Monday, February 8, 2016

# HALLGARTEN & COMPANY

## Initiating Coverage

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# Feronia (FRN.v)

## Strategy: SHORT

| Key Metrics | | |
|---|---|---|
| Price (CAD) | $ | 0.115 |
| 12-Month Target Price (CAD) | $ | 0.080 |
| Upside to Target | | -30% |
| High-low (12 mth) | | $0.07 - $0.35 |
| Market Cap (CAD mn) | $ | 6.35 |
| Shares Outstanding (millions) | | 55.2 |
| Fully Diluted (millions) | | 130.7 |

| | 2014 | 2015e | 2016e |
|---|---|---|---|
| Consensus EPS | | n/a | n/a |
| Hallgarten EPS (est.) | | ($0.20) | ($0.06) |
| Actual EPS | ($0.26) | | |
| P/E | n/a | n/a | n/a |

# Feronia

## Morphing into a QUANGO?

- \+ Recent credit line from European development finance banks shows that it has an ability to raise debt by playing the DRC card
- ✖ Continual and mounting losses have driven the company to take on substantially more debt
- ✖ Brutal financings in recent months have diluted minorities while a creeping takeover by "related parties" is occurring
- ✖ The DRC is the DRC and that counts for a lot of negative sentiment when investors come to assess the risk profile of a project
- ✖ New government rules from 2011 have yet to be implemented but could threaten the company's control position in its plantations and estates
- ✖ The large workforce has made the company vulnerable to government demands for higher wages
- ✖ The travails of other companies in the same corporate grouping reflect negatively on the company in the minds of institutional and London investors

**A (Maybe Deservedly) Forgotten sector**

The plantations sector is not what it was in Western capital markets. We first started covering the last remaining plantation companies that were listed on the London Stock Exchange in the late 1980s. Now the main plantation stocks are listed on Asian exchanges. Therefore Feronia is an oddity due to its listing on the TSX-V, where there is almost zero knowledge of plantations, or of palm oil, while the attitude to anything in the DRC is usually hostile.

**Laying All its Bets on the DRC**

Feronia is a large-scale commercial agricultural company which is currently focused on two operations in the Democratic Republic of Congo: palm oil plantations and arable farmland. The plantations were purchased from Unilever at the end of last decade after the multinational group decided to exit a business activity that it had been engaged in for most of the preceding century. The business model consists of identifying and consolidating farm land and operations in the DRC and rehabilitating them back into production using modern agricultural techniques and practices.

The company markets a belief in what it calls the "immense agricultural potential" of the DRC for high-quality foodstuffs and edible oils given its amenable climate, fertile soil and "skilled and experienced" workforce.

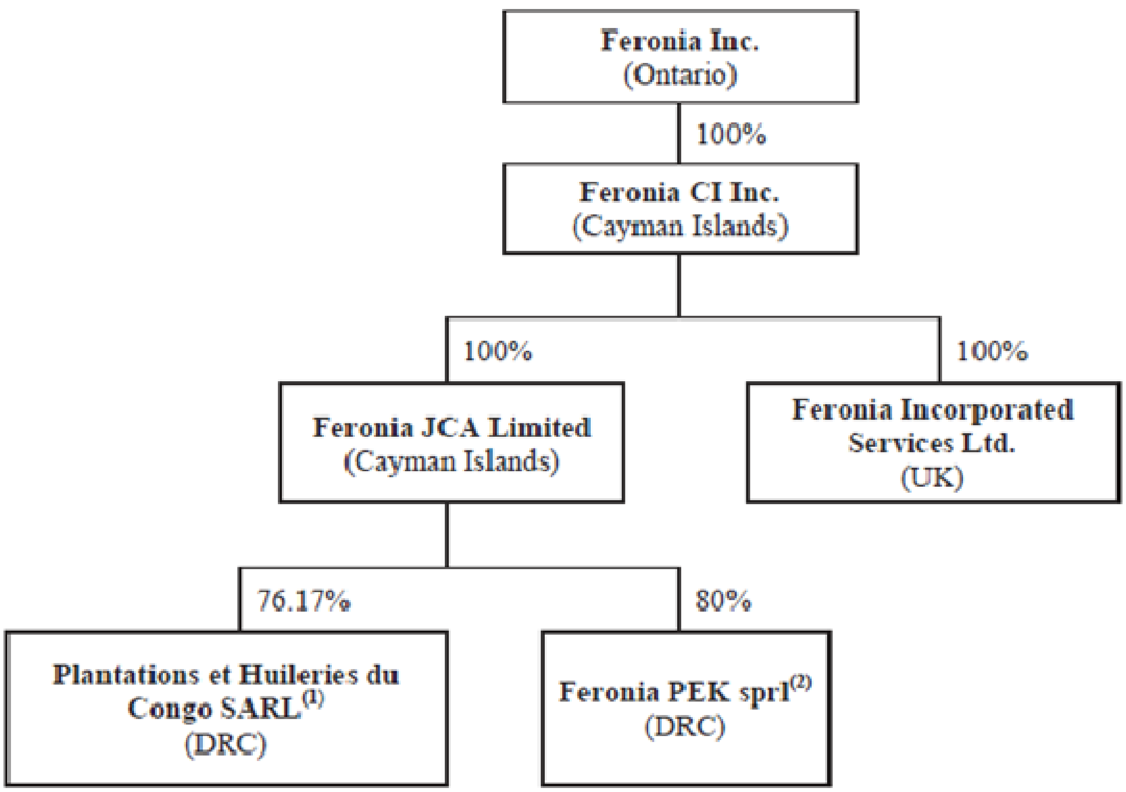
Investors are not necessarily as sanguine as Feronia's management on the prospects of the DRC. Even with the best will in the world, political events there are erratic to say the least and the country is on many investors' permanent "Do not touch with a bargepole" list. The ongoing losses since the change of ownership in 2009 have resulted in the steady erosion of cash and the creeping takeover of the group by the curious quasi-state entity, CDC Group PLC. The latest financing extended by a gaggle of European development banks only reinforces the view that it is viewed as more of a "charity case" than a commercial enterprise with a profit motive. This, in our view, bodes ill for existing shareholders who seem destined to be squeezed inexorably into a position of insignificance and irrelevance.

