

LANNA RESOURCES PLC

No. 197/2022
28 October 2022

CORPORATES

Company Rating: A-
Outlook: Stable

Last Review Date: 09/12/21

Company Rating History:		
Date	Rating	Outlook/Alert
09/12/21	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Lanna Resources PLC (LANNA) at “A-” with a “stable” rating outlook. The rating continues to reflect the company’s long operational record in the coal mining business in Indonesia, its low-cost mining operations, and low-debt financial profile. However, the rating is constrained by regulatory risks associated with mining operations in Indonesia, and the long-term downward trend of global coal demand driven by the decarbonization trend.

KEY RATING CONSIDERATIONS

Long track record with low-cost mining operation in Indonesia

LANNA’s business profile reflects its position as a medium-sized coal mining company in Thailand. The company’s coal mining operations are in Indonesia, operated under two subsidiaries, PT LANNA Harita Indonesia (LHI) and PT Singlurus Pratama (SGP). LANNA’s coal mining business in Indonesia contributes about 70%-80% of its total earnings before interest, taxes, depreciation, and amortization (EBITDA). The balance of earnings is derived from the ethanol production business.

LANNA’s creditability is underpinned by more than 30 years’ experience in the coal mining business with established operations in Indonesia. The company has been engaged in coal mining in Indonesia since 1998 through business ventures with Indonesian partners. The company’s competitiveness in low-cost operations is supported by the characteristics of open-pit mining, proximity of mines to ports, and efficient supply-chain management. The company’s cash cost has been in the USD19-USD22 per tonne range over the last five years, providing a cushion to withstand severe industry downturns.

Coal reserves of seven-to-ten years

At the end of 2021, LANNA’s coal reserves totaled about 71.1 million tonnes, equivalent to about nine years of remaining reserve life, based on the current production rate of 7.5-8.0 million tonnes per year. With the current high coal prices, LANNA intends to ramp up production capacity to 9.0-9.5 million tonnes per year during 2023-2025. SGP’s production volume is targeted to rise to 5.5-6.5 million tonnes per annum, while LHI’s production rate will likely be consistent at 3.5 million tonnes per annum.

Most of LANNA’s coal is of low calorific value (CV), indicating a large price discount in comparison to global benchmarks, such as the Newcastle coal price index. The CV of LANNA’s coal ranges from 3,200-5,000 kilocalories/kilogram.

Constraints from regulatory risk in Indonesia

LANNA is required to comply with domestic market obligation (DMO) regulations in Indonesia, supplying 25% of its annual coal production volume to the local market. At present, the profit margin from supplying coal to the local market is considerably lower than from exports as the domestic price is capped at USD70 per tonne based on the HBA Index. To secure coal supplies in the country, stiff penalties are levied against those who fail to comply with the rule. The penalties for non-compliance of DMO include a cut in permitted production volume in a following year or export suspension until the DMO requirements are fulfilled. With such significant regulatory risk, we believe that LANNA will cautiously follow the rule to avoid penalties.

In addition, LANNA is obliged to divest its ownership in LHI and SGP to the authorities as foreign entities are allowed to hold a maximum shareholding of 49%. The divestment process has not yet been completed since no government agency has shown interest in becoming a shareholder of LHI or SGP. We expect potential future dilutions to have little impact on operations as we view that LANNA will remain the largest shareholder with a controlling interest in the two companies.

Exceptional earnings in 2022

LANNA's financial performance in 2021-2022 has benefited from the unusually high coal prices due to the energy crunch following the European Union's sanctions against Russia. The Newcastle coal price has increased from an average of USD220 per tonne in January 2022 to about USD400 per tonne in the third quarter of 2022. The surge in profitability and cash flow from the coal business has completely offset the impacts of rising energy costs and operating losses from the company's ethanol business.

During the period of high coal prices, the company also accelerated coal production, raising total coal sales volume to 4.16 million tonnes in the first six months of 2022, up by 18.5% year-on-year (y-o-y). In the first half of 2022, LANNA's overall revenue surged to THB12.6 billion, growing by 93% y-o-y, while its EBITDA jumped to THB5.07 billion, up by 165% y-o-y. The EBITDA margin widened to 40.2%, compared to an average of 17%-18% in normal years.

We believe that the demand-supply imbalance of coal will gradually normalize as high prices will encourage miners to increase supplies. Meanwhile, the energy crisis in Europe is expected to ease in the longer term with reduced dependence on Russian energy supplies and policies to boost renewable power capacity. We believe the long-term prospects for coal demand are still on a downward trend due to increasing international decarbonization commitments.

In our base-case forecast, we expect global coal prices to remain high throughout 2022 before softening in 2023 and 2024. Despite the prospect of downward adjustments, we expect global coal prices to remain above USD100 per tonne. We project the company's EBITDA to touch THB10 billion in 2022 and normalize to THB4 billion in 2024, with an EBITDA margin of around 40% in 2022 and 25% in 2024.

