Interim management report of the SIPEF group

as per 30 September 2018 (9m/18)

- Own palm oil production for the Group was up 11.5% during the third quarter, resulting in an increase of 8.4% by the end of September.
- There was a sharp rise in own palm oil volumes from the Indonesian plantations (+11.3%), while the first-quarter production fall in Papua New Guinea was offset in full (+1.8%).
- Good harvests and high stocks in the main vegetable oils led to a quarterly fall in the price of almost USD 100 per tonne on the spot market for palm oil, ending at USD 540 per tonne CIF Rotterdam at the end of September.
- Rising biodiesel production, linked to higher crude oil prices, and the blending program in Indonesia will support the demand for palm oil in the fourth quarter and gradually reduce stocks toward the beginning of 2019.
- To date, *SIPEF* has sold 78% of its 2018 palm oil production at USD 694 per tonne CIF Rotterdam, premiums included.
- In spite of rising volumes and efficiency improvements, the expectations of continuing lower palm oil prices in the fourth quarter will corrode the recurring result for the second half of the year. The annual results for 2018 will therefore be substantially lower than they were for the financial year 2017.
- The investment programs within the context of expansion in South Sumatra, Indonesia continued steadily with 10 278 hectares cultivated in Musi Rawas and the commencement of the limited replanting and expansion of Dendymarker.

1. Interim management report

1.1. Group production

Group production

2018 *(in tonnes)*	Own	Third parties	Q3/18	YoY%	Own	Third parties	YTD Q3/18	YoY%
Palm oil	79 700	15 778	95 478	*12.99%*	217 512	44 168	261 680	*6.35%*
Rubber	1 792	0	1 792	*5.60%*	5 917	0	5 917	*-3.33%*
Tea	473	0	473	*-18.17%*	1 658	0	1 658	*-5.09%*
Bananas	7 262	0	7 262	*-0.56%*	20 563	0	20 563	*-7.02%*

2017 *(in tonnes)*	Own	Third parties	Q3/17	Own	Third parties	YTD Q3/17
Palm oil	71 492	13 012	84 504	200 652	45 393	246 045
Rubber	1 697	0	1 697	6 121	0	6 121
Tea	578	0	578	1 747	0	1 747
Bananas	7 303	0	7 303	22 115	0	22 115

After an exceptionally strong production year in 2017, with our own palm oil production of the third quarter up 12.7%, we recorded again a growth of 11.5% for the same period in 2018. All three mature production centres in Sumatra, Indonesia contributed to this quarterly rise: the Tolan Tiga group (+1.9%), the more recent UMW/TUM group (+11.3%) and the Agro Muko plantations in Bengkulu (+16.3%). Generally favourable climatic conditions for oil palms in Sumatra in 2018 played a part in this growth, but the improved efficiency of the young planted hectares was especially important. In South Sumatra, where since the end of June all Musi Rawas and Dendymarker fruit has been processed in our own mill, third-quarter palm oil production was in excess of 2 000 tonnes.

The same trend has been observed in our own oil palm areas in Papua New Guinea, where third-quarter production was up by 7.8% compared with the same period last year. As a result, the production losses due to the intense rainy season in the first quarter were turned into a 1.8% rise in volume over the first nine months of the year.

A more marked turnaround was observed in the production of the smallholders in Papua New Guinea, where the earlier losses of -31.9% at the end of March were reduced to -6.2%, up until now, due to a 14.2% rise in production in the third quarter.

The strong growth in volume at our own plantations, of 11.5% for the third quarter, led to an 8.4% rise in the combined annual volume in our own plantations at the end of September. This rise was weakened somewhat by the slower response of the smallholders to the positive agronomic conditions, whereby the total palm oil production for the Group rose by 6.4% against the same period last year.

We recorded highly varied production figures for our rubber plantations in Indonesia, depending on the weather and the corresponding wintering period. Production increased again by 4.4% in North Sumatra after a marked wintering period in the second quarter, but combined production remains -16.4% below last year's volumes. In the MAS Palembang plantations we had to deal with a rare leaf disease that caused a long wintering period. As a result, production dropped by -31.6% in the third quarter and by -11.0% cumulated over the year. In Agro Muko in Bengkulu, where the young plantations are now achieving higher maturity, the third quarter was exceptionally good, with a production rise of 45.4%. As a result, the annual volume is 24.5% higher than in the first nine months of last year.

The tea plantations in Cibuni, Java, Indonesia continued to be affected by changeable weather in the third quarter, which did not help leaf growth. As a consequence, we recorded a further production drop in the quarter (-18.2%) and for the year (-5.1%) compared with the same period last year.

Third-quarter banana production in Ivory Coast was in line with the figure for the same period last year. In spite of the production growth from the new expansions at the Azaguié 2 plantation, total production for the first nine months remains -7.0% below the volume achieved in September 2017, with the export volumes for the existing three plantations again considerably below expectations. Restructuring of management and stricter quality standards for harvesting and packing are expected to drive improvements here over the next few months.

