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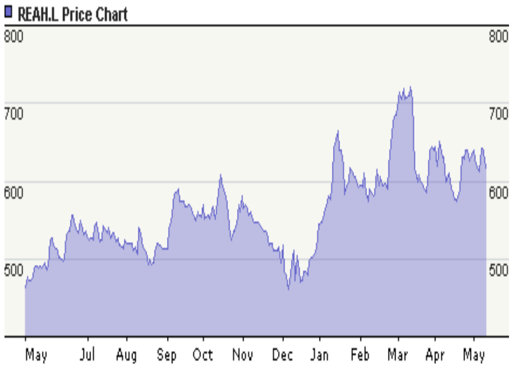
R.E.A. Holdings

The Good Times Keep Rolling. Upgrade

615.5p *13 May 2008*



Full year results from R.E.A Holdings were first rate reflecting the strength of the palm oil price, higher output and exceptional yields from the group's single site plantation in East Kalimantan. We are upgrading our forecasts for both this year and next. Key points are:

- Sales rose 74% during the year while pre-tax profits, excluding the IFRS gain on re-valued biological assets were up 252%.
- The average palm oil price was 63% up on 2006 levels and whilst a rise of this magnitude is unlikely in 2008 we think prices could well consolidate around the $950 per tonne mark until the end of the decade.
- Cash flow is formidably strong – the business generated $28m of cash from operations last year.
- The only disappointment in these results was the significant shortfall in new planting activity. However on the plus side, the purchase of two land allocations in East Kalimantan totalling 37,000 H should reduce the risk of further delays and subject to land concession agreements and weather conditions, we expect the size of the group's planted hectarage to grow from 26,408 H to just shy of 45,000 H by end 2009.

2008 is shaping up to be another record year for the group - palm oil prices have strengthened further since the year end, crop output was 9,000 tonnes ahead of budget at end March, and the new planting programme appears to be capable of moving forward this year after last year's setback.

With a 120,000 H development land bank to exploit and new planting commencing at an average rate of 6,500H per annum R.E.A. looks well positioned for the future.

Share Price: 615.5p

12m High: 727p

12m Low: 452p

Market Cap: £202m

Shares in Issue: 32.8m fully diluted

NAV/Share: 226p inc. biological assets (*assumes £1 = US$2)

Net Gearing: 35%

EPIC Code: RE.

Sector: Food Producers and Processors

Market: London Main Market

Broker: Mirabaud Securities

PR: -

Website: www.rea.co.uk

Previous Research Note: 'Growing the Land Bank', 595p

Analyst: *Sonia Kaur*

**P/E ratio in estimates table assumes an exchange rate of £1 = $2*

Y/E December	FFB Crop Output Tonnes	Sales US$ m	Declared Profit US$ m	Adjusted Profit US$ m	Adjusted Eps US cents	P/e ratio*	Divi pence	Yield %
2006A	334,076	33.1	19.76	11.06	17.8	70	1.0	0.2
2007A	393,217	57.6	47.01	38.98	73.0	17	2.0	0.3
2008E	420,925	81.5	52.91	44.91	87.5	14	3.0	0.5
2009E	508,950	102.6	70.93	62.93	125.4	10	4.0	0.6

A Strong Year

Full year results to end December 2007 were reported in US Dollars for the first time. We view this as a logical move as the majority of the group's costs and sales are in US dollars (palm oil is a dollar denominated commodity) and currency fluctuations have introduced significant distortions to the reported numbers in the past.

The Crop. Crop output for the year was 393,217 tonnes, ahead of our forecast of 380,000 tonnes and 18% up on 2006 crop levels. A lot of this was down to good weather conditions on the plantations but nonetheless it is a pleasing result. Crop output in the first quarter of the current financial year (January-March) was 9,000 tonnes above budget giving us some confidence that our current year crop forecast of 420,925 tonnes is achievable. The palm oil extraction rate was 23.7%, better than the 23.2% achieved last year and substantially better than the industry average though we had looked for 24%. The kernel extraction rate was bang in line with our forecast of 4% and also compares favourably to the 3.8% achieved last year.

Prices. The average CPO price CIF Rotterdam was $780, a rise of 63% on 2006 levels. Palm oil accounts for 92% of group revenues, the balance is accounted for by palm kernel oil. The average CPO Price FOB Samarinda, in other words the price realised by R.E.A. for its palm oil produce after deducting shipping and freight costs, was up 59% at $634.

