Hardman & Co

Leaders in Corporate Research

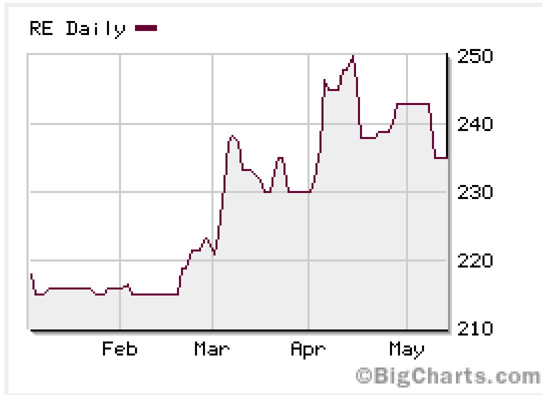
Tel: 020 7929 3399
Fax: 020 7929 3377

www.hardmanandco.com
email: research@hardmanandco.com

4 -5 Castle Court
London EC3V 9DL

REA 232.5p

Full year results - another good year in prospect *25 May 2005*



Full year results to end December 2004 from this pure play plantation group showed profits more than doubled to £4.6m and good cash flows. Key points are:

- Crop volumes rose 32% to 293,882 tonnes during the year and weather permitting, volumes will rise by a further 13% in 2005.
- Meanwhile, the extension planting programme is progressing well and will provide a further boost to output levels and group profitability from 2007 onwards.
- CPO prices have recovered from early 2005 lows and currently stand at CIF Rotterdam $418/tonne. A rise in world freight rates is lowering FOB prices in the Far East however, and this will inevitably hold back margin growth going forward.
- There has been some escalation in the legal dispute with minority shareholder ME Zukerman. Both sides have agreed to mediate and we await further news on this front with interest.

We are trimming our current year profit estimates, but this is largely on account of continued dollar weakness and the impact of higher shipping costs. In all other respects, investors can look forward to another year of good progress.

Share Price: 232.5p

12m High: 270p

12m Low: 195p

Market Cap: £46m

Shares in Issue

Undiluted: 19.75m

Diluted: 27.41m

Gearing: 66% (2004 actual)

EPIC Code: RE.

SEDOL No: 234906

Sector: Food producers and processors

Market: London Full List (FTSE Fledgling)

Broker: Canaccord

Website: www.rea.co.uk

Previous research note: "F/y profits on course to almost treble" published 20/09/04

Analysts: *Sonia Kaur/Roger Hardman*

Y/E December	Sales £m	Declared Profit £m	Adjusted Profit £m	Adjusted Eps p.	P/e ratio	Divi p.	Yield %
2003A	13.8	2.07	2.32	3.72	63	0	-
2004A	16.1	4.69	4.69	7.63	31	0	-
2005E	17.9	5.87	5.87	10.01	23	0	-
2006E	19.4	6.67	6.67	11.64	20	0	-

Background

London-listed REA Holdings is a pure play oil palm plantation group based in the Indonesian state of East Kalimantan. It is currently developing 125,000 H of conversion forest, 13,142 H of which is now substantially mature and capable of producing crop volumes of c.350,000 m/t from 2006 onwards on very good margins.

2004 saw the resumption of planting activities at the rate of 3,000 H per year. This will rise to 4,500 H in the current year and, weather and palm oil prices permitting, we expect the extension planting programme to continue at this rate for at least the next three years.

Research shows the world market for vegetable oils, and for palm oil and soya oil in particular, is growing at 3% plus per annum. The fact that palm oil competes directly with other oils and fats in most of its applications does subject the palm oil price to wide fluctuations, however.

The 2004 Results

Crop Volumes: Crop volumes for the year at 293,885 m/t were only marginally behind our forecast of 298,000 m/t. For an agricultural business focused solely on one crop, we view as this as being very satisfactory. Almost all of the slippage occurred in the four months to October 2004 when dry conditions across the East Kalimantan estate depressed volumes in what is usually REA's seasonally stronger second half.

