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17th February 2021

REA Holdings PLC

Ticker: RELN

ISIN	Type	Issue Size	Min Piece	Coupon	Maturity	Indicative offer	YTM
GB0007185639	Preference Shares	£72m	1	9%	Perpetual	87.5	10.28%*
GB00BD8BTF36	Senior Secured	$24m	120k	7.5%	30/06/2022	98	9.09%
GB00BYY8MM32	Senior Secured	£30.9m	100k	8.75%	31/08/2025	101	9.20%**

** Approximate running yield – does not take into account unpaid accrued dividends. ** Redeems at 104.*

Background

REA Holdings began planting oil palm in Indonesia in 1994. Today the group has 80,000ha of allocated land, over 33,055ha being mature plantation in East Kalimantan, plus a further 3,099 immature hectares. Around 8-10,000ha is not planted, but suitable for farming. The remainder of the land is infrastructure (4,000ha), kept as conservation areas (20,000ha), or otherwise unsuitable for cultivation.

REA is a member of the Roundtable on Sustainable Palm Oil (RSPO), an organisation established in 2004 to promote credible global standards for 'Certified Sustainable Palm Oil'. It has 3,000 members and represents oil palm producers, processors or traders, consumer goods manufacturers, retailers, banks/investors as well as a range of NGOs. REA is ranked 13th out of 100 palm oil industry companies in the SPOTT (Sustainable Palm Oil Transparency Toolkit) system, a measure developed by the Zoological Society of London.

Together with operating cash flows, REA relies on a blend of bank and bond debt to fund its operations. An agreement with a key customer/s to continue funding in exchange for future palm oil supplies – and perhaps even increased funding – is likely to be agreed shortly (farmout). That will free up cash flow for repayment of the senior bank loans as they come due in the next couple of years. Assuming that is agreed, management attention will turn to the two years of preference dividend arrears currently outstanding and the strength of the balance sheet overall. The current thinking is to raise funds by way of an equity linked instrument. The farmout and equity will serve to underpin the balance sheet while delevering and allow for the preference dividend arrears to be addressed in some way. That process looked set to start in 2020 but was stymied by Covid-19's effect on global demand.

2020 Performance

Production and processing proceeded relatively well in the first half with additional safety measures implemented for Covid-19. Harvesting slowed a bit mid-year due to slower ripening conditions seen across the region. The latter part of the second half saw high rains (the La Niña weather phenomenon arrived). That hindered the usual harvesting and evacuation rates in peak season. Covid-19 impacts on travel meant there were fewer harvesters available as well. Upgrades to mills were delayed due to limited spare parts supplies and contractor availability, for similar reasons.

- The FFB (fresh fruit bunches) harvest was 785,850 tonnes, which compared to just over 800,000 in both 2018 and 2019 seems a fair result under the conditions.
- The palm oil extraction rate was only slightly lower, at 22.5%.
- We estimate REA achieved average prices for palm oil and palm kernel oil of roughly $575 and $605 respectively for the full year. All palm oil is sold locally, hence the difference compared to CIF Rotterdam.
- REA was also able to continue with normal fertiliser applications, which many smaller producers could not sustain through the period of low prices in the first half.
- Cost reductions were evident in the first half results and indicate an improvement of around $10mn for the full year.

Despite the challenges, there was clear improvement in financial results. Half year revenue was up 10% to $62.4mn, EBITDA turned from a small negative last year to reach $11.2mn, and the loss before tax fell from $29.5mn to

$7.2mn. Operating cash flow of almost $30mn reflected better performance and better prices than prior years, as well as considerable support from trade creditors and customers through the low point of Covid-19 impact. Balances owing to customers at the year end will probably still be a bit high, but the best average prices since 2016 have started to reverse that support in late 2020/January 2021.

Debt should be around $203mn at the end of December, down from $217.3mn in 2019. On a conservative basis, we expect revenue for the full year to approach $140mn and EBITDA to reach c.$38mn. Operating cash flow in 2019 was just under $26mn before interest payments of $23.8mn, and again we expect it to improve in 2020. Interest should be roughly $2mn lower and below $20mn following scheduled reductions in bank loans of around $6.9mn. There will be significant one-off charges for the 2020 reorganisation of the GBP notes, other debt restructuring and currency movements.

Valuation

We base our LTV calculation on $13,000 per hectare, including crushing installations. That produces an estimated senior gearing ratio (net senior debt versus the value of plantations) of 44%, rising to 63% inclusive of the GBP preference shares. Using the book value of the plantations and mills ($425mn), the leverage ratios come out at 47% and 68% respectively. Against its most comparable peers, REA is looking undervalued on an EV per hectare basis. Assuming stable prices and costs REA should be able to improve on this year's estimated EBITDA of $39mn. The stone and coal concessions REA owns with a local partner look like being restarted during 2021, providing some upside potential as it starts supply of andesite to a neighbouring coal company.

