Trading Statement

,

RNS Number : 6182X
R.E.A.Hldgs PLC
11 February 2013

Trading Statement (February 2013)

Agricultural operations

The group's crop of oil palm fresh fruit bunches ("FFB") for the year to 31 December 2012 amounted to 597,722 tonnes, a little below the FFB crop of 607,335 tonnes for the corresponding period in 2011 but some 12 per cent below the budgeted crop for the year of 682,000 tonnes. The group purchased 64,014 tonnes of FFB from smallholders and other third parties (2011: 34,146 tonnes).

Rainfall across the estates averaged 3,241 mm for 2012, similar to the level of 3,414 mm for the previous year. The widely predicted El Nino weather phenomenon did not materialise.

Processing of the group's own FFB production and the externally purchased FFB, together totalling 661,736 tonnes (2011: 641,481 tonnes) produced 151,516 tonnes of crude palm oil ("CPO") (2011: 147,455 tonnes), 30,734 tonnes of palm kernels (2011: 28,822 tonnes) and 11,549 tonnes (2011: 10,815 tonnes) of crude palm kernel oil ("CPKO") reflecting extraction rates of, respectively, 22.9 per cent for CPO (2011: 23.0 per cent), 4.7 per cent for kernels (2011: 4.5 per cent) and 37.7 per cent for CPKO (2011: 38.4 per cent).

Most of the crop shortfall against budget arose in the first half of 2012 and was attributable to a combination of delayed ripening of crops in the early part of the year (reflecting the particular weather patterns of the latter months of 2011) and crop losses resulting from harvesting disruptions generated by disputes with certain surrounding villages. It had been hoped that the second half of the year would see at least a partial recovery of the crop shortfall of the first half but further disruptions by villages meant that this recovery did not materialise. Further information regarding disputes with villages is provided under "Village issues" below.

Unfortunately, the delays to harvesting caused by the village disruptions meant that significant volumes of FFB were harvested late with a negative impact both on extraction rates and on the free fatty acid ("FFA") content of CPO production. The materially lower sales prices achievable for high FFA oil resulted in lower sales revenues than might otherwise have been expected in the closing months of 2012.

As previously announced, construction of the group's new oil mill was completed in September 2012. This mill and the two existing and recently upgraded mills should provide the group with sufficient capacity to process projected crops from its own estates and from third parties for some time to come. The second kernel crushing plant on the site of the new mill commenced production in November 2012.

The two methane capture plants commissioned during 2012 are performing ahead of expectations. The group now accrues carbon credits as a small scale Clean Development Mechanism Project under the United Nations Framework on Climate Change ("UNFCC") and, subject to final UNFCC evaluation, value for credits accrued during 2012 should be realised during 2013 at a price agreed at the outset of the methane plant project. Given the capacity of the plants to capture far more methane than required to generate power for the group's own needs, the directors are continuing to investigate alternative uses for the methane produced. Options include generating power for sale to the Indonesian state electricity company ("PLN"), ideally by feeding it into the national grid if this can be extended to the group's estates, and using methane as an alternative fuel source for vehicles and other diesel or petrol powered equipment.

The group made its first sales of sustainable CPO during the last few months of 2012 comprising 44,000 tonnes of ISCC certified CPO. The group also sold green palm certificates in respect of a total of 56,051 tonnes of CPO and 9,250 tonnes of PKO during 2012.

A significant feature of 2012 was the increasing throughput of third party FFB. This is providing the group with a valuable additional revenue stream, the benefit of which more than outweighs a slight negative impact on extraction rates. With the continuing expansion of smallholder plantings in the vicinity of the group's estates, material further increases in third party FFB throughput can be expected going forward.

The FFB crop for January 2013 amounted to 49,717 tonnes. This was ahead of the 41,704 tonnes harvested in January 2012 but, with village issues still having an impact, below the budget of 58,719 tonnes. Additional harvesters have been recruited and the frequency of harvesting rounds is gradually improving. Provided that this improvement can be sustained, FFA levels can be expected to return to normal levels.

The Governor of East Kalimantan has recently announced a 49 per cent increase in the minimum wage applicable in East Kalimantan. Whilst a reasonable proportion of the group's employees are paid at a level above the minimum wage, there will be pressure on the group to maintain differentials and it is inevitable that there will be a significant increase in the group's employment costs (which in 2012 represented about one third of the cost of sales of the group's agricultural operations).

In view of the regulatory restrictions on forward looking statements that are expected to apply to the group if the proposals referred to under "Proposed listing in Jakarta" below are implemented, the directors have concluded that no forecast of crops for 2013 should be published.

Village issues

The group's principal estate areas (being those owned by the company's subsidiaries, PT REA Kaltim Plantations ("REA Kaltim") and PT Sasana Yudha Bhakti ("SYB")) are surrounded by 12 larger villages and 11 smaller villages (with the latter administered through the larger villages).