Low-debt financial profile to continue

We believe that LANNA's financial risk will remain low over the next three years based on its conservative financial policy. We take into consideration the prospect of new investments or acquisitions as the company is looking for opportunities in sustainable businesses, such as renewable power projects or biofuel. The company's huge cash surplus from operating cash inflows and strong balance sheet should be adequate to support future investments. In our base-case scenario, we expect the company's debt to EBITDA ratio to stay below 2 times and funds from operations (FFO) to debt ratio to remain above 60% in 2022-2024.

We assess LANNA's liquidity as strong over the next 12 months, with cash on hand of THB4.17 billion at the end of June 2022, compared to total scheduled short- and long-term debt repayments of THB1.17 billion.

Debt structure

At the end of June 2022, LANNA reported debt, excluding financial lease, totaling THB1.73 billion, all of which was priority debt. This means the ratio of priority debt to total debt was about 100%, suggesting significant subordination risk to the company's unsecured creditors. However, in our view, this subordination risk is significantly mitigated by the company's solid financial profile.

BASE-CASE ASSUMPTIONS

- Total coal sales volume, including production and trade, to rise to 8.3 million tonnes in 2022 and 9.0-9.5 million tonnes annually in 2023-2024.
- Revenue to reach THB25 billion in 2022 before declining to THB17-THB20 billion annually in 2023-2024.
- EBITDA margin about 40% in 2022 and 25%-32% in 2023-2024.
- Total capital spending of about THB0.4-THB0.5 billion per annum.
- Dividend payout ratio of 80%.

RATING OUTLOOK

The "stable" outlook reflects our view that LANNA's business and financial profiles will remain healthy. We believe that the company's coal mining business in Indonesia will sustain its smooth operations.

RATING SENSITIVITIES

The prospect of an upward revision of the rating and/or outlook is limited due to the long-term downtrend in demand for coal driven by the global decarbonization trend. However, the rating could be upgraded if LANNA can strengthen its business

profile, leading to more stable cash flow and earnings, while maintaining its strong balance sheet. This could occur from meaningful diversification of operations.

The rating and/or outlook could be revised downward if LANNA’s operations materially weaken, or its financial profile deteriorates significantly for an extended period. This could arise from a rapid reduction in global coal demand or from adverse changes in Indonesian regulations that affect the operation of LANNA’s coal business. Any sizable acquisitions that require large amounts of debt funding causing the company’s debt to EBITDA ratio to rise above 1.5 times for an extended period may also trigger a negative rating action.

COMPANY OVERVIEW

Established in 1985, LANNA is a coal mining company based in Thailand. The company has been listed on the Stock Exchange of Thailand (SET) since 1992. At the end of September 2022, Siam City Cement PLC owned approximately 45% of the company’s total shares outstanding.

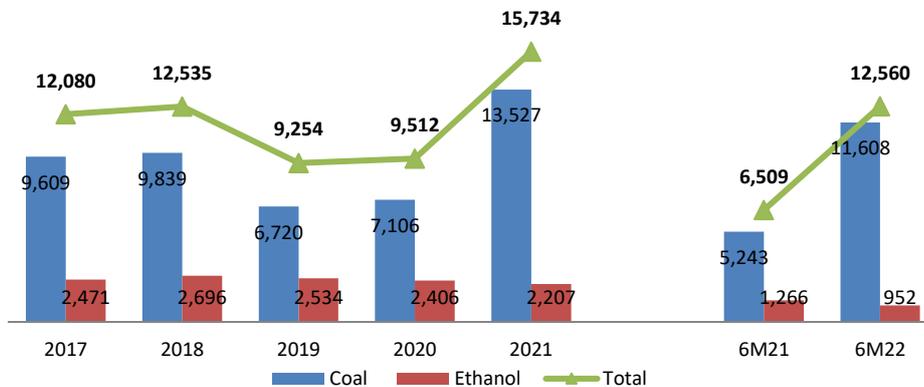
LANNA has two core businesses, coal mining and ethanol production. LANNA started coal mining operations in Thailand in 1985 and expanded the business in Indonesia in 1998. The company has two main subsidiaries, LHI and SGP, to mine coal in Indonesia for export to countries such as India, Bangladesh, and South Korea. LANNA’s shareholdings in LHI and SGP are 55% and 65%, respectively. The company also imports coal from other sources in Indonesia to distribute in Thailand. The company operates a distribution center in Ayutthaya province to store and size imported coal before delivery to domestic customers.

The company engages in the production and distribution of ethanol in Thailand through TAE, a 51%-owned subsidiary. TAE’s factory is located in Suphan Buri province with a total production capacity of 350,000 liters per day. The company’s ethanol production primarily uses molasses as a raw material.