Peer Valuations – in USD

Company name	market cap + pref shares	net debt	enterprise value	ebitda	leverage	ev / ebitda	acreage mature and immature	enterprise value per hectare	LTV based on $13,000
REA HOLDINGS	134	199	332	39	5	9	35,000	9,496	44%
SIPEF NV	579	151	766	74	2	10	74,000	10,348	16%
M P EVANS GROUP	471	67	539	30	2		38,661	13,931	13%
TSH RESOURCES	369	320	698	45	7	11	50,000	13,952	49%
HAP SENG PLANTAT	357	(18)	316	30	(1)	7	35,957	8,788	
IJM PLANTATIONS	373	160	526	40	4	9	60,633	8,681	20%
BUMITAMA AGRI LT	699	449	1,219	121	4	7	131,324	9,282	26%

Financing

Debt is down from $217.3 million at the end of 2019 to around $203mn.

REA is in discussion to provide further bank financing as $39.8mn of the $115.5mn facilities coming due over the next two years, along with $27mn of notes. Discussions for a farmout agreement with a large customer are at an advanced stage. The farmout will likely be in dollars and reduce overall annual interest costs.

• *Equity*
The company raised a total of $20 million by way of equity placements in October 2015, December 2016 and 2019.

• *Preferred 9% Equity*
Cumulative preference shares (currently 72m shares outstanding) form an important source of the funding structure. In October 2018, the company successfully placed 8.3m additional preference shares in the market at par plus accrued. The 9% dividend has been accruing since 1st January 2019, when it was suspended to preserve cash while palm oil prices were low. While the company expects to be able to pay a dividend in 2021, the $18mn arrears will need to be dealt with.

• *Senior secured bank facilities*
The main source of funding is a series of three Indonesian Rupiah bank facilities plus a $5m working capital facility from PT Bank Mandiri (Persero) Tbk. Together they total totalled $115.5mn at 30 June 2020. The working capital

facility was due in November 2020 and was extended for a further year. Maturities include $39.8mn over 2021 and 2022.

• *Non-controlling shareholder loan (DSN Indonesian 15% in Indonesian subsidiary).*
$26.4mn at the half year and subsequently reduced to c. $19mn via conversion to equity in the subsidiary in which DSN is invested.

• *Dollar Notes*
The $27mn 7.5% Dollar notes mature in June 2022.

• *Sterling Notes*
Following the period of low palm oil prices that reduced operating cash flow in 2018 and 2019, the £30.85mn GBP notes were voluntarily extended in early 2020 from the August 2020 maturity to August 2025 and repayable at £1.04 instead of $1.00. In addition, extending noteholders were issued 4,010,760 warrants (5 years; subscription price $1.26 per share).

Commodity risks

REA's revenues are almost exclusively attributable to the sale of palm oil. As such it is heavily exposed to the commodity's spot price, as well as regional weather conditions.

Along with other vegetable oils, palm oil prices went through a prolonged period of weakness during 2018 and 2019. Various factors contributed to lacklustre prices including strong growing conditions in key markets, trade tensions between China and the USA, and import tariffs on edible oil in India which increased global stocks.

Prices rose significantly toward the end of 2019, peaking in early January in response to the Indonesian government announcing measures to increase the use of palm oil as biodiesel, as well as a dip to global stocks. As Covid-19 spread and economic activity contracted, the CIF Rotterdam palm oil price fell to a low of $510 in May. It gradually recovered to around $750 before rising quickly in the final two months to $940.

Indonesia applies export levy and export duty in a sliding scale to palm oil prices to subsidise the local biodiesel market. That keeps a lid on local prices, which adjust to accommodate the imposts and eliminate the price differential. From February 2021 with the reference price between $770 and $1,000, higher prices will mean the benefit will go to the Indonesian government and its biofuel fund rather than palm oil exporters. It will, however, support the purchase of CPO for biodiesel. Given local duties and levies, there is no viable forward sale market locally.

There has been a general reduction in the supply of vegetable oils, which should support palm oil prices as global demand returns, and together with low reserves in Malaysia, these factors indicate stabilisation of realised prices at a sufficient level in 2021 as global demand recovers.

