

# Hardman & Co

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## REA Holdings

### Growing the Land Bank

595p 18 March 2008



REA has announced the acquisition of two land allocations in East Kalimantan, Indonesia totalling 37,000 hectares for a total cash consideration of \$2.5m.

The purchase of holding companies PT Cipta Davia Mandiri (CDM) and PT Kutai Mitra Sejahtera (KMS) boosts the size of REA's development land bank to 120,000 hectares. CDM and KMS are located less than 30km away from the group's existing East Kalimantan estate so from an operations point of view REA will still function as a single-site operation. Both land allocations are deforested and have recently obtained agricultural development permits. We understand REA will begin planting out these new areas during 2008 at the same time as completing the titling process through to HGU which involves land registry surveying the land and other formalities – a process which can take up to 12 months.

In a trading statement accompanying the news, REA cited hurdles in the land titling process as the principal reason for the significant slowdown in new planting activity during 2007. 1,500 hectares of oil plantings actually made it out to the fields in 2007, some way below the group's target of 6,500 hectares. Delays in the titling process have continued to hold back expansion in 2008 to-date.

Management believe the latest land purchases will increase the group's resilience in the face of an increasingly complex land titling process in Indonesia by enabling the company to submit titling applications on multiple land allotments at the same time.

The trading statement also confirmed that total FFB crop output for 2007 was 17.7% up on the previous year and 3.5% ahead of budget. Full year results will be announced in mid-April.

**Share Price:** 595p

**12m High:** 727p

**12m Low:** 377p

**Market Cap:** £192.2m

**Shares in Issue:** 32.3m

**NAV/Share:** 198p inc. biological assets (at end June 2007)

**Gearing:** 41% (at end June 2007)

**EPIC Code:** RE.

**Sector:** Food Producers and Processors

**Market:** London Main Market

**Broker:** Mirabaud Securities

**PR:** -

**Website:** www.rea.co.uk

**Previous Research Note:** 'Gaining from Soaring Demand', 573p

*Analyst: Sonia Kaur*

Y/E December	Sales £m	Declared Profit £m	Adjusted Profit £m	Adjusted EPS p.*	P/e ratio	Divi p.	Yield %
2005A	14.9	9.6	5.5	3.1	191	0	-
2006A	17.8	10.6	5.9	9.6	62	1	0.2
2007E	30.6	17.2	14.9	27.2	22	2	0.3
2008E	36.8	21.3	18.8	32.3	18	3	0.5

\*Adjusted EPS estimates exclude the gain on changes in the fair value of biological investments and associated tax

## **New Purchases**

We are encouraged by these latest land acquisitions which follow the acquisition of PT Putra Bongan Jaya (PBJ), a 20,000 hectare land allotment, in September 2006. The purchase price of \$2.5m equates to \$67 hectare and compares favourably to current market rates of approximately \$250 - \$300 hectare for deforested land in Indonesia. We find this particularly impressive given the increased competition for suitable development land in East Kalimantan as the palm oil price has soared.

As with past acquisitions, the deals have been structured so as KMS and CDM will be 95% owned by REA and 5% by local Indonesian investors.

In purchasing land allotments situated less than 30km away from the group's existing East Kalimantan estate REA will enjoy huge economies of scale once new planting activity begins by continuing to operate as a single site plantation.

Equally importantly, the additional sites reduce the company's risk profile. The land titling process in Indonesia has become increasingly bureaucratic, political and prone to administrative error and delay, so much so that many incumbents now view it as a key barrier to entry. The HGU (Registered Land Title Certificate) gives the right to use state-owned land for the purpose of agriculture, usually for a period of 25 – 35 years and renewable, and is only granted to Indonesian citizens or legal entities.

Uncertainty remains as to when the titling process in relation to REA's existing East Kalimantan estate will complete. A key issue appears to be confusion over the allocation rights to the land with a local mining company having recently been allocated rights over the same area of land targeted by REA for its 2007 extension planting programme. We have little doubt that the administrative error will be corrected because REA's allocation was granted a long time before the mining company's and land clearing and plantation licences have already been issued to REA. However, management have become increasingly concerned that such complications could result in the group's ambitious new plantings programme grinding to a halt. These latest acquisitions go some way towards addressing this by allowing REA to submit titling applications on multiple land allotments at the same time.

It is worth pointing out that the group's seedling planting programme has been unaffected by the titling issues and REA has continued to establish nurseries in line with its target planting programme. This means seedlings are immediately available for planting when the land titling issues are eventually resolved.

## **Results ahead of forecast?**

In terms of current trading, the company has confirmed that the fresh fruit bunch crop output for 2007 amounted to 393,217 tonnes. This was ahead of our forecast for 380,000 tonnes and represents a 17.7% increase on the FFB crop for 2006. Current year crop output is currently running ahead of expectations but weather conditions remain a key area of volatility so we are happy leaving our current year estimate of 426,100 tonnes unchanged.

It is clear that we were too conservative in our average palm oil price projections. In the event the actual average spot CPO price for 2007 was \$780 CIF Rotterdam – our forecast was closer to \$650 CIF Rotterdam. REA will not have benefited from all of this because 20% of its output was sold forward and a new export duty on sales of CPO outside of Indonesia will also have impacted but nonetheless we would be surprised if turnover was not some way ahead of our current 2007 estimate, assuming oil extraction rates have been maintained, of course.

REA has a December year end and is in close period. We expect the full year results to be announced in mid-April and will update our forecasts for the company at that time.

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