Coal Market Update: July 2012

Volatile thermal coal prices and environmental risks make export projects unattractive

This Coal Market Update summarizes general developments from May to July 2012 that raise risks for the global coal industry. Greenpeace tracks coal market developments worldwide through specialist staff in 28 offices, including the United States, China, India, Australia, South Africa and Indonesia. This update is prepared in collaboration with BankTrack. All prices are in USD unless noted.

Key points:

- Asian coal prices fell following softening demand casting doubt on the viability of export projects.
- Coal's 'golden decade' in China may soon be over, say market observers, with overcapacity and disorderly competition likely to lead to volatile boom and bust cycles.
- Fuel shortages continue to erode the profits of coal projects in India as S&P downgrade their outlook for Tata Power's and investors look to renewables.
- The UNESCO World Heritage Committee has warned that it may list the Great Barrier Reef as "in danger" unless Australia acts on a series of recommendations, raising further doubt over several coal terminal projects in the area.
- Patriot Coal has filed for bankruptcy in the US whilst a review has begun on uncompetitive processes for the sale of coal leases.
- Certainty of access to coal resources in Indonesia was put under the spotlight by the Churchill Mining case.
- A World Bank inspection report found that water and environmental concerns over Eskom's Medupi plant were valid.

Companies mentioned include:

Huaneng Power International Inc (902:HK)

Datang International Power Generation Company Limited (991:HK)

Huadian Power International Corporation Limited (1071:HK)

China Power Investment Corporation (China Power International Development Ltd 2380:HK)

Tata Power (TPWR:IN)

CLP (2:HK)

GVK Group (GVK Power & Infrastructure Ltd NSE:532708)

Adani (BSE: 512599, NSE: ADANIENT)

BHP Billiton (LSE: BLT, NYSE: BHP, NYSE: BBL, ASX: BHP, JSE: BIL)

Patriot Coal Corp (PCXCQ:US)

Alpha Natural Resources Inc (ANR:US)

Arch Coal Inc (ACI:US)

Peabody Energy Corp (BTU:US)

Ambre Energy (unlisted, planning IPO)

Churchill Mining (CHL:LN)

Eskom (unlisted)

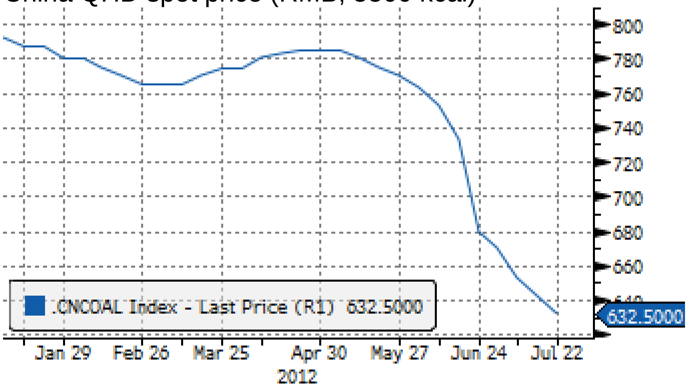
GREENPEACE International

Global

Collapse in thermal coal prices points to rising volatility

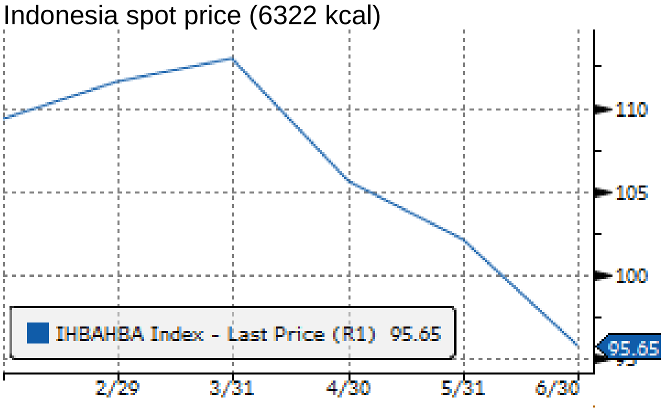
As of July 24th 2012 Source: Bloomberg

China QHD spot price (RMB, 5500 kcal)