The kernel output for the year was close to our estimates. Kernels still make up a relatively small proportion (c.15%) of group sales but the margins on this business, as with those on palm oil, are very good. From H2 2006 onwards, the margins obtained will be even better because by then REA will be running its own kernel crushing plant rather than incurring the costs of transporting its kernels to Indonesian crushers for processing as is currently the case.

Extraction Rates: The 2004 oil extraction rate was 24.3%. We had predicted a rate of 24.5% because we had not allowed for the impact of the heavy rains during H1 (which delayed fruit getting to the mill) or for the temporary disruption caused by the addition of a second 40mt/hr production line in 2003 which in combination pushed the H1 2004 extraction rate down to 24.1%.

Encouragingly, by H2 2005 the oil extraction rate had moved back up to 24.5% and in the current year we understand REA is targeting, and getting, extraction rates of 25% plus. Changes in the extraction rate are very important in the plantation industry because costs have a high fixed element and so any movement tends to fall straight through to the bottom line. As it is, REA's oil extraction rates are amongst the highest in the industry (the current average is between 20-23%) because the East Kalimantan plantation is relatively young, plant husbandry is good and unlike some competitors, REA only processes its own fruit in its mill.

Kernel extraction rates were maintained at 4.1% during the year. A reduction in the dirt content of the extracted kernels means that the quality here is improving all the time, however. We look for a small increase in the kernel extraction rate, possibly to 4.25%, in the current year.

Sales: Sales in Pound Sterling terms were slightly lower than expected at £16.05m versus our forecast of £16.9m. This was partly because of the marginal shortfall in crop production against budgeted levels and partly because of the weakness of the US dollar, something which we had not fully taken account of in our estimates. In 2003 REA's turnover (which is denominated in US dollars because the CIF Rotterdam CPO price is denominated in dollars) was translated at an average exchange rate of £1 = $1.64. In 2004, the average dollar price was £1 = $1.84, a difference of 12%.

Gross Margin: Gross margins rose by a cracking 7% to 53% during 2004 although it is fair to say that at this level margins are probably close to their peak. Certainly there will be some cost pressure coming through in the current year as a result of the reduction in Indonesian fuel subsidies and a rise in Government directed wage rates. On the other hand REA's growth, both in terms of crop output and planted hectarage, is allowing it to operate the East Kalimantan site more efficiently all the time. We tend to take the view that a gross margin of between 52-56% should be sustainable long-term.

Pre-tax Profit: REA reported a pre-tax profit of £4.69m at the declared level, more than double last year's £2.07m. This was lower than our original forecast of £5.4m due to crop volumes and extraction rates being slightly lower than expected and also because the weakness of the US Dollar worked against the company during the year.

Minority Interests: In line with the substantial increase in profits the minority interest charge for the year is also up – from £383k to £724k.

Preference Shares: As announced at the interim results stage, REA has finally cleared arrears amounting to £1,026,643 in its preference dividends by way of a scrip issue of new preference shares to existing holders for the same amount. We are pleased.

Including the placing of an additional 1 million shares at par for cash, the total number of preference shares in circulation is presently 7.72 million and this will increase the preference dividend bill to £695k in the current year. Whilst payment of the arrears on the preference dividends paves the way for payment of an ordinary dividend, we think the current demands on the company's cash from the massive investment in the extension planting programme and from any potential settlement in the outstanding legal action in New York makes this unlikely for at least the next two years.

Tax: Reduced trading losses have pushed the tax charge up to 28%, compared to the 17% reported in 2003. REA still has substantial carried forward tax losses (mainly due to capital and other expenditure) and this means the tax charge is unlikely to become a cash item for some time.

Convertible Loan Stock: REA is in the early stages of discussing a possible reconstruction of its convertible loan stock that would involve conversion of all the existing outstanding stock into a combination of new shares and dollar denominated loan notes, possibly at a small premium to the current share price.

Balance Sheet & Cash Flow

REA generated £5.7m of cash from operating activities last year. This was lower than the £7.2m reported in 2003 and there are two main reasons for this.

