SEABORNE THERMAL COAL

What a difference a year makes

- OR DOES IT?

Assocarboni

March 2018

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Our concluding remarks last year

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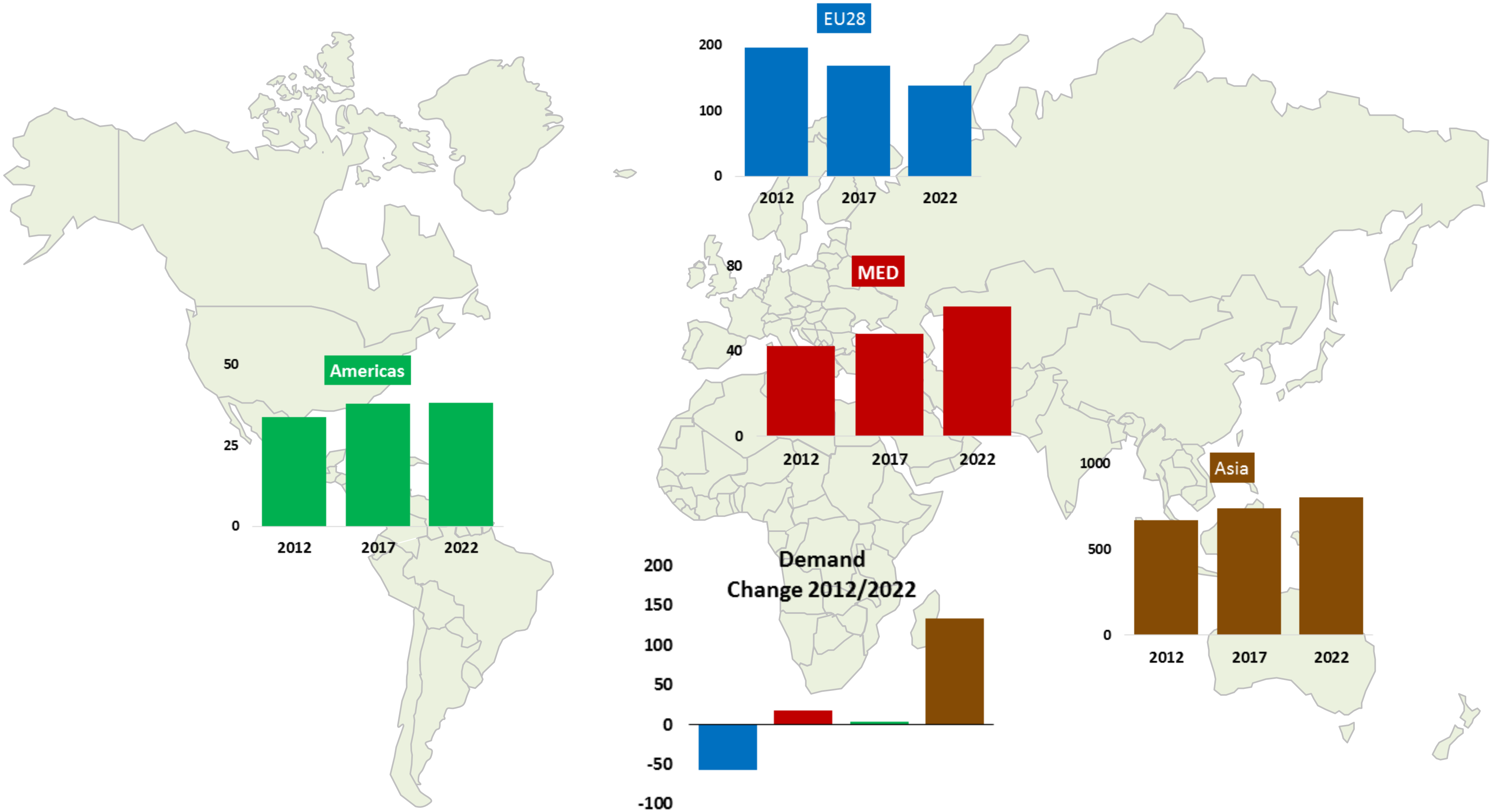
- As the market evolves, it is also becoming more complex and prices are influenced by a wider range of factors: FX, oil, gas, weather and environmental policy
- Global SD is notoriously difficult to predict: consultancies regularly get it wrong
- Although overall Atlantic market is shrinking, there is an important source of new demand originating in the Mediterranean
- The focus remains in what happens in the Pacific, but in particular what happens in China: what would be the next policy move? Weather? The new plenum?
- Surging demand in South Asia will keep the Pacific market strong
- Colombian producers are reacting to demand trends: exports are falling to Europe, increasing in the Mediterranean, and venturing in the Pacific
- Colombia will remain an Atlantic player but:
  - when the arbitrage opens the Pacific market will be targeted (FOB differentials together with low freight rates allow)
  - Over time, as Atlantic demand decreases and should Colombia continue to grow, it will be necessary to look to the Pacific as a permanent option
- **We said very little about the USA. Did we get it all wrong?**

