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REA 376.5p Ordinary Dividends Resumed

20 October 2006



Interim results from this palm oil plantation company showed sales up 10%, gross profits up 16%, and an 8.3% increase in the profit attributable to ordinary shareholders. An interim dividend of 1p per ordinary share to be paid in full as a final dividend has also been declared. This last item came as a pleasant surprise to us – we were not expecting dividend payments to be resumed until 2008. Other key points are:

- First half crop volumes were 29% ahead of the prior first half and 27,000m/t ahead of budget. While palm trees in the mature areas are coming up for a rest period, our f/y crop forecast is maintained at 353,000 m/t.
- Costs are rising but to some extent pressure here will be offset by increasing economies of scale.
- Palm oil prices have rallied to a two year high and appear well underpinned by rising consumption and strong prospective demand from the bio-fuels industry.
- The extension planting programme is proceeding apace following some minor delays and, weather conditions permitting, the size of the planted hectareage will increase by 32% in 2006.

Financially, REA is stronger now than at any time in the company's history and the resumption of dividend payments reflects this. Our forecasts suggest shareholders can expect double digit increases in pre-tax profit and eps from now until end December 2010.

Share Price: 376.5p
12m High: 376.5p
12m Low: 232.5p
Market Cap: £102.4m
Shares in Issue: 27.2m
Fully diluted: 29.3m
Gearing: 46% (2005 actual)
Interest Cover: 4.3X (2005 actual)
EPIC Code: RE.
SEDOL No: 234906
Sector: Food producers and processors
Market: London Full List (FTSE Fledgling)
Broker: Mirabaud Securities
Website: www.rea.co.uk
Previous Research Note: 24.05.06 'Planting the seeds for growth'.

Analyst: Sonia Kaur

Y/E	Sales £m	Declared Profit £m	Adjusted Profit £m	Fully diluted Eps p.	P/e ratio	Divi p.	Yield %
2004A	16.05	9.19	9.19	18.0	21	0	-
2005A	14.94	9.62	9.62	16.7	23	0	-
2006E	18.16	10.93	10.93	21.9	17	1.0	0.3
2007E	20.99	12.96	12.96	26.7	14	1.0	0.3

Interim Results

6 months to end 30 June £'000	2006	2005	% Change
FFB Output	191,000	148,000	+29
Sales	9,064	8,209	+10.4
Gross Profit	4,803	4,141	+16
Gross Margin	53%	50.4%	
IFRS gain on biological assets	1,926	2,410	-20
Operating Profit	5,463	5,735	-4.7
PBT	5,505	5,425	+ 1.5
Profit to ord shareholders	3,143	2,902	+ 8.3
Eps, fully diluted	10.7p	10.6p	+1

REA has produced a 10% increase in turnover and 16% increase in gross profit for the six months to end June 2006.

Gross margins, at 53%, compare favourably to the 50.4% reported in H1 2005 but were held back by a significant increase in operating costs over the period. This reflects a tripling of diesel prices following the removal of state subsidies, wage inflation, and a 7% strengthening of the Indonesian rupiah against the US dollar (which has pushed up costs in US dollar terms). It should be pointed out that the 'cost of goods sold' figure in the p & l account understates the actual cash spend because the costs associated with developing the immature plantings have been capitalised in line with industry accountancy standards. Given that REA had 5,250H of new immature plantings in the field at end December 2005, and will have an additional 6,000H by end December 2006 this is becoming an increasingly significant item.

Profits at the operating level fell 5% to £5.463m. This reflects a reduction in the IFRS gain on revaluation of biological assets as REA's own calculations, which make allowance for detailed development and operating costs, have factored in a reduced contribution margin from future plantings and increased the overall cost per hectare of developing the trees to maturity. Our forecasts have not adjusted for these factors as they are based on total yields, assuming no change in costs or prices. Investment managers should be aware of the potential for variability here, however.

A reduction in the minority interest charge follows REA's acquisition of the MEZ group's 12.3% minority shareholding in subsidiary company Makassar for \$19m in January 2006. As a result, the profit attributable to ordinary shareholders rose 8.3% to £3.143m.

A token interim dividend payment of 1p per ordinary share has been declared in lieu of final for the y/e December 2006. We were not expecting REA to resume ordinary dividend payments until 2008, so this has come as a pleasant surprise. Though the yield on the shares is minimal, at 0.3%, we believe the decision to bring dividend payments forward strongly underlines management's confidence in future prospects.

Net debt at the end of the first half was £29.3m, for gearing of 57%. First half interest cover is over 7x operating profits. \$30m, or £16.2m of the group's total debt is represented by dollar loan notes. The balance of \$41m consists of Indonesian bank debt with an average term of 3 years. Because palm oil plantings do not produce any fruit at all until they are four years old this obviously creates a mismatch in maturity profiles. The company is therefore actively looking at alternative methods of debt finance and we expect more newsflow to follow on this front in due course.

The cash flow statement suggests the company generated a mere £633k from operating activities in the first half. However, this figure was depressed by the one-off payment of £3.4m to ME Zukerman in conjunction with the legal settlement. Excluding this item, the underlying cash flow from operating activities was closer to £4.03m, a 5% increase on the prior half year.