Firstly, the 2004 figure is struck after the repayment of an MEZ loan totalling $8.175m plus accrued interest (as part of the company's wider debt restructuring exercise in April 2004). The result is a significant fall in 'Creditors: amounts falling due within one year," from £15.2m to £6.6m. It is worth pointing out that most investment managers would probably regard this as a financing rather than a 'normal' working capital issue.

Secondly, a £0.9m increase in trade debtors as REA billed for palm oil sold at the year-end but the produce was not collected until early 2005. We happen to know that these goods have now been delivered and the money tied up in debtors converted into cash.

After taking account of capital expenditure of £3.4m related to investment in the extension planting programme and the payment of arrears on the preference dividends, but also including the £1.6m raised by the issue of new preference equity, the net cash flow surplus for the year was £1.7m.

In terms of the balance sheet, net debt at the year-end was £17.9m, giving gearing of 66% if the preference shares are included as part of the equity. With the debt rescheduling within REA Kaltim now complete, 2005 will probably see REA turn its attention to the refinancing of its syndicated Indonesian bank debt. At end December 2004 stood at $28.5m and is on less than favourable terms.

Extension plantings to boost output

After a four year gap, new planting activity has been resumed with the first 3,000 H of extension planting on the Northern side of the East Kalimantan estate completed in February 2005. This was two months behind schedule but only because of the very dry weather in July-October. More importantly, management say this delay will not push back projected crop volumes so we still expect a small contribution from these trees at the back end of the current year.

Meanwhile, tenders for a second oil mill on the Northern side of the estate and for the group's first kernel crushing plant have been awarded and we expect both to be up and running by H2 2006. Initially we expect the second mill to operate at 40mt/hr, although the use of high efficiency turbines and boilers means it will make a good contribution towards the company's electricity needs North of the Belayan river.

In 2005 the extension planting programme will rise to 4,500 H, split 3,000 H on the Northern side of the estate and 1,500 H on the Southern side where REA is working in a joint venture with local interests to plant out 5,000 H over the next four years. Given that the 1994-1998 plantings are set to hit peak yields in the current year, the expansion planting programme will provide an important boost to output and profitability levels from 2007 onwards.

The Legal Action: Latest Developments

There has been some escalation in the legal dispute involving US minority shareholder the MEZ group with a threat to add new proceedings in New Jersey to the existing case in New York. That case was first lodged in 2001 and claimed, amongst other things, fraud and breach of contract in respect of an alleged verbal promise by subsidiaries REA Kaltim and Makassar to pay a rate of return of 30% on an $8m loan. In 2002 a New York judge rejected almost all of the claims relating to fraud but ruled that the contract related claims could proceed.

A mediated discussion of the dispute over three days is now set to take place in New York sometime in September, although it is important not to over-estimate the likelihood of a favourable outcome here. The relationship between the MEZ Group and the directors of REA is not a happy one and these discussions will be non-binding on both parties.

In addition, arriving at anything like an accurate estimate of REA's potential liability in this area is riddled with difficulties. How much is the East Kalimantan development worth for instance? And what minority interest discount rate should one apply? It should be borne in mind that our spreadsheet model on pages 5-6 takes no account of any form of settlement with the MEZ Group.

Industry prospects look good

Competitors *Anglo Eastern Plantations (AEP.L)* and *MP Evans (MPE.L)* have both been expanding their Indonesian palm oil activities in recent weeks suggesting to us at least that the prospects for this industry still look very promising. On 24 March *Anglo Eastern* announced that it had acquired an 80% interest in 4,800 H of vacant land in North Sumatra for $320,000. Development of this land into an oil palm estate is likely to begin in 2006 and the first output from these trees will be in 2009/10.

Shortly afterwards, as part of its strategy to dispose of its ‘low-earning Malaysian oil palm plantations’ and plough the money back into ‘higher-earning Indonesian palm oil’, *MP Evans* acquired a 90% interest in a 12,000 H oil palm development on the Indonesian island of Bangka. Planting is due to start in the current year at the rate of 4,000 H per year and we expect further deal newsflow from *MP Evans* in due course.