Where is demand heading?



Average of industry estimates

Demand – no real change from last year

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Demand in the Atlantic basin has already peaked

- In North West Europe demand is in terminal decline as a result of environmental regulation: EU ETS, carbon taxes and renewable incentives
- In the Mediterranean (Egypt, Morocco and Turkey) and - to a lesser extent - in the Americas demand is showing continuing growth in coal use for electricity and industry **However, taking the Atlantic basin as a whole, it appears that the growth in the Med and Americas is not enough to offset the decline in Europe**

In the Pacific basin, demand continues to grow underpinned by emerging economies

- Japan and South Korean coal running baseload: import demand stable
- Imports in China peaked in 2013 but reforms to the domestic industry driving imports. **Import growth in 2017 unexpected: demand upturn amid tight domestic supply**
- Indian demand is declining as domestic production increases but production targets are very ambitious and India will continue to rely on imports
- Strong growth is expected from emerging economies in South Asia and the need for cheap energy: Malaysia, Philippines, Vietnam and Pakistan
- **Most consultancies forecast demand growth in the Pacific. China and India pivotal**

Supply – what we said last year

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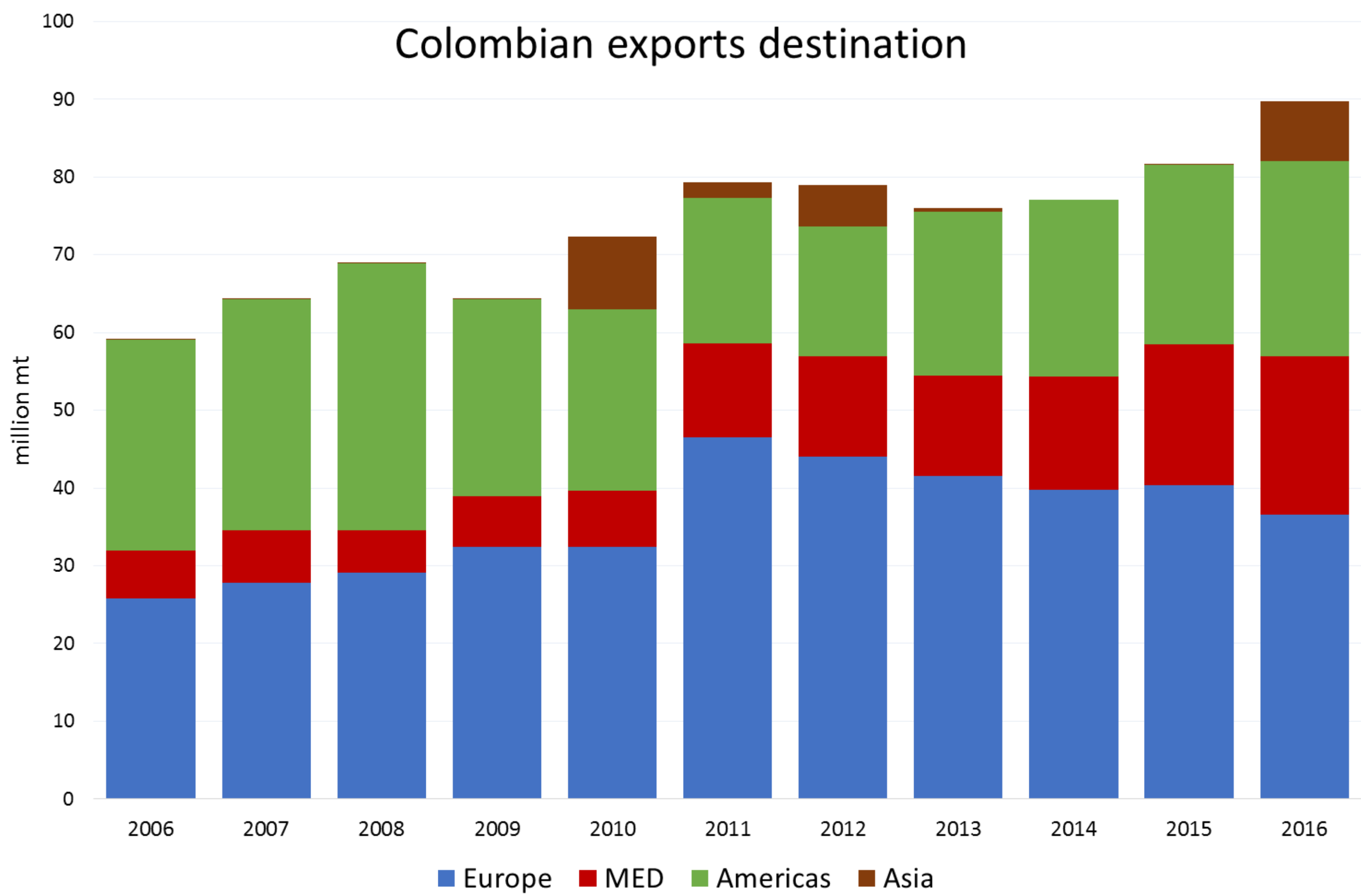
