Investor Newsletter

Coal Market Update July 2013

Low prices take their toll on coal firms

This Coal Market Update summarizes general developments in the last two months that raise the risk of investing in the global coal industry. This is not investment advice. Greenpeace International tracks coal market developments worldwide through specialists located in the 28 national and regional 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:

- Coal producers across the world continue to be battered by low prices and oversupply in the market, resulting in cost-cutting, job-shedding and delayed investment.
- China's Shandong province announced plans to reduce coal consumption by 20 million tonnes on 2012 levels by 2017 in a new air pollution reduction plan, with other coal-reliant provinces likely to follow.
- Several new health studies in China show the human toll of coal-burning in northern provinces and local discontent with current air quality.
- China's first cap-and-trade emissions trading scheme launched in Shenzhen with six others planned.
- Indonesian export figures raise new concerns over coal export restrictions.
- Indian coal firms beginning to diversify into renewable energy.
- Three million cubic metre capital dredging project at Abbot Point remains in limbo as Australia's new Federal Environment Minister delays decision.
- New report released by the US-based Institute for Energy Economics and Financial Analysis claims GVK's Alpha Project is uneconomic.
- Australian political leaders make announcements signalling the end of the country's resource boom.
- Brookfield and Adani coal terminals at Dudgeon Point delayed by a year at least.
- Obama's climate speech outlines new risks for coal companies.
- Report from the Inspector General of the Department of Interior finds significant flaws in Bureau of Land Management's coal leasing program.
- New report claims Ambre Energy's higher-cost Morrow Pacific Project may become "terminal of last resort".
- Eskom's Medupi plant delayed and projected cost rises by almost $1 billion.

Companies mentioned include:
Glencore Xstrata (LSE: GLEN)
Peabody Energy Corp (NYSE: BTU)
Anglo American PLC (LSE: AAL)
Rio Tinto Ltd (ASX: RIO)
Vale S.A. (NYSE: VALE)
Coal India Limited (CIL) (BSE: 533278, NSE: COALINDIA)
NTPC Ltd. (NSE: NTPC)
Lanco Infratech Ltd. (BSE: 532778)
Adani Enterprises Ltd (BSE: 512599, NSE: ADANIENT)
Tata Power Company Limited (NSE: TATAPOWER)
GVK Group (GVK Power & Infrastructure Ltd; BSE: 532708, NSE: GVKPIL)
Hancock Coal (unlisted)
Ambre Energy (unlisted)
Eskom (unlisted)

Global

Weak global demand, market oversupply and low prices leaves coal firms reeling
Consistently low prices caused by slowing global demand and market oversupply have begun to take their toll on coal firms, forcing them to close mines, shed workers and delay investments. In Australia, mining giant Glencore Xstrata has, since May, axed 450 workers at its Newlands and Oaky Creek mines and halted work on its Balaclava Island export terminal in Queensland. The company's subsidiary, Xstrata Coal, shed 46 jobs at its Ravensworth mine in New South Wales. Peabody Energy has also cut about 450 contractor jobs from its Australian operations, Anglo American has mothballed its Aquila mine and Rio Tinto is looking to offload about $3 billion of coal assets. Brazilian miner Vale will also put its Degulla mine in the Galilee Basin on the market, following a $1 billion write-down of its Australian coal assets four months ago.

Coal players in China are also hurting. State-run Xinhua news agency has reported that several of China's largest coal producers have begun to sell coal at their lowest prices in five years. China Coal Energy Co., China Shenhua Energy Co and Datong Coal Industry Co. lowered their benchmark prices to below 600 yuan ($98) per ton in late June.

China

Shandong province announces coal consumption cap with others in the works
Shandong Province, China's single biggest coal-consuming province, has published an air pollution reduction plan which includes a target to reduce coal consumption by 20 million tonnes on 2012 levels by 2017, with coal consumption peaking in 2015. Draft plans have also been announced in Hebei Province (40 million tonne reduction on 2012 levels by 2017), Beijing and Tianjin (both 10 million tonne reductions on 2012 levels by 2017). This follows a State Council announcement of a string of measures to curb air pollution in China, including a target to reduce emissions from heavy polluting industries by 30% by the end of 2017.

