

# LANNA RESOURCES PLC

No. 218/2021  
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## CORPORATES

**Company Rating:** A-  
**Outlook:** Stable

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## RATIONALE

TRIS Rating assigns the company rating on Lanna Resources PLC (LANNA) at “A-” with a “stable” rating outlook. The rating reflects the company’s long operational record in coal mining business in Indonesia, its adequate coal reserves with low-cost mining operations, and low-debt financial profile. However, the rating is constrained by regulatory risks associated with its mining operations in Indonesia, an exposure to coal price risk, and the long-term downward trend of global coal demand driven by growing concerns over global warming.

## KEY RATING CONSIDERATIONS

### Long track record in coal mining operations in Indonesia

LANNA is a medium-sized coal mining company in Thailand with over three decades of experiences in the coal mining business. Over the last five years, LANNA’s coal mining business in Indonesia has contributed about 70%-80% of its total earnings before interest, taxes, depreciation and amortization (EBITDA). The company also engages in the ethanol production business, which makes up the balance of earnings portion.

TRIS Rating views LANNA’s long record of coal mining operations through coal industry cycles as a factor underpinning its creditability. The company has engaged in mining operations in Indonesia since 1998 through business ventures with Indonesian partners. LANNA has two operating coal mines in East Kalimantan in Indonesia, operated by its two subsidiaries, PT Lanna Harita Indonesia (LHI) and PT Singlurus Pratama (SGP). The company’s coal sales volume in 2020 totaled 6.6 million tons, including 6 million tons of self-produced coal and the remainder in trading volumes.

In our view, LANNA’s competitive edge is derived from its efficient and low-cost mining operations. These are supported by the nature of open-pit mining, the proximity of mines to ports, and the company’s effective logistics management. We also note the company’s ongoing cost controls help sustain its cash operating costs and allowed the company to withstand deep industry downturns in the past.

### Coal reserves of over 10 years

LANNA’s adequate coal reserves still demonstrate good prospects of future cash generation. At the end of December 2020, coal reserves at the mines of LHI and SGP totaled approximately 83.6 million tons – an estimated remaining 12 years based on its annual production. The existing coal reserves are primarily of low calorific value (CV), ranging from 3,200-5,000 kilocalories/kilogram. The low CV indicates a relatively large price discount compared with global benchmarks.

LANNA continues to seek to invest in new mines to expand its coal reserves. The company acquired a 10% stake in PT Pesona Khatulistiwa Nusantara (PKN) in September 2021 for a total investment cost of USD5 million. PKN is an Indonesian mining company located in North Kalimantan. PKN has a concession due to end in 2039 and has 36 million tons of measurable coal reserves.

## Regulatory risk of coal mining in Indonesia

The enforcement of the domestic market obligation (DMO) regulation has constrained the company's coal mining operations in Indonesia. The DMO requires all coal miners in Indonesia to allocate a minimum of 25% of coal production for distribution within the domestic market. The selling price under the DMO regulation is also capped, limiting profit margins during periods of coal price uptrends. Those mining companies unable to comply with the DMO requirement may be subjected to a cut in approved production volumes in the following year.

LANNA is also obliged to divest its ownership in LHI and SGP to the authorities as foreign entities are allowed to hold a maximum shareholding of 49% after ten years of production. Currently, LANNA is undertaking the divestment process as the company holds 55% and 65% interests in LHI and SGP, respectively. Future dilutions of equity interest will have limited impact on the company's coal operations as LANNA will remain the largest shareholder with controlling interest over the two companies.

## Exposure to coal price risk

LANNA's profitability is also susceptible to coal price risk as a norm of the commodity-related business. However, profit swings are partially counterbalanced by the benefits of diversification into the ethanol business, which is less volatile than the coal business. LANNA's earnings and cash flow generation have relatively fluctuated following the coal price trend. Its EBITDA was between THB1.2-THB2.6 billion per annum during 2016-2020. EBITDA margin averaged 17.8%, swinging within a range of 13.9%-21.7%.

## Ethanol profitability expected to return to normal levels

LANNA engages in the production and distribution of ethanol in Thailand through Thai Agro Energy PLC (TAE), a 51%-owned subsidiary. Performance of the ethanol business weakened in 2021 due to the sharp decline in fuel demand during the national lockdown in Thailand influenced by Coronavirus Disease 2019 (COVID-19), coupled with cost pressure from rising molasses prices due to the drought in Thailand.

We believe that ethanol sales volume and profitability should return to normal levels from 2022 onwards. This is supported by the improving COVID-19 situation in Thailand and the anticipated decline in the price of molasses following the abundant rainfall and rising sugarcane production this year. We expect the company's ethanol EBITDA margin to gradually return to a normal level of around 15%-16% over the next three years from 8.2% in the first nine month of 2021.

