Coal

Coal's US comeback fuelled by rival

Production and exports increase on back of higher gas prices but outlook still cloudy

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12 HOURS AGO by: Ed Crooks in New York

Paringa Resources, a mining company with no production but some long-cherished plans, has been one of the most immediate beneficiaries of President Donald Trump's election.

Since 2012 it has been looking at a potential coal mine in Kentucky, acquiring leases and drawing up plans. The reserves are thermal coal, used for power generation, and Paringa had a contract to sell 40 per cent of the mine's output to utilities owned by PPL. But last year it still needed to raise the capital to make the project a reality.

Mr Trump, with his promise to "bring back coal", caused "a sea-change in sentiment in the market," says Grant Quasha, Paringa's chief executive.

In the spring, the company was able to raise A$53m (US$42m) on the Australian Stock Exchange and a $20m debt facility from Macquarie, and construction started this month. A year from now, the Poplar Grove mine is scheduled to begin production.

The investment is one of the signs of life in the US industry, along with increased production and exports, fuelling talk that coal is making a comeback.

Production in the first quarter was up 14 per cent on the equivalent period of 2016, and exports were up 58 per cent.

Mr Trump has been quick to claim the credit, telling a rally in Phoenix last week: “We’ve ended the war on beautiful, clean coal.”

After years of falling prices, coal and gas markets have recovered over past 12 months

Coal and gas prices

Source: Bloomberg *Million British thermal units

But Mr Quasha says his business model is about carving out a niche with low-cost production, not relying on the market to grow.

“There is a secular decline in the US thermal coal industry, there is no doubt about that,” he says.

The stock market performance of US mining companies reflects that caution. Peabody Energy, the world’s largest private sector coal miner, which in April emerged from bankruptcy and re-listed on the New York Stock Exchange at $31.50. Its shares closed at $27.88 on Friday.

Shares in Cloud Peak Energy have lost 60 per cent of their value since the week Mr Trump was elected last November.

Contura Energy, formed from some of the assets of Alpha Natural Resources, which went bankrupt in 2015, pulled its planned initial public offering earlier this month, blaming “capital market conditions.”

Privately held Armstrong Energy said two weeks ago it had entered “forbearance agreements” with some of its bondholders and appointed a chief restructuring officer.

The Trump administration has tried to help, scrapping or trying to scrap numerous regulations on the production and use of coal.

But Matt Preston, research director for North American coal at Wood Mackenzie, says that while those moves may make a difference “at the margin”, they are not the reason that production has rebounded.

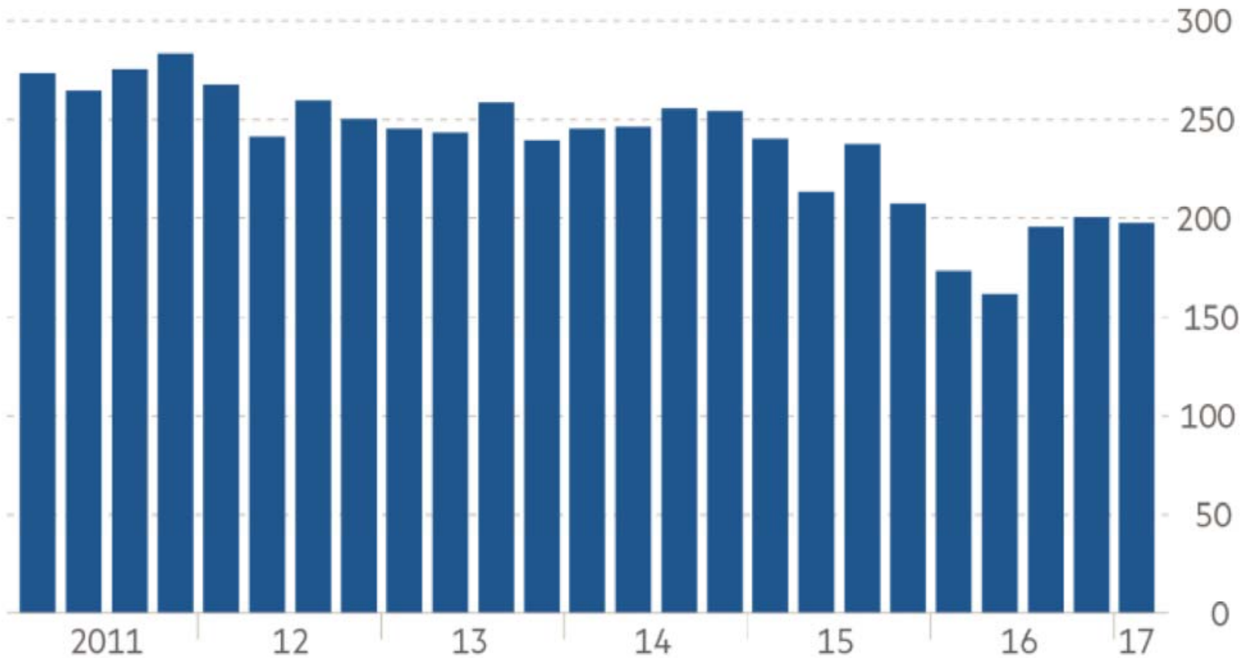
“The real driver is that gas prices are higher,” he says.