- USA exports peaked in 2012 (~47 Mt) and have since declined due to the fall in international prices. The USA will remain a swing supplier in both basins. ***European prices above $80/mt pushed exports higher during 2017: much now depends on international prices***
- Russian exports fell in the Atlantic after the collapse in the UK, only partially offset by an increase in the Med (Morocco and Turkey); exports continue to increase to the Far East where there is more than 30 Mt of additional export capacity to be commissioned over the next few years. ***Exports to the Atlantic recovered following growth in the Mediterranean and Southern Europe due to low hydro: the new Taman port will provide additional export capacity but most analyst expect Atlantic exports to be more or less stable and the Pacific the main focus***
- South African exports will remain fairly stable, partly because the emergence of growing domestic demand. Exports to the ATL have fallen Y/Y as prices are better in the PAC, but exposure to India (>50%) has made them look for new markets: Sri Lanka, South Korea, Pakistan
- Australia surpassed 200 Mt exports in 2014, but the low-price environment forced producers to reduce output in 2016; apart from the resumption of few mines, ongoing expansions, or productivity gains, there are no significant new green field developments. ***Flat in 2017***
- Indonesia has assumed the role of the balancing supplier, its exposure to China and India make them vulnerable to large fluctuations
- Colombia will continue to increase exports ***– or will it?***