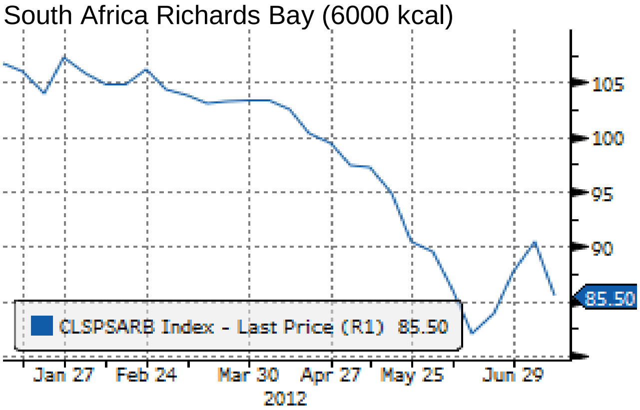


Australia Newcastle spot price (6700 kcal)

Indonesia spot price (6322 kcal)



South Africa Richards Bay (6000 kcal)



The end of June saw a collapse in spot prices for internationally traded (sea borne) coal as oversupply hit the market. Spot prices for Newcastle 5500 kcal thermal coal fell below $80/tonne. Market sources told Platts that producers were reluctant to let coal stocks go at these prices as they were close to their average production costs. Spot prices for FOB 6000 kcal coal at Richard's Bay have fallen to under USD85/tonne, dramatically down from over $115 in mid 2011.

The price of thermal coal at Qinghuangdao and Bohai had both fallen for eight consecutive weeks by late June, with prices staying low in July. The average price of 5500 kcal coal at Bohai port fell below RMB702/tonne ($110). "Whether the price of Qinghuangdao 5500 kcal thermal coal will stabilize at RMB 650/tonne ($101) is largely uncertain," an unnamed source at Henan Shenhuo Coal & Power told the Dayang - Guangzhou Daily. IHS McCloskey reported Qinhuangdao 6000 kcal prices were down to $ 121 by 13 July from prices above $150 in the last quarter of 2011.

However, coal futures at Richard's Bay and Newcastle point to a return to thermal coal prices over $100 a tonne within in the next 18-24 months. Greenpeace analysts believe that the volatility is making planning and execution difficult both for export projects and for power stations relying on imported coal, and as a result, forecasting a reliable IRR for the 20-40 year life of these projects will require bold assumptions.

China

Extent of loss in Chinese coal sector last year confirmed

Five of the largest Chinese electricity companies (Huaneng, Datang, Huadian, Guodian, China Power Investment) collectively posted a loss of RMB15.1 billion ($2.3 billion) in 2011, down 348% year-on-year. Rising coal prices in recent years and escalating financing costs were the main reasons, said the State Electricity Regulatory Commission in the 2011 Electricity Regulatory Annual Report released in late June.

The report also showed total investment in the coal sector has fallen for 6 consecutive years, to RMB105 ($16 billion) in 2011 a decrease of 26% year-on-year. The 2011 investment was barely half of the investment in 2005. This compared to $51 billion invested in renewable energy in China in 2011, 18% higher than 2010. Industry analysts observed that many coal companies are unable to make new investments, due to significant loss and higher debt ratios.

Stockpiles rise why coal miners cut costs

The port of Qinhuangdao, the country's largest coal port in North China's Hebei Province, said the dramatic increase in coal stockpiles over the past few months was a result of overproduction and slumping demand amid the economic slowdown. The power producers, which have also seen inventories rise at their plants, have been hesitant to carry away the coal, while coal producers have maintained supplies, an anonymous staff member at the Qinhuangdao coal transaction center told the Global Times.

Facing an adverse and uncertain operating environment, coal companies are starting to slash costs. China National Coal Group Corp, the second largest coal producer in China, had reportedly slashed salary by 10% in April and again in May. Shanxi Coking Coal Group had also cut salary back significantly.

In addition to cutting costs, coal producers are also restricting production in an attempt to stabilize price. "Production and sales in Henan will drop by 20% this year, because of consolidation of coal resources and stricter enforcement of mining safety regulations" said Li Zhaolin, Henan-based market observer from the China Coal Transportation and Marketing Association.

End of coal's 'golden decade'?

Analysts have attributed the dramatic drop in Chinese coal prices largely to diminishing demand and high inventories. Rising imports in recent months have suppressed the domestic coal price, creating a typical buyer's market this year. Significant falls in pithead prices at all major coal bases, decreasing coal prices at the plant and coal storage near capacity have contributed to a pessimistic outlook.