Since the inception of its East Kalimantan operations in 1989, the group has sought to maintain good relations with the villages surrounding its operations and has supported village development of smallholder oil palm plantings and a variety of community development projects. Inevitably, during the period of over twenty years since 1989, there have been occasional disagreements between the group and surrounding villages but, until recently, these have been minor, rapidly resolved and without significant impact on the group. As already noted, that situation changed during 2012 with disputes concentrated into two waves, the first in the second quarter of the year running into early July and the second in the final weeks of the year and continuing into 2013. These disputes have been more serious than those previously experienced because of actions by villagers to enforce their position by stopping harvesting access to certain areas of the estates and blockading oil mills to prevent processing of FFB.

The recent village dissatisfaction with the group covers a number of issues and different villages have had different claims. However, a common theme has been a demand that the group procure the establishment of additional cooperative smallholder oil palm plantings in each village and provide the land required for such establishment. This demand is based on 2007 Indonesian legislation (the "2007 legislation") that requires that any company receiving a land allocation for oil palm development after the date on which the applicable legislation became effective must pass on to village cooperatives at cost a proportion of the land allocated sufficient to permit the cooperatives to plant an oil palm area equal to 20 per cent of the oil palm area to be developed by such company.

Substantially all the REA Kaltim and SYB plantings are on land allocated prior to the 2007 legislation and, whilst the group has to-date successfully supported smallholder development of some 5,600 hectares of oil palm, such developments have been almost entirely on land provided by villagers and, the group has not hitherto, as a general rule, itself provided land for smallholder plantings by villages surrounding the REA Kaltim and SYB estate areas. Legal advice has confirmed that the group is under no obligation to do so. Nevertheless, the group has for some time recognised that it should endeavour to meet the expectations of villagers who have difficulty understanding why villages adjacent to newer oil palm developments are entitled to be given land while they are not. It has, however, taken time to identify and acquire suitable land for cooperative development and the resultant delay has certainly exacerbated and may well have provoked the village problems that the group has experienced.

As previously reported, in July 2012, the group was successful in acquiring a 95 per cent interest in PT Persada Bangun Jaya ("PBJ2") which owns certain land allocations, including a strip of land of more than 2,000 hectares adjacent to the REA Kaltim and SYB estate areas. This will provide sufficient land for the group to meet the smallholder development obligations to which the group would have been subject had the REA Kaltim and SYB estates been developed after the 2007 legislation was enacted.

With the PBJ2 land now available to meet cooperative aspirations, the group has been working hard with village, district and provincial authorities to resolve village demands for oil palm cooperative developments and other village claims. Such resolution has been complicated, as respects land allocations for cooperatives, by the need for complete and accurate government mapping of all village boundaries to provide a consistent basis for allocation between villages and, as respects other claims, by past fraud by certain intermediaries who were legally appointed by villagers and entrusted with distributing land compensation to individual villagers. Fortunately, the group has received excellent support from the local authorities who have assisted with mediation and, where necessary, the police have intervened. It is clear that village actions interfering with the normal running of the group's estates are illegal but both the police and the group have been concerned to achieve resolutions of outstanding issues by dialogue rather than force and to retain a situation in which, notwithstanding the issues, discussion has remained possible between the group and the various villages without mutual antipathy.

Excellent progress has been made since the beginning of 2013 and settlement agreements in respect of most material issues have now been reached with all of the larger villages. As a result, almost all areas of the REA Kaltim and SYB estates are now open for harvesting and all three mills have resumed normal operations. Continuance of this much improved situation will, of course, be subject to satisfactory completion of the settlement agreements and, thereafter, adherence by villages to the terms of those agreements. Nevertheless the directors are hopeful that the group has passed a watershed.

The current improved position has been reached at a significant cost but that cost should not be without benefit given that the funds committed to procuring additional cooperative oil palm developments will, in due course, provide a return to the group from further increases in group revenues from processing cooperative FFB. Moreover, the stronger relationships forged in recent months with the East Kalimantan authorities and the better mutual understanding achieved between the group and its local communities should enhance the group's ability to continue the development of its East Kalimantan operations.

It is clear that the group and the villages around its estates are interdependent. The group requires the acceptance of its operations by the villages while the villages are reliant upon the group for employment and as a market for services, produce and smallholder grown FFB. In the future, if the group's surplus methane is used to generate power sold to PLN and distributed locally, the villages will also be reliant upon the group for electricity. Whilst it is probably inevitable that there will on occasions in the future be issues between the group and surrounding villages, the directors hope that with a better appreciation of the symbiotic relationship between the group and the villages, such issues will be more readily resolved than has been the case with the recent village issues.