In this note we shall look at the recent strategy and the outlook for the company.

**Palm Oil Plantations**

In 1911, the Belgian state granted Unilever (then Lever Brothers) control over 67,800 square kilometres of land in the Congo to establish plantations to feed its rapidly expanding food processing business.

Feronia acquired 76.17% of the shares of Plantations et Huileries du Congo SARL ("PHC"), a company incorporated under the laws of the DRC, from subsidiaries of Unilever plc in September of 2009. The assets were then backdoored into a vehicle listed on the TSX-V in 2011. The corporate structure is shown below:

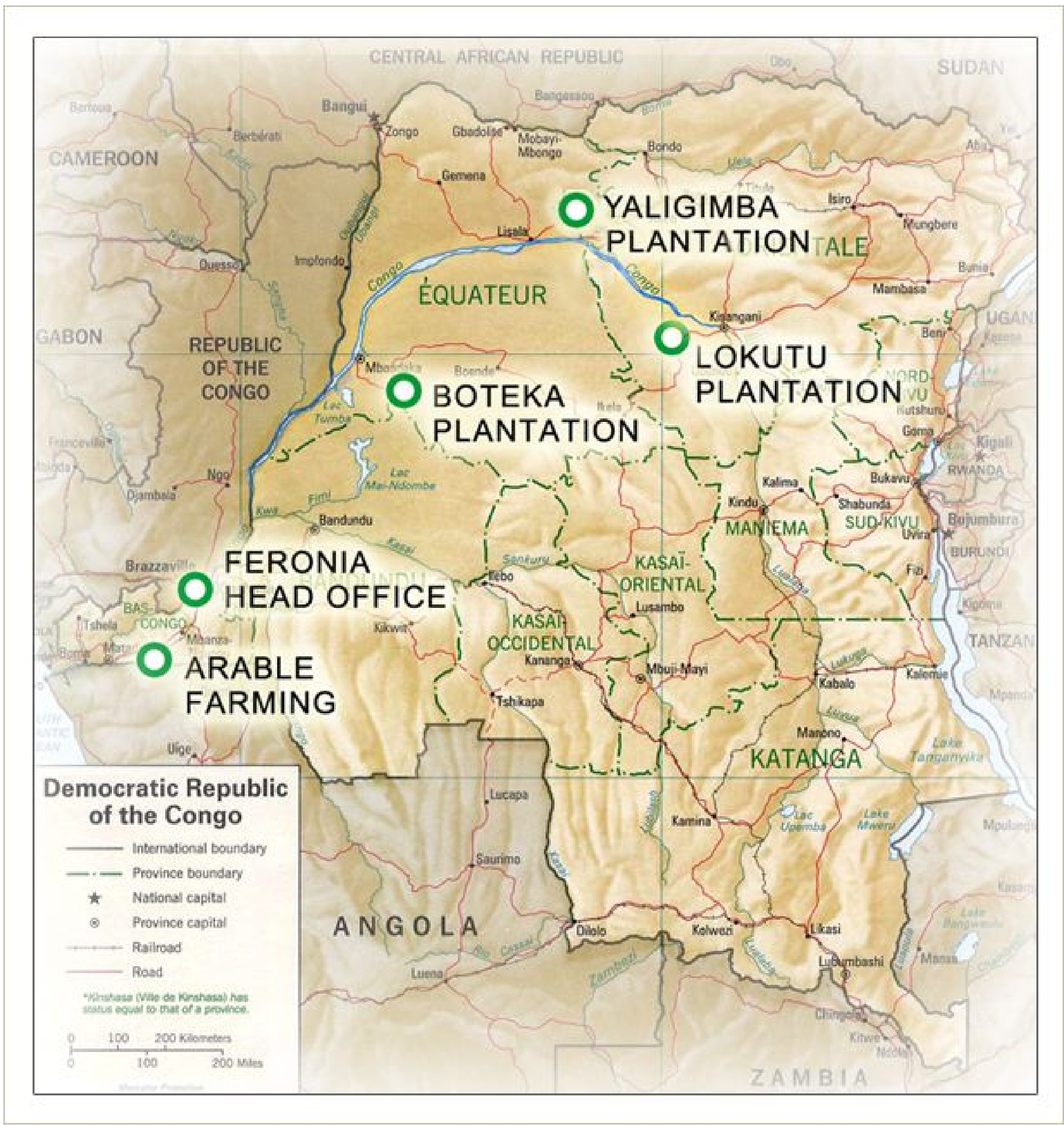



PHC has three remotely located plantations; Lokutu, Yaligimba and Boteka. When Feronia acquired 76.17% of the shares of PHC from subsidiaries of Unilever plc on September 3, 2009, the three plantations had suffered from years of underinvestment and considerable disruption caused by conflict in the DRC.