LANNA’s consolidated revenue was approximately THB15.7 billion in 2021. The coal and ethanol segments contributed about 85% and 15% of total revenue, respectively. LHI and SGP, coal mining subsidiaries in Indonesia, together generated about 79% of total revenue. Total coal sales volume was about 7.17 million tons in 2021. Coal sales volume from its own mines amounted to about 6.6 million tons.

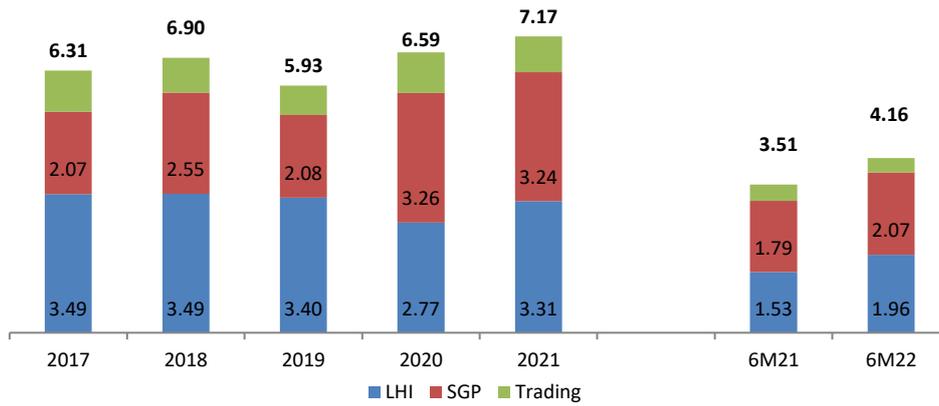
KEY OPERATING PERFORMANCE

Chart 1: Revenue Breakdown (Million THB)



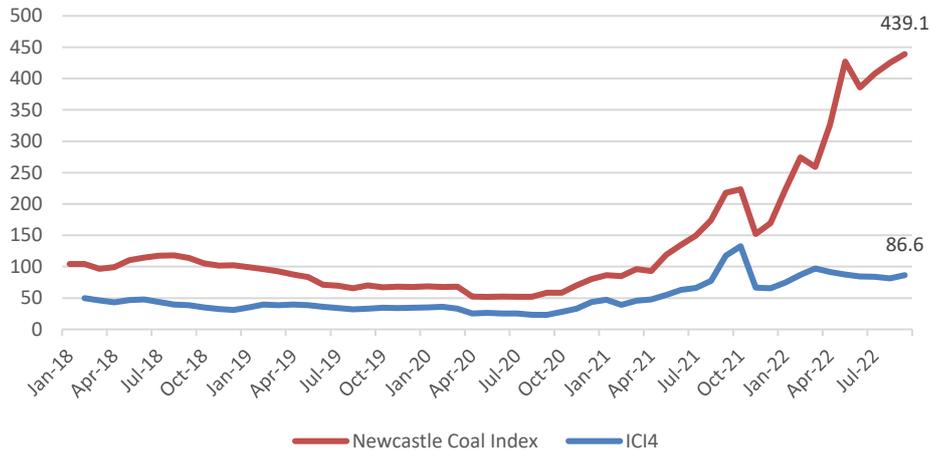
Source: LANNA

Chart 2: Coal Sales Volume Breakdown (Million Tons)



Source: LANNA

Chart 3: Newcastle Coal Price (USD/Ton)



Source: Bloomberg

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*
Unit: Mil. THB

	Jan-Jun 2022	-----Year Ended 31 December -----			
		2021	2020	2019	2018
Total operating revenues	12,623	15,840	9,569	9,323	12,551
Earnings before interest and taxes (EBIT)	4,671	4,441	654	1,073	1,579
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	5,106	5,200	1,466	1,820	2,343
Funds from operations (FFO)	3,775	3,865	1,220	1,546	1,845
Adjusted interest expense	30	71	79	89	80
Capital expenditures	142	143	267	604	671
Total assets	14,790	12,032	9,251	9,735	9,646
Adjusted debt	0	0	714	1,733	1,172
Adjusted equity	9,667	7,581	6,025	5,981	5,916
Adjusted Ratios					
EBITDA margin (%)	40.5	32.8	15.3	19.5	18.7
Pretax return on permanent capital (%)	72.9 **	49.9	7.7	12.6	20.4
EBITDA interest coverage (times)	168.0	73.3	18.5	20.4	29.4
Debt to EBITDA (times)	0.0 **	0.0	0.5	1.0	0.5
FFO to debt (%)	n.m. **	n.m.	170.9	89.2	157.4
Debt to capitalization (%)	0.0	0.0	10.6	22.5	16.5

* Consolidated financial statements

** Trailing with the last 12 months

n.m. Not meaningful

RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022

Lanna Resources PLC (LANNA)
Company Rating:
A-
Rating Outlook:
Stable
TRIS Rating Co., Ltd.

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