
The connection to the world of sustainable tropical agriculture

# Interim management report of the SIPEF group

as per 30 September 2019 (9m/19)

- For the first time this year, the Indonesian palm activities knew a quarter with rising volumes (+ 3.3%) compared to the same period last year.
- The palm plantations in Papua New Guinea were hit three times by volcanic eruptions from Mount Ulawun, and this led to a 48.6% fall in the palm oil produced for the third quarter.
- The total palm oil Group production decreased by 10.4% over the first nine months of the year.
- The demand for palm oil, for both food and biodiesel purposes, was strong in August, causing the palm oil prices to peak at USD 590 per tonne CIF Rotterdam, but then again slightly fell back due to higher production in Malaysia.
- World stocks of palm oil are expected to decrease towards the end of the fourth quarter due to high biodiesel needs, mainly from Indonesia, and lower production after the peak period, driven by cuts in fertilisers and the drought in Indonesia.
- To date, SIPEF has sold 88% of its palm oil production for 2019 at USD 571 per tonne CIF Rotterdam, premiums included.
- Due to the exceptionally lower than expected production volumes for the fourth quarter, especially in Papua New Guinea, the recurring results for the second semester will not be better than those of the first semester, and SIPEF will close the financial year with a loss.
- The investment programs, related to the expansion in South Sumatra in Indonesia, have continued steadily, with 11 695 hectares already cultivated in Musi Rawas, while the replanting on Dendymarker's own plantations was continued.

# 1. Interim management report

## 1.1. Group production

### Group production

| ***2019** (in tonnes)* | **Own** | **Third parties** | **Q3/19** | **YoY%** | **Own** | **Third parties** | **YTD Q3/19** | **YoY%** |
|---|---|---|---|---|---|---|---|---|
| Palm oil | 70 976 | 9 833 | **80 809** | *-15.36%* | 199 054 | 35 451 | **234 505** | *-10.38%* |
| Rubber* | 1 233 | 239 | **1 472** | *-17.86%* | 4 301 | 535 | **4 836** | *-18.27%* |
| Tea | 448 | 0 | **448** | *-5.29 %* | 1 760 | 0 | **1 760** | *6.15%* |
| Bananas | 7 558 | 0 | **7 558** | *4.08%* | 24 286 | 0 | **24 286** | *18.11%* |

| ***2018** (in tonnes)* | **Own** | **Third parties** | **Q3/18** | **Own** | **Third parties** | **YTD Q3/18** |
|---|---|---|---|---|---|---|
| Palm oil | 79 700 | 15 778 | **95 478** | 217 512 | 44 168 | **261 680** |
| Rubber* | 1 469 | 323 | **1 792** | 5 190 | 727 | **5 917** |
| Tea | 473 | 0 | **473** | 1 658 | 0 | **1 658** |
| Bananas | 7 262 | 0 | **7 262** | 20 563 | 0 | **20 563** |

*Tolan Tiga Group rubber production has been split into own and outgrower production. The outgrower production consists of production from PT Timbang Deli. The figures of prior year have been restated.

Fruit development has continued to stagnate in Indonesia in the third quarter. After a very strong year in 2018, there has been virtually no further growth in production at Group level and a 'rest period' is being observed, especially at the younger mature plantations.

Partly due to the recent drought, in which the rainfall remained significantly below the usual level, for both the younger UMW/TUM plantations in North Sumatra (-6.2%) and the plantations under replant in Agro Muko (-5.4%), lower than expected growth rates were noted for the third quarter. Only the mature plantations in North Sumatra maintained last year's high level (+ 2.3%) but the new plantings in South Sumatra even recorded a significant increase in volume (+ 18.8%).

Due to the drought, the extraction rates in all Indonesian production regions were better than last year and in previous quarters this year. This increased for the first time again this year the volume of palm oil for the Indonesian activities (+ 3.3%) compared to the third quarter of last year. The negative growth for total palm oil production in this region at the end of June could therefore be reduced from -3.8% to -1.2% at the end of September.