Sales. The winning combination of higher prices, output and yields translated into a 74% increase in group sales to $57.6m. Of this total, $4.6m was derived from sales of palm kernel oil which currently attracts a 15% premium to the CPO palm oil price. The group's palm crushing plant at the newer of its two oil mills was brought into full scale production at the start of 2007 and achieved a CPKO extraction rate for the year of 41.4%.

12,000 tonnes of palm oil, equivalent to 14% of last year's CPO output, was sold forward at $620, CIF Rotterdam. After deducting shipping costs and Indonesian palm oil export tariffs the net price obtained by the group was $520 tonne highlighting the pitfalls of selling forward in an upward market (particularly as the Indonesian palm oil export tax increases incrementally with the CPO price). R.E.A. currently exports 50% of its CPO production and we expect exports to continue to represent this proportion of sales going forward.

In the current financial year to end December 2008 R.E.A. will sell 12,000 crops forward at $620 per tonne in H1 and a further 12,000 tonnes at $870 per tonne in H2.

Gross Margin Gross margin for the year was 84%, a significant rise on the 55% achieved in 2006. This is partly down to accounting treatment of an unusual short term inventory position which will not be repeated in the current financial year. Excluding the net gain on inventory, the gross margin for the year was still an impressive 74%. In spite of an escalation in costs during the year (wages up 10%, fertilizer costs up 50%), 'Cost of Sales' were held at levels close to 2006 as the group continues to benefit from increasing economies of scale.

Operating Profit. Stripping out the IFRS net gain on biological assets adjusted EBITDA was up 18% to $48.9m. Admin costs as a percentage of sales have fallen from 18.2% to 12.1% and we expect a further decline in the current year because the vast majority of these costs are fixed.

Tax. The amount of tax provided for has increased significantly, from last year's $5.9m to $15m in 2007. In the past most of this was deferred tax but in 2007 the amount of tax paid rose sharply to $5.3m (2006: $222k), the equivalent of 11% of declared pre-tax profits. All of this is local tax due in Indonesia. The balance of the tax charge is deferred tax relating to the IFRS net gain on biological assets.

Dividend. The 2p dividend, up from last year's 1p will not put R.E.A. on the radar screens of investment managers with a yield requirement but nonetheless is to be welcomed. Management clearly state that the rate of growth of dividend payments in coming years will be modest which we believe is a prudent decision given the huge investment requirements of the new plantings programme.

Balance Sheet. R.E.A. finished the year with net debt of $52m and gearing (including preference shares as part of the total equity) is a conservative 35%. Further steps were taken in 2007 to increase the group's capital base. In April, 1.5m of new ordinary shares were issued at 450p a share raising £6.75m net of expenses. This was followed by a placing of

£1m new 9% preference shares in September, and a further £1.1m of new preference shares were issued in October.

Last month the company announced that it would seek shareholder authority at its forthcoming Annual General Meeting on June 6 to create an additional £3m, 9% preference shares and management have flagged that the group's capital base will increase further in 2008 if its ambitious new plantings programme targets are achieved.

Cash Flow. Cash generation was extremely good during the year thanks to the higher palm oil price. Net cash inflows from operating activities were up 296% on the prior year at $28.2m and would have been higher still were it not for unusual working capital movements (namely an $8m increase in stocks earmarked for delivery in Christmas that were not collected until January 2008) and higher tax payments totalling $3.2m (2006:$0.22m).

Capital expenditure was lower than we expected due to lack of progress on the extension planting front (see below) though this did provide a temporary boost to the net cash balance which finished the year at $34.2m.

Planting Delays

The one major disappointment this year was the significant slowdown in new planting activity. R.E.A. had originally planned to plant out 6,500 H of new oil plantings during the course of 2007 but in the event only 1,500 H made it out to the fields. The key issue has been obtaining the necessary full hgu land title certificates on land areas targeted by the 2007 extension planting programme.

In the case of land targeted for development by subsidiary company SYB (15,000 H, 95% owned by R.E.A. and 5% by local Indonesian investors) there appears to be some confusion over who owns the allocations rights to the land after it was discovered that allocation rights had recently been issued to a local mining company for mineral exploration. Given that a) R.E.A. was the first to be awarded allocation rights over the land in question and that b) land clearing and plantation licences have already been issued to R.E.A., we are hopeful that the dispute will be settled in R.E.A.'s favour.