Colombia exports – *up to 2016*



Swing supplier in the PAC

Stable in the Americas

Increasing in the MED

Declining in Europe

Colombia - *oops*

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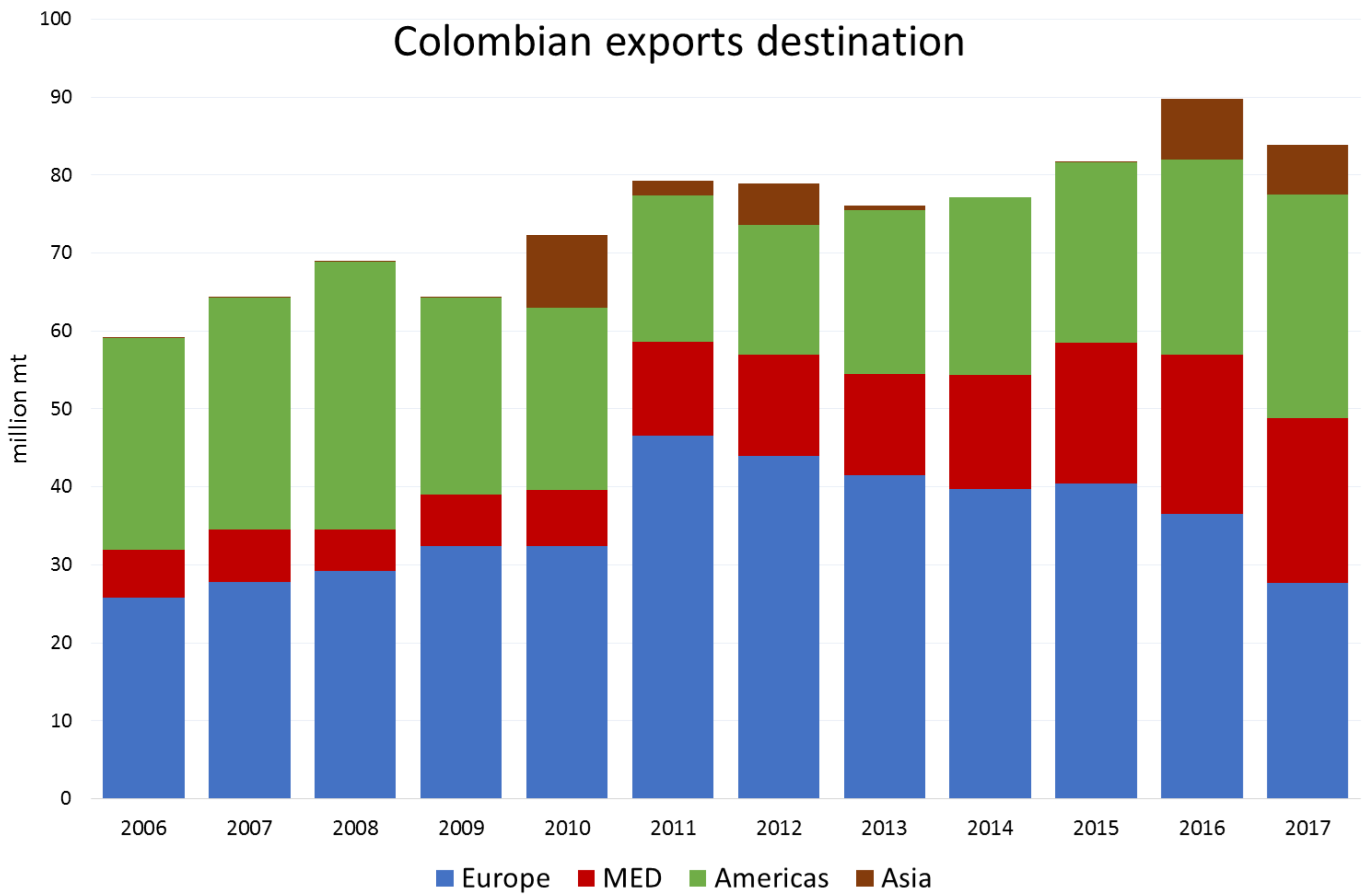

Swing supplier in the PAC

Stable in the Americas

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The US: *really* a committed exporter?

