's Malaysian property interests, out turns at $11,650. More recently: 6th December, 2016, MP Evans has announced the agreement (conditional on shareholder approval) to sell its 36.84% interest in Agro Muko, to joint venture partner SIPEF, for the equivalent of $13,860 per planted ha. This transaction provides a very credible new reference price for sector M&A activity.

MP Evans has sought to focus the valuation debate on the quality of its estates, their high productivity and their youth (average age 7.9 years). An independent professional valuation by Khong & Jaafar SDN BHD (21st November 2016), attributed a valuation of $21,500 per planted ha to MP Evans, East Kalimantan estate with 10,250 ha planted (complete with modern mill). This a very relevant indicator for REA Kaltim's East Kalimantan estates, which like MP Evans', record productivity performances within the top quartile for the region.

REAK Valuation

With the DSN agreement now completed, 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 19% below the Jakarta listed producer sector weighted average EV/planted ha metric (see table below). The recently announced price for the Agro Muko estates provides a sector reference price which is now higher at $13,860 / planted ha, against which, REA's estates are trading at a discount of 35%. The Agro Muko transaction provides strong validation for the 21st November valuations provided by Khong & Jaafar SDN BHD (it valued Agro Muko at $13,100 per ha). Readers will note that the current enterprise valuation of REAK plantations: $9,019 / planted ha (net of the $30m for the electricity operations), stands at a discount of 58% to the $21,500 / ha proposed by Khong & Jaafar for MP Evans, 10,250 ha East Kalimantan estate.

Jakarta Listed Palm Oil Producers	Market Cap ($m)	Current EV ($m)	Adjusted EV ($m)	Adjusted EV/ha ($/ha)
Astra Agro Lestari	2,372.1	2,639.4	2,639.4	11,211
Austindo Nusantara Jaya Agri	492.6	610.1	590.8	13,608
Bakrie Sumatera Plantations	50.6	724.7	559.6	7,617
Bumitama Agri	962.6	1,373.8	1,373.8	11,479
Dharma Satya Nusantara	383.3	728.6	524.6	8,366
Eagle High (BW Plantation)	465.3	1,093.7	1,093.7	7,948
London Sumatra Indo	911.4	861.1	778.5	8,449
Provident Agro	236.4	262.6	262.6	6,422
Salim Ivomas Pratama	589.5	1,497.9	1,497.9	6,088
Sampoerna Agro	265	503.7	478.5	6,214
Sawit Sumbermas Sarana	970.1	1,184.10	1,184.10	34,659
Weighted Average EV / Ha (Adjusted)				**11,096**
London Listed Indonesian Palm Oil Producers				
Anglo-Eastern Plantations	294.2	236.8	236.8	3,611
MP Evans	449.3	325.0	325.0	9,388
R.E.A. Holdings	216.2	392.2	392.2	9,019

Source: Thomson Reuters / Hardman Agribusiness

R.E.A. Valuation relative to Indonesian Peer Group	$/ha
Development Cost to Maturity with Mill, 1 Hectare Oil Palm Kalimantan	9,000
Weighted Average EV/ Planted ha (Jakarta Listed Palm Oil Producer Group)	11,096
Khong & Jaafar SDN BHD Valuation (21st November, 2016), MP Evans 10,250 ha East Kalimantan Estate	21,500
MP Evans @ £7.40 KLK Bid 15th November 2016 (Less Cash/Malaysian Property Interests)	11,650
Implied per hectare valuation based on price agreed for MP Evans' 36.84% stake in Agro Muko	13,860
REA Holdings (Less Electricity Generating Operations at Hardman Estimated Valuation of $30m)	9,019

Source: Thomson Reuters / Hardman Agribusiness

It is notable that the Jakarta group valuations occupy a wide range from $34,659 / planted ha for Sawit Sumbermas Sarana down to $6,088 for Salim Ivomas Pratama. Noting the quality of the REAK plantations, there is a strong argument for EV/ha being at least in line with the Jakarta sector weighted average, and more closely aligned to the valuation references generated by the chain of events flowing from the KLK / MP Evans bid.

Readers should note that we believe any valuation of REA valuation should include an appropriate expression of value for the profitable electricity generating business. Our DCF model for REAK's electricity operations is based on revenues and cash flow assumptions for ten years only. The model assumes that REAK will build from 3 MW of supply currently to 6 MW by end 2020. The terminal growth rate can reasonably be expected higher to be on this project than on the main palm oil production business, noting that only 69% of East Kalimantan was supplied with electricity at June 2015. Assuming a growth rate of 4% and a discount rate of 12.5% would give the operations a valuation of circa $30m. Discounting this from the group EV implies an EV/planted ha of $9,019 as noted above.

Extending Maturities on Medium Term Notes Programme

November 7th, 2016 REA announced a proposed issue of up to $37,500,000 nominal of 7.5% dollar notes 2022 ("new dollar notes"), by way of an exchange offer, inviting holders of the $34,011,003 nominal of outstanding 7.5% dollar notes 2017, to exchange their existing holdings for the new dollar notes. November 21st REA announced that it had received acceptances under the exchange offer, in respect of $13,810,218 nominal of existing dollar notes. Applications received pursuant to the top-up option amounted to a further $225,000 nominal of new dollar notes. In addition, REA Services subscribed for a further $10,000,000 nominal of new dollar notes pursuant to the placing.

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