

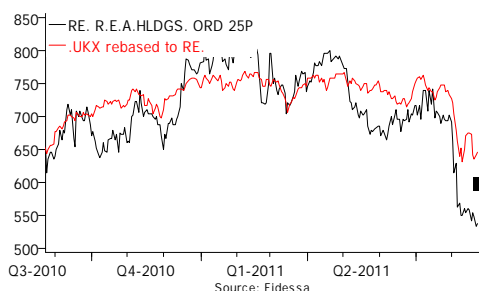
R.E.A. Holdings

598p

25 August 2011

2011 Half Year Results – A Riposte To ‘Mr Market’

Share Price: 598p



12m High: 820p

12m Low: 534p

Market Cap: £199.8m

Shares in Issue: 33.4m ordinary, fully diluted

Also 42m 9% Cumulative Preference Shares

NAV/Share: 475p (1H11 actual)

Gearing: 41% (1H11 actual)

Interest Cover: 8.2x (1H11 actual)

EPIC Code: RE.

Sector: Food Producers and Processors

Market: London Main List

Broker: Mirabaud Securities

Website: www.rea.co.uk

Description: REA is engaged in the operation and further development of a single site palm oil plantation in East Kalimantan, Indonesia. More recently it has acquired rights in respect of two small coal mining concessions, also in East Kalimantan.

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Sometimes ‘Mr Market’, borrowing from Warren Buffett, can behave oddly; at the close of the market 23rd August R.E.A. Holdings (REA) share price was off some 22% on the month, reflecting not just recent market volatility or a reduced CPO price, but also a thin market in the shares of this tightly held company and pricing by the market makers that is anything but finessed. Many of the group’s peers have escaped with price weakness of 5% -8% in similar conditions.

Yesterday as a riposte to the market the company reported interim results that have already reversed some 7% points of the recent weakness. With fresh fruit production up 21% on a maturing acreage and with the palm oil price well ahead of the prevailing prices in the first half of 2010, the company was able to report revenues up 50% at \$75.5m (\$50.3m) and pretax profit up 84% at \$36.9m (\$20.1m). Fully diluted eps out turned at US 75.6 cents. For the full year we anticipate earnings in the region of \$1.51 or £0.92 to put the shares on a 31/12/2011 P/E of 6.36x. For a company that is likely to enjoy compound earnings growth of 12% pa through to 2016, when fully diluted eps of £1.61 could put the stock on a multiple of 3.6x, ‘Mr Market’s’ recent bout of irrational behaviour leaves the shares looking cheap.

This is a prudently run business, that is managed for profitable growth and financed in such a way as to maximise the interests of the ordinary shareholders in the wealth that is being created. Consider the highlights of today’s announcement.

Fresh fruit bunches (FFB) –production up 21.5% at almost 300,000 tonnes on better weather and the growing maturity of the planted hectares. It says a great deal for management’s understanding of its operations that the outcome was a mere 3.4% ahead of budget – and crucially it was ahead of budget. Richard Robinow & John Oakley have worked together in the Indonesian palm sector since 1982 – and they have clearly learned the business. Oil extraction rates were lower at 22.7%, down from last year’s 24.2%, due to inflows from less mature hectares and lower sunlight across the crop. We anticipate FFB of some 330,000 tonnes in this, the second half of 2011 and oil extraction of circa 23% (better in the second half).

| Y/E | Own Crop | Group Sales | Declared Profit | EPS | P/E ratio | Divi | Yield |
|----------|----------|-------------|-----------------|---------|-----------|-------|-------|
| December | Tonnes | US \$m | US \$m | c/share | | UK p. | % |
| 2008A | 450,906 | 79.6 | 36.3 | 71.5 | 13.7 | 2.00 | 0.3 |
| 2009A | 490,000 | 78.9 | 41.7 | 81.4 | 12.0 | 4.00 | 0.7 |
| 2010A | 518,742 | 114.0 | 50.4 | 96.7 | 10.1 | 5.00 | 0.8 |
| 2011E | 623,819 | 155.6 | 79.9 | 149.1 | 6.6 | 7.00 | 1.2 |
| 2012E | 688,359 | 179.6 | 99.4 | 186.0 | 5.3 | 8.00 | 1.3 |