In Papua New Guinea, as a result of the intense rainy season in the first quarter, crops for the first semester fell by 11.9% for the own plantations and by 15.4% for the smallholders. Moreover, in recent months the Group was hit three times by volcanic eruptions from Mount Ulawun, which is located north of the plantations. On June 26 and August 3, approximately 6 300 hectares (44.9% of the total plantings) were covered to a greater or lesser extent with a layer of ash and small stones, reaching heights of 15 cm. In addition to the immediate significant fall in production, the recovery of damaged palm leaves for nearly 5 000 hectares will exceed a year, and partially may even last up to three years. On September 30, a third eruption, on the side of the crater, had only a very limited additional impact on the plantings and, after the evacuation of the surrounding residents, the daily activities were resumed relatively quickly.

These eruptions have obviously had a significant effect on the work, not only in the affected areas. Indeed, due to the successive evacuations of more than 5 000 employees and their families, harvesting activities in the other plantings were interrupted several times. For the third quarter, a fall in crop of 51.6% was recorded for the own plantations and 36.5% for the smallholders. Delays in transportation and the repeated close-down of the Navo mill also had an effect on the quality of the processed fruits and the extraction of the oil. As a consequence, the volume of palm oil produced fell by 48.6% in the third quarter and by 24.4% over the first nine months.

The decrease in total Group production compared to last year amounts to 15.4% for the third quarter and 10.4% for the first nine months of the year.

The previously reported negative effects of the Fusicoccum fungus, which caused an exceptionally long wintering period, have also continued to influence production in North Sumatra (-32.3%) and Bengkulu (-19.0%) in the third quarter. In South Sumatra the MAS Palembang plantation was able to reach increasing volumes again (+ 8.6%). Total Group production, however, remains below last year's for both the third quarter (-17.9%) and for the first nine months (-18.3%).

After a strong start to the year, due to good weather conditions, with production at the end of June exceeding that of last year by 10.7%, a persistent drought has prevailed over the last four months. As a consequence, the third-quarter volumes were lowered by 5.3% and the increase in annual production at the end of September has almost been halved (+ 6.2%).

After a pronounced weak production year in 2018, normalisation of the banana production in Ivory Coast has continued in the third quarter (+ 4.1%). The four plantations all contributed positively to the 18.1% increase in export volumes over the first three quarters of 2019.

## 1.2. Markets

### Average market prices

| *In USD/tonne* | | YTD Q3/19 | YTD Q3/18 | YTD Q4/18 |
|---|---|---|---|---|
| Palm oil | CIF Rotterdam* | 530 | 631 | 598 |
| Rubber | RSS3 FOB Singapore** | 1 672 | 1 619 | 1 565 |
| Tea | Mombasa** | 2 211 | 2 653 | 2 579 |
| Bananas | CFR Europe*** | 662 | 665 | 647 |

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

Palm oil production is showing different trends in the producing powerhouses of Indonesia and Malaysia. The Indonesian crop already peaked in August with a limited annual growth for 2019 in contrast to 2018, whereas Malaysia is peaking towards October and is experiencing a decent growth in 2019 vis-à-vis 2018. This is particularly the case in East Malaysia where production remains good. Demand for palm oil, however, has been very good throughout 2019, both for the export market as well as the domestic biodiesel market. This has led to significant stock reduction during the year, and in August and September stocks were lower than a year ago.

Especially in China and India, demand for palm oil increased strongly. It was driven in China partially by a lower soy bean crush as a result of the lower protein demand, that followed the culling of the pig herd due to African swine fever. The lower bean crush led to less availability of soy bean oil, which is then replaced by palm oil. In the entire Indian subcontinent, the palm oil imports rose due to its competitive price and, since stocks have not been growing but are in fact at a multi-year low, all that oil is being consumed.

The trade war further escalated, and a solution is not expected soon. Therefore, palm oil and sunflower oil could be the preferred choices for the Chinese. At the same time, US soybean production decreased as a result of the poor planting conditions earlier in the year. The global soybean complex became firmer despite the negative input from the trade war. All in all, global vegoil consumption has grown very strongly due to the low prices, and production is falling behind. The global stocks of vegoils are shrinking, and this led to a significant rally during the third quarter.

The palm oil market rallied from USD 490 per tonne CIF Rotterdam in early July to USD 590 in August, after which there was a small setback. The market is tightening in stocks, but it is still the peak production season.