Public pressure intensifies as new studies show health impacts of coal burning in northern China
A new scientific study has found that air pollution causes people in northern China to live an average of 5.5 years shorter than their southern counterparts. The study, which is published in the Proceedings of the National Academy of Sciences, projects that higher levels of air pollution in northern China — much of it caused by an over-reliance on burning coal for heat — will cause 500 million people to lose an aggregate 2.5 billion years from their lives.

Further, Greenpeace have released new research on the health impacts of coal power plants in three of China's heaviest coal-consuming provinces: Shandong, Shanxi and Inner Mongolia. The study results show that PM 2.5 pollution from the 637 power plants in these provinces caused 83,500 premature deaths in China during 2011. Pollution also caused nearly 130,000 cases of asthma and more than 140,000 cases of chronic bronchitis. A recent survey revealed that nearly 70% of residents in the Beijing, Tianjin and Hebei region are unsatisfied with the current air quality, while 92% of residents want local air quality to reach acceptable standards by 2020.

Emissions trading launched in China
China launched its first cap-and-trade carbon trading scheme in Shenzhen on 18 June. With the goal of helping to cut China's emissions intensity per unit of GDP by 40-45% on 2005 levels by 2020, the Shenzhen Emissions Exchange is the first of seven planned pilot emissions exchanges, with the remaining six to be set up in Beijing, Shanghai, Tianjin, Chongqing and the provinces of Guangdong and Hubei respectively. The Shenzhen pilot initially imposes emissions caps on 635 industrial firms and 197 government buildings which contributed 40% of the city's total carbon emissions in 2010, with emitters required to collectively cut their carbon intensity by 6.7 per cent a year between this year and 2015.

India

Indian power plants exposed as Indonesia continues to ponder low-grade coal export ban
Indonesia's recent announcement that it exported 77 million tonnes of coal to India in 2012-13, a 40 per cent year-on-year increase, sparked renewed concerns over whether Indonesia has been exporting too much of the fuel. "It's imperative for Indonesia to tighten its control on exports to secure long-term supply. As there is low domestic consumption of coal till date, the Indonesian government is still evaluating the new regulation that could ban the export of low-grade coal (that below 5,100 kcal) by 2014," said Indonesia's Ambassador to India, Rizali W Indrakesuma. Approximately 78 per cent (304 million tonnes) of Indonesia's annual production of 386 million tonnes of coal is exported to China, India, South Korea, Japan and Taiwan. An article in the Business Standard noted that: "At this rate of exports, by 2020, Indonesia will have to start importing coal to meet its 125-mt annual demand from its local power industry." Any restrictions on the export of low-grade Indonesian coal would increase generation costs for Indian power producers such as Tata Power, Adani Power, Lanco Infratech and NTPC, whose power plants rely heavily on imported coal.

Coal companies moving away from coal and into renewables
India's major coal companies are seeing opportunities in the renewables market. A subsidiary of Tata, India's largest utility, announced that the company sees installing solar systems as a $1.3 billion opportunity. According to Bloomberg New Energy Finance, solar is already cheaper than electricity from the grid for major commercial enterprises in about 10% of India's states and forecast to continue to become cheaper over time. Coal India, the world's largest coal miner, is even looking to install solar energy to reduce its own energy bills. This is supported by new research by HSBC which finds that wind power has reached price parity with new-build coal capacity in the country and that solar is likely to follow suit between 2016-18.

Australia

Decision on dredge spoil dumping at Abbot Point pushed back
Amid "unrelenting controversy" Australia's new Federal Environment Minister has delayed by a month a decision on whether to approve a 3 million cubic metre capital dredging project at Abbot Point to facilitate the expansion of the coal terminal in order to help fulfill the coal export plans of Indian companies GVK and Adani.

GVK/Hancock's Alpha coal project delayed, labelled 'uneconomic'
A Greenpeace-commissioned study by the US-based Institute for Energy Economics and Financial Analysis has questioned the viability of GVK's $10 billion Alpha coal project in Queensland. According to co-author and former Deputy Comptroller for New York, Tom Sanzillo, "GVK simply cannot afford to participate in the Alpha project due to its plummeting stock price, overleverage, and poor track record on other projects amongst other factors. In short, it lacks the financial capacity to deliver." This research follows earlier announcements by Macquarie Group, Australia's biggest investment bank, that project paybacks in the Galilee Basin look extremely poor, and that further delays to projects would be likely unless "deep pocket" backers were willing to ignore conventional economics.

