

## Board of Directors' Report

The extraordinary results achieved in 2016 cannot be merely attributed to the rising CPO prices on the international market, but shall take into account the company's relentless efforts which include intensification, mechanization, and automation, improving the human capital and developing palm oil downstream businesses.



### Dear Shareholders,

Throughout 2016 palm oil plantations had to face a multitude of serious challenges. Global demand for palm oil products declined as an effect of the slowdown in economic growth of a number of countries within the Asian region, including China which is a key market for Indonesian palm oil products. Concurrently, supply of palm oil from Indonesia and Malaysia being the two major Asian producers, also suffered a decline caused by the effect of the long dry season in 2015. This affected FFB production in major parts of the plantations in both countries. Moreover, the 2015 long dry season's impact has been predicted to continue in 2017. Consequently, the average CPO selling price on the world market increased by 12.5% from USD 622 a ton in 2015 to USD 700 a ton in 2016.

During 2016 the Company managed 297,011 hectares of oil palm plantations comprising an area of Mature Plantations with an acreage of 266 thousand hectares, and an area of Immature Plantations of 31 thousand hectares, located in Sumatra, Kalimantan and Sulawesi. Part of these Immature Plantations will soon enter the productive stage and we envisage that operational performance which will ensure our continuous growth throughout the coming years. In addition, during 2016 the Company replanted in several areas covering a total acreage of about 3,508 hectares.

Throughout 2016, FFB production of the Company's nucleus plantations declined by 11.3% from 4.20 million tons in 2015 to 3.73 million tons. FFB production from the plasma plantations declined by 18.1% from 1.40 million tons in 2015 to 1.15 million tons, while FFB purchased from third parties increased by 3.8% from 2.45 million tons to 2.54 million tons.

As a consequence of the declining FFB production from both the nucleus and the plasma plantations, the Company's CPO production also saw a decline of 10.5% from 1.74 million tons in 2015 to 1.55 million tons in 2016. The same occurred in Palm Kernel production which declined 9.3% from 370,637 tons in 2015 to 336,370 tons in 2016. Production of palm oil derivative products such as

RBDPO, Olein, Stearin and PFAD showed a combined total of 524,911 tons, a decrease of 11.8% compared to the previous period of 595,457 tons.

Fortunately, the decline in production was compensated by a rise in the Company's average CPO selling price in 2016 which saw an increase of 11.4% from Rp 6,971/kg in 2015 to Rp 7,768/kg, in line with a bullish trend in the world CPO prices. The increase in average CPO selling price contributed to the improvement in the Company's financial performance throughout 2016.

In 2016 the Company's net revenue increased by 8.1% to Rp 14.12 trillion compared to the same period in the previous year of Rp 13.06 trillion. From the Company's total net revenue, 55.8% or Rp 7.88 trillion was contributed by income from CPO sales, 30.1% or Rp 4.25 trillion by sales of CPO derivatives products such as RBDPO, Olein, Stearin, and PFAD, while the remaining 14.1% or Rp 1.99 trillion came from sales of palm kernels and their derivative products.

Currently, 70% of the Company's revenues is generated by the sales of CPO and palm kernels in the domestic market, while the remaining 30% comprising CPO derivative products are designated to serve the export market.

In its efforts to enhance productivity and efficiency, the Company paid special attention to efforts to reduce operating costs with the objective to achieve cost leadership in the palm oil industry. In 2016 the Company introduced its Excellent Productivity program to achieve operational excellence. All functions within the Company, both at the plantations as well as at the head office, were directly engaged in bringing this program to a success.

The increase in net revenues can be attributed to two key factors, namely a reduction in operating costs and a windfall profit derived from currency exchange transactions caused by the appreciation of the Indonesian Rupiah against the greenback. Consequently, by the end of 2016 the Company succeeded in booking a net profit of Rp 2.01 trillion, representing an increase of 224.2% against last year's net profit of Rp 619.1 billion.

### **Business Development**

The Company's strategic business development in 2016 included among others strengthening of the palm oil downstream business. Currently the Company is operating two palm oil refineries located in West Sulawesi and Dumai, Riau Province. By the end of 2016 it also started operating a Palm Kernel Oil (PKO) refinery in West Sulawesi to meet the demand from the food industry and the oleo chemical export market for countries such as the Philippines, South Korea, China and India. By developing the

downstream industry, the Company expects that this sector will significantly contribute to its revenues in future years.

In addition, the Company also constructed and is operating a NPK fertilizer blending plant, aimed not only to meet the demand for fertilizer for its own plantations, but also to meet market demand from areas around the plantations.

The Company also seized the momentum of a policy to develop a new business opportunity in integrating cattle in its palm oil plantations. For breeding purposes, the Company purchased 2,060 cattle that arrived in 2016.