New planting on areas targeted by a third subsidiary, KKS (20,000 H once again 95% owned by R.E.A., 5% by local interests) has been stopped in its tracks by The Ministry of Forestry which is currently in negotiations with the provincial government of East Kalimantan over whether to approve its new development plan for the region. R.E.A's application for hgu land certificates on this land is obviously subject to the satisfactory outcome of these negotiations.

It is worth pointing out that the group's seedling planting programme has been unaffected by the failure to obtain land titling on untitled land areas and R.E.A. has continued to establish nurseries in line with its budgeted planting programme. This means that seedlings are immediately available for planting when the new development areas come on stream.

Expanding the Land Bank

The acquisition of two new land allocations totalling 37,000 H in early March should help get the expansion planting programme back on track by allowing R.E.A. to submit titling applications on multiple land holdings at the same time.

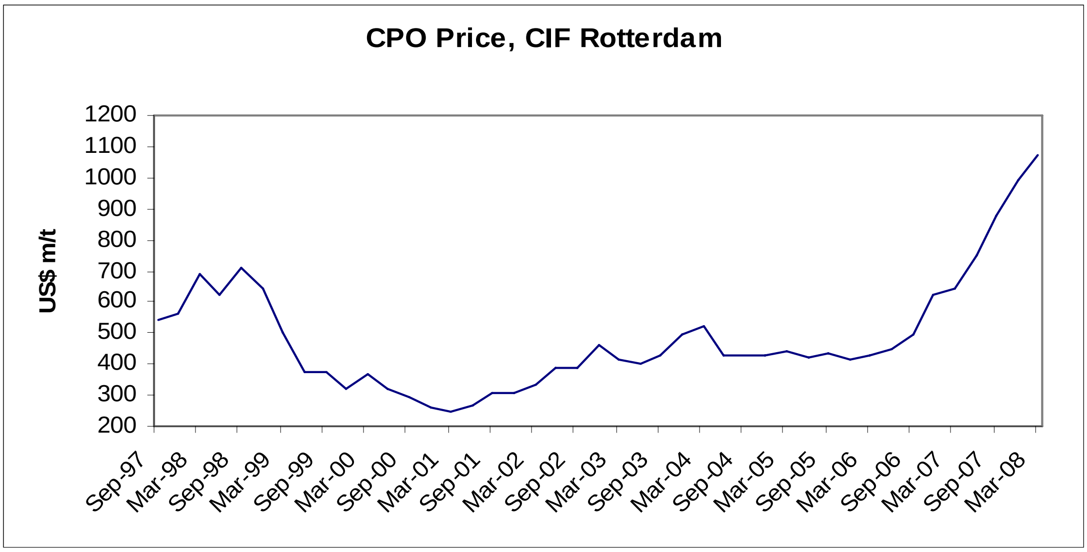
The purchase of holding companies PT Cipta Davia Mandiri (CDM) and PT Kutai Mitra Sejahtera (KMS) follows the conditional acquisition of PT Putra Bongan Jaya, a 20,000 H land allotment, in September 2006. In combination, the three acquisitions take the size of R.E.A.'s development land bank to 120,000 H providing substantial scope for further growth at a time when rivals are struggling to acquire suitable land.

As with past acquisitions, these deals have been structured so as all three holding companies will be 95% owned by R.E.A. and 5% by local Indonesian partners.

Both CDM and KMS are located less than 30km away from the group's existing East Kalimantan estate so from an operations point of view the company will continue to operate as a single site operation. We understand R.E.A. will begin planting out these areas in H2 2008 subject to the agreement of land compensation settlements with local villagers (which has become trickier over the past twelve months as the palm oil price has soared).

Our estimates model assumes a total of 7,500 H will be planted out in the current financial year, rising to 10,500 H in 2009. If management are able to achieve these targets the size of the group's planted hectarage will grow from 26,408 H to just shy of 45,000 H by end 2009. We expect crop levels to increase by 30% over the same period.

Palm Oil Price



Source: Bloomberg, Hardman & Co

2007 was a spectacular year for vegetable oil prices in general and the palm oil price was no exception. The average CPO price CIF Rotterdam during 2007 was 63% up on 2006 levels at $780 and significantly higher than the 10 year average price of $450 per tonne. After hitting a peak of $1245 in February, prices appear to have stabilised around the $1100 mark. The forecasts in our spreadsheet model to end 2010 are based on an average CPO Price, FOB Samarinda of $800 per tonne (the equivalent of $950 CIF Rotterdam). We believe there is price support at this level until the end of the decade for several reasons:

Surging Demand. Economic growth in highly populated developing countries such as India and China continues to fuel demand for palm oil for use as cooking oil with demand from the two countries currently growing at 20% per annum. Despite the threat of a worldwide economic slowdown triggered by the recent downturn in the US we believe this trend will continue not least because of India's recent decision to scrap its high import tax on palm oil and the recent Free Trade Agreement signed between Pakistan and Malaysia.