## Exceptional high profit from recently soaring coal prices

LANNA benefits materially from a recent rally in coal prices, driven by coal supply shortages. The Newcastle coal price has continued to escalate from about USD55 per ton in the third quarter of 2020 to about USD200-USD250 per ton between September and October 2021 before falling to USD150-USD160 per ton in November 2021. For the first nine month of 2021, LANNA's performance reached its new peak. Its revenue was THB11.24 billion, growing by 62% year-on-year (y-o-y), while the EBITDA soared to THB3.9 billion, or up by 272% y-o-y. EBITDA margin was 34.6%, higher than its average of 17%-18%.

We expect coal prices to remain high until at least the end of 2021, backed by seasonal coal demand in winter, power shortages, and low coal inventory in China. However, we believe that the demand-supply imbalance of coal will gradually resolve in the following year, gradually bringing the coal price back to its long-term average of about USD80 per ton in 2023.

In our base-case projection, LANNA's total sales volume will grow to 7.1 million tons in 2021 and will gradually rise to 7.6 million tons in 2023 and 2024, driven by operational commencements of SGP's two new mining sites, Argosari and Margomulyo. Its strong operating results from the coal business offset the weak results of the ethanol business in 2021. We forecast the company's EBITDA to reach an exceptional high between THB4.5-THB5.0 billion in 2021 before declining to an average of about THB1.9-THB2.0 billion annually in 2023-2024.

## Expected low-debt financial profile to continue

LANNA's low-debt financial status plays a critical role to support its credit strength, in our view. Its financial leverage over the last five years has been maintained at a very low level, reflecting the conservative financial policy, and its self-financing ability from its coal-mining operations. During 2016-2020, the net debt to EBITDA ratio was below 1 time and the net debt to capitalization ratio was below 25%. Additionally, the company reserves large cash and cash equivalent to mitigate its debt payment risk. At the end of September 2021, its total outstanding debt was about THB1.7 billion, almost all of which was short-term borrowings for the ethanol business. We view the company's liquidity at the end of September 2021 is adequate, given its cash on hand of around THB3.9 billion.

We believe LANNA will continue its conservative financial policies. We do not expect the company to make material investments during the next three years, while the strong operating cash flow during the next few years should adequately

fund estimated capital expenditures of THB0.4-THB1.0 billion per year. During 2022-2024, the company's net debt to EBITDA ratio is forecast to remain below 2 times and its net debt to capitalization ratio below 30%.

### Debt structure

At the end of September 2021, LANNA's reported debt, excluding financial lease, was THB1.6 billion. All of which was priority debt. This means the ratio of priority debt to total debt was about 100%. As its priority debt ratio is more than the threshold of 50%, we view LANNA's unsecured creditors as being significantly disadvantaged with respect to the priority of claims against its assets in case of default. However, this subordination risk is mitigated by the company's solid financial status.

### BASE-CASE ASSUMPTIONS

- Total coal sales volume, from both production and trade, to grow to 7.1 million tons in 2021 and 7.6 million tons in 2023-2024.
- Revenue to rise to THB15 billion in 2021 before declining to THB11-THB12 billion in 2023-2024.
- EBITDA margin to remain above 30% in 2021 and decline to 17% in 2023-2024.
- Total capital spending of about THB0.4-THB1.0 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. With its strong balance sheet, low capital expenditures, and ample cash, we believe that the company will be able to weather volatility and downturns in the coal industry.

### 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 growing concerns over global warming and the global decarbonization trend. However, the rating could be upgraded if LANNA can strengthen its business profile, leading to substantially enlarged and more stable cash flow and earnings, while maintaining its strong balance sheet. This could occur from a higher degree of diversity of operations and/or a considerable increase in production volumes.

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 and adverse changes in Indonesian regulations that substantially affect the operation of LANNA's coal business. Any debt-financed acquisition which causes the company's net debt to EBITDA ratio to rise above 1.5 times for a sustained period may 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 March 2021, Siam City Cement PLC owned approximately 45% of the company's total shares outstanding.