### **Research and Development**

Research & Development are one of the most important parts to ensure the sustainability of the Company's business. In line with its strategy to improve long term productivity, the Company, through its Research & Development Division, endeavors to produce superior seeds that will generate added value to future oil palm crop.

In the short term, the Research & Development Division focuses on soil enhancement, more effective fertilizing using natural sources, and research in controlling plant diseases.

### **Human Capital Management**

The Company currently employs 35,400 permanent personnel spread over all of its plantations. In order to improve productivity of its human capital management, the Company focuses on raising employee competence enabling them to work more effectively and efficiently. Implementation of the mechanization and automation program demands improvement of the employees' technical skills which can only be achieved through appropriate training and mentoring programs.

The Company management also provided rewards for achieving employees as an incentive to enhance their work spirit and subsequently improve productivity.

### **Good**

### **Corporate**

### **Governance**

Under the oversight of the Board of Commissioners, throughout 2016, the Company implemented Good Corporate Governance according to the principles of Good Corporate Governance as stipulated in the governance guidelines issued by the Indonesian Financial Services Authority (Otoritas Jasa

Keuangan /OJK). These include principles of open information, accountability, independence, responsibility, and principles of equality and reasonableness. Our expectations are that through the implementation of Good Corporate Governance the Company will ensure the continuity of its business.

### **CSR Program and Sustainability**

We believe that the presence of our Company must benefit the people living in the surrounding areas of the plantations. We, therefore, consistently implemented a Corporate Social Responsibility (CSR) program based on four pillars, namely economy, education, health, and environment.

For the economy program, in 2016 the Company entered into a collaborative partnerships with the community, both through a plasma model and a KPPA program by buying FFBs worth Rp 1.83 trillion. Currently the Company has engaged 29,160 smallholders as partners in a nucleus-plasma collaboration program, working on a total acreage of 64 thousand hectares. The Company also conducted public information campaigns on cultivating and managing plantations.

In addition to the nucleus-plasma model, the Company also partnered with around 22 thousand independent smallholders. This model covering a total acreage of 144 thousand hectares yielded a total FFB purchase value of Rp 3,68 trillion.

Education Program: The Company manages 70 schools located within and outside of the plantation area comprising: 37 Kindergartens, 13 Elementary Schools, 9 Junior High Schools, and 11 State Elementary Schools, with a total number of students of 12.889. These school are supported by 512 teachers paid by the Company and for whom we provide various facilities.

Health Program: The Company manages 433 Public Maternal Health Centers (Posyandu) and 31 units of Plantation Polyclinics (Polibun). These Posyandus and Polibuns not only serve Company employees and their families, but are also provide health care to the communities living around the plantations.

On the sustainability aspect, the Company complies with ISPO (Indonesian Sustainable Palm Oil) regulations. By the end of 2016, 21 plantations managed by the Company obtained ISPO certification, 16 plantations were in the final processing stage of obtaining certification, and the others were undergoing an audit as a requirement toward certification.

In the area of environmental management, the Ministry of the Environment and Forestry applies a PROPER rating as an environmental performance indicator for companies. In 2016, 13 of our plantations were awarded the Green PROPER rating, while 14 plantations received the Blue PROPER rating.

## **Business Outlook for 2017**

The Company's business development for 2017 will focus on the following matters:

1. Continue intensification, mechanization and automation in the plantation areas, the processing plants, and other supporting areas, including automation in the administration in order to improve productivity and efficiency.
2. Undertake replanting to maintain the level of quantity and quality of future products.
3. Continue developing the Palm Oil Downstream Industry.
4. Continue developing business diversification in synergy with the palm oil plantations, amongst which are the integration of cattle in the plantations and developing blending plants for NPK fertilizers.
5. Improve the productivity of Human Capital through ongoing training programs and enhancing the employee reward system. These are measures taken by the Company in its endeavor to become the cost leader in the palm oil plantation sector.
6. Strengthen Research & Development with the objective to produce superior oil palm seeds. This is envisaged to become one of the Company's core competences.
7. Strengthen the corporate social responsibility program to foster a harmonious relationship with the communities living around the plantations.

This completes the Board of Director's Report for 2016. On behalf of the Board of Directors, I would like to express our sincere appreciation for the support from all Shareholders, the Board of Commissioners, all employees of the Company, and all stakeholders involved. This support has made it possible for us to achieve the outstanding operational and financial performance in 2016. May the Company continue to prosper and remain an innovative and productive plantation capable of contributing to the advancement and prosperity of the nation.

On behalf of the Board of Directors

**PT Astra Agro Lestari Tbk**

**Widya Wiryawan**

President Director