The palm kernel oil market continues to suffer from high stocks. The prices followed palm oil from USD 540 to USD 660 per tonne CIF Rotterdam and dropped in the last half of September. The premium on palm oil is hovering between USD 20 and USD 50 which, historically, is still very low.

The rubber market has seen a steady drop in prices during the third quarter of this year, as most of the news affecting the rubber market was bearish. The continuing effects of the US-China trade war and the weak demand from the Chinese automobile industry in particular have affected prices negatively. News in late September, that the largest Chinese rubber trader is closing business leaving about 250 000 tonnes of existing contracts unshipped, had a further knock-on effect on rubber prices.

Prices for Sicom RSS3 traded from USD 1 678 to USD 1 454 per tonne by the end of September.

Economic instability in Pakistan resulted in Mombasa tea prices moving lower at the start of the third quarter, but ever since the situation improved, tea prices in Mombasa moved up steadily, although activity remained subdued. Monthly production in Kenya has been trailing 2018 monthly volumes since March 2019, and total crop is 8.34% lower to date. Tea prices in Mombasa moved up 17.5% on average during the third quarter, but are still at a multiyear low.

The third-quarter banana market that coincides with the holiday season - when consumption traditionally falls - remained well-priced and stable thanks to a global supply that remained below demand, due to difficult weather conditions in the producing countries of the dollar zone.

## 1.3. Prospects

### 1.3.1. Production

Production in Indonesia is usually higher in the fourth quarter. Nevertheless, a temporary effect of the past exceptionally dry months during the third quarter is still expected in most plantations. Due to the lack of precipitation, there is a delayed ripening that may also be felt even until the end of the year.

Despite good fruit setting, the production in Papua New Guinea continue to suffer from the volcanic eruptions. To date, more than 3 000 hectares are still not harvestable and the harvesting activities on more than 2 000 less affected hectares are experiencing difficulties. The expectations for a decline in annual production of more than 30% compared to last year are therefore very likely, while the long-term projections are also being adjusted.

Under these circumstances, it seems logical that in the fourth quarter the accumulated backlog of 10.4% over the first three quarters will be perpetuated.

For the rubber activities, the Fusicoccum fungus will continue to negatively influence production. The entire Indonesian rubber sector is looking for effective means to combat this fungus without any side effects for the environment. Tea production for the rest of the year will depend to a large extent on the precipitation volumes recorded up to the end of the year during the rainy season which already started in October. The production volumes of bananas in Ivory Coast remain positive, where also the first SIPEF plantation was certified as a Fair Trade producer. This certification will be expanded to other production sites and will certainly influence our future marketing.

### 1.3.2. Markets

The palm oil market is still priced very competitively versus other vegoils, and normal growth in global food demand is expected. Also a massive increase in biodiesel demand led by Indonesia is anticipated, where B30 is very likely to be implemented from January 2020 onwards. That is an additional demand from Indonesia alone of 2.5 to 3 million tonnes. Moreover, there are increases in blending rates in Malaysia, Brazil and the United States. At current spreads to gasoil, it is anticipated that Europe will continue its big imports of palm oil to produce biodiesel. At the same time, production growth could be very low as trees need a resting phase after the great production in 2017 and 2018. The low prices since the summer of 2018 have resulted in significantly lower fertiliser application by smallholders, but many plantation houses were also looking at any ways to cut costs. The dry spell in the first quarter of 2019 will have its effect, but the recent drought caused by El Niño and the haze produced, will have another impact on production for 2020. The Indonesian government also decided that there will not be any export levy implemented till the end of 2019, even though currently the threshold level has not yet been reached.

If all these inputs are added into our models, there could be a very compelling friendly story for palm oil going forward. Momentum will be felt during the end of the fourth quarter, after peak production and once stocks in origin start dropping. Stocks in destinations are certainly on the lower side and a relatively strong export period for the producing countries in the coming months is expected. The biggest caveat is in the macroeconomic and political situations, where there are turbulent times. Hopefully, there will not be too much impact from them. All in all, the price outlook for palm oil is bright as the next months go by.

Despite the negative news flooding the rubber market in recent months, the overall supply/demand situation is more balanced than in recent years. This should prevent the market from dropping further from current levels. But the Chinese rubber default case needs to be settled first before any upside can be expected.