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Palm plantation development- last year planting was restricted by permitting issues – principally the introduction of a new permitting scheme by the Forestry authorities – and the company achieved a new planted area of circa 1,000 ha only. This year REA expects to plant as many as 7,000 ha, thus retaining faith with its undertaking to plant 8,000 new ha in the period 2010-2011. It is possible that there may be a slight roll over into Q1 2012, but this is not expected to be significant. Additionally the company proposes to plant out another 5,000 ha in the 2012 year. Looking ahead, mindful of the company's continued ambition to expand we understand that management hopes to grow the plantation by up to another 12,000 ha by 2016 in areas contiguous to current operations. The overall area of fully titled land stands at 70,584 ha, additionally REA is actively pursuing titling of currently held land allocations exceeding 15,000ha.

Dividend Payable – a further ordinary dividend (final) of 3p per share to be paid 30th September as a final for 2010 making 5p in total. In January 2012 it is proposed to pay a first interim dividend for 2011 of 3p per share. A final dividend for the 2011 year is proposed for payment in July 2012 [we estimate 4p], making a total cash dividend of 7p per share. Additionally a scrip issue is also proposed on the basis of 3 new 9% cumulative Preference shares for every 50 ordinary shares held 28/09/2011. The substantial investment required to develop the estates constrains the size of cash dividend payouts. The capitalisation of preference shares is described by the company as 'a useful mechanism for augmenting returns to ordinary shareholders in periods in which good profits are achieved but when demands on cash resources limit the scope for payment of ordinary dividends'. This represents broadly another 6.0p per share making for a likely total dividend value of approximately 13 p per share for 2011. In all, the dividend yield would total some 2.2% at the current share price.

Coal Activities – Out of total administrative costs for the half year the coal activities accounted for only \$0.4m or 7%, but up from a mere \$0.12m or 2.9% of interim administrative costs in 2010. Similarly revenues have expanded to \$7.6m (\$0.8m) and produced net operating profit of \$0.24m (\$0.3m). The lower profit contribution reflecting increased management costs as the activity is expanded. While the company's owned operations at Kota Bangun have been temporarily halted due to the financial problems of its principal contractor, the coal trading operations have increased. Sales of traded coal amounted to 118,041 tonnes [2010: nil], with a further 110,061 sold during July & August. Management states that it remains on target to achieve a monthly average of traded coal sales of 100,000 tonnes by end 2011.

RSPO Certification – REA Kaltim with 30,106 ha has now received RSPO Certification. The company is exploring whether there is commercial benefit in shipping the oil from the 2 Kaltim Estate mills to a shipper of certified oil for the European markets. We doubt that there will be enough of a premium to make this worthwhile, but we are strongly supportive of the company's efforts to achieve certification across the entire estate as we believe that uncertified oil will progressively have more limited market opportunities and will likely trade at a discount.

Financing – REA has a clever balance sheet: \$413m of total assets at end 2010 were financed by some \$24m of ordinary paid in equity share capital; \$43m of paid in Preference Capital; \$138m of debt finance; some \$69m of creditors and \$166m of retained earnings. In July this year REA issued another 15m x £1 shares of 9% cumulative preference shares – permanent capital. It proposes to repay maturing borrowings with this new prior ranking capital. At end June 2011 net debt stood at \$102.2m or 39.65% of equity. Finance costs and preference share dividends combined were 6.1x covered by half year EBIT.