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20 years ago	LAXT terminal	EXPORTS
10 years ago	Falling CAPP production End of the synfuel subsidy	IMPORTS
2010/2013	Between 2010 and 2013, it was	EXPORTS
2014	The Polar Vortex: higher gas prices, lower than normal inventories: was this the new norm?	IMPORTS *(limited)*
2015-16	<u>*Imports*</u>*:* Low gas prices (↓) and MATS regulation (↑) <u>*Exports*</u>*:* Low international prices, but some volume still forced into exports … but limited volumes	BOTH *(limited and falling)*
NOW	The excitement is back	EXPORTS

The USA

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What they are saying

Bob Murray in Coaltrans USA (Feb-18): *'the largest limitations to growing US exports are lack of rail performance, sulphur discounts, port capacity, the perception that US supply is temporary and shortage of capital'*

Lucas Pipes (FBR, Mar-18): *'even after the price correction, most U.S. thermal coal exports are still economical. We estimate that the breakeven price for U.S. thermal coal exports in the Atlantic, using current freight and quality adjustments, is between API2 $64/mt for (Northern Appalachian rail coal), $72-$80/mt for Illinois Basin, and $76.00/mt for Central Appalachian'*

The issues

- API2 spot prices currently around $80/mt but the forward curve is $70-75/mt
- High sulphur NAPP coal exports bounced back as a result of the petcoke ban in India but dependent on this regulatory change
- High sulphur ILB needs to be blended in the European markets – ideally, with low sulphur Russian coal) - because of environmental regulations, but demand is in terminal decline
- The high chorine content of ILB coal produces corrosion in boilers
- Export limited by infrastructure: export capacity through the East coast maxed out. One (but only one) of the West Coast projects (Millennium Bulk Terminal) is still hanging on, but the WA State continues to deny the required permits on environmental concerns. And who will make the investments in rail and port infrastructure?

So back to Colombia

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- Colombian producers embarked on projects to increase output during the price boom in 2008 (as everywhere else) but not all potential production came online
  - There is still some spare infrastructure capacity but the bottleneck is largely mining equipment
  - On the production front, additional investment could unlock more volume to make use of the ready available export infrastructure, but will it be made?
- As South Africa focuses on the Pacific, Colombian and Russian coal will dominate supply in Europe and the Med
  - Russia will continue to serve NWE demand, complemented by Colombian coal where capesize ports are available or there are special requirements
  - In contrast, Colombia will grow in the Med, with Russia usually competitive only in non-cape discharge ports or where there are special requirements. The Taman port (Russian coal to the Black Sea) could level the playing field
- The US adds to the supply mix in the short term but is unlikely to be a major competitor to low-sulphur Colombian coal in the medium term
- As total demand in the Atlantic stagnates (or declines) Colombia will need to look for the growing but more distant markets in the Pacific

Europe – Colombian and US supply

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	Cerrejón	Other major Colombian producers	US producers
Exports	100% of production	100% of production	Opportunistic
Port	Own dedicated	Generally own dedicated	Third Party
Rail	Own dedicated	Own shared	Third Party
Quality	5600 – 6000 Low sulphur	5400 – 6200 Low sulphur	5800 - 7000 High sulphur
Perspective	Core market long term	Core market long term	When needed

The US and Colombia look toward Asia

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	Cerrejón	Other major Colombian producers	US producers
Exports	100% of production	100% of production	Needed for survival?
Port	Own - dedicated	Mainly own - dedicated	Canada? Mexico? Those USWC projects?
Rail	150 km - own	200 km - shared	2000 km - third party
Quality	5600 – 6000 Low sulphur	5400 – 6200 Low sulphur	PRB: 4300 - 4600
Cash costs	Reported to be around \$40-50/mt FOB	Reported to be around \$40-55/mt FOB	\$10-15/mt ex mine plus \$60 rail?
Landed Asia			\$88 basis 6000 break even