As at September 30, 2010, PHC's operations consisted of the following:

- 12,125 ha of oil palms in production
- 3,160 ha of immature palms
- 45,149 ha of surveyed plantable reserves
- two working palm oil mills
- a workforce of 3,875 employees and 33 managers
- supporting infrastructure of roads, houses, offices, hospitals and clinics

The basic premise of the initial investment was that Unilever PLC had long underinvested in its plantation businesses so the company has justified its initial focus being on rebuilding the business and resuming production.



As at September 30, 2015, PHC, being the main operating unit of Feronia, had concessions of 107,892 ha located in the provinces of Equateur and Orientale in the DRC. This was an increase of 6,000 hectares from the same quarter in 2010.

Since the change of ownership in 2009, Feronia has embarked on a program of replanting the existing plantations, the rehabilitation of palm oil mills at the Lokutu and the Boteka plantations and the construction of a new palm oil mill at the Yaligimba plantation which commenced production in October 2013. They have also rehabilitated the internal road systems, implemented a substantial replanting program, replacing less productive palm trees over 25 years old with new palms, and rehabilitating the social infrastructure.

**Arable Land**

Frankly we are quite surprised by the support multilateral institutions have lent to Feronia considering that it does have the look of an old-style “colonial” plantation company. While it is only sensible that palm plantations be managed on a large scale, the trend in sub-Saharan Africa with regard to regular farming has been to break up large estates or *latifundias* and return them to cultivation by the local population. This has resulted in low productivity in many places but it does address the issue of landless local populations.

Despite this trend to smaller holdings held by locals, Feronia resolved to move into arable farming. Having researched a number of arable farming opportunities in the DRC, Uganda, Zimbabwe and South Africa, Feronia identified the large scale production of staple crops, such as rice and soybeans, for sale to the domestic marketplace as an attractive project to pursue.

Due to its large reserves of fertile arable land and significant amount of rainfall, the DRC was selected as the most favourable location to establish arable farmland operations. The company now owns 80% of Feronia Arable, with the rest held by Plantations et Elevages de Kitomesa sarl, a private DRC company that transferred the concession rights to a 10,000 hectare Bas Congo property to Feronia Arable in exchange for its 20% interest, on the basis that Feronia would provide the capital investment and services required to farm the concession area. The associated agro-processing is operated through Kimpese Agro Industrie sarl, which is owned 100% by Feronia.

The first farm was established in the western region of the DRC in the third quarter of 2010. In early January 2011, the company sowed its first crop of edible beans at its 10,000 ha arable farming operation in Bas Congo, DRC. Feronia also has an arable farming operation which grows and processes rice.

It owns a five-tonne per hour rice mill and associated drying facilities, which is the only industrial-scale rice mill in the region. This allows Feronia to process its own crop and that potentially produced by other local small-holder farmers.

Africa being Africa we wonder whether producing crops solely for the domestic market then raises the risk of price controls and sale to “domestic marketing boards”. We shall see..

**Palm Oil & Outlook**

Palm oil is an edible vegetable oil derived from the mesocarp (reddish pulp) of the fruit of the oil palms, primarily the African oil palm Elaeis guineensis.

Palm oil is one of the few highly saturated vegetable fats and is semi-solid at room temperature. Like most plant-based products, palm oil contains very little cholesterol. Palm mesocarp oil is 41% saturated, while palm kernel oil and coconut oil are 81% and 86% saturated respectively.

Palm oil is a common cooking ingredient in the tropical belt of Africa, Southeast Asia and parts of Brazil. Its use in the commercial food industry in other parts of the world is widespread because of its lower cost and the high oxidative stability (saturation) of the refined product when used for frying.

Palm oil plantations in South East Asia have become something of a hot button issue with their spread, particularly in Indonesia, being linked with environmental degradation, species extinction and indiscriminate slash and burn type plantation development. The annual "burning season" is now a major source of regional and global pollution.