Elsewhere, latest figures from researcher Oil World show the worldwide consumption of vegetable oils and fats increased by 3.2% to 128.6m tonnes in the year to September 2004 and the demand for palm oil (now the world’s No 2 edible oil) will have kept pace with that growth. Aside from rising demand from India and China, increased production of biodiesel – a direct result of the higher oil price – should also result in significantly greater industrial usage of vegetable oils going forward.

In terms of the palm oil price, prospects appear to be rather more mixed with a return to the highs of $450/tonne CIF Rotterdam in 2005 looking unlikely. This is largely because after a record year for soyabeans in the US and Brazil, the market is now pricing in expectations of a significant soya overhang. With breakeven at around $200 per tonne however, it is clear that the margins to be had in this industry are still astonishingly good even at the current $418 CIF Rotterdam.

In REA’s case of course, there is also the rise in world shipping rates to consider. This is because the price it gets for its palm oil is the official CIF Rotterdam price minus the shipping costs to get its oil from the Far East to Europe. Currently, these shipping costs are around $60-$65/tonne compared to the $50/tonne rates this industry is used to on account of higher fuel costs. We have accounted for this rise in world shipping rates by reducing our average CPO price to $360/tonne FOB Borneo for the current year and next.

REA is currently investigating the possibility of utilising its 4-strong barge fleet to transfer CPO from the East Kalimantan estate to ships anchored outside the river port of Samarinda, where vessel capacities are much larger. An update on developments here is expected at the half year stage.

Accountancy Standards

From the current financial year, REA will be reporting its accounts under the new accountancy standard IAS 41. This new accountancy standard states that all plantation companies must revalue their estates every year rather than include them in the balance sheet at cost minus depreciation.

For the time being we continue to present our forecasts on the basis of the ‘old’ accountancy standards. It is worth noting that under the new standards, REA’s declared profits will be higher because the bulk of its depreciated charge (£2.1m last year) will be eliminated.

Forecasts

Current trading is more or less where management expected it to be and, weather permitting, crop volumes will rise to 331,000 m/t in the current year. While the palm oil price will be lower, extraction rates will show some improvement on last year’s levels and assuming an exchange rate of £1 = $1.86, we look for pre-tax profits of £5.9m and eps of 10p.

That is slightly lower than our previous estimates – we had not factored in the impact of higher world freight rates in those projections or allowed for the continued weakness of the US dollar. It also appears as though we were too bullish on our peak yield forecasts. Our previous model assumed a peak yield of 28 tonnes per hectare. We have since reduced this to 26 tonnes per hectare in line with management’s experience of more recent plantings.

Crop volume growth will be less exciting in 2006 because while the 1994-1998 plantings will have hit their full production potential of c. 350,000 tonnes by then, the first noticeable contribution from the 2004 extension planting programme will not be until 2007. As a result we look for a smaller rise in y/e December 2006 pre-tax profits to say, £6.7m giving eps of 11.6p.