More topical is the growing demand for palm oil for its industrial use in bio-diesel. This is hardly surprising given the astronomical rise in the crude oil price and increasing demand for alternative energy sources. We expect more bio-diesel capacity to come on stream worldwide over the next couple of years further squeezing already tight supplies. In Indonesia alone domestic bio-diesel demand is expected to more double this year inevitably impacting upon exports from the country.

Over the medium term it is highly likely that high palm oil prices and tougher regulations will drive less efficient biofuel producers out of business. Under this scenario it is possible to imagine prices dropping back to $450 tonne – but that time is not yet.

It remains the case that the supply of soybeans and demand for soybean oil are a major determinant of the palm oil palm. Currently, the quantity of land available in both the EU and the US for soybean production is reducing despite record price rises. In the EU it would appear as though farmers are being subsidised to grow grain and corn at the expense of soybean to meet ambitious targets for renewable transport fuels. A similar situation is evolving in the US which has also chosen corn over soybean for its ethanol feedstock. We expect the resultant shortage of soybean oil to strengthen palm oil purchases and therefore prices, at least in the near term.

Supply side pressures. So far, the supply of palm oil has failed to keep up with the growth in demand in spite of an increase in development activity in Indonesia and Malaysia, which between them produce 85% of the world's palm oil. This reflects the fact that many of the new plantations will not be in production as yet since it takes four years from planting to yield commercial quantities of oil, which then yield for a further 20 years. Increased supply could well be an issue from 2010 onwards, however.

Industry forecasters Oil World predict stocks of the major oils and fats may fall to as low as 9.6% of annual usage by end 2008, their lowest level in 20 years. Adverse weather conditions in producer countries could further impact stock levels. An example of this is the recent cold snap in China which wiped out vast areas of rape seed crop last year.

Health Concerns. The CPO market continues to benefit from health concerns in relation to potentially harmful trans-fatty acids. CPO does not produce such acids because unlike the other vegetable oils (rape, sunflower, soyabean) it does not require hydrogenation before it can be used for solid fat applications.

Forecasts & Valuation

Our estimates model has been revised to take account of the change in accounting presentation to US dollars and we have upgraded our estimates for both the current financial year and next to reflect the increase in average CPO prices, FOB Samarinda.

Our new forecasts suggest sales could top $80m this year, a 40% plus increase on 2007 sales and some way ahead of our previous forecast of $72m. Stripping out the IFRS gain on biological assets, our adjusted pre-tax profits estimate is now $44.9m, for adjusted eps (on a fully diluted basis) of 87.45 cents. This compares to our previous estimate of $37.6m and 64.8 cents respectively.

For 2009 we look for sales of $102.6m, adjusted pre-tax profit of $62.9m and fully diluted eps of 125 cents.

On this basis the shares are trading on a 2008E PE of 14x and an Enterprise Value per mature hectare of $28,916 which is broadly in line with values elsewhere in the quoted palm oil sector. With a total development land bank of 120,000 H, R.E.A. has excellent potential to increase its planted hectarage and looks well positioned for the future.

R.E.A. Holdings

Y/E December
US $ Dollars

Palm Oil Production	**Hectares**					
Year of Planting	**Planted**	**2006A**	**2007A**	**2008E**	**2009E**	**2010E**
1994	500	14,000	14,000	14,000	14,000	14,000
1995	2,000	56,000	56,000	56,000	56,000	56,000
1996	2,300	59,800	62,100	62,100	62,100	62,100
1997	2,400	62,400	64,800	64,800	64,800	64,800
1998	5,000	130,000	135,000	135,000	135,000	140,000
1999	300	7,800	7,800	7,800	7,800	8,400
2000	900	23,400	23,400	23,400	23,400	25,200
2001	0	0	0	0	0	0
2002	0	0	0	0	0	0
2003A	0	0	0	0	0	0
2004A	3,000	0	24,000	45,000	60000	75,000
2005A	2,250	0	0	12,825	33750	45,000
2006A	6,500		0	0	52000	97500
2007A	1,500			0	0	12,000
2008E	7,500					
2009E	10,500					
2010E	7,000					
2011E	7,000					
2012E	7,000					
2013E	7,000					
2014E	7,000					
Total Planted Hectares		*25,150*	*26,650*	*34,150*	*44,650*	*51,650*