1.2. Markets

Average market prices

In USD/tonne		YTD Q3/18	YTD Q3/17	YTD Q4/17
Palm oil*	CIF Rotterdam	631	719	715
Rubber**	RSS3 FOB Singapore	1 619	2 121	1 995
Tea**	Mombasa	2 653	2 980	2 971
Bananas***	CFR Europe	665	689	684

** Oilworld Price Data*
***World Bank Commodity Price Data (updated database)*
**** CIRAD Price Data (in EUR)*

The end of the third quarter showed that Malaysian production was still lagging behind 2017 in the first nine months. Indonesian production in 2018, however, has been good, but shows some signs of tapering off towards the end of the year. Currently, that is still being disguised by major logistical hiccups with full tanks at the refineries, which has caused the nearby weakness on physical oil.

The Indian palm oil demand came back slowly, due to a retaliated duty increase on liquid oils. August and September showed ever increasing import figures, but they could not disguise the fact that Indian demand was nearly one million tonnes below expectation.

The US-China ‘trade war’ triggered the implementation of a 25% import duty on US soy beans to China, which is having a strong negative effect for the US farmer. It is actually proving negative for the entire agricultural commodity market and uncertainty about the next step is having a negative effect on the trade.

The petroleum market flirted a few times with USD 80 per barrel, but finally broke the barrier at the end of September. Gasoil rallied with it and the POGO (Palm Oil – Gas Oil) spread increased to USD 230 on the spot and was still projected USD 180 for the first quarter 2019. This is triggering discretionary biodiesel blending, and we have seen biodiesel shipments to China and Africa.

Indonesia finally presented a stronger empowerment from the government to actually achieve the 20% biodiesel blending target. The Widodo government, which seems to be more concerned about the Indonesian rupiah, ordered the minimum of regular diesel imports and maximised palm biodiesel blending. Both should be a win-win for the rupiah. The volumes increased in biodiesel facilities, but logistical hiccups were still experienced. These should disappear now that the biodiesel margins are booming and we should see a full capacity utilisation rate commencing soon.

At the same time, very large crops of soybeans and sunflower seeds were harvested, and their oils fought for market share, which had a negative impact on palm oil.

The palm oil market endured strong losses and tried to buy demand at lower levels. It had traded from USD 625 per tonne CIF Rotterdam in a straight line down to USD 540 per tonne by the end of September.

Palm kernel oil (PKO) has been fighting with coconut oil for demand. But the recent drop in prices below USD 1 000 per tonne for both products has triggered sufficient demand on the spot as well as forward business. The price of PKO hovered between USD 890 and USD 820 per tonne CIF Rotterdam, which is a very narrow range, given its recent historic performance.

The rubber market has been very boring and trading in a narrow range. The premium for latex grades reduced and consumer demand was very slow during the summer. Chinese port stocks are still at a high level and, considering that China should be the growth engine for rubber demand, it is difficult to see a lot of upside as long as stocks remain high. Prices for SICOM RSS3 traded between USD 1 500 and USD 1 400 per tonne.

Tea production in Kenya during the third quarter continued to outperform compared to the same period of 2017. However, demand has been good and prices in the Mombasa auction, our benchmark market, moved in a narrow range during the third quarter of 2018.

Due to the hot summer weather and the large supply of dollar bananas from Central America, banana prices on the European spot market were under pressure throughout the summer period, but beginning in September prices began to rise again on the market, due to increased consumption and strike-related issues affecting the supply from Cameroon and Costa Rica.

1.3. Prospects

1.3.1. Production

As in previous quarters, we observed an enduring increase in palm oil fruit and palm oil production volumes across all *SIPEF* group plantations at the beginning of the fourth quarter compared with the same period last year. After very strong growth in the third quarter, we continue to observe good fruit formation and the outlook for the final months is also positive at our own plantations in Papua New Guinea. As a consequence, we maintain our expectation of at least 9% growth in our palm oil production.

Due to the growing number of mature hectares in the developments in Musi Rawas and the gradual normalisation of production at the Dendymarker plantation acquired last year, we again record rising palm oil volumes in the fourth quarter in the new expansion zone of South Sumatra, where the capacity of the existing processing mill will be doubled in 2019.

In spite of the temporary production ups and downs in the MAS Palembang rubber plantations, we do not expect a further fall in rubber volumes toward the end of the year. We expect the annual volumes to recover. However, expectations remain rather negative for the disappointing tea production in Cibuni, Java. Additionally, for the banana production in Ivory Coast, the full impact of the steps taken to increase the volumes for export to Europe will probably only be felt at the beginning of 2019, which will have a direct impact on the contribution of this activity to the result of the current year.