Comment

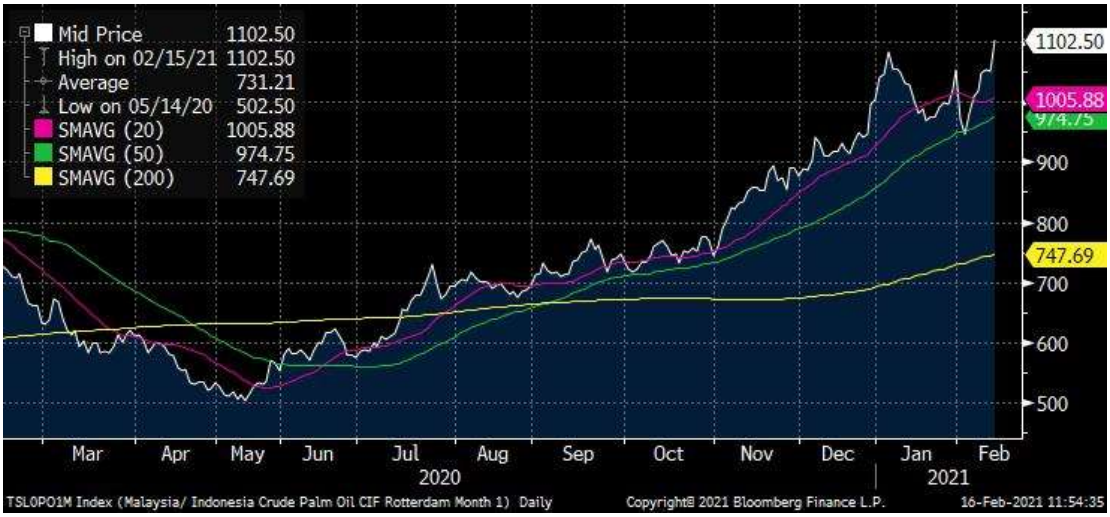
REA has maintained a stable but geared capital structure while expanding its cultivated hectares and making investments to its harvesting capabilities. More favourable weather conditions and more stable prices materially above the sustained lows of 2018-19 provide support for the business to address the dividend arrears and strengthen the balance sheet. Even though local duties and levies effectively cap local prices, once CIF Rotterdam hits $770 per tonne, REA can generate annual EBITDA of $50mn on a normalised basis. The balance sheet itself is underpinned by the plantations and crushing plants, valued at $506mn at FY 2020, covering net debt of c.$321mn by 1.6x. Higher and more stable prices in 2021, combined with the intended corporate actions, should mean that cash flow improves, and debt and annual interest costs can be reduced.

Full year accounts should be available around the end of April. Please contact the desk if you have any questions.

Penelope Fitzherbert

17th February 2021

Appendix 1 Palm oil prices CIF Rotterdam January 2018 – February 2021



Appendix 2 Sustainability

Palm oil has become an important plant-based lipid, both as cooking oil and in the production of a wide range of consumer staples. Observers believe that Asian governments have become serious on restricting licences for new plantations.

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Crude palm oil ("CPO") produced from International Sustainability and Carbon Certification ("ISCC") certified mills can be sold for the production of biodiesel that meets the requirements of the European Union Renewable Energy Directive.

In addition to industry certification practices REA has given substance to biodiversity, carbon footprint, soil improvement and community engagement.

Biodiversity
Of the group titled land area, 26% is set aside as natural habit and is actively managed and researched by a team of conservationists.

Greenhouse Gas Emissions
REA is committed to the use of zero burning and not planting peat areas for new plantations.

- It conducts a carbon stock assessment before oil palm development.
- REA has made progress over recent years by capturing methane gas released from palm oil mill effluent (POME).

Community engagement
REA has made progress over recent years by harvesting methane gas from the organic waste produced by their crushing plants. The methane is scrubbed on site before being used for electricity generation, which maintains the local grid for local communities. Prior to REA's contribution the local villages were living with intermittent electricity provided by diesel generators, or without it entirely.

In order to provide additional support for the local community, REA has developed and sponsored cooperative schemes that now cover a further 5,000 ha of palm oil plantation. This area delivers REA fresh fruit bunches (FFB) for processing at its own crushers at site. This is in conjunction with policies encouraging smallholders to adopt policies of zero burning and no planting on peat soils.

Appendix 3 Palm Oil Price Reference Rates for Indonesian Export Levy & Export Duty

COMBINED EXPORT LEVY AND EXPORT DUTY

From	To	Levy	Duty	Total	Net price*
$	$	$	$	$	$
0	670	55	-	55	615
670	695	60	-	60	635
695	720	75	-	75	645
720	745	90	-	90	655
745	750	105	-	105	645
751	770	105	3	108	662
770	795	120	3	123	672
795	800	135	3	138	662
801	820	135	18	153	667
820	845	150	18	168	677
845	850	165	18	183	667
851	870	165	33	198	672
870	895	180	33	213	682
895	900	195	33	228	672
901	920	195	52	247	673
920	945	210	52	262	683
945	950	225	52	277	673
951	970	225	74	299	671
970	995	240	74	314	681
995	1000	255	74	329	671
1001	1050	255	93	348	702
1051	1100	255	116	371	729
1101	1150	255	144	399	751
1151	1200	255	166	421	779
1201	1250	255	183	438	812
1251	1300	255	200	455	845

**At top of band*