“Where coal goes from here depends on where gas goes.”

Coal is in a head-on battle with gas to supply the US with electricity. As benchmark Henry Hub gas fell below $2 per million British thermal units last year, coal-fired plants provided just 30 per cent of US power, their lowest level on record.

US coal production is down by a third from its output five years ago, but it has picked up in recent months

US coal production (short tons, m)



Source: Energy Information Administration

This year, with gas back above $2.90, coal's share is edging up to 32 per cent, according to the Energy Information Administration.

If gas prices stay at about these levels, lower-cost production from the Powder River Basin of Wyoming and the Illinois Basin, which includes Poplar Grove, can be competitive. But higher-cost Appalachian coal from the eastern US will often be uneconomic.

"Time is not on the side of coal," says Dan Klein of Pira Energy, a research firm owned by S&P Global Platts.

"Most of the installed coal-fired generation capacity is quite old, and if we have natural gas prices around where they are today, companies are not going to want to spend money on coal plants that need repairs."

Over 2012-16, an average of 8.5 gigawatts of coal generation capacity was retired every year, steadily eroding the customer base for coal. Mr Klein expects a further 6-9GW to shut down every year to 2020.

Not a single new commercial coal-fired plant is planned in the US, compared to 2.6GW of new solar capacity, 10GW of new wind and 38GW of new gas-fired plants scheduled to start up in 2017-18.

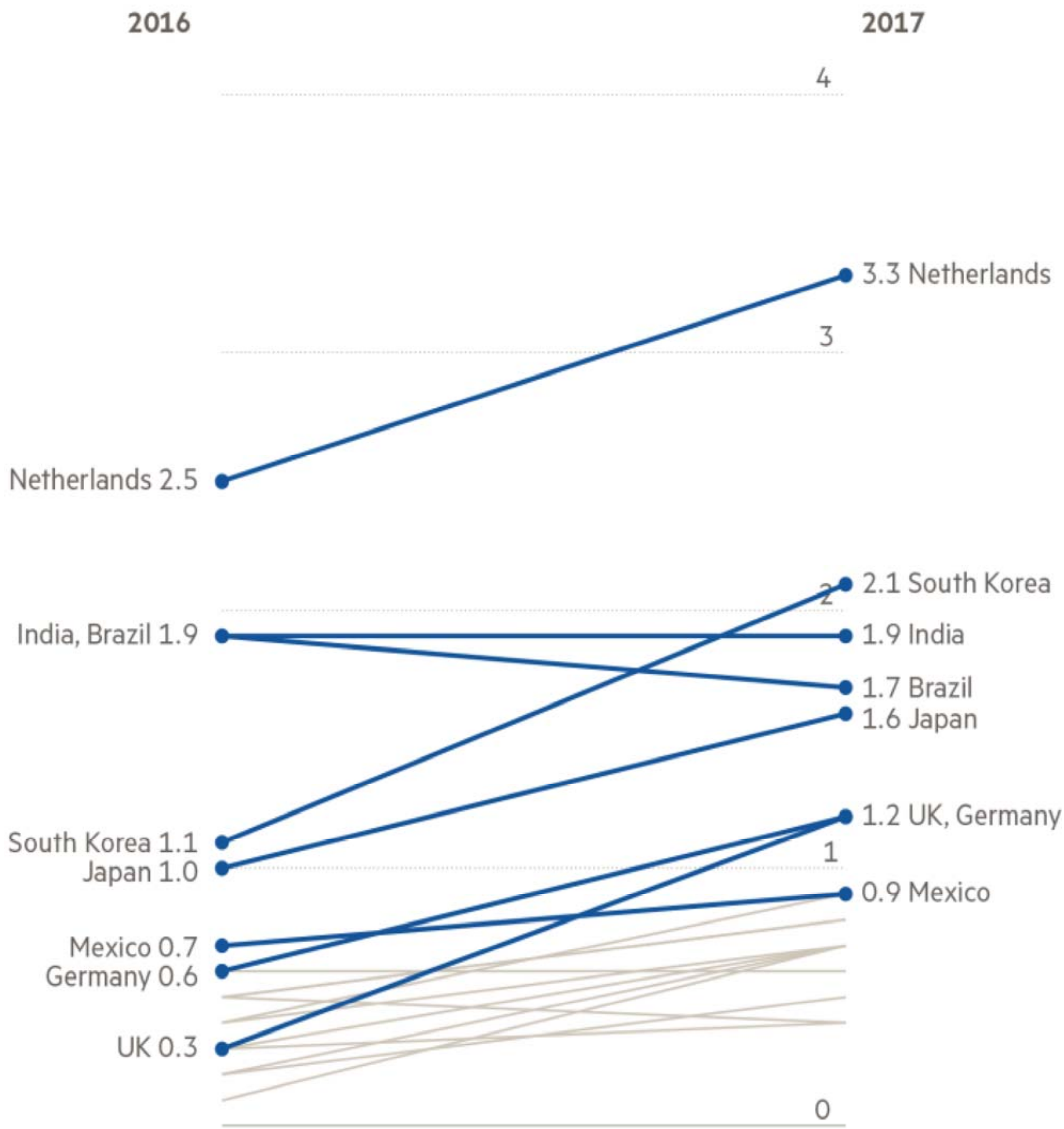
Even AEP, the largest generator from coal in the US in 2015, has been turning to renewable energy. It last month announced a plan to invest $4.5bn to build the largest wind farm in the US.