1.3.2. Markets

The palm oil market is currently in its peak production period and will probably face high stocks until the end of the year, but its price competitiveness versus competing oils as well as in the biodiesel market should attract sufficient demand to see a rather quick reduction of stocks in early 2019. It is expected that Indonesia will be able to reach 20% biodiesel blending by the end of this year, and this percentage is likely to increase next year. In 2019, it is unlikely that Indonesia will reach its targeted 30%, as there could be a lack of capacity, but given the economics for discretionary blending, we should expect to see all capacity to run at full blast. The biodiesel industry could consume an additional 4 to 5 million tonnes of palm oil in 2019.

With the rather limited production growth ahead of us in 2019, this additional biodiesel demand will certainly provide enough incentive for significantly higher markets. The bearish outlook for soybeans is more a protein story, but could have a dampening effect on palm oil. The uncertainty surrounding the US-China ‘trade war’ could lead our markets in any direction. On the other hand, a further rally in petroleum would increase the upside for palm oil. We are confident of seeing a substantially stronger palm oil market for 2019.

The rubber market remains lacklustre and unless there is new input, it is likely to stay in this narrow trading range.

Demand for tea in the Mombasa tea auction normally peaks during the fourth quarter, but sufficient supplies in Kenya will limit the upside. We expect tea prices to remain range-bound with slight upticks.

1.3.3. Results

To date we have sold 78% of our expected palm oil production at an average price of USD 694 CIF Rotterdam, premiums included, compared with 95% at USD 755 CIF Rotterdam at the same time last year.

In spite of the considerable weakening of the palm oil market in the past quarter, we continue to gradually place our rising production volumes on the market. Given the current (USD 535 per tonne CIF Rotterdam) and the expected price level for the fourth quarter, the sale of the remaining 22% of our annual production will undoubtedly lower the market average of sales achieved until now.

We have now sold 80% of the expected production volume of rubber at an average price of USD 1 548 per tonne FOB, which is 23.8% lower than the price achieved at the same time last year and below the average production cost price of our Indonesian rubber plantations. In spite of cost savings, the expected prices for the rest of the year are so low that we expect to close the year with this business making a negative contribution to the result.

For the tea activities on the other hand, as things stand we observe a rise of 6.5% in the average sale price compared with the same period in 2017.

The rises in production and the relative weakness of the local currencies – IDR in Indonesia and PGK in Papua New Guinea – against the USD mean that the limited rises in fertiliser and diesel prices can be kept under control and our average unit production cost prices, expressed in USD, remain steady compared with the previous year.

Given the considerable fall in palm oil and rubber sale prices, we expect the recurring result for the second half of 2018 to be approximately the same as for the first half of the year, which means the recurring annual results will be significantly lower than in 2017.

1.3.4. Cash flow and expansion

In spite of the temporary fall in palm oil prices, subject to the usual replacement investments and replanting of older areas, *SIPEF* continues with the steady development of palm oil activities in South Sumatra, Indonesia, represented by the Musi Rawas and Dendymarker projects.

In Musi Rawas, the compensation of plots, followed by the preparation of the site and the planting of oil palms continues successfully on the four concessions centralised in three enterprises. In the first nine months, an additional 1 695 hectares were compensated and an additional net 1 053 hectares prepared for planting or planted, bringing the total to 10 278 cultivated hectares, which is 68.6% of the total of 14 978 compensated hectares, of which for now 2 179 hectares acquired for planting for smallholders (plasma) and 12 799 hectares for internal development. As of the third quarter, palm oil fruit production of the 2 137 mature hectares was processed in full at our own mill.

The additional acquired licences for a total of 8 641 hectares announced during the financial year, all adjacent to the existing concession of Agro Muara Rupit (AMR) and Agro Kati Lama (AKL), have been subjected to the approval procedures for the development of sustainable oil palm plantations, with assessments by consultants who report to the local governments and the Roundtable on Sustainable Palm Oil (RSPO). The development of these areas is expected to begin in the first quarter of 2019.

After thorough remediation of the mature plantings, the limited replanting of older Dendymarker palm areas between the four Musi Rawas concessions began during the third quarter. 333 hectares have already been renewed, while the compensation in a 2 005-hectare development was begun. We expect 80% of this to be converted gradually to oil palm plantations.

To conclude, the additional acquisition of concessions earlier this year has opened the way to the growth of the *SIPEF* group into a company that, over a 5-year period, will approach 100 000 hectares under own management, of which 80 000 hectares are already planted and the supply base will reach 120 000 hectares.

Translation: this press release is available in Dutch, French and English. The Dutch version is the original; the other language versions are free translations. We have made every reasonable effort to avoid any discrepancies between the different language versions. However, should such discrepancies exist, the Dutch version will take precedence.

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SIPEF is a Belgian agro-industry group listed on Euronext Brussels and specialised in the – as sustainable certified - production of tropical agricultural commodities, primarily crude palm oil and palm products. These labour-intensive activities are consolidated in Indonesia, Papua New Guinea and Ivory Coast and are characterised by broad stakeholder involvement, which sustainably supports the long-term investments.