Australian politicians downbeat about the future of coal
Prominent Australian political leaders recently cast a downbeat outlook on the future of the country's commodity exports. On the topic of coal, West Australian Premier Colin Barnett noted that "the world is making policy decisions which mean that coal usage, in my view, will progressively decline. It's a long-term structural change and that should not be dismissed as something that is purely cyclical." Australian Prime Minister Kevin Rudd added in an important pre-election address that Australia's commodity boom was coming to an end and that economic diversification was a key national priority. "Because the China resources boom is coming off, Australia’s core economic strategy for the future must be one which diversifies our economy, by creating more jobs in manufacturing, food production, infrastructure, construction, and our many other services industries, rather than having all our eggs in just one basket – the resources and energy sector", said Rudd.

Brookfield and Adani Dudgeon Point Coal Terminals delayed another year or more
Construction of two new coal export terminals at Dudgeon Point in Queensland for subsidiaries of India's Adani Group and Canada's Brookfield Infrastructure Group have been delayed by one to two years because of slower global coal demand, according to a spokeswoman for port developer North Queensland

Bulk Ports Corp. The new ports are designed to have a combined capacity of 180 million tonnes per year, with construction of the A$12 billion ($11.1 billion) project originally planned to commence in mid-2013. The Environmental Impact Statements for the Adani and Brookfield project were not expected to be published before the end of 2013, according to the spokeswoman.

United States

Obama's climate speech outlines new risks for US coal companies
On 25 June, President Obama outlined his plan to address climate change, including carbon pollution limits for new and existing power plants, renewable energy and efficiency standards, the elimination of fossil fuel subsidies and a call to end US government financing for coal projects overseas. Coal stocks plummeted in the wake of the announcement. US coal consumption has been on a downward trend in recent years, and news outlets have been suggesting that once-highly-influential coal lobby groups are facing an existential crisis in the wake of new environmental regulation and market realities.

Report from the Inspector General of the Department of Interior finds significant flaws in Bureau of Land Management's coal leasing program
Following the release of a report last year exposing the under-valuation of federal coal leases costing taxpayers an estimated $29 billion, the Inspector General of the DOI announced its own investigation into the agency's leasing program. The Inspector General's findings were released on 11 June, and include 13 recommendations for necessary reforms. Full text here. Key findings included:

- The process BLM uses to calculate the fair market value of coal leases is faulty, inconsistent across states, and fails to consult the agencies with required expertise. The practices are particularly egregious in BLM's consideration of lease modifications.
- BLM fails to consider the role of coal exports in determining the fair market value of coal leases.
- From state to state, BLM's reporting and enforcement practices vary widely, with little federal oversight. BLM investigators lack the ability to deter violations through financial penalties, and investigators “prefer to work informally with mining companies to resolve noncompliances”

The report underscores the need for a coal leasing moratorium. The heads of 21 organisations and over 135,000 have already called for a halt to new coal leases, and Senator Wyden, Chair of the Senate Energy and Natural Resources Committee, has indicated that there may soon be congressional hearings on DOI's coal program. DOI is in the midst of additional investigations from the Government Accountability Office and Inspector General on coal leasing and royalties.

New report highlights financial risks of Ambre Energy's Morrow Pacific Project
New analysis from Sightline Institute finds that, if constructed, Ambre Energy's Morrow Pacific Project may become a "terminal of last resort." Ambre's own financial data suggests the terminal faces higher transportation costs than any nearby competitor, higher handling costs than existing regional terminals, and greater capital costs than comparable projects. Morrow Pacific has yet to receive a single state or federal permit. Ambre's Washington project, Millennium Bulk Terminals, has been the subject of local controversy after Ambre was caught misleading local officials about the size of the project.

Sightline Institute previously published Caveat Investor, a comprehensive analysis of Ambre's troubled finances.

South Africa

Eskom's Medupi plant delayed
South African power utility Eskom announced in early July that first power from its new Medupi plant would not hit the grid until the second half of 2014. Unit 6, the first of Medupi’s six 800 MW units, was originally due to deliver power by the end of 2013, but faces a delay of at least six months due to labour unrest and underperformance by contractors, according to Eskom. The company also conceded that the delay will raise the cost of Medupi to 105 billion rand ($10 billion) from 91.2 billion.