"The coal price had fallen so much, with no sign of a turn-around in the foreseeable future, so we expect the price will fall further. All signs show that coal's 'golden decade' will soon be over. Main commodities closely pegged to the economy do undergo periodic booms and depressions, this is unavoidable," said Huang Shengchu, Dean of the State Production Safety Supervision Administration of the Coal Information Institute.

Huang Shenchu added "The obvious characteristic of the Chinese coal sector is the lack of diversification, which made it extremely vulnerable to market risks. The sector also lacks a self-regulatory mechanism and effective coordination, leading to overcapacity and disorderly competition in the market. These are systemic problems in the coal sector that are yet to be resolved."

Chinese air pollution standards compare favourably to EU, US

Analysis released in June found that Chinese standards for air pollution emissions from new coal fired power plants were similar, in some cases better, than standards in the EU and the US. This many challenge some capital cost assumptions for coal-fired power plants. Stricter standards in China apply for some highly polluted areas. The updated standards apply to new plants starting January 1, 2012, and existing plants have just 2½ years to meet them.

India

S&P downgrade Tata Power after coal project debt pact breach

S&P downgraded its outlook for Tata Power to negative following a breach of the debt pact for its coal-fired Mundra Ultra Mega Power Project. The availability of loans for the 4 000 MW project, which relies on imported coal, could be limited after Tata breached a debt-equity ratio covenant. Tata is losing money on the project following significant coal price increases since the project was designed. Tata has put all new projects based on imported coal on hold.

CLP goes for a renewables strategy in India after coal and gas shortages

CLP, one of the biggest power companies in the Asia-Pacific, said its recently completed 1 320 MW coal plant in Haryana was "dead cold" for lack of coal supplies. Fuel shortages also meant its 655 MW gas-fired plant in Gujarat was also running below 50% capacity. CLP says it will focus new investments in India on renewables.

Australia

UN calls for Great Barrier Reef protection; proposed coal projects under the spotlight

The UNESCO World Heritage Committee has warned that it may list the Great Barrier Reef World Heritage Area as "in danger" in 2013 unless Australia acts on a series of recommendations to avert clear threats to the Reef's "outstanding universal values."

UNESCO flagged serious concern about the scale and pace of coastal industrial development along the Reef and called on Australia "to ensure no developments are permitted which create individual, cumulative or combined impacts on the outstanding universal values of the Great Barrier Reef World Heritage Area and its long-term conservation".

With a strategic assessment of the Great Barrier Reef due to be undertaken by the Australian Government, UNESCO also called for the prevention of major projects that may compromise its outcomes. As the UNESCO meeting commenced in St Petersburg, Greenpeace released a briefing paper outlining seven coal terminal projects that have been allowed to proceed through the approvals process since UNESCO began to voice its concern for the state of the Reef. These projects, if approved, would defy UNESCO's recommendations and add to the risk of the Reef being placed on the "in danger" list. They include projects involving GVK, Adani, BHP Billiton and Waratah Coal.

The recommendations adopted by UNESCO can be found in the UN Reactive Monitoring Mission Report on the Great Barrier Reef.

Investors warned off GVK's Alpha Coal project

On 8 June Greenpeace, GetUp! and BankTrack placed a full page advertisement in the Asian Financial Times warning investors "don't sink your profits on the Great Barrier Reef." The ad highlighted risks facing the project and that national and international NGOs are vowing to fight these coal projects every step of the way. The ad has since appeared in The Economist.

"Clock stopped" on GVK's Alpha Coal Project approval

On the 29th May the Queensland Coordinator-General recommended the approval of the Alpha coal mine and 500km rail line to Abbot Point. This project is owned by Indian conglomerate GVK (79%) and Gina Rinehart (the richest woman in the world).

The Commonwealth and State governments had reached an agreement whereby the states would assess impacts on matters of national environmental significance in environmental approvals, simplifying the overall process. However, the Coordinator-General's report had failed to do this adequately.

Federal Environment Minister Tony Burke announced on 5 June that he was putting the approval process on hold, pending further information. What followed was a major political dispute between the Commonwealth and Queensland governments. Mr Burke accused the Queensland Government of providing "dud information" and declared that "I cannot trust them with Queensland jobs; I cannot trust them with the Great Barrier Reef".