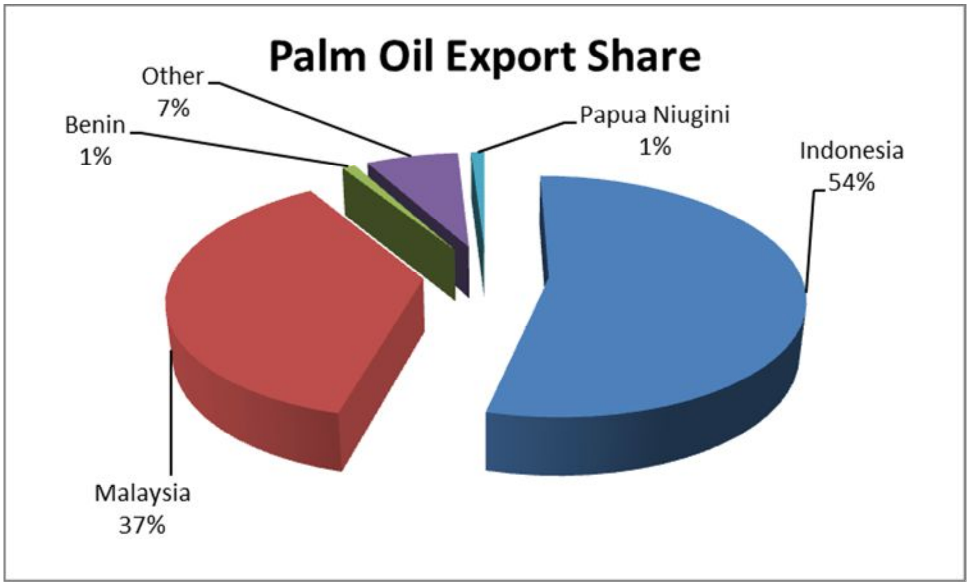
**The Process**

After milling, various palm oil products are made using refining processes. First is fractionation, with crystallization and separation processes to obtain solid (stearin), and liquid (olein) fractions. Then melting and degumming removes impurities. Then the oil is filtered and bleached. Physical refining [clarification needed] removes smells and coloration to produce "refined, bleached and deodorized palm oil" (RBDPO) and free sheer fatty acids, which are used in the manufacture of soaps, washing powder and other products. RBDPO is the basic palm oil product sold on the world's commodity markets. Many companies fractionate it further to produce palm olein for cooking oil, or process it into other products.

The commonly-used measures for the industry are Fresh Fruit Bunch (FFB) denoting the product harvested from the palms and Crude Palm Oil (CPO) is the product that leaves the company's mills to be shipped to refiners.

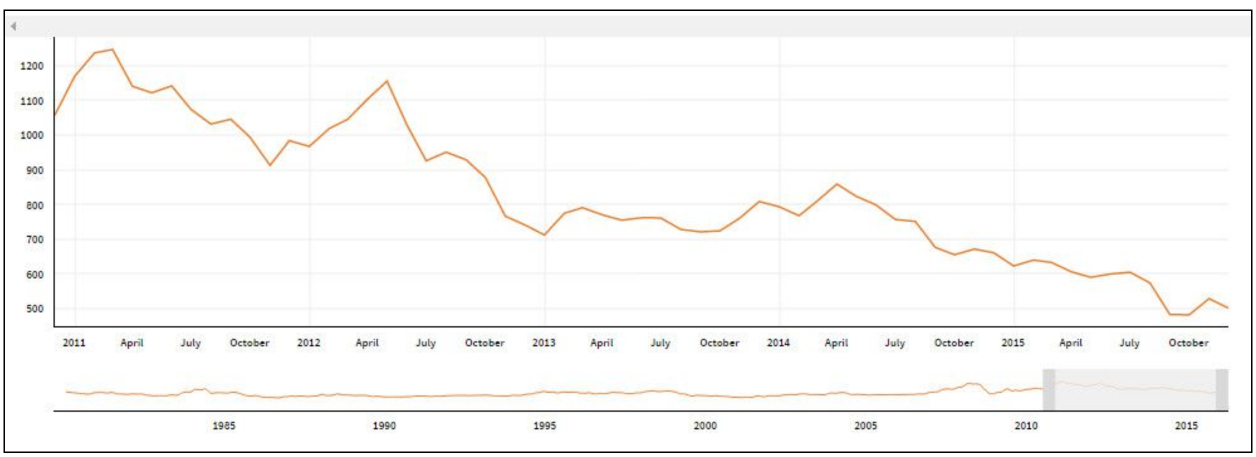
**Output and Prices**

The major producers by far are Indonesia and Malaysia. The pie below shows the share of the export market (Indonesia produces more, but consumes a sizeable amount internally).




Oil World, a research institute specialising in oilseeds and oils, expects global output to edge up only marginally by 0.4 million tons in 2016 – compared with an average of 3.2 million tons in the previous five years – and the stocks-to-use ratio to decrease.

Below can be seen the five year trend for palm oil prices. This is quoted from Malaysia Palm Oil Futures (first contract forward) 4-5 percent FFA, US$ per metric ton. The unit is US Dollars per Metric Ton which is useful to work out how the product looks to buyers but one would note that the Malaysian Ringgit has significantly retreated vis and vis the dollar.



As can be noted it is not the healthiest of trends. The price fell to 1,800 ringgit per ton (MYR/t) in Malaysia in summer 2015 resulting in prices of palm oil marking the lowest level since Autumn 2008. The decline was short-lived, though, and prices started to inch up swiftly. By year-end 2015, palm oil prices were up to around 2,400 MYR/t, marginally higher than at the beginning of the year, and are currently trading at 2,500 MYR/t.

Commerzbank's recent report on palm oil prices noted that "Fears that the weather phenomenon El Niño will negatively affect production has sent palm oil prices significantly higher as of mid-2015. This trend still continues. Expectations are that global production will edge up only marginally in 2015/16, which argues for rising prices in the short term, as demand remains on the uptrend. Further upside should be limited, though. One factor supporting this view is that low crude oil prices are weighing on the prices of vegetable oils used in biofuel production such as palm oil. More importantly, though, soybeans are in abundant supply. As regards price competition, palm oil thus has to stand its ground against soybean oil in order to maintain the market shares secured in recent years".