Net cash flow at the end of the period was £9m, boosted by £13.4m brought in from the placing of new equity. The capital investment charge of £7.5m in this latest first half includes the cost of the new plantings programme as well as investment in completing the construction of the group's second 80m/t oil processing mill. We understand the two mills in combination will take care of all of the group's production needs for the next 4 - 5 years.

Expansion of the Barge Fleet

A fifth barge has been added to the fleet to transport growing oil volumes from REA's single site plantation in East Kalimantan to the coast. By bringing the group's transport needs in-house, the company is able to ensure that it gets the best possible price for its produce as well as ensuring it is delivered on time.

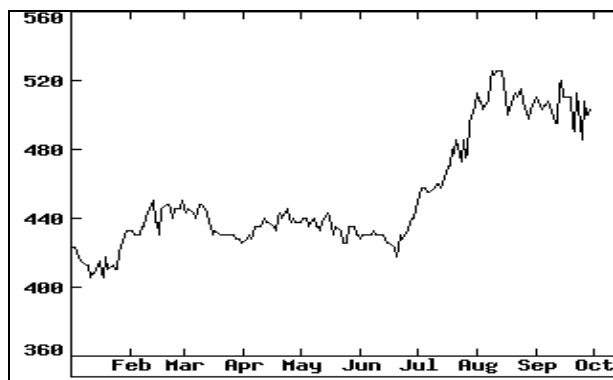
The new barge has a capacity of 3,000 tonnes making it twice the size of the largest barge in the existing fleet. If the CIF Rotterdam price for palm oil is favourable, we understand REA will use the new barge to conduct ship to ship transfers to ocean-going vessels headed for Europe.

Extension Planting Programme

Following some minor delays earlier in the year, REA is currently on track to plant an additional 6,000 H of palm oil plantings in 2006. This will increase the group's total planted hectareage by 32% to some 25,000 H in 2006, and is nearly double the size of the existing mature hectareage of 13,000 H.

An additional 7,000H of oil plantings will be planted out in 2007 subject to the usual weather and political constraints, of course. If these ambitious targets are met, we believe REA will become the largest single site palm oil plantation company in South East Asia.

Palm Oil Prices at two year peak



Graph: US\$ Palm Oil Price per tonne, CIF Rotterdam, Year 2006

The officially quoted CPO Price, CIF Rotterdam hit a two year peak of US\$522 per tonne in July fuelled by prospective strong demand from the bio-fuel industry. This compares to an average price of \$432 per tonne, CIF Rotterdam in the first six months of 2006, and an average of \$418 per tonne in the previous half year.

According to Industry forecasters Oil World, 9 Mn Tonnes of vegetable oils will be utilised by bio-diesel demand in 2006, growing to 20 Mn Tonnes or c.13% of the overall market, in 2007-2008. In response to this prospective demand, the Indonesian and Malaysian governments recently agreed to limit the consumption of palm oil for bio-fuels to a combined 12 Mn Tonnes annually. But with supply tight, Oil World believes "not even half of that quantity can be provided in the next 3-4 years without jeopardising satisfaction of food demand".

Supply fears have been heightened further by reports suggesting a weak El Nino, triggering drier-than-average weather conditions, is developing over much of Malaysia and Indonesia. Whilst the event is unlikely to be as severe as the major climatic switch that brought on two years on El Nino in 1997 and

1998, crop production could well be impacted across the region.

In light of the robust outlook for demand and tightness of world supply we believe the price of palm oil looks well underpinned at current levels. It should be noted that if an El Nino were to develop, prices are likely to spike sharply upwards thereby mitigating the impact of any fall in production volumes.

After deducting freight costs of \$70 per tonne (to get oil from the Far East to Europe), the US\$ FOB Borneo CPO price currently stands at \$430 per tonne. We have used an average US\$ FOB Borneo price of \$367 per tonne in our 2006 profit forecasts. As there is a high fixed cost element to REA's operations, any further escalation in the CPO price (caused by factors other than El Nino) could warrant a profits upgrade.

Forecasts

Higher sales in the first half were driven by a 29% increase in crop volumes to 191,000 tonnes. Given that this was an impressive 27,000 tonnes ahead of the company's own budgeted levels it would seem logical to raise our crop estimates for the full year. However, with bunch census forecasts suggesting some of the mature trees are due for a resting period, we have maintained our full year estimate at 353,00m/t. We believe this is in line with management's own internal budgets.

Our palm oil extraction rate forecast is lowered from 24% to 23.5% and we have also reduced our kernel extraction rate, from 4.5% to 4%. This is entirely down to sub-optimal cross-pollination in the second half of 2005 which resulted in extraction rates falling to 23% in the first half of the current year.

Based on an average US\$ FOB Borneo CPO price of \$367 per tonne and an assumed exchange rate of £1 = \$1.85 we now look for 2006 sales of £18.16m compared to our previous forecast of £17.89m.

Our current year pre-tax profit estimate remains broadly unchanged at £10.93m, giving eps on a fully diluted basis of 21.87p. This will rise to c.£12.96m and 26.7p respectively in 2007 as crops from trees planted in the 2004 extension planting programme start to come through for the first time. Despite this growth we expect the 2007 dividend be no more than maintained because of the massive investment in the extension planting programme.

There are no consensus estimates available for quoted competitors MP Evans (MPE.L) and Anglo Eastern Plantations (AEP.L) so valuing REA is difficult. However, on a 2007 PER of 14X against forecast eps growth of 22%, we do not believe the current valuation is demanding.

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