Other Items – the statement accompanying the half year results included a first time advice that the Board is considering the merits of a listing of a minority share of its important Indonesian subsidiary REA Kaltim. Management has been considering for sometime the merits of perhaps relocating its main listing from London to Singapore – an important market location for Indonesian oil palm operators including Wilmar [\$27bn market cap] and Golden Agri-Resources [\$6.4bn market cap]. In all the Singaporean listed Indonesian operators enjoy a combined market capitalisation of some US \$36bn. We doubt that this would produce a material benefit, despite the concentration of Indonesian operators on that exchange; London provides ample liquidity, but this is not REA's primary concern – after all

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while it is a frequent user of the London bond markets, it is not a regular issuer of ordinary shares. More important to the company are its relationships in the region – and in this context a Jakarta listing makes great sense. Companies perceived as local are likely to enjoy greater access to land and government benevolence. REA is an important and long standing employer, tax payer and socially responsible corporate citizen in Indonesia – a local listing would only confirm its status. The company indicates that the proceeds of any such listing would be retained in reserves for the repurchase of ordinary shares in London – providing just the sort of support needed when ‘Mr Market’ is behaving irrationally. REA is above all a company that is run for the benefit of its ordinary shareholders and in this context the proposal is likely to be strongly supported.

The statement also referred to ‘additions to senior management as part of the group’s succession planning’. We have raised this issue with management for clarification. While Chairman Richard Robinow is 65 and Managing Director John Oakley is 62, both are in excellent health and totally committed to the business and their roles, neither is intending to retire anytime soon. Observers have noted however that aside from this founding duo, there is little other senior resource. With the group’s oil palm activities growing apace, and with a new coal venture in prospect, it has been deemed necessary and prudent to provide greater depth to the senior management resource – and in turn this answers questions about both depth and continuity of management.

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| Management | Major Shareholders |
|---|---|
| <p>Non-Executive Chairman: Richard Robinow</p> <p>Managing Director: John Oakley</p> <p>Non-Executive Director: Chan Lok Lim</p> <p>Non-Executive Director: David Blackett</p> <p>Non-Executive Director: Jock Green-Armytage</p> <p>Non-Executive Director: John Keatley</p> <p>Non-Executive Director: David Killick</p> <p>Non-Executive Director: Charles Letts</p> | <p>Richard Robinow 30.79%</p> <p>Prudential 14.25%</p> <p>Alcatel Bell Pension Fund 11.99%</p> <p>Artemis UK Smaller Cos 5.74%</p> |
| Key Dates | Key Milestones |
| | <p>1989: Commences a 125,000H single site oil palm plantation in East Kalimantan, Indonesia.</p> <p>1997: Asian Economic Crisis closes the door on debt finance. Seeks equity finance, part of which is provided by the MEZ Group.</p> <p>Oct 2001: Palm oil price plunges to \$250m/t and REA halts new planting activity. Also, the MEZ group launches legal proceedings.</p> <p>2004: Extension planting is resumed at the rate of 3,000 – 4,000 H per annum.</p> <p>2005: Two share placings at 260p/share raise 10.24m.</p> <p>2006: Resolves legal dispute with the MEZ group. Issues \$30m of 7.5% dollar-denominated loan notes 2012/14.</p> <p>Sept 2006: Acquires PBJ, a 20,000 H land allotment in East Kalimantan.</p> <p>Jan 2007: £22m nominal of 9.5% sterling loan notes 2015/17 issued.</p> <p>Mar 2008: Acquires a further two land allocations in East Kalimantan, KMS and CDM, totalling 37,000 H.</p> <p>Aug 2008: £15m nominal of 9.5% sterling loan notes 2015/17 issued.</p> <p>Aug 2008: Acquires rights in respect of two adjoining coal concessions, Liburdinding and Muser.</p> <p>Dec 2009: Acquires a further coal concession at Kota Bangun.</p> <p>Feb 2010: \$15m nominal 7.5% dollar loan notes 2012/14 issued and 150,000 shares of \$10 in subsidiary KCC.</p> <p>Oct 2010: Issues 9m new 9% preference shares.</p> <p>Jul 2011: Issues 15m new 9% preference shares REA Kaltim estate obtained RSPO certification</p> |

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