REA Holdings

25.05.2005

Y/E December

Palm Oil Production	**Hectares**	**Theoretical Tonnes Yield**									
Year of Planting	**Planted**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
1994	500	10,000	12,500	14,000	14,000	13,000	13,000	14,000	14,000	14,000	14,000
1995	2,000	30,000	40,000	50,000	56,000	52,000	52,000	56,000	56,000	56,000	56,000
1996	2,300	18,400	34,500	46,000	57,500	57,500	59,800	62,100	62,100	62,100	62,100
1997	2,400	19,200	36,000	43,200	60,000	60,000	62,400	64,800	64,800	64,800	64,800
1998	5,000	0	40,000	65,513	100,000	125,000	130,000	135,000	135,000	130,000	140,000
1999	300	0	2,400	3,000	2,500	6,000	7,800	7,800	7,800	7,800	8,400
2000	900	0	0	1,000	3,883	18,000	23,400	23,400	23,400	23,400	25,200
2001	0		0	0	0	0	0	0	0	0	0
2002	0			0	0	0	0	0	0	0	0
2003A	0				0	0	0	0	0	0	0
2004A	3,000					0	12,000	24,000	45,000	60000	75,000
2005E	4,500						0	0	36,000	67500	90,000
2006E	4,500							0	0	36000	67500
2007E	4,500								0	0	36,000
TOTAL THEORETICAL CROP				222,713	293,883	331,500	360,400	387,100	444,100	521,600	639,000
% Yield				24.9%	24.3%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
Oil Tonnage Produced****				55,456	71,473	82,875	90,100	96,775	111,025	130,400	159,750
Kernel Tonnage Produced		34,000	59,000	10,022	12,169	14,089	15,317	16,452	18,874	22,168	27,158
Total Palm Products Tonnes		34,000	59,000	65,478	83,642	96,964	105,417	113,227	129,899	152,568	186,908
Price Per Tonne US$ FOB Borneo		286	391	370	385	360	360	380	380	380	380
Price per Tonne £UK		191	261	231	209	196	196	207	207	207	207
Palm Oil Revenue		0	0	12,824	14,955	16,215	17,628	19,986	22,929	26,930	32,992
Palm Kernel Revenue***		0	0	927	1,033	1,654	1,798	2,039	2,339	2,747	3,365
Cy Theoretical Turnover £000		0	0	13,751	15,988	17,869	19,426	22,025	25,268	29,677	36,357
Reported Fresh Fruit Crop		123,992	199,184	222,713	293,883	331,500	360,400	387,100	444,100	521,600	639,000
Reported Palm Oil tonnage		28,557	49,604	55,456	71,473	82,875	90,100	96,775	111,025	130,400	159,750
Extraction Rate		23%	25%	24.9%	24.3%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%

	2001A	**2002A**	**2003A**	**2004E**	**2005E**	**2006E**	**2007E**	**2008E**	**2009E**	**2010E**
Reported Turnover £000	1,326	12,831	13,781	16,052	17,869	19,426	22,025	25,268	29,677	36,357
Cost of Sales	403	7,897	7,469	7,530	8,000	8,700	10,000	11,000	12,400	13,800
Gross Margin %	70%	38%	46%	53%	55%	55%	55%	56%	58%	62%
Administrative Expenses	1223	2,571	2,236	2,359	2,595	2,854	3,140	3,454	3,799	4,179
Admin as % of Sales	92.2%	20.0%	16.2%	14.7%	14.5%	14.7%	14.3%	13.7%	12.8%	11.5%
Associates	122	0	0	0	0	0	0	0	0	0
Profit/loss on asset disposals	448	-326	-257	7	0	0	0	0	0	0
Interest Charge In/Out	52	-581	-1,749	-1,485	-1,400	-1,200	-900	-400	-200	-50
Pre-tax Profit	**427**	**1,456**	**2,070**	**4,685**	**5,874**	**6,672**	**7,985**	**10,414**	**13,278**	**18,328**
Tax £000	147	49	345	1,320	1,762	2,002	2,395	3,124	3,983	5,498
Tax Charge* %	34%	3%	17%	28%	30%	30%	30%	30%	30%	30%
After Tax Profit	280	1407	1,725	3,365	4,112	4,670	5,589	7,290	9,295	12,830
Minority Interests	-59	-725	-383	-724	-822	-934	-1,118	-1,458	-1,859	-2,566
Preference Dividends	-512	-512	-513	-639	-695	-695	-695	-695	-695	-695
For Ordinary Shareholders	-291	170	829	2,002	2,594	3,041	3,777	5,137	6,741	9,569
Cost of Ordinary Dividend	0	0	0	0	0	0	0	296	593	889
Retained Earnings	-291	170	829	2,002	2,594	3,041	3,777	4,841	6,148	8,680
Average No. of Shares	11346	12,628	16,385	19,755	19,755	19,755	19,755	19,755	19,755	19,755
Earnings Per Share Undiluted p.	-2.56	1.35	5.06	10.13	13.13	15.40	19.12	26.00	34.12	48.44
Dividend Per Share p.	0	0	0	0	0.00	0.00	0.00	1.50	3.00	4.50
Shares in Issue Fully Diluted		22,422	24,965	27,411	27,411	27,411	27,411	27,411	27,411	27,411
EPS Fully Diluted		**0.76**	**3.75**	**7.63**	**10.01**	**11.64**	**13.78**	**18.74**	**24.59**	**34.91**