	2006A	**2007A**	**2008E**	**2009E**	**2010E**
TOTAL THEORETICAL CROP	**334,076**	**393,217**	**420,925**	**508,850**	**600,000**
% Yield	23.2%	23.7%	24.0%	24.0%	24.0%
Oil Tonnage Produced	77,506	93,192	101,022	122,124	144,000
Oil Tonnage Sold	77,506	85,755	101,022	122,124	144,000
Kernel Tonnage Produced	12,695	15,729	16,837	20,354	27,000
Total Palm Products Tonnes	90,201	108,921	117,859	142,478	171,000
Average Price Per Tonne US$ FOB Borneo	400	634	800	800	800
Assumed US$/UK£ Exchange Rate	1.83	2.00	2.00	2.00	2.00
Price per Tonne £UK	219	317	400	400	400
Palm Oil Revenue US$	31,002	53,001	75,418	95,299	115,200
Palm Kernel Revenue*	3,047	4,618	6,061	7,327	9,720
Cy Theoretical Turnover £000	34,049	57,619	81,479	102,627	124,920
Reported Fresh Fruit Crop	334,076	393,217	420,925	508,850	600,000
Reported Palm Oil tonnage	77,506	93,192	101,022	122,124	144,000
Extraction Rate	23.2%	23.7%	24.0%	24.0%	24.0%

R.E.A. Holdings

Profit & Loss Account

Y/E December
US $ Dollars

	2006A	2007A	2008E	2009E	2010E
Reported Turnover US$000	33,095	57,600	81,479	102,627	124,920
Inventory Gain	-54	5,578	-5,578	0	0
Total Revenue	33,041	63,178	75,901	102,627	124,920
Cost of Sales	14,938	14,875	19,000	26,000	29,000
Gross Margin %	55%	84%	70%	75%	77%
Gross Profit	18,103	48,303	56,901	76,627	95,920
Administrative & Distribution Expenses	6,040	6,953	7,996	9,195	10,575
Admin & Dist as % of Sales	18.3%	12.1%	9.8%	9.0%	8.5%
Other operating income	9	6	0	0	0
IFRS Biological Asset Adjustment	8,700	8,030	8,000	8,000	8,000
Operating Profit	20,772	49,386	56,905	75,431	93,345
Investment Revenues	640	1,641	1,500	0	0
Net Interest Charge in/-Out	-1,650	-4,017	-5,500	-4,500	-4,800
Exceptional Item	0	0	0	0	0
PTP ex exceptional items	**19,762**	**47,010**	**52,905**	**70,931**	**88,545**
Declared Pre-Tax Profit	**19,762**	**47,010**	**52,905**	**70,931**	**88,545**
Adj Pre-tax Profit ex IFRS Bio	**11,062**	**38,980**	**44,905**	**62,931**	**80,545**
Tax £000	5,898	15,013	15,871	21,279	26,564
of which: Deferred Tax on Bio Adjustment	2,597	2,564	2,400	2,400	2,400
Tax Charge % (on declared profit)	30%	32%	30%	30%	30%
Tax Charge* % (on adj pft)	53%	39%	35%	34%	33%
After Tax Profit	13,864	31,997	37,033	49,652	61,982
Minority Interests	-523	-278	-278	-278	-278
Preference Dividends	-1,795	-2,266	-2,401	-2,536	-2,536
For Ordinary Shareholders	11,546	29,453	34,354	46,838	59,168
Cost of Ordinary Dividend	289	641	962	1,282	3,205
Retained Earnings	11,257	28,812	33,393	45,556	55,963
Average No. of Shares	28,857	32,050	32,050	32,050	32,050
Earnings Per Share Undiluted cents	40.01	91.90	107.19	146.14	184.61
Dividend Per Share p.	1.00	2.00	3.00	4.00	10.00
Shares in Issue Fully Diluted	30,523	32,881	32,881	32,881	32,881
EPS Fully Diluted cents	37.83	89.58	104.48	142.45	179.95
EPS fully dil ex IFRS Bio & Associated Tax	**17.83**	**72.95**	**87.45**	**125.42**	**162.91**