Because of the long lead time of trees' lifecycle the producers cannot respond with alacrity to market trends but essentially have to be price takers most of the time. On the contrary soybean producers can enter or exit that product depending on prices with a one-year to 18-month lead time (and sometimes even less depending on where they are in their crop rotation cycle).

**The Way Feronia Business Works**

The usual lifespan of an oil palm is over in around 25 years. The first three/four years of the palm's existence are non-productive as it grows to maturity, thus the productive life of the average palm is a bit over twenty years. With Unilever gradually exiting oil palm plantations over the decade before Feronia acquired its DRC position, investment was low in replanting of the existing stock of oil palms.

As we have noted previously, the net territory of Feronia's concessions has grown by around 6,000 has over the last five years, however, intriguingly the planted area is only around 23% of total concession areas.

**Plantations (Hectares)**

| | | As at Sept 30, 2015 | | | Total as at Sept 30 | | |
|---|---|---|---|---|---|---|---|
| | | **Lokutu** | **Yaligimba** | **Boteka** | **2015** | **2014** | **2013** |
| **Immature** | | | | | | | |
| Year 0 | | | | | | 3,255 | 4,448 |
| Year 1 | | 2,400 | 1,802 | 437 | 4,639 | 5,007 | 3,924 |
| Year 2 | | 2,200 | 2,132 | 675 | 5,007 | 3,924 | 2,110 |
| Year 3 | | 1,707 | 1,447 | 770 | 3,924 | 2,110 | 1,027 |
| | Total | 6,307 | 5,381 | 1,882 | 13,570 | 14,296 | 11,509 |
| **Producing** | | | | | | | |
| 4 - 7 Years | | 2,342 | 1,815 | 1,136 | 5,293 | 3,941 | 3,149 |
| 8 – 18 Years | | 294 | 418 | 650 | 1,362 | 1,198 | 1,515 |
| 19 – 25 Years | | 2,784 | 1,462 | - | 4,246 | 4,469 | 5,045 |
| | Total | 5,420 | 3,695 | 1,786 | 10,901 | 9,608 | 9,709 |
| **Total Planted** | | **11,727** | **9,076** | **3,668** | **24,471** | **23,904** | **21,218** |

As the preceding table shows planting activity has been quite intense in recent years with the peak of activity being 2013 after which planting trailed off with none being done in the first nine months of 2015. Most activity has been concentrated in the Lokutu plantation, but that is also where the company has the most trees coming towards the end of their productive lives. Trees coming into production at that property over the next three years are slightly more double the number that are nearing the ends of their productive life.

The situation is better at Boteka where there are no trees in the end of life category but then again, Boteka is just a small fraction of the company's planted area.

The profile of the estates shows that the vintage estates were quite sizeable until underinvestment between the late 1990s and the middle of last decade reduced plantings by 60-90% depending on the property. Then the pace picks up again under Feronia.

The effect of the coming on stream of the newer trees is evident in the nine months ended September 30, 2015, with Feronia producing 65,983 tonnes of FFB and 12,692 tonnes of CPO, representing increases on the corresponding period in 2014 of 26.4% and 32.5% respectively.

**Development Banks to the Rescue**

In December it was announced that FRN's plantation subsidiary, PHC, had entered into a secured term facility agreement for up to US$49mn with a syndicate of four European development finance institutions. The purpose is to finance equipment, replanting, fertilizer, and environmental and social governance expenditures required as part of the rehabilitation of PHC's three palm oil plantations.

Deutsche Investitions und Entwicklungsgesellschaft mbH, was the lead arranger and agent for the syndicate, and agreed to provide US$16.5mn of the facility. Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden NV, the Dutch development bank, agreed likewise to provide US$16.5mn, the Belgian Investment Company for Developing Countries (the Belgium government's development finance institution) has agreed to provide US$11mn and the Emerging Africa Infrastructure Fund, a facility of the Private Infrastructure Development Group, agreed to provide US$5mn.

The company expects that the first advance under the facility will occur in the first quarter of 2016. The amounts advanced under the facility will be repaid semi-annually over a six-year period commencing September, 2019. The facility is subject to covenants, pledges and charges typical of a loan facility of this nature and shall be secured by way of a first-ranking security against the assets of PHC and by way of a pledge of the shares of PHC by a Belgian subsidiary of Feronia. Essentially the main assets of Feronia have been mortgaged via this transaction.

The repeated references to the "3,800 employees and tens of thousands of people who are directly dependent on our company" make us wonder if this is just some salve for investor consciences or if this group are the main beneficiaries of the company's efforts. In light of the "multilaterals" involved, this becomes a pertinent question. Feronia seems to be on the road to conversion into a QUANGO (a quasi-autonomous non-government organization).