Land areas and development

Completion of a bridge over the Senyiur River in October 2012 improved access to the land areas being developed by company's subsidiary, PT Kutai Mitra Sejahtera ("KMS"). This has made it possible to accelerate planting out of the KMS land areas which were already prepared for planting during 2011. It is hoped that the plantable area of some 5,000 hectares will be fully planted by around mid 2013 but it is likely that, of the 5,000 hectares, some 850 hectares will be transferred to a smallholder cooperative scheme in compliance with the requirements of the 2007 legislation. The group is negotiating to acquire an additional strip of land close to KMS of a similar size to the area to be transferred. If such negotiations prove successful, this would permit eventual expansion of KMS's own planted hectarage to 5,000 hectares.

The group retains its plans for further expansion in the substantial plantable areas held by its subsidiaries, PT Putra Bongan Jaya ("PBJ") and PT Cipta Davia Mandiri ("CDM"). Development of these areas was delayed during 2012 by the group's decision, given the issues that it had been experiencing with villages surrounding the REA Kaltim and SYB estates, not to commence development in new areas until it had ensured that, to the maximum extent practicable, compensation arrangements with villagers had been settled and registered with the local Indonesian authorities. Priority is now being given to the development of PBJ and land clearing in the southern areas held by PBJ is expected to start in the near future.

Work is continuing with a view to completing the conditional settlement agreement between SYB and an Indonesian third party company relating to mineral rights on certain land areas held by SYB. The continuing delay has been caused by the need to resolve certain complexities in relation to the land titles held by PT Praesetia Utama, the company to be acquired by SYB under the settlement agreement.

Coal and quarry operations

Following the group's decision to limit further capital committed to the coal mining operations, new trading activity has been put on hold and the group's primary concentration has been on how best to realise value from the three coal concessions in which the group has invested.

A successful conclusion of current discussions in relation to the Kota Bangun concession would result in that concession being mined by a third party with adjacent coal mining interests on a basis that would limit the group's downside and provide a return to the group that, at current coal prices, could reasonably be expected to recover the group's investment and, if coal prices recover further, yield a reasonable profit. Whilst the group would entertain a similar arrangement in relation to the Liburdinding and Muser concession, the group's current preferred option is to seek an outright sale of those concessions.

The group remains confident of the economic viability of its stone concession and work is continuing on plans to quarry the concession to provide stone for the group's agricultural operations and for sale to other prospective buyers in the area of those operations. To minimise development costs, it has now been decided to postpone evaluation of the stone for other uses, such as concrete manufacture, until after the quarry has been brought into production.

7.5 per cent dollar notes 2017 ("new dollar notes")

Further to announcements made on 13 and 16 November 2012 in respect of the issue of new dollar notes and as anticipated at that time, Guy Butler has sold on to third parties all of the

$2,024,000 nominal of new dollar notes initially subscribed by the group's subsidiary company R.E.A. Services Limited, on the same terms as those on which the new dollar notes were placed. Accordingly, a total of $15,000,000 nominal of new dollar notes has now been acquired by investors and, together with the new dollar notes issued to holders on 19 November 2012 in exchange for their existing dollar notes 2012/14, the total amount of new dollar notes in issue is, as previously announced, $34,011,003 nominal.

Proposed listing in Jakarta

As a preliminary to the planned public offering of new shares in REA Kaltim and the listing of REA Kaltim on the Indonesian Stock Exchange in Jakarta, the group needs to be restructured so that the company's Indonesian plantation subsidiaries form a single sub-group headed by REA Kaltim. It had been hoped to complete this restructuring by 31 December 2012 but this did not prove possible because of delays in obtaining the necessary Indonesian regulatory approvals.

The restructuring requires intra-group transfers of ownership of five of the company's Indonesian subsidiaries and each transfer must have individual authorisation from the Indonesian Investment Coordinating Board. At 31 December 2012, the required authorisations had been obtained for three of the five companies. Every effort is being made to secure the two outstanding authorisations but, realistically, these are unlikely to be forthcoming before the end of March 2013 at the earliest. Once the restructuring is complete, the minimum lead time to the planned public offering will be five months.

Carbon footprint report

Concurrently with the issue of this trading statement, the company is publishing its first carbon footprint report. This report identifies and quantifies the greenhouse gas emissions associated with the group's agricultural operations and will facilitate the design and implementation of strategies for further reducing emissions in the future, as well as allowing the group to report more effectively on all aspects of sustainability. The report will shortly be available for downloading from the company's website at www.rea.co.uk.

Conclusion

East Kalimantan is a recently democratised and rapidly developing society and this has added a social dimension to the challenges of infrastructure and remote location that the group has always faced. Nevertheless, East Kalimantan does offer excellent conditions for the cultivation of oil palm and provides opportunity for further expansion of established oil palm estates. The directors believe that the challenges can be surmounted and that the group will continue to accrue value from the further development of its oil palm operations which already represent a high quality large scale agricultural business.

Publication of results

In line with the timetable adopted in previous years, it is expected that the final results for 2012 will be announced, and the annual report in respect of 2012 published, in the second half of April 2013.

Enquiries:
R.E.A Holdings plc
Tel: 020 7436 78

END

TSTNKDDDQBKDNBD