Stopping coal plant closures has become a priority for the mining industry. Glenn Kellow, chief executive of Peabody, argued in a speech last week that there should be a two-year moratorium on coal-fired power plant closures "to protect reliability . . . until a thorough review of the grid is complete."

Privately held miner Murray Energy has similarly called for the administration to use its emergency authority under the Federal Power Act to keep coal plants open.

US coal exports

Short tons (m)



Source: Energy Information Administration

So far, though, the Trump administration has been reluctant to interfere in the market directly.

Robert Murray, Murray Energy's chief executive, wrote in a letter shown to the Associated Press that Mr Trump had assured him he would use those emergency powers. But the administration has since said it has no plans to do so.

A report on grid reliability from staff at the energy department, which had been widely expected to offer excuses for subsidising coal, turned out to be something of a damp squib when it was published last week.

Paul Bailey of the American Coalition for Clean Coal Electricity commended the department for studying reliability, but acknowledged that he would still have to work with policymakers at all levels "to value the important attributes of the coal fleet".

The sting in the Trump administration for coal producers is that it has also been trying to encourage more oil and gas production, again by cutting regulation and by opening more areas up for drilling. The best hope for coal would be faltering gas supplies and soaring prices.

Mr Quasha argues it could happen. "Shale gas does not make any money," he says.

"Eventually that will start to affect sentiment in the capital markets, and in the long term it will result in higher gas prices. And that will help the coal business."

The only way the Trump administration may be able to succeed in one of its key energy policy goals may be to fail in another.

Exports under pressure

Compared to the war of coal against gas in the US market, exports are a sideshow for the mining industry, accounting for only 11 per cent of US production in the first quarter. They did provide a useful boost to demand, though, helped by the weak dollar and China's moves to close inefficient mines, tightening world markets.

However, there are questions about whether those sales can be sustained. Among the strongest markets in the first quarter were Britain, France and Germany. But France plans to shut all its coal-fired plants by 2022, and Britain by 2025, while Germany is curbing its coal demand. South Korea and Japan were also important growth markets, but the International Energy Agency has forecast that over 2017-21, thermal coal imports will fall for Japan, and rise only slowly for South Korea.

As it does at home, American coal competes against American gas in international markets. Rising US exports of liquefied natural gas have helped drive down world prices, making gas-fired generation more competitive against coal-fired rivals.

One segment that does seem to have a robust long-term future is metallurgical or met coal, used for making steel. Met coal accounts for about 55 per cent of US exports by weight, but more by value, because its price is more than double that of thermal coal.

US met coal exports fell in 2012-16, but have revived since the second half of last year as world steel production rose.

“For as long as we are making steel, there will always be a market for the high-quality met coal that the US produces,” says Matt Preston of Wood Mackenzie.