**FERONIA**

In Millions of USD

| | FY16e | FY15e | 3Q15 | 2Q15 | 1Q15 | FY14 | 4Q14 | 3Q14 | FY13 | FY12 | FY11 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Revenue | 11.10 | 8.84 | 0.79 | 3.46 | 2.49 | 10.83 | 2.30 | 2.93 | 6.69 | 7.13 | 7.45 |
| Cost of Revenue, Total | 9.74 | 10.02 | 1.34 | 2.83 | 3.87 | 15.61 | 3.75 | 5.29 | 9.58 | 9.68 | 6.83 |
| Gross Profit | 1.36 | -1.18 | -0.55 | 0.63 | -1.38 | -4.78 | -1.45 | -2.36 | -2.9 | -2.55 | 0.61 |
| Selling/General/Admin. Expenses | 10.86 | 11.93 | 3.35 | 2.77 | 3.16 | 11.7 | 3.14 | 3.21 | 10.59 | 9.76 | 11.05 |
| Depreciation/Amortisation | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.02 | 0.00 | 0.00 | 0.06 | 0.06 | - |
| Unusual Expense (Income) | 2.70 | -3.22 | 3.7 | 3.78 | -12.65 | 1.69 | -4.27 | 1.87 | -3.51 | -5.12 | -0.65 |
| Other Operating Expenses, Total | 0.15 | 0.04 | 0.03 | 0.06 | -0.07 | 0.44 | 0.25 | 0.17 | 0.05 | 0.06 | 0.03 |
| Total Operating Expense | 23.45 | 18.77 | 8.42 | 9.45 | -5.69 | 29.46 | 2.87 | 10.53 | 16.76 | 14.45 | 17.25 |
| Operating Income | -12.35 | -9.93 | -7.63 | -5.99 | 8.18 | -18.63 | -0.57 | -7.61 | -10.08 | -7.32 | -9.8 |
| Interest Income (Expense) | - | - | - | - | - | - | - | - | - | - | - |
| Gain (Loss) on Sale of Assets | - | - | - | - | - | - | - | - | - | - | - |
| Other, Net | -0.36 | -1.14 | -5.10 | 3.73 | 0.15 | -0.22 | -0.05 | -0.06 | -0.20 | -0.08 | 0.00 |
| Income Before Tax | -12.71 | -11.07 | -13.75 | -2.5 | 8.9 | -19.71 | -0.82 | -7.89 | -11.00 | -7.01 | -5.62 |
| Tax | -2.92 | 2.47 | -2.95 | 0.59 | 4.53 | 0.56 | 2.52 | -0.59 | 1.86 | 1.94 | 1.21 |
| Income After Tax | -9.79 | -13.54 | -10.8 | -3.09 | 4.37 | -20.27 | -3.34 | -7.3 | -12.86 | -8.95 | -6.83 |
| Minority Interest | 1.96 | 2.63 | 1.95 | 1.73 | -0.87 | 4.62 | 0.72 | 1.7 | 2.75 | 2.29 | 1.11 |
| Net Income After Minorities | -7.83 | -10.91 | -8.85 | -1.35 | 3.5 | -15.65 | -2.62 | -5.6 | -10.12 | -6.66 | -5.71 |
| | | | | | | | | | | | |
| Diluted Weighted Average Shares | 130.67 | 55.21 | 55.24 | 55.23 | 73.81 | 55.21 | 55.22 | 55.22 | 31.02 | 15.51 | 13.36 |
| Diluted EPS Excluding Extraordinary Items | -0.06 | -0.20 | -0.16 | -0.02 | 0.05 | -0.28 | -0.05 | -0.10 | -0.33 | -0.43 | -0.43 |
| Diluted Normalised EPS | -0.06 | -0.20 | -0.12 | 0.02 | -0.06 | -0.26 | -0.1 | -0.08 | -0.4 | -0.64 | -0.46 |
| | | | | | | | | | | | |
| Tax Rate | 23.0% | -22.3% | 21.5% | -23.6% | 50.9% | -2.8% | -307.3% | 7.5% | -16.9% | -27.7% | -21.5% |

**Financial Results – From Bad to Dire**

Results have been negative for as far back as we go. It should be noted that these are operating results rather than a record of what has been poured into recuperation of the estates from their previously run-down state. The table on the preceding page says most of what needs to be said.

Fiscal year 2014 was a bumper year for poor numbers with a net loss of $15.65mn, however the loss in the fiscal year, as yet unreported for 2015 would have been substantially higher if not for a revaluation of the biological assets in the first quarter.

First quarter showed a net positive movement on the valuation of biological assets totaling $14.89mn. This figures within the Unusual Expense highlighted on the table. The company's rationale for this was that under IFRS, the oil palm trees are classified as non-current biological assets and are valued on the basis of discounted cash flows taking into account the assets' expected 25-year economic life, the mature and immature hectares in production, the three-year rolling average price of CPO and a discount rate of 22% (2013: 22%).

Feronia says it reviews the discount rate, mature and immature hectares annually. The variable element in the computation at each quarter end is the price of CPO. If the price of CPO increases, the value of the biological asset will increase and if the price of CPO decreases, the value of the biological asset will decrease. The three year rolling average price of CPO used at March 31, 2015 was $857 per metric tonne, a decrease of $35 from $892 per metric tonne as at December 31, 2014. However, improvement in sales terms achieved during the year eliminated direct selling costs of $150 per metric tonne which more than offset the reduction in the rolling average price of CPO used in the valuation model.

Despite this revaluation the bottom line continued to be dire during the current financial year.