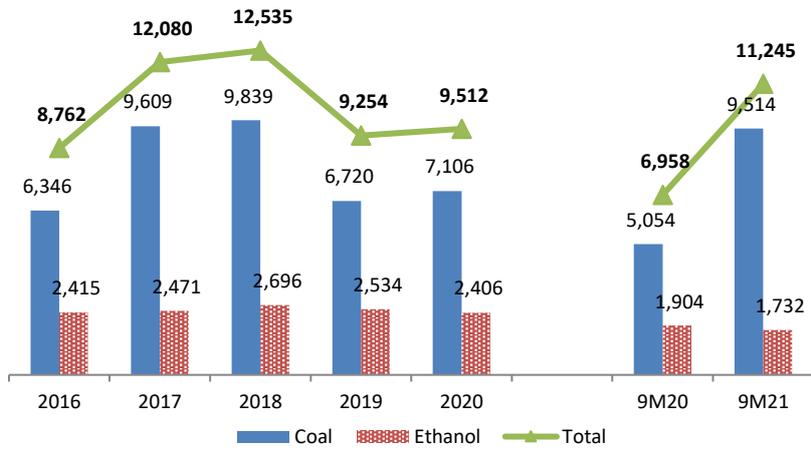
LANNA has two core businesses, coal mining and ethanol production. LANNA started coal mining operations in Thailand in 1985 and expanded the business in Indonesia in 1998. The company has two main subsidiaries, LHI and SGP, to mine coal in Indonesia for export to countries such as India, Bangladesh, 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 THB9.51 billion in 2020. The coal and ethanol segments contributed about 75% and 25% of total revenue, respectively. LHI and SGP, coal mining subsidiaries in Indonesia, together generated about 65% of total revenue. Total coal sales volume was about 6.6 million tons in 2020. Coal sales volume from its own mines amounted to about 6 million tons.

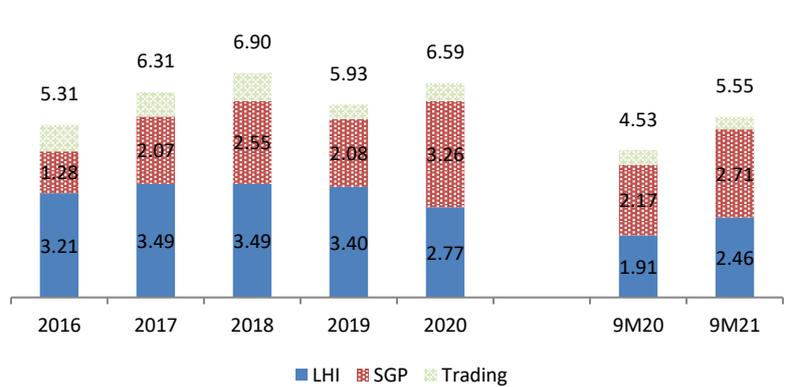
**KEY OPERATING PERFORMANCE**

**Chart 1: Revenue Breakdown (Million THB)**



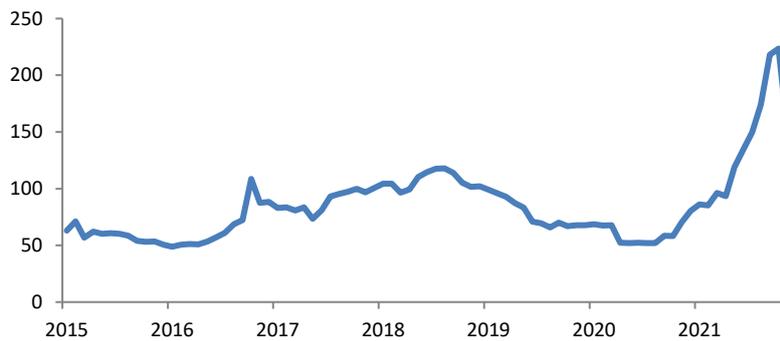
Source: LANNA

**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-Sep 2021	----- Year Ended 31 December -----			
		2020	2019	2018	2017
Total operating revenues	11,313	9,569	9,323	12,551	12,113
Earnings before interest and taxes (EBIT)	3,226	660	1,073	1,579	1,929
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,913	1,472	1,820	2,343	2,626
Funds from operations (FFO)	2,733	1,224	1,538	1,814	1,902
Adjusted interest expense	41	72	89	80	80
Capital expenditures	118	267	604	671	268
Total assets	12,118	9,251	9,735	9,646	8,775
Adjusted debt	0	714	1,733	1,172	0
Adjusted equity	7,812	6,025	5,981	5,916	5,808
<b>Adjusted Ratios</b>					
EBITDA margin (%)	34.6	15.4	19.5	18.7	21.7
Pretax return on permanent capital (%)	37.1 **	7.8	12.6	20.4	26.3
EBITDA interest coverage (times)	95.4	20.5	20.4	29.4	32.7
Debt to EBITDA (times)	0.0 **	0.5	1.0	0.5	0.0
FFO to debt (%)	n.m. **	171.4	88.7	154.7	n.m.
Debt to capitalization (%)	0.0	10.6	22.5	16.5	0.0

\* Consolidated financial statements

\*\* Trailing with the last 12 months

**RELATED CRITERIA**

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

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**Lanna Resources PLC**

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<b>Company Rating:</b>	A-
<b>Rating Outlook:</b>	Stable

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**TRIS Rating Co., Ltd.**

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