New coal plant loses government funding

A $100 million grant from the federal government for a coal-fired power station has been cut after the proponent failed to meet grant conditions. HRL had proposed a 600 MW brown-coal fired power plant in Victoria. The proposed plant has been opposed by an on-going community campaign since 2007. The decision will make it difficult for HRL to proceed and may put an end to new coal-fired power stations in Australia.

The United States

Patriot coal files for bankruptcy as US coal industry struggles

Patriot Coal Corp (PCX), with 13 active mining complexes in Appalachia and the Illinois Basin, filed for bankruptcy protection on 9 July. The US coal industry continues to struggle with electricity generators switching to natural gas (and increasingly to renewables) and reducing pollution following regulatory pressure. The move saw Patriot shares fall 71% on 9 July alone and the share price stood at 98% below a year earlier by 13 July. BlackRock Inc. (BLK), State Street Corp. (STT) and Vanguard Group Inc faced losses as entities controlling more than 5% of Patriot's voting stock.

Shares of competitors also fell on 9 July including Alpha Natural Resources (down 7.5%), Arch Coal (down 6.7%) and Peabody Energy Corp (down 6.25%). Patriot is expected to secure a $802 million loan to continue operations with US NGOs pushing for the banks involved to work with Patriot to close and clean up mountain top removal mines and transition the Appalachia region into a producer of clean, renewable energy.

US losing billions through coal mining lease sales

The US government may have lost as much as $28.9 billion over the past 30 years through non-competitive auctions of coal mining leases, according to an analysis by the Institute for Energy Economics and Financial Analysis. The auction practices, which allowed sales to go ahead when there was just one bidder, are now under review. This could lead to increased costs for coal miners over time. Greenpeace and several other organisations called for coal mining lease sales to be suspended. The US analysis follows a similar scandal in India in March, where the government may have lost $210 billion by under-pricing coal.

Congressman proposes tax on coal mining for health and environmental costs

Congressman Jim McDermott (D-WA) has introduced the True Cost of Coal Act of 2012 to add a $10/ton tax for coal mined in the US to cover the costs of health, environmental, and public safety impacts associated with transporting coal for export. The bill also requires rail companies to cover coal trains or otherwise suppress coal dust. Rep. McDermott is joining the growing chorus of elected officials in Washington and Oregon expressing concern or opposition to coal exports.

Ambre Energy sued by coal mining partner

Ambre Energy is being sued by Cloud Peak Energy over its management of the Decker coal mine in Montana, which is 50% owned by each company. Cloud Peak alleges Ambre developed export plans without their approval that would see Ambre take a disproportionate share of profits. Cloud Peak also raised concerns in the lawsuit over Ambre Energy's "potential financial instability".

Ambre's coal export projects continue to stir public controversy. A protest against coal export terminals in Portland saw 600 people turn out to hear speakers including Robert Kennedy Jr., Hao Xin, Executive Director of Qiantang River Waterkeeper and Paul Lumley, Executive Director of Columbia River Inter-Tribal Fish Commission. The protest was organised by Greenpeace, Columbia Riverkeeper, Sierra Club and Climate Solutions.

Indonesia

Churchill Mining case highlights risks for coal investors

The Indonesian Supreme Court said it would not hear an appeal from Churchill Mining over its case for compensation for a coal project the company claims was unfairly seized. Churchill Mining's legal battle was profiled in the New York Times, highlighting the lack of business certainty and contract certainty for foreign investors in Indonesia coal projects.

South Africa

Eskom's water consumption in the spotlight

The World Bank's inspection report on the 4800 MW Medupi coal fired power station found that water and environmental concerns were valid. Econometrix's chief economist, Azar Jammine, said Eskom might face difficulties in raising funds if environmental organisations kept challenging decisions to fund coal plants.

Greenpeace continued to highlight the water implications of the Kusile coal-fired power plant currently under construction, which will require 2.9 million litres of water per hour. Water may have to be diverted from agriculture and residential use as concerns over water shortages grow. It is estimated that South Africa will face a 17% gap between water supply and demand as early as 2030.

This came as GE's director of global strategy and planning, Peter Evans, said a lack of water made China's and India's plans to build more coal-fired power plants unfeasible.

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