We expect revenues will start to trend up as trees move up through their lifecycle to the production phase, while the seeming suspension of planting of new trees in 2015 means costs will be lower. Therefore we are positing lower losses in FY2016, with a net loss of $7.83mn.

**And the DRC being the DRC….**

Those who have worked in the Third World (sorry, developing economies) know the ever-present danger of expropriation. Frankly in light of the legislative environment (if one can call it that) in the DRC, we are surprised that shareholder and strategic stakeholders at Feronia seem so blithe about the risks.

In December 24, 2011, the government of the DRC promulgated a new agricultural law, "*Loi Portant Principes Fondamentaux Relatifs a L'Agriculture*", with the goal of developing and modernizing the country's agricultural sector. This Agriculture Law has garnered some controversy with respect to various provisions, including a provision which purports to limit the rights of foreign corporations to farmland in the DRC. Certain agribusinesses in the DRC have raised concerns that this provision may impede existing and new foreign investment in the agricultural sector. The company in its MDA filings admits that, in particular, Article 16 of the Agriculture Law appears to impose a requirement that a holder of farmland in the DRC be either a DRC citizen or, in the case of a corporation, that such corporation be incorporated in the DRC and be majority owned by the DRC government and/or by DRC citizens. Currently, Feronia's primary operating subsidiaries, PHC and Feronia Arable are owned 23.83% by the DRC government and 20% by a private DRC corporation, respectively.

As a result of this looming threat Feronia has been involved in discussions with various levels of government in the DRC with respect to the proper interpretation of the Agriculture Law and its application to its concessions in the DRC. If the Agriculture Law is interpreted by the DRC government to apply to the existing concession rights held by Feronia and the Agriculture Law is not amended, the company warns that it "could have a material and substantial adverse effect on the value of the business and its share price". This is putting it mildly for in such a situation, Feronia might be required to sell or otherwise dispose of a sufficient interest in its operating subsidiaries so as to ensure that it meets the local ownership requirements.

The new Agriculture Law came into force on June 24, 2012 and, according to its terms, holders of concessions to agricultural lands had until June 24, 2013 to comply with its provisions.

Earlier this year the company in an MD&A filing made reference to various reports suggesting that proposals to amend the Agriculture Law had been tabled to the DRC parliament. It said it was unable to verify such reports "and, as a result, is continuing to monitor the situation and is reviewing various alternatives for a number of possible outcomes". We are surprised that amendments might have been tabled in Parliament but yet there is no evidence as to whether they have been or not.

Feronia's management says it has determined that it is "in the best interest of the company to take no action" in respect of the Agriculture Law. This is the corporate equivalent of believing in the power of prayer.

We would note that an NGO called Grain has launched a campaign against Feronia terming its activities in the DRC as "agro-colonialism". Whether this will have any effect though is unclear.

**CDC Group**

Depending on which version one reads, or seemingly the day of the month, CDC Group plc is either the largest or second largest shareholder in Feronia. The other party competing for the title is Phatisa, which may or may not be) close to CDC Group.

CDC Group (formerly the Commonwealth Development Corporation, and previous to that, the Colonial Development Corporation) is a Development Finance Institution owned by the UK Government. CDC currently holds 15,149,600 shares of Feronia representing 27.4% of the issued and outstanding common shares.

The UK's Department for International Development is responsible for CDC, with shareholder duties managed by the Shareholder Executive. It has an investment portfolio valued around £2.8 billion and is focused on the emerging markets of Asia, Africa and Latin America, with particular emphasis on South Asia and sub-Saharan Africa.

**Not Without Blemishes**

CDC was the subject of extensive investigations by the British satirical magazine Private Eye, which launched a critique of the organisation in September 2010. Amongst other allegations, it claimed that CDC had moved away from financing beneficial international development towards seeking large profits from schemes that enriched CDC's managers while bringing little or no benefit to the poor; and that when Actis (its emerging markets hedge fund arm) was spun out it was given an "implausibly low valuation".

The Actis deal was also the subject of criticism by British politicians (particularly Gregory Barker, now Lord Barker of Battle) as far back as 2004. In October 2010, the then Secretary of State for International Development, Andrew Mitchell announced to Parliament that the British Government was to reconfigure CDC, saying that whilst he applauded its financial success, it had also "become less directly engaged in serving the needs of development". Later that month the International Development Committee announced that it was to conduct an inquiry into CDC to examine issues such as its effectiveness and possible reforms, including its abolition. Their report was published in March 2011 and as a result CDC implemented a new business plan, focusing its investments on the poorer countries of South Asia and sub-Saharan Africa, as well as once again providing direct investments to businesses alongside its fund of funds model.

**CDC and Feronia's November Funding**

In what looked like something of a lifeline, in early November, CDC Group plc announced that it had taken up 100% of a private placement of a convertible debenture issued by Feronia with a principal amount of US$10mn. The debenture bears interest at a rate of 12% per annum, compounded semi-annually and all interest shall accrue and be payable on January 22nd, 2016 and is convertible into common shares of Feronia. The outstanding principal and all accrued and unpaid interest will be convertible at CAD$0.25 per Common Share at the option of the holder at any time prior to maturity. If Feronia does not complete an Amended Debt Financing prior to December 31, 2015, the conversion price would be reduced to CAD$0.14 per Common Share.