New Supply Order: how it works

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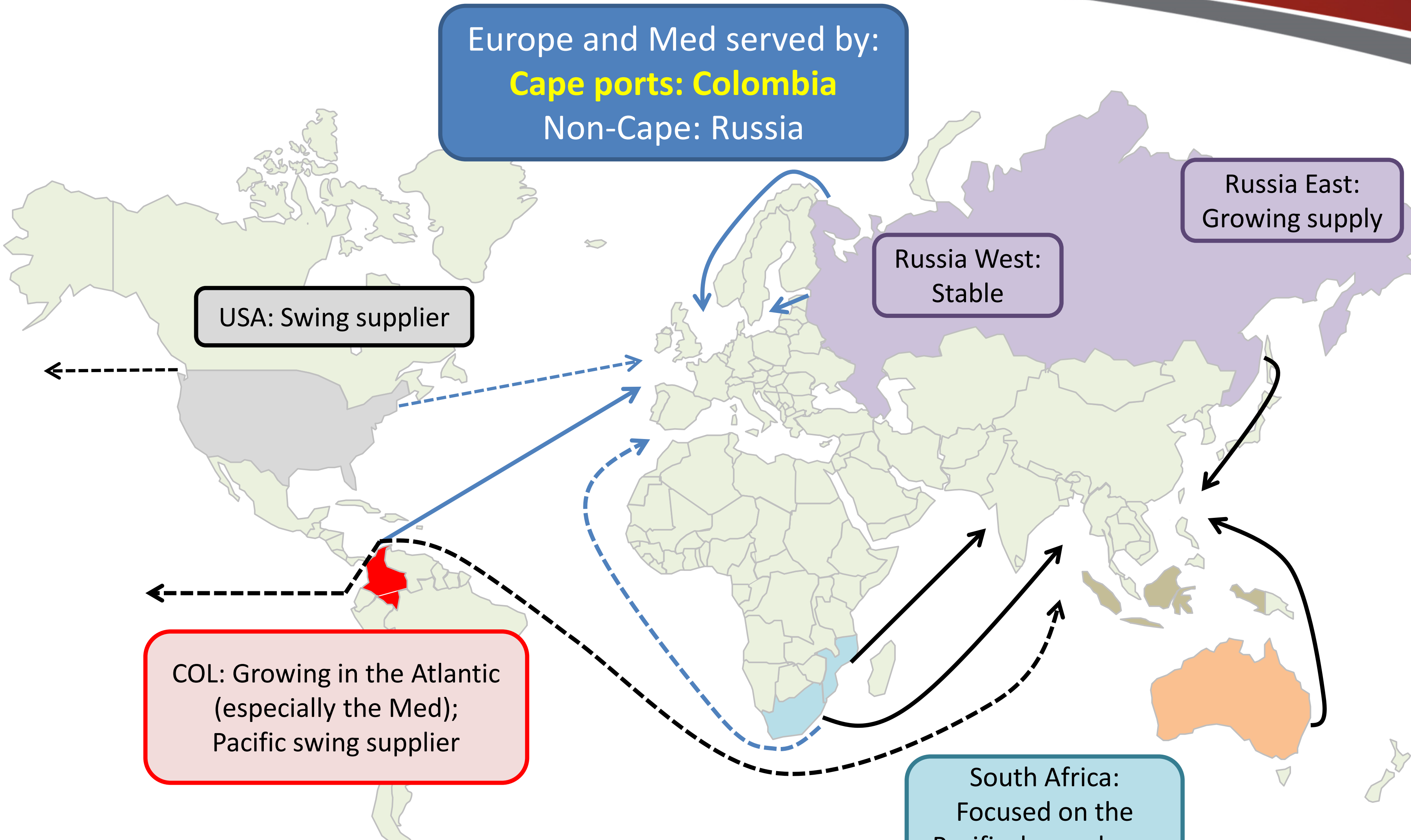

The reassuring sight of Colombian coal

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