Some tea growing areas in Kenya are experiencing a prolonged cold and dry spell, which will keep the monthly production figures below those of 2018. Therefore, it is expected that prices will move up from current levels, although the strength of this will be limited by the economic situation in Pakistan.

After the end of the school holidays and thanks to the cooler weather, at the start of the fourth quarter, banana consumption is increasing, and banana prices are traditionally rising. This trend will allow to predict a relatively stable market until the end of 2019.

### 1.3.3. Results

To date, 88% of the expected production volumes for palm oil have been sold at an average price of USD 571 per tonne CIF Rotterdam, premiums included, compared to 78% at USD 694 per tonne CIF Rotterdam at the same time last year.

Production volumes remain to be gradually placed in the market, with the necessary precautions for those from Papua New Guinea, given the difficult harvesting activities. In view of the current price (USD 557 per tonne CIF Rotterdam) and the expected price level for the fourth quarter, the sale of the remaining 12% of the annual production will slightly strengthen the market average of sales achieved so far.

For rubber, to date, 88% of the expected production volume has been sold at an average price of USD 1 544 per tonne FOB.  This is almost identical to the price level of USD 1 548 per tonne FOB reached in the same period last year. The expected price levels for the remainder of the year remain so low that, despite cost savings, it is expected to close the year with a limited negative contribution to results for this business.

For the tea activities, the Group is currently recording a decrease in the average selling price of 15.9%, compared to the same period in 2018. Banana exports from Ivory Coast remain at the expected level in the fourth quarter. As a consequence, Plantations J. Eglin will be able to improve the contribution to the result from this sector.

The persistently weak local currencies against the USD, the fall in fertiliser demand and the current lower diesel prices all contribute to the control of unit production cost prices.  These are only negatively affected by lower than expected production volumes.

Given the short-term impact of the drought in Indonesia and the exceptional effect of the volcanic eruptions in Papua New Guinea, the recurring results of the second semester will be in line with those of the first semester.  The Group will therefore see 2019 close with a loss.

### 1.3.4. Cash flow and expansion

Despite the disappointing production volumes and the lower than expected selling prices for palm oil, rubber and tea, SIPEF continues, except for the usual capital expenditure and the replanting of older areas, to maintain the steady expansion of the palm oil activities in South Sumatra, Indonesia, mainly through the Musi Rawas and Dendymarker projects.

In Musi Rawas at the four concessions, which are centralised in three companies, the land compensation is continuing. This is not yet the case for the three additional concessions that were acquired in 2018, and for which the investigations carried out in line with the RSPO sustainability standards ('New Planting Procedures') have not yet been completed. It is expected to proceed here with the first planting after New Year.

For the seven concessions combined, 1 104 hectares were additionally compensated in the past nine months. This brings the total to 16 645 compensated hectares, of which provisionally 14 309 hectares were acquired for planting for own development and 2 336 hectares for smallholders.

Furthermore, on the four previously acquired concessions, 934 hectares were additionally prepared for planting or planted in order to reach a total of 11 695 cultivated hectares, representing 70.3% of the total compensated hectares.

Work is also continuing on the replanting of the own palm plantations in Dendymarker, which have been managed by SIPEF Indonesia since August 2017. Following the replanting of 957 hectares in 2018, 954 hectares were replanted in the first nine months of 2019. The existing plasma area (smallholders) is not yet under SIPEF's control, and approval from local authorities is expected in order to also gradually replant these.

Due to the persistent drought in the last four months, both the expansion planting in Musi Rawas and the replanting in Dendymarker have been delayed. However, these activities will be restarted from mid-October at the beginning of the rainy season. Dendymarker was also confronted with forest fires during this period, outside the areas under control of the Group. Besides reports to the police and the authorities, all means were used to prevent further expansion of the fires. The hot spots were also reported by the RSPO and are the subject of extensive reporting.

It remains the intention to renew the area of Dendymarker as quickly as possible and to develop the concessions of Musi Rawas. Depending on the future generated cash flow, and subject to the temporary lower prices for palm oil, rubber and tea, this replanting and expansion program may be delayed to avoid a higher debt ratio.

*Translation: this press release is available in Dutch and English. The Dutch version is the original; the other language version is a free translation. 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*.

Schoten, 17 October 2019

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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.