Assuming that CDC fully converts the principal at the conversion price of CAD$0.25, CDC would see its holdings surge to 63,149,600 Common Shares (calculated at the fixed exchange rate of US$1.00=CAD$1.20), representing approximately 61.2% of the issued and outstanding common shares at the time of conversion.

This was followed recently by another transaction in a similar vein with another company, the relationship with CDC being unclear, though seemingly there is some common history.

**Phatisa and its Fund**

In late January, it was announced that Golden Oil Holdings Ltd., a wholly owned Mauritius special purpose vehicle subsidiary of African Agriculture Fund LLC, (AAF) had acquired, by way of private placement, ownership of a convertible debenture issued by Feronia for a principal amount of $3.2mn on 15th of January, 2016, representing 100% of the convertible debenture.

AAF, it turns out, is managed by an investment company of which the two managing partners are both ex-CDC Group executives, namely Duncan Owen and Stuart Bradley. The AAF has DFI investment from France, US, and Spain as well as the African Development Bank and several other African multilateral banks. The Alliance for a Green Revolution in Africa (AGRA) is listed as a "promoter" of the fund, while the European Commission and the Italian Cooperation Agency finance the AAF's Technical Assistance Facility.

This debenture similarly bears interest at a rate of 12% per annum, compounded semi-annually and all interest shall accrue and be payable on January 22nd, 2016, and is convertible into common shares of Feronia. The outstanding principal amount of the debenture together with all accrued and unpaid interest will be convertible at the option of the holder at any time prior to the date which is one year from the closing date. As an amended debt financing was not completed by Feronia on or before December 31st, 2015, the debenture is convertible at a conversion price of 14 cents per common share.

GOHL reportedly holds 17,918,877 common shares, representing 32.4%. Assuming that GOHL fully converts the principal of the debenture into common shares at the conversion price of 14 cents, GOHL would hold 45,347,449 common shares, representing approximately 54.9% of the issued and outstanding common shares at the time of conversion.

**Minorities Diluted Out of Sight**

We hope we might be excused but we fail to understand how the conversion of CDC's stake into 61.2% of the expanded capital and Golden Oil's stake into 54.9% of the capital adds up!

It was more than slightly disingenuous of the company to make two announcements a month apart on two financings and report what each might convert into but never report the combined effect of the two transactions. The table below makes this clearer:

| | On Issue | % | Conversion | Total | % |
|---|---|---|---|---|---|
| **CDC Group** | 15,149,600 | 27.4% | 48,000,000 | 63,149,600 | 48.3% |
| **GOHL** | 17,918,877 | 32.4% | 27,428,572 | 45,347,449 | 34.7% |
| **Others** | 22,175,883 | 40.1% | | 22,175,883 | 17.0% |
| **Total** | 55,244,360 | 100.0% | 75,428,572 | 130,672,932 | 100.0% |

The transactions were classified as "related parties". What is happening here is effectively a creeping takeover with no premium for existing shareholders that have borne the brunt of the company's lean years. Far from a premium, the parties boosting their stake are getting to do so at a discount.

**Management & Board**

In September 2014, Feronia appointed Xavier de Carniere as Chief Executive Officer and a director as from mid-January 2015. He was previously the Chief Financial Officer of SIAT. The Belgium-domiciled

Société d'Investissement pour l'Agriculture Tropicale is a major palm oil and rubber plantation company with operations in West Africa and Asia.

**London Listing and its Pitfalls**

As is well-known the plantation sector has a long history in the London markets (indeed we were analyzing the space in the late 1980s) and is also prominent and well understood in markets like Kuala Lumpur and Singapore.

This company has been mooted amongst those that might make the jump to the AIM market in light of the plantation and the Africa focus being better understood in London. However, it should be remembered that the London market is very unforgiving and there are quite a lot of London investors who are aware of the evolution of other matters in the corporate grouping of which Feronia is part, and they are far from happy campers. The situation has been made worse by the recent corralling of a sometime Turkish explorer into the same corporate "grouping" as Feronia, with a shared director. The connection is fairly inescapable with both companies now ensconced at 181 Bay Street, Toronto.

Therefore any dipping into the London waters by Feronia may be fraught with perils in light of the bad vibes circulating on this side of the pond.

**Risks**

Where to start? The risks pile up and many, quite literally "come with the territory". The obvious unavoidable risks are:

- Political risk in the DRC is always a paramount concern, this includes not only government measures but insurgent action
- Weather issues are always a factor in agriculture
- High debt burden
- Ongoing losses leading to financing difficulties
- Reputational risk of being associated with the current corporate grouping
- Environmentalist action as part of on-going global campaign against oil palm plantations
- Further dilution of minorities by "related parties"

**Conclusion**

The market recently took some brief solace from some multi-lateral financial institutions extending credit to this company but then the reality set in that such institutions can also lose money when making loans to entities operating in developing economies. Banks with development briefs are not always the most careful lenders.

Then the stock price was pummeled by the financing deals with their stinging dilution for existing holders.

Six years into the new ownership the asset is yet to show a profit despite enormous amounts of money having been directed at the venture. Meanwhile shareholders who agonized through the lengthy plantation rehabilitation process are now being squeezed out through a creeping takeover by "related parties".

We are allocating a **SHORT** stance to this company with our twelve-month target price being CAD$0.08.

## Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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