** Deferred tax provision only until 2006*

**** 4.25% yield @60% of Palm Oil price*

Assumed exchange rate is £1 = $1.84

REA Holdings
Y/E December

Cash Flow	2001A	2002A	2003A	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Retained Earnings	-291	170	829	2,002	2,594	3,041	3,777	4,841	6,148	8,680
Deferred Tax	0	0	345	1,320	1,762	0	0	0	0	0
(Paid)/Unpaid Preference Dividend	257	513	257	-639	-695	-695	-695	-695	-695	-695
Depreciation	137	1,616	2,114	2,125	2,400	2,500	2,600	2,700	2,800	3,000
Asset Sales	5,697	60	637	15	0	0	0	0	0	0
Conversion of Convertible Loan	0	0	0	0	0	-3,419				
Issue of New Equity	1,268	-5	4,994	47	0	3,419	0	0	0	0
Investment in new Plantations	-664	-2,154	-2,300	-3,420	-3,900	-3,900	-3,900	-3,900	-3,900	-3,900
Issue of preference shares	0	0	0	1,600	0	0	0	0	0	0
Other Investment#	0	-560	-2,375	-1,067	-1,000	-1,000	-1,000	-1,000	-1,000	-1,000
Working Capital etc	-2,464	-2,944	-1,066	-374	0	0	0	0	0	0
Net Cash Flow	**3,940**	**-3,304**	**3,435**	**1,609**	**1,161**	**-54**	**782**	**1,946**	**3,353**	**6,085**

Balance Sheet	2001A	2002A	2003A	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Estates Land and Buildings	45,071	45,577	45,000	44,663	46,955	49,180	51,338	53,429	55,453	57,343
Plant and Machinery	4,532	4,727	5,238	5,575	5,783	5,958	6,100	6,209	6,285	6,295
Stocks	1,143	857	1,346	1,248	1,248	1,248	1,248	1,248	1,248	1,248
Debtors	2,892	4,544	3,710	3,307	3,307	3,307	3,307	3,307	3,307	3,307
Cash	5,398	5,156	6,790	1,061	2,222	2,169	2,950	4,896	8,249	14,333
Investments	0	0	0	1,067	1,067	1,067	1,067	1,067	1,067	1,067
Short term Loans - Agriculture##	27,931	3,416	5,059	2,680	1,519	1,572	791	-1,155	-4,508	-10,592
Short term Loans -MEZ Group	5,638	5,078	0	0	0	0	0	0	0	0
Leases	83	71	71	318	318	318	318	318	318	318
Trade Creditors	1,284	739	739	442	442	442	442	442	442	442
Other Creditors and accruals	4,437	4,461	11,784	3,191	3,191	3,191	3,191	3,191	3,191	3,191
Convertible Loan Stock	0	3,419	3,463	2,837	2,837	2,837	2,837	2,837	2,837	2,837
Other term loans	1,871	21,134	15,312	13,402	13,402	13,402	13,402	13,402	13,402	13,402
Term Leases	94	68	0	0	0	0	0	0	0	0
Provisions	0	0	288	2,107	200	200	200	200	200	200
Minority Interests	4,403	4,574	4,308	4,871	4,871	4,871	4,871	4,871	4,871	4,871
Preference Shares	5,705	5,705	6,732	6,732	6,732	6,732	6,732	6,732	6,732	6,732
Ordinary Shareholders' Funds	8,892	11,563	16,737	20,506	23,100	26,142	29,918	34,759	40,907	49,586
Net Debt	30,219	28,030	20,211	17,911	16,750	16,803	16,022	14,076	10,723	4,639
Gearing %###	**207%**	**162%**	**86%**	**66%**	**56%**	**51%**	**44%**	**34%**	**23%**	**8%**
Year end Shares in Issue	12,427	12,727	18,650	19,755	19,755	25,100	25,100	25,100	25,100	25,100
nav per share, undiluted, p.	72	91	90	104	117	104	119	138	163	198
nav per share, diluted, p.		**76**	**89**	**95**	**104**	**115**	**129**	**147**	**169**	**201**